

Despite Clash Over Tax Cuts, Governor Dayton Signs Bill Enacting Important Income Tax Changes for Minnesota Residents and Nonresidents

by Katina M. Peterson and Katrina Wessbecker

On May 30, 2017, Governor Dayton signed into law Minnesota's omnibus tax bill ([HF 1](#)), which contains significant income tax changes of interest to both residents and nonresidents of Minnesota.

Initially, Governor Dayton returned the bill without signature due to concerns he expressed in two letters to legislative leaders (available [here](#) and [here](#)) about the bill's cost and tax cuts to certain businesses and high net-worth individuals. To remove any doubt about the status of the bill, which also provides necessary funding for the Minnesota Department of Revenue, Governor Dayton signed the bill into law despite his concerns.

The bill includes roughly 40 changes to Minnesota's individual income tax provisions, including: (1) much needed clarity about the effect of the location of a taxpayer's attorneys, accountants, financial advisers, and bank accounts in the application of Minnesota's domicile test for determining whether an individual is a Minnesota resident; (2) accelerating individual income tax on installment sales of Minnesota pass-through entities by nonresidents or by residents who move out of Minnesota; and (3) subtractions and credits for education expenses, including a subtraction for contributions to section 529 college savings plans.

Location of a Taxpayer's Attorneys, Accountants, and Bank Accounts

The bill modifies the domicile test under Minn. Stat. § 290.01, subd. 7, by prohibiting the Minnesota Department of Revenue (the "Department") and courts from considering the location of an individual's attorney, certified public accountant, or financial adviser in determining where an individual is domiciled for Minnesota income tax purposes. The bill also prohibits consideration of the place of business of a financial institution where an individual applies for any new type of credit or at which the individual opens or maintains any type of account. The change is effective beginning in tax year 2017.

Since 2014, the Department and the Legislature have attempted repeatedly to address

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the uncertainty around the effect of these relationships on a taxpayer's residency (see our prior article on the topic available [here](#)). Under the Department's 26-factor analysis for determining whether an individual is domiciled in Minnesota, see Minn. R. 8001.0300, subp. 3, the location of a taxpayer's bank accounts was considered in determining a taxpayer's residency. While the location of a taxpayer's attorneys and accountants was not expressly mentioned in any of the Department's 26 factors, the Department interpreted one of the factors, the "location of business relationships and the place where business is transacted," to encompass all types of contacts and relationships, including a taxpayer's relationships with attorneys and accountants.

This change will significantly alter how the Department and Minnesota courts currently apply the domicile test. It also provides much needed certainty for taxpayers and their tax advisers on excluding the location of an individual's professional advisers from the current domicile considerations.

Installment Sales of Pass-Through Entities by Nonresidents

The 2017 omnibus tax bill also accelerates recognition of gains on installment sales of Minnesota pass-through entities by a nonresident owner or a person who becomes a nonresident owner during the tax year. For purposes of this provision, "installment sale" means any installment sale under Section 453 of the Internal Revenue Code, or any other sale that is reported utilizing an accounting method that allows a taxpayer to delay reporting or recognizing a realized gain until a future year. The provision applies to a sale of the assets of, or any interest in, an S corporation or partnership that operated in Minnesota during the year of the sale.

Nonresident taxpayers may elect out of the accelerated treatment by filing an election form on or before the due date (including any extension) of the individual income tax return for the tax year of the sale. On the election form, the taxpayer must agree to:

- File Minnesota tax returns in years in which the gain from the installment sale is recognized for federal tax purposes and reported to the Internal Revenue Service;
- Allocate the gain to Minnesota as though the gain was realized in the year of the sale; and
- Include all relevant federal tax documents reporting the installment sale with subsequent Minnesota tax returns.

If a nonresident taxpayer does not file the election form and accelerated treatment applies, the income or gain recognized for Minnesota tax purposes is excluded in the year it is recognized for federal tax purposes.

The new law, which is effective beginning in tax year 2017, requires careful consideration and planning for nonresidents and residents intending to leave Minnesota that own interests in pass-through entities operating in Minnesota. Taxpayers will want to consider the timing of the sale, the applicable tax rates, and whether to elect out of accelerated treatment. A taxpayer electing out of accelerated treatment should pay close attention to the procedural requirements for making the election to be sure that the election applies.

Subtraction for Contributions to Section 529 College Savings Plans

Among the provisions addressing education expenses, the subtraction for contributions to Section 529 college savings plans is noteworthy. Unlike the credit for contributions to such plans, which applies to residents and part-year residents and fully phases out for income of \$100,001 and above (or \$160,000 and above in the case of married filing joint), there are no income limitations for claiming the subtraction.

The new law allows taxpayers to deduct up to \$1,500 (or \$3,000 in the case of married joint filers) of contributions to any state's Section 529 college savings plan or prepaid tuition plan for purposes of computing Minnesota individual income tax. The subtraction excludes amounts that are rolled-over from other college savings plans. The subtraction also cannot be claimed by resident and part-year resident taxpayers who claim the credit for contributions to such plans. The law is effective beginning in tax year 2017.

If you would like additional information or have any questions about how these new laws apply in your particular circumstances, please contact us.