

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

	FY 2022	FY 2023	FY 2024	FY 2025
		(\$000s)		
Individual Income Tax	(\$285,500)	\$5,500	\$800	\$400
Corporate Franchise Tax	<u>(\$700)</u>	<u>(\$1,500)</u>	<u>(\$1,500)</u>	<u>(\$800)</u>
General Fund Total	(\$286,200)	\$4,000	(\$700)	(\$400)

Note: The impact of the Paycheck Protection Program is included in a separate estimate.

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repay the amount or include the distribution in gross income over a three-year period, instead of in the year it was withdrawn.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 loan 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 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. The Consolidated Appropriations Act, 2021 expanded the credit and extended it for wages paid through the first two quarters of 2021. The estimate includes the total impact of the credit, including the modifications in the CAA 2021.

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.

Paycheck Protection Program. The Act established the Paycheck Protection Program (PPP) to provide low-interest loans to small businesses with less than 500 employees to assist with payroll, mortgage interest, rent, and utilities. Loans are eligible for forgiveness if they meet certain requirements. The amount of the loan that is forgiven is not included in gross income. The Consolidated Appropriations Act, 2021 clarified that expenses paid with forgiven loans may be deducted from income. The impact of the exclusion is not included here but is included in a separate estimate.

- 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.

Net Operating Loss Modifications

- The amount of NOLs that will be claimed in tax year 2020 is unknown. Based on information from income tax returns and the November 2020 forecast, this estimate assumes that total business income will rise by 6.9% in 2020 and net negative income will increase by 20%.
- It is assumed that 80% of the increased NOLs will be claimed as refunds or on 2020 returns, and the remainder will be carried forward over the next 10 years.
- Adopting the NOL modifications interacts with the Paycheck Protection Program (PPP) loan exclusion, since allowing the exclusion for forgiven loans will generate significant net operating losses. Conforming to both provisions would increase the amount of NOLs claimed in 2020 and the amount that will be carried back to previous years. Those revenue losses are allocated to FY 2022. There will be a revenue gain beginning in FY 2023 as the pool of NOLs will be smaller in future years.

- Retroactive impacts are allocated to fiscal year 2022. For other years, corporate franchise tax impacts are allocated 30% / 70% to fiscal years. Individual income tax impacts are allocated to the following fiscal year.

Charitable Deduction for Nonitemizers

- The estimate is based on information from a sample of 2018 income tax returns and the House Income Tax Simulation (HITS) model.
- Taxpayers with the charitable subtraction for nonitemizers are expected to claim the above-the-line federal deduction for the first \$300 in contributions.
- The Minnesota subtraction was reduced by the amount used to claim the federal deduction.
- The estimate was increased by 10% to include taxpayers with less than \$500 in contributions, who do not qualify for the Minnesota subtraction but could claim the federal deduction.

Minnesota Department of Revenue
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Coronavirus Aid, Relief, and Economic Security Act
Revised for November 2020 Forecast
(\$000s)

	FY 2022	FY 2023	FY 2024	FY 2025
Special rules for use of retirement funds (TY20 only)				
Individual Income Tax	(\$1,600)	\$1,700	\$0	\$0
Above-the-line deduction for charitable contributions (TY20 only)				
Individual Income Tax	(\$8,400)	\$0	\$0	\$0
Increase individual limitation on charitable contributions (TY20 only)				
Individual Income Tax	(\$10,400)	\$4,000	\$1,560	\$790
Increase corporate limitation on charitable contributions (TY20 only)				
Corporate Franchise Tax	(\$1,000)	\$400	\$170	\$100
Increase charitable deduction limit for food inventory (TY20 only)				
Individual Income Tax	(\$300)	\$100	\$40	\$10
Corporate Franchise Tax	(\$200)	\$100	\$30	\$0
Exclusion for certain employer payments of student loans (TY20 only)				
Individual Income Tax	(\$5,000)	\$0	\$0	\$0
Employee retention credit for employers affected by COVID-19 (TY20 only)				
Individual Income Tax	\$12,000	\$0	\$0	\$0
Corporate Franchise Tax	\$31,800	\$0	\$0	\$0
Net operating losses for pass-through entities (TY18-TY20 only)				
Individual Income Tax	(\$244,400)	\$1,400	\$700	\$400
Modification of limitation on business interest (TY19-TY20 only)				
Individual Income Tax	(\$27,400)	(\$1,700)	(\$1,500)	(\$800)
Corporate Franchise Tax	(\$31,300)	(\$2,000)	(\$1,700)	(\$900)
Inclusion of certain over-the-counter medical products as qualified medical expenses (beginning TY20)				
Individual Income Tax	(Negl.)	(Negl.)	(Negl.)	(Negl.)
All Provisions				
Individual Income Tax	(\$285,500)	\$5,500	\$800	\$400
Corporate Franchise Tax	(\$700)	(\$1,500)	(\$1,500)	(\$800)
General Fund Total	(\$286,200)	\$4,000	(\$700)	(\$400)