

# HOUSE RESEARCH

## Bill Summary

**FILE NUMBER:** H.F. 129

**DATE:** January 20, 2010

**Version:** First engrossment

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**Subject:** Permanently enacts state revenues savings initiatives enacted temporarily during the 2010 session and conforms to federal income tax changes

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### Article 1: Tax Aids and Credits

#### Overview

This article:

- makes permanent all Pay 2010 aid and credit reductions to local governments;
- reduces the percent of rent constituting property taxes for renter property tax refund claims from 19 percent to 15 percent, effective for claims based on rent paid in 2010 and following years;
- repeals the political contribution refund; and
- limits payments to individual claimants under the sustainable forest incentive program.

These are all temporary revenue savings initiatives enacted for one year in the 2010 session; this article makes all of these provisions permanent and ongoing.

- 1 Political contribution refund.** Strikes a reference to the political contribution refund, which is repealed in section 12.
- 2 Credit reduction.** Provides for a permanent annual reduction in each county's and city's market value credit reimbursements beginning in Pay 2011 equal to its total loss in market value credit reimbursements under the Pay 2010 supplementary reduction contained in Laws 2010, ch. 215. These reimbursement reductions total about \$96 million annually. The market value credit reimbursement reductions under the governor's January 2010 unallotment, later ratified in Laws 2010, First Special Session chapter 1, are already a permanent annual reduction.

- 3 Political contribution refund; conforming changes.** Eliminates a reference to the political contribution refund, which is repealed in section 12.
- 4 Political contribution refund; conforming changes.** Strikes a definition of the term “taxpayer” that is used in determination of the political contribution refund, which is repealed in section 12.
- 5 Renter property tax refund; rent constituting property taxes.** Reduces the percent of rent constituting property taxes used in calculating the property tax refund for renters from 19 percent to 15 percent. Effective for refund claims based on rent paid in 2010 and following years.
- The percent of rent constituting property taxes was reduced from 19 to 15 percent for 2009 refunds only under the June 2009 unallotment. This reduction was subsequently enacted into law in Laws 2010, First Special Session chapter 1.
- 6 Renter property tax refund; manufactured homes.** Reduces the percent of rent constituting property taxes for rent paid on the site on which a manufactured home or park trailer taxed as a manufactured home is located from 19 percent to 15 percent. Effective for refund claims based on rent paid in 2010 and following years.
- 7 Calculation of incentive payment (sustainable forest initiative program).** Permanently limits the maximum sustainable forest incentive refund beginning in calendar year 2011. Program payments for any Social Security number or tax identification number may not exceed \$100,000.
- 8 City aid distribution.** Changes the amount used to calculate maximum increases and decreases to individual city LGA payments for Pay 2012 only. The base used in the calculation will be the Pay 2011 paid LGA amount rather than the Pay 2011 certified LGA amount.
- 9 2011 reductions, counties and cities.** Calculates Pay 2011 LGA and county program aid (CPA) reductions for each city and county based on a percentage of their total LGA or CPA reductions in Pay 2010. The percentages are based on how much of the CPA and LGA reductions from Pay 2010 are already permanent through enactment of lower Pay 2011 appropriations during the previous session. The amount of Pay 2010 aid reductions made permanent was calculated by comparing the pay 2011 appropriation to the total amounts originally certified for Pay 2010 in each program. For a city the cut is equal to 91.5% of its Pay 2010 total LGA reduction. For a county the cut is equal to 48.5% of its total Pay 2010 CPA reduction. These reductions total about \$132 million.
- 10 Appropriation.** Permanently reduces the LGA and CPA appropriations beginning with aids payable in 2012. The annual city LGA appropriation is reduced by \$100.5 million – from \$527 million to \$426.54 million. The annual CPA appropriation is reduced by \$32 million – from \$197.7 million to \$165.7 million.
- 11 Administration of 2011 property tax refund claims; renters.** Directs the commissioner of revenue to recalculate claims for 2011 renter property tax refunds to reflect the reduction in the percent of rent constituting property taxes from 19 percent to 15 percent provided in sections 5 and 6. Requires the commissioner to notify claimants whose refunds are recalculated that the recalculation was mandated by action of the 2011 Legislature.

**Background.** By January 31, 2011, landlords are required to issue form CRP to renters for use in claiming the renter property tax refund. Form CRP reports on line 1 the dollar amount of rent paid, and on line 3 the rent multiplied by the 19 percent, which equals the percent constituting property taxes. Renters are instructed to use the amount on line 3 in filling out form M-1PR, the claim form for property tax refunds. The Department of Revenue would then recalculate the M-1PR claim as if the line 3 amount had been rent multiplied by 15 percent, rather than 19 percent.

- 12 Repealer.** Repeals the political contribution refund program, the section of the data practices law relating to political contribution refunds, and the section providing for refund receipts. Effective for contributions made after June 30, 2011.

## Article 2: Federal Update

### Overview

Conforms Minnesota's individual income tax and corporate franchise tax to most federal changes enacted since March 18, 2010, in the Patient Protection and Affordable Care Act of 2010, the Health Care and Education Reconciliation Act of 2010, and the Small Business Jobs Act of 2010. Does not conform to the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. Some of the principal changes Minnesota would conform to are:

- Extending the income exclusion for health insurance to benefits for adult children up to age 26
- Disallowing reimbursement from health savings accounts and similar accounts for over-the-counter medicines
- Increased section 179 expensing amounts for tax year 2011

Minnesota would not conform to the following provisions:

- Increased section 179 expensing for tax year 2010
- Extension of 50 percent bonus depreciation to tax year 2010

- 1 Update of administrative tax provisions.** Adopts federal tax administrative provisions made between March 18, 2010, and September 27, 2010, that Minnesota references for state tax administration purposes under chapter 289A. The new federal laws did not change federal provisions that Minnesota provisions refer to in chapter 289A.

**Effective date:** day following final enactment.

- 2 Update to federal definition of taxable income.** Adopts all of the federal changes to taxable income effective when the federal changes became effective, with the exception of increased bonus depreciation and section 179 expensing for tax year 2010 (does conform to increased section 179 expensing amounts for tax year 2011).

The three new federal laws enacted through September 27, 2010, and important changes were:

**The Patient Protection and Affordable Care Act of 2010**, Public Law 111-148, enacted

March 23, 2010, and **The Health Care and Education Reconciliation Act of 2010**, Public Law 111-152, enacted March 30, 2010, made the following major changes:

- Extended the income exclusion for health insurance to benefits for adult children up to and including age 26, effective for plan years beginning on or after September 23, 2010. Under prior federal law, the exclusion was limited to coverage for dependents who were under age 19, students under age 24, or permanently and totally disabled.
- Disallowed reimbursement from health savings accounts and similar accounts for over-the-counter medicines, effective tax year 2011.
- Increased the maximum exclusion for employer-provided adoption assistance to \$13,170 for tax year 2010, and extended the increased amount adjusted for inflation to tax year 2011.
- Allowed an income exclusion for state loan forgiveness programs for health care professionals intended to increase the availability of health professionals in underserved areas, retroactive to tax year 2009.
- Increased the floor on deductibility of medical expenses by itemizers from 7.5 percent to ten percent of adjusted gross income, effective in tax year 2013.
- Codified the economic substance doctrine, requiring transactions to which the doctrine is relevant to change the taxpayer's economic position in a meaningful way, excepting the effects on federal income tax liability, and requiring the taxpayer to have a substantial purpose, excepting the corresponding change in federal income tax liability, from entering into the transaction.

**The Small Business Jobs Act of 2010**, Public Law 111-240, enacted September 27, 2010, made the following major changes:

- Increases the 75 percent exclusion for the gain on sale of qualified small business stock held for more than five years for stock acquired after February 18, 2009, and before January 1, 2011, to 100 percent for stock acquired after September 27, 2010, and before January 1, 2011. The exclusion will revert to 50 percent for stock acquired on or after January 1, 2011.
- Reduces the holding period for assets of S corporations that converted from C corporations from ten years to five years, for tax year 2011 only, allowing S corporations to sell assets held more than five years without being taxed on built-in gains. Effective for tax year 2011 only.
- Increases the section 179 expensing amount and phase-out threshold for tax years 2010 and 2011 to \$500,000 and \$2 million (*Minnesota would not conform retroactively to the extension of increased section 179 amounts for tax year 2010, but would conform prospectively for tax year 2011. For tax year 2010, Minnesota 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*).

- Extends 50 percent bonus depreciation amounts to tax year 2010 (*Minnesota would not conform to the extension of bonus depreciation but would retain its current law requirement that taxpayers add-back 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*).
- Provides that the percentage completion method for long-term contracts, which requires that income be recognized when related costs are recognized, is calculated without regard to bonus depreciation amounts claimed. This prevents bonus depreciation, which shifts costs into the first year of a contract, from also shifting income into the first year of the contract. Effective for tax year 2010 only.
- Increases the amount of start-up expenditures that can be directly expensed in the first year of a start-up, from \$5,000 to \$10,000, with the threshold for the dollar-for-dollar phaseout of the allowance increased from \$50,000 to \$60,000, effective for tax year 2011 only.
- Removes cell phones and similar devices from “listed property,” so that the employer deduction for cell phone expenses is not reduced by personal use of the phone by the employee. Effective beginning in tax year 2010.
- Allows 2010 rollovers from deferral plans, such as 401(k) or 403(b) plans, to Roth IRAs to be recognized 50 percent in tax year 2011 and 50 percent in tax year 2012, rather than 100 percent in tax year 2010.
- Allows annuity holders to annuitize, or take payment of, a portion of the assets in an annuity while keeping the remaining assets in the contract; previously annuity holders wishing to take payments from only a portion of the annuity had to exchange the annuity for two separate annuities. Effective beginning in tax year 2011.
- Reduces the share of income on guarantees that can be sourced outside the United States, effective for guarantees issued after September 27, 2010.

**3 Additions to federal taxable income (FTI) for individuals.** Conforms Minnesota’s income tax to the increased section 179 expensing amounts for tax year 2011, by limiting the addition to taxable income for this item to earlier tax years. Also limits the addition for subsidies received by companies that provide retiree drug benefits to tax years before 2013; changes to federal law eliminated the federal exclusion for subsidies, making the state tax addition duplicative.

**Effective date:** tax year 2010.

**4 Additions to FTI for corporations.** Conforms Minnesota’s income tax to the increase in section 179 expensing amounts for tax year 2011, by limiting the addition to taxable income for this item to earlier tax years. Also limits the addition for subsidies received by companies that provide retiree drug benefits to tax years before 2013; changes to federal law eliminated the federal exclusion for subsidies, making the state tax addition duplicative.

**Effective date:** tax year 2010.

- 5 **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. FAGI also is the starting point for calculating household income which is used to compute the dependent care and K-12 education credit for tax year 2010 and following years. The main changes to federal adjusted gross income are described in section 2.
- 6 **Update of references to Internal Revenue Code in the 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.
- 7 **Corrected form W-2 not required.** Provides that employers are not required to issue corrected 2010 W-2s to employees if they have already issued W-2s for 2010 that show the value of health insurance coverage provided to adult children under age 27 that was includible in state taxable income under prior law. This coverage would be excluded from state taxable income under this article.