

MINNESOTA • REVENUE

INDIVIDUAL INCOME TAX CORPORATE FRANCHISE TAX Charitable Contributions for Tsunami Relief

January 13, 2005

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

Department of Revenue

Analysis of S.F. 218 (Rest) H.F. 166 (Abrams) As Amended in the House Tax Committee

| | <u>Fund Impact</u> | | | | |
|--------------|--------------------|------------------|------------------|------------------|------------------|
| | <u>F.Y. 2005</u> | <u>F.Y. 2006</u> | <u>F.Y. 2007</u> | <u>F.Y. 2008</u> | <u>F.Y. 2009</u> |
| General Fund | (\$45) | \$40 | (000's) \$0 | \$0 | \$0 |

Effective the day following final enactment.

EXPLANATION OF THE BILL

The bill would adopt the provisions of federal Public Law 109-1 for the Minnesota individual income and corporate franchise taxes to be effective at the same time as for federal tax purposes. The federal legislation was signed by the President on January 7, 2005.

Public Law 109-1 pertains to cash contributions made for the relief of victims in areas affected by the December 26, 2004, Indian Ocean tsunami for which a charitable contribution deduction is allowable under Section 170 of the Internal Revenue Code. A taxpayer may elect to treat a contribution made in January 2005 as if it had been made on December 31, 2004, and not in January 2005. Therefore, a calendar year taxpayer could elect to take the deduction on their 2004 income tax return rather than on the 2005 return.

As amended, this provision would also apply to the charitable contribution subtraction on the Minnesota return. This subtraction is available to individuals who do not itemize deductions on the federal return and is equal to 50% of charitable contributions that exceed \$500.

REVENUE ANALYSIS DETAIL

- The option to take the deduction for January 2005 contributions on the 2004 return would be available to two groups of taxpayers: individuals who itemize their deductions and businesses with a tax year ending on December 31st.
- Only a portion of taxpayers eligible to take the deduction on the 2004 return would choose to do so. To the extent that taxpayers make the election, there is a potential for a shift of revenue between fiscal years.

- Under current law, taxpayers can adjust their quarterly estimated payments or withholding in 2005 for a deduction they will take on their 2005 return. Taxpayers most likely to make such an adjustment are businesses and higher-income individuals who make a sizable contribution. Therefore, the potential shift due to the proposal is minimized for businesses and higher-income individuals.
- Any shift would come primarily from other individuals who itemize deductions. Based on the current version of the House Income Tax Simulation Model, which is consistent with the November 2004 forecast, an estimated 658,000 taxpayers will have a state tax benefit from the itemized deduction for charitable contributions for tax year 2004. If 10% of the 658,000 make an average contribution of \$25 for tsunami victim relief in January 2005 and if 30% of those eligible choose to take the deduction on their 2004 return, the impact at a tax rate of 7% would be about \$35,000. This represents the impact of the deduction that would be shifted from fiscal year 2006 to fiscal year 2005.
- In addition to the shift, some taxpayers may receive a larger tax benefit from taking the deduction in 2004 due to their specific tax situation. Fifteen percent is added to the loss in fiscal year 2005 to reflect this impact.
- **As amended**, the provision would also apply to the Minnesota charitable contribution subtraction for nonitemizers. The subtraction was taken on 170,400 returns for tax year 2003 and is assumed to increase by 6% to about 180,000 for tax year 2004. If 10% of the 180,000 make an average qualifying contribution of \$25 (50% of which would be subtracted) in January 2005 and if 30% of those eligible choose to take the deduction on their 2004 return, the impact at an average tax rate of 6% would be about \$5,000.

Note: The Joint Committee on Taxation did not publish estimates for the federal bill before its enactment but did forward estimates to the Congressional Budget Office. CBO published the JCT estimates on January 10, 2005, which show a revenue loss of \$11 million in federal fiscal year 2005 and a gain of \$9 million in fiscal year 2006.

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