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NOTABLE DIFFERENCES IN STATE AND FEDERAL INCOME TAX STATUTES*

JOSEPH S. ABDNOR**

The Minnesota Income Tax Act of 1933 adopted many of the provisions of the Internal Revenue Code of that time. Professor Rottschaeffer,¹ in reviewing the then newly created Minnesota law, said:

"The statutory provisions dealing with them follow closely the principles and terminology found in the various Federal income tax acts since 1918. It would probably be unjustified to deduce from this an inference that our legislature specifically intended to incorporate into its own law every judicial or administrative interpretation of the Federal acts heretofore made. Its intention was more probably the narrower one of aiding officials and others likely to be involved in administering the law by making available to them a highly developed body of opinion entitled to great persuasive force."

Judicial developments in the Minnesota State Court indicate that Professor Rottschaefer's estimate of the applicability of prior federal judicial interpretation was somewhat modest. In State v. Stickney² the Minnesota Supreme Court said:

"The language and principles of the state income tax statute were taken from the various Federal income tax acts enacted prior thereto since 1918. . . . The prior construction of the Federal act should be considered in construing the state law. Where the state statute is the same or substantially the same as the Federal act from which it was copied, the prior construction of the Federal statute should be deemed controlling by us in construing the state statute."

*This article was presented as a lecture at the Continuation Legal Course in Income Taxation at the University of Minnesota Center for Continuation Study on May 28, 1953.
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¹ Rottschaefer, The Minnesota State Income Tax, 18 Minn. L. Rev. 93, 94 (1934).
² 213 Minn. 89, 91-92, 5 N. W. 2d 351, 352 (1942).
While decisions of the federal courts rendered subsequent to the time of the adoption of the Minnesota Income Tax Act are not controlling, they are nevertheless of considerable assistance in interpreting the Minnesota law. In *Drew v. Commissioner of Taxation*\(^3\) the Minnesota Supreme Court said with reference to *Helvering v. Horst*\(^4\) that:

"The Horst case was decided some seven years after we adopted our state law, and consequently, as an interpretation, it is not controlling on this court within the rule of State v. Stickney, 213 Minn. 89. . . .

* * *

"We are not bound by the Horst case, though it is entitled to due deference and respect."\(^5\)

Experience of tax administrators as well as taxpayers through the past twenty years since the adoption of the Minnesota Income Tax Act has, for the most part, demonstrated that the framers of the Minnesota act were wise in following the federal law. Certainly the adoption of the federal law as construed by the federal courts initially eliminated a great deal of the litigation normally required in the interpretation and application of any new tax law. Through the years multiplicity of litigation has been diminished by the fact that an interpretation by the federal courts has often been acceptable as interpretative of the Minnesota law to the Minnesota tax administrators and taxpayers alike. The desirability of maintaining uniformity between the federal and state income tax laws is demonstrated further by the fact that in virtually every session of the legislature the Minnesota law has been amended to conform to certain changes made in the federal law. For example, in the 1953 legislature the following amendments were enacted, all of which tend to bring the Minnesota Income Tax Act into even greater conformity with the federal law.

1. Chapter 664\(^6\) permits a husband and wife to make a single return jointly even though one of them has neither gross income nor deductions and permits a surviving spouse to file a joint return for the full taxable year including the income of the deceased spouse for that part of the taxable year during which he was alive.

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3. 222 Minn. 186, 190, 23 N. W. 2d 565, 567 (1946).
4. 311 U. S. 112 (1940).
2. Chapter 622 permits estates and trusts filing income tax returns for a period of less than 12 months because of termination of the estate or trust to file on the 15th day of the fourth month following the close of their taxable years, provided they pay their taxes in full at that time.

3. Chapter 648 amends our law to conform the Minnesota definition of a stock dividend to the federal definition.

From the foregoing it is seen that the Minnesota law at the time of its original enactment in 1933 and through the years following has largely conformed to the provisions of the Internal Revenue Code. Unfortunately, the general conformity of the Minnesota law to the federal law sometimes leads practitioners to overlook or fail to recognize the differences that do exist. This discussion will not pretend to present all of the differences in the two laws for some of these differences are so commonly known that a discussion here would not be warranted. Still other differences are of such narrow application that they would not be of general interest.

It is perhaps natural that our discussion should first center around the differences in filing requirements in the state and federal laws. I should like to review briefly the requirements under Minnesota law for filing tax returns by individuals and fiduciaries. While these requirements are relatively simple and very fundamental in the law, representatives of the state rarely overlook an opportunity to review them because of what appears yet to be a failure on the part of a great many taxpayers to understand these rules. If an individual or fiduciary has gross income of $1,000 or more or a normal income tax in excess of applicable credits, a Minnesota income tax return is required. If the combined income of a husband and wife exceeds $2,000 or if the tax upon the combined income of husband and wife exceeds applicable credits, then joint or separate returns are required. If a corporation has gross income before deductions in excess of $5,000 or net income after deductions in excess of $500 a Minnesota income tax return must be filed. It should be observed that many corporations have income arising within Minnesota as well as in states outside of Minnesota, under which circum-
stance provisions are made for allocating net income to this state.\textsuperscript{12} The law requiring the filing of a return by a corporation if its gross income exceeds $5,000 or its net taxable income exceeds $500 contemplates income from all sources and not simply income assignable to the State of Minnesota under the apportionment statute.\textsuperscript{13}

While the federal law permits corporations to file consolidated returns under certain circumstances,\textsuperscript{14} Minnesota has no law permitting such consolidated returns by corporations.

No estimates, declarations or withholding are required under the Minnesota law, but our law does permit an advance payment of estimated taxes before the end of the taxable year for which the payment is made.\textsuperscript{15} Minnesota law also permits payment of income taxes in two instalments in the year following the year for which the taxes are assessed.\textsuperscript{16}

At this point I should like to call attention to a provision of the Minnesota law which is virtually the same as the federal law but which is often overlooked. A Minnesota taxpayer may change his accounting period only with the consent of the Commissioner of Taxation.\textsuperscript{17} Article 7-2 of Minnesota regulations provides that application for such permission shall be filed with the Commissioner at least 30 days prior to the close of the proposed period for which a return would be required to effect the change. Unfortunately, too often taxpayers request of the Commissioner of Internal Revenue permission to change their accounting period but overlook the necessity for making a similar request of the Commissioner of Taxation for Minnesota until after the time limited by the regulation has passed.

As to items includible in gross income there are certain basic differences between the federal and state laws. Interest on U. S. Government Bonds is for the most part includible for federal income tax purposes.\textsuperscript{18} The State of Minnesota does not tax interest on Government bonds to individuals\textsuperscript{19} but under Minnesota law such interest is includible in the measure of the franchise tax imposed by

\begin{itemize}
  \item \textsuperscript{12} Minn. Stat. § 290.19 (1949).
  \item \textsuperscript{13} Minn. Stat. § 290.01(20) (1949) defines gross income as including 
  \"... income derived from any source.\"
  \item \textsuperscript{14} Int. Rev. Code § 141(a) permits an affiliated group of corporations to file a consolidated return if all consent to all the consolidated return regulations made prior to the last day for filing. The term \"affiliated group\" is defined in Int. Rev. Code § 141(d) and U. S. Treas. Reg. 129 § 24.2(b) (1951).
  \item \textsuperscript{15} Minn. Stat. § 290.45(3) (1949).
  \item \textsuperscript{16} Minn. Stat. § 290.45(1) (1949).
  \item \textsuperscript{17} Minn. Stat. § 290.07(2) (1949).
  \item \textsuperscript{18} Int. Rev. Code § 22(b) (4) (C).
  \item \textsuperscript{19} Minn. Stat. § 290.08(7) (1949).
\end{itemize}
Minnesota Statutes, Section 290.02, against corporations. The State of Minnesota exempts interest on bonds of the State of Minnesota from tax except that such interest is included in the measure of the franchise tax imposed against corporations. Interest on bonds issued by states other than Minnesota is not exempt from tax under Minnesota law. The Federal Government does not tax interest on bonds of any state.

Under Minnesota Statutes, Section 290.08(5), the State of Minnesota excludes from gross income:

"Amounts, including interest, received by any person from the United States or from the State of Minnesota or any of its political or governmental subdivisions, either as a refund of contributions to, or by way of payment as a pension, public employee retirement benefit, . . . ."

Most of the aforementioned items excluded from gross income in Minnesota are taxed by the Federal Government under the 3% rule applicable to annuities and after the taxpayer's investment in any of these various funds is recovered, the Federal Government taxes the remaining payments on the full amount thereof.

Under Minnesota law $3,000 of the military pay of servicemen and women is excluded from gross income and there is no provision in the state law requiring that military services be performed in combat areas. Furthermore, there is no distinction drawn between the pay of commissioned and non-commissioned personnel. The federal law excludes from gross income the compensation of members of the armed services received for any month during any part of which such members served in a combat zone after June 24, 1950 and prior to January 1, 1954, except that such exclusion is limited to $200.00 per month in the case of commissioned officers. The Federal Internal Revenue Act of 1951 extended the exemption for both commissioned and non-commissioned men to include the compensation received while hospitalized as a result of wounds, disease or injury incurred while serving in a combat zone.

Except for the limitation upon the jurisdiction of the state to tax income earned or produced outside of its borders, the foregoing

constitute the principal differences between the federal and state laws relating to inclusions in gross income. I shall now turn to provisions relating to deductions and credits and treat these matters together for, while an item may be termed a deduction under federal law and a credit under state law, the effect is generally about the same.

The federal law allows to individuals an automatic ten per cent deduction in lieu of itemized deductions. Under the federal law this deduction is limited to $1,000 for a husband and wife together when filing a joint return and is limited to $500 each when husband and wife file separate returns.\(^2^9\) The Minnesota law is similar as to the allowance of an automatic deduction of ten per cent of adjusted gross income but under our law since the last session of the legislature each taxpayer may claim this automatic deduction up to $1,000 if husband and wife have separate income and file separate returns.\(^3^0\)

Under the provisions of Minnesota Statutes, Section 290.10(9), no deduction is allowed in this state for expenses, interest and taxes connected with or allocable against the production or receipt of income not included in the measure of the tax imposed by our act. The only similar provision in the Internal Revenue Code appears to be contained in Section 211(c)(2) wherein deductions except for charitable deductions allowed under Section 213(c) are allowed only to the extent they are allocable to gross income in the case of a non-resident alien individual not engaged in a trade or business within the United States.

Minnesota Statutes, Section 290.06(5), allows to corporations a property payroll credit against the Minnesota tax computed by applying to the tax a fraction equal to 1/10 of the average of the ratio of property and wages in Minnesota to property and wages everywhere. No similar provision exists under the federal law and it is amazing to observe how many corporate taxpayers have overlooked this property payroll credit. This credit is substantial and should be noted by everyone preparing a return for a corporate taxpayer in Minnesota.

Both the state and federal law have similar provisions relating to the taxation of items of gross income received or receivable by the estate of the decedent or beneficiaries thereto after the date of death. With regard to this general law and particularly with respect to

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income distributed or distributable during a taxable year to a beneficiary the Minnesota law at Section 290.077(3) provides:

“If a right described in subdivision 1 of this section to receive an amount is transformed to a non-resident by the executor or administrator of an estate, the fair market value of such right at the date of the transfer shall be included in the gross income of the estate for the year in which such transfer occurs and the value of such right shall not be allowed as a deduction in computing the taxable net income of the estate. The estate shall not include the value of such right in its gross income and the executor or administrator shall be relieved of any further liability with respect to such right if the non-resident; (A) includes the fair market value of such right (as of the date the right is received) in his gross income for the year such right is received and pays the tax thereon, or (B) elects to include the amount received in payment of such right in his gross income for the year in which such payment is received and pays the tax thereon in the same manner as a resident of this state and files a bond with the commissioner of taxation during the year such right is received, in such form and in such amount as the commissioner may deem necessary to assure payment of the tax. A bond required under (B) shall be deemed sufficient if in an amount equivalent to the tax which would be due if the method provided in (A) were followed.”

Obviously, the foregoing rule is designed to protect the state in collection of taxes from a non-resident beneficiary of income from a Minnesota estate and no similar provision is contained or required in the federal law. With regard to trusts and estates the federal law has what is known as the 65-day rule to the effect that if a distribution of income is made to beneficiaries within 65 days after the close of the taxable year such distribution is treated as though it was made during the taxable year.31 There is no comparable provision in Minnesota law.

Before the Internal Revenue Act of 1942 non-trade or non-business expenses were not deductible although non-trade or non-business income such as income from investments was fully taxable. In 1942 the Federal Act was amended. Under the provisions of Section 23(a)(2) the Internal Revenue Code now allows as a deduction in the computation of net income:

“In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.”

The State of Minnesota has not adopted the Federal Amendment of 1942 to Section 23(a) of the Internal Revenue Code and under

state law no deduction is allowed for expenses paid or incurred for the management, conservation or maintenance of non-trade or non-business property held for the production of income. The Minnesota law does allow expenses paid or incurred for the production or collection of income from such property.\textsuperscript{32}

With regard to the allowance of deduction for depletion in the case of mines, oil and gas wells, other natural deposits and timber, Minnesota Statutes, Section 290.09(7) in common with Section 23(m) of the Internal Revenue Code permits a reasonable allowance for depletion. The similarity in the two laws with regard to such depletion ends at this point, however, for Section 114(b)(3) and (4) of the Internal Revenue Code authorizes a percentage depletion for oil and gas wells, coal and metal mines and certain other mines and natural mineral deposits. The Minnesota law has no part comparable to the aforementioned provision of the Internal Revenue Code allowing percentage depletion. Also with regard to mines, the federal law at Section 114(b)(2) authorizes for purposes of computing depletion other than percentage depletion the use of the fair market value of the property at the date of discovery of minerals in commercial quantities contained within a vein or deposit under certain conditions and with certain limitations. This section of the federal law has no counterpart in the state law.

With regard to deductions for hospital, medical and dental expenses it is quite generally known among the taxpayers in this state that the federal law and regulations are somewhat broader than the state law. If there is any question on these deductions, I suggest examination of the applicable laws and regulations.\textsuperscript{33} I should like to emphasize, however, that the federal regulation allows reasonable costs of travel primarily for and essential to the rendition of the medical service or to the prevention or alleviation of a physical or mental defect or illness as a deduction.\textsuperscript{34} The Minnesota Statute specifically provides that payments for travelling expenses shall not be deductible and that payments for hotel or similar lodging expenses shall be deductible only if the taxpayer is required to remain in a medical center away from his usual place of abode for the purpose of receiving prescribed medical treatment.\textsuperscript{35} While the

\textsuperscript{32} See Minn. Reg. Comm'r Tax., Art. 10-1; "The following are considered as nondeductible items under Section 290.10: . . . "Expenditures made in preparation for an activity which is intended to produce income where it may properly be capitalized."

\textsuperscript{33} Int. Rev. Code § 23(x); U. S. Treas. Reg. 111, § 29.23(x)-1; Minn. Stat. § 290.09(11) (1949); Minn. Reg. Comm'r Tax., Art. 9-24.

\textsuperscript{34} U. S. Treas. Reg. 111, § 29.33(x)-1 (1943).

\textsuperscript{35} Minn. Stat. § 290.09(11) (1949).
federal law is more liberal in types of medical deductions allowed, it should be noted that the same law permits a deduction of medical expenses for persons under sixty-five of only that amount that exceeds 5% of the adjusted gross income and limits a deduction for medical expenses to $1,250 multiplied by the number of exemptions (exemption for age and blindness cannot be considered) with a maximum of $2,500 for each taxpayer. The Minnesota law has neither of these limitations.

With regard to a deduction for charitable and other contributions the state and federal laws are very similar except that deduction for contributions by the state law is limited to 15% of gross income as to all taxpayers, both individual and corporation. Under the current federal law contributions are limited to 20% of gross income as to individuals and 5% as to corporations. A further distinction lies in the Minnesota law as to contributions made by taxpayers earning income both within and without Minnesota. As to such taxpayers a deduction is allowed of 100% of contributions to Minnesota organizations. As to non-Minnesota organizations, allowance for contributions is prorated on the basis of Minnesota net taxable income to net taxable income everywhere. For example, if a corporate taxpayer does business in Minnesota and South Dakota and 75% of its income is taxable in Minnesota then a deduction is allowed for 75% of its contributions to a charitable organization located in South Dakota.

Under both the state and federal law a credit or deduction is allowed based upon 85% of dividends received by a corporation during the taxable year from another corporation when the corporate stock with respect to which the dividends are paid does not constitute the stock in trade of the taxpayer or would not be included in the inventory of the taxpayer or does not constitute property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or when the trade or business of the taxpayer does not consist principally of the holding of the stocks and the collection of the income and gains therefrom. The state law goes one step further than the federal law and provides that the remaining 15% of such dividends shall be allowed as a deduction or credit if the recipient owns 80% or more of all the voting stock of

37. Minn. Stat. § 291.21(2) (e) (1949).
41. See Int. Rev. Code § 26(b) (1); Minn. Stat. § 290.21(3) (a) (1949).
42. Ibid.
such other corporation and the dividends were paid from income arising out of business done in this state by the corporation paying such dividends.\textsuperscript{42} Also, under state law if the corporation paying the dividends does business partly within and partly without Minnesota then the additional credit is prorated under the terms of Minnesota Statutes, Section 290.21(3)(a).\textsuperscript{43}

We now turn to a discussion of net operating loss and the treatment of such loss under state and federal law. The federal law allows a carry-back of net operating losses for one year\textsuperscript{44} and permits such losses to be carried forward for five years.\textsuperscript{45} Under Minnesota law, there is no provision for the carry-back of net operating losses but the law does provide that losses may be carried forward for two years.\textsuperscript{46} In computing net operating loss under Minnesota law, federal income taxes paid are not includible.\textsuperscript{47} So far as we know there is no similar provision specifically contained in the federal law. It is to be noted, however, that I. T. 3951, 1949-1 Cum. Bull. 84, holds "that in determining a net operating loss under section 122 of the Internal Revenue Code in the case of a taxpayer other than a corporation, the amount of state income tax paid is allowable as a deduction only to the extent of gross income not derived from a trade or business." Another point at which the Minnesota law differs from the federal law is again with regard to income produced both within and without the State of Minnesota. Minnesota losses carried forward are limited to Minnesota business operations for the year in which the operating loss occurred.\textsuperscript{48} For example, if a business operating within and without Minnesota suffered a loss in the year 1951 and under the apportionment formula only 5\% of its net income would be assignable to Minnesota in that year, then in the next year of 1952 a deduction for operating losses is limited to 5\% of those losses suffered in 1951 even though in 1952 that business may have had 10\% of its net income assignable to Minnesota.

Section 112 of the Internal Revenue Code governs the recognition of gain or loss. The analogous law in Minnesota is found at Minnesota Statutes, Section 290.13. To discuss these laws and the

\textsuperscript{42} The amount of dividend credit allowable is determined by applying the ratio which the Minnesota taxable net income for the taxable year preceding that of the dividend distribution bears to the entire corporate net income for such year. See Minn. Reg. Commr Tax., Art. 21-3 and examples.  
\textsuperscript{43} Int. Rev. Code § 122(b) (1) (B).  
\textsuperscript{44} Int. Rev. Code § 122(b) (2) (B).  
\textsuperscript{45} Minn. Stat. § 290.095(2) (1949); Minn. Reg. Commr Tax., Art. 95-2.  
\textsuperscript{46} Minn. Reg. Commr Tax., Art. 95-1(7).  
\textsuperscript{47} Minn. Reg. Commr Tax., Art 95-1(4).
numerous differences in detail would take more time than I am able to devote. I shall, therefore, be required to point out the differences in these two laws very briefly. All section numbers to which I refer will be those of the Internal Revenue Code. Section 112(b), Paragraph 1, relates to exchanges solely in kind of property held for productive use or investment; Paragraph 2 relates to exchange solely in kind of stock for other stock of the same corporation; Paragraph 3 relates to exchanges solely in kind of stock for other stock on reorganization; Paragraph 4 relates to non-recognition of gain or loss when a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization; Paragraph 5 relates to non-recognition of gain or loss under certain circumstances if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; and Paragraph 6 relates to property received by a corporation on complete liquidation of another corporation. The Minnesota law is virtually the same as those paragraphs cited just above. The federal law relating to gain and loss from exchanges not solely in kind is found at Section 112(c), (d) and (e). The Minnesota law in this respect also is virtually the same. Under federal law the recognition of gain and loss from an involuntary conversion is found at Section 112(f). Stated generally and briefly, Section 112(f)(2) provides that in certain cases wherein property is compulsorily or involuntarily converted into money, and the disposition of the converted property occurred before January 1, 1951, no gain shall be recognized if such money is forthwith in good faith, under regulations prescribed by the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted. Minnesota law has virtually adopted the provisions of Section 112(f), Paragraphs 1 and 2, except that there is no limitation in the Minnesota law relating to conversion occurring before January 1, 1951. Sections 112(g) and 112(h) of the federal law relating to the definition of reorganization and definition of control have been adopted in the Minnesota law. Section 112(k) relating to certain situations wherein an assumption of liability is not

recognized has been adopted in the Minnesota law.\textsuperscript{54} Section 112(n) relating to gain from sale or exchange of residence under the federal law was adopted by the Minnesota Legislature in the 1953 session except that in Minnesota both the residence sold and the new residence acquired must be located within the State of Minnesota.\textsuperscript{55}

The provisions of Section 112 not referred to above have not been incorporated into the Minnesota law. They include:

1. Section 112(f) (3) relating to conversion into money where disposition occurred after 1950 and time for assessment of deficiency attributable to gain or conversion.

2. Section 112(b) (7) relating to an election granted as to recognition of gain in certain corporate liquidations made in pursuance of a plan of liquidation adopted after December 31, 1950 and wherein disposition is completed within some calendar month in 1951 or 1952.

3. Section 112(b) (8) relating to exchanges and distributions in obedience to orders of the Security Exchange Commission.

4. Section 112(b) (9) relating to non-recognition of loss on certain railroad reorganizations.

5. Section 112(b) (10) relating to the non-recognition of gain or loss on reorganization of corporations and certain receivership and bankruptcy proceedings.

6. Section 112(b) (11) relating to distribution of stock not in liquidation.

7. Section 112(i) relating to foreign corporations.

8. Section 112(l) relating to exchanges by security holders in connection with certain corporate reorganizations.

9. Section 112(m) relating to gain from sale or exchange to effectuate policies of the Federal Communications Commission.

There are a number of differences between the federal and state laws relating to capital gains or losses. First, of course, there is a difference in the effective dates of the two laws in determining cost basis. Under federal law the basis relates fundamentally to cost or fair market value on March 1, 1913, whichever is higher.\textsuperscript{56} Under Minnesota law the basis relates to cost or fair market value on January 1, 1933, whichever is higher.\textsuperscript{57} With regard to capital assets acquired through probate proceedings upon the death of a person, the federal law permits the use of the higher market value within one year after the date of death if for federal estate tax

\textsuperscript{54} Minn. Laws 1951, c. 267, § 1.
\textsuperscript{55} Minn. Laws 1953, c. 141, § 2.
\textsuperscript{56} Int. Rev. Code § 113(a) (14).
\textsuperscript{57} Minn. Stat. §§ 290.12, 290.14, 290.15 (1949).
purposes that higher optional value was used in computing such federal estate tax.\textsuperscript{58} There is no similar provision in Minnesota law. If property is acquired by gift prior to 1921 the federal law permits the use of the fair market value at the date of the gift for purposes of computing the cost base.\textsuperscript{59} Here again, there is no like provision in Minnesota law.

In the computation of tax on capital gains and allowances for capital losses there are fundamental differences in the state and federal law.\textsuperscript{60}

1. If only long term gains are involved, then the effect of both laws is to tax 50% of the long term gains.

2. If long term gains are in excess of long term losses then the effect of both laws is to tax the excess of such gains over losses at 50%.

3. If only short term gains are involved, then under both laws such gains are taxed at 100%.

4. If short term gains exceed short term losses then the excess of short term gains over short term losses is taxable at 100% under both laws.

5. If there are only short term losses the federal law allows a deduction of 100% of such loss with a limitation of $1,000 and permits such losses to be carried forward 5 years. Minnesota law permits a deduction of 100% of such short term losses with a limitation of $2,000 and permits such losses to be carried forward two years.

6. If there are only long term losses the federal law allows the full amount of the loss subject to a limitation of $1,000 with a right to carry forward such losses 5 years. Minnesota law allows a deduction of 50% of such long term loss with a limitation of $2,000 deductible and permits the taxpayer to carry forward such losses for two years.

7. If there are long term gains and short term losses, various results are possible. The federal law applies 100% of long term gains against 100% of short term losses. If 100% of long term gains exceed 100% of short term losses then the net balance of gains is taxed at 50%. If 100% of short term losses exceeds 100% of long term gains, the excess of such short term losses over such long term gains is taxable at 50% under both laws.

\textsuperscript{58} Int. Rev. Code § 113(a) (5); U. S. Treas. Reg. 111, § 29.113(a) (5)-1 (b) (3) (1943).

\textsuperscript{59} Int. Rev. Code § 113(a) (2); U. S. Treas. Reg. 111, § 29.113(a) (2)-1.

\textsuperscript{60} The federal provisions creating the deduction from gross income of the excess of net long-term capital gains over net short-term capital loss is contained in Int. Rev. Code § 117(b). Limitations on allowable capital losses are set out in § 117(d) and carry-over provisions in § 117(e). The comparable Minnesota provisions are Minn. Stat. §§ 290.16(4), 290.16(5) and 290.16(6) (1949).
term gains, then the net loss is fully deductible with a limit of $1,000 and a right to carry over such loss for five years.

Under Minnesota law you apply 50% of long term gains against 100% of short term losses. On this basis if there is an excess of gains over losses such excess is taxable at the 50% figure. If there is an excess of short term losses over 50% of long term gains then the losses are fully deductible up to $2,000 with the right to carry over for two years.

8. Where there are long term losses and short term gains similar distinctions exist. Under federal law 100% of long term losses are applied against 100% of short term gains. If 100% of long term losses exceeds 100% of short term gains the losses are fully deductible up to $1,000 with the right to carry over five years. If short term gains exceed long term losses, then gains are taxable at 100%.

Under Minnesota law 50% of long term losses are applied against 100% of short term gains. If 50% of long term losses exceeds 100% of short term gains, then the excess of such 50% of long term losses is deductible up to $2,000 with the right to carry over two years. If 100% of short term gains exceeds 50% of long term losses then excess of gains is taxable at 100%.

Minnesota law has no provision for an alternative tax on capital gains such as that found in the federal law which puts a ceiling on the tax rate applicable to capital gains at 26%. Minnesota law treats individuals and corporations the same with regard to capital gains and losses while the federal law does not allow a capital loss to corporations.

An important distinction in the federal and state law is found in the treatment of worthless securities and non-business bad debts. The federal law treats non-business bad debts as short term capital losses and treats worthless securities as a loss from the sale or exchange, on the last day of the taxable year, of capital assets. Thus, a deduction for these items under the federal law is limited to $1,000 and can be carried forward 5 years. Minnesota law, on the other hand, treats worthless securities and non-business bad debts as a

63. Int. Re. Code, § 23(k)(4).
64. Int. Rev. Code 23(k)(2).
deduction from net income rather than capital losses and such de-
duction is allowed in full without the limitation applicable to capital
losses. It should be noted, however, that in Minnesota you cannot
carry forward any non-business deductions consisting of worthless
securities and bad debts.

This discussion probably would not be complete without refer-ence to the now famous Section 117(j) of the federal law as it
applies to farm animals. Under this section of the federal law as now
amended property used in the trade or business includes:

“Livestock, regardless of age, held by the taxpayer for draft,
breeding, or dairy purposes, and held by him for twelve months
or more from the date of acquisition. Such term does not include
poultry.”

The counterpart in the Minnesota law is found at Section 290.16
Subd. 9, which provides:

“For the purposes of this subdivision, livestock used for draft,
dairy, or breeding purposes and held for more than six months,
shall not be considered to be held by the taxpayer primarily
for sale to customers in the ordinary course of his trade or busi-
ness, irrespective of whether such livestock was raised or other-
wise acquired; and livestock which had been used for draft,
dairy, or breeding purposes and held for more than six months,
shall be considered to be held by the taxpayer primarily for sale
to customers in the ordinary course of his trade or business,
irrespective of whether such livestock was raised or otherwise
acquired if such livestock is not sold within two months after its
use for draft, dairy or breeding purposes has been discontinued.”

You will note the difference in the time set out in the two statutes
and the fact that the Minnesota law does not exclude poultry.

It is not possible to include all of the differences in the state and
federal laws. There are a number of provisions in the Minnesota
law appropriate to a state law which would not be as readily adapt-
able or necessary to the federal administration. For example, Minne-
sota law at Section 290.075 relates to treatment of income from
renegotiated contracts. Sections 290.17 through 290.20 relate to
apportionment of income and deductions of taxpayers receiving in-
come both within and without the State of Minnesota. Section
280.081 in Minnesota law deals with reciprocity granted to persons
earning income in Minnesota and living in adjoining states. For
the most part, I think that the preceding discussion calls attention
to the principal difference in the two laws which cause the most
concern to lawyers practicing in the State of Minnesota.