

**INDIVIDUAL INCOME TAX
CORPORATE FRANCHISE TAX
Prohibit the Deduction of Fines and Penalties**

February 9, 2004

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

Department of Revenue
Analysis of S.F. 1624 (Marty) Preliminary Analysis

	Revenue Gain or (Loss)			
	(000's)			
	<u>F.Y. 2004</u>	<u>F.Y. 2005</u>	<u>F.Y. 2006</u>	<u>FY2007</u>
General Fund	\$0	\$50	\$50	\$50

Effective for tax years beginning after December 31, 2003

EXPLANATION OF THE BILL

Current Law: With the exception of compensatory fines and penalties, IRC section 162(f) currently prohibits the deduction of fines and penalties as an ordinary and necessary business expense. The list of prohibited fines and penalties are listed in detail by Internal Revenue Service regulation 1.162-21.

Proposed Law: The bill prohibits the deduction of compensatory fines and penalties. Beyond the list of fines and penalties listed in section (b) of the bill that are also mentioned in Internal Revenue Service regulation 1.162-21, the bill as intended expands the list of prohibited deductions to include legal fees and related expenses paid in the defense of a prosecution or civil action if the expenses are associated with the payment of a fine or a penalty.

The expanded list of prohibited deductions would be taken as an addition to taxable income for both individual and corporate franchise taxpayers.

REVENUE ANALYSIS DETAIL

- The language in this bill is similar to the language in bills before Congress to expand the list of prohibited deductions in IRC section 162(f) to include legal fees and related expenses paid in the defense of a prosecution or civil action if the expenses are associated with the payment of a fine or a penalty. The federal bill prohibits the deduction of compensatory fines and penalties, but it allows an exception for restitution payments. This exception is designed to cover a narrow range of compensatory fines and penalties.

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- The estimate for the bill is based on estimates done by the Joint Committee on Taxation on January 29, 2004 for the Highway Reauthorization and Excise Simplification Act of 2004.
- Federal estimates show a large revenue gain during the first fiscal year. This large first revenue gain will not be captured because the federal bill covers fines, penalties and other amounts paid or incurred after April 27, 2003. This bill covers fines and penalties paid during tax years beginning after December 31, 2003.
- The estimates assume that the Minnesota portion of the federal estimate is 1.5% and that federal taxes are three times higher than Minnesota taxes.

Number of Taxpayers Affected: unknown.

Source: Minnesota Department of Revenue
Tax Research Division

Sf1624-1 / dkd