Preliminary Estimates
Revised to Correct Income Tax Totals

Federal Update: The Tax Cuts and Jobs Act of 2017
As Enacted

	FY 2018	FY 2019	FY 2020	FY 2021
		($000s)		
Individual Income Tax	$8,320	$395,480	$406,820	$492,320
Property Tax Refund	$0	$0	$84,410	$84,830
Corporate Franchise Tax	$26,980	$418,200	$217,400	$204,700
General Fund Total	$35,300	$813,680	$708,630	$781,850

NOTE: *This document is a preliminary estimate of the impact of adopting recent changes to the Internal Revenue Code with no corresponding Minnesota tax policy changes.*

Because changes to Minnesota tax rates and other tax policies are likely to be considered in response to the federal changes, this estimate should be considered a starting point for policy discussions rather than a policy proposal. Depending on the final combination of federal update and policies ultimately enacted by the legislature and Governor, there may be additional effects on Minnesota tax liability and Minnesota withholding amounts that are not reflected in this estimate. For example, withholding tax collections may change because of the modifications to the standard deduction and repeal of personal exemptions, but this estimate does not include any shift in withholding because the final impact depends on the timing of enactment and the full package of policy changes.

These estimates are preliminary and will be updated as we refine our models and understanding of the federal changes.

Public Law 115-97, commonly known as the Tax Cuts and Jobs Act (TCJA), was enacted on December 22, 2017. The law includes many items that affect the definition of federal taxable income, which is the starting point for determining Minnesota taxable income. This estimate shows the fiscal impact of updating reference to the Internal Revenue Code to December 22, 2017.

This estimate includes only provisions that change the definition of federal taxable income, such as the repeal of deductions or exclusions. Most of these provisions increase federal taxable income. Other features of the TCJA such as federal rate changes or credits were excluded because they do not affect the definition of income. Many of these excluded provisions reduce federal tax liability. The net effect is that federal update would mostly include items that expand the tax base, resulting in an increase in Minnesota tax revenue.

Most individual provisions are effective for tax years 2018 through 2025. Most business-related provisions are permanent beginning with tax year 2018. The attached table includes the effective date for each provision. The law includes the following major provisions:

Increase the standard deduction to $24,000 for married joint filers, $12,000 for single and married separate filers, and $18,000 for head of household filers beginning in tax year 2018. This will decrease federal taxable income for taxpayers currently claiming the standard deduction and will cause many current itemizers to switch to the standard deduction. Conforming to this provision would reduce tax revenue.

Adopt an alternative inflation measure. The standard deduction amounts, federal tax brackets, and other thresholds will be indexed using chained CPI-U beginning in tax year 2019. Because chained CPI is generally lower than the current inflation measure, the standard deduction amounts will grow more slowly than under current law, increasing taxable income over time. Conforming to this provision would increase tax revenue. This estimate assumes that traditional CPI-U would continue to be used for Minnesota income tax purposes.

Repeal personal and dependent exemptions. Previously a taxpayer could claim an exemption ($4,150 in 2018) for each person included on the return, including the taxpayer, spouse, and any dependents, reducing federal taxable income. The law repeals the exemptions and replaces them with an increased child credit and new credits for the taxpayer, spouse and non-child dependents. Conforming to the repeal of the exemptions increases taxable income. The credits are not included in this estimate because they have no impact on federal taxable income.

Repeal most itemized deductions. The law repeals or modifies the following deductions:

- Expand the medical expense deduction. Under current law, medical expenses may be deducted to the extent that they exceed 10% of adjusted gross income. The law lowers that threshold to 7.5% for tax years 2017 and 2018 only.
- Limit the sum of state and local tax deductions to $10,000 ($5,000 for married separate filers).
- Disallow the mortgage interest deduction for home equity debt and limit the deduction for new acquisition debt to $750,000. The limit for existing mortgage debt would remain at $1,000,000.
- Increase the limit on charitable contributions from 50% to 60% of FAGI.
- Repeal the deduction for casualty or theft losses, with exceptions for certain disaster-related losses.
- Repeal the deduction for unreimbursed employee expenses, tax preparation expenses, and other miscellaneous deductions.
- Repeal the overall limit on itemized deductions.

Most of these changes will increase federal taxable income, increasing Minnesota tax revenue. State income tax deductions are already added back to Minnesota taxable income, but the combined limit on state and local tax deductions will increase taxable income for some taxpayers. This estimate assumes that the state income tax deduction will continue to be added back to Minnesota taxable income, up to the maximum of $10,000 ($5,000 for married separate filers.) The increased limit on charitable contributions and the repeal of the limit on itemized deductions may reduce taxable income for some taxpayers. The additional medical expense deduction will also reduce taxable income.

Other deductions and exclusions.

- Repeal the deduction for moving expenses (other than for military service members).
- Repeal exclusion for qualified moving expenses reimbursed by an employer.

Deduction for certain pass-through income. The law allows a deduction for certain qualified business income from a partnership, S corporation, or sole proprietorship. For taxpayers with taxable income of not more than $157,500 ($315,000 for married joint filers), the deduction is equal to 20% of qualified business income.

For taxpayers over that threshold, the deduction is limited in two ways: 1) it is limited to 50% of the taxpayer's allocated share of employee wages paid by the pass-through entity plus 2.5% of the unadjusted basis of the tangible property owned by the business, and 2) the deduction is not allowed for income from a service trade or business, including health care, law, engineering, accounting, and financial services.

Taxpayers with income between $157,500 and $207,500 ($315,000 to $415,000 for married joint filers) are eligible for a partial deduction. Conforming to this provision would reduce taxable income.

Limit active pass-through losses. Under the law, a taxpayer may not claim active losses from a partnership, S corporation, or sole proprietorship of more than $250,000 ($500,000 for married joint filers.) Any excess losses over that amount may be carried over to following tax years. Conforming to this provision would increase taxable income.

Bonus depreciation and Section 179 expensing. Bonus depreciation would be increased to 100% and extended through tax year 2022. It is phased out by 20% each year beginning tax year 2023. The maximum amount of Section 179 expensing would be permanently increased from $500,000 to $1.0 million, and the phase–out threshold would be increased from $2.0 million to $2.5 million of property placed in service. The estimates for bonus depreciation and Section 179 expensing assume an addback of 80% in the first year and five-year recovery, as under current Minnesota law.

Deemed repatriation of certain deferred foreign income. The TCJA requires a U.S. shareholder in a foreign corporation to recognize its share of the corporation's accumulated deferred foreign income since 1986, whether or not the income is actually brought back to the U.S. The provision applies to cash and non-cash holdings. The included amount is eligible for certain deductions, effectively reducing the federal tax rate. The increased tax liability may be paid over eight years beginning in tax years ending in 2018.

There is a lack of legal certainty concerning the treatment of deferred foreign income for Minnesota purposes. However, for this estimate, it is assumed that it would be eligible for the Minnesota dividends received deduction and that Minnesota tax liability would be spread over eight years. Conforming to this provision would increase Minnesota tax revenue.

Inclusion of certain foreign intangible income. A domestic corporation is required to include in its gross income certain foreign derived intangible income (FDII) and global intangible low-taxed income (GILTI). The corporation may deduct a portion of the FDII or GILTI, with certain exceptions, lowering the effective tax rate. There is a lack of legal certainty concerning the eligibility of FDII and GILTI in the calculation of the Minnesota dividends received deduction. However, for the purposes of this estimate, it is assumed that FDII and GILTI will be eligible for the dividends received deduction in a manner similar to subpart F income.

- The House Income Tax Simulation Model (HITS 6.6) was used to estimate individual provisions where possible. These simulations assume the same economic conditions used by Minnesota Management and Budget for the forecast published in November 2017. The model uses a stratified sample of 2015 individual income tax returns compiled by the Minnesota Department of Revenue.

- For other provisions, the estimates are based on the estimates of the federal impacts prepared by the staff of the Joint Committee on Taxation, dated December 18, 2017. The estimates for each provision were apportioned to Minnesota based on information relevant to that provision. The estimates were adjusted for the difference between federal and state tax rates and federal and state fiscal years.
- The estimates were done in the order shown. For example, the repeal of most itemized deductions assumes conformity to the increased standard deduction and repeal of personal exemptions. If Minnesota conformed to some provisions but not others, the impact of each provision could change.
- This estimate assumes one month of impact in fiscal year 2018 due to changes in withholding and estimated payments. The fiscal year impacts could change depending on the final date of enactment.
- The property tax interaction estimates are based on the November 2017 forecast.
- The federal provisions increase the household income amount used to calculate PTR, which would reduce state-paid refunds to more than 500,000 homeowners and renters beginning in FY 2020.

Minnesota Department of Revenue
Tax Research Division
January 9, 2018

Federal Update Tax Cuts and Jobs Act_5 / dkd nrg cej tj mjr ct cw

Federal Update: The Tax Cuts and Jobs Act of 2017
As Enacted
($000s)

	FY 2018	FY 2019	FY 2020	FY 2021
Standard Deduction and Exemptions				
Increase standard deduction to $24,000 married joint, 12,000 single; 18,000 head of household; indexed by Chained CPI-U beginning TY 2019 (TY18-25)	($76,900)	($1,298,400)	($924,100)	($919,300)
Repeal personal and dependent exemptions (TY18-25)	$94,600	$1,615,500	$1,199,000	$1,238,900
Subtotal: Standard Deduction and Exemptions	**$17,700**	**$317,100**	**$274,900**	**$319,600**
Education-Related Provisions				
Allow exclusion of discharged student loan debt in case of death or disability (TY18-25)	(Negl.)	(Negl.)	(Negl.)	(Negl.)
Allow Section 529 plan withdrawals of up to $10,000 for K-12 tuition (TY18-25)	($100)	($700)	($800)	($900)
Subtotal: Education-Related Provisions	**($100)**	**($700)**	**($800)**	**($900)**
Federal Deductions				
Repeal or modify most itemized deductions; remove limitation (TY18-25)	$13,400	$207,800	$184,000	$202,900
Medical expense deduction: Reduce FAGI floor from 10% to 7.5% (TY17 & 18)	($13,800)	($3,300)	$0	$0
Repeal deduction for moving expenses (other than service members) (TY18-25)	$300	$4,700	$3,800	$4,000
Repeal deduction for alimony payments and corresponding inclusion of received alimony (for agreements beginning 2019)	$0	$500	$1,100	$2,300
Clarify limit on wagering losses (TY18-25)	$10	$140	$90	$90
Subtotal: Federal Deductions	**($90)**	**$209,840**	**$188,990**	**$209,290**
Federal Exclusions				
Repeal exclusion for qualified moving expense reimbursement (TY18-25)	$300	$5,300	$3,900	$3,900
Repeal exclusion for certain employer-provided bicycle commuter fringe benefits (TY18-25)	$0	$40	$30	$30
Subtotal: Federal Exclusions	**$300**	**$5,340**	**$3,930**	**$3,930**

	FY 2018	FY 2019	FY 2020	FY 2021
Retirement, Savings, and Pensions				
Allow increased contributions to Able accounts (TY18-25)	(Negl.)	(Negl.)	(Negl.)	(Negl.)
Extend rollover period for certain retirement plan loan offsets (beginning TY18)	(Negl.)	(Negl.)	(Negl.)	(Negl.)
Repeal special rule permitting recharacterization of IRA contributions (beginning TY18)	$50	$400	$300	$300
Subtotal: Retirement, Savings, and Pensions	**$50**	**$400**	**$300**	**$300**
Bonus Depreciation and Section 179 Expensing				
Bonus depreciation of 100%, with 80% addback and 5-year recovery; phased out beginning in TY 2023 (TY18-26)				
Individual Income Tax	($600)	$1,000	$8,700	$10,700
Corporate Franchise Tax	($1,300)	$2,100	$18,300	$22,600
	($1,900)	$3,100	$27,000	$33,300
Increased Section 179 expensing, with 80% addback and 5-year recovery (beginning TY18)				
Individual Income Tax	($40)	$600	$2,600	$2,800
Corporate Franchise Tax	($20)	$200	$1,000	$1,100
	($60)	$800	$3,600	$3,900
Bonus Depreciation and Section 179 Expensing				
Individual Income Tax	**($640)**	**$1,600**	**$11,300**	**$13,500**
Corporate Franchise Tax	**($1,320)**	**$2,300**	**$19,300**	**$23,700**
Subtotal	**($1,960)**	**$3,900**	**$30,600**	**$37,200**
Other Business and Investment Provisions				
Allow 20% deduction of certain non-service pass-through income (TY18-25)				
Individual Income Tax	($18,100)	($353,000)	($289,700)	($302,300)
Disallow active pass-through losses over $500,000 married joint, $250,000 for other filers (TY18-25)				
Individual Income Tax	$6,200	$121,300	$99,800	$104,800
Tax gain on the sale of partnership on a look-through basis (beginning TY18)				
Individual Income Tax	$0	$1,100	$1,800	$1,900
Expand the definition of built-in loss for purposes of partnership loss transfers (beginning TY18)				
Individual Income Tax	$0	$400	$300	$300
Recharacterize gains of certain property held by partnerships (beginning TY18)				
Individual Income Tax	$100	$2,100	$800	$600

	FY 2018	FY 2019	FY 2020	FY 2021
Other Business and Investment Provisions (Cont.)				
Charitable contributions and foreign taxes taken into account in determining limit on partner's share of loss (beginning TY18)				
Individual Income Tax	$0	$700	$700	$800
Charitable deduction not allowed for amounts paid for college athletic event seating rights (beginning TY18)				
Individual Income Tax	$100	$1,900	$1,200	$1,200
Repeal rollover of publicly traded securities gain into specialized small business investment companies (beginning TY18)				
Individual Income Tax	$0	$300	$300	$300
Corporate Franchise Tax	$0	$700	$600	$600
Small business accounting method reform and simplification (beginning TY18)				
Individual Income Tax	($4,300)	($62,700)	($22,000)	($12,200)
Corporate Franchise Tax	($500)	($6,900)	($2,400)	($1,300)
Limit net interest deduction to 30% of income, with carryforward (beginning TY18)				
Individual Income Tax	$4,400	$97,700	$90,500	$92,500
Corporate Franchise Tax	$700	$16,600	$15,400	$15,700
Modification of net operating loss deduction (beginning TY18)				
Individual Income Tax	$2,100	$38,800	$31,900	$43,300
Repeal deferred gain on like-kind exchanges, except for real property (beginning TY18)				
Individual Income Tax	$100	$2,300	$2,500	$3,300
Corporate Franchise Tax	$100	$2,900	$3,100	$4,200
Reduce recovery period for certain real property (beginning TY18)				
Individual Income Tax	$0	($200)	($400)	($600)
Corporate Franchise Tax	$0	($500)	($800)	($1,100)
Repeal deduction for local lobbying expenses (DOE)[1]				
Individual Income Tax	$0	$200	$100	$100
Corporate Franchise Tax	$0	$400	$300	$300
Limit deduction for employer-provided meals and entertainment expenses (beginning TY18)				
Individual Income Tax	$200	$3,600	$2,600	$2,700
Corporate Franchise Tax	$600	$9,800	$7,000	$7,300
Limit deduction for certain employer-provided transportation benefits (beginning TY18)				
Individual Income Tax	$200	$2,700	$2,000	$2,000
Corporate Franchise Tax	$400	$7,300	$5,400	$5,600

	FY 2018	FY 2019	FY 2020	FY 2021
Other Business and Investment Provisions (Cont.)				
Prohibit deduction for achievement awards of cash, gift cards and other nontangible personal property (beginning TY18)				
Individual Income Tax	Negl.	Negl.	Negl.	Negl.
Corporate Franchise Tax	Negl.	Negl.	Negl.	Negl.
Limit deduction for FDIC Premiums (beginning TY18)				
Individual Income Tax	$100	$1,900	$1,800	$1,800
Corporate Franchise Tax	$200	$5,000	$4,900	$4,900
Deny deduction for sexual harrasment settlements paid subject to a nondisclosure agreement (DOE)[1]				
Individual Income Tax	Negl.	Negl.	Negl.	Negl.
Corporate Franchise Tax	Negl.	Negl.	Negl.	Negl.
Revise treatment of contributions to capital (DOE)[1]				
Individual Income Tax	$0	$300	$400	$700
Corporate Franchise Tax	$0	$800	$1,100	$2,000
Modify historic rehabilitation credit to provide 20% credit spread over 5 years (beginning TY18)				
Corporate Franchise Tax[2]	$200	$12,900	$26,000	$29,700
Modify treatment of interest for producers of beer, wine, and distilled spirits (TY18 & 19)				
Individual Income Tax	($100)	($1,500)	($900)	$0
Corporate Franchise Tax	($100)	($1,900)	($1,100)	$0
Modify limit on excessive compensation (beginning TY18)				
Individual Income Tax	$0	$500	$600	$600
Corporate Franchise Tax	$0	$2,800	$3,600	$3,600
All Other Business and Investment Provisions				
Individual Income Tax	**($9,000)**	**($141,600)**	**($75,700)**	**($58,200)**
Corporate Franchise Tax	**$1,600**	**$49,900**	**$63,100**	**$71,500**
Subtotal	**($7,400)**	**($91,700)**	**($12,600)**	**$13,300**
Bond Interest				
Repeal exclusion of interest on advance refunding bonds (beginning TY18)				
Individual Income Tax	$100	$3,500	$3,900	$4,800
Corporate Franchise Tax	$100	$1,800	$2,100	$2,500
Subtotal: Bond Interest	**$200**	**$5,300**	**$6,000**	**$7,300**

	FY 2018	FY 2019	FY 2020	FY 2021
International Business Income				
Deemed repatriation of certain deferred foreign income (beginning TY18)[3]				
Corporate Franchise Tax	$23,300	$285,600	$66,100	$42,200
Inclusion of global intangible low-taxed income (GILTI), with deduction (beginning TY18)				
Corporate Franchise Tax	$3,400	$64,900	$41,300	$38,100
Inclusion of foreign-derived intangible income (FDII) derived from domestic trade or business, with deduction (beginning TY18)				
Corporate Franchise Tax	($100)	$13,700	$25,500	$26,700
Subtotal: International Business Income				
Corporate Franchise Tax	**$26,600**	**$364,200**	**$132,900**	**$107,000**
Property Tax Refund				
Repeal exemptions for dependents, senior/disabled				
Homestead Credit Refund	$0	$0	$50,100	$50,300
Renter Property Tax Refund	$0	$0	$33,800	$34,000
Modifications to federal adjusted gross income				
Homestead Credit Refund	$0	$0	$350	$360
Renter Property Tax Refund	$0	$0	$160	$170
Subtotal: Property Tax Refund	**$0**	**$0**	**$84,410**	**$84,830**
All Provisions				
Individual Income Tax	**$8,320**	**$395,480**	**$406,820**	**$492,320**
Property Tax Refund	**$0**	**$0**	**$84,410**	**$84,830**
Corporate Franchise Tax	**$26,980**	**$418,200**	**$217,400**	**$204,700**
General Fund Total	**$35,300**	**$813,680**	**$708,630**	**$781,850**

1 Date of enactment.

2 The historic rehabilitation credit may also be claimed against the individual income tax or insurance premiums tax. Since the distribution of future credits is unknown, the entire estimate is included in the corporate franchise tax total.

3 The federal act taxes deferred foreign income regardless of whether it is repatriated. To the extent that the income is actually returned to the U.S., it would be subject to tax under current Minnesota law without further legislation. Therefore the revenue gain from actually repatriated income will be carried as a forecast adjustment, with the remainder included in this federal update estimate. In addition to the revenue gain shown here, the provision is expected to increase revenue by about $11.6 million in FY 2018, $142.7 million in FY 2019, $33.0 million in FY 2020, and $21.1 million in 2021. Those amounts will be carried as a forecast adjustment, regardless of whether federal update legislation is enacted.