

April 28, 2025

	Yes	No
DOR Administrative Costs/Savings		X

Department of Revenue
Analysis of H.F. 3127 (Davids) / S.F. 3405 (Rest)

	Fund Impact			
	<u>F.Y. 2026</u>	<u>F.Y. 2027</u>	<u>F.Y. 2028</u>	<u>F.Y. 2029</u>
	(000's)			
General Fund	\$0	(Unknown)	(Unknown)	\$0

Effective the day following enactment.

EXPLANATION OF THE BILL

Current Law: Pass-through entities such as S corporations and partnerships do not generally pay state or federal income taxes directly. Their income is passed to shareholders, who report the income on their individual income tax returns.

Beginning in tax year 2021, Minnesota created a pass-through entity tax that allows a partnership, S corporation, or limited liability company to file and compute tax liability at the entity level. The pass-through entity tax is equal to the sum of the tax liability of each qualifying owner. Beginning in 2023, all of the income of a resident qualifying owner of a partnership or limited liability company taxed as a partnership is allocated to Minnesota. The income of a nonresident and a resident qualifying owner of an S corporation is allocated to the state as it is for income tax purposes. The resulting income is then multiplied by 9.85%.

Certain nonresident owners may have their Minnesota income tax filing requirement satisfied by the entity's Schedule PTE, similar to composite income tax. The other owners will receive a refundable income tax credit equal to 100% of their portion of the PTE tax paid by the entity.

If the election is made by the majority of qualifying owners of the qualifying entity (having more than 50% of the ownership interest of qualifying owners), the election is binding on all qualifying owners of the entity. The election must be made by the date the return is due or the extended due date.

The credit expires at the same time as the federal limitation on state and local taxes expires, after tax year 2025.

Proposed Law: The bill would extend the pass-through entity tax and the credit through tax year 2027.

REVENUE ANALYSIS DETAIL

- In tax year 2022, about \$1.67 billion in PTE tax credits were claimed on 48,200 returns. In 2023, about \$1.94 billion in credits were claimed on 60,600 returns.

REVENUE ANALYSIS DETAIL (Cont.)

- Because the PTE tax credit offsets the tax, the net effect will generally be revenue neutral. However, the federal deduction for PTE taxes paid may reduce a shareholder's federal adjusted gross income and may affect the shareholder's Minnesota tax liability and eligibility for tax credits.
- For example, the standard deduction and itemized deductions are phased out by adjusted gross income over a certain threshold. The reduction in FAGI may increase a taxpayer's standard deduction or itemized deductions. Credits such as the child and working family credits also depend on FAGI.
- Because the bill extends the pass-through entity tax, it will reduce Minnesota tax liability by an unknown amount in tax years 2026 and 2027.
- Tax year impacts are allocated to the following fiscal year.

Number of Taxpayers: About 60,600 returns.

Minnesota Department of Revenue
Tax Research Division
[https://www.revenue.state.mn.us/
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