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 March 18, 2010, for tax year 2010 only.
Some of the principal changes Minnesota would conform to for tax year 2010 are:

- Extending of the income exclusion for health insurance to benefits for adult children up to age 26
- Increasing the maximum exclusion for employer-provided adoption assistance
- Extending the authority for individuals age 701/2 or older to transfer up to $100,000 from an IRA or Roth IRA directly to a qualified charity
- Extending the increase in the federal adjusted gross income limit on the amount of qualified conservation easements that may be claimed as a charitable deduction
- Extending various provisions related to depreciation and expensing

Minnesota would not conform to the following provisions:

- Increase in section 179 expensing for tax year 2010
- Extension of 50 percent bonus depreciation to tax year 2010, with increased 100 percent bonus depreciation for property placed in service after September 8, 2010
- Extension of the higher education tuition deduction
- Extension of the educator classroom expense deduction
- Extension of the enhanced deduction of charitable contributions of computers

1 **Update of administrative tax provisions.** Adopts federal tax administrative provisions made between March 18, 2010, and December 17, 2010, that Minnesota references for state tax administration purposes under chapter 289A, for tax year 2010 only. The new federal laws did not change federal provisions that Minnesota provisions refer to in chapter 289A.

Effective date: day following final enactment

2 **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 2010 only, with the following exceptions:

- Increased section 179 expensing for tax year 2010

- 50 percent bonus depreciation for tax years 2010, with temporary 100 percent bonus depreciation for property placed in service after September 8, 2010
- Higher education tuition expense deduction
- Teacher classroom expense deduction
- Enhanced deduction for charitable contributions of computers

The four new federal laws and important changes for tax year 2010 were:

The Patient Protection and Affordable Care Act of 2010, Public Law 111-148, enacted March 23' 2010, and **The Health Care and Education Reconciliation Act of 2010,** Public Law 111-152, enacted March 30, 2010, made the following major changes that affect tax year 2010:

- Extends the income exclusion for health insurance to benefits for adult children up to and including age 26, effective for plan years beginning on or after September 23, 2010. Under prior federal law, the exclusion was limited to coverage for dependents who were under age 19, students under age 24, or permanently and totally disabled.
- Increases the maximum exclusion for employer-provided adoption assistance to $13,170 for tax year 2010.
- Allows an income exclusion for state loan forgiveness programs for health care professionals intended to increase the availability of health professionals in underserved areas, retroactive to tax year 2009. *This bill would conform to the exclusion for tax year 2010 only.*
- Codifies the economic substance doctrine, requiring transactions to which the doctrine is relevant to change the taxpayer's economic position in a meaningful way, excepting the effects on federal income tax liability, and requiring the taxpayer to have a substantial purpose, excepting the corresponding change in federal income tax liability, from entering into the transaction.

The Small Business Jobs Act of 2010, Public Law 111-240, enacted September 27, 2010, made the following major changes that affect tax year 2010:

- Increased the section 179 expensing amount and phase-out threshold for tax years 2010 and 2011 to $500,000 and $2 million *(Minnesota would not conform to the extension of increased section 179 amounts, but would retain its current law requirement that taxpayers add-back to taxable income 80 percent of the expensing amount in the first tax year, and then subtract one-fifth of the amount added back in each of the five following tax years)*.
- Extends 50 percent bonus depreciation amounts to tax year 2010 *(Minnesota would not conform to the extension of bonus depreciation but would retain its current law requirement that taxpayers add-back to taxable income 80 percent of the additional depreciation amount in the first tax year, and then subtract one-fifth of the amount added back in each of the five following tax years)*.
- Provides that the percentage completion method for long-term contracts, which requires that income be recognized when related costs are recognized, is calculated without regard to bonus depreciation amounts claimed. This prevents bonus depreciation, which shifts costs into the first year of a contract, from also shifting income into the first year of the contract. Effective for tax year 2010 only.
- Increases the amount of start-up expenditures that can be directly expensed in the first year of a start-up, from $5,000 to $10,000, with the threshold for the dollar-for-dollar phaseout of the allowance increased from $50,000 to $60,000, effective beginning in tax year 2010.
- Removes cell phones and similar devices from "listed property," so that the employer deduction for cell phone expenses is not reduced by personal use of the phone by the employee. Effective

beginning in tax year 2010.

- Allows participants in government section 457(b) retirement plans to make nonexcludable contributions to associated Roth IRA accounts. Present law permits 401(k) and 403(b) plan participants to make these contributions. Also allows amounts rolled over from qualified distributions from deferral plans, such as 401(k), 403(b) or 457(b) plans, to associated Roth IRA accounts in 2010 to be recognized 50 percent in tax year 2011 and 50 percent in tax year 2012, rather than 100 percent in tax year 2010.

- Reduces the share of income on guarantees that can be sourced outside the United States, effective for guarantees issued after September 27, 2010.

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Public Law 111-321, enacted December 17, 2010, made the following major changes that affect tax year 2010:

- Allows temporary 100 percent bonus depreciation for property placed in service after September 8, 2010, and before January 1, 2012. *(Minnesota would not conform to the extension of bonus depreciation but would retain its current law requirement that taxpayers add-back to taxable income 80 percent of the additional depreciation amount in the first tax year, and then subtract one-fifth of the amount added back in each of the five following tax years)*

- Extends the teacher classroom expense deduction of up to $250 to tax years 2010 and 2011. *Minnesota would not conform to this deduction; instead taxpayers would be required to add the amount deducted at the federal level to state taxable income. Minnesota conformed to this deduction from tax year 2002, when it was first allowed, through tax year 2006. Minnesota did not conform in tax years 2007 through 2009.*

- Extends the option for taxpayers to claim an itemized deduction for sales taxes rather than income taxes paid to tax years 2010 and 2011 (Minnesota taxpayers will be unaffected by this, since present law requires any deducted sales tax to be added back in computing Minnesota tax; the same add-back is required for income taxes deducted at the federal level)

- Extends the increase in the federal adjusted gross income limit on the amount of qualified conservation easements that may be claimed as a charitable deduction to tax years 2010 and 2011. General law limits deduction of contribution of capital property to 20 or 30 percent of adjusted gross income, depending on the type of recipient organization. Beginning in 2006, the limit was increased to 50 percent for donations of qualified conservation easements by most taxpayers, and to 100 percent for donations made by farmers and ranchers, defined as individuals with 50 percent of gross income from farming/ranching.

- Extends the higher education tuition expense deduction to tax years 2010 and 2011. The deduction applies to up to $4,000 of qualifying expenses for taxpayers with adjusted gross income up to $65,000 ($130,000 for married joint filers), and to up to $2,000 of qualifying expenses for taxpayers with adjusted gross income over $65,000 but less than $80,000 ($130,000 to $160,000 for married joint filers. *Minnesota would not conform to this deduction; instead taxpayers would be required to add the amount deducted at the federal level to state taxable income. Minnesota conformed to this deduction from tax year 2002, when it was first allowed, through tax year 2006. Minnesota did not conform in tax years 2007 through 2009.*

- Extends the authority for individuals age 701/2 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 2010 and 2011, and provides that distributions made before after December 31, 2010, and before February 1, 2011, may be recognized in tax year 2010.

- Extends to tax years 2010 and 2011 various provisions related to depreciation and expensing, including more generous rules for leasehold and restaurant improvements, including new restaurant property and improvements to retail property (15-year straight-line recovery), motorsports entertainment complexes (seven-year recovery period), advanced mine safety equipment, accelerated deprecation for business property on Indian reservations, brownfields environmental remediation costs, and qualified film and television productions expenses.

- Extends to tax years 2010 and 2011 the enhanced deductions for contributions of food inventory, book inventory, and computers. *Minnesota would not conform to this deduction with regard to computers; instead taxpayers would be required to add the amount deducted for contributions of computers at the federal level to state taxable income. Minnesota did not conform to this deduction in tax years 2007 through 2009.*

- Extends preferential treatment of dividends of regulated investment companies to tax years 2010 and 2011

- Extends to tax years 2010 and 2011 the limit on basis adjustments in S corporation stock when S corporations donate appreciated property to the tax basis of the property rather than the fair market value (this reduces capital gain on later sales of the S corporation stock, compared with prior law).

3 **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 for tax year 2010. 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 2010 and following years. The main changes to federal adjusted gross income are described in section 2.

4 **Update of references to Internal Revenue Code in the property tax refund chapter.** Adopts for tax year 2010 the federal changes that affect household income, which uses the definition of federal adjusted gross income as a starting point.

5 **Corrected form W-2 not required.** Provides that employers are not required to issue corrected 2010 W-2s to employees if they have already issued W-2s for 2010 that show the value of health insurance coverage provided to adult children under age 27 that was includible in state taxable income under prior law.
Effective date: day following enactment