**HOUSE RESEARCH** | **Short Subjects**

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# Extension of Federal Individual Income Tax Provisions in 2010 and Effects on Minnesota's Income Tax

In December 2010, Congress enacted the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA), extending many tax reductions through tax year 2012. Most of the tax provisions in TRUIRJCA were originally enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), or the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), and were scheduled to expire after tax year 2010.

***What EGTRRA and JGTRRA provisions were extended to tax year 2012 in TRUIRJCA?***

The principal individual income tax components of EGTRRA and JGTRRA that were extended to tax years 2011 and 2012 are the following:

- Marriage penalty relief through the standard deduction and rate brackets
- No income limit on itemized deductions
- No income phaseout of personal and dependent exemptions
- Lower individual income tax rates
- Lower tax rate for capital gains and dividend income
- Federal child credit maintained at $1,000 per child, rather than $500
- Increased qualifying expenses, credit rate, and phaseout floor for federal dependent care credit

***Which of these provisions affect Minnesota's income tax?***

Extension of the EGTRRA and JGTRRA provisions affects Minnesota's income tax in several ways:

- Because Minnesota's income tax calculation starts with federal taxable income, federal changes to the definition of federal taxable income affect Minnesota's income tax calculation. Providing an increased standard deduction for married joint filers, not having a limit on itemized deductions, and not having a phaseout of exemptions all result in smaller federal taxable income; if Minnesota conforms to these federal changes then Minnesota taxable income would be lower, as would Minnesota income tax revenues.
- Minnesota's dependent care credit is tied to the federal dependent care credit. Extension of the increased qualifying expenses, credit rate, and phaseout floor for the federal dependent care credit results in higher state credits for some claimants.

***Which of the EGTRRA and JGTRRA extensions do not affect Minnesota's income tax?***

Because Minnesota sets its own income tax rates and brackets, Minnesota's income tax is not affected by the extension of lower federal individual income tax rates, marriage penalty relief through bracket adjustments, or the special rate for capital gain and dividend income. Because Minnesota does not offer a companion credit to the federal child credit, Minnesota's tax is not affected by keeping the federal child credit at $1,000 per child.

***Will the federal changes automatically flow through to Minnesota's income tax?***

The extension of the EGTRRA and JGTRRA tax reductions does not automatically flow through to Minnesota's income tax. Instead, the legislature will have to act to "conform" to the new definition of federal taxable income. Because adopting the EGTRRA and JGTRRA extensions at the state level would affect Minnesota taxable income, the Minnesota Department of Revenue (DOR) will prepare an official revenue estimate showing the amount of revenue that would be gained or foregone at the state level for each provision affecting state taxable income or state tax credits. The revenue gained or lost for each provision Minnesota conforms to would be carried in the state's budget.

***What happens if Minnesota does not conform to the new federal tax law?***

If Minnesota does not conform to the federal changes, then DOR will prepare income tax forms and approve tax preparation software developed by third parties (such as TaxCut and TurboTax) that calculate Minnesota taxable income and credits as though prior federal law were still in effect.

For example, in tax year 2011 married joint taxpayers would be required to add the difference between the increased standard deduction allowed at the federal level ($11,600) and the lower standard deduction that would have been in effect under prior federal law ($9,650). Affected taxpayers in the 7.05 percent state bracket would pay higher state taxes of $137 ($11,600 minus $9,650 times 7.05 percent).

Similarly, taxpayers who would have been subject to the limit on itemized deductions and the phaseout of exemptions that would have been in effect under prior federal law would be required to add the amount that would have been limited or phased out at the federal level to their state taxable income, and as a result would owe higher state income taxes.

Taxpayers in the phaseout range for the state dependent care credit would have to calculate the federal dependent care credit they would have been eligible for if the more generous program parameters had not been extended, and use that figure to determine their state credit. This would result in many taxpayers receiving smaller state dependent care credits.

***What other provisions of TRUIRJCA affect Minnesota's income tax?***

TRUIRJCA also extended several provisions that had expired following tax year 2009 for two years, through tax year 2011:

- Itemized deduction for state and local sales taxes
- More generous income limitations for charitable deduction of donations of qualified conservation easements, with higher limits for farmers and ranchers
- Deduction for higher education tuition expenses
- Allowance of direct transfers to charities from IRAs and Roth IRAs
- Deduction for educator classroom expenses

The revenue effects of conforming Minnesota's income tax to these items will be included in the TRUIRJCA estimate prepared by DOR.

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