2011 FEDERAL UPDATE LEGISLATIVE BULLETIN
(2011 Regular Session)

MINNESOTA·REVENUE

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Bulletin Date: June 14, 2011

The provisions discussed in this bulletin can be found in 2011 Minn. Laws, Chapter 8.

Federal Update

2011 Minn. Laws, Chapter 8 adopted all of the changes to the Internal Revenue Code ("Code") made since March 18, 2010, effective at the same time as they are effective for federal purposes. However, the changes are effective only for tax year 2010.

Overview

Minnesota income and franchise tax is based on "federal taxable income" (FTI) for regular Minnesota tax purposes; "federal alternative minimum taxable income" (AMTI) for Minnesota alternative minimum tax purposes; "federal adjusted gross income" (FAGI) for household income used for the Minnesota dependent care credit, education credit, and property tax refund; and "earned income" for the working family credit.

Minnesota law referenced these federal concepts as amended through March 18, 2010.

Since that date, Congress enacted at least four Acts that make changes to the Code. The Patient Protection and Affordable Care Act (Pub. L. No. 111-148) signed into law on March 23, 2010 and the Health Care and Education Reconciliation Act of 2010 (Pub. L. No. 111-152) signed into law on March 30, 2010, made various changes to the Code related primarily to medical plans and deductions related to medical expenses.

The Small Business Jobs Act of 2010 (Pub. L. No. 111-240) signed into law September 27, 2010, made a number of changes to the Code primarily related to taxation of business income.

Finally, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Pub. L. No. 111-312) enacted December 17, 2010 was a comprehensive tax bill that made numerous changes to the Code, including the extension of many provisions that had otherwise been scheduled to sunset in 2010.

All of the federal bills contained numerous provisions that are effective for taxes payable for 2010. While many of these are permanent changes to the Code, many others merely extend provisions for one or two additional years. The effective dates for particular changes will be pointed out later in this explanation.

Two of the changes are extensions of provisions that Minnesota previously decided not to fully conform to. The separate state treatment of the following items will continue:

1. Treatment of enhanced section 179 expensing of business property. With earlier federal enhancements of section 179 expensing, Minnesota required taxpayers to add to income 80% of

the enhanced federal deduction, and then allowed taxpayers a subtraction from income of the amount of the addition ratably over five years. That treatment will continue for the section 179 expensing enhancements contained in the Small Business Jobs Act.

2. Treatment of bonus depreciation of assets. With earlier federal bonus depreciation, Minnesota has required taxpayers to add to income 80% of the bonus, and has then allowed taxpayers a subtraction from income of the amount of the addition ratably over five years. That treatment will continue for both the 50% bonus depreciation contained in the Small Business Jobs Act and the 100% bonus depreciation contained in the Tax Relief, Unemployment Reauthorization and Job Creation Act.

Finally, taxpayers have previously been required to include in income the following deductions, which were extended to 2010 by Congress in 2010. For 2010, taxpayers will not have to include these items in Minnesota income:

1. The $250 deduction allowed in the computation of federal adjusted gross income for classroom expenses of K-12 educators.

2. The $4,000 deduction for student tuition paid for higher education for taxpayers or their dependents.

3. The enhanced charitable deduction for corporation charitable contributions of computer inventory.

4. The exclusion of certain active financing income of corporations under Subpart F.

Section 1. Federal update to Minnesota administrative provisions. Minn. Stat. § 289A.02, subd. 7, was amended to incorporate the federal administrative provisions as defined in the Internal Revenue Code through December 31, 2010. However, since there were no changes to sections of the Code referenced in Minn. Stat. ch. 289A, this change has no substantive effect. The section is effective at the same time as the provisions are effective for federal purposes.

Section 2. Minnesota net income. Minn. Stat. § 290.01, subd. 19, was amended to adopt all of the changes made to federal taxable income from March 18, 2010 through December 31, 2010. These changes include:

Highlights of the Health Care Act, as amended by the Reconciliation Act include:

- For purposes of determining the tax free employee medical insurance fringe benefit and the deductions for medical insurance expenses paid, a child under the age of 27 at the end of the tax year of the taxpayer is considered a "dependent". This means that the value of the fringe benefit will generally be excluded from income of the parent and the cost of the policy will be deductible by the self employed parent. This is effective for benefits paid after March 30, 2010 but before January 1, 2011.

- Payments made under a state loan repayment or forgiveness program to encourage health care service providers to work in underserved communities is excluded from income. This provision is effective for amounts received in 2010.

Highlights of the Small Business Jobs Act include:

- The allowable maximum section 179 expensing of business property is increased from $250,000 to $500,000 for property placed in service in 2010. The maximum allowable expensing is reduced dollar for dollar by the amount of assets acquired in the year in excess of $2,000,000. This phase out threshold was increased from $530,000 for 2010.

  The definition of property eligible for section 179 expensing was expanded to include up to $250,000 of improvements to qualified leasehold property, restaurant property or retail improvement property. The expansion of the section 179 expensing applies to assets placed in service in 2010.

  However, Minnesota will continue to treat all of the enhanced section 179 expensing as it has treated other recent federal enhancements of section 179 expensing. The additions and subtractions dealing with this type of section 179 expensing are already part of permanent Minnesota law and therefore were not amended.

- The exclusion of gain from the sale of qualified small business stock sold by an individual was increased from 75% of the gain to 100% of the gain for original issue C corporation stock acquired after September 27, 2010, and before January 1, 2011. The exclusion applies to certain stock purchased in businesses with less than $50 million of assets that is held for at least five years.

- The ability to claim 50% additional ("bonus") depreciation in the year of acquisition of certain business property was extended to include assets placed in service in 2010. However, Minnesota will continue to treat this bonus depreciation as it has treated other versions of federal bonus depreciation. The additions and subtractions dealing with this type of bonus depreciation are already part of permanent Minnesota law and therefore were not amended.

- The maximum first year deduction for light trucks, vans and automobiles used in a trade or business was increased by $8,000 for qualified vehicles placed in service in 2010.

- The maximum deduction for business start up expenses was increased from $5,000 to $10,000 for expenses incurred in 2010. The ability to deduct 2010 start up expenses phases out when start up expenses exceed $60,000, a $10,000 increase from prior law.

- In determining the percentage of completion under certain long term contracts that require income to be determined based on the percentage of expenses incurred on the project, for property placed in service after December 31, 2009, the cost of qualified property will be taken into account without regard to any bonus depreciation taken on the property.

- Employer sponsored 401(k), and 403(b) plan participants can roll over their pre-tax balances into a designated employer sponsored Roth account after September 27, 2010. If the rollover is made in 2010, the taxpayer can elect to include the income attributable to the rollover in taxable income ratably in 2011 and in 2012.

- Rules defining income from sources within the United States were amended to include various amounts received, whether directly or indirectly, from a noncorporate resident or a domestic corporation for the provision of a guarantee of indebtedness of such person. This is effective for guarantees issued after September 27, 2010.

- Recordkeeping requirements for business use of cell phones are eased for tax years beginning after December 31, 2009 and before January 1, 2011.

Highlights of the Tax Relief, Unemployment Reauthorization and Job Creation Act include:

- The deduction in the computation of adjusted gross income of up to $250 of classroom expenses paid by a K-12 grade educator was extended through 2010. Prior Minnesota law required taxpayers to include this deduction in the computation of Minnesota income.

- The ability of taxpayers age 70½ or older to exclude from gross income up to $100,000 of their distributions from an individual retirement account that are made directly to charitable organizations was extended to 2010. The amount excluded is not allowed as a charitable contribution deduction.

- The special rules to encourage charitable contributions of real property for conservation purposes were extended to contributions made in calendar years 2010.

- The deduction in the computation of adjusted gross income of up to $4,000 of qualified tuition for higher education was extended through 2010. Prior Minnesota law required taxpayers to include this deduction in the computation of Minnesota income.

- The percentage of bonus depreciation was increased to 100% for property placed in service after September 8, 2010 and before January 1, 2011. However, Minnesota will continue to treat this bonus depreciation as it has treated other versions of federal bonus depreciation. The additions and subtractions dealing with this type of bonus depreciation are already part of permanent Minnesota law and were not amended.

- The ability to depreciate leasehold improvements and qualified restaurant property, new restaurant property and improvements to retail property over 15 years (rather than 39 years) was extended to property placed in service in 2010.

- The ability to expense the first $15 million of production costs of films and television shows was extended through 2010.

- The ability to expense environmental remediation expenditures at a brownfield site was extended to expenses paid or incurred through 2010.

- The ability to expense 50% of the cost of advanced mine safety equipment was extended to equipment placed in service in 2010.

- The suspension of the 100% of income limitation on the depletion for oil and gas produced from marginal properties was extended to include tax years beginning in 2010.

- The ability to depreciate certain motorsports entertainment complex property over 7 years rather than 15 or 39 years was extended to property placed in service through 2010.

- The ability of a C corporation to donate computer inventory to educational facilities or libraries and deduct the lesser of cost basis plus one-half the normal mark-up or two times basis was extended to contributions made in taxable years beginning in 2010. Prior Minnesota law required taxpayers to include the enhanced deduction in the computation of Minnesota tax.

- The ability of other than C corporations to take a deduction for contributions to a charity equal to the cost basis plus one-half the normal price mark-up of apparently wholesome food inventory was extended to contributions made through 2010.

- The ability of a C corporation to donate book inventory to a public school and deduct the cost basis plus one-half the normal mark-up was extended to contributions made through 2010.

- The basis adjustment to S corporation stock when the S corporation donates appreciated property, which is equal to the tax basis of the property rather than the fair market value, was extended to contributions made in taxable years beginning in 2010.

- The ability to use accelerated depreciation of qualified Indian reservation property was extended to property placed in service in 2010.

- The exclusion from unrelated business income of certain qualifying payments (generally rent, interest, royalties and annuities not in excess of amount of payments that would be made at arm's length) to a tax-exempt organization by an entity controlled by the tax-exempt organization was extended to payments received through December 31, 2010.

- The ability of a taxpayer to elect to recognize gain on certain qualifying electric transmission transactions ratably over an eight-year period to the extent the amount realized is used to purchase exempt utility property within four years of the sale date was extended to apply to gains attributable to dispositions in 2010.

- The ability of Alaska Native Settlement Trusts to elect to have income taxed at the lowest individual rate was extended through December 31, 2010.

All of the changes are effective for Minnesota purposes at the same time as they are effective for federal purposes.

Section 3. Additions to income – individuals, estates and trusts. Minn. Stat. § 290.01, subd. 19a, was amended to modify two existing additions to tax.

The additions that were modified are:

1. The K-12 educator expense addition will not be required effective for taxable years beginning after December 31, 2009 and before January 1, 2011.

2. The higher education tuition addition will not be required effective for taxable years beginning after December 31, 2009 and before January 1, 2011.

Section 4. Additions to income – corporations. Minn. Stat. § 290.01, subd. 19c, was amended by making the addition equal to the enhanced charitable contribution of corporate computer inventory not apply to taxable years beginning after December 31, 2009 and before January 1, 2011.

Section 5. Update of individual alternative taxable income, credits, and 501(c)(3) hospitals. Minn. Stat. § 290.01, subd. 31, was amended to incorporate federal changes which impact Minnesota tax provisions that are not part of the computation of regular tax.

For alternative minimum tax, the new changes to federal adjusted gross income incorporated into the definition of net income will apply to the computation of Minnesota alternative taxable income.

The definition of "income" for purposes of the Minnesota dependent care credit and the education credit will also adopt the new changes to federal adjusted gross income incorporated into the definition of net income.

Hospitals that meet the requirements to be exempt from income tax under section 501(c)(3) of the Internal Revenue Code will not be exempt from income tax under the Internal Revenue Code, or under Minn. Stat. § 290.05, unless they meet requirements of new IRC section 501(r) that include conducting a community health needs assessment, adopting a financial assistance policy, imposing limits on charges and adopting certain billing and collection practices. Generally effective for taxable years beginning after May 23, 2010.

All of the changes are effective for Minnesota purposes at the same time as they are effective for federal purposes.

Section 6. Federal update of property tax refund. Minn. Stat. § 290A.03, subd. 15, was amended to adopt the 2010 federal changes that affect household income, which uses the definition of federal adjusted gross income as a starting point. Effective for refunds based on property taxes payable after December 31, 2009 and rent paid after December 31, 2008.

Section 7. No corrected W-2's. An uncodified provision was enacted which 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 prior to the enactment of the 2011 federal update.