MINNESOTA · REVENUE

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

April 27, 2005

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

Department of Revenue
Analysis of S.F. 383 (Marty) / H.F. 429 (Atkins)

	Fund Impact			
	F.Y. 2006	**F.Y. 2007**	**F.Y. 2008**	**F.Y. 2009**
		(000's)		
General Fund	$75	$75	$75	$75

Effective for tax years beginning after December 31, 2004.

EXPLANATION OF THE BILL

Current Law: IRC section 162(f) under current law prohibits the deduction of fines and penalties as an ordinary and necessary business expense. Treasury regulation 1.162-21(b)(1) describes the penalties and fines levied by governments that cannot be deducted. Minnesota law follows these federal rules.

Proposed Law: The language in the bill adding M.S. 290.10 subdivision 2 closely mirrors the language of Treasury regulation 1.162-21(b)(1). In addition and beyond the scope of current law, the bill prohibits the deduction of legal fees and related expenses paid to a government for a prosecution or civil action arising from a violation of law. Under this bill, deductions of fines, damages, and penalties permitted by federal law would be added back to gross income.

REVENUE ANALYSIS DETAIL

- This bill is similar to a proposed law change introduced during the last session of Congress. In a manner similar to this bill, the proposed law change would have prohibited the deduction of legal fees paid to a government for a prosecution or civil action arising from a violation of law. This bill appears to be more comprehensive in the area of damages paid to governments than the proposed federal law.
- The estimate for the bill is based on estimates for the similar federal bill prepared by the Joint Committee on Taxation on January 29, 2004, for the Highway Reauthorization and Excise Tax Simplification Act of 2004.

REVENUE ANALYSIS DETAIL (Continued)

- Federal estimates show a large revenue gain during the first fiscal year. This large first year 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, 2004.
- The estimate uses appropriate federal and state marginal tax rates, and it assumes the Minnesota portion of the federal estimate is 1.5%.
- The federal bill made some exceptions for restitution damages but this bill does not. Therefore, the estimate was increased to reflect this difference.
- Tax year impact was allocated to the following fiscal year.

Number of Taxpayers Affected: Unknown.

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

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