

2013 FEDERAL UPDATE LEGISLATIVE BULLETIN

(2013 Regular Session)

MINNESOTA REVENUE

Appeals and Legal Services Division
600 North Robert Street
Saint Paul, Minnesota 55146-2220

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The provisions discussed in this bulletin can be found in 2013 Minn. Laws, Chapter 3.

Biennial report on incidence of taxes. Amends Minn. Stat. 2012 § 270C.13, subd. 1, to eliminate the inclusion of information on the distribution of the federal income taxes borne by Minnesota residents in the commissioner's biennial report to the legislature on the overall incidence of the state's income, sales, and property taxes. Effective February 21, 2013. 2013 Minn. Laws, Chapter 3, Section 2.

Federal Update

2013 Minn. Laws, Chapter 3 adopted all of the changes to the Internal Revenue Code ("Code") made through January 3, 2013 effective at the same time as they are effective for federal purposes. However, the changes are effective only for tax year 2012. For tax years 2013 and thereafter, Minnesota taxable income, alternative minimum taxable income, dependent care credit, working family credit, and household income will be based on Internal Revenue Code as amended thru April 14, 2011 and will require modifications for the federal changes listed below.

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 April 14, 2011.

Since that date, Congress enacted two Acts that make changes to the Code. The two new federal laws for tax year 2012 were:

The Federal Aviation Administration Modernization and Reform Act of 2012, Public Law 112-95, enacted February 14, 2012, allows employees who received payments in airline bankruptcy cases filed after September 11, 2001, and before January 1, 2007, to roll over all or part of the payments to Individual Retirement Accounts (IRAs). A previous federal law allowed employees to roll over bankruptcy payments into Roth IRAs; this law allows amounts previously rolled over into Roth IRAs to be further rolled over into traditional IRAs. Taxpayers had 180 days, until August 12, 2012, to elect to make a rollover into a traditional IRA. The income limits on deductible IRA contributions do not apply to the rollovers. The rollovers are retroactive to the year in which the payments were received, and taxpayers are allowed to file amended returns to claim refunds of federal income taxes reflecting the reduction in taxable income resulting from the deduction of rolled-over amounts.

The American Taxpayer Relief Act of 2012, Public Law 112-240, enacted January 2, 2013, made the following major changes that affect tax year 2012. While some of these federal provisions extend beyond tax year 2012, the legislation that was enacted conforms for tax year 2012 only.

- Increased the section 179 expensing amount and phase-out threshold for property placed in service in tax years 2012 and 2013 to \$500,000 and \$2 million. (Minnesota does not conform to the extension of increased section 179 amounts for tax year 2012, but retains 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.
- Extends the educator classroom expense deduction of up to \$250.
- Extends the itemized deduction for mortgage insurance premiums.
- Extends the option for taxpayers to claim an itemized deduction for sales taxes rather than income taxes paid. (Minnesota taxpayers will be unaffected 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.)
- Extends the increase in the federal adjusted gross income limit on the amount of qualified conservation easements that may be claimed as a charitable deduction. General law limits deduction of contributions of appreciated property to 20 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.
- Extends the higher education tuition expense deduction. The deduction applies up to \$4,000 of qualifying expenses for taxpayers with adjusted gross income up to \$65,000 (\$130,000 for married joint filers), and 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).
- Extends the 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, and allows taxpayers to recharacterize distributions made in January 2013 as having been made in 2012.
- Extends various provisions related to depreciation and expensing for property placed in service in tax year 2010, including more generous rules for 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, and qualified film and television productions expenses.
- Extends parity in qualified transportation fringe benefits, under which employers may exclude up to the same maximum amount per month (\$240 in 2012) per employee for vanpool and transit pass expenses for parking, rather than \$125 per month.
- Extends the 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 normal price markup of food inventory, or two times basis, but may not exceed 10 percent of the taxpayer's net income from pass-through entities.

- Extends the 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, providing that a binding written contract between the organizations was in effect as of August 17, 2006.
- Extends 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.
- Extends the exception under subpart F which allows the United States shareholders with a 10 percent or greater interest in controlled foreign corporation to defer recognition of income earned by the corporation but not distributed to the shareholders.
- Extends the 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 prior law).
- 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, 2012, to apply to stock acquired before January 1, 2014. The exclusion will revert to 50 percent for stock acquired on or after January 1, 2014.
- Extends the 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.

Update to federal definition of taxable income. Minn. Stat. § 290.01, subd. 19 was amended to adopt all of the federal changes to taxable income effective when the federal changes became effective, for tax year 2012 only, with the exception of increased section 179 expensing for tax year 2012 as described in the overview above.

Update to other references to the Internal Revenue Code in chapter 290. Minn. Stat. § 290.01, subd. 31 was amended to adopt federal changes to federal adjusted gross income used for computing individual alternative minimum tax and determining withholding on wages for tax year 2012. 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 the overview and are effective for Minnesota purposes at the same time the changes were effective federally.

Update of references to Internal Revenue Code in the property tax refund chapter. Minn. Stat. § 290A.03, subd. 15 was amended to adopt for tax year 2012 the federal changes to federal adjusted gross income described in the overview which is the starting point for calculating "household

income” used in calculating Minnesota property tax refunds effective for refunds based on property taxes payable in 2013 and for rent paid in 2012.

Update of references to Internal Revenue code in the estate tax chapter. Minn. Stat. § 291.005, subd. 1, was amended to move the date through which Minnesota incorporates the federal estate tax to January 3, 2013, but without regard to the federal termination of the federal credit for state death taxes. This change has no substantive effect.

Amended returns. This uncodified provision 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, 2013, if the 3½ year time limit on amending returns to make claims for refunds in statute has expired. Effective February 20, 2013.

Changes affecting tax year 2013 only. For tax year 2013, Minnesota only adopted 2 changes to the Internal Revenue Code that were enacted in the American Taxpayer Relief Act of 2012. Those changes, enacted in Minn Laws, chapter 143, are:

Section 179 expensing. For federal purposes, the maximum section 179 expensing amount and phase-out threshold for property placed in service in tax year 2013 was increased to \$500,000 (from \$25,000) and \$2 million (from \$200,000). However, Minnesota will continue to treat all of the enhanced 179 expensing as it has treated other recent federal expansions of federal 179 expensing. This means taxpayers will be required to include 80% of the additional expensing in Minnesota taxable income, and subtract an amount equal to 20% of this amount in each of the next five years. The additions and subtractions dealing with this type of 179 expensing are already part of Minnesota law.

50% bonus depreciation. For property placed in service in 2013 or in 2014 for certain airline property or other long production property, Minnesota will continue to treat all of the bonus depreciation as it has treated other recent federal bonus depreciation. This means taxpayers will be required to include 80% of the bonus in Minnesota taxable income, and subtract an amount equal to 20% of this amount in each of the next five years. The additions and subtractions dealing with this type of bonus depreciation are already part of Minnesota law.

Thus, none of the changes discussed earlier in this bulletin as relating to tax year 2012 apply to Minnesota for 2013, nor do a number of other changes Congress enacted, including changes to the definition of federal taxable income and the calculation of the child and dependent care credit.