DEPARTMENT OF REVENUE

Governor's Supplemental Tax Bill

May 3, 2021

	Yes	No
DOR Administrative Costs/Savings	X	

State Taxes Only—See Separate Analysis For Property Tax Provisions

Department of Revenue
Analysis of H.F. 991 (Marquart) As Proposed to be Amended (A21-0148)

	Fund Impact			
	F.Y. 2022	**F.Y. 2023**	**F.Y. 2024**	**F.Y. 2025**
		(000's)		
Federal Update				
Further Consolidated Appropriations Act				
Individual Income Tax	($17,380)	$750	$450	$140
Corporate Franchise Tax	($4,740)	$660	$550	$550
Subtotal	($22,120)	$1,410	$1,000	$690
CARES Act				
Individual Income Tax	($25,700)	$5,800	$1,600	$800
Corporate Franchise Tax	($1,200)	$500	$200	$100
Subtotal	($26,900)	$6,300	$1,800	$900
Consolidated Appropriations Act				
Individual Income Tax	($56,905)	($10,065)	($10,155)	($11,155)
Corporate Franchise Tax	($19,000)	($3,640)	($2,670)	($2,380)
Subtotal	($75,905)	($13,705)	($12,825)	($13,535)
PPP Loan Exclusion up to $350,000				
Individual Income Tax	($116,200)	($11,100)	($8,800)	($6,000)
Corporate Franchise Tax	($104,200)	($9,100)	($6,900)	($5,300)
Subtotal	($220,400)	($20,200)	($15,700)	($11,300)
Individual Income Tax				
Angel Investment Credit	$0	($7,000)	$0	$0
Definition of Casualty Losses	($1,000)	($1,000)	($1,000)	($1,000)
GILTI Addition	$2,200	$1,700	$1,700	$1,700
Capital Gains Tax Surcharge	$294,100	$249,000	$215,600	$208,100
Expand 5.35% Bracket; Lower 3rd Bracket	($59,200)	($36,300)	($46,800)	($48,700)
Create 5th Bracket at 10.85%	$233,900	$200,400	$184,800	$183,600
Interaction with GILTI	$70	$160	$160	$160
Interaction with Casualty Losses	($10)	($10)	($10)	($10)
Interaction with Federal Update	($5,600)	($700)	($700)	($600)
Working Family Credit: Taxpayers with ITINs	($9,800)	($9,800)	($9,900)	($9,900)
Working Family Credit Expansion	($124,000)	($126,700)	($129,100)	($131,800)
WFC for 19 and 20 Year Olds	($4,300)	($4,400)	($4,500)	($4,500)
WFC Using 2019 Income	($10,000)	$0	$0	$0
Interaction: WFC Provisions	($6,200)	($6,200)	($6,300)	($6,300)
Unemployment Benefit Subtraction	($259,700)	$0	$0	$0
Section 179 Carryovers	($3,800)	$1,000	$1,000	$1,000
Subtotal	$46,660	$260,150	$204,950	$191,750

	Fund Impact			
	F.Y. 2022	F.Y. 2023	F.Y. 2024	F.Y. 2025
	(000's)			
Corporate Franchise Tax				
Definition of Resident Trust	$3,100	$3,100	$3,100	$3,100
Interaction with 5th Tier	300	$300	$300	$300
Section 965 Repatriation	$261,100	$23,300	$23,300	$23,300
GILTI Addition	$20,400	$16,000	$16,100	$16,400
Addition for Cooperatives	Unknown	Unknown	Unknown	Unknown
Increase Corporate Rate to 10.8%	$189,900	$140,400	$142,100	$147,200
Interaction with Section 965 Repatriation	$3,100	$2,400	$2,400	$2,400
Interaction with GILTI	$700	$1,600	$1,600	$1,700
Interaction with Federal Update	($4,170)	($1,130)	($860)	($680)
Section 179 Carryovers	($1,400)	$400	$400	$400
Subtotal*	$473,030	$186,370	$188,440	$194,120
Gross Premiums Tax				
Directly Purchased Nonadmitted Insurance	$0	$800	$800	$900
Cigarette and Vapor Taxes				
Tobacco Products Excise Tax				
Nicotine Solution Products	($2,900)	($7,300)	($7,700)	($8,100)
Electronic Vaping Devices	$400	$900	$1,000	$1,000
Gross Receipts Tax				
Nicotine Solution Products	$5,500	$13,700	$14,400	$15,100
Electronic Vaping Devices	$300	$800	$800	$900
Sales Tax				
Nicotine Solution Products	($460)	($1,200)	($1,200)	($1,300)
Electronic Vaping Devices	($80)	($180)	($190)	($200)
Subtotal	$2,760	$6,720	$7,110	$7,400
Sales and Use Tax				
Qualified Data Center Software	$12,300	$20,500	$30,000	$40,000
Fundraising Sales for School Organizations	($640)	($670)	($690)	($720)
Subtotal	$11,660	$19,830	$29,310	$39,280
Solid Waste Management Tax				
Weight-to-Volume Conversion	Unknown	Unknown	Unknown	Unknown
General Reserve Account Appropriation	($35,800)	($64,600)	($74,300)	($84,000)
General Fund	$35,800	$64,600	$74,300	$84,000
Appropriation to Department of Revenue	($4,349)	($1,860)	($1,860)	($1,860)
General Fund Total*	**$184,436**	**$445,815**	**$403,025**	**$408,345**

	Fund Impact			
	F.Y. 2022	**F.Y. 2023**	**F.Y. 2024**	**F.Y. 2025**
	(000's)			
Natural Resources and Arts Funds				
Nicotine Solution Products	($30)	($70)	($70)	($70)
Electronic Vaping Devices	(negl.)	($10)	($10)	($10)
Qualified Data Center Software	$700	$1,200	$1,700	$2,300
Fundraising Sales for School Organizations	($40)	($40)	($40)	($40)
Natural Resources and Arts Funds Total	**$630**	**$1,080**	**$1,580**	**$2,180**
Environmental Fund				
Weight-to-Volume Conversion	Unknown	Unknown	Unknown	Unknown
Total* – All Funds	**$185,066**	**$446,895**	**$404,605**	**$410,525**

*Totals do not include the impacts of the addition for cooperatives or the weight-to-volume conversion rates, which are unknown.

EXPLANATION AND ANALYSIS OF THE BILL

Individual Income and Corporate Franchise Taxes – Article 1

Angel Credit (Article 1, Sections 1, 2)
Effective for tax year 2022 only.

A refundable credit is allowed to investors for qualifying investments in a small business. The credit is equal to 25% of the qualifying investment. The maximum credit is $250,000 for a married joint return and $125,000 for all other filers. In 2019, the credits was extended for tax years 2019 and 2021 only, with a limit of $10 million each year.

The bill extends the credit for tax year 2022, with a maximum of $7 million.

- It is assumed that the maximum of $7 million in credits will be claimed in tax year 2022.
- Tax year impacts were allocated to the following fiscal year.

Casualty Losses (Article 1, Section 5)
Effective beginning with tax year 2019.

Casualty and Theft Losses. Under federal law, an itemized deduction is allowed for unreimbursed casualty and theft losses, including losses caused by theft, vandalism, storms, or other accidents. The deduction is allowed to the extent that each loss exceeds $100 and the total of all losses exceeds 10% of adjusted gross income. Losses are only deductible if they are uncompensated by insurance or otherwise.

The Tax Cuts and Jobs Act suspended the deduction for tax years 2018 through 2025, with certain exceptions.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

In 2019, Minnesota created an itemized deduction for casualty and theft losses. The deduction is based on the definition of losses eligible for the federal deduction, disregarding the temporary suspension. The bill clarifies that only unreimbursed expenses qualify for the subtraction, and also clarifies references to the Internal Revenue Code to include all losses that were temporarily suspended under the TCJA.

Ponzi Losses. Federal law allows an itemized deduction for losses from transactions entered into for profit that are not connected with a trade or business, including losses that are a result of Ponzi schemes or other fraudulent/criminal activity.

Minnesota's itemized deduction for casualty and theft losses does not specifically include these losses. The bill amends the statute to make these losses eligible for the Minnesota itemized deduction.

- The revised deduction for casualty and theft losses will have no revenue impact. The language clarifies the definition of losses to match the prior federal deduction and is consistent with the way the subtraction is currently being administered.
- Expanding the deduction to include Ponzi losses will have a revenue impact. The estimate is based on Ponzi losses reported on Form 4684 for Minnesotan electronic filers over the years 2012-2018.
- Over that time period, total deductions for Ponzi losses averaged about $12.6 million per year.
- The estimate was increased by 10% to account for paper filers.
- A marginal rate of 7% is assumed.
- No growth is assumed since losses are unpredictable from year to year, although in some years the revenue impact could be significantly higher or lower than the amounts shown.

Capital Gains Tax (Article 1, Sections 3, 14, 24)
Effective beginning with tax year 2021.

The bill creates an additional tax (or surcharge) on net capital gains and dividend income of individuals, estates, and trusts over $500,000. Income that is subject to this tax includes net long-term capital gains and qualified dividend income. The tax rate is 1.5% on income over $500,000 up to $1 million and 4% on income over $1 million.

For nonresidents and part-year residents, the tax would be apportioned to Minnesota based on the percentage of the taxpayer's preferential income that is allocable to Minnesota. The capital gains tax is excluded from the calculation of the alternative minimum tax.

- The House Income Tax Simulation Model (HITS 7.0) was used to estimate the revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the budget forecast published in February 2021. The model uses a stratified random sample of tax year 2018 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year impacts were allocated to fiscal years using a standard formula.
- For tax year 2021, an estimated 7,400 returns would have an average increase in tax of $31,850 per return.
- Since capital gains and dividends can vary considerably from year to year, the tax could be volatile.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Expand 5.35% Bracket; Lower 3rd Bracket (Article 1, Sections 16 & 18)
Effective beginning with tax year 2021.

The bill expands the 5.35% bracket and lowers the threshold for the 7.85% bracket, as shown in the following table.

Income Tax Brackets: Tax Year 2021

	2nd Bracket Threshold		3rd Bracket Threshold	
	Current	Proposed	Current	Proposed
Single	$27,230	$29,270	$89,440	$86,620
Married Joint	$39,810	$42,800	$158,140	$154,010
Married Separate	$19,905	$21,400	$79,070	$77,005
Head of Household	$33,520	$36,030	$134,700	$131,230

Returns with their last dollar of taxable income in the 2nd bracket will have a tax decrease, with more income taxed at 5.35% rather than 6.8%. Returns with some income in the 3rd bracket or higher will have no change in tax, other than minor changes in the alternative minimum tax or marriage credit. The brackets are set so that the tax reduction from expanding the 5.35% bracket is offset by the reduction in the third bracket threshold.

Beginning in tax year 2022, the thresholds would be adjusted for inflation in the same manner as existing brackets. The tax year impact is as follows:

Tax Year Impact
($000s)

TY 2021	($42,600)
TY 2022	($44,400)
TY 2023	($46,500)
TY 2024	($48,300)
TY 2025	($50,100)

- The House Income Tax Simulation Model (HITS 7.0) was used to estimate the revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the budget forecast published in February 2021. The model uses a stratified random sample of tax year 2018 individual income tax returns compiled by the Minnesota Department of Revenue.
- All of tax year 2021 was allocated to fiscal year 2022. In allocating other tax years to fiscal years, a standard formula was applied.
- For tax year 2021 an estimated 1,194,550 returns would have an average decrease in tax of $36 per return.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Fifth Tier 10.85% Rate (Article 1, Sections 17 & 18)
Effective beginning with tax year 2021.

The bill adds a new top bracket at a rate of 10.85% starting in tax year 2021. The 10.85% bracket is set at $1,000,000 for married joint filers, $500,000 for married separate and single filers, and $750,000 for head of household filers. Beginning in tax year 2022, the thresholds would be adjusted for inflation in the same manner as existing brackets. The tax year impact is as follows:

Tax Year Impact ($000s)	
TY 2021	$185,900
TY 2022	$190,000
TY 2023	$185,500
TY 2024	$182,500
TY 2025	$185,900

- The House Income Tax Simulation Model (HITS 7.0) was used to estimate the revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the budget forecast published in February 2021. The model uses a stratified random sample of tax year 2018 individual income tax returns compiled by the Minnesota Department of Revenue.
- All of tax year 2021 was allocated to fiscal year 2022. In allocating other tax years to fiscal years, a standard formula was applied.
- For tax year 2021 an estimated 21,880 returns would have an average increase in tax of $8,493 per return.

WFC for Taxpayers with ITINs (Article 1, Sections 20 & 21)
Assumed effective beginning tax year 2021.

Under current law, a taxpayer generally must be eligible for the federal earned income credit to receive the working family credit. Taxpayers filing an income tax return with an Individual Taxpayer Identification Number (ITIN) are not eligible for the federal credit, and therefore cannot receive the working family credit. Similarly, a qualifying child with an ITIN cannot be counted for purposes of the working family credit. The bill expands the working family credit to include taxpayers who file using an ITIN, and amends the definition of qualifying child to allow the use of an ITIN if all other requirements are met. ITINs are issued by the Internal Revenue Service to individuals who are not eligible for a social security number but are required to file taxes. They are used exclusively for the purpose of filing taxes. Examples of individuals who require an ITIN include non-resident alien individuals who are required to file with their resident spouse or international students who have not received permission to work outside of their educational department.

- Minnesota state income tax information from 2018 was used in this estimate.
- In 2018, there were 22,600 returns filed using an ITIN for the taxpayer and/or the spouse. Of those, approximately 10,800 returns would qualify for the working family credit.
- The average credit for tax year 2018 would have been about $885 per return.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- The number of taxpayers with an ITIN has declined slightly each year since 2015, while the average credit per return is expected to grow slightly. An annual growth rate of 0.6% is assumed.
- Tax year impacts were allocated to the following fiscal year.

Working Family Credit Expansion (Article 1, Sections 19 & 22)
Effective beginning with tax year 2021.

The bill would expand the working family credit as shown in the table below.

Tax Year 2021 Working Family Credit Amounts and Rates

	Eligible Earned Income	Credit Rate	Phase-out Begins*	Phase-out Rate
No children				
Current law	$7,340	3.9%	$8,960	2.0%
Proposal	$9,000	8.0%	$19,000	7.0%
One child				
Current law	$12,270	9.35%	$23,380	6.0%
Proposal	$12,730	11.0%	$23,820	7.0%
Two children				
Current law	$20,120	11.0%	$27,720	10.5%
Proposal	$20,120	13.0%	$28,000	11.0%
Three or more children				
Current law	$20,530	12.5%	$28,030	10.5%
Proposal	$20,530	15.0%	$28,030	12.0%

*Phase-out threshold is $6,000 higher for married taxpayers filing a joint tax return.

All dollar amounts are adjusted for inflation starting in tax year 2022.

- The House Income Tax Simulation (HITS 7.0) Model was used to estimate the tax year revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the forecast published in February 2021. The model uses a stratified sample of 2018 individual income tax returns compiled by the Minnesota Department of Revenue.
- The impacts shown are the additional impacts assuming the enactment of the credit expansion in H.F. 991.
- Tax year impacts are allocated to the following fiscal year.
- About 345,000 tax returns would be affected in tax year 2021. The average increased credit would be about $209. The number of returns eligible for the credit would increase by 29,700.

WFC Age Expansion for 19 and 20 year olds (Article 1, Section 19)
Effective beginning with tax year 2021.

Under current law, taxpayers without children are eligible for the working family credit if they are at least 21 years old and are younger than 65 years old.

The bill would lower the minimum age for taxpayers without children from 21 to 19.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- The House Income Tax Simulation (HITS 7.0) Model was used to estimate the tax year revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the forecast published in February 2021. The model uses a stratified sample of 2018 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year impacts are allocated to the following fiscal year.
- The number of returns eligible for the credit would increase by 26,200. The average reduction in tax would be about $165.

Working Family Credit using Prior Year's Income (Article 1, Section 32)
Effective for tax year 2020 only.

The Minnesota working family credit is a refundable credit against the individual income tax. To qualify, the taxpayer (or spouse) must have income from wages or self-employment, and total earned income (or adjusted gross income, whichever is larger) cannot exceed a maximum amount.

For tax year 2020 only, the bill would allow a taxpayer to calculate the credit using the previous year's income. This is similar to a provision in federal law allowing taxpayers to use their 2019 income to claim the earned income credit.

- The estimate is based on a sample of 2018 income tax returns.
- The credit was calculated based on expected declines in income in 2020 and compared to the credit using unadjusted incomes.
- It is assumed that taxpayers would only choose to use their 2019 income if doing so would increase their credit.
- The tax year impact 2020 is allocated to fiscal year 2022.

Unemployment Insurance Subtraction up to $10,200 (Article 1, Section 9)
Effective for tax year 2020 only.

The bill creates a temporary subtraction for taxable unemployment insurance compensation. For tax year 2020 only, a taxpayer is allowed a subtraction equal to the taxpayer's regular and supplemental unemployment compensation up to $10,200. This will include supplemental unemployment payments to traditional workers, self employed individuals, and those that received emergency assistance under the lost wage program.

- About 821,300 individuals received $9.68 billion in unemployment insurance payments in 2020, according to information provided by the Department of Employment and Economic Development.
- It was assumed that about 65% of unemployment insurance claims would result in taxable income on individual returns.
- Subtractions are expected to total $3.995 billion with the $10,200 limit, based on unemployment insurance reported on 2018 returns, adjusted to reflect payments in 2020.
- A marginal rate of 6.5% was assumed.
- The tax year 2020 impact was allocated to fiscal year 2022.
- About 533,900 returns will have an average reduction in tax of $486 in tax year 2020.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Section 179 Carryovers (Article 1, Section 31)
Effective for Federal Section 179 carryovers beginning in tax year 2020.

Prior to tax year 2020, Minnesota law required a taxpayer to 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 could be subtracted in equal parts over the next five years.

Minnesota conformed to the federal treatment of Section 179 property beginning with property placed in service in 2020, eliminating the need for the additions and subtractions. However, full conformity does not apply to carryovers from a previous year if the property was placed in service before tax year 2020. For example, Section 179 expenses for property placed in service in 2019 may be carried over to tax year 2020 if the taxpayer is unable to claim the full deduction in 2019. In that case, the expenses would still be subject to the addition and subtractions on the Minnesota return, since the property was placed in service in 2019.

The bill would extend full conformity for Section 179 expensing to include carryovers beginning in tax year 2020, regardless of when the property was placed in service.

- Based on information from the Internal Revenue Service Statistics of Income, carryovers accounted for about 6.9% of total Section 179 expenses on individual income tax returns in 2018.
- On Minnesota returns, full-year residents claimed about $1.08 billion in Section 179 expensing in 2018. Carryovers are estimated at 6.9% of that amount, or $74.5 million.
- Assuming a growth rate of 3%, carryovers in 2020 are estimated at $79.0 million.
- A marginal rate of 7.75% is assumed.
- The estimate was increased by 5% to account for nonresidents.
- The corporate franchise tax impact is estimated at 38% of the individual income tax impact, based on the ratio of Section 179 expenses reported on individual and corporate returns.
- Retroactive impacts were allocated to fiscal year 2022. All other tax years were allocated 30% / 70% to fiscal years.

Definition of Resident Trust (Article 1, Sections 4 & 33)
Effective beginning in tax year 2021.

This bill is a response to the Minnesota Supreme Court's ruling in *Fielding v. Commissioner of Revenue,* ("*Fielding*") and the U.S. Supreme Court's decision in *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust,* ("*Kaestner*"). The bill updates the factors to be considered when determining whether a trust has sufficient minimum connections with Minnesota to be taxed as a resident trust.

Under current Minnesota law, the definition of a resident trust differs depending on the date—before or after December 31, 1995—the trust becomes irrevocable or is first administered in Minnesota.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

The U.S. Supreme Court addressed the Due Process Clause requirements for a state's ability to tax a trust in *Kaestner*. In that case, the Court applied a two-step analysis to determine whether a state tax abides by the Due Process Clause. The first test requires a minimum connection between a state and the person, property or transaction it seeks to tax. The second test requires the income attributed to the state for tax purposes to be rationally related to the taxing state. The Minnesota Supreme Court applied the same two-step analysis in *Fielding*.

The trusts at issue in *Fielding* and *Kaestner* were both *inter vivos* (i.e., during the life of the grantor) trusts. In each case, the Court held that the trust – which met the state's statutory definition of a "resident trust" – did not have sufficient minimum connections with the state to be taxed as a resident trust for purposes of due process. In both cases, the Court noted that its holding was limited to the facts presented in the case. Specifically, the holding in *Fielding* only applies to (1) irrevocable *inter vivos* trusts; and (2) that have the same "connections" to Minnesota that were at issue in *Fielding*.

As a result of the *Fielding* and *Kaestner* decisions, there is a lack of clarity in the constitutional application of the current Minnesota resident trust statute. For that reason, the bill changes the definition of resident trust to conform to the "minimum connections" standard set out in both decisions. The bill identifies relevant connections between Minnesota and the trust that are to be considered when determining whether the trust qualifies as a resident trust.

- The bill could change the amount of tax paid by trusts that were classified as resident trusts before the Supreme Court decision but as nonresident trusts after the decision.
- Only intangible income is affected by the bill, since it is assigned 100% to the trust's state of residence. Other income is apportioned to Minnesota, for resident and nonresident trusts.
- The estimate assumes that about 11.5% of total intangible income is earned by trusts that have been classified as nonresidents since the Supreme Court decision but would be reclassified as resident trusts under the bill.
- The revenue gains would begin with tax year 2021. The tax year revenue gains are reflected in the collections for following fiscal year.

Section 965 Repatriation and GILTI (Article 1, Sec. 6, 8, 10, 11, 13, 25-26, 33)
Effective retroactively to tax year 2016.

Prior to the federal law change in the Tax Cuts and Jobs Act (TCJA), the income earned by foreign chartered corporations owned by domestic corporations could be deferred from taxation. Under federal law, these corporations are called controlled foreign corporations (CFCs). The past or current year income earned by CFCs could be taxed if any of its income was received by the domestic corporation that owned it. The term used to describe the transfer of income from a CFC subsidiary to its domestic parent corporation is repatriation.

Under the TCJA, the deferral of income earned by CFCs since 1986 is deemed to be repatriated and taxable under Internal Revenue Code Section 965, regardless whether it is actually repatriated (transferred) to the United States. The TCJA also imposes a tax on certain foreign income designated as global intangible low-taxed income (GILTI) under IRC Section 951A. This income is taxed regardless of whether it is repatriated to the United States.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

The response to the federal law by the 2019 legislature was to exempt from taxation any Section 965 repatriation income or GILTI reported on the federal return.

The bill creates an addition for any income of a C corporation, resident, or part-year resident that is transferred to the United States but is excluded from federal income because it was previously taxed by the federal government as Section 965 repatriated income or GILTI. Any amount reported as an addition would be eligible for the dividends received deduction.

Section 965 Repatriation
- The revenue estimate is based on estimates of dividends and withdrawals by the U.S. Bureau of Economic Analysis (BEA) published in September 2020. Of this BEA data, about 80% is assumed to be Section 965 repatriated income. The BEA estimates show a spike of repatriated income in calendar years 2018 and 2019 equaling about $1.3 trillion, and preliminary data indicates a higher than normal flow of repatriated income in 2020. Projections for calendar years 2020 through 2025 assume about an additional $1 trillion of repatriated income.
- The pool of potentially repatriated income will flow to United States as repatriated income until the pool is depleted. It is assumed that the level of repatriated income will stabilize at levels slightly higher than historic norms beginning in 2021.
- Due to the retroactive effective date, all of the revenue gain associated with tax years 2017 through 2021 is allocated to FY 2022. The fiscal year 2021 estimate includes about $254 million in revenue associated with tax years 2018 through 2021.
- All other tax years are allocated 30%/70% to fiscal years.

GILTI
- The estimate is based on the estimates of the federal legislation prepared by the staff of the Joint Committee on Taxation, dated December 18, 2017, and estimates of dividends and withdrawals from the Bureau of Economic Analysis.
- These estimates were adjusted to reflect the assumed amount of GILTI income that would be repatriated and were adjusted to reflect the effect of the dividends received deduction. Due to the large amount of income associated with actual repatriations connected to Section 965 during tax years 2018 and 2019, the amount of repatriated income tied to GILTI is assumed to be 7.75% and 17.5% in fiscal years 2020 and 2021.
- In fiscal year 2023 the percentage of total GILTI repatriated is assumed to plateau at 29% of total GILTI income.
- Due to the retroactive effective date, the revenue gain associated with fiscal year 2020 and 2021 is allocated to FY 2022. This gain is about $11.7 million of the FY 2022 total of $22.6 million.

Addition for Cooperatives (Article 1, Sections 7, 12, 23, 28)
Effective beginning with tax year 2021.

Public Law 115-97, known as the Tax Cuts and Jobs Act (TCJA), created a deduction for qualified business income (QBI), including qualified dividends received from an agricultural or horticultural cooperative. As a result, farmers had a tax incentive to sell their crops to a cooperative rather than a private company, to qualify for the QBI deduction. This provision was informally known as the "grain glitch."

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

The Consolidated Appropriations Act of 2018 (Public Law 115-141), enacted March 23, 2018, fixed the grain glitch, but allowed specified cooperatives a deduction generally equal to 9% of qualified domestic activities income. This deduction was in place of the domestic production activities deduction, which was repealed by the TCJA.

Minnesota had never conformed to the domestic production activities deduction, so its repeal had no effect on Minnesota tax liability. However, when Minnesota conformed to the TCJA and the Consolidated Appropriations Act, it allowed the domestic production activities deduction for cooperatives under Section 199A. This was a new deduction beyond what had been allowed before the TCJA, giving an additional tax benefit for specified cooperatives.

The bill would create an addition to income for cooperatives that claim a federal deduction under Section 199A. The effect of the bill is to restore the definition of taxable income for cooperatives to what it was prior to the TCJA.

- The fiscal impact of the addition is unknown.
- About 340 cooperatives filed returns in tax year 2018 with total taxable income of about $30 million. Over the past three years, total federal taxable income of cooperatives has averaged about $106 million per year. The amount of Section 199A deductions by cooperatives is unknown.
- The bill would increase the taxable income of cooperatives, raising revenue by an unknown amount beginning in fiscal year 2022.

Increase Corporate Rate to 10.8% (Article 1, Section 15)
Effective beginning tax year 2021.

Under current law the corporate franchise tax rate is 9.8%. The bill would increase the corporate franchise tax rate to 10.8%. The minimum fee would remain unchanged.

- Estimates are based on the February 2021 forecast.
- Due to the retroactive effective date, all of the tax year 2021 revenue gain is allocated to fiscal year 2022. All other tax year impacts were allocated 30% / 70% to fiscal years.

<u>Federal Update – Article 2</u>

The bill updates reference to the Internal Revenue Code as amended through December 31, 2020, thereby adopting the federal law changes in the following Acts, with certain exceptions:
- The Further Consolidated Appropriations Act, 2020 (FCAA 2020) (Public Law 116-94), enacted on December 20, 2019.
- The Families First Coronavirus Response Act (FFCRA) (Public Law 116-127), enacted on March 18, 2020.
- The Coronavirus Aid, Relief, and Economic Security (CARES) Act (Public Law 116-136), enacted on March 27, 2020.
- The Consolidated Appropriations Act, 2021 (CAA 2021) (Public Law 116-260), enacted on December 27, 2020.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Paycheck Protection Program (Article 2, Sections 4 & 16)
The Paycheck Protection Program (PPP) provides low-interest loans to small businesses with less than 500 employees to assist with payroll, mortgage interest, rent, and utilities. The loans are to be spent over an 8-week to 24-week period for qualified business expenses. The total loan covers up to 2.25 times the business's average monthly costs up to $10 million. After the covered period, business 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. The CAA 2021 clarified that expenses paid with forgiven loans may be deducted from income.

The bill would partially conform to federal law by excluding the amount of the loan that is forgiven from gross income up to $350,000.

Shuttered Venue Grants (Article 2, Sections 5 & 17)
The CAA appropriated $15 billion for grants to live theater and performing arts organizations that suffered reductions in revenue due to COVID-related closures. The grants are not included in income, and expenses paid with the grants are deductible.

The bill would partially conform to federal law by excluding the amount of the grant from gross income up to $350,000.

Deduction for business meals (Article 2, Sections 6 & 18)
The Tax Cuts and Jobs Act limited the deduction for business meals to 50% of expenses. The CAA 2021 allows a deduction for the full amount of expenses for food and beverages provided by a restaurant in 2021 and 2022.

The bill does not adopt the expanded federal deduction for business meal expenses. Any deduction over 50% of expenses must be added back to Minnesota taxable income.

Net operating losses for pass-through entities (Article 2, Sections 7,8, 10, 11, 24, 25)
The CARES Act modified the treatment of net operating losses (NOLs) for pass-through businesses in three ways, for losses generated in 2018, 2019, and 2020: 1) it waives the 80% limitation on NOL deductions, 2) it removes the limit on excess business losses over $250,000, and 3) it allows NOLs to be carried back for up to five years.

The bill does not adopt the revisions to the treatment of NOLs. Excess losses deducted federally must be added back on the Minnesota return and may be subtracted in later years as under current law.

Modify limit on business interest (Article 2, Sections 9, 12, 19, 20)
The CARES Act increased the amount of interest expenses businesses are allowed to deduct on their tax returns, by increasing the limitation from 30% to 50% of taxable income (with adjustments) for tax years 2019 and 2020.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

The bill maintains the 30% limitation, requiring an addition for interest deductions above that amount. Beginning in tax year 2020, a taxpayer may claim a subtraction for any excess interest added back in previous years, subject to the 30% limitation in each year. There is no limit on the number of years the delayed interest can be carried forward.

Employee retention credit (Article 2, Sections 13 & 21)
The CARES Act created a refundable payroll tax credit. Qualifying employers can claim a tax credit of up to $5,000 per employee. Under federal law, the credit is not included in gross income and any expenses paid with the credit are not deductible. The bill allows a subtraction for any expenses paid with the credit to the extent not allowed under federal law. The subtraction holds employers harmless, resulting in no change in taxable income relative to current law.

Paid Sick Leave and Family Leave Credits (Article 2, Sections 14, 15, 22, 23)
The Families First Coronavirus Response Act created tax credits for employers who provide paid sick leave and paid family and medical leave, and similar tax credits for self-employed individuals who would qualify for paid leave if they were employees. The federal credits are equal to 100% of the eligible expenses for providing leave, with certain limits. Federal law requires the credits to be included in gross income. The bill allows a subtraction for the amount of the federal credits, holding employers harmless.

<u>Vapor and Tobacco Taxes – Article 3</u>

Vapor Products (Article 2, Sections 1-6, 8-16)
Effective January 1, 2022.

The bill would impose a gross receipts tax of 35% on the retail sale of all nicotine solution products, in addition to the current excise and sales taxes. The nicotine solution products definition would be expanded to include electronic devices meant to be used in the consumption of a nicotine solution regardless of whether sold with the solution containing nicotine. Electronic vaping devices would be subject to the tobacco products excise tax as well as the gross receipts tax. The bill would also require out-of-state retailers to collect and remit the gross receipts tax on all products subject to tobacco tax, including nicotine solution products and devices sold into Minnesota.

A heating device used to heat a cigarette to produce a vapor or aerosol rather than burn the tobacco is defined and added to the definition of tobacco products. Heat devices would be subject to the tobacco products excise tax and the gross receipts tax.

- It is estimated that excise tax collections for vapor products were $19.1 million for fiscal year 2020.
- An elasticity factor of -0.9 was applied and an annual growth rate of 3% is assumed.
- It is estimated that 20% of vapor products are sold online.
- It is estimated that electronic vaping devices comprise 15% of the vapor market.
- The estimates assume remote sellers of vapor products are remitting sales tax due on their sales into Minnesota.
- Heat-not-burn cigarettes are available in the United States but are not in Minnesota. The products are subject to the PACT Act and cannot be sold online or shipped through the mail. It is assumed that heat-not-burn cigarettes will not be available in Minnesota during the forecast period.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

The bill reverses the unintended effect of the accounting change on the sales tax exemption for fundraising sales. The sales tax exemption would again apply to educational or social nonprofit organizations for people age 18 and under, regardless of the accounting with the school district treasurer. The proposed exemption would require that: 1) the fundraising sales are for elementary and secondary school student activities, 2) separate accounting records are maintained by the school group, and 3) the school district reserves and spends revenues raised by a particular extracurricular activity only for that activity.

- Other sales tax exemptions apply to certain fundraising sales including candy, food, clothing, and coupon books, which limited the impact of the legislative change.
- The 2018 Minnesota Tax Expenditure Budget reported a tax expenditure estimate for fundraising sales by nonprofits of $13 million for fiscal year 2022. Based on information from Minnesota Department of Education, it is estimated that 5% of the tax expenditure would be exempt under the bill.

<u>**Miscellaneous – Article 7**</u>

Weight-to-Volume Conversion (Article 7, Sections 2 & 3)
Effective after June 30, 2021.

The solid waste management tax is imposed on charges for the collection and disposal of solid waste. For mixed municipal solid waste, the tax is 9.75% for service provided to residential customers and 17% for commercial customers. The tax is 60¢ per non-compacted cubic yard for non-mixed municipal solid waste (construction debris, industrial waste, and infectious and pathological waste). For self-haulers, the statute provides a weight-to-volume conversion for construction debris of one ton equal to 3.33 cubic yards, or a tax rate of $2 per ton.

The bill provides for a tax on construction debris for self-haulers of 60¢ per cubic yard. The bill would have the Department consult with the Pollution Control Agency to determine a weight-to-volume conversion amount.

- The estimates depend on when and whether the tax rate is adjusted.

Directly Procured Nonadmitted Insurance (Article 7, Section 4)
Effective beginning in tax year 2022.

Nonadmitted insurance may be purchased through a surplus lines agent, or it may be purchased directly by the insured. Nonadmitted insurance typically covers unusual risks that are not covered by insurers that are licensed by state insurance departments. Nonadmitted insurance may be labeled as excess, surplus lines, E & S, or captive.

Under current law, the purchase of surplus lines insurance through a surplus lines agent is subject to a 3% gross premium tax. However, the direct purchase of nonadmitted insurance by the insured is subject to a 2% gross premium tax.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

The bill would subject the direct purchase of nonadmitted insurance to a 3% gross premium tax rate. The tax rate would be the same as nonadmitted insurance purchased through a surplus lines agent.

- In 2019, the premiums for directly purchased nonadmitted insurance totaled $67.6 million.
- With a 2% tax rate, the tax on these premiums was $1.35 million.
- The estimate was calculated by applying a 3% tax rate to the 2019 nonadmitted direct purchased tax collections.
- The estimates are adjusted by the growth of insurance gross premium revenue as projected in the February 2021 forecast.
- Because payment of tax is due on March 1 after the end of the calendar year, the bill would change collections beginning in fiscal year 2023.

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

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Federal Update: Governor's Supplemental Tax Bill
Further Consolidated Appropriations Act, 2020
($000s)

	FY 2022	FY 2023	FY 2024	FY 2025
Individual Provisions				
Exclusion of discharge of indebtedness on qualified principal residence (TY18-20)	($6,700)	$0	$0	$0
Expansion of Section 529 plans (beginning TY19)	($400)	($150)	($160)	($160)
Extension of above-line deduction for qualified tuition and related expenses (TY18-20)	($5,300)	$0	$0	$0
Benefits for volunteer firefighters and emergency medical responders (TY20)	($300)	$0	$0	$0
Subtotal: Individual Provisions	**($12,700)**	**($150)**	**($160)**	**($160)**
Business and Investment Provisions				
Seven-year recovery period for motorsports entertainment complexes (TY18-20)				
Corporate Franchise Tax	($320)	($60)	($40)	($20)
Accelerated depreciation for business property on Indian reservations (TY18-20)				
Individual Income Tax	($260)	($10)	($10)	($10)
Corporate Franchise Tax	($200)	($10)	($10)	($10)
Special expensing rules for certain film, television, and live theatrical productions (TY18-20)				
Individual Income Tax	($2,200)	$500	$400	$300
Corporate Franchise Tax	($1,800)	$400	$300	$300
Special depreciation allowances for 2nd generation biofuel plant property (TY18-20)				
Corporate Franchise Tax	(Negl.)	(Negl.)	(Negl.)	(Negl.)
Energy-efficient commercial building deduction (TY 18-20)				
Individual Income Tax	($690)	$10	$10	$10
Corporate Franchise Tax	($1,090)	$60	$40	$30
Special rule for the production period for beer, wine, and distilled spirits (TY20 only)				
Individual Income Tax	($50)	$10	$10	$0
Corporate Franchise Tax	($80)	$20	$10	$0

	FY 2022	FY 2023	FY 2024	FY 2025
Special rule for sales or dispositions of transmission lines for qualified electric utlities (TY18-20)				
Corporate Franchise Tax	($1,250)	$250	$250	$250
Business and Investment Provisions				
Individual Income Tax	**($3,200)**	**$510**	**$410**	**$300**
Corporate Franchise Tax	**($4,740)**	**$660**	**$550**	**$550**
Subtotal	**($7,940)**	**$1,170**	**$960**	**$850**
Disaster Relief Provisions				
Special disaster-related rules for use of retirement funds (1/1/18-2/18/20)	($80)	$90	$0	$0
Special rules for qualified disaster-related personal casualty losses (1/1/18-2/18/20)	($600)	$0	$0	$0
Temporary increase in limitation on qualified contributions (1/1/18-2/18/20)	($800)	$300	$200	$0
Disaster Relief Provisions Subtotal	**($1,480)**	**$390**	**$200**	**$0**
FCAA 2020: All Provisions				
Individual Income Tax	**($17,380)**	**$750**	**$450**	**$140**
Corporate Franchise Tax	**($4,740)**	**$660**	**$550**	**$550**
General Fund Total	**($22,120)**	**$1,410**	**$1,000**	**$690**

Federal Update: Governor's Supplemental Tax Bill
Coronavirus Aid, Relief, and Economic Security Act
($000s)

	FY 2022	FY 2023	FY 2024	FY 2025
Special rules for use of retirement funds (TY20 only)				
Individual Income Tax	($1,600)	$1,700	$0	$0
Above-the-line deduction for charitable contributions (TY20 only)				
Individual Income Tax	($8,400)	$0	$0	$0
Increase individual limitation on charitable contributions (TY20 only)				
Individual Income Tax	($10,400)	$4,000	$1,560	$790
Increase corporate limitation on charitable contributions (TY20 only)				
Corporate Franchise Tax	($1,000)	$400	$170	$100
Increase charitable deduction limit for food inventory (TY20 only)				
Individual Income Tax	($300)	$100	$40	$10
Corporate Franchise Tax	($200)	$100	$30	$0
Exclusion for certain employer payments of student loans (TY20 only)				
Individual Income Tax	($5,000)	$0	$0	$0
Inclusion of certain over-the-counter medical products as qualified medical expenses (beginning TY20)	(Negl.)	(Negl.)	(Negl.)	(Negl.)
Individual Income Tax				
CARES Act: All Provisions				
Individual Income Tax	**($25,700)**	**$5,800**	**$1,600**	**$800**
Corporate Franchise Tax	**($1,200)**	**$500**	**$200**	**$100**
General Fund Total	**($26,900)**	**$6,300**	**$1,800**	**$900**

Federal Update: Governor's Supplemental Tax Bill
Consolidated Appropriations Act, 2021
($000s)

	FY 2022	FY 2023	FY 2024	FY 2025
Individual Provisions				
Exclusion of discharge of indebtedness on qualified principal residence (TY21-TY25)	($1,300)	($1,500)	($1,600)	($1,600)
Benefits for volunteer firefighters and emergency medical responders (TY21)	($300)	($300)	($400)	($400)
Exclusion for certain employer payments of student loans (TY21-25)	($7,100)	($7,200)	($7,300)	($7,400)
Exclusion for certain financial aid grants made under the CARES Act (TY20)	($600)	$0	$0	$0
Partial above-the-line deduction for charitable contributions (TY21)	($14,600)	$0	$0	$0
Modification of limitation on charitable contributions (TY21)				
Individual Income Tax	($11,300)	$4,200	$2,700	$1,200
Expansion of educator expense deduction beginning (`2/27/20)	($25)	($15)	($15)	($15)
Temporary special rules for health and dependent care flexible spending arrangements (TY21)	$300	$0	$0	$0
Subtotal: Individual Provisions	**($34,925)**	**($4,815)**	**($6,615)**	**($8,215)**
Business and Investment Provisions				
Exclusion of EIDL loan advances and repayments (TY20-21)				
Individual Income Tax	($6,900)	($500)	($500)	($400)
Corporate Franchise Tax	($6,600)	($600)	($500)	($400)
SBA loan assistance (TY20-21)				
Individual Income Tax	($4,100)	($300)	($400)	($200)
Corporate Franchise Tax	($3,900)	($300)	($200)	($200)
Exclusion of shuttered venue grants (TY21)				
Individual Income Tax	($1,800)	($200)	($300)	($200)
Corporate Franchise Tax	($1,600)	($200)	($300)	($200)
Seven-year recovery period for motorsports entertainment complexes (TY21-25)				
Corporate Franchise Tax	($110)	($90)	($100)	($110)
Accelerated depreciation for business property on Indian reservations (TY21)				
Individual Income Tax	($50)	($30)	($10)	(Negl.)
Corporate Franchise Tax	($40)	($20)	($10)	$0

	FY 2022	FY 2023	FY 2024	FY 2025
Depreciation of certain residential rental property over 30 years (Retroactive to TY18)				
Individual Income Tax	($5,900)	($2,600)	($1,100)	($900)
Corporate Franchise Tax	($3,400)	($900)	($500)	($400)
Special expensing rules for certain film, television, and live theatrical productions (TY21-25)				
Individual Income Tax	($2,400)	($1,000)	($600)	($600)
Corporate Franchise Tax	($2,700)	($1,200)	($700)	($700)
Energy-efficient commercial building deduction (TY 21)				
Individual Income Tax	($230)	($190)	($200)	($200)
Corporate Franchise Tax	($370)	($310)	($320)	($320)
Special rule for the production period for beer, wine, and distilled spirits (beginning TY21)				
Individual Income Tax	($80)	($40)	($40)	($40)
Corporate Franchise Tax	($120)	($70)	($70)	($70)
Business and Investment Provisions				
Individual Income Tax	**($21,460)**	**($4,860)**	**($3,150)**	**($2,540)**
Corporate Franchise Tax	**($18,840)**	**($3,690)**	**($2,700)**	**($2,400)**
Subtotal	**($40,300)**	**($8,550)**	**($5,850)**	**($4,940)**
Disaster Relief Provisions				
Special disaster-related rules for use of retirement funds (TY21-22)	($20)	$10	$10	$0
Special rule for qualified disaster relief contributions (TY21-22)				
Corporate Franchise Tax	($160)	$50	$30	$20
Deduction for disaster-related casualty losses (beginning TY20)	($500)	($400)	($400)	($400)
Disaster Relief Provisions Subtotal	**($680)**	**($340)**	**($360)**	**($380)**
CAA 2021: All Provisions				
Individual Income Tax	**($56,905)**	**($10,065)**	**($10,155)**	**($11,155)**
Corporate Franchise Tax	**($19,000)**	**($3,640)**	**($2,670)**	**($2,380)**
General Fund Total	**($75,905)**	**($13,705)**	**($12,825)**	**($13,535)**