

File Number: H.F. 2
Version: As introduced

Date: January 5, 2017

Authors: Davids

Subject: Federal conformity

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

This publication can be made available in alternative formats upon request. Please call 651-296-6753 (voice); or the Minnesota State Relay Service at 1-800-627-3529 (TTY) for assistance. Summaries are also available on our website at: www.house.mn/hrd/.

Overview

Retroactively conforms Minnesota's individual income tax and corporate franchise tax to federal changes enacted since December 31, 2014, for tax year 2015 and following years.

Taxpayers who in tax year 2015 claimed deductions at the federal level that were not at the time allowed at the state level may be required to amend their tax year 2015 Minnesota returns in order to claim state tax benefits. Business taxpayers who claimed depreciation or expensing items affected by federal changes also may be required to file amended tax year 2015 Minnesota returns in order to restate depreciation and expensing.

Federal changes that affect the definition of household income as used in calculating the homestead credit state refund and the property tax refund for renters are adopted prospectively for refunds based on rent paid in 2016 and property taxes payable in 2017. The federal changes would not affect refund claims based on property taxes payable in 2016 and rent paid in 2015.

Section

1

Update of administrative tax provisions. Adopts federal tax administrative changes made between December 31, 2014, and November 15, 2016, that Minnesota references for state tax administration purposes under chapter 289A. None of the federal acts enacted changed federal provisions referenced in chapter 289A.

Effective date: Effective retroactive to tax year 2015.

Section

2

Update to federal definition of taxable income. Adopts all of the federal changes to taxable income, with the exception of the extension of bonus depreciation. The federal changes to taxable income are effective retroactively to when they became effective for federal purposes.

The five new federal laws and important changes are as follows.

The Slain Officer Family Support Act of 2015, Public Law 114-7, enacted April 1, 2015, allowed taxpayers to elect to treat contributions for supporting the families of New York Police Department detectives Wenjian Liu and Rafael Ramos made before April 15, 2015, as though they were made on December 31, 2014. The effect was to allow individual and corporate calendar-year taxpayers to deduct contributions for the families of the detectives on their 2014 federal income tax returns, rather than on their 2015 returns. This section would allow deductions made by Minnesota taxpayers to flow through to their 2014 state returns. Without this change, taxpayers deducting contributions for the families of the detectives on their 2014 federal returns would be required to add those contributions to Minnesota taxable income on their 2014 state returns and then deduct them from Minnesota taxable income on their 2015 state returns.

The Don't Tax Our Fallen Public Safety Heroes Act, Public Law 114-14, enacted May 22, 2015, clarifies that the exclusion of federal or state benefits paid to surviving dependents of a public safety officer killed in the line of duty also apply to state benefits that were payable without regard to whether the officer's death was in the line of duty.

The Bipartisan Budget Act of 2015, Public Law 114-74, enacted November 2, 2015, clarified the treatment of partnership interests created by gift.

The Protecting Americans from Tax Hikes Act of 2015 (PATH), and **The Consolidated Appropriations Act of 2016 (CAA)**, of which PATH was a division, Public Law 114-113, enacted December 18, 2015, contained new provisions, modified existing provisions, extended some expiring provisions, generally for two years (tax years 2015 and 2016), and made others permanent. The major changes included in PATH were:

New provisions

- Excludes from gross income compensation paid to individuals who were wrongfully incarcerated. This provision is effective retroactively for all tax years. PATH allowed affected individuals to file amended returns within one year of December 18, 2015 (the date of enactment); section 8 allows affected individuals to file amended state returns through September 1, 2017.
- Allows rollovers from employer-sponsored retirement plans and traditional IRAs into SIMPLE (savings incentive match plan for employees) IRAs following the end of the two-year period that started when the employee first participated in the SIMPLE IRA.
- Allows contributions to agricultural research organizations to be claimed under the itemized deduction for charitable contributions.
- Clarifies valuation rules for charitable remainder unitrusts.

Section

- Makes real estate investment trusts (REITs) ineligible to participate in tax-free spinoffs.
- Allows non-corporate taxpayers to exclude from gross income clean coal power grants. The exclusion is already allowed for corporate taxpayers; in both cases the grant recipients must reduce the basis of any property acquired using the grant.
- Prohibits the transfer of losses from tax indifferent parties.

Modifications to existing provisions

- Expands the definition of qualified higher education expenses that can be paid for with distributions from section 529 college savings plans to include the purchase of computers and related equipment. Changes the manner of calculating the portion of a distribution that must be included in taxable income (in the case of amounts not used for qualifying expenses) to be made on a distribution-by-distribution basis, rather than aggregated over the taxable year. Enacts a new rule so that if a beneficiary receives a refund from a higher education institution of amounts paid with a distribution from a 529 plan, the refund is not subject to tax if it is recontributed to the 529 plan within 60 days.
- Extends the exclusion from gross income for qualified scholarships to apply to payments resulting from required participation in a comprehensive work-learning-service program at a work college. The exclusion does not generally apply to amounts paid to students for teaching, research, or other services.
- Allows the excise tax on high-cost employer-sponsored health coverage to be claimed as an itemized deduction. CAA also delayed the imposition of the excise tax to 2020.
- Extends the exclusion of reimbursements of medical expenses of a deceased employee's beneficiary who is not a surviving spouse or dependent under age 27 to apply to distributions from medical trusts. This exclusion is limited to certain governmental health plans.
- Allows ABLE (achieving a better life experience) accounts for a designated beneficiary to be opened in states other than the state of residency of the beneficiary.

Provisions extended to tax years 2015 and 2016, unless noted

- 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).
- Exclusion from gross income of discharges of indebtedness on principal residences.
- Itemized deduction for mortgage insurance premiums.
- Bonus depreciation, extended at 50 percent to tax years 2015 to 2017, 40 percent in tax year 2018, and 30 percent in tax year 2019 (*Minnesota would not conform to the extension of bonus depreciation, but would retain its current law requirement that*

Section

taxpayers add-back to taxable income 80 percent of the increased 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.)

- Various provisions related to depreciation and expensing, including more generous rules for certain racehorses (three-year property), motorsports entertainment complexes (seven-year recovery period), mine safety equipment, accelerated depreciation for business property on Indian reservations, qualified film and television production expenses, and second generation biofuel plant property.
- Increased Section 179D deduction for energy efficient commercial buildings.

Provisions made permanent

- Educator classroom expense deduction of up to \$250. The deduction was also extended to expenses for professional development.
- 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. Prior permanent law limited 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.
- 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 entities.
- 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 underlying law).
- Increased the section 179 expensing amount and phaseout threshold for tax year 2015 to \$500,000 and \$2 million; with the increased amounts indexed for inflation beginning in 2016. *(Minnesota would not conform to the increased section 179*

Section

expensing amounts, but would retain its current law requirement that taxpayers add-back to taxable income 80 percent of the increased 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.)

- More generous depreciation rules for leasehold and restaurant improvements, including new restaurant property and improvements to retail property (15-year straight-line recovery).
- 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, if 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.
- Exception under subpart F, which allows U.S. shareholders with a ten percent or greater interest in a controlled foreign corporation that consists of banking, financing, and similar businesses to defer recognition of active income earned by the corporation but not distributed to the shareholders.
- The 100 percent exclusion for the gain on sale of qualified small business stock held for more than five years, which applies to stock acquired after September 27, 2010.
- 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.
- 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. (*Minnesota taxpayers are not affected by this, since Laws 2014, chapter 308, provided for the increased exclusion to be allowed at the state level regardless of the amount allowed at the federal level. Laws 2016, chapter 189 (the supplemental appropriations bill) deleted the Minnesota-only subtraction.*)
- Extended the date for taxpayers to make rollovers to IRAs of payments in previous bankruptcy cases, including that of Delta Airlines, and to file claims for federal tax to 180 days after December 18, 2015 to accommodate the effects of Public Law 113-43, which amended the definition of "airline employee" thus expanding the pool of individuals eligible to make rollovers, and also expanded the definition of "airline payment amount". Section 8 allows affected individuals to file amended state returns through September 1, 2017.

The United States Appreciation for Olympians and Paralympians Act, Public Law 114-239, enacted October 7, 2016, excludes from gross income the value of any Olympic or

Section

Paralympic medal or prize money for competing in the Olympic or Paralympic games. The exclusion applies to medals and prizes awarded after December 31, 2015, and is not allowed for filers with adjusted gross income of more than \$1 million (\$500,000 for married separate filers).

- 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. 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 2.
- 4 Section 179 expensing; addition for individuals.** Clarifies that the state's tax treatment of section 179 expensing allowed at the federal level applies to heating and air conditioning equipment, which was first included in section 179 expensing at the federal level in tax year 2016. Effective date: tax year 2016.
- 5 Section 179 expensing; addition for corporations.** Clarifies that the state's tax treatment of section 179 expensing allowed at the federal level applies to heating and air conditioning equipment, which was first included in section 179 expensing at the federal level in tax year 2016. Effective date: tax year 2016.
- 6 Update of references to Internal Revenue Code in the property tax refund chapter.** Prospectively adopts the federal changes that affect household income, which uses the definition of federal adjusted gross income as a starting point. Effective for refunds based on rent paid in 2016, and property taxes payable in 2017. Property tax refund claimants will not amend returns to reflect the federal changes for refunds based on rent paid in 2015 and property taxes payable in 2016.
- 7 Estate tax.** Updates to changes in federal law made between December 31, 2014, and November 15, 2016. This change has no substantive effect on computation of the estate tax, but instead keeps the Internal Revenue Code date reference consistent with other sections of statute. Effective retroactively for the estates of decedents dying after December 31, 2015.
- 8 Amended returns.** Extends the time for filing amended returns to September 1, 2017, if the 3½ year time limit on amending returns to make claims for refunds in statute has expired, for individuals who:
 - became eligible to make retroactive IRA rollovers under federal amendments to the Federal Aviation Administration Modernization and Reform Act of 2012; and
 - received compensation for wrongful incarceration.
- 9 Individual income tax collection action prohibited.** Prohibits the commissioner from increasing the amount due from individual income taxpayers for tax year 2015 as a result of changes enacted in this bill, provided that the taxpayer filed a 2015 return based on state law as it existed prior to enactment of this bill.