

April 20, 2020

To Taxes Committee
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Subject Conformity to the Families First Coronavirus Response Act (FFCA) and Federal CARES Act

The recently enacted Families First Coronavirus Response Act (FFCA) and Coronavirus Aid, Relief, and Economic Security ACT (the CARES Act) include a number of tax provisions, some of which affect the calculation of Federal Adjusted Gross Income (FAGI) and Federal Taxable Income (FTI). Because the state uses FAGI and FTI as the starting point for determining the state individual income and corporate franchise tax bases, these federal tax changes raise the question of whether the legislature should conform to this latest version of the Internal Revenue Code (IRC).

As with most questions of conformity, conforming to the relevant tax provisions in the FFCA and CARES Acts will have a cost to the state, while nonconformity would create administrative complexity due to the continued state use of an older version of the IRC to determine the starting point for Minnesota income tax.

This memo describes those provisions of the FFCA and CARES Acts raising conformity questions, first for individuals and then for businesses.

Families First Coronavirus Response Act (FFCA)

FFCA required certain employers with more than 500 employees to provide paid sick or family leave to their employees.¹ The leave is available to employees who experience COVID-19 symptoms and are seeking a medical diagnosis, are unable to work due to quarantine, or who care for a sick family member or child whose school or child care is closed.

The act also established temporary employer tax credits for wages paid to employees for qualified sick leave or qualified paid family leave. The credits are refundable, and are allowed against the employer's payroll taxes paid in a quarter. The amount of the credits equals 100 percent of qualified sick or paid family leave, but is limited to \$200 in wages per day of leave taken by an employee. An employer is allowed to claim the credit for up to ten days of leave taken per quarter in excess of aggregate number of sick or family medical leave days claimed for all preceding quarters. The family medical leave credit is limited to \$10,000.

¹ Public Law 116-127, sections 7001 and 7003.

Federal tax credits typically do not affect Minnesota's income tax, because they do not affect FAGI (for individuals) or FTI (for corporations). However, the tax credits for employers in FFCA include a provision that increases the employer's gross income by the amount of the credit. Because wages paid by the employer are deductible as a business expense, the credit amount is added to gross income to ensure that the employer does not receive the double benefit of a 100 percent credit as well as a deduction for wages paid. The amounts added to gross income affect Minnesota liability because they would increase the FAGI of a pass-through business owner subject to the state's individual income tax, and would increase the FTI of a C corporation subject to the state's corporate franchise tax. The act additionally established credits for self-employed individuals, but those credits do not affect the gross income of self-employed individuals, so they consequently do not affect Minnesota liability.

Individual Provisions

Withdrawals from retirement plans (sec. 2202). This provision is similar to provisions in recent federal disaster tax bills, including the Further Consolidated Appropriations Act, 2019. Taxpayers can take a penalty-free distribution of up to \$100,000 from their retirement accounts without penalty, and can repay the amount withdrawn over the three years following the distribution. Distributions are added in three equal parts to the taxpayer's gross income for the three years beginning in the year of the distribution.

Above-the-line charitable contribution (sec. 2204). Allows an above-the-line charitable contribution deduction of \$300.

Charitable contribution limits (sec. 2205). Suspends the 60 percent AGI limitation on the itemized deduction charitable contributions for cash contributions. The charitable contributions limits would affect Minnesota liability through our state itemized deduction for charitable contributions, which references the federal deduction.

Exclusion for employer payments of student loans (sec. 2206). Provides an exclusion from gross income for up to \$5,250 in employer payments to employee's student loan.

Business Provisions

Many of the business provisions in the CARES Act temporarily and retroactively suspend certain "base-broadener" provisions enacted in 2017 under the Tax Cuts and Jobs Act (TCJA). These provisions expanded the tax base for business taxpayers; the legislature retroactively conformed to this tax base expansion in 2019.

Exclusion from gross income for forgiven Paycheck Protection Act loans (sec. 1105(i)). The CARES Act authorized a "Small Business Interruption Loan" program under section 7(a) of the Small Business Act. The lending program, which the Small Business Administration calls the Paycheck Protection Program (PPP), allows businesses to receive loan forgiveness for part or all of the loan amount. The amount of forgiveness is based on the amount the business spent in the eight weeks after receiving the first loan disbursement on payroll, rent, mortgage interest, and utilities. For many businesses, the loan will be fully forgiven. Discharged debt is generally

taxable, but the CARES Act included a provision to exclude forgiven loans from the gross income of a business.

Unless the state enacts conformity legislation, loans forgiven through the Paycheck Protection Program in Minnesota would be included in gross income and subject to Minnesota income or corporate franchise taxes. The Small Business Administration reported that \$9.01 billion in loans have been distributed to Minnesota businesses as of April 16.² Appropriations for the program lapsed as of April 16, but Congress is considering additional appropriations. It is unclear what percentage of those loans will be forgiven, but the forgiven amount will be significant.

The Department of Revenue (DOR) did not include PPP loan forgiveness in the February forecast, but has indicated that it will include revenue from the loan forgiveness in the forthcoming May forecast.

C corporation charitable contributions (sec. 2105(a)(2)(B)). Under current law a C corporation's charitable contributions are limited to 10 percent of taxable income. The CARES Act increases the limitation to 25 percent of taxable income.

C corporation charitable contributions of food (sec. 2205). Under current law, a C corporation may make a donation of food inventory, but the contribution is limited to 15 percent of taxable income (there is also a second, more complicated limitation on such donations). The CARES Act increases the limitation from 15 percent to 25 percent of taxable income.

Employer retention credit (sec. 2301). Employers who fully or partially suspend operations due to an order from an appropriate governmental authority, or who experience a significant decline in gross receipts, are eligible for an employee retention credit in tax year 2020. The credit equals 50 percent of qualifying wages paid after March 12, 2020, and before January 1, 2021. The maximum credit is \$5,000.

A federal credit normally does not directly affect state liability. However, like the credit for sick leave and family leave, conforming to the Employer retention credit would indirectly increase state revenue. Employers are not allowed to deduct wages used to claim the credit as a business expense. Because the credit limits the federal deduction for wages, it increases FAGI for pass-through businesses and FTI for C corporations. Conforming to this provision would therefore increase Minnesota liability for affected businesses.

Net operating losses (sec. 2303). The CARES Act allows losses generated in 2018, 2019, and 2020 to be carried back five years. Under current law, net operating losses (NOL) carrybacks are not allowed (the TCJA eliminated the three-year carryback in 2017.) In addition, the act retroactively suspends the TCJA's NOL deduction limit of 80 percent of taxable income until 2021.

² Small Business Administration. Paycheck Protection Program (PPP) Report. Approvals through 4/16/2020. <https://www.sba.gov/sites/default/files/2020-04/PPP%20Deck%20copy.pdf>

Excess business losses (sec. 2304). The TCJA limited the extent to which pass-through business losses could be used to offset nonbusiness income. The CARES Act retroactively delays the imposition of these limits until 2021.

Business interest deduction (sec. 2306). The act modifies the TCJA's business interest deduction limit from 30 percent of taxable income to 50 percent, for tax years 2019 and 2020. In addition, a business may use their 2019 income to determine the limit for 2020.

Depreciation; qualified improvement property (sec. 2307). The CARES Act fixes the so-called "retail glitch" in the TCJA that disallowed certain improvements to real property from qualifying for 100 percent bonus depreciation as qualified improvement property. The act retroactively treats this property as 15-year property, thus allowing it to qualify for bonus depreciation.

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