HOUSE RESEARCH
Bill Summary

FILE NUMBER: ief. Allows an ex-spouse seeking innocent spouse relief from joint income taxes to claim a refund of any payments made within 60 days of the claim for relief. Expands **DATE:** February 2, 1999

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Subject: Department of Revenue Policy Bill

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Overview

This is the Department of Revenue's policy bill. The bill makes a variety of changes to improve the administration and collection of state and local taxes.

Article 1: Sales and Special Taxes

Section

1 **Retaliatory provisions.** Provides that assessments, including the insurance guarantee association assessment, are not included in the retaliatory tax calculation for the insurance premiums tax. Effective for tax years beginning after December 31, 1999.

2 **Interest on purchaser refunds.** Provides that unless a taxpayer furnishes a detailed schedule of purchases made during each taxable period, the interest on a refund claim will be computed from the date the claim is filed. If a taxpayer provides a schedule of purchases, the interest on a refund will be computed from the 20th day of the month following the invoice date.

3 **Revolving account.** Establishes a revolving fund for the commissioner to use for purchase of cigarette stamps. $40,000 is transferred from the general fund in order to establish the account.

4 **Self-hauler.** Reduces the solid waste management tax on self-haulers of mixed municipal sold waste from residential generators from 17% (the rate applied to commercial generators) to 9.75% (the rate applied to residential generators).

5 **Effective dates.** Effective July 1, 1999, unless indicated otherwise in the individual section summary.

Article 2: MinnesotaCare Taxes

1 **Definition of health care provider.** Excludes the following from the definition of 'health care provider':

> providers of home health care services. Under current law, these providers are required to file a MinnesotaCare tax return although all their receipts are excluded from tax under the home health care services exemption. Excluding them from the definition will mean they will not be required to register for the tax.
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> employers that provide patient services solely to their employees.
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> schools and other educational institutions that employ a health care provider to provide services to their students. Educational institutions that receive fee for service payments and payments for extended coverage remain subject to tax.

This section also eliminates the portion of the definition of health care providers that specifies independent medical examinations for insurance or other purposes are patient services. (This specification is added to the definition of patient services in the Department of Revenue's technical bill.)

2 **Exemptions.** Exempts from tax the following:

> payments received from a health care provider who is paid by the government. Under current law, the exemptions for medical assistance, Medicare, general assistance medical care, MinnesotaCare and the chemical dependency fund all flow through from one provider to the next. This change includes government payments in this list of exemptions.
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> payments for services received outside of Minnesota, regardless of the patient's domicile. This change clarifies current law.
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> payments for services provided to nursing homes. This change eliminates the tax on providers who contract to provide services to nursing homes. Services provided to individual nursing home residents remain subject to tax.

3 **Effective dates.** Effective for payments received on or after January 1, 2000.

Article 3: Income and Franchise Taxes

1 **Trade or business income.** Provides that all income of a unitary business, except non-business income is subject to apportionment. Changes the term 'trade or business' to 'unitary business' throughout this section.

2 **Unitary business principle.** Makes the definition of a 'unitary business' consistent with the U.S. Supreme Court definition, and creates a presumption that a unitary business exists whenever business operations are of mutual benefit, dependent upon or contributory to one another. Clarifies that a sole proprietorship may be a unitary business, but neither requires nor permits proprietorships to file combined reports.

3 **Non-business income.** Makes the definition of 'non-business income' consistent with U.S. and Minnesota Supreme Court cases that have found that certain types of unitary business income cannot be apportioned. Income derived from a capital transaction that solely serves an investment purpose is specifically defined as non-business income. (This codifies the rule in the most recent United States Supreme Court case on this issue, *Allied-Signal, Inc. v. Director, Division of Taxation,* 504 U.S. 768 (1992).) In most cases, non-business income is assigned to a taxpayer's domicile.

4 **Amnesty for prior years.** Provides that if a taxpayer reported all income not subject to a specific exception as business income, the commissioner may not assess additional tax for the year by treating the income as non-business income.

5 **Effective dates.** Effective for tax years beginning after December 31, 1998, except the amnesty

provision which is effective for years before January 1, 1999.

Article 4: Federal Update

1 **Administrative provisions update.** Updates to federal changes relating to tax administration.

Lengthens the time period for claiming a refund due to a net operating loss generated by a farm loss from two years to five years;

Broadens the availability of innocent spouse relief (see also Article 5, section 7)

2 **Net income update.** Adopts federal changes to the definition of 'taxable income' made in the Internal Revenue Service Restructuring and Reform Act, the Omnibus Consolidated and Emergency Supplemental Appropriations Act, the Transportation Equity Act for the 21st Century, and the Ricky Ray Hemophilia Relief Fund Act. These acts include many technical changes to the definition of 'taxable income.' Substantive changes include:

Lottery winnings. Allows lottery winners who elect to receive annuity payments after winning prizes to recognize income as payments are made. Effective for prizes won after October 21, 1998;

Education loan interest deduction phaseout. Excludes employer-provided adoption assistance that is excluded from taxable income and U.S. bond interest from the income measure used in phasing out the deduction for education loan interest. Effective for loans incurred after August 5, 1977, and interest due after December 31, 1997;

Education loan interest deduction. Provides that interest paid on a loan from an employer's qualified pension plan does not qualify for deduction as education loan interest. Effective for loans incurred after August 5, 1977, and interest due after December 31, 1997;

Also provides that to be considered deductible interest, the debt must be incurred solely to pay higher education expenses. Effective for interest paid in tax years beginning after December 31, 1997;

Charitable contributions. Allows taxpayers to deduct the fair market value of appreciate stock gifted to a private foundation as a charitable contribution deduction. Effective for gifts made after June 30, 1998, and following years;

Casualty losses. Treats non-business theft or casualty losses incurred in a transaction entered into for profit as business losses for net operating loss purposes and as a miscellaneous itemized deduction not subject to the 2 percent federal adjusted gross income threshold. Effective retroactively to tax year 1987;

Farm income. Allows farmers who choose to receive federal production payments under the Federal Agriculture Improvement and Reform Act of 1996 (FAIR) in January rather than December to recognize the income in the year in which they receive the payment. Effective for tax year 1996 and following years;

Shareholders of RICs and REITs. Provides that corporate shareholders who hold an 80 percent or greater share of a Regulated Investment Company (RIC) or a Real Estate Investment Trust (REIT) may not receive liquidating distributions tax free if they can claim a deduction for dividends paid on the distribution. Effective for distributions after May 21, 1998;

Education IRA. Deems that funds in an education IRA are deemed distributed 30 days after the IRA beneficiary's 30th birthday. Effective for tax years beginning after December 31, 1997;

Sale of principal residence. Allows the $250,000 capital gain exclusion on the sale of a principal resident to be pro-rated for taxpayers who do not meet the two year ownership or use requirement because of employment, health, or unforeseen circumstances. The $250,000 is reduced proportionately based on actual months of use and ownership.

Transportation fringe benefit. Allows employees to exclude from income cash benefits that they choose in place of employer-provided transportation fringe benefits such as bus pass, parking, and van pools . Effective for tax year 1998 and following years. Adjusts the allowable exclusion for transportation fringe benefits for inflation beginning in 1999.

Small business stock. Allows certain partnerships and 'S' corporations to sell qualified small business stock and use the proceeds to buy other small business stock without recognizing gain. Effective for sales after August 5, 1997;

Employer-provided meals. Provides that employer-provided meals are excluded from the income of all employees if the meals for at least half of the employees are provided for the convenience of the employer. Effective for tax years beginning before, on, or after July 22, 1998;

Vacation pay. Allows employers to deduct accrued vacation or severance pay only if the pay is actually received by the employee prior within two and a half months of the end of the tax year. Effective for tax years ending after July 22, 1998;

Corporate charitable deduction. Extends the enhanced corporate deduction for computer technology and equipment donations to elementary and secondary schools through the year 2000;

Personal injury recovery. Excludes from taxable income amounts received by HIV victims from the federal government through the Ricky Ray Fund. The Ricky Ray Fund is a $750 million compensatory fund for hemophiliacs who contracted HIV from tainted blood products between 1982 and 1987. Those affected receive $100,000 from the Ricky Ray Fund and an additional $100,000 from a settlement fund established by the pharmaceutical companies that supplied the tainted blood. Effective for payments received after November 12, 1998;

Roth IRA. Provides that the election to spread income attributable to a conversion from a regular IRA to a Roth IRA over four years is elective rather than mandatory;

Mark-to-Market. Provides that trade receivables are not subject to the mark-to-market or the lower of cost or market provisions. Effective for tax years ending after July 22, 1998;

Stapled REITS. Provides that a 'stapled' real estate investment trust (REIT) and its subsidiary will be treated as a single unit if after March 26, 1998, the REIT acquires new real property or makes substantial improvement to existing property. The term 'stapled REITs' refers to REITS that predate 1984 and have corporate subsidiaries. They are otherwise allowed to continue to treat income from the corporate subsidiaries separately.

Subpart F exceptions for active financing income. Extends for one year the exception that allows U.S. corporations with foreign-controlled banking and insurance subsidiaries to exclude unearned income of the subsidiary. U.S. corporations are otherwise required to recognize the unearned income of foreign-controlled subsidiaries that are engaged in business other than banking and insurance.

3 **Self-employed health insurance subtraction.** Clarifies that the Minnesota subtraction for health insurance expenses of self-employed taxpayers does not depend on the percentage subtraction allowed under federal law, but instead allows taxpayers to subtract at the state level any insurance expenses that are not subtracted at the federal level. Effective for tax years beginning after December 31, 1998.

4 **Update to alternative minimum tax (AMT) and net operating losses (NOL).** Updates references to the Internal Revenue Code, with the following effects:

> allows individual taxpayers a five year carry-back for net operating losses (NOL) from farming.
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> allows taxpayers calculating the AMT to use the 150% declining balance method of depreciation with the recovery period used for regular tax purposes without creating a timing preference under the AMT. Effective for assets placed in service after December 31, 1998.

5 **Property tax refund update.** Conforms the income measure used in calculating the property tax refund to changes in the federal definition of adjusted gross income. Effective at the same time the federal changes take effect.

6 **Estate tax.** Updates references to the Internal Revenue Code for technical changes to the federal definition of 'taxable estate.' This definition is used to compute Minnesota's estate tax. Effective at the same time the federal changes take effect.

7 **Effective dates.** Effective dates shown in each section.

Article 5: Miscellaneous

1 **Abatement of penalties.** Authorizes the commissioner of revenue to abate penalties and interest on state taxes for taxpayers located in a presidentially-declared disaster area, and eliminates the requirement that the Attorney General approve abatement of penalties over $5,000.

2 **Erroneous refunds.** Provides that if an erroneous refund results from a taxpayer's bad check, remittance of the check is an assessment for the erroneous refund made on the date the check is received by the commissioner. This situation occurs when a taxpayer understates estimated payments or withholding on the return, and then makes a balance due payment that is greater than the actual balance due. The Department may issue a refund check, before the taxpayer's check is returned for insufficient funds.

3 **Interest on electronic funds transfer (EFT) penalty.** Provides that interest on the penalty for failure to pay tax by electronic funds transfer begins on the date the payment was due. Also eliminates an obsolete sunset provision.

4 **Requests for copies of returns.** Permits the commissioner to accept non-written requests by taxpayers for copies of their own tax returns.

5 **Taxpayer's consent to disclosure.** Permits the commissioner to accept non-written consents by taxpayers to disclosure of their tax return information to a third party.

6 **Disclosure to commissioner of commerce.** Allows the commissioner of revenue to disclose to the commissioner of commerce the social security numbers of taxpayers whose names appear on the list of unclaimed tax refunds, which the commissioner of revenue is required to provide under the Uniform Disposition of Unclaimed Property Act.

7 **Divorced and innocent spouse relief.** Allows an ex-spouse seeking innocent spouse relief from joint income taxes to claim a refund of any payments made within 60 days of the claim for relief. Expands innocent spouse relief to include widowed and legally separated spouses, as does recent federal law.

A taxpayer who qualifies for expanded innocent spouse relief under the 1998 IRS Restructuring and Reform Act will also qualify for innocent spouse relief for Minnesota purposes. Effective at the same time as for federal purposes.

8 **Suspension of time to make a refund claim during period of disability.** Suspends the time period for filing a refund claim during a period disability, if the taxpayer qualifies for a suspension under federal tax law. Generally, disability exists when a taxpayer is physically or

mentally unable to manage financial affairs, and ends when the taxpayer recovers or a guardian is appointed. Eliminates the current reasonable cause standard and the ten-year time period for filing a claim. Effective for disabilities existing on or after the date following final enactment for which claims for refund have not expired as of the date of enactment.

9 **Claims for refund.** Provides for an automatic denial of a claim for refund if the commissioner has not issued a denial within 30 months of the date the claim was filed. The taxpayer has 18 months after the automatic denial to bring an action in the district court or tax court. If the taxpayer does not bring an action, the claim expires and the taxpayer has no further recourse. This reverses the recent Minnesota Supreme Court decision in *Klein Bancorporation & Rural American Bank-Add v. Commissioner* (1998). Effective for refund claims filed on or after the day following final enactment, except that corporate tax refund claims filed before enactment are deemed denied 30 months after the day following final enactment.

10 **Interest on penalties.** Provides that interest on the penalty for failure to pay tax by electronic funds transfer begins on the date the payment was due. Also eliminates an obsolete sunset provision.

This section is similar to section 3, but applies to the tax administration chapter while section 3 relates to the general authority of the department.

11 **Effective dates.** Effective the day following final enactment, unless otherwise indicated in the summary of the individual section.