IDAHO
State Tax Commission

Attachment 1

2021 Idaho Conformity to Internal Revenue Code and Federal Tax Law Changes

Idaho is aligned with the Internal Revenue Code (IRC) as of January 1, 2020. This bill will move that date forward to January 1, 2021. This bill is to enable taxpayers and tax professionals to prepare 2020 income tax returns.

Idaho's income tax code is based on starting with the federal taxable income. Our state tax returns begin with adjusted gross income (AGI) for convenience. It's important to note that the only thing we really conform to is the calculation of federal taxable income, including IRC changes affecting that calculation. Federal taxable income for each taxpayer then is adjusted according to Idaho law to arrive at their Idaho taxable income.

I'm including a copy of the Idaho statutes governing conformity.

By starting with the federal taxable income, Idaho can use most of the federal definitions of income and deductions and avoid having to duplicate all the statutes necessary to get to that point while retaining control of specific issues that Idaho chooses whether to adopt. There's no need to define wages, expenses, and all the basics separately in Idaho law.

Using the federal taxable income as a starting point saves Idaho taxpayers a tremendous amount of work by not having to replicate the effort of preparing the federal income tax return – by using the answer from that return as the starting point for the Idaho return and then making the adjustments required by Idaho law.

The fiscal impact this year is large. The CARES Act and the December stimulus bill that Congress passed have some large tax cuts. The cost of Idaho conforming to those are estimated at approximately $59 million.

Idaho has opted not to conform to specific federal laws in the past while still conforming to the IRC in general. Bonus depreciation is one example.

Using the taxable income number from the federal return as the starting point for the Idaho return and then making the adjustments required by Idaho law dramatically simplifies the income tax reporting process. If Idaho didn't update the conformity date it would have a significant negative impact on Idaho businesses and individuals. It would delay the 2020 tax filing season significantly and increase the cost of processing.

The higher-than-average cost of conforming this year is because Congress was trying to help businesses and individuals survive the uncertain economy in 2020. In addition to the direct stimulus payments, Congress relaxed the tax rules in several places to provide relief. This year we've given a likely range for the cost of each item. A lot of these depend on taxpayer behavior. We took an overall weighted average for the total cost to be $59 million. A review committee made up of Tax Commission staff, Division of Financial Management staff, and some members of the Idaho Society of CPAs' tax committee was formed to review these bills and formulate the cost.

1. Looking at our fiscal note, the first item listed is a temporary waiver of the minimum distribution and contribution rules for individual retirement arrangements. The old rules required people to start taking distributions from IRAs and stop making contributions in the year that they turned 70½. This change allows taxpayers to wait until they reach 72 years of age to start taking distributions and stop making

contributions. We estimated the cost range to be approximately $9.5 million to $12.7 million. This change exclusively helps individual taxpayers. The federal laws involved are IRA –26 USC 72, distributions are in code sections 408a & 408b.

2. The next item is some changes to the charitable contribution rules. One new rule is that people who don't itemize on their 2020 income tax return can still take a $300 deduction for charitable contributions "above the line." That means the deduction for charitable contributions is included in the starting point for calculating Idaho taxes – the AGI. In addition, individuals who itemize can deduct charitable contributions up to 100% of their taxable income for 2020. It previously was 60%. Corporations can deduct 25%, which is up from 10%. We estimate the cost of these changes at between $1.3 million and $1.7 million. These changes help both individuals and corporations. The federal law involved is 26 USC 62(a)(22), & 170.

3. This next one is the relaxation of the noncorporate loss limitation that was imposed by the Tax Cuts and Jobs Act, (TCJA) of 2017. The limit in that law for claiming losses from partnerships and Sub Chapter S Corporations was set at $250,000 for a single person or $500,000 if you were married filing a joint return. Congress since has removed the limitation for the 2018 through the 2020 tax years. This is one of the most expensive changes for tax year 2020, but it's meant to help struggling business owners. We estimate the cost at between $24 million and $53.4 million. This helps individual taxpayers that own or invest in businesses. The federal law involved is 26 USC 461(l).

4. Next is a relaxation of the deduction limit on business operating interest. The TCJA limited the amount of operating interest a business could deduct to 30% of their adjusted taxable income – before operating interest expense. The CARES Act increased that limit to 50% for tax years 2019 and 2020. We estimate the cost of that change to be between $8.5 million and $9.2 million. This impacts large corporations and businesses. The federal law involved is 26 USC 163(j).

5. The CARES Act also gave taxpayers a break for nonprescription medical products. The definition of qualified medical expenses was expanded to include over-the-counter medications and personal care products. Federal law allows amounts paid from Health Savings Accounts and Archer Medical Savings Accounts after December 31, 2019, to be treated as payments for medical care even if no prescription is involved. The same standard applies to payments from voluntary Employee Flexible Spending Arrangements and Employer Health Reimbursement Arrangements. Having different federal and state definitions of qualified medical expenses would require taxpayers to keep two sets of records. The estimated cost of this change is approximately $70,000. This change impacts individual taxpayers. The federal law involved is 26 USC 223(d)(2).

The next section involves tax laws that were changed or extended by the December 2020 stimulus bill.

IDAHO
State Tax Commission

6. Congress made permanent a lower threshold for claiming medical expenses on Schedule A, the itemized deduction form. The threshold dropped from 10% to 7.5% of the taxpayer's AGI. We estimate the cost of that change at between $445,300 and $594,400. This change only impacts individual taxpayers. The federal law involved is 26 USC 213(f).

7. The December bill also contained an extension of the law allowing employers to deduct payments for employees' student loans. Employers previously were only allowed to reimburse tuition fees for employees. The TCJA expanded that to temporarily include student loan payments. We estimate the cost of this measure to be between $385,100 and $513,800. This change impacts employers regardless of the type of entity and the employees that receive these benefits. The federal law involved is 26 USC 127(c)(1)(B).

8. The next change is to allow a shorter depreciable life for nonresidential real estate. The life of nonresidential property has been 39 years for decades. This allows using a 30-year life, which increases the depreciation expense taken. We estimate this to cost between $532,380 and $1.4 million. This could impact individuals or corporations, anyone who invests in nonresidential property. The federal law involved is 26 USC 168(g)(2)(C).

9. The deduction for business meals has been expanded from 50% to 100%. The estimated cost is between $1.1 million and $1.5 million. This will impact both corporations and individual business owners. The federal law involved is 26 USC 274(n)(2).

10. The expanded charitable contributions deduction in the CARES Act that was mentioned above also was extended by Congress in December. This will impact the 2021 tax filing year and therefore Idaho's fiscal year 2021. The estimated cost is between $1.1 million and $1.5 million. This is primarily a deduction for individuals, there are no further changes for corporations in this one. The federal law involved is 26 USC 62(a)(22) & IRC 170.

11. In our SOP / fiscal note we combined the next seven items because each one is relatively small.

a. Deductions for energy efficient buildings were relaxed. The estimate for that change is between . $41,000 and $55,000. This impacts anyone that invests in energy efficient buildings. The federal law involved is 26 USC 179D(h).

b. The TCJA allowed taxpayers to remove from income any debt relief from a default on a principal residence. That's less important for Idaho because of rising home prices. To constitute debt relief, the homeowner must not only default on the mortgage, but the debt relief represents any amount the bank is unable to recover from selling the house. Our estimated cost is between $71,800 and $95,800. This exclusively impacts individuals that lose a home to foreclosure. The federal law involved is 26 USC 108(a)(1)(E).

c. There's an extra depreciation expense allowed for motor sports facilities. This certainly is going to impact states with NASCAR facilities more than Idaho. But since it's at least possible to have such a facility in Idaho, we estimate an approximately $1,000 cost. This is limited to businesses that own motor sports facilities. The federal law involved is 26 USC 168(i)(15)(D).

d. The TCJA allowed some additional costs for live theater and movie production. Again, those activities are more prevalent in other states, but we do have both theaters and some movie production in Idaho. We estimate that cost between $24,400 and $32,500. This benefits movie and theater businesses and the local economies that are involved. The federal law involved is 26 USC 181(g).

e. The TCJA also expanded the deductions available to investors in "Empowerment Zones." Several new empowerment zones were created by the TCJA. Those are overseen by the Idaho Department of Commerce. Those expanded deductions for expenses were extended in the December stimulus bill. Our estimate for the cost to Idaho is between $80,800 and $107,790. This helps taxpayers that invest in the designated empowerment zones. The federal law involved is 26 USC 1391(d)(1)(A)(i).

f. The last item is expected to be relatively small. The depreciation rules for businesses that are located on Indian reservations have been relaxed. Our estimated cost for this change is between $4,500 and $6,000. This helps owners of businesses that are located on Indian reservations. The federal law involved is 26 USC 168(j)(9).

Below are the Idaho tax statutes that affect conformity. I've added some bolding and underlining for emphasis. 63-3004 is the only statute that our conformity bill changes, and that change is limited to the effective date.

63-3002. DECLARATION OF INTENT. It is the intent of the legislature by the adoption of this act, insofar as possible to make the provisions of the Idaho act identical to the provisions of the Federal Internal Revenue Code ***relating to the measurement of taxable income,*** to the end that the taxable income reported each taxable year by a taxpayer to the internal revenue service shall be the identical sum reported to this state, subject only to modifications contained in the Idaho law; to achieve this result by the application of the various provisions of the Federal Internal Revenue Code relating to the definition of income, exceptions therefrom, deductions (personal and otherwise), accounting methods, taxation of trusts, estates, partnerships and corporations, basis and other pertinent provisions to gross income as defined therein, resulting in an amount called "taxable income" in the Internal Revenue Code, and then to impose the provisions of this act thereon to derive a sum called "Idaho taxable income"; to impose a tax on residents of this state measured by Idaho taxable income wherever derived and on the Idaho taxable income of nonresidents which is the result of activity within or derived from sources within this state. All the foregoing is subject to modifications in Idaho law including, without limitation, modifications applicable to unitary groups of corporations, which include corporations incorporated outside the United States. ***Emphasis added.***

63-3004. INTERNAL REVENUE CODE. (63-3004. INTERNAL REVENUE CODE. (1) The term "Internal Revenue Code" means the Internal Revenue Code of 1986, as amended, and in effect on the first day of January 202~~0~~1.

(2) For all purposes of the Idaho income tax act, a marriage must be one that is considered valid or recognized under section 28, article III, of the constitution of the state of Idaho and defined in section 32-201, Idaho Code, or as recognized under section 32-209, Idaho Code.

(3) Notwithstanding subsection (2) of this section, marriages recognized and permitted by the United States supreme court and the ninth circuit court of appeals shall also be recognized for purposes of the Idaho income tax act.

63-3011. GROSS INCOME. The term "gross income" means gross income as defined in section 61(a) of the Internal Revenue Code.

63-3011A. ADJUSTED GROSS INCOME. The term "adjusted gross income" means adjusted gross income as defined in section 62 of the Internal Revenue Code.

63-3011B. TAXABLE INCOME. The term "taxable income" means federal taxable income as determined under the Internal Revenue Code. Emphasis added.

63-3011C. IDAHO TAXABLE INCOME. The term "Idaho taxable income" means taxable income as modified pursuant to the Idaho adjustments specifically provided in this chapter. Emphasis added.