

Testimony As prepared for House and Senate Taxes Committees

February 20 and 21, 2018

SLIDE 1: Introduction

We are here to give you an overview of how the 2017 Federal Tax Law could impact Minnesota and will be happy to take questions at the end. The law changed the federal tax code considerably. As we consider the options before us this session, we look forward to working with you on the best way to help our customers meet their obligations under the Minnesota tax code.

SLIDE 2: Our mission/vision/values

Before we move into an overview of the 2017 federal tax law and its administrative impacts to Minnesota's revenue system, I wanted to give you a very brief reintroduction to our work at the department. We do all of this work guided by our mission: *Working together to fund Minnesota's future.*

Our vision is: *Everyone reports, pays and receives the right amount: no more, no less.* Our work is to implement the tax code consistently and transparently to ensure fairness.

We do this work guided by four core values: integrity, respect, excellence and accountability.

SLIDE 3: Administering MN's Tax Code

We opened the Individual Income tax filing season late last month, January 29, 2018. The individual income tax filing season is what most Minnesotans think of when they think of the Department of Revenue, but individual income taxes are just one of the many tax types that the department is responsible for administering. We have already received over 583,000 returns and have sent over 300,000 refunds to Minnesotans.

We work year-round with our customers to help them understand well-known taxes like income, sales, and corporate taxes, lesser known taxes like mineral, lawful gambling, tobacco, petroleum taxes, and even less well known taxes like the farm winery tax, the dry cleaner solvent fees, the solid waste management tax, and more.

SLIDE 4: Our Customers

Each year, we serve about 2.9 million individual income tax filers, from first-time filers trying to figure out how to file and pay for the first time, to people who use tax preparers and accountants to file. About 1.7 million will receive a refund, and others will make a payment. An additional over 800,000 Minnesotans will file homeowner and renter property tax refunds.

We serve veterans, homeowners, renters, members of the military, seniors, tribal governments, people new to Minnesota and more.

Our customers also include tax preparers and professionals who work to help their customers – individuals and businesses - file and pay their taxes. We work closely with tax preparation software vendors to ensure those who use their products will be able to file correctly.

We serve volunteer preparers who work at the Volunteer Income Tax Assistance (VITA) sites across the state. VITA is a service for taxpayers who are 60 or older, have a disability, speak limited or no English or have an annual income of \$54,000 or less.

We serve all 87 Minnesota counties, directly and through the Board of Assessors which is housed at the Department by overseeing the 800 licensed property tax assessors.

We also make state aid payments to counties, cities, towns, and special taxing districts through 31 state programs.

Over 160,000 businesses collect, file and pay sales tax every month.

There are 415,000 businesses in our online file and pay system. Most of these businesses are located in Minnesota. Others are doing business here, but are located across the country and the world.

All of our customers have unique circumstances, and we have a responsibility to serve all of them.

Slide 5: Minnesota and the 2017 Federal Tax Law

As we consider a response to the federal law that is in the best interest of Minnesota, we continue to monitor activity at the federal level.

I want to give you some context of what's happening in Washington D.C. for future federal law changes.

We know there are some needed corrections to the 2017 Federal Tax Law. Members of Congress have discussed this need but at this point we are unaware of a specific bill to do so.

New IRS guidance on the federal law is forthcoming and the IRS's schedule indicates that they plan to issue guidance throughout 2018. That is causing some uncertainty for our customers – taxpayers, vendors, and tax professionals – in the meantime

And, Congress included federal tax extenders for 2017 in the most recent federal budget appropriations passed on February 9th.

All of these things are combined to what is already a complicated situation with the 2017 federal tax law changes.

Today we want to ensure the committee and the public have an overview of the scope of the federal changes and a better understanding of their impact on Minnesotans.

If Minnesota does not respond by making changes to our own law, Minnesotans will be affected by a more complex filing system. The department's job is to ensure the most efficient and effective filing system for our customers, and we will do that. Under these circumstances however, if there is no law to respond to the federal changes, there will be complexity that we cannot mitigate.

Federal nonconformity affects the vast majority of Minnesota taxpayers. This is different from past years where nonconformity was limited to specific provisions for a limited number of taxpayers.

We will walk through a high-level summary of the federal changes and share with you in detail some of the consequences of doing nothing in this session. Again, we want to ensure that the committee and the public understand the consequences if we do not act.

The most significant issue is complexity. For a subset of taxpayers, inaction by Minnesota could mean additional tax in Minnesota because of the connection between federal elections and state elections for certain provisions.

The department has been asked in the context of federal law changes about whether elections for federal purposes are binding on taxpayers for state purposes. When taxpayers make an election under federal law on their federal return, they are also making an election under Minnesota law.

After making the election, if there are differences between the federal provision and state provision, taxpayers must make adjustments on their Minnesota return to reflect those differences.

We acknowledge that the current differences between federal and Minnesota law are more significant this year than in past years; however, neither those differences nor the results they produce changes the department's longstanding position under current Minnesota law. (Minn. Stat. 290.01, subd. 19)

Slide 6: 2017 Federal Tax Law | Overview

On December 22, 2017, President Trump signed 2017 Federal Tax bill into law. The new federal tax law makes many changes to tax rates and base provisions and removes the fines for not having health insurance, effectively removing the Affordable Care Act's individual mandate. Because of this law, according to the CBO, about 4 million Americans would lose health insurance in 2019, rising to 13 million in 2027.

Minnesota relies on the federal tax system as its starting point for determining each individual and corporation's Minnesota income taxes. Right now, Minnesota statutes are conformed to the definition of federal taxable income (FTI) as it was constructed on December 16, 2016. Any amendments to the federal tax code since that time are not incorporated into Minnesota's calculation of income.

As shown on this slide, federal taxable income is the starting point for calculating Minnesota taxable income, the tax base used to calculate Minnesota income tax liability.

For individuals, federal taxable income equals federal adjusted gross income (FAGI) after deductions and exemptions.

FAGI includes: wages, salaries, and tips; taxable interest; dividends; alimony received by the taxpayer; business income or loss; capital gains or losses; other gains or losses; taxable IRA distributions; taxable pension and annuity distributions; income from rental real estate, royalties, partnerships, S-corporations, and trusts; farm income or loss; unemployment compensation; and taxable Social Security benefits.

The federal tax law changes the definition of federal adjusted gross income in several ways.

Income is modified by altering the definition of wages (repealing the exclusion for employer moving expense reimbursement and exclusion for bicycle commuting reimbursements), changing business and other income (limiting business loss carryforwards), changing the treatment of alimony (the federal law

makes this nontaxable income for the recipient ex-spouse), and repealing the deduction for moving expenses, among other changes. In almost all cases, these modifications or repeals increase FAGI.

After FAGI is determined, taxpayers may claim either the standard deduction or itemized deductions. Itemized deductions include state and local property tax payments, mortgage interest, charitable contributions, certain medical expenses and health insurance premiums, and allowable job and miscellaneous expenses.

Slide 7: 2017 Federal Tax Law | Overview

The federal standard deduction and itemized deduction are also changed in several ways.

Beginning in tax year 2018, the federal standard deduction increases to \$24,000 for married joint filers, \$12,000 for single and married separate filers, and \$18,000 for head of household filers. This nearly doubles the prior year standard deduction for federal purposes.

The federal tax law also modifies many itemized deduction items, including: expanding the medical and dental expense deduction in tax years 2017 and 2018, increasing the maximum allowable charitable contribution deduction, limiting the home mortgage interest deduction, capping the state and local tax deduction at \$10,000, and repealing the tax preparation fees deduction, casualty and theft loss deduction, unreimbursed employee expense deduction, and the phase-out of itemized deductions.

The federal tax law also creates a 20% deduction for certain business income reported on individual returns.

Finally, in order to get to federal taxable income, personal and dependent exemptions are applied.

The new federal law reduces the personal and dependent exemptions to zero, replacing them with an increased federal child tax credit of up to \$2,000. The federal law imposes a requirement of having a Social Security Number to claim certain credits, this means that taxpayers are treated differently based on immigration status. Though these families pay federal taxes, this would disqualify the ability for many of them to claim the child tax credit. In Minnesota, we don't have a counterpart to the federal child tax credit.

The federal tax law also increases the exemption and exemption phase outs for the Individual Alternative Minimum Tax (AMT). And for 529 plans, they are expanded to allow expenses for K-12 private and charter schools up to a \$10,000 cap. That is not allowed under current Minnesota law.

Most individual provisions will end in 2025 and revert to previous law.

Under the federal tax law, for the estate tax, federal tax law doubles the estate tax exemption to over \$11 million for individuals and over \$22 million for couples.

Slide 8: 2017 Federal Tax Law | Overview

As I mentioned before, corporations will see their tax rate cut from 35 percent to 21 percent on a permanent basis. Under the federal tax law, the corporate alternative minimum tax is repealed.

For Bonus Depreciation, 100% "bonus" depreciation is allowed for qualified properties under the federal tax law. It phases down from 100% by 20% per year starting in 2023. For small business

expensing (typically called 179 expensing) it is allowed up to \$1,000,000 permanently under the federal tax law.

For the Business Interest Deduction, it is currently generally fully deductible. Under the federal tax law, it is allowed for net interest in excess of 30% of business income (excluding depreciation after 2022). There is an exemption for businesses with gross receipts of \$25 million or less though.

Under the federal tax law, there will be a limitation on the net operating loss deduction to 80% of taxable income. It also allows carry forwards to continue indefinitely and eliminates the carry back. These are permanent changes.

For the taxation of multinational companies, the federal tax law moved from a worldwide system with deferral and foreign tax credit to a quasi-territorial tax system with base erosion provisions. It includes an “anti-abuse” tax on certain payments to foreign corporations. In addition, a one-time tax is imposed on unrepatriated foreign earnings at 8% or 15.5% depending on the form of the asset. These changes are also permanent.

Slide 9: 2017 Federal Tax Law: Impacts to Individual Income Tax Customers

Slide 10: Individual Income Tax Filers

The individual income tax filing season is what many Minnesotans think of when they think of the Department of Revenue. More than 2.9 million Minnesotans file individual income tax returns each year.

About 56% are assisted by professional tax preparers who use tax preparation software; another 31% self-prepare their returns using software, 11% self-prepare their returns on paper, and about 2% are filed on paper by professional tax preparers.

The 2017 Federal Tax Law is a significant change. It will impact virtually all Minnesotans in all parts of the state. It will impact all tax preparers and all vendors that provide tax preparation software.

Slide 11: Individual Income Tax Customers

We know, through listening sessions and other feedback channels, that our customers expect excellent customer service, clear information and guidance, and for us to be available and responsive.

Based on customer feedback, we have made strides to increase our outreach and education efforts to serve Minnesota taxpayers better. We strive to provide timely information on our website, through our email subscription services, our social media outlets, and through in-person outreach to the preparer communities and constituent groups including members of the military and veterans.

We use plain language principles in all of our communications to provide clear and transparent information to help our customers find answers to their questions about Minnesota’s tax laws.

Plain language is also important for our forms and instructions. Forms and instructions require continuous review and updating to make sure they are relevant and helpful to all of our customers, including taxpayers and preparers.

We also help fund and promote over 220 Volunteer Income Tax Assistance, or VITA, sites that provide free income tax preparation help to Minnesotans. For tax year 2016, Minnesota VITA sites processed over 200,000 state, federal, and property tax returns for Minnesotans totaling nearly \$130 million in refunds. We know this service is incredibly important to our customers.

We also know that there has been an increase in stolen identities, across the country and in Minnesota. Criminals use stolen identities to file returns in the hope of stealing taxpayer refunds.

We use a combination of skilled staff and technology to make sure we do our part to keep taxpayer refunds safe from cyber criminals.

The services we provide to our customers so that they can file and pay the right amount, safely, accurately, and on time, are critical to our work of protecting taxpayer money and the state's revenue stream.

It is important to understand our current scope of work because the 2017 Federal Tax Law will increase our customer's need for these services. We will need to maintain our current service levels and meet the new demands that come from responding to the new federal tax laws.

Slide 12: Examples of Complexity

I am going to describe some examples of what the 2017 Federal Tax Law means for Minnesotans who file Individual Income Tax. These are basic examples and only meant to illustrate a very few of the changes that will affect our customers.

The 2017 Federal Tax Law made changes to many provisions that impact Minnesota Individual Income Tax filers.

Examples of just a few of the differences that will affect nearly every Minnesota filer include the standard deduction, election to itemize, and personal exemptions.

Minnesota net income is federal taxable income incorporating any elections made by the taxpayer on their federal return

In other words, if a taxpayer takes the standard deduction on their federal return, they must take the standard deduction on their Minnesota return. If a taxpayer elects to itemize on their federal return, then the taxpayer must also itemize on their Minnesota return.

Historically the value of the standard deduction for federal and state purposes was the same and the expenses available for the itemized deduction were also the same.

Beginning next year, the standard federal deduction for a married couple filing jointly will be \$24,000. Under current law, the standard Minnesota deduction will be \$13,000, adjusted for inflation. The result is a Minnesota taxable income that is automatically \$11,000 higher than federal taxable income for taxpayers that elect to take the standard deduction. But, if taxpayers filing jointly have Minnesota itemized deductions that are more than \$13,000, they may benefit from itemizing.

Also beginning next year, the items included in the federal itemized deduction will not include things like casualty losses, tax preparation fees, and unreimbursed employee expenses, to name just a few. Under current Minnesota law, Minnesota's itemized deduction will include those items.

The 2017 Federal Tax Law also made changes to the way that personal and dependent exemptions affect federal tax liability as described earlier.

Slide 13: Standard Deduction

Many taxpayers claim the standard deduction. Public estimates by the Congressional Joint Committee on Taxation indicate that many more will claim the standard deduction going forward. To help illustrate what taxpayers will need to do if Minnesota does not act, I'd like to walk you through an example.

I'm going to go over the process for how a family of four would calculate their standard deduction for their federal and state taxes.

As you follow along on the PowerPoint slides, you will notice that some of the steps have boxes around them. Those boxes indicate new steps for Minnesota filers.

First, we will go over how a taxpayer would **calculate their federal tax liability**:

- First, the taxpayer will calculate federal adjusted gross income following IRS instructions that incorporate the 2017 Federal Tax Law changes
- Next the taxpayer will reduce their income by the larger standard deduction to calculate federal taxable income. For a married couple filing jointly, this would be \$24,000
- The taxpayer will determine federal tax, calculate the federal credit for dependents, and deduct that amount from their federal tax to determine their federal tax liability

When the taxpayer prepares their **state return**, they will start with federal taxable income.

- Next, they will apply Minnesota additions and subtractions
- They will add back the larger federal standard deduction of \$24,000 to income, and subtract a smaller standard deduction of \$13,000 which is the 2017 Minnesota standard deduction amount adjusted for inflation
- Then, another new step for Minnesota taxpayers will be a need to calculate a deduction for exemptions based on their family size
- Finally, the taxpayer will determine their Minnesota tax liability

The taxpayer now knows their total federal and state tax liability using the standard deduction.

Recall, however, that because Minnesota has not acted, the family has the longer list of itemized deductions available at the state level.

In order to determine whether it's most beneficial to claim the standard or itemized deduction, the family may need to calculate both to make the best decision.

Slide 14: Itemized Deduction

To calculate the itemized deduction options for their federal and state taxes, they would follow this process:

Again, we will start with the **federal return**:

- As before, the taxpayer starts by calculating federal adjusted gross income following IRS instructions that incorporate the 2017 Federal Tax Law changes

- Next the taxpayer prepares federal schedule A for itemized deductions. Their itemized deduction will likely be less than it has been in previous years because of changes that eliminate deductions for things like unreimbursed business expenses, tax preparation fees, and home equity interest.
- Next they reduce their adjusted gross income by the amount of itemized deductions to calculate federal taxable income.
- Like the previous example, they will determine their federal tax liability, then reduce it by the amount of the federal credit for dependents to determine their federal tax

Now, let's look at the **Minnesota return**:

- Next, the taxpayer will carry their federal taxable income over to their Minnesota return and apply Minnesota additions and subtractions to income.
- They will prepare a new Minnesota supplemental schedule for additional items that qualify for the Minnesota itemized deduction. Common additional deductions include interest on home equity loans, tax preparation fees, and unreimbursed employee business expenses.
- The supplemental amount will also be deducted from income
- As with the previous example, the taxpayer needs to calculate and subtract personal and dependent exemptions based on family size, and determine Minnesota tax liability.

Now the taxpayer is ready for their decision.

Slide 15: Decision

They will compare their total federal and state tax liability using the standard deduction to their total federal and state tax liability using itemized deductions and select the best option.

After making that decision, they will proceed with preparing their federal and state returns for filing.

Slide 16: Impact to Individual Income Tax Customers

How will this affect Minnesota individual income tax customers? The very basic example we walked through demonstrates how complex the process would be. The example did not include many other differences that exist as a result of the 2017 Federal Tax Act, some that are described above. As a result of the added complexity:

- More of our customers may need to hire tax professionals or buy software to prepare their tax returns because of the added complexity.
- Taxpayers may need to pay more to have their taxes prepared.
- Some taxpayers may wait longer for their refund because of inadvertent errors made in preparing complicated forms and schedules.
- Taxpayers will need to plan ahead. They may want to make changes to withholding or estimated payments.
- Taxpayers may also need to retain their receipts for itemized deductions like meals and entertainment expenses that are no longer allowed for federal, but would be allowed for Minnesota under current law.

Slide 17: Impact to Preparers and Vendors

We have been in touch with our partners in the tax preparation and software vendor community, and I am sure they could share more details with you, but at this point we anticipate a number of consequences if Minnesota does not act.

Tax preparers may need to spend more time to prepare a Minnesota return and to explain why and how things are different this year to taxpayers. They will also need to plan ahead.

Vendors will need to make changes to their programming which takes time.

Finally, preparers will need to research and understand the impacts to properly advise taxpayers and prepare returns

Slide 18: New Forms, Schedules, and Instructions

We have begun to assess how the 2017 federal law impacts current Minnesota law to understand how tax forms, schedules, worksheets and instructions will be impacted.

Our job at the department is to make tax filing as easy as possible for taxpayers, however, we need to be clear that there is only so much we can do to minimize the complexity created by the 2017 federal tax law for Minnesota filers.

Overall, we estimate a need to create several new income tax schedules.

One example is creating a new Minnesota schedule similar to the old federal Schedule A for taxpayers who choose to itemize.

Another example is creating a Minnesota form similar to the old federal form used to report casualty and theft losses (Federal form 4684—Casualty and Theft Losses).

We will also need to modify a number of existing income tax and property tax refund forms and schedules to reflect the differences for customers.

We will also need to draft dozens of pages of income tax instructions, along with changes to many existing instructions.

We will need to replicate the 2016 internal revenue code in forms and instructions that will no longer apply to federal returns.

Historically, Revenue referred taxpayers to IRS instructions for items that impacted federal taxable income. Now that federal taxable income and Minnesota taxable income are different, the IRS won't maintain and update some of these instructions which means that Minnesota will have to create and maintain them on our website.

Many Minnesota taxpayers will be faced with preparing new or more complex forms, worksheets, and schedules to meet their filing requirements.

Slide 19: Demand for Services

The department will need to be prepared to assist taxpayers who want to voluntarily comply but are being challenged by the complexity resulting from the 2017 federal law.

We anticipate more customers will need help on the front end and that the volume and complexity of our review during processing and during audit will increase.

For example:

- Outreach efforts yet this year will be critical to helping customers prepare for filing next year.
- We expect more customers will contact us for guidance while preparing their returns. We expect higher numbers of requests, and that those requests will take more time than in past years because of their complexity.
- Although customers will work to comply, the department's review will continue to identify errors that require us to contact customers for more information prior to processing the return or sending a refund. This is the most effective way to serve customers who tried to comply but made mistakes or errors.
- Finally, for more complex situations, errors not identified in processing will be corrected in audit, sometimes up to a year or two after filing.

Slide 20: Revenue's Priorities

As we review the federal law changes, how they interact with current Minnesota law, and our current forms and processes, we are guided by our priorities around serving customers and identifying a solution that is best for taxpayers.

We are working to minimize the impacts to all of our customers including taxpayers, preparers, and software vendors.

We need to support voluntary compliance through forms and instructions that illustrate the changes required to calculate 2017 Minnesota Taxable Income in as clear and transparent a way as possible.

We will need to collect enough information from taxpayers to be able to assist them when they intended to file correctly but did not due to the additional complexity of the federal law changes.

We must also protect the integrity of the tax system and administer it in accordance with the laws currently in place.

With these priorities in mind, we continue to analyze options and talk to other states that base their state income tax on federal taxable income. We are also seeking feedback from software vendors, the preparer community and others.

We will do our best. However, if Minnesota does not act, this will be complicated and it will affect all 2.9 million of Minnesota's Individual Income tax filers.

These are just a few examples of the impacts to individual income tax customers from the 2017 federal tax law if Minnesota does not act.

Slide 21: 2017 Federal Tax Law | Impacts to Business Tax Customers

Slide 22: Business Tax Customers

Almost 50,000 corporations and other businesses make up over 30,000 unitary groups that are doing business in Minnesota and annually file a Minnesota corporate income tax return.

Just under 225,000 flow through businesses, like partnerships and trusts, file entity-level returns each year in Minnesota. These businesses pass their income, credits and Minnesota modifications to over 700,000 partners, shareholders and beneficiaries, who include those items on their Minnesota income tax returns.

Slide 23: Improved Service

When it comes to service over the past few years, the Department has particularly emphasized the value of doing our work “together.” We heard loud and clear that our business partners needed more from us in the areas of customer service and engagement.

In particular, we heard that tax administration in Minnesota could improve with a renewed focus on technical advice in complex areas of law. After hearing this feedback, we promised to publish more Revenue Notices in 2017 than we published in 2016, and we also promised more transparency. In 2017 we delivered.

We are providing more – timelier – and transparent guidance that is easy to access and broadly applicable to as many customers as possible. We are working more closely on Revenue Notices with the Minnesota State Bar Association and the Minnesota Society of Certified Public Accountants, among others. And we are sharing drafts of Revenue Notices before publication for input.

In 2017, we published 13 Revenue Notices – which is 5 more than we published in 2016, and 10 more than we published in 2015.

We are also putting resources towards Rulemaking activities. In 2017, we began work to improve and clarify three existing rules—one in the area of property tax, another in corporate franchise tax, and the third in sales and use tax.

We are focused on outreach – having more conversations and sharing more of our training in advance technical areas at forums like the Annual Tax Institute with the Minnesota State Bar Association and the Annual Tax Conference with the Minnesota Society of CPAs.

Finally, we heard that our corporate audits in particular were taking too long. To address this issue, we focused on reducing the number of “aging” audits in our Corporate Division.

In January 2017, we had 114 open audits over 1 year old and by the end of December we had reduced that number to 32.

Slide 24: Impacts All Businesses

I raise these examples of improved service and engagement because the differences between the 2017 Federal Tax Law and current Minnesota law will significantly increase the scope and need for robust technical advice from the Department, as well as potential areas of noncompliance on complicated business income tax returns.

As you heard, the 2017 Federal Tax Law includes wide-ranging tax changes that impact all business types that file in Minnesota. These changes to the Internal Revenue Code affect the calculation of federal taxable income. Like individuals, FTI is also the starting point for determining Minnesota taxable income for businesses.

As a result, under the 2017 Federal Tax Law paired with current Minnesota law, most business filers will need to make many adjustments to FTI at each level of their Minnesota returns.

Slide 25: Examples of Complexity

There are two examples that illustrate the complexity businesses will face in complying with current Minnesota law under the 2017 Federal Tax Law – and why a significant change in forms, instructions, and schedules will be necessary:

- Bonus depreciation
- Like kind exchange

Slide 26: Bonus Depreciation

As you follow along on the PowerPoint slides, you will notice that some of the steps have boxes around them. Those boxes indicate new steps for Minnesota filers.

Federal law and Minnesota law both provide an election to apply bonus depreciation on eligible newly acquired original use property.

The 2017 Federal Tax Law allows this election for more types of property, new and used property, and for 100% of the property's value if the property was acquired and placed in service after September 27, 2017.

Current Minnesota law only allows up to 50% of the value of the non-used property to be eligible for bonus depreciation.

On a Minnesota return, for property acquired and placed in service after September 27, 2017, this means our business customers will need to:

- Separate the value of used and new property that qualified for bonus depreciation on the federal return
- Add 100% of property value attributable to used property back to FTI
- Add 50% of property value attributable to new property back to FTI
- Then make the existing Minnesota modification by adding 80% of the remaining 50% of new property that was eligible for bonus under the 2016 federal code
- Then in each of the five following years, subtract 1/5 of the 80% addition
- Over as many as 20 years, keep track of separate basis and depreciation schedules for each asset

Over those 20 years, if assets are sold, there will be different items of adjustment on the Minnesota return because basis and depreciation for federal and state purposes will not be the same.

Slide 27: Like Kind Exchange

Federal law and Minnesota law both provide for an election to defer the gain or loss from the sale of business property, if the proceeds from the sale are invested in a property that is like the kind that was sold.

Under the 2017 Federal Tax Law this treatment is only available for certain types of real property.

Current Minnesota law allows for this deferral for real property and tangible personal property used in a trade or business.

On a Minnesota return, this means our business customers will need to:

- Determine if property is eligible for like-kind exchange in Minnesota under pre-2017 federal tax laws, rules and regulations
- Subtract gains from the sale of that property included in FTI
- Claim like-kind exchange treatment for the first time on their Minnesota return
- Separately track basis until newly acquired property is sold

These examples are illustrative of the complexities that will impact businesses of all sizes and types, and there are many more – some of which, like the accounting method changes, are the basic building blocks for any business in determining the timing of income and deductions.

Nonconformity in these areas will significantly increase record keeping burdens for our business customers.

Slide 28: New Schedules and Instructions

To administer through a taxable year under the 2017 Federal Tax Law paired with current Minnesota law, our business customers would likely see significant changes to current forms and instructions.

At a minimum, there would be new nonconformity schedules for each entity level return and for each K schedule.

There would be new instructions, worksheets and schedules for the more complex modifications like bonus depreciation, section 179 adjustments, and 1031 like kind exchanges.

Our preliminary estimate is that the nonconformity schedules would have a minimum of 40 new lines.

This is a minimum number as we would attempt to group like items together as much as possible.

While the approach I'm describing focuses on providing guidance, information and transparency, we know it will also result in additional burdens to our business customers who will be required to complete and issue the new Nonconformity Schedules.

It will also be a significant change from the past when nonconformity modifications were much smaller in number, scope and impact – and we were able to largely maintain the normal course of Minnesota forms and schedules without substantial change.

Slide 29: Revenue's Priorities

Our goals in any filing season include minimizing impact to customers where we can, supporting voluntary compliance, providing assistance – including information on complex questions, as well as protecting the integrity of the tax system overall.

Nonconformity creates new complexities for Minnesota modifications, and shifts some areas of law to the department to administer on its own, provide guidance, and answer questions. This will increase the need for services on top of responding to the current needs of our business partners – in the areas of more robust, transparent guidance, as well as timely completion of our business income audits.

Slide 30: 2017 Federal Tax Law Administrative Impacts | Minnesota Department of Revenue

Slide 31: Administrative Costs

As we have shared today, there will be a great deal of new effort to ensure the department can help customers with filing in this scenario. We would strive to do that without diminishing our current service levels.

House State Government Finance Committee Chair Sarah Anderson has requested information about the financial and personnel impacts of the 2017 Federal Tax Law on the department's operations absent any response from Minnesota to the changes. We will provide a formal response to that request as soon as it is ready. In the meantime, we want to provide you with an update on our process to analyze the impacts of the 2017 law on the department.

As my colleagues have shared, the impacts are many, broad, and sweeping. We are analyzing a plan to implement our tax management system under current state law and the new federal law that minimizes impacts to all of our customers, supports voluntary tax filing, provides filing processes that are as simple as possible, and that protects the integrity of the tax system.

Slide 32: Administrative Costs

We have started to scope the impacts to customers, our operations, filing payment and review processes, and other systems in order to fully implement the 2017 Federal Tax Law.

Our work will include creating forms and re-writing instructions. Our integrated tax system must be updated and maintained to respond to those changes. Extensive training will be necessary to prepare our employees to serve customers accurately and effectively. We will need to implement a broad communication plan with taxpayers, preparers, and software vendors to help them comply with the law. And, we expect our customers will have more questions on how the new tax laws work.

Our goal is to provide excellent service to all of our customers, and to ensure our current service levels are maintained. We are analyzing the additional work and increased customer demands that will come from the 2017 Federal Tax Law.

Slide 33: Next Steps

Before I close I wanted to also touch briefly on the set of extenders that was contained in the budget deal reached by Congress on February 9th also include a package of tax provisions, or extenders, which had previously expired.

These extenders would be retroactive for 2017 taxes and Minnesota would need to pass legislation to conform to these provisions.

This package of provisions is similar to what Congress has passed in previous years and Minnesota has conformed to parts of the package in prior sessions.

We are reviewing this legislation, and will review the guidance from the Internal Revenue Service (IRS), when released, to determine the appropriate next steps Minnesota individual income tax customers should take. We will provide additional information when it is available.

We want Minnesotans to know that some of the changes in the federal legislation may affect their returns if any of the following occurred during 2017:

- They paid tuition and fees for post-secondary education (generally reported on federal Form 1098-T).
- They paid private mortgage insurance (generally reported on federal Form 1098).
- They entered into an arrangement under which debt was discharged on their principal residence including through a short sale or foreclosure.
- They are a part-year Minnesota resident who lived in the California wildfire disaster area between Oct. 8, 2017 and Dec. 31, 2017, and they claimed the federal Earned Income Tax Credit.
- They operated a business on an Indian reservation and placed assets in service.
- They placed certain mine safety equipment in service.
- They operated a motorsports entertainment complex and placed certain property in service.
- They paid certain film, television, or theatrical expenses.
- They suffered a casualty loss of personal property located in the California wildfire disaster area.
- They lived in the California wildfire disaster area between Oct. 8, 2017 and Dec. 31, 2017 and received a distribution from their retirement account.
- They contributed to charitable organization for relief efforts in the California wildfire disaster area.

This federal legislation may also affect certain businesses filing their 2017 Minnesota tax return. If any of the provisions included in the legislation affect the amount of taxable income reported on a 2017 federal return, they may be required to adjust their income on their 2017 Minnesota return.

We will continue our review of the extended and modified tax provisions for tax year 2017, and will provide additional information to our customers and to you when it becomes available.

Looking forward to next steps for our work together, we will look to the February forecast to give us context for any possible response that Minnesota may take in regards to the 2017 Federal Tax Law.

In mid-March, the Governor will submit his supplemental budget proposal which will include the tax priorities that he has held to throughout his administration.

The Governor's proposal will support a tax system that is fair for hard-working Minnesotans while creating a responsible budget for Minnesota's future.

The Governor has also indicated that he is concerned about three items from the 2017 tax bill including the tax breaks for big tobacco companies, the business property tax inflator and the estate tax changes that threaten our state's financial security.

And, we need to make sure that Minnesota's response to the new federal tax law enacted by Congress continues our responsible commitment to a fair and balanced budget, and treats all Minnesotans fairly – especially low- and middle-income working families.

As we consider a response to the federal law that is in the best interest of Minnesota, we are reminded of the pillars of our state's strength that we have built over the past seven years:

- fiscal responsibility;
- key investments in education;
- infrastructure;
- services to build our economy; and,
- fairness in our tax system.

Minnesota has many options for ways to respond to the 2017 Federal Tax Law. We look forward to discussing these options with you to find the best path forward for Minnesota. We would be happy to answer any questions.