HOUSE RESEARCH

Bill Summary

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Overview

Conforms Minnesota's individual income tax and corporate franchise tax to most federal changes enacted since February 13, 2008. The principal federal changes that Minnesota would conform to are:

- **deduction for teacher classroom expenses**
- **counting nontaxable combat pay as earned income for members of the military for purposes of claiming the earned income credit and working family credit**
- **allowance of direct transfers to charities from traditional IRAs and Roth IRAs for tax years 2008 and 2009**
- **extension of the special rule for contribution of conservation property by qualified farmers and ranchers**
- **apportioning of the exclusion of gain on the sale of an individual's principal residence for time periods after January 1, 2009, when the residence was not used as the principal residence**
- **extension of various provisions related to depreciation and expensing (does not affect general section 179 expensing or bonus depreciation)**
- **provision of preferential tax treatment within the Midwestern Disaster Relief Area and within other federally designated disaster areas**
- **changes requirements for employer-sponsored group health plans to qualify for the employee income exclusion,**

Federal changes that Minnesota would not conform to are:

- **deduction for higher education tuition expenses**
- **deduction for qualified computer donations by corporations**
- **additional standard deduction for property taxes paid**
- **treatment of certain preferred stock losses as ordinary losses**

Waives penalties and interest on employers who fail to withhold taxes on differential pay paid to employees called to active service, for calendar year 2009 only.
Directs the commissioner to delay payment of corporate tax refunds from fiscal year 2009 to fiscal year 2010, and from fiscal year 2011 to fiscal year 2012, in order for the overall impact of this bill to be revenue-neutral for both the 2008-2009 and 2010-2011 biennia.
Prohibits the governor from appointing as commissioner of revenue an individual who has failed to comply with tax laws.

Section

1 **Commissioner of revenue.** Prohibits the governor from appointing as commissioner of revenue an individual who has

- been convicted of a criminal violation of federal or state tax or revenue law;
- failed to file a required income tax return within one year of its due date; or
- unpaid federal, state, or local taxes for a prior tax year at the time the appointment is announced.

2 **Update of administrative tax provisions.** Adopts federal tax administrative provisions made between February 13, 2008, and December 31, 2008, that Minnesota references for state tax administration purposes under chapter 289A. None of the seven federal acts enacted since May 18, 2006, changed federal provisions that Minnesota provisions refer to in chapter 289A.

Effective the day following final enactment.

3 **Update to federal definition of taxable income.** Adopts all of the federal changes to taxable income effective when the federal changes became effective, for tax year 2008 and following years. The seven new federal laws and important changes were:

The Heroes Earnings Assistance and Relief Tax Act, Public Law 110-245, enacted June 17, 2008, made several changes mostly relating to military personnel. Provisions include:

- making permanent the ability of military personnel to count tax-exempt combat pay as earned income for the purpose of qualifying for the earned income tax credit (and, by reference, Minnesota's working family tax credit), effective in tax year 2008
- modifying requirements and limitations relating to contributions to and distributions from tax advantaged accounts (IRAs, 401Ks, etc.) for members of the military
- imposing income tax on unrealized gain on property as if the property had been sold for fair market value on individuals with net worth over $2 million and over $600,000 of unrealized gains who relinquish their U.S. citizenship or terminate long-term residency on or after June 17, 2008

Heartland, Habitat, Harvest, and Horticulture Act of 2008, Public Law 110-246, enacted June 18, 2008, which made a large number of changes to federal agriculture provisions. Provisions with tax consequences include:

- extends the special rule for contribution of conservation property by qualified farmers and ranchers, allowing deduction of contributions valued at greater than 50 percent of the donor's adjusted gross income, effective in tax year 2008
- allows deduction for site-specific actions recommended in management plans for endangered species
- changes the depreciation schedule for race horses from three years to seven years, for horses two years old or younger
- allows like-kind exchange treatment for shares in mutual ditch, reservoir, or irrigation companies (effective June 19, 2008)
- disallows excess farming losses for taxpayers who receive certain federal subsidies

Housing Assistance Tax Act of 2008, Public Law 110-289, enacted July 30, 2008, made changes to federal housing provisions. Provisions with tax consequences include:

- allows an additional standard deduction amount of $500 for property taxes paid ($1,000 for married joint filers), effective for tax year 2008 only (*Minnesota would not conform to this deduction; instead an addition to taxable income would be required under section 4*)
- extends the state and local bond interest exemption to bonds guaranteed by federal home loan banks
- excludes from alternative minimum taxable income interest for tax-exempt housing bonds issued for first-time home buyers, moderate income housing, and owner-occupied housing for veterans
- reforms Real Estate Investment Trust (REIT) treatment
- makes changes related to the Gulf Opportunity Zone losses and bonus depreciation
- apportions the exclusion of gain on the sale of an individual's principal residence for time periods after January 1, 2009, when the residence was not used as the principal residence

Emergency Economic Stabilization Act of 2008, Public Law 110-343, enacted October 3, 2008, extended and expanded several pre-existing tax provisions, provided tax relief for federally declared disaster areas and for a designated Midwestern disaster area, included the Mental Health Parity and Addiction Parity Act of 2008, and raised revenue by changing the tax treatment of nonqualified deferred compensation for certain taxpayers. Major provisions include:

- extends the higher education tuition expense deduction of up to $4,000 to tax years 2008 and 2009 (*Minnesota would not conform to this deduction; instead an addition to taxable income would be required under section 4*)
- extends the additional standard deduction amount for property taxes enacted in the

Housing Assistance Tax Act to tax year 2009 (*Minnesota would not conform to this deduction; instead an addition to taxable income would be required under section 4*)

- extends the teacher classroom expense deduction of up to $250 to tax years 2008 and 2009
- extends the authorization for individuals age 70½ or older to transfer up to $100,000 from a traditional IRA or Roth IRA directly to a qualified charity, while excluding that amount from adjusted gross income to tax years 2008 and 2009
- extends preferential treatment of dividends of regulated investment companies to tax years 2008 and 2009
- extends the enhanced deductions for contributions of food inventory, book inventory, and computers to tax years 2008 and 2009 (*Minnesota would not conform to with regard to computers; instead an addition to taxable income would be required under section 5*)
- extends various provisions related to depreciation and expensing, including more generous rules for cellulosic biofuel plant property, refineries, energy efficient commercial buildings, qualified smart electric distribution property, certain reuse and recycling property, 15-year straight-line recovery for leasehold and restaurant improvements, including new restaurant property and improvements to retail property, advanced mine safety equipment, accelerated deprecation for business property on Indian reservations, brownfields environmental remediation costs, qualified film and television productions, and certain farming business machinery and equipment
- provides preferential tax treatment within the Midwestern Disaster Relief Area, including temporary suspension of limits on charitable contributions, and temporary suspension on limits on casualty losses. The area is defined as counties in which a disaster was declared between May 20, 2008, and July 31, 2008; this includes the Minnesota counties of Cook, Fillmore, Freeborn, Houston, Mower, and Nobles.
- allows an additional standard deduction for casualty losses occurring in a federally declared disaster area, for disasters occurring before January 1, 2010 (does not apply to the Midwestern Disaster Relief Area)
- provides more generous expensing and depreciation for 2008 and 2009 federally declared disaster areas, excluding areas in the Midwestern Disaster Relief Area and a similar Kansas Disaster Relief Area
- changes requirements for employer-sponsored group health plans to qualify for the employee income exclusion, as part of the Mental Health Parity and Addiction Equity Act

4 **Additions to taxable income; individuals.** Requires the extended federal deduction for up to $4,000 of higher education tuition to be added to taxable income by individuals. Minnesota did not conform to this deduction in tax year 2007 and the bill continues that

treatment permanently (federal law allows this deduction for tax year 2008 and 2009).

Also requires the new additional standard deduction amount for property taxes ($1,000 for married joint filers, $500 for other taxpayers) to be added to taxable income. Modifies the definition of standard deduction used in limiting the addition for state income or sales taxes deducted at the federal level to include the new additional amount for property taxes.

5 **Additions to taxable income; corporations.** Extends the requirement that taxpayers add back the amount excluded from subpart F income at the federal level for tax year 2010; EESA 2008 extended the additional subpart F exclusion to 2010.

6 **Subtractions from taxable income; corporations.** Extends the requirement that taxpayers disregard the additional amount excluded from subpart F income at the federal level when calculating the allowable subtraction for decreases in that income to tax year 2010; EESA 2008 extended the additional subpart F exclusion to 2010.

7 **Preferred stock losses treated as capital losses.** Directs individual and corporate taxpayers to treat losses on the sale or transfer of certain preferred stock as capital losses for purposes of Minnesota's regular and alternative minimum taxes, and also for calculation of Minnesota net operating losses. EESA 2008 authorized certain financial institutions to treat losses on preferred stock in the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation that was sold or exchanged between January 1, 2008, and September 7, 2008, as ordinary losses rather than capital losses, as a result lifting the limit on the amount of losses that may be recognized in tax year 2008. This section subjects those losses to the limits on recognition of capital losses for state tax purposes, with outstanding amounts carried forward to future tax years.

8 **Update to other references to the Internal Revenue Code in chapter 290.** Adopts federal changes to federal adjusted gross income used for computing individual alternative minimum tax and determining withholding on wages. FAGI also is the starting point for calculating household income which is used to compute the dependent care and K-12 education credit for tax year 2008 and following years. The main changes to federal adjusted gross income are described in section 3.

9 **Household income; dependent care credit.** Adds the deduction for teacher classroom expenses and the disallowed deduction for tuition expenses to the definition of household income used in calculating the dependent care credit and also the K-12 education credit.

10 **Household income; property tax refund.** Adds the deduction for teacher classroom expenses and the disallowed deduction for tuition expenses to the definition of household income used in calculating the homeowner and renter property tax refund.

11 **Update of references to Internal Revenue Code in the property tax refund chapter.** Adopts the federal changes that affect household income, which uses the definition of federal adjusted gross income as a starting point.

12 **Federal update; estate tax.** Changes the date through which Minnesota incorporates the federal estate tax from February 13, 2008, to December 31, 2008. Since there have not been any federal changes to the estate tax since the last update, this change does not have any substantive effect.

13 **Withholding on differential pay; temporary prohibition on penalties and interest.** Prohibits the commissioner from assessing tax penalty or interest against an employer for failure to withhold taxes on wage differentials paid in calendar year 2009 to members of military called to active service. A wage differential is the amount by which the servicemember's civilian pay exceeds his or her military pay; some employers have chosen to voluntarily continue to pay this amount to servicemembers while they are deployed. Federal changes to the definition of "wages" being conformed to in this bill require withholding on differential pay for wages paid after December 31, 2008.

In a related provision, HEARTA 2008 provides a federal tax credit to small businesses with fewer than 50 employees that pay wage differentials, equal to 20 percent of the first $20,000 of wage differential paid per employee.

14 **Payment of corporate franchise tax refunds.** Directs the commissioner of revenue to delay payment of $15,795,000 of corporate tax refunds from fiscal year 2009 to fiscal year 2010, and $7,150,000 from fiscal year 2011 to fiscal year 2012. Requires the commissioner to minimize the delay of payment of refunds that would result in payment of additional interest by the state. Effective for fiscal years 2009 and 2011 only.