

HOUSE RESEARCH

Bill Summary

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Overview

Retroactively conforms Minnesota's individual income tax and corporate franchise tax to most federal changes enacted since March 26, 2014. The federal changes to taxable income affect only tax year 2014.

Minnesota would not conform to federal bonus depreciation or increased section 179 expensing for tax year 2014, but would follow the pattern of allowing 20 percent of the federal amount in tax year 2014 and the rest to be deducted in equal amounts over the following five tax years.

Also modifies the computation of state aid for the Destination Medical Center (DMC) project in the city of Rochester, enacted by the 2013 legislature. As originally enacted and confirmed in the MMB fiscal note, this aid was intended to be computed and paid based on the cumulative private expenditures (by the Mayo Clinic and other private entities in Rochester) over a \$200 million threshold. However, the Office of the Attorney General and the Department of Employment and Economic Development concluded that the language was ambiguous and did not provide for a cumulative calculation, but rather based a year's aid on the amount of private expenditures (after the \$200 million threshold was reached) in the prior year only (not the cumulative amount). The bill modifies the statutory language to make it clear that the computation is to be based on the cumulative qualifying expenditures (i.e., the sum of the expenditures for all years) over the

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\$200 million threshold. The bill also makes a series of other minor or technical and clarifying changes in the DMC statute.

- 1 Update of administrative tax provisions.** Adopts federal tax administrative changes made between March 26, 2014, and December 31, 2014, that Minnesota references for state tax administration purposes under chapter 289A. None of the federal acts enacted changed federal provisions referenced in chapter 289A.

Effective date: Effective retroactive to tax year 2014.

- 2 Update to federal definition of taxable income.** Adopts all of the federal changes to taxable income, with the exceptions of the extension of increased section 179 expensing allowances and bonus depreciation. The federal changes to taxable income were effective retroactively for one year only, tax year 2014.

The four new federal laws and important changes are as follows.

The Tax Increase Prevention Act of 2014 (TIPA) and the Achieving a Better Life Experience Act of 2014 (ABLE), Public Law 113-295, enacted December 19, 2014, made the following major changes:

- Educator classroom expense deduction of up to \$250.
- Higher education tuition expense deduction. The deduction applies to up to \$4,000 of qualifying expenses for taxpayers with adjusted gross income up to \$65,000 (\$130,000 for married joint filers), and to up to \$2,000 of qualifying expenses for taxpayers with adjusted gross income over \$65,000 but less than \$80,000 (\$130,000 to \$160,000 for married joint filers).
- Excludes from gross income discharges of indebtedness on principal residences.
- Itemized deduction for mortgage insurance premiums.
- Option for taxpayers to claim an itemized deduction for sales taxes rather than income taxes paid. *(Minnesota taxpayers are not affected by this, since present law requires any deducted sales tax to be added back in computing Minnesota tax; the same add-back is required for income taxes deducted at the federal level.)*
- Increased federal adjusted gross income limit on the amount of qualified conservation easements that may be claimed as a charitable deduction. Permanent law limits deduction of contributions of appreciated property to 20 percent or 30 percent of adjusted gross income, depending on the type of recipient organization. Beginning in 2006, the limit was increased to 50 percent for donations of qualified conservation easements by most taxpayers, and to 100 percent for donations made by farmers and ranchers, defined as individuals with 50 percent of gross income from farming/ranching.
- Authority for individuals age 70½ or older to transfer up to \$100,000 from a traditional IRA or Roth IRA directly to a qualified charity, while excluding that amount from adjusted gross income.

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- Enhanced deduction for charitable contributions of food inventory, which allows pass-through entities (S corporations, partnerships, and proprietors) to deduct contributions of food inventory under the same rules as C corporations. Instead of being limited to the basis in the food inventory, the enhanced deduction equals the lesser of basis plus one-half of the appreciation in the food inventory, or two times basis, but may not exceed ten percent of the taxpayer's net income from pass-through entities.
- Limit on basis adjustments in S corporation stock when S corporations donate appreciated property to the tax basis of the property rather than the fair market value (this reduces capital gain on later sales of the S corporation stock, compared with underlying law).
- 50 percent bonus depreciation extended to tax year 2014. *(Minnesota would not conform to the extension of increased section 179 amounts for tax year 2014, but 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.)*
- Increased the section 179 expensing amount and phaseout threshold for tax year 2014 to \$500,000 and \$2 million. *(Minnesota would not conform to the extension of increased section 179 amounts for tax year 2014, but 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.)*
- Various provisions related to depreciation and expensing, including more generous rules for certain racehorses (three-year property), leasehold and restaurant improvements, including new restaurant property and improvements to retail property (15-year straight-line recovery), motorsports entertainment complexes (seven-year recovery period), mine safety equipment, accelerated depreciation for business property on Indian reservations, qualified film and television production expenses, and second generation biofuel plant property.
- Special rule limiting the amount of payments from controlled subsidiaries to parent exempt organizations that are subject to the unrelated business income tax to the amount in excess of allowable payments under the arm's-length transaction rules, if a binding written contract between the organizations was in effect as of August 17, 2006.
- Preferential treatment of dividends of regulated investment companies, under which dividends paid to foreign shareholders are exempt to the extent the dividends are derived from interest income that would be exempt if it had been earned directly by the foreign shareholder.
- Exception under subpart F, which allows U.S. shareholders with a ten percent or greater interest in a controlled foreign corporation that consists of banking, financing, and similar businesses to defer recognition of active income earned by the corporation but not distributed to the shareholders.

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- Extends the 100 percent exclusion for the gain on sale of qualified small business stock held for more than five years for stock acquired after September 27, 2010, and before January 1, 2014, to apply to stock acquired before January 1, 2015. The exclusion will revert to 50 percent for stock acquired on or after January 1, 2015.
- Reduction in the minimum holding period to avoid the tax on built-in gains on sales of assets of S corporations that converted from C corporations from ten years to five years, allowing S corporations to sell assets held more than five years without being taxed on built-in gains.
- Increased Section 179D deduction for energy efficient commercial buildings.
- Parity in qualified transportation fringe benefits under which employers may exclude up to the same maximum amount per month per employee for vanpool and transit pass expenses as for parking. (*Minnesota taxpayers are not affected by this, since Laws 2014, chapter 308 provided for the increased exclusion to be allowed at the state level regardless of the amount allowed at the federal level.*)
- Authorized creation of tax-preferred savings accounts for disabled individuals (ABLE accounts); earnings on accounts and amounts withdrawn for designated uses are excluded from taxable income.

Amendments to The Federal Aviation Administration Modernization and Reform Act of 2012, Public Law 113-243, enacted December 18, 2014, made two changes that could affect Minnesota taxable income

- Modified the date by which an airline must have filed for bankruptcy in order for employees to be eligible to roll over all or part of the payments received as part of the bankruptcy into traditional IRAs to include bankruptcy cases filed on November 29, 2011, in effect allowing rollovers for American Airlines employees who received payments. Taxpayers had 180 days from the time of receipt of payments to elect to make a rollover into a traditional IRA. The income limits on deductible IRA contributions do not apply to the rollovers.
- Extended the date for taxpayers who made rollovers of payments in previous bankruptcy cases, including that of Delta Airlines, to file claims for federal tax refunds from June 1, 2013, to April 15, 2015.

The Multiemployer Pension Reform Act of 2014, a Division of **The Consolidated and Further Continuing Appropriations Act, 2015**, Public Law 113-235, enacted December 16, 2014, made various changes to the Employee Retirement Income Security Act of 1974 (ERISA), and the Pension Protection Act of 2006, including changes to Internal Revenue Code definitions and criteria related to multiemployer plans.

The Tribal General Welfare Exclusion Act of 2014, Public Law 113-168, enacted September 26, 2014, formalized in the Internal Revenue Code current Internal Revenue Service regulations providing that the general welfare exclusion law applies to welfare payments made by tribes to their members.

- 3 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

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tax and determining withholding on wages for tax year 2014. Federal adjusted gross income also is the starting point for calculating household income which is used to compute the dependent care and K-12 education credit. The main changes to federal adjusted gross income are described in section 2.

- 4 **Estate tax definitions.** Updates to changes in federal law made between March 26, 2014, and December 31, 2014. This change has no substantive effect on computation of the estate tax, but instead keeps the Internal Revenue Code date reference consistent with other sections of statute.
- 5 **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.
- 6 **Public infrastructure project; development plan.** Clarifies that the public infrastructure project definition includes preparation and modification of the development plan. This will allow (1) these costs to be paid with state DMC aid or (2) payments of the costs out of city funds to qualify as a local match for state aid. The law requires the development plan to be prepared and to specify projects that will comprise the DMC.
- 7 **Project costs incurred before plan approval.** Provides that amounts spent by the city before the development plan has been approved may be paid with state aid, if they are approved by the DMC corporation. Under current law, these amounts may be credited against the local match. This change extends that authority to include payment with state aid. Since the project authority is expressed as the combination of state aid and local match, this will eliminate the need to separately trace where the funding for these project costs came from.
- 8 **Definition of qualified expenditures.** Provides that the definition of qualified expenditures for a year (the amount that is used to calculate state aid) is the cumulative amount of expenditures made since June 30, 2013, less \$200,000,000. Present law defines these expenditures as an annual amount. (The aid calculation in section 9 was intended to be cumulative by summing these annual amounts that exceed \$200 million.)
- 9 **Aid calculation.** Eliminates the requirement that aid not be paid until qualified expenditures exceed \$200 million and that the aid calculation is the sum of the annual amounts. The \$200 million threshold and cumulative computation are now explicitly incorporated into the definition of qualified expenditures under section 8's changes. This section also explicitly clarifies how the carryover aid amounts are to be calculated. Carryover amounts may be triggered if the city fails to make the required local matching contribution and, then, makes the required local matching contribution for that year in a later year. At that point, the withheld state aid may be paid, except that the current aid plus paid withheld aid cannot exceed \$30 million in any year.
- 10 **Local match for general state aid.** Adds a reference to the development plan in the local match requirement to make it clear that city payments for preparation of the development plan also qualifies as a local match. This is consistent with the changes made in section 6. The section also corrects an erroneous statutory cross reference.

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- 11** **State transit aid.** Makes changes to the computation of transit aid that conform with section 9's changes to the general state aid.
- 12** **Amended returns.** Extends the time for filing amended returns for individuals who made retroactive IRA rollovers under the Federal Aviation Administration Modernization and Reform Act of 2012 to June 1, 2015, if the 3½ year time limit on amending returns to make claims for refunds in statute has expired.
- 13** **Effective date.** Provides that the provisions of the bill are effective upon local approval by Rochester's governing body and, if approved, apply retroactively to the original effective date of the DMC legislation.