DEPARTMENT OF STATE REVENUE

Information Bulletin #119
Income Tax
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SUBJECT: Internal Revenue Code Provisions Not Followed by Indiana and Clarification of Related Issues

REFERENCE: IC 6-3-1-11; IC 6-3.1-21-6.

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I. INTRODUCTION

Under IC 6-3-1-11, the definition of "Internal Revenue Code" is established as of a specific date. At the time of publication of this bulletin, IC 6-3-1-11 defined "Internal Revenue Code" as the version in effect on January 1, 2020.

Because legislation is commonly enacted after the specified date but prior to when the Indiana General Assembly reconvenes each year, modifications made to the Internal Revenue Code after the specified date are not captured by Indiana. Further, these modifications are not listed in IC 6-3 or IC 6-5.5, so the modifications may not be readily apparent.

This bulletin is intended to provide a list of the most significant modifications necessary other than those specifically enumerated in IC 6-3 or IC 6-5.5. In many cases, these modifications may be adopted retroactively by the Indiana General Assembly.

Any reference in this document to the "CARES Act" is to P.L. 116-136, enacted March 27, 2020. Any reference to the "COVID-related Tax Relief Act of 2020" is to Division N, Title II, Subtitle B of the Consolidated Appropriations Act, 2021, P.L. 116-260, enacted December 27, 2020. Any reference to the "Taxpayer Certainty and Disaster Tax Relief Act of 2020" is to Division EE of the Consolidated Appropriations Act, 2021.

II. ITEMS NOT FOLLOWED BY INDIANA

A. Charitable Contributions

If an individual made a qualified charitable contribution deducted under IRC § 62(a)(22), the amount of that contribution must be added back in determining adjusted gross income. If an individual is a part-year resident, only the portion deducted for federal purposes and paid while the individual was an Indiana resident shall be required to be added back.

B. Student Loan Payments by an Employer

If an employer makes student loan payments to an employee, whether to the employee or directly to the lender, the employee is required to add back the amount of such payments made by the employer and excluded from the employee's gross income under IRC § 127(c)(1)(B), as added by the CARES Act § 2206(a) and extended by the § 120 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020. Any other payment excluded from gross income under the previous IRC § 127(c)(1)(B) (now IRC § 127(c)(1)(C)) shall continue to be allowed as excludible from adjusted gross income by Indiana.

However, if a payment is required to be added back under this provision, the deduction disallowance under IRC § 127(c)(7) and IRC § 221(e)(1) will *not* apply for Indiana purposes to the extent the amount added back otherwise would have been deductible for federal purposes.

C. Section 461*(l)* Loss Limitation Suspension

Under § 2304 of the CARES Act, the loss limitation under IRC § 461(*l*) was suspended for 2018, 2019, and 2020. Indiana does not follow this treatment. Instead, an affected taxpayer will be required to:

1. Add back the amount of any current-year excess loss that would have been disallowed for federal purposes in determining Indiana adjusted gross income, and
2. Add the amount disallowed under (1) to the individual's current year net operating loss available for carryover to future years.

For instance, if a married couple had a 2020 business loss of $900,000 that would have been treated as an excess business loss prior to the CARES Act, they would add back $400,000 in determining adjusted gross income and add that $400,000 to their 2020 net operating loss available for carryforward in 2021 and later. In the event there is no net operating loss available for 2020, this would create a new 2020 net operating loss.

In addition, in computing the loss, the technical amendments to IRC § 461(*l*) will be disregarded. Thus, the "without regard to any deduction allowable under § 172 or 199A" language will be disregarded and the new IRC § 461(*l*)(1)(B) provisions relating to capital gains also will be disregarded.

D. Excess Deduction Upon Termination of a Trust

Prior to 2020, an excess deduction upon the termination of a trust was considered an itemized deduction. However, in 2020, the Internal Revenue Service adopted Treas. Reg. 1.642(h)-2 and 1.642(h)-5 allowing certain excess deductions upon termination of an estate or trust to be treated as deductible in determining adjusted gross income. Though the federal regulations are generally applicable to taxable years beginning after October 19, 2020, taxpayers may elect the treatment under the regulations for taxable years beginning after December 31, 2017, and on or before October 19, 2020. Indiana does not recognize this allowance of above-the-line deductions, either prospectively or retroactively.

E. Special Rules for Retirement Distributions

Section 2202 of the CARES Act (IRC § 72 note) and § 312 of Taxpayer Certainty and Disaster Tax Relief Act of 2020 permit special relief for coronavirus-related retirement plan distributions and loans. Any references to the CARES Act shall also be applied in a similar manner to the provisions in the Taxpayer Certainty and Disaster Tax Relief Act of 2020.

Section 2202(a)(5) of the CARES Act permits an individual to elect inclusion of CARES Act distributions over a three-year period. Indiana has not adopted that provision permitting the election. Thus, Indiana will require full inclusion of any distribution in the year of distribution. However, future inclusions will be deductible in determining Indiana adjusted gross income. For purposes of applying the state of inclusion rules under 4 U.S.C. 114, the state of residence at the time of distribution will be used.

In addition, § 2202(a)(3) of the CARES Act permits repayments of distributions from retirement plans to be treated as qualified rollovers under certain conditions and to be excluded from federal adjusted gross income. Indiana does not follow this treatment. Thus, if a repayment is made to a qualified retirement plan, the amount repaid will be required to be added back in determining Indiana adjusted gross income. This rule also applies to recontributions of withdrawals for home purchases described in § 302(b) of the Taxpayer Certainty and Disaster Tax Relief Act of 2020.

Further, § 2202(b)(1) of the CARES Act increased the maximum amount outstanding as a loan from a qualified employer plan. The first change was to increase the threshold under IRC § 72(p)(2)(A)(i) from $50,000 to $100,000. The second change was to increase the ceiling in IRC § 72(p)(2)(A)(ii) from one-half of the present value of the nonforfeitable accrued benefit of the employee to the full present value. In this case, Indiana will treat a portion of the loan as a distribution. For an Indiana resident at the time of the excess loan, the amount includible in Indiana adjusted gross income as a distribution shall be computed as if these provisions were not enacted.

In addition, § 2202(b)(2) of the CARES Act allows for a delay in repayments with due dates from March 27, 2020, to December 31, 2020. For purposes of applying this section, Indiana will not treat the delay as resulting in a deemed distribution.

F. Depreciation on Qualified Improvement Property

Section 2307 of the CARES Act made two technical corrections relating to qualified improvement property. First,

the depreciation life was changed from 39-year property to 15-year property, which in turn allowed the property to be subject to bonus depreciation under IRC § 168(k). Indiana will continue to treat qualified improvement property as being subject to a 39-year life span.

In addition, the CARES Act added language to the definition of "qualified improvement property" such that the improvement is required to be "made by the taxpayer." The definition of qualified improvement property for Indiana purposes will be the current definition under IRC § 168(e) without the "made by the taxpayer" language.

G. Treatment of Menstrual Care Products

Section 3702 of the CARES Act provides various changes related to menstrual care products, retroactive to December 31, 2019. For purposes of this discussion, the definition of menstrual care products under IRC § 223(d)(2)(D), which applies to tampons, pads, and similar products, will be used.

First, for purposes of the exclusion for certain reimbursements, IRC § 106(f) was rewritten to provide that reimbursements for menstrual care products are treated as being for medical care and thus excludible from gross income. However, such amounts will not be excluded from gross income for Indiana purposes. Further, for Indiana purposes, the pre-2020 limitation under IRC § 106(f) will apply. That provision limited the reimbursement exclusion to prescribed medications and to insulin.

In addition, under IRC § 220(d)(2)(A) and § 223(d)(2)(A), amounts distributed from an Archer medical savings account or health savings account for menstrual care products will not be considered for qualified medical expenses unless such expense would have qualified under 2019 law. Accordingly, any such distribution will be includible in the Indiana adjusted gross income of the account holder if the account holder was an Indiana resident at the time of distribution.

H. Excess Interest Deductions under IRC § 163(j)

Section 2306 of the CARES Act modified the rules for the interest deduction under IRC § 163(j) to increase the allowance of interest from thirty percent (30%) of modified taxable income to fifty percent (50%) for 2019 and 2020. In addition, certain special provisions were enacted with regard to business interest expenses incurred by partnerships and S corporations for 2020.

In 2018, Indiana decoupled from the provisions of IRC § 163(j), allowing the full amount of the deduction. The allowance of the full deduction will continue to be allowed. Due to the interplay of conformity addbacks and the accelerated disallowance, the amount to be reported as an addback (or deduction, if negative) remains:

Federal interest allowable after limitation minus interest otherwise deductible for that taxable year.

I. Net Operating Loss Changes

Section 2303 of the CARES Act amended IRC § 172 to permit net operating loss carrybacks and increased the allowance of net operating losses available as carryforwards. In addition, § 281 of the COVID-related Tax Relief Act of 2020 permitted waiver of certain modifications in determining farm losses.

Due to Indiana specific addback for federal net operating loss deductions, Indiana conformity modifications, and specific provisions in IC 6-3-2-2.5, IC 6-3-2-2.6, and IC 6-5.5-2-1, the net effect is that, despite Indiana not recognizing these changes, Indiana's overall treatment will remain unchanged.

J. Coronavirus-Related Teacher Supply Expenses

Section 275 of the COVID-related Tax Relief Act of 2020 requires that regulations be adopted regarding the allowance of certain COVID-related expenses related to preventing the spread of COVID-19 in determining the deduction allowable under IRC § 62(a)(2)(D)(ii) in calculating adjusted gross income. Because the regulation will go into effect after January 1, 2020, Indiana will not regard this deduction as allowable in determining Indiana adjusted gross income and therefore will require the addback of any deduction unless the educator can establish other qualifying expenses to substitute for these expenses.

In addition, because this is not considered part of the Internal Revenue Code and thus the COVID-prevention expenses are not considered qualified expenses under IRC § 62(a)(2)(D)(ii) (the analogous reference to IRC § 62(a)(2)(D) as in effect on December 31, 2013), the expenses are not allowable in computing the credit under IC

6-3-3-14.5.

K. Thirty-year Depreciation of Certain Residential Real Property

Section 202 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020 amended IRC § 168 to allow certain residential rental property placed into service before January 1, 2018, to be treated as being depreciable over 30 years as opposed to the original 40-year depreciation under the federal alternative depreciation system. Because Indiana does not follow this provision, the difference between 30-year depreciation and 40-year depreciation for applicable property must be added back in determining Indiana adjusted gross income. This treatment for Indiana adjusted gross income tax applies not only for taxable year 2020, but also the 2018 and 2019 taxable years. No adjustment is necessary for property placed into service after December 31, 2017.

L. Business Meal Deductions

IRC § 274(n) was amended by § 210 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020 to allow a full deduction for business meals for amounts paid in 2021 and 2022. Indiana does not follow this provision and thus will not recognize IRC § 274(n)(2)(D). However, Indiana will allow a fifty-percent deduction as a general rule and also recognize the exceptions in IRC § 274(n)(2)(A), (B), and (C).

M. Earned Income Tax Credit Special Income Rule

Section 211 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020 permits taxpayers to elect to use their 2019 earned income in lieu of their earned income for the first taxable year beginning in 2020. Because this provision was not in the Internal Revenue Code as of the date specified in IC 6-3.1-21-6, Indiana will not recognize this provision. Thus, the amount of earned income in 2020 alone must be used for purposes of determining the Indiana credit.

N. Extenders

In the case of various provisions of the Internal Revenue Code that expire, legislation has been enacted to permit the provision to be permanently enacted or extended for an additional period of time. For these provisions, Indiana recognizes the 2020 federal treatment unless there is an Indiana-specific provision requiring different treatment. However, Indiana will not recognize the tax treatment for 2021 and later.

These provisions are as follows:

1. The energy-efficient buildings deduction under IRC § 179D for property placed in service after December 31, 2020. However, these buildings will be allowed to be depreciated if such depreciation is otherwise allowable for federal tax purposes.
2. Benefits provided to volunteer firefighters and emergency medical responders and excluded under IRC § 139B, for taxable years beginning after December 31, 2020.
3. Extension of look-through treatment of payments between related controlled foreign corporations under foreign personal holding company rules under IRC § 954 after 2020.
4. Exclusion of discharge of indebtedness on qualified personal residences under IRC § 108(a)(1)(E) after December 31, 2020. For purposes of this exclusion, a discharge arrangement entered into and evidenced in writing before January 1, 2021, shall be treated as a discharge before January 1, 2021.
5. Special seven-year depreciation for motorsports improvement property under IRC § 168(i) for property placed in service after December 31, 2020. However, depreciation of such property over the otherwise-allowable period under the Internal Revenue Code shall be permitted.
6. Special expensing rules for certain productions under IRC § 181 for productions commencing after December 31, 2020. However, regular depreciation or amortization of expenses is allowable for Indiana purposes.
7. Special tax incentives for empowerment zones under IRC § 1391 *et. seq.* For purposes of IRC § 1393, the exclusion from income is not allowable for interest on such bonds after December 31, 2020. However, the disallowance of extra IRC § 179 expensing permitted under IRC § 1397A and disallowance of gain nonrecognition under IRC § 1397B will continue after December 31, 2020, even if Indiana recouples with the Internal Revenue Code.
8. Three-year depreciation for racehorses under IRC § 168(e)(3)(A)(i) is disallowed. However, standard seven-year depreciation is allowable.
9. Accelerated depreciation of property on Indian reservations under IRC § 168(j) is disallowed. However, standard depreciation of such property is allowable.

O. Federal Regulations Adopted After January 1, 2020.

In addition, because Indiana also adopts federal regulations in effect on January 1, 2020, as Indiana regulations, Indiana has not conformed to any federal regulations adopted since January 1, 2020. Beyond the regulations discussed in Section II(D), these include many of the conforming and clarifying amendments to the federal Tax Cuts and Jobs Act enacted in 2017.

III. NOTABLE ITEMS FOR WHICH INDIANA FOLLOWS FEDERAL TREATMENT

Indiana does follow certain federal tax treatment for various exemptions, deductions, and other rules incorporated into federal law outside the Internal Revenue Code. Most notably, Indiana follows the exclusion of Paycheck Protection Program loan forgiveness from adjusted gross income because the forgiveness is found in Title 15 of the United States Code. In addition, due to the addition of clarifying provisions outside the Internal Revenue Code in the COVID-related Tax Relief Act of 2020, Indiana permits the deductibility of related expenses, notwithstanding IRC § 265, and also follows partnership and S corporation account and basis rules contained in the clarifying provisions.

Accordingly, Indiana follows the tax provisions of the CARES Act and the COVID-related Tax Relief Act of 2020 as to the following items:

1. Paycheck Protection Program Loans (15 U.S.C. 9005 and COVID-related Tax Relief Act of 2020 § 276)
2. Qualified Emergency Financial Aid Grants (20 U.S.C. 1001 note and COVID-related Tax Relief Act of 2020 § 277)
3. United States Treasury Program Management Authority Loans (15 U.S.C. 9008 and COVID-related Tax Relief Act of 2020 § 278)
4. Emergency EIDL Grants and Targeted EIDL Advances (15 U.S.C. 9009 and COVID-related Tax Relief Act of 2020 § 278)

In addition, there are various provisions in the CARES Act, COVID-related Tax Relief Act of 2020, and Taxpayer Certainty and Disaster Tax Relief Act of 2020, that relate to relief from plan disqualification based on taking specific actions authorized under those acts. Indiana will not disqualify a retirement plan, retirement account, health savings account, or any deductions made to such accounts based on the plan or account taking an otherwise-allowable action for federal purposes.

Apart from the specific items listed, various government grants may or may not be includible in federal adjusted gross income without a specific statutory provision governing tax treatment. Absent a provision enacted into the Internal Revenue Code after January 1, 2020, that specifically changes such treatment, Indiana will follow the federal treatment of taxation related to such grants with no modification.

IV. REPORTING OF DIFFERENCES

In the cases where Indiana has decoupled from federal treatment without a return code specified or a specified line on the return being included, Code 120 must be used to report positive adjustments (i.e., those where Indiana does not recognize a federal deduction or exclusion). If the decoupling has a negative impact on Indiana adjusted gross income (i.e., Indiana does not recognize an inclusion or has accelerated an inclusion), Code 147 must be used to reflect those adjustments.

For the adjustments listed in Section II of this bulletin, this will be true with the following exceptions:

1. For qualified improvement property, this will be reported using Code 104 or, if the form or related schedule has a specific line to adjust bonus depreciation, that specific line.
2. For excess interest deductions under IRC §163(j), the net required addback will be reported using Code 142.
3. For net operating losses, the net required addback will be reported on the specified line of the form or, in the case of resident individuals, Line 2 on Schedule 1 of Form IT-40.
4. For the section 179 expensing disallowed from empowerment zones, the addback will be reported using Code 105 or, if the form or related schedule has a specific line to adjust Section 179 expensing, that specific line.

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