HOUSE RESEARCH

Bill Summary

FILE NUMBER: H.F. 451 **DATE:** February 22, 2011
Version: As introduced

Authors: Davids and others

Subject: Income tax federal conformity, December federal tax bill only

Analyst: Nina Manzi (651) 296-5204
Joel Michael (joel.michael@house.mn)

Overview

Conforms Minnesota's individual income tax and corporate franchise tax to federal changes enacted in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA).

Some of the principal changes Minnesota would conform to are:

- Extends the increase in the standard deduction for married joint filers at twice the amount for single filers to tax years 2011 and 2012
- Extends the elimination of the limitation on itemized deductions and the phaseout of personal and dependent exemptions to tax years 2011 and 2012
- Extends the increased income limits and unlimited time period for deduction of student loan interest to tax years 2011 and 2012
- Extends 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
- 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
- Extends various provisions related to depreciation and expensing
- Extends increased credit rates and maximum credit amounts for the federal dependent care credit, which affect the calculation of the state dependent care credit

Minnesota would not conform to the following provisions:

- Increased section 179 expensing allowances for tax year 2012
- Bonus depreciation of 100 percent for property placed in service after September 8, 2010, and before January 1, 2012, and extension of 50 percent bonus depreciation to tax years 2012 and 2013
- 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 enacted in TRUIRJCA that Minnesota references for state tax administration purposes under chapter 289A. TRUIRJCA did not change federal provisions that Minnesota provisions refer to in chapter 289A.

2 **Update to federal definition of taxable income.** Adopts federal changes to taxable income enacted in TRUIRJCA, effective when the federal changes became effective, with the following exceptions:

- Increased section 179 expensing for tax year 2012
- Temporary 100 percent bonus depreciation for property placed in service after September 8, 2010, and before January 1, 2012, and extension of 50 percent bonus depreciation to tax years 2012 and 2013
- Higher education tuition expense deduction
- Teacher classroom expense deduction of up to $250
- Enhanced deduction for charitable contributions of computers

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:

- Extends provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) that were scheduled to sunset after tax year 2010 for two years, to tax years 2011 and 2012. The major EGTRRA provisions that affect Minnesota's income definition are:
  - § Increase in the standard deduction for married joint filers to be twice that for single filers (from $9,650 to $11,600 in tax year 2011)
  - § Elimination of the phaseout of personal and dependent exemptions
  - § Elimination of the limitation on itemized deductions
  - § Increased income limits and unlimited time period for deduction of student loan interest - for married joint filers, income eligibility for the deduction would otherwise decrease from $120,000 to $70,000 in tax year 2011, and for single filers income eligibility would decrease from $60,000 to $45,000.
- Extends 50 percent bonus depreciation to tax years 2011 to 2013, with 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). The Small Business Jobs Act of 2010, P.L. 111-240, extended 50 percent bonus depreciation to tax year 2010. This bill does not address how Minnesota would treat 50 percent bonus depreciation claimed for property placed in service from January 1, 2010, through September 8, 2010.*
- Increases the section 179 expensing amount and phase-out threshold for tax year 2012 to $125,000 and $500,000, indexed from 2007 to 2012, estimated at $137,000 and $540,000. *(Minnesota would not conform to the extension of section 179 but would retain its current law requirement that taxpayers add-back to taxable income 80 percent of the additional 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). The Small Business Jobs Act of 2010, P.L. 111-240, increased section 179 expensing amounts for tax years 2010 and 2011. This bill does not address how Minnesota would treat increased federal section 179 expensing allowances in tax years 2010 and 2011.*
- 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 the maximum amount of benefit that an employer may exclude from gross income for employee transit and vanpool expenses to equal the amount allowed to be excluded for employee parking expenses, for tax year 2011 only.

- 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).

- Extends the 100 percent exclusion for the gain on sale of qualified small business stock held for more than five years for stock acquired after September 27, 2010, and before January 1, 2011, to apply to stock acquired before January 1, 2012. The exclusion will revert to 50 percent for stock acquired on or after January 1, 2012.

- Extends the itemized deduction for mortgage insurance premiums to tax year 2011.
- Extends increased credit rates and maximum credit amounts for the federal dependent care credit, which affect calculation of the state dependent care credit, to tax years 2011 and 2012.

3 **Update to other references to the Internal Revenue Code in chapter 290.** Adopts federal changes to federal adjusted gross income enacted in TRUIRJCA. Federal adjusted gross income is 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 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 federal changes enacted in TRUIRCA that affect household income, which uses the definition of federal adjusted gross income as a starting point.