DEPARTMENT OF REVENUE

VARIOUS TAX TYPES
Income, Business and Misc. Taxes

June 15, 2020

	Yes	No
DOR Administrative Costs/Savings	X	

State Taxes Only – See Separate Analysis for Property Tax Impacts

Based on the May 2020 Interim Budget Projection

Department of Revenue
Analysis of S.F. 8, 1st Special Session (Chamberlain)

	Fund Impact			
	F.Y. 2020	**F.Y. 2021**	**F.Y. 2022**	**F.Y. 2023**
		(000's)		
Angel Investment Credit (DFE)	$0	($10,000)	$0	($10,000)
Section 179 Expensing (1/1/18)				
Individual Income Tax	$0	($146,600)	($20,100)	($12,300)
Corporate Franchise Tax	$0	($56,700)	($7,800)	($4,700)
Charitable Subtraction for Non-itemizers (1/1/20)	$0	($24,800)	($25,000)	($26,800)
K-12 Education Credit (1/1/20)				
Increased K-12 Credit	$0	($13,900)	($14,200)	($14,500)
Reduced K-12 Subtraction	$0	$900	$900	$1,000
Lawful Gambling Tax (7/1/20)				
Combined Net Receipts Tax	$0	($6,500)	($6,800)	($7,300)
Extension for Filing and Payment (TY19)				
Estate Tax	($4,000)	$4,000	$0	$0
General Fund Total	($4,000)	($253,600)	($73,000)	($74,600)

EXPLANATION OF THE BILL

Article 2: Individual Income, Business and Miscellaneous Taxes

<u>Angel Investment Credit</u> *(sections 1 and 20)*
The angel investment tax credit is the commonly used name for the small business investment tax credit. The refundable individual income tax credit is equal to 25% of the investment made in a qualified small business. The maximum credit for a tax year is $250,000 for a married couple filing a joint return and $125,000 for other filers. The investment can be made directly by a qualified taxpayer or through a qualified angel investment network fund that invests in a qualified small business. The law specifies the requirements for the investor, the investment fund, the investment, and the small business.

Under current law, $10 million in credits may be allocated in tax years 2019 and 2021. The credit expires at the end of tax year 2021. Effective the day following final enactment, the bill permanently extends the credit at a maximum of $10 million per year beginning in tax year 2020.

<u>Paycheck Protection Program Loans</u> *(sections 2-4, 9-11 and 19)*
The Coronavirus Aid, Relief, and Economic Security (CARES) Act established a Paycheck Protection Program (PPP) to provide low-interest loans to small businesses with less than 500 employees to assist with payroll, mortgage interest, rent, and utilities. PPP loans can cover up to 2.25 times the business's average monthly costs up to $10 million. After an 8-week period, an employer can contact the loan provider to seek possible loan forgiveness. Loans are eligible for forgiveness if they meet certain requirements. The amount of the loan that is forgiven is not included in gross income and expenses paid with amounts from the loan cannot be deducted from income.

The bill adopts the federal treatment of the PPP loan forgiveness and specifies that a taxpayer must not take a business deduction for forgiven loan amounts that are excluded from income. Net income would include the greater amount resulting from either the exclusion of the forgiven loan or the business expense deduction, but not both.

<u>Section 179 Expensing</u> *(sections 5, 7 and 17)*
Section 179 of the Internal Revenue Code allows a taxpayer to treat the cost of qualified business property as an expense in the year the property is placed in service. The current limit on Section 179 expensing is $1.0 million. That amount is reduced by one dollar for every dollar of property placed in service over $2.5 million, so a taxpayer who places $3.5 million or more of property in service during the tax year is ineligible. The thresholds are indexed for inflation beginning in tax year 2019.

For Minnesota purposes, a taxpayer must add back 80% of the difference between the amount deducted federally and the amount that was allowed under pre-2003 federal law (up to $25,000, reduced by one dollar for each dollar that total expenses exceed $200,000). The amount of the addback may be subtracted in equal parts over the next five years.

Effective retroactive to tax year 2018, the bill fully conforms to the increased limits on Section 179 expensing, eliminating the need for the addbacks and associated subtractions. Subtractions would continue to be claimed for additions made before tax year 2018.

<u>Charitable Contribution for Non-itemizers</u> *(section 6)*
Currently, an individual who claims the standard deduction is allowed a subtraction for charitable contributions. The subtraction is equal to 50% of the amount of contributions in excess of $500.

The bill changes the allowed subtraction to 60% of the amount of contributions in excess of $300, effective beginning with tax year 2020.

EXPLANATION OF THE BILL (Cont.)

K-12 Education Credit *(sections 8 and 20)*
Under current law, a taxpayer is allowed a refundable income tax credit equal to 75% of eligible education expenses for a qualifying child in kindergarten through 12th grade. The maximum credit is $1,000 for each child. Eligible expenses include fees for instruction outside the regular school day or school year, expenses for textbooks or instructional materials, and transportation costs paid to others. Tuition is not an eligible expense.

The maximum credit is phased out beginning at household income of $33,500. For taxpayers with one child, the maximum credit is reduced by one dollar for every four dollars of household income over $33,500. For taxpayers with two or more children, the maximum credit is reduced by two dollars for every four dollars of household income over $33,500. The phase-out range is increased by $2,000 for each additional child. The income thresholds are not indexed for inflation. Household income includes income from all sources, both taxable and nontaxable.

The bill would phase out the credit based on adjusted gross income over: 1) The current thresholds or 2) the income eligibility guidelines for the federal reduced school lunch program as of July 1 of the tax year, whichever is greater. The reduced lunch guidelines are equal to 185% of the federal poverty guidelines and vary with the size of the household. In determining the credit, a household would include the taxpayer (and spouse for married joint returns) plus any dependents, as defined in the Internal Revenue Code.

For taxpayers with one eligible child, the credit would be reduced by one dollar for every four dollars of adjusted gross income over the eligibility guideline. For taxpayers with two or more children, the maximum credit would be reduced by two dollars for every four dollars of adjusted gross income over the eligibility guidelines. The following table shows the eligibility guidelines for tax year 2020.

Proposed Phase-Out Thresholds
Tax Year 2020

Household Size	Annual Income
2	$33,500
3	$40,182
4	$48,470
5	$56,758
6	$65,046
7	$73,334
8	$81,622

The thresholds are increased by $8,288 for each additional household member. The 2020 reduced lunch guidelines are greater than the current K-12 credit phase-out threshold for all but two-member households. The thresholds are indexed annually for inflation.

EXPLANATION OF THE BILL (Cont.)

Combined Net Receipts Gradual Rates Reduction (*section 12)*
The combined net receipts tax is imposed on a lawful gambling organization's net receipts after prizes from pull-tabs, tip-boards, and electronic linked bingo. Tax rates are graduated from 9% to 36%. The tax does not apply to paper bingo, raffles, and paddlewheels, which are subject to a separate tax.

Combined Net Receipts Tax

Net Receipts			Rate
$0	To	$87,500	9%
$87,501	To	$122,500	18%
$122,501	To	$157,500	27%
$157,501		or more	36%

Fiscal year gambling tax revenue in excess of $36.9 million is either used for stadium-related expenses or added to the stadium reserve fund within the General Fund. In addition, one percent of total gambling revenues is appropriated to the Department of Human Services to address problem gambling.

Combined net receipts tax will change to the below graduated rates effective July 1, 2020. There is no change to the definition of net receipts nor adjustment to the types of games under this tax.

Proposed
Combined Net Receipts Tax

Net Receipts			Rate
$0	to	$87,500	8%
$87,501	to	$122,500	16%
$122,501	to	$157,500	24%
$157,501		or more	32%

Extension for Filing and Payment *(section 16)*
The bill extends the filing and payment deadline for the 2019 tax year to July 15, 2020. The extension applies to individuals, partnerships, S corporations, or C corporations. The deadline for filing an estate tax return with no penalty is also extended to July 15, 2020 or the federal extension date, whichever is later.

This section is effective the day following final enactment and applies retroactively to tax payments due and penalties and interest applied for the 2019 taxable year only.

Waive Penalties and Interest *(section 18)*
The bill waives any penalties and interest if a taxpayer had an increase in tax in 2018 due to gains on property that formerly qualified as like-kind exchange property. The waiver applies if a taxpayer had an increase of tax liability of at least 12% due to the retroactive adoption of the federal treatment of like-kind exchanges. This section is effective retroactively for interest and penalties on assessments ordered after June 1, 2019.

REVENUE ANALYSIS DETAIL

Angel Investment Credit *(sections 1 and 20)*

- It is assumed that the maximum credit of $10 million per tax year would be allocated.
- Tax year impacts are allocated to the following fiscal year.
- Due to the repeal of the sunset, there would be an ongoing impact of $10 million per year beyond the forecast window.

Paycheck Protection Program Loans *(sections 2-4, 9-11 and 19)*

- Under current law, loan forgiveness is generally included in taxable income and business expenses are deductible.
- Adopting the federal treatment of PPP loans would exclude the forgiven loan amounts from income but the expenses paid with the loans would no longer be deductible.
- The effect on net income would be the same in either case, resulting in no revenue impact.

Section 179 Expensing *(sections 5, 7 and 17)*

- The estimates are based on estimates for the federal legislation prepared by the staff of the Joint Committee on Taxation, dated December 18, 2017.
- The estimate was divided between the individual income tax and corporate franchise tax based on the percentage of eligible property owned by entities subject to each tax.
- The estimate was apportioned to Minnesota and adjusted for differences in federal and state tax rates and federal and state fiscal years.
- The estimate was adjusted to reflect projected capital expenditures from the April 2020 forecast from IHS Markit.
- The average marginal tax rate was reduced in tax year 2020 to account for decreased profitability of businesses in the May 2020 interim budget projection.
- All retroactive impacts and tax year 2020 impacts are allocated to FY 2021. Other tax years were allocated 30%/70% to fiscal years.

Charitable Contribution for Non-itemizers *(section 6)*

- The House Income Tax Simulation Model (HITS 6.9) was used to estimate the revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the interim budget projection published in May 2020. The model uses a stratified random sample of tax year 2017 individual income tax returns compiled by the Minnesota Department of Revenue.
- The estimate was increased by 7.7% to account for newly eligible taxpayers claiming the subtraction, based on the percentage of itemizers with charitable contributions between $300
- and $500 in tax year 2017.
- No adjustment was made to account for the above-the-line deduction for cash contributions in the federal CARES Act. It is assumed that a taxpayer could claim the federal deduction or the Minnesota subtraction, but not both for the same contributions. Conforming to that provision
- of the CARES Act would reduce the impact of the subtraction by about $3.5 million in fiscal year 2021.

REVENUE ANALYSIS DETAIL (Cont.)

- Approximately 874,800 returns would benefit from the bill in tax year 2020. The average reduction in tax would be about $35.
- Tax year impacts were allocated to the following fiscal year.

K-12 Education Credit *(sections 8 and 20)*
- The analysis is based on Minnesota income tax returns for tax year 2018. In that year, K-12 education credits totaled $8.5 million on 34,600 returns.
- The estimate was adjusted for changes in income and education expenses since 2018, including an adjustment for lower expected incomes and education expenses in 2020.
- The proposed credit was estimated separately for: 1) those claimants that currently take the existing credit and 2) new taxpayers that can now claim the proposed credit.
- Any expenses used to claim the K-12 education credit reduce the amount that can be claimed
- as a subtraction. The estimate includes the tax benefit of the reduced education subtraction for those claimants that are better off with the proposed K-12 credit and no longer take the subtraction.
- A marginal rate of 5.2% is assumed to reflect the economic assumptions in the May 2020 interim budget projection.
- For tax returns where there was no information on the number of qualifying children, the number of dependents aged 5-18 was used to estimate the number of qualifying children.
- Consumer Price Index projections were applied to income and expenses for tax years after 2020.
- The estimate is increased by the estimated growth in population of children aged 5-18 from the Minnesota State Demographic Center.
- Tax year impacts are allocated to the following year.
- About 51,800 returns would benefit from the proposed credit in tax year 2020, of which 17,200 would be newly eligible. The average credit would be $421 compared to $246 under current law.

Combined Net Receipts Gradual Rates Reduction (*section 12)*
- The estimates are based on data from fiscal year 2019 gambling tax returns filed with the Department of Revenue and the May 2020 interim budget projections.
- A reduction in gambling activity is forecast for fiscal year 2021 and the following years are forecast to experience slower growth than previous forecasts.
- Over the four fiscal years, the bill will reduce gambling tax revenues, and amounts transferred for stadium purposes, by $20.6 million.
- The estimate assumes all charitable gambling organizations will be able to resume business by July 1, 2020.
- There are appropriations to the Commissioner of Human Services of one-half of one percent of tax revenues for a compulsive gambling treatment program and one-half of one percent of tax revenues for a grant to increase public awareness of problem gambling and support for effective treatment services. The total appropriations for problem gambling of 1% would be reduced by $206,000.
- There are about 1,100 charitable gambling organizations in Minnesota that pay the combined net receipts tax.

REVENUE ANALYSIS DETAIL (Cont.)

Extension for Filing and Payment *(section 16)*

- Final payments for individual income tax have already been delayed until July 15, 2020 by executive order.
- Corporate franchise tax returns are due on the 15th day of the 3rd month following the tax year. It is assumed that returns due on June 15th will be filed as scheduled under current law, resulting in no revenue shift between fiscal years.
- The payment of the estate tax is due no later than nine months after the death of the decedent. The bill would waive penalties and interest for estate tax return payments that are normally due before July 15, 2020 by extending the due date to July 15, 2020. It is assumed that one third of the estate tax returns due in June of 2020 would be affected by the extension of the filing deadline. It is assumed that 75% of those payments would shift to fiscal year 2021.

Waive Penalties and Interest (*section 18*)

- The Department of Revenue has existing authority to waive penalties and interest at its discretion. Based on current Department policy, the special penalty exception would have no additional impact on penalties or fees.

Minnesota Department of Revenue
Tax Research Division
https://www.revenue.state.mn.us/revenue-analyses

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