INDIVIDUAL INCOME TAX
CORPORATE FRANCHISE TAX
Disallowed Vehicle Deductions

March 23, 2004

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

Department of Revenue
Analysis of S.F. 2403 (Marty)/ H.F. 2435 (Kahn)

	Revenue Gain or (Loss)			
	F.Y. 2004	F.Y. 2005	F.Y. 2006	F.Y. 2007
	(000's)			
Individual Income Tax	$0	$17,700	$16,800	$11,300
Corporate Franchise Tax	$0	$8,300	$7,800	$5,300
General Fund Total	$0	$26,000	$24,600	$16,600

Effective beginning with tax year 2004.

EXPLANATION OF THE BILL

Current Law: In computing the individual income and corporate franchise taxes, a depreciation or expensing deduction can be taken for a vehicle used in a trade or business. For a passenger vehicle with a gross vehicle weight of over 6,000 pounds, no maximum deduction applies.

For computing depreciation for tax purposes, a vehicle is considered five-year property. For property acquired from September 11, 2001, through May 5, 2003, a temporary bonus depreciation provision allowed 30% of the amount to be deducted in the first year. From May 6, 2003, through December 31, 2004, the bonus depreciation is 50%. For both the 30% and 50% bonus deprecation deductions, an addition is required on the Minnesota return equal to 80% of the bonus depreciation. That amount is then subtracted on the state return in equal parts over the next five years.

Up to $25,000 of equipment purchased in a tax year can be expensed if the total amount of equipment acquired by the business in that year did not exceed $100,000. For tax years 2003 through 2005, the expensing amount was increased from $25,000 to $100,000 and the limit on total purchases was increased from $100,000 to $400,000.

Proposed Law: For both the individual income tax and the corporate franchise tax, an addition to federal taxable income would be required for the total amount of the depreciation or expensing deduction taken on the federal return for a motor vehicle defined in the bill as being disqualified. A disqualified vehicle is a four-wheeled vehicle manufactured primarily for use on public streets, roads, and highways, rated between 6,001 and 14,000 pounds gross vehicle weight, designed to seat nine for fewer individuals, and not equipped with an open cargo area measuring 72 inches in length or more or does not have a covered box measuring 72 inches or more in length.

EXPLANATION OF THE BILL (cont.)

A vehicle would not be disqualified if it were used predominately: in the business of farming; in a timber or wood products business to transport employees, customers, cargo, or equipment; or in a construction business to transport employees, customers, cargo, or equipment. Real estate operations would not be considered a construction business.

For state tax purposes, the basis of a disqualified vehicle would be the same as the basis for federal tax purposes, meaning that the addition to income required under this bill would not result in a basis adjustment.

REVENUE ANALYSIS DETAIL

- The makes and models of vehicles meeting the design, weight, and size requirements of the bill were identified from published information. From a file from the Department of Public Safety of all motor vehicles registered in Minnesota, the identified vehicles were selected for model years 2002 and 2003, and the amount of base value for such vehicles was totaled. An adjustment of 10% was made for model year 2003 because the file was incomplete.
- An annual growth rate of 10% over 2003 was used to estimate model years 2004 and 2005, and a 5% annual rate was used for 2006 and 2007. Years prior to 2002 assumed an annual growth rate of 10%.
- The model year was assumed to be the year of acquisition.
- The base value on the file is that used for the motor vehicle registration tax and does not include separately-stated options. Base value was increased by 5% to reflect purchase price.
- It was assumed that 25% of the total value for identified vehicles would be for business use subject to the provisions of the bill.
- The proposal would first be effective for tax year 2004 and would apply to deductions for acquisitions in 2004 and prior years. For each year of acquisition, the portion of the total business value that would be taken the first year was estimated, based on the expensing and any bonus depreciation laws in effect for that year. The remaining value was spread over the following years according to the rules for depreciating five-year property.
- It was assumed that the addback of deductions under the proposal would be independent of and in addition to the amount added back on the Minnesota return under current law for 80% of the bonus depreciation claimed on the federal return.
- It was assumed that 75% of the disallowed deductions would affect the individual income tax (including proprietors, partners, and S corporation shareholders) and 25% the corporate franchise tax (C corporations). A marginal tax rate of 7% for the individual income tax and the corporate franchise tax rate of 9.8% were applied.

REVENUE ANALYSIS DETAIL (cont.)

- The revenue impact of the bill decreases for tax year 2005 because 50% bonus depreciation expires and decreases further for tax year 2006 because the increased expensing limits expire.
- Tax year impact was allocated to the following fiscal year.

Number of Taxpayers: The disallowed deductions for a given tax year would affect acquisitions in that year and some acquisitions for prior years. Deductions for an estimated 7,400 vehicles acquired in 2004 would be affected by the bill.

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

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