HOUSE RESEARCH

Bill Summary

FILE NUMBER: H.F. 1493 **DATE:** April 2, 2013
Version: With author's amendments H1493A1 and H1493A3

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Subject: Individual income tax, corporate franchise tax, and other taxes and aid programs

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Overview

This bill makes significant changes in the individual income, corporate franchise and occupation taxes, modifies the sustainable forest incentive program, extends the suspension of the political contribution refund program, and clarifies the imposition of local lodging taxes.

Eliminates or repeals the following features of the income and corporate franchise taxes:

- The itemized deductions for mortgage interest other than interest on the principal residence, real and personal property taxes other than taxes on the principal residence, and charitable contributions
- The charitable contribution subtraction for nonitemizers
- The exemption for newly issued (after 6/30/2013) Minnesota state and local bonds
- The subtraction for national service (Americorps) education awards
- The subtraction for foreign subnational taxes in excess of the federal foreign tax credit
- The subtraction and refundable credit for K-12 education expenses
- The long term care insurance credit
- The special rules for foreign operating corporations or FOCs
- The exclusion for 80 percent of foreign royalties

Provides a nonrefundable credit equal to 8 percent of charitable contributions in excess of two percent of adjusted gross income (or $400, whichever is greater)

Makes the following changes to existing features of the tax system:

- Indexes the corporate franchise tax minimum fee for inflation
- Expands the definition of domestic corporations to include tax havens

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- Increases the occupation tax rate to one-half the corporate franchise tax rate
- Modifies sustainable forest incentive payments

Section

1 **FOCs.** Eliminates a reference (in the tax administration chapter) to FOCs, which are repealed by the bill.

2 **Domestic corporation definitions.** Expands the definition of domestic corporation for purposes of the corporate franchise tax to include the following foreign corporations (i.e., corporations or other entities organized under the laws of a foreign country) that:

- Have 20 percent or more of the average of their property, payroll, and sales in the United States.
- Derive less than 80 percent of their income from foreign sources (as defined in section 7.)
- Are incorporated in or have their principal places of business in a foreign country that either does not impose an income tax, or imposes an income tax at a rate lower than 10 percent of the U.S. rate on the corporate tax base in the U.S. and meet either of the following two conditions: (1) 50 percent or more of any of its sales, purchases, or payment of income or expenses is with a domestic member of the unitary business or (2) the corporation does not conduct significant economic activity.
- Are foreign entities (corporations, partnerships, and so forth) whose income federal tax law requires to be included in the federal taxable income of a domestic entity or resident individual. (This has the effect of reversing the Minnesota Supreme Court's decision in the *Manpower, Inc. v. Commissioner*, 724 N.W.2d 526 (Minn. 2006)).

Domestic corporations that are part of a unitary business must be included on the combined report. As a result, this will require the income and apportionment factors of these foreign corporations to be reflected in the combined report and will subject them to Minnesota corporate franchise tax. Present Minnesota law excludes all foreign corporations from the combined report, except foreign sales corporations.

Effective date: tax year 2013.

3 **Additions to federal taxable income (FTI) for individuals.** Requires the following items to be added to FTI, subjecting this income to Minnesota tax:

- Interest on Minnesota state and local government bonds issued after June 30, 2013
- Real and personal property taxes deducted in computing FTI, other than taxes paid on the taxpayer's principal residence; this will affect motor vehicle registration tax and tax paid on second homes and other non-income producing properties
- Qualified residence interest other than interest paid on the principal home (home mortgage interest) deducted in computing FTI

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- Charitable contributions deducted as itemized deductions in computing FTI

The additions for real and personal property taxes, home mortgage interest on second homes/properties and home equity loans, and charitable contributions would be limited to the amount that the sum of itemized deductions, less these deductions and the deduction for state income or sales tax, exceeds the standard deduction. Thus, the addition cannot be more than total itemized deductions in excess of the standard deduction.

Also strikes obsolete language relating to the additional standard deduction amount for motor vehicle sales taxes and real property taxes, and the exclusion for federal subsidies for prescription drug programs, all of which have expired at the federal level, as well other obsolete language.

Effective date: tax year 2013.

4 **Subtractions from FTI for individuals.** Eliminates the following subtractions from FTI:

- K-12 education expenses
- Charitable contribution subtraction for nonitemizers (50% of contributions in excess of $500)
- Foreign subnational taxes in excess of the federal foreign tax credit
- National service (Americorps) education awards

Effective date: tax year 2013.

5 **Additions to FTI for corporations.** Repeals the corporate franchise tax additions to federal taxable income for FOCs' deemed dividends. Section 22 repeals the preferential treatment of FOCs. This provision eliminates the corresponding addition to income for the deemed dividends that are not derived from foreign source income.

Eliminates obsolete language related to foreign sales corporations, federal subsidies for prescription drug benefits, and the additional deduction amount for business donations of computers.

Effective date: tax year 2013.

6 **Subtractions from FTI for corporations.** Repeals the subtraction from federal taxable income for foreign royalties.

Effective date: tax year 2013.

7 **Foreign source income definition.** Adds a definition of foreign source income to chapter 290. This language follows federal law and parallels language used by present law, which section 5 eliminates in repealing the add-back for FOCs.

8 **Nonresident ratio.** Updates the ratio used by nonresidents and part-year residents to apportion liability to Minnesota to conform to changes to additions and subtractions in section 3 and 4.

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9 **Charitable contribution credit.** Allows an 8-percent nonrefundable individual income tax credit for charitable contributions made in excess of the greater of:

- $400 ($800 for married joint filers), or
- 2 percent of the taxpayer's adjusted gross income

Charitable contributions qualifying for the credit are subject to the same limitations as under federal law. The charitable contribution credit is allowed against both the regular tax and the alternative minimum tax.

Effective date: tax year 2013.

10 **Dependent care credit; limitation to earned income.** Updates cross-references to military pay to reflect the re-numbering of subtractions from taxable income in section 4.

11 **Dependent care credit; income definition.** Updates a cross-reference in the definition of household income.

12 **Working family credit; limitation to earned income.** Updates cross-references to military pay to reflect the re-numbering of subtractions from taxable income in section 4.

13 **Marriage credit; calculation of earned income of lesser-earning spouse.** Updates a cross-reference to the additional standard deduction amount for married filers to reflect the re-numbering of additions to taxable income in section 3.

14 **Research credit carryover.** Restores the 15 year carryover of research credit amounts in excess of liability to conform with the elimination of the refundability of the research credit in section 15.

Effective date: tax year 2013.

15 **Research credit.** Makes the research credit nonrefundable. Section 14 restores the 15 year carryover of credit amounts in excess of liability.

Background. The credit applies principally to amounts expended for wages for qualifying research activities that exceed a base amount. When the research credit was first enacted in 1982, it applied to both corporate franchise and individual income tax liability. In 1987, as part of elimination of several credits, the research credit was restricted to the corporate franchise tax. The 2010 Jobs bill extended the research credit to the individual income tax, allowing it to be claimed by owners of pass-through entities, and made it refundable for both individual and corporate claimants. The federal research credit, on which the Minnesota credit is based, is available to both corporate and individual taxpayers, and is nonrefundable.

Effective date: tax year 2013.

16 **Elderly exclusion.** Updates a cross-reference to reflect the re-numbering of subtractions from taxable income in section 4.

17 **Elderly exclusion.** Updates a cross-reference to reflect the re-numbering of subtractions

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from taxable income in section 4.

18 **Alternative minimum tax; individuals.** Strikes the deduction allowed under the alternative minimum tax (AMT) for charitable contributions. The proposed charitable contribution credit in section 9 would apply against the AMT. Also makes conforming changes to cross-references to reflect the changes to individual additions and subtractions in sections 3 and 4.

19 **AMT; corporations.** Makes conforming changes to cross-references in the corporate AMT to reflect the changes to corporate additions and subtractions in sections 5 and 6.

20 **Franchise tax minimum fee.** Increases the corporate minimum fee amounts and thresholds at which the fee amounts apply. The lowest fee under present law of $100 is increased to $190; the highest fee under present law of $5,000 increases to $9,340. The thresholds at which these fees apply increase from $500,000 (for the $100 fee) to $930,000 and from $20 million (for the $5,000 fee) to $37.36 million. These amounts are based on adjusting these amounts for inflation, as measured by the consumer price index, from the year in which the original fee amounts were set.

Effective date: tax year 2013.

21 **Net operating losses.** Strikes a reference to the foreign royalty subtraction, which is repealed in section 6.

22 **Unitary business principle.** Eliminates the authority to exclude the income and apportionment factors of FOCs from the combined report and eliminates the deemed dividend deduction for 80 percent of FOC income.

In addition, Minnesota sales of no-nexus subsidiaries must be reflected in the combined report and be reported by a corporation that is subject to tax by Minnesota.

23 **Determination of sales factor.** Eliminates the exclusion of foreign royalties that qualify for the subtraction from the sales factor, since section 6 eliminates the foreign royalty subtraction.

24 **REIT dividends.** Excludes real estate investment trust (REIT) dividends from the dividend received deduction allowed to corporations to the extent that the REIT dividends do not qualify for the dividend received deduction under the federal corporate tax.

Effective date: tax year 2013.

25 **Sustainable forests.** Modifies the definition of "forest land" that qualifies under the Sustainable Forest Incentive Act (SFIA) program to exclude properties on which the Lessard-Sams program has purchased conservation easements or where comparable easements have been otherwise conveyed to a governmental or nonprofit entity.

26 **Sustainable forests.** Requires participants in the SFIA program to provide a copy of their property tax statements and any other information that the commissioner requires along with the annual certification form that is required to receive a payment.

27 **Sustainable forests.** Limits the amount of the sustainable forest payment to one-half of the

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property tax paid.

28 **Occupation tax; other ores.** Increases the occupation tax from 2.45 percent to 4.9 percent (from one-quarter to one-half of the corporate franchise tax rate). The occupation tax is paid in-lieu of the corporate tax for taconite and non-ferrous mining.

29 **Occupation tax; taconite and iron ore.** Increases the occupation tax from 2.45 percent to 4.9 percent (from one-quarter to one-half of the corporate franchise tax rate).

30 **Local lodging taxes.** Clarifies that all local lodging taxes, whether authorized under general law (Minn. Stat. § 269.190) or special law, are imposed on the same tax base as lodging taxes collected by the Department of Revenue (DOR). Under present law, it is clear that taxes collected by DOR apply to the same tax base as the state sales tax on lodging and related services. As a result, these taxes apply to the full price or consideration for the lodging, including intermediary services (e.g., for online booking services). The same is less clear with regard to the tax under section 469.190 and some special law lodging taxes that are collected by political subdivisions (rather than DOR). This section clarifies that all of these taxes are to be treated consistently.

Effective date: Day following final enactment and states the legislature intends to confirm its original intent to apply these taxes to the full price or compensation paid for access to short-term lodging.

31 **Local lodging tax; return filing by intermediaries.** Provides that accommodation intermediaries subject to local lodging taxes that are not administered by the Department of Revenue may only be required to file and pay tax once each calendar year.

32 **Political contribution refund.** Extends the suspension of the political contribution refund for two years for campaign contributions made from July 1, 2013 through June 30, 2015. Laws 2010, 1st special session, chapter 1, suspended the political contribution refund program for campaign contributions made from July 1, 2009, to June 30, 2011, and Laws 2011, 1st special session, chapter 7, extended the suspension through June 30, 2013.

33 **Repealer.** Repeals the following provisions, effective in tax year 2013.

Section of Statute	Description
290.01 subd. 6b	Definition of FOC
290.06, subd. 22a	Nonresidents' credit for taxes paid to state of domicile
290.06, subd. 27	Tax paid to another state by corporations
290.06, subd. 28	Transit pass credit
290.0672	Long term care insurance credit
290.0674	Minnesota K-12 education credit
290.0679	Assignment of education credit

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290.0921, subd. 7	Definition of FOC for the corporate AMT