HOUSE RESEARCH

Bill Summary

FILE NUMBER: H.F. 63 **DATE:** January 15, 2013
Version: As introduced

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Subject: Income tax federal conformity for tax year 2012

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Overview

Conforms Minnesota's individual income tax and corporate franchise tax to most federal changes enacted since April 14, 2011, for tax year 2012 only.

Some of the principal federal changes Minnesota would conform to for tax year 2012 are:

- Extending the higher education tuition deduction
- Extending the educator classroom expense deduction
- Extending the authority for individuals age 70½ 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
- Allowing airline employees who received bankruptcy payments to retroactively roll over the payments into traditional individual retirement accounts (IRAs), in the year in which the payments were received.

Minnesota would not conform to the increase in section 179 expensing for tax year 2012.

Section

1 **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 2012 only, with the exception of increased section 179 expensing for tax year 2012.

The two new federal laws and important changes for tax year 2012 were:

The Federal Aviation Administration Modernization and Reform Act of 2012, Public Law 112-95, enacted February 14, 2012, allows employees who received payments in airline bankruptcy cases filed after September 11, 2001, and before January 1, 2007, to roll over all or part of the payments to traditional individual retirement accounts (IRAs). A previous federal law allowed employees to roll over bankruptcy payments into Roth IRAs; this law allows amounts previously rolled over into Roth IRAs to be further rolled over into traditional IRAs. Taxpayers had 180 days, until August 12, 2012, to elect to make a rollover into a traditional IRA. The income limits on deductible IRA contributions do not apply to the rollovers. The rollovers are retroactive to the year in which the payments were received, and taxpayers are allowed to file amended returns to claim refunds of federal income taxes reflecting the reduction in taxable income resulting from the deduction of rolled-over amounts.

The American Taxpayer Relief Act of 2012, Public Law 112-240, enacted January 2, 2013, made the following major changes that affect tax year 2012. While some of these provisions extend beyond tax year 2012, this bill conforms for tax year 2012 only.

- Increased the section 179 expensing amount and phase-out 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 for tax year 2012, 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. This bill does not address extension of increased amounts for tax year 2013.)*
- Extends the educator classroom expense deduction of up to $250.
- Extends the itemized deduction for mortgage insurance premiums.
- Extends the option for taxpayers to claim an itemized deduction for sales taxes rather than income taxes paid. (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. General law limits deduction of contributions of appreciated 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.

Section

- Extends the 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).
- Extends the 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, and allows taxpayers to recharacterize distributions made in January 2013 as having been made in 2012.
- Extends 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.
- Extends 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.
- Extends the 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 10 percent of the taxpayer’s net income from pass-through entities.
- Extends the 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.
- Extends 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.
- Extends the exception under subpart F which allows U.S. shareholders with a 10 percent or greater interest in a controlled foreign corporation to defer recognition of income earned by the corporation but not distributed to the shareholders.
- Extends 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).

Section

- 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, 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.
- Extends the 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.

2 **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 2012. Federal adjusted gross income also 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 1.

3 **Update of references to Internal Revenue Code in the property tax refund chapter.** Adopts for tax year 2012 the federal changes that affect household income, which uses the definition of federal adjusted gross income as a starting point.

4 **Amended returns.** Extends the time for filing amended returns for individuals who made IRA rollovers under the new federal law to April 15, 2013, if the 3½ year time limit on amending returns to make claims for refunds in statute has expired. This parallels the extension of time to file amended federal returns provided in the Federal Aviation Administration Modernization and Reform Act of 2012, P.L. 112-95.