Deloitte.

External Multistate Tax Alert
June 26, 2019

Minnesota Enacts Broad Tax Changes Including Retroactive IRC Conformity

Overview

After calling a special session for the Minnesota Legislature, on May 30, 2019 Governor Tim Walz signed House File 5 ("H.F. 5" or "Bill").[1] As currently enacted, H.F. 5 impacts individual income, corporate income, sales and use tax, and estate tax. Of the changes to the Minnesota tax statutes, the following are the most notable modifications to Minnesota tax law:

Income Tax

- Updates the date of individual and corporate income tax conformity to the Internal Revenue Code ("IRC") to December 31, 2018, effective retroactively;
- Modifies the Minnesota treatment of various provisions under the Tax Cuts and Jobs Act of 2017 ("Act") [2], including IRC section 965, global intangible low-taxed income ("GILTI") and foreign-derived intangible income ("FDII");
- Decouples from the qualified business income deduction under IRC section 199A for trusts and estates;
- Conforms to the federal standard deduction amount and the state and local tax deduction limitation;
- Creates state-only itemized deductions to parallel certain items repealed by the Act;
- Modifies several Minnesota Corporate Alternative Minimum Tax ("AMT") provisions to conform to IRC in effect on December 2016;
- Defines a "disqualified captive insurance company", which will be subject to Minnesota corporate franchise tax, retroactive to tax years beginning after December 31, 2016; and
- For tax years beginning after December 31, 2018, connects the Minnesota individual income tax starting point to federal adjusted gross income ("FAGI") and modifies the tax rates.

Sales and Use Tax

The Bill also further outlines the duties of a remote seller or marketplace in collecting and remitting sales tax in light of the *Wayfair*[3] decision.

This Tax Alert summarizes these law changes, which are generally effective retroactively to tax years beginning on or after December 31, 2017, or as otherwise noted.

Corporate Income Tax

Minnesota's H.F. 5 incorporates a number of provisions in response to the Act. Chiefly among these provisions is the update of Minnesota's conformity date to the IRC to December 31, 2018,[4] thus conforming to a version of the IRC that includes the provisions of the Act. This change in conformity is effective the day after enactment; however, changes incorporated in response to the Act are retroactive to the date effective for federal purposes.[5]

With the updated conformity date, the bill provides guidance on how Minnesota taxpayers are required to treat certain items created or modified by the Act, such as deferred foreign income under IRC section 965, GILTI, FDII, the amended interest expense deduction limitation of IRC section 163(j), and the net operating loss ("NOL") deduction limitation.

---

[1] Laws 2019, ch.1, 1st Special Session (H.F. 2019). A copy of the adopted law is accessible here.
[2] P.L. 115-97.
[3] *South Dakota v. Wayfair, Inc.,* 138 S. Ct. 2080 (2018)
[4] Minn. Stat. § 289A.02, subd. 7, as amended by H.F. 5, Art. I, § 3, Laws 2019.
[5] *Id.*

The Bill provides a subtraction for deferred foreign income recognized under IRC section 965 for corporate franchise taxpayers.[6] Similarly, the bill requires corporate taxpayers to subtract the amount of GILTI included in income.[7] Additionally, H.F. 5 requires Minnesota taxpayers to add back amounts deducted under IRC section 250.[8] These provisions effectively remove any impact from IRC section 965, GILTI, and FDII from the Minnesota corporate income tax base.

H.F. 5 modifies the dividends received deduction ("DRD") to disallow any DRD taken for dividends received from debt-financed stock.[9] Additionally, the Bill provides that subpart F income under IRC section 951 should be treated as dividend income and is eligible for the Minnesota DRD.[10]

Further, H.F. 5 adopts the interest expense deduction limitations under IRC section 163(j).[11] Additionally, a taxpayer's Minnesota NOL deduction cannot exceed 80% of taxable income.[12] The Bill, however, decouples the state from the federal repeal of corporate AMT, thus Minnesota continues to provide a state-specific corporate AMT by incorporating the federal AMT provision as of December 16, 2016.[13]

H.F. 5 provides a newly-created definition for "disqualified captive insurance companies,"[14] clarifying which captive insurance companies are not exempt from corporate franchise tax. The bill defines "disqualified captive insurance company" as captive insurance company that either:

- Pay less than 0.5% of its total annual premiums under Minn. Stat. 297I (or comparable law of another state); or
- Receive less than 50% of its gross annual gross receipts from premiums.[15]

Disqualified captive insurance companies are subject to Minnesota's corporate income tax and are includable in the combined filing of a unitary business group.[16] This disqualified captive insurance company definition and treatment is effective retroactively for tax years beginning after December 31, 2016.[17]

The provisions of H.F. 5 also amend the sales factor statutes regarding the treatment of mutual fund manager receipts from mutual funds. H.F. 5 expands the types of mutual fund manager entities required to apportion their sales based on the location of the shareholders of the funds to include any entity type, updating from corporations or trusts.[18] This change is effective for tax years beginning on or after December 31, 2018.[19]

Individual Income Tax

H.F. 5 enacted numerous changes applicable to individual income tax. The Bill not only updated Minnesota's date of conformity to the IRC,[20] but also changed the starting point for individual income tax from federal taxable income to FAGI for tax years beginning after December 31, 2018.[21]

Pursuant to the Bill, individual taxpayers must subtract the amounts included in FAGI for deferred foreign income (amounts included under IRC section 965)[22] and GILTI.[23] Additionally, the Bill adjusts the standard deduction and itemized deductions

---

[6] Minn. Stat. § 290.0134, subd. 18, as amended by H.F. 5, Art. I, § 33, Laws 2019.
[7] Minn. Stat. § 290.0134, subd. 17, as amended by H.F. 5, Art. I, § 32, Laws 2019.
[10] Minn. Stat. § 290.0133, subd. 6, as amended by H.F. 5, Art. I, § 31, Laws 2019.
[9] Minn. Stat. § 290.21, subd. 4, as amended by H.F. 5, Art. II, § 22, Laws 2019.
[10] Minn. Stat. § 290.21, subd.9, as amended by H.F. 5, Art. I, § 57, Laws 2019.
[11] Minn. Stat. § 290.34, subd. 5, as amended by H.F. 5, Art. I, § 58, Laws 2019.
[12] Minn. Stat. § 290.095, subd. 2(c), as amended by H.F. 5, Art. I, § 55, Laws 2019.
[13] Minn. Stat. § 290.0921, subd. 3 as amended by H.F. 5, Art. I, § 52, Laws 2019.
[14] Minn. Stat. § 290.01, subd. 5c, as amended by H.F. 5, Art. II, § 11, Laws 2019.
[15] *Id.*
[16] Art. II, § 20, Laws 2019.
[17] Minn. Stat. § 290.01, subd. 5c, as amended by H.F. 5, Art. II, § 11, Laws 2019.
[18] Minn. Stat. § 290.191, subd. 5, as amended by H.F. 5, Art. II, § 21, Laws 2019.
[19] *Id.*
[20] Minn. Stat. § 289A.02, subd.7, as amended by H.F. 5, Art. I, § 3, Laws 2019.
[21] Minn. Stat. § 290.01, subd. 19, as amended by H.F. 5, Art. I, § 10, Laws 2019.
[22] Minn. Stat. § 290.0132, subd. 27, as amended by H.F. 5, Art. I, § 29, Laws 2019.
[23] Minn. Stat. § 290.0132, subd. 28, as amended by H.F. 5, Art. I, § 30, Laws 2019.

available; the Bill conforms to the increased standard deduction of $12,200 for single filers ($24,400 for married filing jointly)[24] and creates state-specific itemized deductions that mirror those repealed under the Act such as medical expense deduction an excess of 10% of AGI,[25] unreimbursed employee expenses in excess of 2% of AGI,[26] and does not limit the deduction for personal casualty and theft losses.[27] Because of the change in starting point for Minnesota individual income, the qualified business income deduction under IRC section 199A will not apply for Minnesota individual income tax purposes for tax years beginning after December 31, 2018. For tax years beginning after December 31, 2017, H.F. 5 also requires individual taxpayers to add back to income any distributions taken from 529 Qualified Tuition Plans used to pay for expenses for kindergarten through 12th grade.[28]

Applicable only to the 2018 tax year, H.F. 5 created a "special limited adjustment to tax" for individual income taxpayers.[29] This provision provides two important limited adjustments for individuals for 2018. First, individuals may take an itemized deduction for Minnesota purposes even if they took the standard deduction for federal purposes.[30] Second, the state has adopted a special tax adjustment to 2018 Minnesota individual income tax to address the potential differences in Minnesota tax based on updated IRC conformity.[31]

The 2018 special limited adjustment is applicable only to individual taxpayers and partnerships that elect to file a composite return.[32] As H.F. 5 was enacted after the original due date of Minnesota income tax returns and is effective retroactively to 2018, the Bill provides an automatic adjustment to 2018 tax equal to the difference between calculated tax prior to the Bill, December 16, 2016 IRC conformity, and calculated tax pursuant to the updated conformity.[33] By operation of the automatic special limited adjustment provisions, most individual taxpayers will not see any impact to their 2018 taxes, and will not need to file an amended 2018 Minnesota individual income tax return.

Additionally, H.F. 5 modified the individual tax bracket and rates for tax years beginning after December 31, 2018, including changing the tax rate for the second tier from 7.05% and 6.80%.[34] To provide a partial offset for the reduction in the tax rate for the second bracket, there is a reduction in the income threshold for the fourth tier income bracket (the highest tier subject to 9.85% tax rate);[35] therefore more taxpayers will be subject to the top income tax bracket.

Trust and Estate Tax

H.F. 5 requires a trust or estate add back of the 20% deduction for qualified business income under IRC section 199A.[36] This provision is effective for tax years beginning on or after December 31, 2017.[37]

Sales and Use Tax

H.F. 5 is the most recent state tax bill enacted since the Supreme Court decision in *Wayfair.*[38] The Bill reorganizes the definitions to more clearly define and establish the duty of remote sellers and marketplace providers to collect sales and use tax.[39] In determining when a remote retailer must collect Minnesota sales tax, the Bill effectively replaces its definition of regular or systematic solicitation of sales with the de minimis thresholds of 200 retail sales or $100,000 in retail sales in a 12-month period as provided in *Wayfair*.[40] That same provision makes the new de minimis threshold applicable to all

---

[24] Minn. Stat. § 290.0123, subd. 1, as amended by H.F. 5, Art. I, § 17, Laws 2019.
[25] Minn. Stat. § 290.122, subd. 2(6), as amended by H.F. 5, Art. I, § 16, Laws 2019.
[26] Minn. Stat. § 290.122, subd.7, as amended by H.F. 5, Art. I, § 16, Laws 2019.
[27] Minn. Stat. § 290.122, subd. 8, as amended by H.F. 5, Art. I, § 16, Laws 2019.
[28] Minn. Stat. § 290.0131, sub. 15, as amended by H.F. 5, Art. I, § 20, Laws 2019.
[29] Minn. Stat. § 290.993, as amended by H.F. 5, Art. I, § 61, Laws 2019.
[30] Minn. Stat. § 290.993(a)(1), as amended by H.F. 5, Art. I, § 61, Laws 2019.
[31] *Id.*
[32] *Id.*
[33] *Id.*
[34] Minn. Stat. § 290.06, subd. 2c, as amended by H.F. 5, Art. II, § 16, Laws 2019.
Minn.
Stat. § 290.06, subd. 2c, as amended by H.F. 5, Art. II, § 16, Laws 2019.
s 2019.
[37] *Id.*
[38] *See* supra n. 2.
[39] Minn. Stat. § 297A.66, subd. 1, as amended by H.F. 5, Art. III, § 4, Laws 2019.
[40] Minn. Stat. § 297A.66, subd. 1, as amended by H.F. 5, Art. III, § 4, Laws 2019.

remote sellers, regardless of whether the seller utilizes a marketplace provider. This provision is effective for sales and purchases after September 30, 2019.

Additional changes

Due to numerous changes within H.F. 5, this Alert does not provide a comprehensive summary of all law changes. Taxpayers should note in addition to the changes summarized above, H.F. 5 provides numerous other changes that have various effective dates.

Considerations

Taxpayers should consult with their tax advisers regarding how changes in H.F. 5 may impact their filing requirements and Minnesota tax liabilities.

Contacts:

If you have questions regarding H.F. 5 or other Minnesota tax matters, please contact any of the following Deloitte professionals:

Raymond Goertz
Managing Director
Deloitte Tax LLP, Minneapolis
+1 612 659 2768
rgoertz@deloitte.com

David Welliver
Senior Manager
Deloitte Tax LLP, Minneapolis
+1 612 659 2938
dwelliver@deloitte.com

For further information, visit our website at www.deloitte.com/us/multistatetax

Follow @DeloitteTax