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 April 14, 2011, on an ongoing basis beginning in tax year 2013.

Minnesota would not conform to increased section 179 expensing and increased bonus depreciation, which were extended at the federal level to tax year 2013.

Section

1 **Update of administrative tax provisions.** Adopts federal tax administrative changes made between April 14, 2011, and December 20, 2013, that Minnesota references for state tax administration purposes under chapter 289A. There are no changes to federal provisions referenced in chapter 289A.

Effective date: Effective retroactive to tax year 2013.

2 **Composite returns.** Updates a reference in the statute providing filing requirements for nonresidents to reflect the renumbering of additions to taxable income in section 4.

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 2013 and following years, with the exception of the reinstated and modified limitation on itemized deductions and phaseout of exemptions, and the increase in section 179 expensing and bonus depreciation, which applied to tax year 2013 only.

The new federal laws and important changes are as follows.

Section

The American Taxpayer Relief Act of 2012 (ATRA), Public Law 112-240, enacted January 2, 2013, made the following major changes:

Provisions Made Permanent

- Increased the adjusted gross income (AGI) thresholds for the limitation on itemized deductions to $300,000 for married joint filers, $250,000 for single filers, and $275,000 for head of household filers, indexed after tax year 2013 for inflation. *(Minnesota would not conform to this provision, but instead would retain its own limitation on itemized deduction, which in tax year 2013 began when AGI reaches $178,150, adjusted annually for inflation, and allow a new subtraction from taxable income in section 5 for the amount limited at the federal level.)*

- Increased the adjusted gross income (AGI) thresholds for the phaseout of personal and dependent exemptions to $300,000 for married joint filers, $250,000 for single filers, and $275,000 for head of household filers, indexed after tax year 2013 for inflation. *(Minnesota would not conform to this provision, but instead would retain its own phaseout of exemptions, which in tax year 2013 began when AGI reaches $267,200 for married joint filers, $178,150 for single filers, and $222,700 for heads of household, adjusted annually for inflation, and allow a new subtraction from taxable income in section 5 for the amount phased out at the federal level.)*

- Increased the standard deduction for married joint filers to be twice that for single filers (from $10,150 to $12,200 in tax year 2013), with a corresponding increase in the standard deduction for married separate filers to equal the amount allowed for single filers.

- Increased the contribution limit for education savings accounts and allows use of education savings accounts for elementary and secondary school expenses.

- Exclusion of up to $5,250 of employer-provided educational assistance.

- Increased income limits and allowed an unlimited time period for deduction of student loan interest—for married joint filers, income eligibility for the deduction would otherwise decrease from $125,000 to $75,000 in tax year 2013, and for single filers income eligibility would decrease from $60,000 to $50,000.

- Exclusion of awards under the National Health Service Corps scholarship program and related awards for healthcare professionals.

- Extended increased credit rates and maximum credit amounts for the federal dependent care credit, which affect calculation of the state dependent care credit.

- Increased maximum exclusion for employer-provided adoption assistance ($12,770 in tax year 2013), adjusted annually for inflation.

Section

Provisions Temporarily Extended Through Tax Year 2013

- Increased the section 179 expensing amount and phaseout threshold for tax years 2012 and 2013 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.)*

- Educator classroom expense deduction of up to $250.

- Higher education tuition expense deduction. 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).

- Itemized deduction for mortgage insurance premiums.

- Option for taxpayers to claim an itemized deduction for sales taxes rather than income taxes paid. *(Minnesota taxpayers are not affected 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.)*

- Increased federal adjusted gross income limit on the amount of qualified conservation easements that may be claimed as a charitable deduction. Permanent law limits deduction of contributions of appreciated property to 20 percent 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.

- Parity in qualified transportation fringe benefits under which employers may exclude up to the same maximum amount per month per employee for vanpool and transit pass expenses as for parking.

- Authority 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.

- Enhanced deduction for charitable contributions of food inventory, which allows pass-through entities (S corporations, partnerships, and proprietors) to deduct contributions of food inventory under the same rules as C corporations. Instead of being limited to the basis in the food inventory, the enhanced deduction equals the lesser of basis plus one-half of the appreciation in the food inventory, or two times basis, but may not exceed ten percent of the taxpayer's net income from pass-through

Section

entities.

- Special rule limiting the amount of payments from controlled subsidiaries to parent exempt organizations that are subject to the unrelated business income tax to the amount in excess of allowable payments under the arm's-length transaction rules, providing that a binding written contract between the organizations was in effect as of August 17, 2006.

- Preferential treatment of dividends of regulated investment companies, under which dividends paid to foreign shareholders are exempt to the extent the dividends are derived from interest income that would be exempt if it had been earned directly by the foreign shareholder.

- 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), mine safety equipment, accelerated depreciation for business property on Indian reservations, and qualified film and television productions expenses.

- Exception under subpart F, which allows U.S. shareholders with a ten percent or greater interest in a controlled foreign corporation that consistent of banking, financing, and similar businesses to defer recognition of active income earned by the corporation but not distributed to the shareholders.

- 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).

- 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, 2012, to apply to stock acquired before January 1, 2014. The exclusion will revert to 50 percent for stock acquired on or after January 1, 2014.

- Reduction in the minimum holding period to avoid the tax on built-in gains on sales of assets of S corporations that converted from C corporations from ten years to five years, allowing S corporations to sell assets held more than five years without being taxed on built-in gains.

- 50 percent bonus depreciation to tax year 2013. *(Minnesota would not conform to the extension of bonus depreciation but would retain its current law requirement that taxpayers add 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).*

- Excludes from gross income discharges of indebtedness on principal residences.

Section

The Fallen Firefighters Assistance Tax Clarification Act of 2013, Public Law 113-63, enacted December 20, 2013, provides that payments to firefighters and their survivors by a specific relief association in New York are considered to be tax exempt; because the group benefiting from the payments was not large enough to be considered a charitable class the law was necessary for the organization to avoid losing its tax exempt status. In the event any taxpayer required to file a Minnesota return made contributions to the specified relief association, conforming to this change ensures that the contributions will be deductible at the state level.

4 **Additions to federal taxable income (FTI) for individuals.** Makes various changes.

Conforms Minnesota's income tax to the increased federal standard deduction for married filers retroactively to tax year 2013 by striking the addition to taxable income for the difference between the "old" and "new" federal deduction amounts. ATRA made the increased standard deduction for married filers a permanent feature of the income tax.

Conforms to the deductions for higher education tuition expenses and educator classroom expenses by striking additions for these items. ATRA extended this provision to tax year 2013 only.

Srikes obsolete language relating to the additional standard deduction amounts 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 as other obsolete language, and modifies the current law addition for state income taxes deducted at the federal level to reflect the retention of Minnesota's limitation on itemized deductions.

Effective date: Retroactive to tax year 2013.

5 **Subtractions from FTI for individuals.** Provides new subtractions for the federal limitation of itemized deductions and phaseout of personal and dependent exemptions. The federal limitation and phaseout results in additions to taxable income at the federal level; this section subtracts these amounts from state taxable income. Section 4 retains Minnesota's current law limitation of itemized deductions and phaseout of exemptions, which apply at lower income thresholds than the federal limitation and phaseout. The new subtractions in this section are necessary to avoid limiting deductions and phasing out exemptions twice.

Effective date: Retroactive to tax year 2013.

6 **State itemized deduction; definition.** Provides a definition of "state itemized deduction" equal to federal itemized deductions before the federal limitation. This definition is referenced in the changes to the existing addition to taxable income of state income taxes in section 4.

7 **Internal Revenue Code.** Adopts federal changes to federal adjusted gross income (FAGI) made between April 14, 2011, and December 20, 2013. FAGI is used for computing individual alternative minimum tax and determining withholding, and is the starting point for calculating household income, which is used to compute the dependent care and K-12 education credit. The main changes to federal adjusted gross income are described in section 3.

Section

8 **Individual income tax rates.** Updates cross references to conform to other changes in the bill.

Effective date: Retroactive to tax year 2013.

9 **Dependent care credit; income definition.** Updates a cross reference in the definition of household income; modifies the addition for the federal tuition deduction to reference the Internal Revenue Code, and strikes the obsolete addition for unemployment benefits.

Effective date: Retroactive to tax year 2013.

10 **Working family credit; phaseout.** Reduces the marriage penalty in the working family credit phaseout by increasing the income level at which the credit begins to phase out for married joint filers, beginning in tax year 2013. For tax years 2013 to 2017, the threshold is increased by $5,000, with the $5,000 amount indexed for inflation from 2009, so that the additional phaseout amount for tax year 2013 is estimated to be $5,340. For tax year 2018 and following years, increases the threshold by $3,000, with the $3,000 amount indexed for inflation from 2008. This would match the working family credit phaseout to the federal earned income credit phaseout for tax years 2013 and following years.

Effective date: Retroactive to tax year 2013.

11 **Marriage credit; calculation of earned income of lesser-earning spouse.** Strikes a reference in the calculation of the marriage credit to the add-back of the additional standard deduction amount for married filers, since Minnesota would conform to the additional amount, with the add-back eliminated in section 4.

Effective date: Retroactive to tax year 2013.

12 **Alternative minimum tax; individuals.** Updates cross references to reflect the changes to individual additions in section 4.

Effective date: Retroactive to tax year 2013.

13 **Update of references to Internal Revenue Code; 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.

Effective date: Retroactive to tax year 2013.