Conference Call with Tax Professionals: January 26, 2017

Minnesota Individual Income Tax

Hello and thank you for joining us today. I'm Geoff Fournier with the Income Tax and Withholding Division. There are several people with me today who will be available to answer your questions as well.

As the filing season begins, I want to thank you on behalf of Minnesota Department of Revenue for the work you do to provide a service to our shared customers. We look forward to working with you to ensure this filing season goes as smoothly as possible.

Tax Year 2015 & 2016 Federal Conformity Update

On January 13, 2017, Minnesota lawmakers enacted legislation providing tax relief to more than 200,000 Minnesota taxpayers. This relief, known as federal conformity, extends federal income tax deductions, exemptions, and enhanced depreciation to apply on the Minnesota return for tax years 2015 and 2016.

We know that you are busy, and we appreciate you taking the time to join us today. The "cliff notes" version of today's meeting is:

- **For tax year 2015:** Do not file an amended return only to remove the effects of Schedule M1NC, *Federal Adjustments,* from your client's return unless we request this. If you review the return and an amended return is necessary for another reason, include the changes to remove Schedule M1NC, and its effects.
- **For tax year 2016:** We are accepting 2016 returns. Accept any software updates your provider releases to make sure you are filing using the most up to date forms available.

Today, we will discuss:

- legislative changes affecting individual income tax returns,
- our updated forms and error rejection codes,
- tax year 2015, and
- common questions we have received.

Legislative changes affecting individual income tax returns

Because the provisions we are going to discuss are now allowed for Minnesota tax purposes, you do not need to make an adjustment for these items when calculating Minnesota taxable income.

The federal above the line deductions that are now allowed for Minnesota tax purposes:

- up to $250 deduction for Educator expenses reported on federal Form 1040, line 23, or Form 1040A, line 16, and
- deduction of up to $4,000 deduction for higher education tuition and fees reported on federal Form 1040, line 34, or Form 1040A, line 19.

Both of these deductions must be added back on line 5 of Schedules M1CD, *Child and Dependent Care Credit,* Schedule M1ED, *K-12 Education Credit,* and Form M1PR, *Homestead Credit Refund for Homeowners and Renters' Property Tax Refund.*

The federal itemized deduction that are now allowed for Minnesota tax purposes are the:

- Deduction for mortgage insurance premiums reported on federal Schedule A, line 13
- Enhanced deductions for qualified food inventory, and conservation easements

The federal income exclusions that are no longer required to be added back while calculating Minnesota taxable income are the exclusions for:

- Principal residence indebtedness cancelled or forgiven
- IRA distributions distributed directly to a charity
- Compensation received for being wrongfully incarcerated
- Certain interest-related dividends
- The value of any medal or prize money received for competing in Olympic or Paralympic games for taxpayers whose AGI is less than $1,000,000 ($500,000 for married taxpayers filing separate returns)

These exclusions must be added back on line 5 of Schedules M1CD, *Child and Dependent Care Credit,* Schedule M1ED, *K-12 Education Credit,* and Form M1PR, *Homestead Credit Refund for Homeowners and Renters' Property Tax Refund.*

The federal depreciation schedules that Minnesota now follows for assets placed in service for tax years 2015 and 2016, are the:

- Enhanced depreciation for business property on an Indian Reservation
- Modified treatment of qualified film and television production expenses
- Modified depreciation of qualified leasehold improvement, restaurant, or retail improvement property
- Special 7-year cost recovery period for property used for land improvements and support facilities for motor sports entertainment facilities
- Election to expense 50% of the cost of qualified advanced mine safety equipment

These depreciation provisions conform Minnesota's depreciation to federal depreciation. Future year depreciation expenses for these assets will be calculated the same for federal and Minnesota purposes.

An additional provision for Minnesota now conforms to allow shareholders of S-corporations that donated appreciated property in 2015 or 2016, to reduce their basis in the corporation by the corporation's adjusted basis in that property. Because Minnesota now conforms to this provision, these shareholders do not need to recalculate their basis in the entity for Minnesota purposes.

How does this affect other schedules?

On the 2016 Schedule M1M, *Income Additions and Subtractions,* we have updated lines 14, and 37 to read, "This line intentionally left blank." No amount should be entered on these lines. We made similar updates to the 2015 Schedule M1M.

What about federal Section 179 expensing and bonus depreciation?

The enacted law updates the federal definitions and thresholds used when calculating the Minnesota adjustments for section 179 expensing and bonus depreciation.

For section 179 expensing, this means taxpayers must add back 80% of the amount by which their federal section 179 expensing deduction exceeds $25,000. Subtractions of 20% of this addition will be allowed in the following 5 years.

For bonus depreciation, this means taxpayers must add back 80% of the bonus depreciation claimed on their federal return. Subtractions of 20% of this addition will be allowed in the following 5 years.

Updated Error Rejection Codes (ERC)

We added a few ERCs that went into effect last week. The new ERCs do not allow a return to be submitted with a Schedule M1NC, or an amount on Schedule M1M, line 14, or line 37 (line 38 for the 2015 schedule).

These changes were communicated to software providers and tax preparers before they became effective.

2015 Minnesota returns filed with Schedule M1NC

As a general rule, affected taxpayers should not amend their return only to take advantage of these deductions or exclusions now allowed for Minnesota tax purposes unless we request it.

We received and processed about 200,000 2015 Minnesota individual income tax returns that were impacted by these changes. By the end of the year, we will review affected returns.

Taxpayers who are impacted by this law change can expect one of three things to happen after the department's review:

1. We will make the necessary adjustments to your return, if possible. We will send a letter explaining the changes and issue a refund.

2. We will request (via letter) more information from you. We will use that information to make adjustments to the return, if possible. We will send a letter explaining the changes and issue a refund.

3. If we cannot make adjustments to a return, we will notify the customer that they will need to file an amended return to get the benefits of these tax law changes.

We will review most of the affected 2015 returns this summer; however, we will be reviewing and adjusting the returns impacted by the exclusion for principal residence mortgage debt forgiveness beginning next week.