MN tax law changes: knowledge is power

December 12, 2013
Today’s discussion

- Tax law changes – property, income, estate & gift
- MN residency requirements
- Sales tax changes
- New taxable goods and services
- Exemptions
- Nexus developments
H.F. No. 677 – Omnibus Tax Bill brought most significant changes to MN tax in quite some time, encompassing changes to:

> Property tax
> Individual income tax
> Corporate income tax
> Estate and gift tax
> Sales and use tax
> And a host of other transactional taxes
What did we get?

- Combination of parts of all three original proposed budget bills
- Increased individual income tax rate for high-income earners
- Property tax relief for middle-class
- Expanded base for sales and use tax
- Increased corporate minimum fee
- Changes to estate and gift taxes
Increases maximum refund allowed and household income thresholds for homestead credit and renters’ credit

**Homestead**
- Max income of $105,499 from $100,779
- Refund range increased to $500 - $2,580 from $480 - $2,460

**Renters’**
- Max income of $57,169 from $41,819
- Refund range increased to $200 - $2,000 from $120 - $1,190
Added 4th tier of income tax and increased rate of highest tier to 9.85%

- Married Filing Jointly (MFJ) with taxable income > $250,000
- Single with taxable income > $150,000
- Head of Household (HOH) with taxable income > $200,000

Increased bracket thresholds for lower tiers
### Income tax – MFJ rates

<table>
<thead>
<tr>
<th>Previous</th>
<th>Tax years beginning 2013</th>
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</thead>
<tbody>
<tr>
<td>Up to $25,680</td>
<td>Up to $35,480</td>
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<tr>
<td>5.35%</td>
<td>5.35%</td>
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<tr>
<td>$25,681 - $102,030</td>
<td>$35,481 - $140,960</td>
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<tr>
<td>7.05%</td>
<td>7.05%</td>
</tr>
<tr>
<td>All over $102,031</td>
<td>$140,961 - $250,000</td>
</tr>
<tr>
<td>7.85%</td>
<td>7.85%</td>
</tr>
<tr>
<td>All over $250,001</td>
<td>All over $250,001</td>
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<tr>
<td></td>
<td>9.85%</td>
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</tbody>
</table>
### Income tax – single rates

<table>
<thead>
<tr>
<th>Previous</th>
<th>Tax years beginning 2013</th>
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<tbody>
<tr>
<td>Up to $17,570</td>
<td>Up to $24,720</td>
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<tr>
<td>5.35%</td>
<td>5.35%</td>
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<tr>
<td>$17,571 - $57,710</td>
<td>$24,721 - $79,730</td>
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<tr>
<td>7.05%</td>
<td>7.05%</td>
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<tr>
<td>All over $57,711</td>
<td>$79,731 - $150,000</td>
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<tr>
<td>7.85%</td>
<td>7.85%</td>
</tr>
<tr>
<td>All over $150,001</td>
<td></td>
</tr>
<tr>
<td>9.85%</td>
<td></td>
</tr>
</tbody>
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### Income tax – HOH rates

<table>
<thead>
<tr>
<th>Previous</th>
<th>Tax years beginning 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to $21,630</td>
<td>Up to $29,880</td>
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<tr>
<td>5.35%</td>
<td>5.35%</td>
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<tr>
<td>$21,631 - $86,910</td>
<td>$29,881 - $120,070</td>
</tr>
<tr>
<td>7.05%</td>
<td>7.05%</td>
</tr>
<tr>
<td>All over $86,911</td>
<td>$120,071 - $200,000</td>
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<tr>
<td>7.85%</td>
<td>7.85%</td>
</tr>
<tr>
<td>All over $200,001</td>
<td></td>
</tr>
<tr>
<td></td>
<td>9.85%</td>
</tr>
</tbody>
</table>
### Adjusts tiers and minimum fees - increased minimum fee

#### Prior minimum
- $100
- $300
- $1,000
- $2,000
- $5,000

#### New minimum
- $190
- $560
- $1,870
- $3,740
- $9,340

- Maximum fee is $9,340
- Apportionment – 96% sales in 2013, 100% sales in 2014
## Income tax - corporate

<table>
<thead>
<tr>
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<th>Tax years beginning after 12/31/12</th>
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</thead>
<tbody>
<tr>
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<td>$500,000 – 999,999</td>
<td>$100</td>
</tr>
<tr>
<td>$1,000,000 – 4,999,999</td>
<td>$300</td>
</tr>
<tr>
<td>$5,000,000 – 9,999,999</td>
<td>$1,000</td>
</tr>
<tr>
<td>$10,000,000 – 19,999,999</td>
<td>$2,000</td>
</tr>
<tr>
<td>More than $20,000,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>More than $20,000,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>More than $37,360,000</td>
<td>$9,340</td>
</tr>
</tbody>
</table>
Research and Development credit not refundable effective tax years beginning after December 31, 2012.

If part of a unitary group, excess credit must be allocated across members of the group before being carried forward.
Expanded definition of qualified business entity for the Angel Investment Credit

> Increases time of operations limit from 10 to 20 years for a business engaged in research, development, or production of medical devices or pharmaceuticals where FDA approval is required for use in treatment of diagnosis of disease or condition

> Business cannot have issued securities on a public exchange
> Alternative Minimum Tax rate increases to 6.75% from 6.4%
> Repeals MN nonresident credit for taxes paid to state of domicile
> Underpayment of estimated tax before December 15, 2013, resulting from the new 9.85% income tax rate will be exempt from penalties and interest
Estate & gift tax

Imposition of gift tax

- 10% tax on amount of taxable gift
- Effective for taxable gifts made after June 30, 2013

> Follows federal annual exclusion ($14,000 for 2013)

> Tax not imposed on out-of-state gifts
  - Real property located outside of state
  - Tangible personal property (TPP) normally kept at location outside of state at time of gift
  - Intangible personal property made by an individual who is not a MN resident at time of gift
Imposition of gift tax (cont’d)

*Lifetime credit*

> Credit of $100,000 for cumulative amount of taxable gifts made by donor during donor’s lifetime

> Potential to use credit twice – gift & estate level

*Donor is liable for payment*

> If tax is not paid when due, donee of gift is personally liable to the extent of the value of the gift

Return is due by April 15 following close of calendar year in which gift was executed
Minnesota adjusted taxable estate

> Federal adjusted estate plus add-back of taxable gifts made within 3 years of decedent’s date of death
> Effective for decedents dying after December 31, 2012
> Location of taxable gift – if within 3 years of decedent’s date of death, the state or country in which it was normally kept when gift was executed
Nonresident decedent tax credit

Credit allowed on estate of nonresident decedent equal to lesser of:

> Amount of estate tax paid to another state that is attributable to the MN situs property held in a pass-through entity

> Amount of tax paid under Sec 291.03 attributable to the MN situs property held in pass-through entity
Foreign Operating Corporations

> Deemed dividend deduction for 80% of Foreign Operation Corporations (FOC) income eliminated

> Repeals addition to federal taxable income for FOC deemed dividend

> Repeals subtraction to federal taxable income for foreign royalties
Cigarette tax increase to $2.83 per pack from $1.23

Greater Minnesota Internship Program
  – Provides credits for eligible employers who hire interns for employment in greater Minnesota

Repeals MN membership in multi-state tax compact effective July 1, 2013

Same sex marriage – MN to follow federal filing status for income tax purposes
Two cases related to residency argued before Supreme Court

- Kenneth B. Mauer v. Commissioner of Revenue
- William D. Larson v. Commissioner of Revenue

Both cases decided against taxpayer

Taxpayers’ acts and declarations in both cases did not overcome presumption that taxpayer remained domiciled in Minnesota.

No longer enough to simply prove domicile in new state, but taxpayer must prove severance of domicile with Minnesota.

Notable in Larson – subsequent acts and declaration can be used to prove severance of domicile with Minnesota.
Several cases related to residency currently on Tax Court docket

> Larry & Diane Zavadil v. Comm of Rev
  - Has employee of MN company, who works remotely in different state, overcome presumption of residence in MN?

> Robert J. & Michele R. Keith v. Comm of Rev
  - Should time spent in MN for medical reasons and care of ailing relatives be considered days present in MN?
Sales and use tax: embracing the changes
“The retail sales tax in its current form is a complex, uncertain, and a profoundly flawed mechanism that is peculiarly unsuited to an increasingly service-oriented, digital, and borderless economy.”

Jerome Hellerstein, “State Taxation” (WG&L)
> Sales tax is a pass-through tax!
> Most concerning to people is the *burden and cost of collection and remittance of the taxes.* (There are, by some counts, over 9,000 taxing jurisdictions in the country.)
> Even though the consumer is usually ultimately responsible for tax, if the seller has nexus, the obligation to collect is on the seller.
> Audit scenario: a state can look back to the seller to collect the liability. **Even with a sophisticated software program, a company is likely to have a significant compliance burden.**
What’s new in MN sales and use tax?

Proposed legislation:
Governor Dayton proposed budget, January 22, 2013

> Broaden the tax base and lower the rate
  – More services and items taxable and general state rate from 6.875% to 5.5%
> "Amazon" law or click-through nexus
> Clothing over $100
> SaaS
> Over-the-counter drugs
> Professional services (accounting, legal, etc.)
Proposed legislation:
Governor Dayton proposed budget “TAKE II”

Major pushback from businesses leads to:
> No longer wants to lower the rate or broaden the base
> "Amazon" law or click-through nexus stayed
Proposed legislation

Senate version, April 11, 2013

> Broaden the tax base and lower the rate
  - More services and items taxable and general state rate from 6.875% to 6%
    » New services include car repair, OTC drugs, tattoos, dating services, etc.
    » Clothing would be taxable, but include a small income tax credit
    » Raise the tax rate on tobacco

> "Amazon" law or click-through nexus

House version

> Does not go as far
  » Would increase sales tax rate on alcohol
Final bill signed into law on May 23, 2013
Omnibus Tax Bill – Chapter 143, House File 677
(Sales and Use Tax is Article 8 of H.F. 677)

> Sales tax base expanded to new services
> Definition of retail sale modified to include new taxable goods
> Sales tax now applies to certain digital goods
> Modifies provisions for the rental motor vehicle tax rate
> Provides for multiple Points of Use Certificates (software)
> Modifies sales tax exemptions
> Authorizes new local taxes
> Click-through nexus
Special session on September 9, 2013

> NO TAX REPEAL, although there was talk of it, especially the repair and maintenance labor on farm equipment
  – Discussed and approved storm disaster relief
New taxable services

Business related warehousing and storage

> Excludes ag products, electronic data (digital storage), self-storage units, refrigerated storage, motor vehicles, and boats

> Not applicable when inventory is stored in a company’s own warehouse storage facility or a facility owned by a parent company or affiliated group.

Effective March 31, 2014
New taxable services

Business related electronic and precision equipment repair/maintenance and commercial and industrial machinery and equipment repair/maintenance labor

Electronic and precision equipment
> Computer equipment, copy/fax machines, printers, TVs, stereos, sound systems, medical equipment, etc.
> Excluded are computer software and motor vehicles
> NO exclusion for fixtures
New taxable services

Repair labor (cont’d)

Commercial and industrial machinery and equipment

> Manufacturing and production equipment, farm machinery used in ag production (B2B), heavy machinery (construction equipment), restaurant equipment

> Exclusions for motor vehicles, furniture and *fixtures, ships, railroad stock, and aircraft

* Fixtures are permanently attached to a building and cannot be removed without substantial damage, e.g. plumbing, power outlets, and vents. Does not include production equipment.

> Does not qualify for CE refund claim

Effective July 1, 2013
New taxable goods

> Telecommunications equipment purchased or leased for use directly by telecom providers
  – Effective July 1, 2013

> Motor vehicle repair paint (and primer, clear coat, thinner) and repair materials by a repair or body shop business
  – Effective July 1, 2013
Newly taxable digital goods

Certain digital products subject to sales and use tax

> Digital audio works – songs, readings of books, speeches, and other sound recordings
> Digital audiovisual works – movies, music videos, news, and entertainment, including live events
> Digital books – any literary work expressed in words, numbers, etc., excluding periodicals, magazines, newspapers, blogs, product manuals
> Other digital products - ring tones, greeting cards, online video or electronic games

Effective July 1, 2013
Vehicle rental tax increase

Effective July 1, 2013, the tax on motor vehicle rentals for a period of not more than 28 days is increased from 6.2% to 9.2%
Multiple points of use

Allows a business purchaser to use a multiple-points-of-use exemption certificate when purchasing electronically delivered goods and services that are concurrently available for use in multiple taxing jurisdictions – e.g., multiuser software licenses

> Burden now on purchaser

Effective July 1, 2013
Exemptions modified

> Expands business sales and use tax exemption from certain JOBZ areas to include “Greater Minnesota”
  – Must meet certain requirements – e.g., create so many new jobs
  – Effective July 1, 2013

> Provides sales tax exemptions for construction materials used in an industrial measurement manufacturing and controls facility, a biopharmaceutical manufacturing facility, and a research and development facility
Capital equipment exemption

Allows an up-front sales tax exemption for qualifying capital equipment purchases

> No more rebate program!
  Sales tax practitioners 😞, taxpayers 😊
> Effective August 31, 2014
Effective for sales and purchases starting on January 1, 2014, the bill expands the exemption for townships to include all cities and counties.

> Applies to purchases of goods and services that are “inputs” – used to provide local government services.

> Not applicable for purchases used to provide services generally provided by a private business, such as a municipal liquor store or golf course.

> Local government must provide vendor with exemption certificate.
Local taxes

> The “new” sunset date for the City of St. Paul’s .5% sales tax is now December 31, 2042
> The city of Rochester is authorized to increase its lodging tax from 1% to 3%
> Olmstead County may impose a transit tax of .25%
> The “new” sunset date for the St. Cloud Area’s .5% sales tax is now December 31, 2038
Sales and use tax nexus developments
The states’ view of nexus

- States have a budget shortfall for fiscal year beginning on July 1, 2012 of $55 billion (Center for Budget & Policy Priorities)
- One of the main weapons states are using to close the fiscal gap is the adoption of highly aggressive “nexus” policies
- Purpose – raise additional revenue by getting out-of-state businesses to register and collect sales tax – e.g., Internet sales
Internet sales – “click-through nexus”

> Not inherently exempt from tax
> Does the physical presence test still apply?
> New York’s “click through” nexus law and litigation.
  – Amazon.com presumed to be vendor required to collect sales tax sales when it entered into agreements with NY residents under which, the resident representatives directly or indirectly referred potential customers to for a commission.
> Other states: AR, CA, CT, DC, GA, IL, KS, ME*, MN*, NC, PA, RI, VT

*Just adopted
“Click-through” nexus template

- Nexus established through business relationship between retailer and Internet affiliates and aggregators
- Sales referred directly or indirectly via a link on affiliates’/aggregators’ website
- In-state customers “click through” to seller
- Must have a commission or similar agreement
- Active solicitation by affiliate/aggregator - “rebuttable presumption” option?
- In-state gross receipts test - $10,000 / previous 12 months
After 5 years of litigation and appeals, New York's highest court upheld the state's "Amazon.com tax" in a 4 to 1 decision.

The New York Court of Appeals ruled that New York's "Amazon.com tax" law is NOT unconstitutional because it subjects online retailers (without a physical presence in New York) to New York sales and use tax.

Court “punts” physical presence issue to US Supreme Court…

UPDATE: US SUPREME COURT DECLINES TO TAKE CASE
Department of Revenue Statement on today’s New York Court of Appeals ruling that affirms state’s “Amazon law”

Today’s ruling is good news for Minnesota. In his budget, Governor Dayton recommends that we require out-of-state retailers to collect sales tax when selling taxable goods to Minnesota customers through websites or other “affiliates” located in Minnesota.

Similar to New York’s law, the governor’s proposal will help increase fairness and level the playing field between our state’s “brick-and-mortar” businesses and out-of-state sellers. The proposal also reduces the burden on Minnesotans who would otherwise be required to report and pay use tax when they buy taxable goods from Internet sellers.
Federal Internet tax legislation is back on the table!

> The Marketplace Fairness Act of 2013 (“MFA of 2013”) is a compromise or hybrid bill which would grant collection authority to Streamlined Sales Tax (“SST”) full-member states and to non-SST states that enact state legislation to adopt the proposal’s simplification and other provisions.

> Passed US Senate back on May 6, 2013, still waiting on House decision.
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