

**Federal Update
Coronavirus Aid, Relief, and Economic Security Act**

	FY 2020	FY 2021	FY 2022	FY 2023
		(\$000s)		
Individual Income Tax	\$0	(\$303,000)	(\$1,900)	(\$2,200)
Corporate Franchise Tax	<u>\$0</u>	<u>(\$14,600)</u>	<u>(\$3,600)</u>	<u>(\$1,700)</u>
General Fund Total	\$0	(\$317,600)	(\$5,500)	(\$3,900)

The Coronavirus Aid, Relief, and Economic Security (CARES) Act (Public Law 116-136) was enacted on March 27, 2020. The proposal is to update reference to the Internal Revenue Code to include the Act.

The Act includes the following provisions which would affect the definition of income for Minnesota individual income tax or corporate franchise tax purposes.

Special rules for use of retirement funds. The Act establishes special rules for taxpayers taking an early distribution from a retirement plan for coronavirus-related expenses in tax year 2020. An eligible taxpayer may take an early distribution of up to \$100,000 without paying the 10% federal penalty and may either repay the amount or include the distribution in gross income over a three-year period, instead of in the year it was withdrawn. The provision also increases the limit on borrowing from retirement accounts for coronavirus-related expenses.

Above-the-line deduction for charitable contributions. The Act allows a deduction of up to \$300 for cash charitable contributions made by taxpayers who do not itemize deductions on their federal return. The deduction applies for tax year 2020 only.

Modify limits on charitable contributions. The Act adjusts the limitations on charitable contributions in three ways. (1) The limitation on deductions for cash contributions for individuals is increased from 60% to 100% of federal adjusted gross income. (2) The corporate deduction limit for cash contributions is increased from 10% to 25% of federal taxable income. (3) The deduction limit for food inventory is increased from 15% to 25% of taxable income for corporations or net income for individuals. These modifications apply to charitable contributions made during tax year 2020.

Exclusion of student loans payments. The Act enables employers to provide a student loan repayment of up to \$5,250 annually to employees on a tax-free basis. The payment is excluded from the employee's income and applies to both loan repayment and other educational assistance (e.g. tuition, fees, and books). The exclusion applies to payments made after March 27, 2020 and before January 1, 2021.

Employee retention credit. The Act creates a refundable payroll tax credit. Qualifying employers can claim a tax credit of up to \$5,000 per employee. Under circumstances before the creation of the credit, employers were allowed to deduct payroll taxes as a business expense on their income tax return. Federal law allows employers to continue to deduct payroll taxes. However, as a condition of receiving the payroll tax credit, the wages used to calculate the payroll tax credit claimed is included as an item of income and no deduction is allowed for the portion of the wages that equals the payroll tax credit

amount. Under federal law the net effect is that the amount of the federal credit may not be deducted as employee compensation.

To the extent that claiming the credits reduces federal deductions for compensation, it would increase taxable income for employers. Adopting the federal changes could result in an increase in Minnesota taxable income for those employers.

Net operating losses for pass-through entities. The Act modifies the treatment of net operating losses for pass-through businesses in three ways, for losses generated in 2018, 2019, and 2020: 1) it waives the 80% limitation on net operating loss deductions, 2) it removes the limit on excess business losses over \$250,000, and 3) it allows net operating losses to be carried back for up to five years.

Modify limit on business interest. The Act increases the amount of interest expenses businesses are allowed to deduct on their tax returns, by increasing the limitation from 30% to 50% of taxable income (with adjustments) for tax years 2019 and 2020.

Include menstrual products as qualified medical expense. The Act allows amounts paid for menstrual care products to be treated as qualified expenses to be paid from pre-tax medical savings accounts, flexible spending arrangements, and health reimbursement arrangements, beginning with expenses incurred in tax year 2020.

- The estimates for most provisions are based on the estimates for the federal legislation prepared by the staff of the Joint Committee on Taxation, dated March 27, 2020.
- Where applicable, the estimates were divided between the individual income tax and corporate franchise tax. The estimates for each provision were apportioned to Minnesota based on information relevant to that provision. The estimates were adjusted for the difference between federal and state tax rates and federal and state fiscal years.
- For the net operating loss modifications, the estimate is based on flow-through income reported on Minnesota income tax returns.
- Net operating losses for tax year 2020 are unknown. This estimate assumes that losses will be similar to those experienced in the last recession. The projected increase in net operating losses in 2020 is estimated based on the increase in net negative income between 2007 and 2009, the period of the previous downturn.
- From 2007 to 2009, net flow-through income declined 20.6% and net negative income increased by 28.4%. This estimate assumes a similar percentage change in net income and negative income from 2019 to 2020.
- It is assumed that 80% of the losses will be claimed as refunds or on 2020 returns, and the remainder will be carried forward over the next 10 years.
- These estimates are preliminary and will be updated as additional economic information becomes available.
- Impacts for tax years 2018, 2019, and 2020 are allocated to fiscal year 2021.

Minnesota Department of Revenue
Tax Research Division
April 14, 2020

Federal update CARES Act / dkd aeh tj js sat ct cw

**Federal Update
Coronavirus Aid, Relief, and Economic Security Act
(\$000s)**

	FY 2020	FY 2021	FY 2022	FY 2023
Special rules for use of retirement funds (TY20 only)				
Individual Income Tax	\$0	(\$3,400)	\$1,700	\$1,700
Above-the-line deduction for charitable contributions (TY20 only)				
Individual Income Tax	\$0	(\$6,400)	\$0	\$0
Modification of limitation on charitable contributions (TY20 only)				
Individual Income Tax	\$0	(\$17,800)	\$6,600	\$4,300
Corporate Franchise Tax	\$0	(\$2,300)	\$800	\$500
Exclusion for certain employer payments of student loans (TY20 only)				
Individual Income Tax	\$0	(\$5,300)	\$0	\$0
Employee retention credit for employers affected by COVID-19 (TY20 only)				
Individual Income Tax	\$0	\$6,800	\$0	\$0
Corporate Franchise Tax	\$0	\$18,100	\$0	\$0
Net operating losses for pass-through entities (TY18-TY20 only)				
Individual Income Tax	\$0	(\$250,300)	(\$6,300)	(\$6,300)
Modification of limitation on business interest (TY19-TY20 only)				
Individual Income Tax	\$0	(\$26,600)	(\$3,900)	(\$1,900)
Corporate Franchise Tax	\$0	(\$30,400)	(\$4,400)	(\$2,200)
Inclusion of certain over-the-counter medical products as qualified medical expenses (beginning TY20)				
Individual Income Tax	\$0	(Negl.)	(Negl.)	(Negl.)
All Provisions				
Individual Income Tax	\$0	(\$303,000)	(\$1,900)	(\$2,200)
Corporate Franchise Tax	\$0	(\$14,600)	(\$3,600)	(\$1,700)
General Fund Total	\$0	(\$317,600)	(\$5,500)	(\$3,900)