

March 19, 2019

	Yes	No
DOR Administrative Costs/Savings		X

Department of Revenue
Analysis of H.F. 2429 (Loeffler)

	Fund Impact			
	<u>F.Y. 2020</u>	<u>F.Y. 2021</u>	<u>F.Y. 2022</u>	<u>F.Y. 2023</u>
		(000's)		
General Fund	\$0	\$300	\$1,500	\$2,500

Effective beginning in tax year 2019.

EXPLANATION OF THE BILL

The bill is a response to the Minnesota Supreme Court decision of *HMN Financial Inc., v. Commissioner of Revenue*. The court ruled that the common law doctrine of economic substance does not exist under Minnesota law. Under the economic substance doctrine, the tax reduction from a transaction can be denied if the tax reduction was created by a transaction taken solely for the purpose of creating a tax reduction.

The bill establishes the common law doctrine of economic substance in Minnesota law, using the same language as in a March 2010 federal law change. As with the federal law change, the bill has a two-prong test to determine whether a transaction has economic substance. A transaction has economic substance if it changes the taxpayer's economic position in a meaningful way and if it has a substantial purpose other than its tax effects.

A transaction also must have a non-tax purpose that produces a profit that is substantial in relation to the net tax reduction from a transaction.

As with the federal law change, new penalties are included in the bill. The proposed penalties are similar to the federal penalties. In some cases the penalty increases to 40% if a taxpayer does not adequately disclose the relevant facts of a transaction that is found to lack economic substance.

REVENUE ANALYSIS DETAIL

- It is assumed that the federal law change has altered how taxpayers report items of income, deductions, and credits controlled by federal law. However, items of income, deductions, and credits controlled by state law are not covered by the federal law change. Under the bill, a tax reduction under state law could be denied if a transaction creating the tax reduction lacks economic substance.
- Revenue estimates are based on the magnitude of revenue gains associated with similar economic substance cases decided in Minnesota and other states.

REVENUE ANALYSIS DETAIL (Cont.)

- The estimate assumes most of the revenue gain will be delayed until corporate taxpayers are audited in fiscal years 2022 and 2023.
- This estimate is limited to the increased tax liability that would be assessed under the bill and does not include any associated penalties.

Minnesota Department of Revenue
Tax Research Division
www.revenue.state.mn.us/research/stats/Pages/Revenue-Analyses.aspx

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