

MINNESOTA • REVENUE

INDIVIDUAL INCOME TAX Federal Update

March 16, 2004

	Yes	No
Separate Official Fiscal Note Requested		
Fiscal Impact		
DOR Administrative Costs/Savings		

Department of Revenue

Analysis of H.F. 3058 (Abrams) As Proposed to be Amended (H3058A1)

	<u>Revenue Gain or (Loss)</u>			
	<u>F.Y. 2004</u>	<u>F.Y. 2005</u>	<u>F.Y. 2006</u>	<u>F.Y.2007</u>
		(000's)		
Health Savings Accounts	\$0	(\$3,200)	(\$3,200)	(\$3,600)
Travel Expense Deduction for the National Guard and Military Reserve	(\$260)	(\$300)	(\$305)	(\$310)
Other Provisions, Military Tax Relief Act	<u>(\$40)</u>	<u>(\$55)</u>	<u>(\$20)</u>	<u>(\$20)</u>
General Fund Total	(\$300)	(\$3,555)	(\$3,525)	(\$3,930)

Health savings accounts effective beginning with tax year 2004.

Travel expense deduction for the National Guard and Military Reserve effective beginning with tax year 2003.

Various effective dates for other provisions in the Military Family Tax Relief Act.

EXPLANATION OF THE BILL

In General

The bill would adopt for Minnesota tax purposes the federal law changes enacted from June 16 through December 31, 2003. The two federal acts that contained the relevant changes were the Military Family Tax Relief Act of 2003, Public Law 108-121, and the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Public Law 108-173.

Under the proposed amendment, Minnesota would not adopt the income exclusion for federal subsidies to employers with qualifying prescription drug plans for their retirees. The amount excluded federally would be added back to income in computing the regular tax and alternative minimum tax for individuals and for corporations.

The bill also adds a subtraction for compensation paid to a service member for military service performed by a nonresident. The Service Members Civil Relief Act, Public Law 108-189, prohibits states from increasing the state income tax for a nonresident active duty service member (or their spouse) for the amount of their active duty pay. This subtraction would codify the effect of the federal prohibition.

EXPLANATION OF THE BILL (cont.)

Health Savings Accounts

Under the new federal law, an eligible individual with a high-deductible health plan is allowed to make contributions to a health savings account. An employer may also make contributions to the individual's account. The individual is allowed a deduction from gross income for contributions to the account, interest on the account accumulates tax free, and withdrawals from the account are not taxable if they are used for medical expenses.

A health plan qualifies as a high-deductible plan if the annual deductible is at least \$1,000 for self-only coverage (\$2,000 for family coverage) and the sum of the annual deductible and other annual out-of-pocket expenses does not exceed \$5,000 for self-only coverage (\$10,000 for family coverage). The maximum annual deduction is the lesser of the annual deductible or \$2,250 for self-only coverage (\$4,500 for family coverage). The maximum deduction is prorated on a monthly basis if the individual qualifies for only part of the year. For a person age 55 or older, the maximum deductible contribution is increased by \$500 for tax year 2004, and the \$500 is increased by \$100 each year until it reaches \$1,000 in 2009. The maximum deduction is reduced by the amount of any employer contributions to the health savings account which are excluded from employee's income.

Travel Expense Deduction for the National Guard and Military Reserve

Members of the National Guard and Military Reserve would be allowed an above-the-line deduction for unreimbursed travel expenses incurred to attend a National Guard or Reserve meeting at least 100 miles from home.

Other Provisions, Military Family Tax Relief Act

The rules relating to the income exclusion for the gain from the sale of a principal residence are modified to take into account absence due to military service, retroactive to sales made after May 6, 1997. Claims for refunds for closed years could be filed until November 2004. An exclusion is allowed for amounts received under the Department of Defense Homeowners Assistance Program after enactment of the bill. The exclusion for death gratuity payments made to families of members of the armed forces is increased from \$3,000 to \$12,000, effective retroactive to September 11, 2001. The bill contains several other provisions with small or no revenue impact.

REVENUE ANALYSIS DETAIL

Health Savings Accounts

- The estimates are based on the estimates for the federal bill prepared by the Joint Committee on Taxation and released on November 21, 2003.
- The estimates were apportioned to Minnesota based on Minnesota's portion of federal adjusted gross income, which is 1.9%. Appropriate federal and state marginal rates were applied.
- The estimates were converted from federal to state fiscal years. It was further assumed that none of the impact for tax year 2004 would occur before FY 2005.

Travel Expense Deduction for the National Guard and Military Reserve and Other Provisions in the Military Family Tax Relief Act

- The estimates are based on the estimates for the federal bill prepared by the Joint Committee on Taxation and released on November 7, 2003.
- For the provision relating to the travel expenses for Members of the National Guard and Military Reserve, the estimates were apportioned to Minnesota based on the number of National Guard and Reserve members in Minnesota compared to the nation, which is 1.3%.
- The federal estimates for the other provisions were aggregated and treated together. The estimates were apportioned to Minnesota based on Minnesota's portion of active duty military personnel, which is about 0.7%. Because military persons on active duty stationed outside Minnesota are considered nonresidents for Minnesota tax purposes, the estimates were further reduced by 50%.
- Appropriate federal and state marginal rates were applied. The estimates were converted from federal to state fiscal years. The impact for fiscal year 2004 reflects the fact that many of the provisions have retroactive effective dates.

Source: Minnesota Department of Revenue
Tax Research Division
http://www.taxes.state.mn.us/taxes/legal_policy