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2018 Minnesota Tax Summary

The 2018 session marks the third time in the last four years a Tax bill failed to become law. This year, Governor Dayton vetoed both of the omnibus Tax bills sent to him by the legislature. While a veto is never a good thing for those that supported the bill, these vetoes are troubling because of the far reaching implications they have due to the failure to conform Minnesota tax law to the recent federal tax changes. The Governor has now said several times he will not call a special session to address any of the outstanding issues of the session, including tax policy, which leaves Minnesota taxpayers facing an extremely complicated tax filing season for their 2018 income taxes.

There were several significant areas of tax agreement between the Governor and legislators, including moving Minnesota from Federal Taxable Income (FTI) to Adjusted Gross Income (AGI) as the starting point for computing state tax liability. Minnesota is one of only a handful of states to still use FTI as a base for state taxes. Both parties also agreed to minimize the impact of the federal changes to individual income tax payers as much as possible.

Just how to achieve that minimal impact became an issue of dispute, however. The Governor wanted to shift more of the burden to businesses and increase the earned income tax credit for low income individuals, something that went beyond simple conformity. The Republican legislature preferred to decrease individual income tax rates: the House included a reduction of the second tier while the Senate went with a lowering of the first tier. Dayton opposed those reductions because of his concerns about the costs to the state in future biennia and his dedication to sustaining a balanced budget long-term.

The House and Senate opted to index tax brackets and convert a number of tax credits to Chained Consumer Price Index for Urban Consumers (C-CPI-U) from the current CPI-U. This is a slower measure of inflation and would have decreased costs to the state, but Governor Dayton opposed the change. He preferred pursuing a much more aggressive approach to taxing overseas income that was part of the federal tax law. His proposal would have raised far more revenue than the legislature was comfortable with and it was not included in either of the Tax bills passed. The Republican majorities believed - as did the Governor's own Department of Revenue at one time - there was a significant amount of risk associated with the state attempting to fully tax the overseas income taxed by the federal government.

The vetoed Tax bills contained several important provisions of note:

- Made AGI the starting point for determining Individual Income tax liability
- FTI remained the starting point for estates, trusts, and corporate returns
- Full conformity on section 179 expensing
- Temporary conformity regarding allowance of bonus depreciation, limited in the first year to 20%

- Repealed the state alternative minimum tax for corporations
- More businesses allowed to use cash basis accounting
- Business deductions of payments to employees for meals, lodging, and some transportation costs were disallowed as business deductions
- Corporate tax rate reduced from 9.8% to 9.65% for 2018 & 2019; and to 9.1% for the following years
- First tier individual income tax rate reduced from 5.35% to 5.3% for 2018 & 2019; and to 5.25% for the following years
- Second tier individual income tax rates reduced from 7.05% to 6.95% for 2018 & 2019; and to 6.85% for the following years
- Partial conformity to taxation of foreign income, treating it much the same way the state handled repatriated income in 2004

Late in the session Governor Dayton called for an influx of $138 million in "emergency" education funding and tied it directly to the tax issue. Without that funding he wouldn't agree to sign a Tax bill, regardless of its contents. Republicans did include some education funding in their second Tax bill, but the Governor found it unacceptable because he believed it was redistributing existing funds rather than authorizing new dollars. Both Tax bills met with a veto.

Without decisions on federal conformity, and no special session likely, Minnesotans are left with much uncertainty. Passage of a federal conformity bill in the 2019 session is expected, to ensure clarity for future years, but that likely won't prevent difficulties in filing 2018 taxes. Even if the legislature passed a bill as soon as they return in January, there is little chance the Department of Revenue and the tax preparation industry could make the necessary changes before tax filing season opens. Barring a change of heart by Governor Dayton regarding a special session, this is likely the situation taxpayers will face next year. Most impacted will be individual income taxpayers who will face more complicated filing and some will also see an increased tax liability.