



2011 Legislative issues and talking points



Federal Conformity

Issue

Minnesota state tax calculations do not use the federal taxable income as the starting point for the state return and the state does not automatically conform to the definitions contained in the Internal Revenue Code.

Each year there are new changes to the Internal Revenue Code while the legislature is not in session. Usually, if addressed, these changes are generally not adopted until well into the tax filing season. There are also ongoing non-conforming issues that continue to carry forward each year. A few include: Section 179 expensing, Alternative Minimum Tax and the Estate Tax.

Why is this issue important?

A uniform tax code with similar provisions at both the state and federal level allows for more efficiency when administering the tax laws. It would reduce the number of compliance issues tax payers continue to face.

Talking points

- Non-conformity increases the cost for Minnesotan's to comply with the tax code
- Non-conformity increases the possibility of non compliance
- Taxpayers who prepare their own returns may unknowingly file arrant returns
- Conformity works best when passed early in the legislative session and eliminates a lot of uncertainty among taxpayers

The partial list of Minnesota non-conforming items as of Jan. 25, 2011 includes:

- Alternative Minimum Tax (AMT)
- Estate Tax
- Section 179 expensing
- Health benefits for children up to age 26:
 - Exclusion for employer-powered amounts
 - Deduction for self-employed persons
- Increase in allowable deduction for start-up expenditures

What is the AMT?

The AMT is a parallel tax to the regular income tax. It was created by congress in 1969 as a response to wealthy individuals (millionaires) and businesses avoiding their tax liability. The theory of the AMT tax, at both the state and federal level, is to require taxpayers who benefit heavily from some tax preferences to pay a minimum amount of tax relative to their incomes.

The current AMT tax rate: 6.4 percent

The current regular tax rate: 5.35 percent, 7.05 percent, 7.85 percent

How is Minnesota's Alternative Minimum Tax (MNAMT) structured?

The Minnesota alternative minimum tax roughly follows the federal AMT, but there are some key differences that broaden Minnesota's base for determining AMT liability. The biggest difference is that Minnesota does not allow taxpayers to deduct home mortgage interest when calculating AMT.

Both taxes follow the model of requiring taxpayers to compute a tentative tax liability under a second tax structure. This second tax structure, the AMT, has a broader tax base and lower rate(s) than the regular tax. If this tentative tax is higher than the taxpayer's regular tax liability, the taxpayer pays the difference.

Why Should You Care?

This tax was not intended to affect the middle-income people it impacts. Your clients could be affected by this tax and may not know an alternate structure exists until they have their returns prepared. As a CPA, legislators trust you as a source of information and listen to your recommendations on improving the tax statutes in Minnesota.

Talking Points

- The AMT has had an unintended effect on middle income individuals and families. It is also confusing and further complicates the tax returns of those who were not the AMT targets.
- The AMT creates possible compliance issues – There are people who hire CPAs to assist them with their tax returns. CPAs who know about the AMT will advise clients about complying with the AMT, and the clients will listen. Those who do not use a CPA may not even know about this tax or that they are to be paying it, and therefore, will not pay it. As a result, they will be out of compliance.
- In Minnesota, the additional state's preferences are contributing to the problem. We have the same preferences as the federal AMT, and then to exacerbate the problem, we have some additional ones. Minnesota does not allow deductions for home mortgage interest or gambling losses.
- In 2005, the legislature changed the AMT law so that beginning Jan. 1, 2006 charitable contributions will not be subject to the one percent threshold of Adjusted Gross Income. In 2006, the legislature adjusted the exemption amounts, increased them by 50 percent and indexed them for inflation. These are steps in the right direction toward reforming the Minnesota AMT tax code.

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- Allowing the home mortgage interest deduction will reduce the number of returns impacted by AMT, and bring the number and revenue generated close to what the AMT returned in 1985.
- In 2008, the legislature passed a small change that allows non-itemizers to exclude certain charitable contributions when determining AMT liability.

AMT Facts

- 37,000 returns saw their liability go away with the 2006 changes
- In 1985, there were only 3,342 taxpayers who paid MN AMT
- 8,000 returns were subject to AMT after the changes in 2006
- 18,400 people are expected to pay AMT in 2010
- 15,400 people are expected to pay AMT in 2011
- 7,000 returns would see their AMT liability go away with a home mortgage interest deduction allowance
- \$7 million is the approximate cost to conform with the home mortgage interest deduction
- \$28 million was projected to be collected in 2009
- \$29.1 million is projected to be collected in 2010
- \$32.1 million is projected to be collected in 2011

MNCPA Solutions

- Allowing all or a percentage of mortgage interest for deduction
- Federal conformity

Compliance Audit Initiatives

Issue

Over the past seven years the legislature has increased funding for the Department of Revenue (DOR), allowing an increase in the number of auditors collecting money owed to the state. When this initiative began the DOR was netting a 12:1 return. Today, the return is approximately 4:1. This significant increase in the number of auditors also means an increase in the number of inexperienced auditors.

Why you should care

MNCPA members are sharing their frustrations with how the DOR is conducting audits. CPAs are spending a lot of time "helping" these auditors through the process. The DOR has been charged with returning a specific amount of money and must follow the law.

Your legislators may not fully understand the negative impact these initiatives are having on their constituents. The actual net results may be impacted by unintended increased inefficiency in the audit process.

Talking Points

Inexperienced auditors in the field have not fully developed an understanding of the rules and regulations involved with audits.

The legislature has charged the Department of Revenue with returning a specific amount of money from each compliance initiative and has not included a public education component.

The state is likely not realizing the return expected because inexperienced auditors are causing more cases to be appealed. The appeal process currently has a back log of two to three years.

Solutions

- Include funding for additional training and mentoring of new auditors. The MNCPA successfully advocated for this funding with the 2010 compliance initiative.
- If the legislature plans to continue these initiatives they need to provide the DOR adequate resources for proper training.
- Provide more flexibility to the department so they can better select the audits and conduct sampling to maximize their return-on-investment.
- Allow the DOR more flexibility to retain talent and examine the compensation structure for professional auditors.

Tort Reform

Issue

Tort reform attempts to limit damages so accounting firms are not held responsible for the action or inaction of another party. CPAs are often viewed as one of the last resources for a plaintiff to seek compensation even if the CPA or firm was not directly involved in the issue being disputed.

State lawmakers will consider changes to legal procedures in order to potentially prevent lawsuit abuse, make liability insurance more affordable and create a more favorable business climate in Minnesota. Tort reform includes revising the laws that determine responsibility for damages and reducing the amount of punitive damages that civil actions can seek.

Why is this issue important?

Tort and liability laws found in Minnesota statutes tend to be more liberal than what is found in many other states. These laws can create additional liability for CPAs choosing to work in Minnesota and may lead to CPAs and firms looking to locate in states with more favorable liability laws.

Talking points

Reducing the statute of limitations from six years to something less (three or four years), would provide CPAs and other business a more level playing field with competitors in other states. A reduction would decrease the ability for plaintiffs to “shop” for a state with the most favorable liability laws.

Reducing pre-and post-judgment interest rates from 10 to four percent would bring these rates closer to what the market rates are and closer to other states. The interest rule is especially harmful to CPAs since claims against you are almost always for, what are known as, “liquidated” damages (i.e., damages that can be readily ascertained by looking at accounting records), and thus pre-judgment interest can be awarded from the time when the cause of action first starts to run on our current six year statute of limits.

Tax on professional services

Issue

Minnesota is facing a record budget deficit and will be looking at any and all possible revenue sources to balance the budget. Taxing professional services has been proposed several times over the past 25 years, but the potential for something passing is greater today than it has ever been. There is an increased interest in lowering the corporate tax rate and expanding the sales tax base to include more services.

The MNCPA has opposed this tax in the past and continues to oppose a tax on accounting services. Many unique situations arise during the creation and delivery of services and these situations are not suited well to the imposition of a traditional sales tax.

Why is this issue important?

The MNCPA is a strong proponent of good tax policy and the creation of tax law that tax payers understand and comply with correctly and cost efficiently. A sales tax system that has exemptions, multiple definitions and potentially different rates is not simple. What services would be exempt from a new tax on professional services? What rules will be developed to define what a service is and what is not?

The MNCPA recognizes the need for legislators to balance the state budget and look for revenue sources to accomplish that goal, but there are many unresolved issues and potential problems for CPAs. A few include: multiple points of delivery and use, multiple points of creation of the service, and multiple taxing jurisdictions.

Talking points

- It does not work and has been difficult to administer in states that have passed it. Florida, Iowa and Michigan have repealed it. Florida repealed it six months after passage, Iowa one month after passage and Michigan repealed their law before it even became effective.
- Potential compliance issues may arise when trying to determine where the service was actually provided. Will it be where the CPA is located or where the client is located? If the state chooses to tax professional services, the law needs to be clear and not leave administration interpretations to the Department of Revenue.
- Potential for a service to be taxed twice. Once where it originated and once where it was delivered.
- With the passing of mobility in 2008, a tax on accounting services creates a competitive disadvantage for CPAs doing work for clients in states without a tax on accounting services.
- Should Minnesota tax people for seeking professional advice to ensure they are following tax law when filing their taxes?

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- Without a business-to-business exemption there is the potential for tax pyramiding on services and final goods. The potential for goods and services to be taxed several times exists and will result in higher consumer costs.

County Government Audits

The Issue

In 2004, the MNCPA was successful in passing legislation allowing the state auditor to permit counties to seek bids from private CPA firms to conduct the county audits. The legislation was permissive and did not require the state auditor to allow all counties to participate in this process. Instead a group of counties was selected as a pilot program for three years, with the original intent to then allow all counties the option.

The program has not been fully implemented across the state. There are many counties that have not been given the opportunity to seek competitive bids and potentially reduce the county costs for the audits.

The Minnesota Association of Counties will again work again to resolve this issue during the 2011 session. The MNCPA Legislative Issues Committee recommends the MNCPA support the counties efforts to find acceptable resolution with the state auditor's office.

Talking Points

CPA firms have demonstrated they can perform the audits for less cost and complete the audit report in significantly less time than the state.

All levels of government are facing budget issues and should not be forced to incur higher costs when statutory language exists that would allow them to save money through a competitive bid process.

Solution

Allow all counties the option to seek competitive bids for their audit services. The state auditor should also be allowed to seek bids.

Board of Accountancy Funding

The Issue

Like most other state agencies, the BOA will be expected to reduce costs and run even more efficiently. The BOA is a model agency and future reductions could impact its ability to adequately regulate the CPA profession.

Why you should care

Over regulation can hinder a CPAs ability to succeed, but inadequate regulation could be disastrous for the profession and your business.

Talking Points

- The Board of Accountancy needs the necessary resources to maintain the level of oversight needed to protect the public and the integrity and credibility of the CPA profession.
- Legislators should maintain funding to the BOA at levels that will allow adequate oversight
- The BOA should not be punished for efficiencies other agencies and boards have not yet implemented.
- There should be some consistency between the number of licensees and the number of board staff and those boards that have already made changes to improve efficiency and cut costs.

State agency	Licensees/firms	Total staff (FTE)	Investigators	Ratio
Board of Accountancy	17,072	3.5	1	4878:1
Board of Chiropractic	2,500	5	1	500:1
Board of Pharmacy	18,618	11	5	1693:1
Board of Psychology	3,400	11	2	309:1
Board of Physical Therapy	5,200	3	0	1733:1
Board of Cosmetology	38,000	13	4	2923:1
Board of Dentistry	16,250	10	1	1625:1
AELSLAGID	17,805	5.5	1	3237:1

**AELSLAGID=Board of Architecture, Engineers, Land Surveying, Landscape Architecture, Geoscience and Interior Design*

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