CHAPTER 8009
DEPARTMENT OF REVENUE
INCOME TAX DIVISION
DEDUCTIONS

8009.0100 PROCEDURE FOR DETERMINING ALLOWABLE DEDUCTIONS.

Subpart 1. **General tests.** To determine to what extent, if at all, an item is allowable as a deduction, several tests must be applied. The general procedure is as follows:

A. First the item must qualify as a deduction listed in Minnesota Statutes, section 290.09.

B. If the item meets the above test, it then must be determined whether the deduction is allowable in its entirety, only in part, or not at all:

(1) If the taxpayer has income which is not assignable to the state of Minnesota, certain deductions may not be allowable or may be allowable only in part (see Minnesota Statutes, section 290.18 and the rules thereunder).

(2) If the taxable net income from a trade or business is to be computed under Minnesota Statutes, section 290.19, deductions are allowable in accordance with the formula set forth in that section.

(3) If the taxpayer has income not included in the measure of the Minnesota income tax, deductions allocable against the production or receipt of such income may not be allowable (see Minnesota Statutes, section 290.10, clause (9) and the rules thereunder).

Subp. 2. **Which deductions computed.** After it is determined that a deduction is allowable in its entirety or in part, the deduction is then considered under Minnesota Statutes, section 290.18, subdivision 2. This subdivision states which deductions may be used in computing adjusted gross income.

Statutory Authority: *MS s 290.52*

BUSINESS EXPENSES IN GENERAL

8009.0200 BUSINESS EXPENSES.

Subpart 1. **In general.** Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except items which are used as the basis for a deduction or a credit under provisions of law other than Minnesota Statutes, section 290.09, subdivision 2. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. See part 8001.0500, subpart 6. Among the items included in business expenses are management expenses, commissions (but see Minnesota Statutes, section 290.09, subdivisions 16, 17, and 21 and the rules thereunder), labor, supplies, incidental repairs, operating expenses of automobiles, traveling expenses while away from home solely in the pursuit of a trade or business (see part 8009.0300), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. No such items shall be included in business expenses however, to the extent that it is used by the taxpayer in computing the cost of property included in its inventory or used in determining the gain or loss basis of its plant, equipment, or other property. Penalty payments with respect to federal taxes, whether on account of negligence, delinquency, or fraud, are not deductible from gross income. The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is nevertheless deductible, even though such expenses exceed the gross income derived during the taxable year from such business.

Subp. 2. **Cross-references.** For charitable contributions by individuals and corporations not deductible under Minnesota Statutes, section 290.09, subdivision 2, see part 8009.1600.

For items not deductible see Minnesota Statutes, section 290.10, inclusive, and the rules thereunder.

For research and experimental expenditures, see Minnesota Statutes, section 290.09, subdivision 18 and the rules thereunder.

For soil and water conservation expenditures, see Minnesota Statutes, section 290.09, subdivision 21 and the rules thereunder.

Statutory Authority: *MS S 290.52*

8009.0300 TRAVELING EXPENSES.

Subpart 1. **Includes reasonable and necessary expense.** Traveling expenses include travel fares, meals and lodging, and expenses incident to travel such as expenses for sample rooms, telephone and telegraph, public stenographers, etc. Only such traveling expenses as are reasonable and necessary in the conduct of the taxpayer's business and directly attributable to it may be deducted. If the trip is undertaken for other than business purposes, the travel fares and expenses incident to travel are personal expenses and the meals and lodging are living expenses. If the trip is solely on business, the reasonable and necessary traveling expenses, including travel fares, meals and lodging, and expenses incident to travel are business expenses.

Subp. 2. **Primarily business or personal.** If a taxpayer travels to a destination and while at such destination engages in both business and personal activities, traveling expenses to and from such destination are deductible only if the trip is related primarily to the taxpayer's trade or business. If the trip is primarily personal in nature, the traveling expenses to and from the destination are not deductible even though the taxpayer engages in business activities while at such destination. However, expenses while at the destination which are properly allocable to the taxpayer's trade or business are deductible even though the traveling expenses to and from the destination are not deductible.

Subp. 3. **Factual determination test.** Whether a trip is related primarily to the taxpayer's trade or business or is primarily personal in nature depends on facts and circumstances in each case. The amount of time during the period of the trip which is spent on personal activity compared to the amount of time spent on activities directly relating to the taxpayer's trade or business is an important factor in determining whether the trip is primarily personal. If, for example, a taxpayer spends one week while at a destination on activities which are directly related to his trade or business and subsequently spends an additional five weeks for vacation or other personal activities, the trip will be considered primarily personal in nature in the absence of a clear showing to the contrary.

Subp. 4. **Spouse expense.** Where a taxpayer's wife accompanies him on a business trip, expenses attributable to her travel are not deductible unless it can be adequately shown that the wife's presence on the trip has a bona fide business purpose. The wife's performance of some incidental services does not cause her expenses to qualify as deductible business expenses. The same rules apply to any other members of the taxpayer's family who accompany him on such a trip.

Subp. 5. **Convention expense.** Expenses paid or incurred by a taxpayer in attending a convention or other meeting may constitute an ordinary and necessary business expense under Minnesota Statutes, section 290.09, subdivision 2, depending upon the facts and circumstances of each case. No distinction will be made between self-employed persons and employees. The fact that an employee uses vacation or leave time or that his attendance at the convention is voluntary will not necessarily prohibit the allowance of the deduction. The allowance of deduction for such expenses will depend upon whether there is a sufficient relationship between the taxpayer's trade or business and his attendance at the convention or other meeting so that he is benefiting or advancing the interests of his trade or business by such attendance. If the convention is for political, social, or other purposes unrelated to the taxpayer's trade or business, the expenses are not deductible.

Subp. 6. **Commuters' expense.** Commuters' fares are not considered as business expenses and are not deductible.

Subp. 7. **Substantiation.** For rules with respect to the reporting and substantiation of traveling and other business expenses of employees for taxable years beginning after December 31, 1958, see part 8009.1500.

Statutory Authority: *MS 290.52*

8009.0400 COST OF MATERIALS.

Taxpayers carrying materials and supplies on hand should include in expenses the charges for materials and supplies only in the amount that they are actually consumed and used in operation during the taxable year for which the return is made, provided that the costs of such materials and supplies have not been deducted in determining the net income or loss or taxable income for any previous year. If a taxpayer carries incidental materials or supplies on hand for which no record of consumption is kept or of which physical inventories at the beginning and end of the year are not taken, it will be permissible for the taxpayer to include in his expenses and to deduct from gross income the total cost of such supplies and materials as were purchased during the taxable year for which the return is made, provided the taxable income is clearly reflected by this method.

Statutory Authority: *MS s 290.52*

8009.0500 REPAIRS.

The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as an expense, provided the cost of acquisition or production or the gain or loss basis of the taxpayer's plant, equipment, or other property, as the case may be, is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life of the property, shall either be capitalized and depreciated in accordance with Minnesota Statutes, section 290.09, subdivision 7(A) or charged against the depreciation reserve if such an account is kept.

Statutory Authority: *MS s 290.52*

8009.0600 EXPENSES FOR EDUCATION.

Subpart 1. **When deductible.** Expenditures made by a taxpayer for his education are deductible if they are for education (including research activities) undertaken primarily for the purpose of:

A. maintaining or improving skills required by the taxpayer in his employment or other trade or business; or

B. meeting the express requirements of a taxpayer's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the taxpayer of his salary, status, or employment.

Whether or not education is the type referred to in item A shall be determined upon the basis of all the facts of each case. If it is customary for other established members of the taxpayer's trade or business to undertake such education, the taxpayer will ordinarily be considered to have undertaken this education for the purpose described in item A. Expenditures for education of the type described in item B are deductible under item B only to the extent that they are for the minimum education required by the taxpayer's employer, or by applicable law or regulations, as a condition to the retention of the taxpayer's salary, status, or employment. Expenditures for education other than those so required may be deductible under item A if the education meets the qualifications of item A. A taxpayer is considered to have made expenditures for education to meet the express requirements of his employer only if the requirement is imposed primarily for a bona fide business purpose of the taxpayer's employer and not primarily for the taxpayer's benefit. Except as provided in the last sentence of subpart 2, in the case of teachers, a written statement from an authorized official or school officer to the effect that the education was required as a condition to the retention of the taxpayer's salary, status, or employment will be accepted for the purpose of meeting the requirements of this subpart.

Subp. 2. **When not deductible.** Expenditures made by a taxpayer for his education are not deductible if they are for education undertaken primarily for the purpose of obtaining a new position or substantial advancement in position, or primarily for the purpose of fulfilling the general educational aspirations or other personal purposes of the taxpayer. The fact that the education undertaken meets express requirements for the new position or substantial advancement position will be an important factor indicating that the education is undertaken primarily for the purpose of obtaining such position or advancement, unless such education is required as a condition to the retention by the taxpayer of his present employment. In any event, if education is required of the taxpayer in order to meet the minimum requirements for qualification or establishment in his intended trade or business or specialty therein, the expense of such education is personal in nature and therefore is not deductible.

Subp. 3. **Travel as form of education.** In general a taxpayer's expenditures for travel (including travel while on sabbatical leave) as a form of education shall be considered as primarily personal in nature and therefore not deductible.

Subp. 4. **Travel away to obtain education.** If a taxpayer travels away from home primarily to obtain education the expenses of which are deductible under this section, his expenditures for travel, meals, and lodging while away from home are deductible. However, if as an incident of such trip the taxpayer engages in some personal activity such as sightseeing, social visiting or entertaining, or other recreation, the portion of the expenses attributable to such personal activity constitutes nondeductible personal or living expenses and is not allowable as a deduction. If the taxpayer's travel away from home is primarily personal, the taxpayer's expenditures for travel, meals, and lodging (other than meals and lodging during the time spent in participating in deductible educational pursuits) are not deductible. Whether a particular trip is primarily personal or primarily to obtain education the expenses of which are deductible under this section depends upon all the facts and circumstances of each case. An important factor to be taken into consideration in making the determination is the relative amount of time devoted to personal activity as compared with the time devoted to educational pursuits. Expenses in the nature of commuters' fares are not deductible.

Subp. 5. **Examples.** The provisions of this part may be illustrated by the following examples:

A. A is employed by an accounting firm. In order to become a certified public accountant he takes courses in accounting. Since the education was undertaken prior to the time A became qualified in his chosen profession as a certified public accountant, A's expenditures for such courses and expenses for any transportation, meals, and lodging while away from home are not deductible.

B. B, a general practitioner of medicine, takes a course of study in order to become a specialist in pediatrics. C, a general practitioner of medicine, takes a two-week course reviewing developments in several specialized fields, including pediatrics, for the purpose of carrying on his general practice. B's expenses are not deductible because the course of study qualified him for a specialty within his trade or business. C's expenses for his education and any transportation, meals, and lodging while away from home are deductible because they were undertaken primarily to improve skills required by him in his trade or business.

C. D is required by his employer (or by state law) either to read a list of books or to take certain courses giving six hours academic credit every two years in order to retain his position as a teacher. D fulfills the requirement by taking the courses and thereby receives an automatic increase in salary in his present position and salary schedule. Also, as the result of taking the prescribed course, at the end of ten years, D receives a master's degree and becomes automatically eligible for an additional salary increase. Since D's purpose in taking the courses was primarily to fulfill the educational requirement of his employer, his expenses for such education and transportation, meals, and lodging while away from home are deductible.

D. The facts are the same as in item C except that, due solely to a shortage of qualified teachers, D's employer does not enforce the prescribed educational requirements in that other teachers who do not fulfill those requirements are retained in their positions. D's expenses are nevertheless deductible.

E. E, a high school teacher of physics, in order to improve skills required by him and thus improve his effectiveness as such a teacher, takes summer school courses in nuclear physics and educational methods. E's expenses for such courses are deductible.

F. F takes summer school courses in order to improve skills required by him in his employment as a teacher. As a result of taking such courses F receives an in-grade increase in salary in his present position pursuant to a salary schedule established by the school system for which he works. F's expenditures for such courses are deductible.

G. G, a graduate student at a university, plans to become a university professor. In order to qualify as a regular faculty member, G must obtain a graduate degree. While taking the required graduate courses, G is engaged in teaching at the university. G's expenses therefore are not deductible since he has not completed the education required to become qualified as a regular faculty member at the time he takes such courses.

H. H, a self-employed tax consultant, decides to take a one-week course in taxation, which is offered in city X, 500 miles away from his home. His primary purpose in going to X is to take the course, but he also takes a side trip to city Y (50 miles from X) for one day, takes a sightseeing trip while in X, and entertains some personal friends. H's transportation expenses to city X and return to his home are deductible but his transportation expenses to city Y are not deductible. H's expenses for meals and lodging while away from home will be allocated between his educational pursuits and his personal activities. Those expenses which are entirely personal such as sightseeing and entertaining friends, are not deductible to any extent.

I. The facts are the same as in item H except that H's primary purpose in going to city X is to take a vacation. This purpose is indicated by several factors, one of which is the fact that he spends only one week attending the tax course and devotes five weeks entirely to personal activities. None of H's transportation expenses are deductible and his expenses for meals and lodging while away from home are not deductible to the extent attributable to personal activities. His expenses for meals and lodging allocable to the week attending the tax course are, however, deductible.

Statutory Authority: *MS s 290.52*

8009.0700 PROFESSIONAL EXPENSES.

A professional man may claim as deductions the cost of supplies used by him in the practice of his profession, expenses paid or accrued in the operation and repair of an automobile used in making professional calls, dues to professional societies and subscriptions to professional journals, the rent paid or accrued for office rooms, the cost of the fuel, light, water, telephone, etc., used in such offices, and the hire of office assistance. Amounts currently paid or accrued for books, furniture, and professional instruments and equipment, the useful life of which is short, may be deducted.

Statutory Authority: *MS s 290.52*

8009.0800 COMPENSATION FOR PERSONAL SERVICES.

Subpart 1. **General test.** There may be included among the ordinary and necessary expenses paid or incurred in carrying on any trade or business a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services.

Subp. 2. **Test illustrated.** The test set forth in subpart 1 and its practical application may be further stated and illustrated as follows:

A. Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payments correspond or bear a close relationship to the stockholdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock. An ostensible salary may be in part payment for property. This may occur, for example, where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the corporation. In such case it may be found that the salaries of the former partners are not merely for services, but in part constitute payment for the transfer of their business.

B. The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

C. In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is, in general, just to assume that reasonable and true compensation in only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

D. For disallowance of deduction in the case of certain transfers of stock pursuant to employees stock options, see Minnesota Statutes, section 290.078 and the rules thereunder.

Statutory Authority: *MS s 290.52*

NOTE: Minnesota Statutes, section 290.078, was repealed by Laws of Minnesota 1965, chapter 677, section 2.

8009.0900 TREATMENT OF EXCESSIVE COMPENSATION.

The income tax liability of the recipient in respect of an amount ostensibly paid to him as compensation, but not allowed to be deducted as such by the payor, will depend upon the circumstances of each case. Thus, in the case of excessive payments by corporations, if such payments correspond or bear a close relationship to stockholdings, and are found to be a distribution of earnings or profits, the excessive payments will be treated as a dividend. If such payments constitute payment for property, they should be treated by the payor as a capital expenditure and by the recipient as part of the purchase price. In the absence of evidence to justify other treatment, excessive payments for salaries or other compensation for personal services will be included in gross income of the recipient.

Statutory Authority: *MS s 290.52*

8009.1000 BONUSES TO EMPLOYEES.

Bonuses to employees will constitute allowable deductions from gross income when such payments are made in good faith and as additional compensation for the services actually rendered by the employees, provided such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered. It is immaterial whether such bonuses are paid in cash or in kind or partly in cash and partly in kind. Donations made to employees and others, which do not have in them the element of compensation or which are in excess of reasonable compensation for services, are not deductible from gross income.

Statutory Authority: *MS s 290.52*

8009.1100 CERTAIN EMPLOYEE BENEFITS.

Subpart 1. **In general.** Amounts paid or accrued by a taxpayer on account of injuries received by employees, and lump-sum amounts paid or accrued as compensation for injuries, are proper deductions as ordinary and necessary expenses. Such deductions are limited to the amount not compensated for by insurance or otherwise. Amounts paid or accrued within the taxable year for dismissal wages, unemployment benefits, guaranteed annual wages, vacations, or a sickness, accident, hospitalization, medical expense, recreational, welfare, or similar benefit plan, are deductible under Minnesota Statutes, section 290.09, subdivision 2, paragraph (a) if they are ordinary and necessary expenses of the trade or business. However, except as provided in subpart 2, such amount shall not be deductible under Minnesota Statutes, section 290.09, subdivision 2, paragraph (a) if, under any circumstances, they may be used to provide benefits under a stock bonus, pension, annuity, profit-sharing, or other deferred compensation plan of the type referred to in Minnesota Statutes, section 290.26. In such an event, the extent to which these amounts are deductible from gross income shall be governed by the provisions of Minnesota Statutes, section 290.26 and the rules issued thereunder.

Subp. 2. **Certain negotiated plans.** Subject to the limitations set forth in Minnesota Statutes, section 290.26, subdivisions 2 and 3, contributions paid by an employer under a plan under which such contributions are held in a welfare trust for the purpose of paying (either from principal or income or both) for the benefit of employees, their families, and dependents, at least medical or hospital care, and pensions on retirement or death of employees, are deductible when paid as business expenses under Minnesota Statutes, section 290.09, subdivision 2, paragraph (a).

Subp. 3. **Other plans providing deferred compensation.** For rules relating to the deduction of amounts paid to or under a stock bonus, pension, annuity, or profit-sharing plan or amounts paid or accrued under any other plan deferring the receipt of compensation, see Minnesota Statutes, section 290.26 and the rules thereunder.

Statutory Authority: *MS s 290.52*

8009.1200 RENTALS.

Subpart 1. **Business lease.** If a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord, the amount of the tax being deductible by the latter. For disallowance of deduction for income taxes paid by a lessee corporation, see the Internal Revenue Code of 1954, section 110 and the regulations thereunder.

Subp. 2. **Lessee costs and depreciation.** The cost to a lessee of erecting buildings or making permanent improvements on property of which he is the lessee is a capital investment, and is not deductible as a business expense. If the estimated useful life in the hands of the taxpayer is equal to or shorter than the remaining period of the lease, this deduction shall be computed under the provisions of Minnesota Statutes, section 290.09, subdivision 7, (A) (relating to depreciation). Where there is a possibility that the lease may be renewed, the matter of spreading such costs over the term of the original lease, together with the renewal period or periods, depending upon the facts in the particular case, including the presence or absence of an option of renewal and the relationship between the parties. As a general rule, unless the lease has been renewed or the facts show with reasonable certainty that the lease will be renewed, the cost or other basis of the lease, or the cost of improvements shall be spread only over the number of years the lease has to run without taking into account any right of renewal.

This subpart may be illustrated by the following examples:

A. A subsidiary corporation leases land from its parent at a fair rental for a 25-year period. The subsidiary erects on the land valuable factory buildings having a normal useful life of 50 years. These facts show with reasonable certainty that the lease will be renewed, even though the lease contains no option of renewal. Therefore, the cost of the buildings shall be depreciated over the estimated useful life of the buildings in accordance with Minnesota Statutes, section 290.09, subdivision 7, (A) and the rules thereunder.

B. A retail merchandising corporation leases land at a fair rental from an unrelated lessor for the longest period that the lessor is willing to lease the land (30 years). The lessee erects on the land a department store having a normal useful life of 40 years. These facts do not show with reasonable certainty that the lease will be renewed. Therefore, the cost of the building shall be spread over the remaining term of the lease. An annual deduction may be made in an amount equal to the cost of the building divided by the number of years remaining in the term of the lease, and such deduction shall be in lieu of a deduction for depreciation.

Statutory Authority: *MS s 290.52*

8009.1300 EXPENSES OF FARMERS.

A farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in the carrying on of the business of farming. The cost of ordinary tools of short life or small cost, such as hand tools, including shovels, rakes, etc., may be deducted. The purchase of feed and other costs connected with raising livestock may be treated as expense deductions insofar as such costs represent actual outlay, but not including the value of farm produce grown upon the farm or the labor of the taxpayer. Where a farmer is engaged in producing crops which take more than a year from the time of planting to the process of gathering and disposal, expenses deducted may, with the consent of the commissioner (as Minnesota Statutes, section 290.07, subdivision 2 and the rules thereunder), be determined upon the crop method, and such deductions must be taken in the taxable year in which the gross income from the crop has been realized. If a farmer does not compute income upon the crop method, the cost of seeds and young plants which are purchased for further development and cultivation prior to sale in later years may be deducted as an expense for the year of purchase, provided the farmer follows a consistent practice of deducting such costs as an expense from year to year. The preceding sentence does not apply to the cost of seeds and young plants connected with the planting of timber. See Minnesota Statutes, section 290.09, subdivision 8 and the rules thereunder. The cost of farm machinery, equipment, and farm buildings represent a capital investment and is not an allowable deduction as an item of expense. Amounts expended in the development of farms, orchards, and ranches prior to the time when the productive state is reached may be regarded as investments of capital. For the treatment of soil and water conservation expenditures as expenses which are not chargeable to capital account, see Minnesota Statutes, section 290.09, subdivision 21 and the rules thereunder. Amounts expended in purchasing work, breeding, or dairy animals are regarded as investments of capital, and may be depreciated unless such animals are included in an inventory in accordance with part 8001.0500, subpart 7. The purchase price of an automobile, even when wholly used in carrying on farming operations, is not deductible, but regarded as an investment of capital. The cost of gasoline, repairs, and upkeep of an automobile if used wholly in the business of farming is deductible as an expense; if used partly for business purposes and partly for the pleasure or convenience of the taxpayer or his family, such cost may be apportioned according to the extent of the use for purposes of business and pleasure or convenience, and only the proportion of such cost justly attributable to business purposes is deductible as a necessary expense. If a farm is operated for recreation or pleasure and not on a commercial basis, and if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from the sale of farm products may be ignored in rendering a return of income, and the expenses incurred, being regarded as personal expenses, will not constitute allowable deductions. See 2001-20 (9), part 8009.4800, and Minnesota Statutes, section 290.09, subdivision 5.

Statutory Authority: *MS s 290.52*

NOTE: Regulation 2001-20 (9) has been repealed.

8009.1400 EXCEPTED CONTRIBUTIONS.

Subpart 1. **Contribution; gift.** No deduction is allowable under Minnesota Statutes, section 290.09, subdivision 2, paragraph (a) for a contribution or gift by an individual or a corporation if any part thereof is deductible under Minnesota Statutes, section 290.21. For example, if a taxpayer makes a contribution of $5,000 and only $4,000 of this amount is deductible under Minnesota Statutes, section 290.21, no deduction is allowable under Minnesota Statutes, section 290.09, subdivision 2, paragraph (a) for the remaining $1,000.

Subp. 2. **Scope; examples.** The limitations provided in this section apply only to payments which are in fact contributions or gifts to organizations described in Minnesota Statutes, section 290.21. For example, payments by a street railway company to a local hospital (which is a charitable organization within the meaning of Minnesota Statutes, section 290.21) in consideration of a binding obligation on the part of the hospital to provide hospital services and facilities for the company's employees are not contributions or gifts within the meaning of Minnesota Statutes, section 290.21 and may be deductible under Minnesota Statutes, section 290.09, subdivision 2, paragraph (a) if the requirements of Minnesota Statutes, section 290.09, subdivision 2, paragraph (a) are otherwise satisfied. Donations to organizations other than those described in Minnesota Statutes, section 290.21 which bear a direct relationship to the taxpayer's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. For example, a street railway company may donate a sum of money to an organization (of a class not referred to in Minnesota Statutes, section 290.21) intending to hold a convention in the city in which it operated, with a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its cars.

Statutory Authority: *MS s 290.52*

8009.1500 REPORTING AND SUBSTANTIATING TRAVEL AND OTHER BUSINESS EXPENSES OF EMPLOYEES.

Subpart 1. **Purpose.** The purpose of this part is to provide rules for the reporting of information on income tax returns by taxpayers who pay or incur ordinary and necessary business expenses in connection with the performance of services as an employee and to furnish guidance as to the type of records which will be useful in compiling such information and in its substantiation, if required. This part does not apply to expenses paid or incurred for incidentals, such as office supplies for the employer or local transportation in connection with an errand. Employees incurring such incidental expenses are not required to provide substantiation for such amounts. The term "ordinary and necessary business expenses" means only these expenses which are ordinary and necessary in the conduct of the taxpayer's business and are directly attributable to such business. The term does not include nondeductible personal, living, or family expenses.

Subp. 2. **Expenses for which employee is required to account to employer.** Items A to D set out the expenses for which an employee must account to his employer:

A. The employee need not report on his tax return (either itemized or in total amount) expenses for travel transportation, entertainment, and similar purposes paid or incurred by him solely for the benefit of his employer for which he is required to account and does account to his employer and which are charged directly or indirectly to the employer (for example, through credit cards) or for which the employee is paid through advances, reimbursements, or otherwise; provided the total amount of such advances, reimbursements, and charges is equal to such expenses. In such a case the taxpayer need only state in his return that the total of amounts charged directly or indirectly to his employer through credit cards or otherwise and received from the employer as advances or reimbursements did not exceed the ordinary and necessary business expenses paid or incurred by the employee.

B. In case the total of amounts charged directly or indirectly to the employer and received from the employer as advances, reimbursements, or otherwise, exceeds the ordinary and necessary business expenses paid or incurred by the employee and the employee is required to and does account to his employer for such expenses, the taxpayer must include such excess in income and state on his return that he has done so.

C. If the employee's ordinary and necessary business expenses exceed the total of the amounts charged directly or indirectly to the employer and received from the employer as advances, reimbursements, or otherwise, and the employee is required to and does account to his employer for such expenses, the taxpayer may make the statement in his return required by item A unless he wishes to claim a deduction for such excess. If, however, he wishes to secure a deduction for such excess, he must submit a statement showing the following information as part of his tax return:

(1) the total of any charges paid or borne by the employer and of any other amounts received from the employer for payment of expenses whether by means of advances, reimbursements, or otherwise; and

(2) the nature of his occupation, the number of days away from home on business, and the total amount of ordinary and necessary business expenses paid or incurred by him (including those charged directly or indirectly to the employer through credit cards or otherwise) broken down into such broad categories as transportation, meals and lodging while away from home overnight, entertainment expenses, and other business expenses.

D. To "account" to his employer as used in this subpart means to submit an expense account or other required written statement to the employer showing the business nature and the amount of all the employee's expenses (including those charged directly or indirectly to the employer through credit cards or otherwise) broken down into such broad categories as transportation, meals and lodging while away from home overnight, entertainment expenses, and other business expenses. For this purpose, the commissioner in his discretion may approve reasonable business practices under which mileage, per diem in lieu of subsistence, and similar allowances providing for ordinary and necessary business expenses in accordance with a fixed scale may be regarded as equivalent to an account to the employer.

Subp. 3. **Expenses for which employee is not required to account to employer.** If the employee is not required to account to his employer for his ordinary and necessary business expenses, e.g., travel, transportation, entertainment, and similar items, or, though required fails to account for such expenses, he must submit, as a part of his tax return, a statement showing the following information:

A. the total of all amounts received as advances or reimbursements from his employer in connection with the ordinary and necessary business expenses of the employee, including amounts charged directly or indirectly to the employer through credit cards or otherwise; and

B. the nature of his occupation, the number of days away from home on business, and the total amount of ordinary and necessary business expenses paid or incurred by him (including those charged directly or indirectly to the employer through credit cards or otherwise) broken down into such broad categories as transportation, meals and lodging while away from home overnight, entertainment expenses, and other business expenses.

Subp. 4. **Substantiation of items of expenses.** Although the commissioner may require any taxpayer to substantiate such information concerning expense accounts as may appear to be pertinent in determining tax liability, taxpayers ordinarily will not be called upon to substantiate expense account information except those in the following categories:

A. a taxpayer who is not required to account to his employer, or who does not account;

B. a taxpayer whose expenses exceed the total of amounts charged to his employer and amounts received through advances, reimbursements, or otherwise and who claims a deduction on his return for such excess;

C. a taxpayer who is related to his employer within the meaning of the Internal Revenue Code of 1954, section 267(b); and

D. other taxpayers in cases where it is determined that the accounting procedures used by the employer for the reporting and substantiation of expenses by employees are not adequate.

The Minnesota Income Tax Act contemplates that taxpayers keep such records as will be sufficient to enable the commissioner to correctly determine income tax liability. Accordingly, it is to the advantage of taxpayers who may be called upon to substantiate expense account information to maintain as adequate and detailed records of travel, transportation, entertainment, and similar business expenses as practical since the burden of proof is upon the taxpayer to show that such expenses were not only paid or incurred but also that they constitute ordinary and necessary business expenses. One method of substantiating expenses incurred by an employee in connection with his employment is through a preparation of a daily diary or record of expenditures, maintained in sufficient detail to enable him to readily identify the amount and nature of any expenditure, and the preservation of supporting documents, especially in connection with large or exceptional expenditures. Nevertheless, it is recognized that by reason of the nature of certain expenses or the circumstances under which they are incurred, it is often difficult for an employee to maintain detailed records or to preserve supporting documents for all his expenses. Detailed records of small expenditures incurred in traveling or for transportation, as for example, tips, will not be required.

Where records are incomplete or documentary proof is unavailable, it may be possible to establish the amount of the expenditures by approximations based upon reliable secondary sources of information and collateral evidence. For example, in connection with an item of traveling expense a taxpayer might establish that he was in a travel status a certain number of days but that it was impracticable for him to establish the details of all his various items of travel expense. In such a case rail fares or plane fares can usually be ascertained with exactness and automobile costs approximated on the basis of mileage covered. A reasonable approximation of meals and lodging might be based upon receipted hotel bills or upon average daily rates for such accommodations and meals prevailing in the particular community for comparable accommodations. Since detailed records of incidental items are not required, deductions for these items may be based upon a reasonable approximation. In cases where a taxpayer is called upon to substantiate expense account information, the burden is on the taxpayer to establish that the amounts claimed as a deduction are reasonably accurate and constitute ordinary and necessary business expenses paid or incurred by him in connection with the trade or business. In connection with the determination of factual matters of this type, due consideration will be given to the reasonableness of the stated expenditures for the claimed purposes in relation to the taxpayer's circumstances (such as his income and the nature of his occupation), to the reliability and accuracy of records in connection with other items more readily lending themselves to detailed recordkeeping, and to all of the facts and circumstances in the particular case.

Statutory Authority: *MS s 290.52*

NONBUSINESS EXPENSES

8009.1600 NONTRADE OR NONBUSINESS EXPENSES.

Subpart 1. **General rule.** An expense may be deducted under Minnesota Statutes, section 290.09, subdivision 2, paragraph (b) only if:

A. It has been paid or incurred by the taxpayer during the taxable year (1) for the production or collection of income, which, if and when realized, will be required to be included in income for Minnesota income tax purposes, or (2) for the management, conservation, or maintenance of property held for the production of such income, or (3) in connection with the determination, collection, or refund of any tax; and

B. It is an ordinary and necessary expense for any of the purposes stated in item A.

Subp. 2. **Income defined.** The term "income" for the purpose of Minnesota Statutes, section 290.09, subdivision 2, paragraph (b) includes not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. For example, if defaulted bonds, the interest from which if received would be includable in income, are purchased with the expectation of realizing capital gain on their resale, even though no current yield thereon is anticipated, ordinary and necessary expenses thereafter paid or incurred in connection with such bonds are deductible. Similarly, ordinary and necessary expenses paid or incurred in the management, conservation, or maintenance of a building devoted to rental purposes are deductible notwithstanding that there is actually no income therefrom in the taxable year, and regardless of the manner in which or the purpose for which the property in question was acquired. Expenses paid or incurred in managing, conserving, or maintaining property held for investment may be deductible under Minnesota Statutes, section 290.09, subdivision 2, paragraph (b) even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto.

Subp. 3. **Hobby expense.** Expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses. The question whether or not a transaction is carried on primarily for the production of income or for the management, conservation, or maintenance of property held for the production or collection of income, rather than primarily as a sport, hobby, or recreation, is not to be determined solely from the intention of the taxpayer but rather from all the circumstances of the case. For example, consideration will be given to the record of prior gain or loss of the taxpayer in the activity, the relation between the type of activity and the principal occupation of the taxpayer, and the uses to which the property or what it produces is put by the taxpayer.

Subp. 4. **Ordinary and necessary.** Expenses, to be deductible under Minnesota Statutes, section 290.09, subdivision 2, paragraph (b), must be "ordinary and necessary." Thus, such expenses must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

Subp. 5. **Restrictions.** A deduction under Minnesota Statutes, section 290.09, subdivision 2, paragraph (b) is subject to the restrictions in Minnesota Statutes, section 290.10, relating to items not deductible. Thus, no deduction is allowable under Minnesota Statutes, section 290.09, subdivision 2, paragraph (b) for any amount allocable to the production or collection of one or more classes of income which are not includable in gross income, or for any amount allocable to the management, conservation, or maintenance of property held for the production of income which is not included in gross income. Nor does Minnesota Statutes, section 290.09, subdivision 2, paragraph (b) allow the deduction of any expenses which are disallowed by any of the provisions of Minnesota Statutes, chapter 290, even though such expenses may be paid or incurred for one of the purposes specified in Minnesota Statutes, section 290.09, subdivision 2, paragraph (b).

Subp. 6. **Certain expenses not deductible.** Among expenditures not allowable as deductions under Minnesota Statutes, section 290.09, subdivision 2, paragraph (b) are the following: commuter's expenses; expenses for improving personal appearance; the cost of rental of a safe-deposit box for storing jewelry and other personal effects; expenses such as those paid or incurred in seeking employment or in placing oneself in a position to begin rendering personal services for compensation, bar examination fees and other expenses paid or incurred in securing admission to the bar, and corresponding fees and expenses paid or incurred by physicians, dentists, accountants, and other taxpayers for securing the right to practice their respective professions.

Subp. 7. **Fees for services.** Fees for services of investment counsel, custodial fees, clerical help, office rent, and similar expenses paid or incurred by a taxpayer in connection with investments held by him are deductible under Minnesota Statutes, section 290.09, subdivision 2, paragraph (b) only if (1) they are paid or incurred by the taxpayer for the production or collection of income or for the management, conservation, or maintenance of investments held by him for the production of income; and (2) they are ordinary and necessary under all the circumstances, having regard to the type of investment and to the relation of the taxpayer to such investment.

Subp. 8. **Property; residential and rental.** Ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held for use as a residence by the taxpayer are not deductible. However, ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held by the taxpayer as rental property are deductible even though such property was formerly held by the taxpayer for use as a home.

Subp. 9. **Fiduciary expenses.** Reasonable amounts paid or incurred by the fiduciary of an estate or trust on account of administration expenses, including fiduciaries' fees and expenses of litigation, which are ordinary and necessary in connection with the performance of the duties of administration are deductible under Minnesota Statutes, section 290.09, subdivision 2, paragraph (b), notwithstanding that the estate or trust is not engaged in a trade or business, except to the extent that such expenses are allocable to the production or collection of tax-exempt income.

Subp. 10. **Guardian expenses.** Reasonable amounts paid or incurred for the services of a guardian or committee for a ward or minor, and other expenses of guardians and committees which are ordinary and necessary, in connection with the production or collection of income inuring to the ward or minor, or in connection with the management, conservation, or maintenance of property held for the production of income, belonging to the ward or minor, are deductible.

Subp. 11. **Property; title, improvements.** Expenses paid or incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of which, if when recovered, must be included in gross income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents. Expenses paid or incurred in protecting or asserting one's rights to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deductible.

Subp. 12. **Tax expenses.** Expenses paid or incurred by an individual in connection with the determination, collection, or refund of any tax, whether the taxing authority be federal, state, or municipal, and whether the tax be income, estate, gift, property, or any other tax, are deductible. Thus, expenses paid or incurred by a taxpayer for tax counsel or expenses paid or incurred in connection with the preparation of his tax returns or in connection with any proceedings involved in determining the extent of his tax liability or in contesting his tax liability are deductible.

Subp. 13. **Liability expense.** An expense (not otherwise deductible) paid or incurred by an individual in determining or contesting a liability asserted against him does not become deductible by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability.

Subp. 14. **Capital expenditures.** Capital expenditures are not allowable as nontrade or nonbusiness expenses. The deduction of an item otherwise allowable under Minnesota Statutes, section 290.09, subdivision 2, paragraph (b) will not be disallowed simply because the taxpayer was entitled under Minnesota Statutes, chapter 290 to treat such item as a capital expenditure, rather than to deduct it as an expense. Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in Minnesota Statutes, chapter 290, no deduction is allowable under Minnesota Statutes, section 290.09, subdivision 2, paragraph (b); and this is true regardless of whether any basis adjustment is allowed under any other provision of Minnesota Statutes, chapter 290.

Subp. 15. **Deductibility; double deductions.** The provisions of Minnesota Statutes, section 290.09, subdivision 2, paragraph (b) are not intended in any way to disallow expenses which would otherwise be allowable under Minnesota Statutes, section 290.09, subdivision 2, paragraph (a) and the rules thereunder. Double deductions are not permitted. Amounts deducted under one provision of the Minnesota Statutes, chapter 290 cannot again be deducted under any other provision thereof.

Statutory Authority: *MS s 290.52*

8009.1700 TAXES.

Subpart 1. **General rule and exceptions.** Taxes paid or accrued within the taxable year are deductible, except:

A. Minnesota state income and franchise taxes and Minnesota cigarette and tobacco products taxes;

B. improvement taxes;

C. inheritance, estate, and gift taxes except as provided in Minnesota Statutes, section 290.077, subdivision 4;

D. real property taxes paid by other than the owner.

Subp. 2. **Extent of deduction.** Caution should be used in ascertaining the extent to which taxes are deductible. See Minnesota Statutes, sections 290.09, 290.10, 290.18, and 290.19.

Subp. 3. **Income taxes.** Income taxes, including federal victory taxes, deductible hereunder, are deductible only in the taxable year in which paid or withheld and then only to the extent provided by Minnesota Statutes, section 290.18. Taxpayers keeping books on an accrual basis cannot accrue income taxes of any kind and use such accruals as deductions. In the case where income or victory taxes withheld are in excess of the amount of tax actually due, the excess shall be considered as taxable income in the year in which received to the extent the deduction for such federal taxes resulted in a tax benefit.

Subp. 4. **State income tax refunds.** Refunds of Minnesota income taxes which are included in the computation of federal adjusted gross income shall be deductible in arriving at taxable net income.

Subp. 5. **Gift taxes.** For all taxable years beginning on or after January 1, 1943, gift taxes are not deductible from gross income.

Subp. 6. **State real estate taxes.** Taxes on Minnesota real estate are due and payable on the first Monday of the year following assessment and are deductible accordingly. Taxes paid, except improvement taxes, on a home situated in Minnesota are deductible in their entirety. Taxes on Minnesota unimproved property, such as vacant lots, are deductible in the year when paid or accrued, dependent on the accounting method employed. Taxes on real estate located without this state where the income from such property is not includible in gross income assignable to Minnesota are not deductible. See Minnesota Statutes, section 290.18, clause (2).

Subp. 7. **Delinquent mortgage taxes.** Delinquent taxes paid by the mortgagee prior or subsequent to foreclosure of the mortgage are not deductible, but must be capitalized.

Subp. 8. **Assessments.** So-called taxes, more properly assessments, paid for local benefits, such as street, sidewalk, and other like improvements, imposed because of and measured by some benefit inuring directly to the property against which the assessment is levied, do not constitute an allowable deduction from gross income. A tax is considered assessed against local benefits when the property subject to the tax is limited to property benefited. Special assessments are not deductible, even though an incidental benefit may inure to the public welfare.

Subp. 9. **Federal excise taxes.** Federal excise taxes, such as cigarette taxes, liquor taxes, taxes on the purchase of automobiles, cosmetics, jewelry, furs, or any other indirect taxes are not deductible by the consumer. Dealers or manufacturers, however, may deduct such taxes paid to the federal government, if levied against them, to the extent provided in Minnesota Statutes, section 290.18. Dealers or manufacturers may deduct these taxes if paid to the state of Minnesota, and if levied against them, in their entirety. Taxes paid to the federal government under the Retailers' Excise Tax Act of the 1941 Internal Revenue Code, chapter 19 relating to the sale of jewelry, furs, and toilet preparations, may be deducted by the retailer to the extent provided in Minnesota Statutes, section 290.18; such taxes are not deductible by the consumer.

Subp. 10. **Amusement taxes; automobile and gasoline taxes; postage.** Amusement taxes are deductible by the consumer if the taxing act imposes the burden to pay the tax directly upon the consumer, providing the taxpayer maintains a sufficiently accurate record or memorandum from which information may be obtained to substantiate the deduction. Auto license fees paid to the state of Minnesota are deductible in their entirety.

Minnesota gasoline taxes are deductible in their entirety. Federal gasoline taxes are not deductible by the consumer. Postage is not a tax.

Subp. 11. **Social security and unemployment compensation contributions.** Social security and Minnesota unemployment compensation contributions are deductible by the employer. Such items must be reported as taxes paid in the income tax return and they must not be deducted as part of the payroll under salaries paid. Social security contributions made by the employee are not deductible from the gross income of such employee after January 1, 1941.

Subp. 12. **Corporate bonds; payment of shareholder interest.** In the case of corporate bonds or obligations containing a tax-free covenant, the corporation paying a state or federal tax for someone else without reimbursement, such payment may be deducted by the corporation as interest paid on indebtedness. The amount of the tax so withheld need not be included in gross income of the bondholder, but in such event neither can it be deducted from his gross income. If a corporation pays taxes which are imposed upon a shareholder's interest therein without reimbursement from the shareholder, such taxes are deductible by the corporation and not by the shareholder.

Subp. 13. **Cooperative apartment property taxes.** A tenant-stockholder may claim a portion of the real estate taxes paid or accrued to the cooperative apartment corporation by the tenant-stockholder within the taxable year on the apartment building and the land on which it is situated, in the proportion which the stock of the corporation owned by the tenant-stockholder is to the total outstanding stock of the corporation, including that held by the corporation. However, in order to be entitled to this deduction, the stock of the tenant-stockholder must be fully paid up in an amount bearing reasonable relationship to the portion of the value of the corporation's equity in the building and land on which it is situated which is attributable to the apartment such individual is entitled to occupy.

Statutory Authority: *MS s 290.52*

LOSSES, WORTHLESS SECURITIES, AND BAD DEBTS

8009.1800 LOSSES.

Subpart 1. **Allowance of deduction in general.** Losses sustained which are not compensated for by insurance or otherwise are deductible under Minnesota Statutes, section 290.09, subdivision 5, paragraph (a) if deduction of such losses is not prohibited or limited by any other provisions of Minnesota Statutes, chapter 290. See, for example, Minnesota Statutes, section 290.09, subdivision 5, paragraph (c) relating to individuals; Minnesota Statutes, section 290.09, subdivision 5, paragraph (g) and Minnesota Statutes, section 290.16, subdivision 5 relating to capital losses; Minnesota Statutes, section 290.09, subdivision 5, paragraph (d), relating to wagering losses; Minnesota Statutes, section 290.10, clause (6) relating to losses from sales or exchanges of property between related taxpayers, and Minnesota Statutes, section 290.13 relating to exchanges of property where no gain or loss is recognized.

In general, losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide, and actually sustained during the taxable year for which allowed. Substance and not mere form will govern in determining the amount of losses actually sustained. See Minnesota Statutes, section 290.12, subdivision 2.

Subp. 2. **Voluntary removal of buildings.** Subject to the provisions of 2009 (15) (a)-8, an abnormal retirement loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements is deductible from gross income. When a taxpayer buys real estate upon which is located a building, which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal. It will be presumed that the value of the real estate, exclusive of old improvements, is equal to the purchase price of the land and building plus the cost of removing the useless building.

Subp. 3. **Loss of useful value.** When, through some change in business conditions, the usefulness in the business of some or all of the assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the basis, (adjusted to the extent provided in Minnesota Statutes, section 290.12, subdivision 2 or as otherwise specifically provided for under applicable provisions of Minnesota income tax laws) and the salvage value of the property. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost or change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be fully explained in the return of income. The limitations provided in Minnesota Statutes, section 290.16, subdivisions 5 and 6, with respect to the sale or exchange of capital assets have no application to losses due to the discarding of capital assets.

The method of computing the allowable deduction resulting from a casualty loss to business and nonbusiness property is provided for in the rules under 2009 (5)-3 (c).

Subp. 4. **Shrinkage in value of stocks.** A person possessing stock of a corporation cannot deduct from gross income any amount claimed as a loss merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. If stock of a corporation becomes worthless, its cost or other basis as determined under Minnesota Statutes, sections 290.14 and 290.15 and adjusted to the extent provided in Minnesota Statutes, section 290.12, subdivision 2 or as otherwise specifically provided for under applicable provisions of the Minnesota Income Tax Act is deductible by the owner for the taxable year in which the stock showing is made of its worthlessness. See part 8009.2000. Federal or state authorities, incident to the regulation of banks and certain other corporations, may require that stock be charged off as worthless or written down to a nominal value. If, in any case, the basis of the requirement is the worthlessness of the stock, such charging off or writing down will, for income tax purposes, be considered prima facie evidence of worthlessness; but if the charging off or writing down is due to market fluctuations, or if no reasonable attempt has been made to determine worthlessness, no deduction for income tax purposes of the amount so charged off or written down can be allowed. For limitations on deductions for losses from sales or exchanges of capital assets generally, including stocks and bonds, see Minnesota Statutes, section 290.16, subdivisions 5 and 6.

Subp. 5. **Losses in farming.** Losses incurred in the operation of farms as business enterprises are deductible from gross income. If farm products are held for favorable markets, no deduction on account of shrinkage in weight or physical value or by reason of deterioration in storage shall be allowed, except as such shrinkage may be reflected in an inventory if used to determine profits. The total loss by frost, storm, flood, or fire of a prospective crop is not a deductible loss in computing taxable income. A taxpayer engaged in raising and selling stock, such as cattle, sheep, horses, etc., is not entitled to claim as a loss the value of animals that were raised on the farm, except as such loss is reflected in an inventory if used. If livestock has been purchased for any purpose, and afterwards dies from disease, exposure, or injury, or is killed by order of the authorities of a state or the United States, the actual purchase price of such livestock, less any depreciation allowable as a deduction in respect of such perished livestock, may be deducted as a loss if the loss is not compensated for by insurance or otherwise. The actual cost of other property (with proper adjustment for depreciation) which is destroyed by order of the authorities of a state or of the United States, may in like manner be claimed as a loss. If reimbursement in whole or in part is made by a state or the United States on account of stock killed or other property destroyed in respect of which a loss was claimed for a prior year, the amount received shall be reported as income for the year in which reimbursement is made. The cost of any feed, pasture, or care which has been deducted as an expense of operation shall not be included as part of the cost of the stock for the purpose of ascertaining the amount of a deductible loss. If gross income is ascertained by inventories, no deduction can be made for livestock or products lost during the year, whether purchased for resale or produced on the farm, as such losses will be reflected in the inventory by reducing the amount of livestock or products on hand at the close of the year. If a taxpayer owns and operates a farm, in addition to being engaged in another trade, business, or calling, and sustains a loss from such operation of the farm, then the amount of loss sustained may be deducted from gross income received from all sources, provided the farm is not operated for recreation or pleasure. As to losses claimed as deductions for estate tax purposes, see 2009 subdivision 2 (5)-3 (a) (1).

Statutory Authority: *MS s 290.52*

NOTE: Regulations 2009 (15) (a)-8; 2009 (5)-3 (c); and 2009 subdivision 2 (5)-3 (a) (1) have been repealed.

8009.1900 AMOUNT OF DEDUCTIONS IN GENERAL.

In ascertaining the amount of the deduction for a loss allowed under Minnesota Statutes, section 290.09, subdivision 5, paragraph (a), the amount of the loss realized and recognized is determined under Minnesota Statutes, section 290.12, by reference to the adjusted basis provided in Minnesota Statutes, sections 290.14 and 290.15 for determining the loss from the sale or other disposition of property. Adjustments to basis shall be made in accordance with Minnesota Statutes, section 290.12, subdivision 2. For example, proper adjustment under Minnesota Statutes, section 290.16, subdivision 2 must be made for any expenditure, receipt, loss, or other item properly chargeable to capital account and for depreciation, obsolescence, amortization, and depletion.

Statutory Authority: *MS s 290.52*

8009.2000 WORTHLESS SECURITIES.

Subpart 1. **In general.** Any loss sustained by virtue of a security becoming worthless during the taxable year is, under Minnesota Statutes, section 290.09, subdivision 5, paragraph (g), made subject to the limitations provided in Minnesota Statutes, section 290.16, subdivisions 5 and 6, with respect to sales or exchanges, provided the security is a capital asset as that term is defined in Minnesota Statutes, section 290.16, subdivision 3. For the purposes of computing the taxable income of any taxpayer, such loss is to be considered as being sustained from the sale or exchange of the security on the last day of the taxable year, irrespective of when during the taxable year such security actually became worthless. No deduction shall be allowed on account of the worthlessness of any security, as defined in Minnesota Statutes, section 290.09, subdivision 5, paragraph (g), clause (2) and subpart 2, which is recoverable only in part.

Subp. 2. **Definition of security.** As used in Minnesota Statutes, section 290.09, subdivision 5, paragraph (g) and this section, the term "security" means a share of stock in a domestic or foreign corporation; a right to subscribe for or to receive such a share; or a bond, debenture, note, or certificate, or other evidence of indebtedness to pay a fixed or determinable sum of money, which has been issued at any time by a domestic or foreign corporation (including those issued by any government or political subdivision thereof), in registered form or with interest coupons.

Subp. 3. **Loss on securities of affiliate.** In general, if a taxpayer is a domestic corporation and is affiliated, within the provisions of item B and Minnesota

Statutes, section 290.09, subdivision 5, paragraph (g), clause (3), with another corporation, a security in such affiliated corporation owned by the taxpayer shall not be deemed to be a capital asset for the purpose of determining the loss under Minnesota Statutes, section 290.09, subdivision 5, paragraph (g) from the worthlessness of such security. No deduction shall be allowed to the taxpayer with respect to any security which is recoverable only in part.

For the purpose of Minnesota Statutes, section 290.09, subdivision 5, paragraph (g), a corporation shall be deemed to be affiliated with the taxpayer only if all the following factors are present:

A. the taxpayer is a domestic corporation of the United States;

B. the taxpayer owns directly at least 95 percent of each class of the stock of such corporation; and

C. more than 90 percent of the aggregate of the gross receipts of such corporation for all the taxable years during which it has been in existence has been from sources other than royalties, rents (except rents derived from rental of properties to employees of the corporation in the ordinary course of its operating business), dividends, interest (except interest received on deferred purchase price of operating assets sold), annuities, and gains from sales or exchanges of stocks and securities. For the purposes of Minnesota Statutes, section 290.09, subdivision 5, paragraph (3), clause (B), gross receipts is the total amount of receipts before reduction of cost of goods sold. In computing gross receipts for the purposes of Minnesota Statutes, section 290.09, subdivision 5, paragraph (g), clause (3)(B), gross receipts from sales or exchanges of stocks and securities shall be taken into account only to the extent of gains therefrom.

The application of this subpart may be illustrated by the following example: Corporation P, a domestic manufacturing corporation which makes its income tax returns on the calendar year basis, owns 100 percent of each class of the stock of corporation S, and, in addition, four percent of the common stock (the only class of stock) of corporation R which it acquired in 1948. Corporation S, a domestic manufacturing corporation which makes its income tax returns on the calendar year basis, owns 96 percent of the common stock of corporation R which it acquired in 1952. It is established that the stock of corporation R which has from its inception derived all its gross receipts from manufacturing operations, became worthless during 1956. Since corporation C does not own directly 95 percent of the stock of corporation R, and thus for purposes of Minnesota Statutes, section 290.09, subdivision 5, paragraph (g), clause (3) be considered to be a loss from the sale or exchange of a capital asset. Since such stock was held for more than six months, such loss shall be considered a long-term capital loss as defined in Minnesota Statutes, section 290.16, subdivision 3. Since corporation R is deemed to be affiliated with corporation S for the purposes of Minnesota Statutes, section 290.09, subdivision 5, paragraph (g), clause (3) and this paragraph, the stock of corporation R is not a capital asset in the hands of corporation S for the purposes of Minnesota Statutes, section 290.09, subdivision 5, paragraph (g). Consequently, the loss upon such stock may, under the provisions of Minnesota Statutes, section 290.09, subdivision 5, paragraph (g), clause (1) and subpart 1, may be treated as a capital loss, the taxpayer may not convert such loss into an ordinary loss under this subpart by the acquisition of additional securities in the affiliated corporation solely for the purpose of bringing the holdings of the taxpayer up to the minimum stock ownership requirement provided in Minnesota Statutes, section 290.09, subdivision 5, paragraph (g), clause (3).

Statutory Authority: *MS s 290.52*

8009.2100 BAD DEBTS.

Subpart 1. **Allowance of deduction.** Minnesota Statutes, section 290.09, subdivision 6 provides that, in computing taxable income under Minnesota Statutes, section 290.18, a deduction shall be allowed in respect to bad debts owed to the taxpayer. For this purpose, bad debts shall, subject to the provisions of Minnesota Statutes, section 290.09, subdivision 6 and the rules thereunder, be taken into account either as:

A. a deduction in respect of debts which become worthless in whole or in part; or

B. a deduction for a reasonable addition to a reserve for bad debts.

Subp. 2. **Manner of selecting method.** A taxpayer filing a return of income for the first taxable year for which he is entitled to a bad debt deduction may select either of the two methods prescribed by subpart 1 for treating bad debts, but such selection is subject to the approval of the commissioner upon examination of the return. If the method so selected is approved, it shall be used in returns for all subsequent taxable years unless the commissioner grants permission to use the other method. A statement of facts substantiating any deduction claimed under Minnesota Statutes, section 290.09, subdivision 6 on account of bad debts shall accompany each return of income.

Taxpayers who have properly selected one of the two methods for treating bad debts under provisions of prior law corresponding to Minnesota Statutes, section 290.09, subdivision 6 shall continue to use that method for all subsequent taxable years unless the commissioner grants permission to use the other method.

For taxable years beginning before December 31, 1958, application for permission to change the method of treating bad debts shall be made at least 30 days before the close of the taxable year for which the change is effective.

Subp. 3. **Bona fide debt required.** Only a bona fide debt qualifies for purposes of Minnesota Statutes, section 290.09, subdivision 6. A bona fide debt is a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money. A gift or contribution to capital shall not be considered a debt for purposes of Minnesota Statutes, section 290.09, subdivision 6. The fact that a bad debt is not due at the time of deduction shall not of itself prevent its allowance under Minnesota Statutes, section 290.09, subdivision 6.

Subp. 4. **Amount deductible; general rule.** Except in the case of a deduction for a reasonable addition to a reserve for bad debts, the basis for determining the amount of deduction under Minnesota Statutes, section 290.09, subdivision 6 in respect of a bad debt shall be the same as the adjusted basis prescribed by Minnesota Statutes, sections 290.14 and 290.15 for determining the loss from the sale or other imposition of property.

Subject to any provision of Minnesota Statutes, section 290.09, subdivision 6 and the rules thereunder which provides to the contrary, the following amounts are deductible as bad debts:

A. Notes or accounts receivable. If, in computing taxable income, a taxpayer values his notes or accounts receivable at their fair market value when received, the amount deductible as a bad debt under Minnesota Statutes, section 290.09, subdivision 6 in respect of such receivables shall be limited to such fair market value even though it is less than their face value.

A purchaser of accounts receivable which become worthless during the taxable year shall be entitled under Minnesota Statutes, section 290.09, subdivision 6 to a deduction which is based upon the price he paid for such receivables but not upon their face value.

B. Only the difference between the amount received in distribution of the assets of a bankrupt and the amount of the claim may be deducted under Minnesota Statutes, section 290.09, subdivision 6 as a bad debt.

C. The excess of the amount of the claim over the amount received by a creditor of a decedent in distribution of the assets of the decedent's estate may be considered a worthless debt under Minnesota Statutes, section 290.09, subdivision 6.

Subp. 5. **Prior inclusion in income required.** Worthless debts arising from unpaid wages, salaries, fees, rents, and similar items of taxable income shall not be allowed as a deduction under Minnesota Statutes, section 290.09, subdivision 6 unless the income such items represent has been included in the return of income for the year for which the deduction as a bad debt is claimed or for a prior taxable year.

Subp. 6. **Recovery of bad debts.** Any amount attributable to the recovery during the taxable year of a bad debt, or of a part of a bad debt, which was allowed as a deduction from gross income in a prior taxable year shall be included in gross income for the taxable year of recovery, except to the extent that the recovery is excluded from gross income under the provisions of Minnesota Statutes, section 290.071, subdivision 5, relating to the recovery of certain items previously deducted or credited. This paragraph shall not apply, however, to a bad debt which was previously charged against a reserve by a taxpayer on the reserve method of treating bad debts.

Subp. 7. **Worthless securities.** Minnesota Statutes, section 290.09, subdivision 6 and the rules thereunder do not apply to a debt which is evidenced by a bond, debenture, note, or certificate, or other evidence of indebtedness, issued by a corporation or by a government or political subdivision thereof, with interest coupons or in registered form. See, Minnesota Statutes, section 290.09, subdivision 6, paragraph (e). For provisions allowing the deduction of a loss resulting from the worthlessness of such a debt, see part 8009.2000.

These provisions do not apply to any loss sustained by a bank and resulting from the worthlessness of a security described in Minnesota Statutes, section 290.09, subdivision 5, paragraph (g), clause (2)(C).

Statutory Authority: *MS s 290.52*

8009.2200 EVIDENCE OF WORTHLESSNESS.

Subpart 1. **General rule.** In determining whether a debt is worthless in whole or in part the commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt, and the financial condition of the debtor.

Subp. 2. **Legal action not required.** Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of a debt for purposes of the deduction under Minnesota Statutes, section 290.09, subdivision 6.

Subp. 3. **Bankruptcy; general rule; year of deduction.** Bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt.

In bankruptcy cases, a debt may become worthless before settlement in some instances; and in others, only when a settlement in bankruptcy has been reached. In either case, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, thereby confirming the conclusion that the debt is worthless, shall not authorize the shifting of the deduction under Minnesota Statutes, section 290.09, subdivision 6 to such later year.

Subp. 4. **Banks and other regulated corporations.** Worthlessness is presumed in the year of charge-off. If a bank or other corporation which is subject to supervision by federal authorities, or by state authorities maintaining substantially equivalent standards, charges off a debt in whole or in part in obedience to the specific orders of such supervisory authorities, then the debt shall, to the extent charged off during the taxable year, be conclusively presumed to have become worthless, or worthless only in part, as the case may be, during such taxable year. But no such debt shall be so conclusively presumed to be worthless, or worthless only in part, as the case may be, if the amount so charged off is not claimed as a deduction by the taxpayer at the time of filing the return for the taxable year in which the charge-off takes place.

If such a bank or other corporation does not claim a deduction for such a totally or partially worthless debt in its return for the taxable year in which the charge-off takes place, but claims the deduction for a later taxable year, then the charge-off in the prior taxable year shall be deemed to have been involuntary and the deduction under Minnesota Statutes, section 290.09, subdivision 6 shall be allowed for the taxable year for which claimed, provided that the taxpayer produces sufficient evidence to show that:

A. the debt became wholly worthless in the later taxable year, or became recoverable only in part subsequent to the taxable year of the involuntary charge-off, as the case may be; and

B. to the extent that the deduction claimed in the later taxable year for a debt partially worthless was not involuntarily charged off in prior taxable years, it was charged off in the later taxable year.

Statutory Authority: *MS s 290.52*

8009.2300 PARTIAL OR TOTAL WORTHLESSNESS.

Subpart 1. **Partial worthlessness.** Applicable to specific debts only. A deduction under Minnesota Statutes, section 290.09, subdivision 6, paragraph (a), clause (2) on account of partially worthless debts shall be allowed with respect to specific debts only.

Charge-off is required:

A. If, from all the surrounding and attending circumstances, the commissioner is satisfied that a debt is partially worthless, the amount which has become worthless shall be allowed as a deduction under Minnesota Statutes, section 290.09, subdivision 6, paragraph (a), clause (2) but only to the extent charged off during the taxable year.

B. If a taxpayer claims a deduction for a part of a debt for the taxable year within which that part of the debt is charged off and the deduction is disallowed for that taxable year, then, in a case where the debt becomes partially worthless after the close of that taxable year, a deduction under Minnesota Statutes, section 290.09, subdivision 6, paragraph (a), clause (2) shall be allowed for a subsequent taxable year but not in excess of the amount charged off in the prior taxable year plus any amount in the prior taxable year shall, if consistently maintained as such, be sufficient to that extent to meet the charge-off requirement of Minnesota Statutes, section 290.09, subdivision 6, paragraph (a), clause (2) with respect to the subsequent taxable year.

C. Before a taxpayer may deduct a debt in part, he must be able to demonstrate to the satisfaction of the commissioner the amount thereof which is worthless and the part thereof which has been charged off.

Subp. 2. **Total worthlessness.** If a debt becomes wholly worthless during the taxable year, the amount thereof which has not been allowed as a deduction from gross income for any prior taxable year shall be allowed as a deduction for the current taxable year.

Statutory Authority: *MS s 290.52*

8009.2400 RESERVE FOR BAD DEBTS.

Subpart 1. **Allowance of deduction.** A taxpayer who has established the reserve method of treating bad debts and has maintained proper reserve accounts for bad debts or who, in accordance with part 8009.2100, subpart 2, adopts the reserve method of treating bad debts may deduct from gross income a reasonable addition to a reserve for bad debts in lieu of deducting specific bad debt items.

Subp. 2. **Reasonableness of addition to reserve.** What constitutes a reasonable addition to a reserve for bad debts shall be determined in the light of the facts existing at the close of the taxable year of the proposed addition. The reasonableness of the addition will vary as between classes of business and the conditions of business prosperity. It will depend primarily upon the total amount of debts outstanding as of the close of the taxable year, including those arising currently as well as those arising in prior taxable years, and the total amount of the existing reserve.

In the event that subsequent realizations upon outstanding debts prove to be more or less than estimated at the time of the creation of the existing reserve, the amount of the excess or inadequacy in the existing reserve shall be reflected in the determination of the reasonable addition necessary in the current taxable year.

Subp. 3. **Statement required.** A taxpayer using the reserve method shall file with his return a statement showing:

A. the volume of his charge sales or other business transactions for the taxable year and the percentage of the reserve to such amount;

B. the total amount of notes and accounts receivable at the beginning and close of the taxable year;

C. the amount of the debts which have become wholly or partially worthless and have been charged against the reserve account; and

D. the computation of the addition to the reserve for bad debts.

Subp. 4. **Special rules.** For special rules with respect to the addition to the reserve for bad debts of banks, savings, building and loan associations, and mutual savings and cooperative banks, see Minnesota Statutes, section 290.09, subdivision 6, paragraph (c).

Statutory Authority: *MS s 290.52*

8009.2500 SALE OF MORTGAGED OR PLEDGED PROPERTY.

Subpart 1. **Deficiency deductible as bad debt.** If mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser) for less than the amount of the debt, and the portion of the indebtedness remaining unsatisfied after the sale is wholly or partially uncollectible, the mortgagee or pledgee may deduct such amount under Minnesota Statutes, section 290.09, subdivision 6, paragraph (a) (to the extent that it constitutes capital or represents an item the income from which has been returned by him) as a bad debt for the taxable year in which it becomes wholly worthless or is charged off as partially worthless. See part 8009.2300.

Accrued interest may be included as part of the deduction allowable under this paragraph, but only if it has previously been returned as income.

Subp. 2. **Realization of gain or loss.** If, in the case of a sale described in subpart 1, the creditor buys in the mortgaged or pledged property, loss or gain is also realized, measured by the difference between the amount of those obligations of the debtor which are applied to the purchase or bid price of the property (to the extent that such obligations constitute capital or represent an item the income from which has been returned by the creditor) and the fair market value of the property.

The fair market value of the property for this purpose shall, in the absence of clear and convincing proof to the contrary, be presumed to be the amount for which it is bid in by the taxpayer.

Subp. 3. **Basis of property purchased.** If the creditor subsequently sells the property so acquired, the basis for determining gain or loss upon the subsequent sale is the fair market value of the property at the date of its acquisition by the creditor.

Statutory Authority: *MS s 290.52*

8009.2600 WORTHLESS BONDS ISSUED BY INDIVIDUAL.

Subpart 1. **Allowance of deduction.** A bond or other similar obligation issued by an individual, if it becomes worthless in whole or in part, is subject to the bad debt provisions of Minnesota Statutes, section 290.09, subdivision 6. The loss from the worthlessness of any such bond or obligation is deductible in accordance with Minnesota Statutes, section 290.09, subdivision 6, paragraph (a), unless such bond or obligation is a nonbusiness debt as defined in Minnesota Statutes, section 290.09, paragraph (d), clause (2). If the bond or obligation is a nonbusiness debt, it is subject to Minnesota Statutes, section 290.09, subdivision 6, paragraph (d) and 2009 (6)-5.

Subp. 2. **Decline on market value.** A taxpayer possessing debts evidenced by bonds or other similar obligations issued by an individual shall not be allowed any deduction under Minnesota 290.09, subdivision 6 on account of mere market fluctuation in the value of such obligations.

Subp. 3. **Worthless bonds issued by corporations.** For provisions allowing the deduction under Minnesota Statutes, section 290.09, subdivision 5, paragraph (a) of the loss sustained upon the worthlessness of any bond or similar obligation issued by a corporation or a government, see part 8009.2000.

Subp. 4. **Application to inventories.** This part does not apply to any loss upon the worthlessness of any bond or similar obligation reflected in inventories required to be taken by a dealer in securities under Minnesota Statutes, section 290.11.

Statutory Authority: *MS s 290.52*

NOTE: Regulation 2009 (6)-5 has been repealed.

8009.2700 LOSSES OF GUARANTORS, ENDORSERS, AND INDEMNITORS.

Subpart 1. **Noncorporate obligations.** Noncorporate obligations:

A. A payment during the taxable year by a taxpayer other than a corporation in discharge of part or all of his obligation as a guarantor, endorser, or indemnitor of an obligation issued by a person other than a corporation shall, for purposes of Minnesota Statutes, section 290.09, subdivision 6 and the rules thereunder, be treated as a debt's becoming worthless within the taxable year, if:

(1) the proceeds of the obligation so issued have been used in the trade or business of the borrower; and

(2) the borrower's obligation to the person to whom the taxpayer's payment is made is worthless at the time of payment except for the existence of the guaranty, endorsement, or indemnity whether or not such obligation has in fact become worthless within the taxable year in which payment is made.

B. If a payment is treated as a loss in accordance with the provisions of item A, Minnesota Statutes, section 290.09, subdivision 6, paragraph (d), relating to the special rule for losses sustained on the worthlessness of a nonbusiness debt, shall not apply. Accordingly, in each instance the loss shall be deducted under Minnesota Statutes, section 290.09, subdivision 6, paragraph (a), clause (1) as a wholly worthless debt even though there has been a discharge of only a part of the taxpayer's obligation. Thus, if the taxpayer makes a payment during the taxable year in discharge of only part of his obligation as a guarantor, endorser, or indemnitor, he may treat such payment under Minnesota Statutes, section 290.09, subdivision 6, paragraph (a), clause (1) as a debt's becoming wholly worthless within the taxable year, provided that he can establish that such part of the borrower's obligation to the person to whom the taxpayer's payment is made is worthless at the time of payment and the conditions of item A have otherwise been satisfied.

C. Other provisions of the internal revenue laws relating to bad debts, such as Minnesota Statutes, section 290.071, subdivision 5, relating to the recovery of bad debts, shall be deemed to apply to any payment which, under the provisions of this part, is treated as a bad debt. If the requirement of Minnesota Statutes, section 290.09, subdivision 6, paragraph (f) are not met, any loss sustained by a guarantor, endorser, or indemnitor upon the worthlessness of the debtor's obligation shall be treated under the provisions of law applicable thereto. See, for example, subpart 2.

Subp. 2. **Corporate obligations.** The loss sustained during the taxable year by a taxpayer other than a corporation in discharge of all of his obligation of a guarantor of an obligation issued by a corporation shall be treated, in accordance with Minnesota Statutes, section 290.09, subdivision 6, paragraph (d) and the rules thereunder, as a loss sustained on the worthlessness of a nonbusiness debt if the debt created in the guarantor's favor as a result of the payment does not come within the exceptions prescribed by Minnesota Statutes, section 290.09, subdivision 6, paragraph (d), clause (2)(A) or (B). See paragraph (a) (2) of 2009 (6)-5.

Subp. 3. **Examples.** The application of this part may be illustrated by the following examples:

A. During 1959, A, an individual who makes his return on the basis of the calendar year, guarantees payment of an obligation of B, an individual, to the X bank, the proceeds of the obligation being used in B's business. B defaults on his obligation in 1960. A makes payment to the X bank during 1961 in discharge of his entire obligation as a guarantor, the obligation of B to the X bank, being wholly worthless. For his taxable year 1961, A is entitled to a deduction under Minnesota Statutes, section 290.09, subdivision 6, paragraph (a), clause (1) as a result of his payment during that year.

B. During 1959, A, an individual who makes his return on the basis of the calendar year, guarantees payment of an obligation of B, an individual, to the X bank, the proceeds of the obligation being used in B's business. In 1960, B pays a part of his obligation to the X bank but defaults on the remaining part. In 1961, A makes payment to the X bank, in discharge of part of his obligation as a guarantor, of the remaining unpaid part of B's obligation to the bank, such part of B's obligation then being worthless. For his taxable year 1961, A is entitled to a deduction under Minnesota Statutes, section 290.09, subdivision 6, paragraph (a), clause (1) as a result of his payment of the remaining part of B's obligation.

C. During 1959, A, an individual who makes his return on the basis of the calendar year, guarantees payment of an obligation of B, an individual, to the X bank, the proceeds of the obligation being used for B's personal use. B defaults on his obligation in 1960. A makes payments to the X bank during 1961 in discharge of his entire obligation as a guarantor, the obligation of B to X bank being wholly worthless. A may not apply the benefit of Minnesota Statutes, section 290.09, subdivision 6, paragraph (f) to his loss, since the proceeds of B's obligation have not been used in B's trade or business.

D. During 1959, A, an individual who makes his return on the basis of the calendar year, guarantees payment of an obligation of Y corporation to the X bank, the proceeds of the obligation being used in X corporation's business. Y corporation defaults on its obligation in 1960. A makes payment to the X bank during 1961 in discharge of his entire obligation as a guarantor, the obligation of Y corporation to the X bank being wholly worthless. At no time during 1959 or 1961 is A engaged in a trade or business. For the taxable year 1961, A is entitled to deduct a capital loss in accordance with the provisions of Minnesota Statutes, section 290.09, subdivision 6, paragraph (d), and (a) (2) of 2009 (6)-5. He may not apply the benefit of Minnesota Statutes, section 290.09, subdivision 6, paragraph (f) to his loss, since his payment is in discharge of an obligation issued by a corporation.

Statutory Authority: *MS s 290.52*

NOTE: Regulation 2009 (6)-5, paragraph (a) (2) has been repealed.

DEPENDENT EDUCATION EXPENSE

8009.3000 SCHOOL TUITION AND TRANSPORTATION.

Subpart 1. **In general.** Subject to the following conditions, a deduction from gross income is allowed for amounts the taxpayer has paid to others during the taxable year for a dependent's tuition and the cost of transportation in attending an elementary or secondary school.

Subp. 2. **Elementary or secondary school.** The dependent (as defined below) must have been enrolled in an elementary or secondary school at the time the tuition expense or cost of transportation was incurred. An "elementary or secondary school" is defined as:

A. a kindergarten, grade, or high school in the Minnesota public school system; or

B. a school which is part of another public school system or which is nonpublic, provided that such school is equivalent to one of the schools referred to in item A, in both purpose and scope of instruction given. (But see subpart 3 regarding schools for the mentally retarded or physically impaired.)

Limitation: The term "elementary or secondary school" does not include prekindergarten or post-high-school-graduation grades.

Subp. 3. **Mentally retarded or physically impaired dependent.** If the dependent is mentally retarded or physically impaired, the cost of tuition and transportation of such dependent in receiving instruction in courses similar in content to courses taught in elementary or secondary schools for normal children is deductible.

However, the cost of tuition and transportation expenses incurred to give such dependent other instruction, therapy, or medical care is not deductible under Minnesota Statutes, section 290.09, subdivision 22. Any amounts deducted under Minnesota Statutes, section 290.09, subdivision 10 cannot also be deducted under Minnesota Statutes, section 290.09, subdivision 22.

Subp. 4. **Dependent defined.** A dependent for the purposes of this rule is the same as a dependent for the purposes of Minnesota Statutes, section 290.06, subdivision 3, clause (3). See 2006 (3) (b).

Subp. 5. **In attending an elementary or secondary school defined.** For purposes of this rule, "in attending an elementary or secondary school" means:

A. physically attending an elementary or secondary school;

B. receiving instruction given by an elementary or secondary school to students who are unable to physically attend classes conducted at such school; or

C. receiving instruction from a private teacher or school which is not an elementary or secondary school, provided that such instruction was acceptable for credit by the elementary or secondary school in which the dependent was enrolled.

Subp. 6. **Supplementary instruction.** No deduction is allowed for tuition or the cost of transportation paid to have a dependent receive instruction which is merely supplementary to class work taken by the dependent in his elementary or secondary school. Example: The taxpayer hires a private tutor to assist his son to receive a passing grade in the son's high school history class. Expenditures made to receive such instruction from the tutor are not deductible.

Subp. 7. **Extracurricular activities.** Amounts paid for the purpose of having the dependent attend extracurricular school activities such as sporting events, concerts, plays, dances, etc., are not deductible.

Subp. 8. **Tuition.** "Tuition" is defined as the charge made by an educational institution or individual to compensate such institution or individual for instruction given or to be given to the dependent. Thus, tuition does not include charges made to compensate for feeding, lodging, or clothing of the dependent, nor does it include separate charges for the purchase or use of books, supplies, or equipment.

Subp. 9. **Cost of transportation.** Unreimbursed amounts actually paid to a person or organization which provided the dependent with transportation in attending an elementary or secondary school are deductible. However, no deduction is permitted for any expense the taxpayer incurred in using his own car to provide such transportation for his dependent.

Subp. 10. **Limit on deduction.** The maximum amount a taxpayer may deduct for tuition and the cost of transportation for an individual dependent is limited to $200. If the amounts paid for an individual dependent total less than $200, the deduction with respect to such individual dependent is the total amount actually paid for such dependent.

Subp. 11. **Statement to be included in return.** The taxpayer must maintain a record or memorandum sufficient to substantiate the amounts claimed as tuition and transportation costs. A mere estimate of the amounts is not acceptable.

A statement must be included in the return listing, under the name of each dependent for whom the taxpayer paid tuition or transportation expenses, the following information:

A. the amount paid for dependent's tuition and to whom paid; and

B. the amount paid for the dependent's transportation and to whom paid.

Statutory Authority: *MS s 290.52*

NOTE: Regulation 2006 (3) (b) has been repealed.

DEPRECIATION AND DEPLETION

8009.4000 DEPRECIATION IN GENERAL.

Subpart 1. **Reasonable allowance.** Minnesota Statutes, section 290.09, subdivision 7, (A)(a) provides that a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or of property held by the taxpayer for the production of income shall be allowed as a depreciation deduction. The allowance is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property, as provided in Minnesota Statutes, section 290.09, subdivision 7, (A)(f) and part 8009.5800. An asset shall not be depreciated below a reasonable salvage value under any method of computing depreciation. See subpart 3 for definition of salvage. The allowance shall not reflect amounts representing a mere reduction in market value.

Subp. 2. **Useful life.** For the purpose of Minnesota Statutes, section 290.09, subdivision 7, (A) the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. This period shall be determined by reference to his experience with similar property taking into account present conditions and probable future developments. Some of the factors to be considered in determining this period are (1) wear and tear and decay or decline from natural causes, (2) the normal progress of the art, economic changes, inventions, and current developments within the industry and the taxpayer's trade or business, (3) the climatic and other local conditions peculiar to the taxpayer's trade or business, and (4) the taxpayer's policy as to repairs, renewals, and replacements. Salvage value is not a factor for the purpose of determining useful life. If the taxpayer's experience is inadequate, the general experience in the industry may be used until such time as the taxpayer's own experience forms an adequate basis for making the determination. The estimated remaining useful life may be subject to modification by reason of conditions known to exist at the end of the taxable year and shall be redetermined when necessary regardless of the method of computing depreciation. However, estimated remaining useful life shall be redetermined only when the change in the useful life is significant and there is a clear and convincing basis for the redetermination. For rules covering agreements with respect to useful life, see Minnesota Statutes, section 290.09, subdivision 7, (A)(d) and part 8009.5600.

Subp. 3. **Salvage.** Salvage value is the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer. Salvage value shall not be changed at any time after the determination made at the time of acquisition merely because of changes in price levels. However, if there is a redetermination of useful life under the rules of subpart 2, salvage value may be redetermined based upon facts known at the time of such redetermination of useful life. Salvage, when reduced by the cost of removal, is referred to as net salvage. The time at which an asset is retired from service may vary according to the policy of the taxpayer. If the taxpayer's policy is to dispose of assets which are still in good operating condition, the salvage value may represent a relatively large proportion of the original basis of the asset. However, if the taxpayer customarily uses an asset until its inherent useful life has been substantially exhausted salvage value may represent no more than junk value. Salvage value must be taken into account in determining the depreciation deduction either by a reduction of the amount subject to depreciation or by a reduction in the rate of depreciation, but in no event shall an asset (or an account) be depreciated below a reasonable salvage value. See, however, part 8009.5200, subpart 1 for the treatment of salvage under the declining balance method. The taxpayer may use either salvage or net salvage in determining depreciation allowances but such practice must be consistently followed and the treatment of the costs of removal must be consistent with the practice adopted. For specific treatment of salvage value see parts 8009.5100, 8009.5200, and 8009.5300. When an asset is retired or disposed of, appropriate adjustments shall be made in the asset and depreciation reserve accounts. For example, the amount of the salvage adjusted for the costs of removal may be credited to the depreciation reserve.

Statutory Authority: *MS s 290.52*

8009.4100 TANGIBLE PROPERTY.

The depreciation allowance in the case of tangible property applies only to that part of the property which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence. The allowance does not apply to inventories or stock in trade, or to land apart from the improvements or physical development added to it. The allowance does not apply to natural resources which are subject to the allowance for depletion provided in Minnesota Statutes, section 290.09, subdivision 8. No deduction for depreciation shall be allowed on automobiles or other vehicles used solely for pleasure, on a building used by the taxpayer solely as his residence, or on furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be depreciated.

Statutory Authority: *MS s 290.52*

8009.4200 INTANGIBLES.

If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. Examples are patents and copyrights. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life. No deduction for depreciation is allowable with respect to goodwill. For rules with respect to organizational expenditures, see Minnesota Statutes, section 290.09, subdivision 19 and the rules thereunder.

Statutory Authority: *MS s 290.52*

8009.4300 LEASED PROPERTY.

Capital expenditures made by a lessee for the erection of buildings or the construction of other permanent improvements on leased property are recoverable through allowances for depreciation or amortization. If the useful life of such improvements in the hands of the taxpayer is equal to or shorter than the remaining period of the lease, the allowances shall take the form of depreciation under Minnesota Statutes, section 290.09 subdivision 7, (A). See parts 8009.5000, 8009.5100, 8009.5200, 8009.5300, and 8009.5400 for methods of computing such depreciation allowances. If, on the other hand, the estimated useful life of such property in the hands of the taxpayer, determined without regard to the terms of the lease would be longer than the remaining period of such lease, the allowances shall take the form of annual deductions from gross income in an amount equal to the unrecovered cost of such capital expenditures divided by the number of years remaining of the term of the lease. Such deductions shall be in lieu of allowance for depreciation. See Minnesota Statutes, section 290.09, subdivision 2 and the rules thereunder. Capital expenditures made by a lessor for the erection of buildings or other improvements shall if subject to depreciation allowances, be recovered by him over the estimated life of the improvements without regard to the period of the lease.

Statutory Authority: *MS s 290.52*

8009.4400 APPORTIONMENT OF BASIS.

In the case of the acquisition on or after January 1, 1933, of a combination of depreciable and nondepreciable property for a lump sum, as for example buildings and land, the basis for depreciation cannot exceed an amount which bears the same proportion to the lump sum as the value of the depreciable property at the time of acquisition bears to the value of the entire property at that time. In the case of property which is subject to both the allowance for depreciation and amortization, depreciation is allowable only with respect to the portion of the depreciable property which is not subject to the allowance for amortization and may be taken concurrently with the allowance for amortization. After the close of the amortization period or after amortization deductions have been discontinued with respect to any such property, the unrecovered cost or other basis of the depreciable portion of such property will be subject to depreciation. For adjustments to basis, see Minnesota Statutes, section 290.12, subdivision 2, and other applicable provisions of law.

Statutory Authority: *MS s 290.52*

8009.4500 DEPRECIATION IN SPECIAL CASES.

Subpart 1. **Depreciation of patents or copyrights.** The cost or other basis of a patent or copyright shall be depreciated over its remaining useful life. Its cost to the patentee includes the various government fees, cost of drawings, models, attorneys' fees, and similar expenditures. For rules applicable to research and experimental expenditures, see Minnesota Statutes, sections 290.09, subdivision 18 and 290.12, subdivision 2 and the rules thereunder. If a patent or copyright becomes valueless in any year before its expiration the unrecovered cost or other basis may be deducted in that year.

Subp. 2. **Depreciation in case of farmers.** A reasonable allowance for depreciation may be claimed on farm buildings (except a dwelling occupied by the owner), farm machinery, and other physical property but not including land. Livestock acquired for work, breeding, or dairy purposes may be depreciated unless included in an inventory used to determine profits in accordance with

Minnesota Statutes, section 290.01, subdivision 20 and the rules thereunder. Such depreciation should be determined with reference to the cost or other basis, salvage value, and the estimated useful life of the livestock. See also Minnesota Statutes, section 290.09, subdivision 2 and the rules thereunder relating to trade or business expenses, Minnesota Statutes, section 290.09, subdivision 5 and the rules thereunder relating to losses of farmers, and Minnesota Statutes, section 290.09, subdivision 21 and the rules thereunder relating to soil or water conservation expenditures.

Statutory Authority: *MS s 290.52*

8009.4600 ACCOUNTING FOR DEPRECIABLE PROPERTY.

Subpart 1. **Types of accounts for individual items or combinations.** Depreciable property may be accounted for by treating each individual item as an account, or by combining two or more assets in a single account. Assets may be grouped in an account in a variety of ways. For example, assets similar in kind with approximately the same useful lives may be grouped together. Such an account is commonly known as a group account. Another appropriated grouping might consist of assets segregated according to use without regard to useful life, for example, machinery and equipment, furniture and fixtures, or transportation equipment. Such an account is commonly known as a classified account. A broader grouping, where assets are included in the same account regardless of their character or useful lives, is commonly referred to as a composite account. Group, classified, or composite accounts may be further broken down on the basis of location, dates of acquisition, cost, character, use, etc.

Subp. 2. **Depreciation reserve.** When group, classified, or composite accounts are used with average useful lives and a normal retirement occurs, the full cost or other basis of the asset retired unadjusted for depreciation or salvage, shall be removed from the asset account and shall be charged to the depreciation reserve. Amounts representing salvage ordinarily are credited to the depreciation reserve. Where an asset is disposed of for reasons other than normal retirement, the full cost or other basis of the asset shall be removed from the asset account, and the depreciation reserve shall be charged with the depreciation applicable to the retired asset. For rules with respect to losses on normal retirements, see part 8009.4700.

Subp. 3. **Procedures.** A taxpayer may establish as many accounts for depreciable property as he desires. Depreciation allowances shall be computed separately for each account. Such depreciation preferably should be recorded in a depreciation reserve account; however, in appropriate cases it may be recorded directly in the asset account. Where depreciation reserves are maintained a separate reserve account shall be maintained for each asset account. The regular books of account or permanent auxiliary records shall show for each account the basis of the property, including adjustments necessary to conform to the requirements of Minnesota Statutes, section 290.12, subdivision 2 and other provisions of law relating to adjustments to basis, and the depreciation allowance for tax purposes. In the event that reserves for book purposes do not correspond with reserves maintained for tax purposes, permanent auxiliary records shall be maintained with the regular books of accounts reconciling the differences in depreciation for tax and book purposes because of different methods of depreciation, basis, rates, salvage, or other factors. Depreciation schedules filed with the income tax return shall show the accumulated reserves computed in accordance with the allowances for income tax purposes.

Subp. 4. **Redetermination of classified or composite accounts.** In classified or composite accounts, the average useful life and rate shall be redetermined whenever additions, retirements, or replacements substantially alter the relative proportion of types of assets in the accounts. See part 8009.5100, subpart 2, item B for method of determining the depreciation rate for classified or composite account.

Statutory Authority: *MS s 290.52*

8009.4700 RETIREMENTS.

Subpart 1. **Gains and losses on retirements.** For the purposes of this part, the term "retirement" means the permanent withdrawal of depreciable property from use in the trade or business or in the production of income. The withdrawal may be made in one of several ways. For example, the withdrawal may be made by selling or exchanging the asset, or by actual abandonment. In addition, the asset may be withdrawn from such productive use without disposition as, for example, by being placed in a supplies or scrap account. The tax consequences of a retirement depend upon the form of the transaction, the reason therefor, the timing of the retirement, the estimated useful life used in computing depreciation, and whether the asset is accounted for in a separate or multiple asset account. Upon the retirement of assets, this part applies in determining whether gain or loss will be recognized, the amount of such gain or loss, and the basis for determining gain or loss:

A. Where an asset is retired by sale at arm's length, recognition of gain or loss will be subject to the provisions of Minnesota Statutes, section 290.16, subdivision 9, and other applicable provisions of law.

B. Where an asset is retired by exchange, the recognition of gain or loss will be subject to the provisions of Minnesota Statutes, sections 290.13 and 290.16, subdivision 9, and other applicable provisions of law.

C. Where an asset is permanently retired from use in the trade or business or in the production of income but is not disposed of by the taxpayer or physically abandoned (as, for example, when the asset is transferred to a supplies or scrap account), gain will not be recognized. In such a case, loss will be recognized measured by the excess of the adjusted basis of the asset at the time of retirement over the estimated salvage value or over the fair market value at the time of such retirement if greater, but only if:

(1) the retirement is an abnormal retirement; or

(2) the retirement is a normal retirement from a single asset account (see subpart 4 for special rule for item accounts); or

(3) the retirement is a normal retirement from a multiple asset account in which the depreciation rate was based on the maximum expected life of the longest lived asset contained in the account.

D. Where an asset is retired by actual physical abandonment (as, for example, in the case of a building condemned as unfit for further occupancy or other use), loss will be recognized measured by the amount of the adjusted basis of the asset abandoned at the time of such abandonment. In order to qualify for the recognition of loss from physical abandonment, the intent of the taxpayer must be irrevocably to discard the asset so that it will neither be used again by him nor retrieved by him for sale, exchange, or other disposition.

Experience with assets which have attained an exceptional or unusual age shall, with respect to similar assets, be disregarded in determining the maximum expected useful life of the longest lived asset in a multiple asset account. For example, if a manufacturer establishes a proper multiple asset account for 50 assets which are expected to have an average life of 30 years but which will remain useful to him for varying periods between 20 and 40 years, even though an occasional asset of this kind may last 60 years.

Subp. 2. **Definition of normal and abnormal retirements.** For the purpose of this part, the determination of whether a retirement is normal or abnormal shall be made in the light of all the facts and circumstances. In general, a retirement shall be considered a normal retirement unless the taxpayer can show that the withdrawal of the asset was due to a cause not contemplated in setting the applicable depreciation rate. For example, a retirement is considered normal if made within the range of years taken into consideration in fixing the depreciation rate and if the asset has reached a condition at which, in the normal course of events, the taxpayer customarily retires similar assets from use in his business. On the other hand, a retirement may be abnormal if the asset is withdrawn at an earlier time or under other circumstances, as, for example, when the asset has been damaged by casualty or has lost its usefulness suddenly as the result of extraordinary obsolescence.

Subp. 3. **Basis of assets retired.** The basis of an asset at the time of retirement for computing gain or loss shall be its adjusted basis for determining gain or loss upon a sale or other disposition as determined in accordance with the provisions of Minnesota Statutes, section 290.12 and the following:

A. In the case of a normal retirement of an asset from a multiple asset account where the depreciation rate is based on average expected useful life, the term "adjusted basis" means the salvage value estimated in determining the depreciation deduction in accordance with part 8009.4000, subpart 3.

B. In the case of a normal retirement of an asset from a multiple asset account in which the depreciation rate was based on the maximum expected life of the longest lived asset in the account, the adjustment for depreciation allowed or allowable shall be made at the rate which would have been proper if the asset had been depreciated in a single asset account (under the method of depreciation used for the multiple asset account) using a rate based upon the maximum expected useful life of that asset.

C. In the case of an abnormal retirement from a multiple asset account the adjustment for depreciation allowed or allowable shall be made at the rate which would have been proper had the asset been depreciated in a single asset account (under the method of depreciation used for the multiple asset account) and using a rate based upon either the average expected useful life or the maximum expected useful life of the asset, depending upon the method of determining the rate of depreciation used in connection with the multiple asset account.

Subp. 4. **Special rule for item accounts.** As indicated in subpart 1, item C, subitems (2) and (3), a loss is recognized upon the normal retirement of an asset from a single asset account but a loss on the normal retirement of an asset in a multiple asset account is not allowable where the depreciation rate is based upon the average useful life of the assets in the account where a taxpayer with more than one depreciable asset chooses to set up a separate account for each such asset and the depreciation rate is based on the average useful life of such assets (so that he uses the same life for each account). The question arises whether his depreciation deductions in substance are the equivalent of those which would result from the use of multiple asset accounts and, therefore, he should be subject to the rules governing losses on retirements of assets from multiple asset accounts.

A. Where a taxpayer has only a few depreciable assets which he chooses to account for in single asset accounts, particularly where such assets cover a relatively narrow range of lives, it cannot be said in the usual case that the allowance of losses on retirements from such accounts clearly will distort income. This results from the fact that where a taxpayer has only a few depreciable assets it is usually not possible clearly to determine that the depreciation rate is based upon the average useful life of such assets. Accordingly, it cannot be said that the taxpayer is in effect clearly operating with a multiple asset account using an average life rate so that losses should not be allowed on normal retirements. Therefore, losses normally will be allowed upon retirement of assets from single asset accounts where the taxpayer has only a few depreciable assets.

On the other hand, when a taxpayer who has only a few depreciable assets chooses to account for them in single asset accounts, using for each account a depreciation rate based on the average useful life of such assets, and the assets cover a wide range of lives, the likelihood that income will be distorted is greater than where the group of assets covers a relatively narrow range of lives. In those cases where the allowance of losses would distort income, the rules with respect to the allowance of losses on normal retirement shall be applied to such assets in the same manner as though the assets had been accounted for in multiple asset accounts using a rate based upon average expected useful life.

B. Where a taxpayer has a large number of depreciable assets and depreciation is based on the average useful life of such assets, then, whether such assets are similar or dissimilar and regardless of whether they are accounted for in individual asset accounts the allowance of losses on the normal retirement of such assets would distort income. Such distortion would result from the fact that the use of average life (and, accordingly, average rate) assumes that while some assets normally will be retired before the expiration of the average life, others normally will be retired after the expiration of the average life. Accordingly, if instead of accounting for a large number of similar or dissimilar depreciable assets in multiple asset accounts, the taxpayer chooses to account separately for such assets, using a rate based upon the average life of such assets, the rules with respect to the allowances of losses on normal retirements will be applied to such assets in the same manner as though the assets were accounted for in multiple asset accounts using a rate based upon average expected useful life.

C. Where a taxpayer who does not have a large number of depreciable assets, and who therefore is not subject to item B, chooses to set up a separate account for each such asset, and has sought to compute an average life for such assets on which to base his depreciation deductions (so that he uses the same life for each account), the allowance of losses on normal retirements from such accounts may in some situations substantially distort income. Such distortion would result from the fact that the use of average useful life (and, accordingly, average rate) assumes that while some assets normally will be retired before expiration of the average life, others normally will be retired after expiration of the average life. Accordingly, where a taxpayer chooses to account separately for such assets instead of accounting for them in multiple asset accounts, and the result is to substantially distort his income, the rules with respect to the allowance of losses on normal retirements shall be applied to such assets in the same manner as though the assets had been accounted for in multiple asset accounts using a rate based upon average expected useful life.

D. Whenever a taxpayer is treated under this subpart as though his assets were accounted for in a multiple asset account using an average life rate, and, therefore, he is denied a loss on retirements, the unrecovered cost less salvage of each asset which was accounted for separately may be amortized in accordance with subpart 5, item A, subitem 2.

Subp. 5. **Accounting treatment of asset retirements.** In the case of a normal retirement where under the foregoing rules no loss is recognized and where the asset is retired without disposition or abandonment:

A. if the asset was contained in a multiple asset account, the full cost of such asset, reduced by estimated salvage, shall be charged to the depreciation reserve; or

B. if the asset was accounted for separately, the unrecovered cost or other basis, less salvage, of the asset may be amortized through annual deductions from gross income in amounts equal to the unrecovered cost or other basis of such asset, divided by the average expected useful life (not the remaining useful life) applicable to the asset at the time of retirement.

For example, if an asset is retired after six years of use and at the time of retirement depreciation was being claimed on the basis of an average expected useful life of ten years, the unrecovered cost or other basis less salvage would be amortized through equal annual deductions over a period of ten years from the time of retirement.

Where multiple asset accounts are used and acquisitions and retirements are numerous, if a taxpayer, in order to avoid unnecessarily detailed accounting for individual retirements, consistently follows the practice of charging the reserve with the full cost or other basis of assets retired and of crediting it with all receipts from salvage, the practice may be continued so long as, in the opinion of the commissioner, it clearly reflects income. Conversely, where the taxpayer customarily follows a practice of reporting all receipts from salvage as ordinary taxable income such practice may be continued so long as, in the opinion of the commissioner, it clearly reflects income.

Subp. 6. **Cross-reference.** For special rules in connection with the retirement of the last assets of a given year's acquisitions under the declining balance method, see part 8009.5200, subpart 2, item B.

Statutory Authority: *MS s 290.52*

8009.4800 OBSOLESCENCE.

The depreciation allowance includes an allowance for normal obsolescence which should be taken into account to the extent that the expected useful life of property will be shortened by reason thereof. Obsolescence may render an asset economically useless to the taxpayer regardless of its physical condition. Obsolescence is attributable to many causes, including technological improvements and reasonably foreseeable economic changes. Among these causes are normal progress of the arts and sciences, supercession or inadequacy brought about by developments in the industry, products, methods, markets, sources of supply, and other like changes, and legislative or regulatory action. In any case in which the taxpayer shows that the estimated useful life previously used should be shortened by reason of obsolescence greater than had been assumed in computing such estimated useful life, a change to a new and shorter estimated useful life computed in accordance with such showing will be permitted. No such change will be permitted merely because in the unsupported opinion of the taxpayer the property may become obsolete. For rules governing the allowance of a loss when the usefulness of an asset is suddenly terminated, see Minnesota Statutes, section 290.09, subdivision 7, (A)(d) and part 8009.5600.

Statutory Authority: *MS s 290.52*

8009.4900 WHEN DEPRECIATION DEDUCTION IS ALLOWABLE.

Subpart 1. **Failure to deduct.** A taxpayer should deduct the proper depreciation allowance each year and may not increase his depreciation allowances in later years by reason of his failure to deduct any depreciation allowance or of his action in deducting an allowance plainly inadequate under the known facts in prior years. The inadequacy of the depreciation allowance for property in prior years shall be determined on the basis of the allowable method of depreciation used by the taxpayer for such property or under the straight line method if no allowance has ever been claimed for such property. The preceding sentence shall not be construed as precluding application of any method provided in Minnesota Statutes, section 290.09, subdivision 7, (A)(b) if taxpayer's failure to claim any allowance for depreciation was due solely to erroneously treating as a deductible expense an item properly chargeable to capital account. For rules relating to adjustments to basis, see Minnesota Statutes, section 290.12, subdivision 2 and the rules thereunder.

Subp. 2. **Period for depreciation.** The period for depreciation of an asset shall begin when the asset is placed in service and shall end when the asset is retired from service. A proportionate part of one year's depreciation is allowable for that part of the first and last year during which the asset was in service. However, in the case of a multiple asset account, the amount of depreciation may be determined by using what is commonly described as an averaging convention, that is, by using an assumed timing of additions and retirements. For example, it might be assumed that all additions and retirements to the asset account occur uniformly throughout the taxable year, in which case depreciation is computed on the average of the beginning and ending balances of the asset account for the taxable year. See part 8009.5100, subpart 2, item C. Among still other averaging conventions which may be used is the one under which it is assumed that all additions and retirements during the first half of a given year were made on the first day of that year and that all additions and retirements during the second half of the year were made on the first day of the following year. Thus, a full year's depreciation would be taken on additions in the first half of the year and no depreciation would be taken on additions in the second half. Moreover, under this convention, no depreciation would be taken on retirements in the second half. An averaging convention, if used, must be consistently followed as to the account or accounts for which it is adopted, and must be applied to both additions and retirements. In any year in which an averaging convention substantially distorts the depreciation allowance for the taxable year, it may not be used.

Statutory Authority: *MS s 290.52*

8009.5000 METHODS OF COMPUTING DEPRECIATION.

Subpart 1. **In general.** Any reasonable and consistently applied method of computing depreciation may be used or continued in use under Minnesota Statutes, section 290.09, subdivision 7, (A). Regardless of the method used in computing depreciation, deductions for depreciation shall not exceed such amounts as may be necessary to recover the unrecovered cost or other basis less salvage during the remaining useful life of the property. The reasonableness of any claim for depreciation shall be determined upon the basis of conditions known to exist at the end of the period for which the return is made. It is the responsibility of the taxpayer to establish the reasonableness of the deduction for depreciation claimed. Generally, depreciation deductions so claimed will be changed only where there is a clear and convincing basis for a change.

Subp. 2. **Certain methods.** Methods previously found adequate to produce a reasonable allowance under prior laws will, if used consistently by the taxpayer, continue to be acceptable under Minnesota Statutes, section 290.06, (A)(a). Examples of such methods which continue to be acceptable are the straight line method, the declining balance method with the rate limited to 150 percent of the applicable straight line rate, and under appropriate circumstances, the unit of production method. The methods described in Minnesota Statutes, section 290.09, subdivision 7, (A)(b) and parts 8009.5100, 8009.5200, 8009.5300, and 8009.5400 shall be deemed to produce a reasonable allowance for depreciation except as limited under Minnesota Statutes, section 290.09, subdivision 7, (A)(c) and part 8009.5500. See also part 8009.5700 for rules relating to change in method of computing depreciation.

Subp. 3. **Application of methods.** In the case of item accounts, any method which results in a reasonable allowance for depreciation may be selected for each item of property, but such method must thereafter be applied consistently to that particular item. In the case of group, classified, or composite accounts, any method may be selected for each account. Such method must be applied to that particular account consistently thereafter but need not necessarily be applied to acquisitions of similar property in the same or subsequent years, provided such acquisitions are set up in separate accounts. See, however, part 8009.5700 and Minnesota Statutes, section 290.07, subdivision 2 and the rules thereunder, for rules relating to changes in the method of computing depreciation, and part 8009.5500 for restriction on the use of certain methods. See also 8009.4600 for definition of account.

Statutory Authority: *MS s 290.52*

8009.5100 STRAIGHT LINE METHOD.

Subpart 1. **Application of method.** Under the straight line method the cost or other basis of the property less its estimated salvage value is deductible in equal annual amounts over the period of the estimated useful life of the property. The allowance for depreciation for the taxable year is determined by dividing the adjusted basis of the property at the beginning of the taxable year, less salvage value, by the remaining useful life of the property at such time. For convenience, the allowance so determined may be reduced to a percentage or fraction. The straight line method may be used in determining a reasonable allowance for depreciation for any property which is subject to depreciation under Minnesota Statutes, section 290.09, subdivision 7, (A) and it shall be used in all cases where the taxpayer has not adopted a different acceptable method with respect to such property.

Subp. 2. **Illustrations.** The straight line method is illustrated by the following examples:

A. Under the straight line method items may be depreciated separately:

Year	Item	Cost or other basis less salvage	Useful life Years[1]	Depreciation allowable 1958	1959	1960
1958	Asset A.	$ 1,600	4	$200	$400	$400
	Asset B.	12,000	40	150	300	300

[1]In this example, it is assumed that the assets were placed in service on July 1, 1958.

B. In group, classified, or composite accounting, a number of assets with the same or different useful lives may be combined into one account, and a single rate of depreciation, i.e., the group, classified, or composite rate used for the entire account. In the case of group accounts, i.e., accounts containing assets which are similar in kind and which have approximately the same estimated useful lives, the group rate is determined from the average of the useful lives of the assets. In the case of classified or composite accounts, the classified or composite rate is generally computed by determining the amount of one year's depreciation for each item or each group of similar items, and by dividing the total depreciation thus obtained by the total cost or other basis of the assets. The average rate so obtained is to be used as long as subsequent additions, retirements, or replacements do not substantially alter the relative proportions of different types of assets in the account. An example of the computation of a classified or composite rate follows:

Cost or other basis	Estimated useful life Years	Annual depreciation
$10,000	5	$2,000
10,000	15	667
$20,000		$2,667

Average rate is 13.33 percent ($2,667 - $20,000) unadjusted for salvage. Assuming the estimated salvage value is ten percent of the cost or other basis, the rate adjusted for salvage will be 13.33 percent (13.33 percent - 1.33 percent), or 12 percent.

C. The use of the straight line method for group, classified, or composite accounts is illustrated by the following example: A taxpayer filing his returns on a calendar year basis maintains an asset account for which a group rate of 20 percent has been determined, before adjustment for salvage. Estimated salvage is determined to be six and two-thirds percent, resulting in an adjusted rate of 18.67 percent. During the years illustrated, the initial investment, additions, retirements, and salvage recoveries, which were determined not to change the composition of the group sufficiently to require a change in rate, were assumed to have been made as follows:

DEPRECIABLE ASSET ACCOUNT AND DEPRECIATION COMPUTATION ON AVERAGE BALANCES

Year	Asset Balance Jan. 1	Current Additions	Current Retirements	Asset Balance Dec. 31	Average Balance	Rate (percent)	Allowable Depreciation
1958		$12,000		$12,000	$ 6,000	18.67	$1,120
1959	$12,000			12,000	12,000	18.67	2,240
1960	12,000			12,000	12,000	18.67	2,240
1961	12,000		$2,000	10,000	11,000	18.67	2,054
1962	10,000		2,000	8,000	9,000	18.67	1,680
1963	8,000	10,000	4,000	14,000	11,000	18.67	2,054
1964	14,000		2,000	12,000	13,000	18.67	2,427
1965	12,000		2,000	10,000	11,000	18.67	2,054

CORRESPONDING DEPRECIATION RESERVE ACCOUNT

Year	Depreciation Reserve Jan. 1	Depreciation Allowable	Current Retirements	Salvage Realized	Depreciation Reserve Dec. 31
1958		$1,120			$1,120
1959	$1,120	2,240			3,360
1960	3,360	2,240			5,600
1961	5,600	2,054	$2,000	$200	5,854
1962	5,854	1,680	2,000	200	5,734
1963	5,734	2,054	4,000	400	4,188
1964	4,188	2,427	2,000		4,615
1965	4,615	2,054	2,000		4,669

1958 - Initial investment of $12,000.

1959 - Retirement $2,000, salvage realized $200.

1960 - Retirement $2,000, salvage realized $200.

1961 - Retirement $4,000, salvage realized $400.

1962 - Additions $10,000.

1963 - Retirement $2,000, no salvage realized.

1964 - Retirement $2,000, no salvage realized.

Statutory Authority: *MS s 290.52*

8009.5200 DECLINING BALANCE METHOD.

Subpart 1. **Application of method.** Under the declining balance method a uniform rate is applied each year to the unrecovered cost or other basis of the property. The unrecovered cost or other basis is the basis provided by Minnesota Statutes, section 290.09, subdivision 7, (A)(f), adjusted for depreciation previously allowed or allowable, and for all other adjustments provided by Minnesota Statutes, section 290.12, subdivision 2 and other applicable provisions of law. The declining balance rate may be determined without resort to formula. Such rate determined under Minnesota Statutes, section 290.09, subdivision 7, (A)(b)(2) shall not exceed twice the appropriate straight line rate computed without adjustment for salvage. While salvage is not taken into account in determining the annual allowances under this method, in no event shall an asset (or an account) be depreciated below a reasonable salvage value. See Minnesota Statutes, section 290.09, subdivision 7, (A)(c) and part 8009.5500 restrictions on the use of the declining balance method.

Subp. 2. **Illustrations.** The declining balance method is illustrated by the following examples:

A. A new asset having an estimated useful life of 20 years was purchased on January 1, 1958, for $1,000. The normal straight line rate (without adjustment for salvage) is five percent, and the declining balance rate at twice the normal straight line rate is ten percent. The annual depreciation allowances for 1958, 1959, and 1960 are as follows:

Year	Basis	Declining balance rate (Percent)	Depreciation allowance
1958	$1,000	10	$100
1959	900	10	90
1960	810	10	81

B. A taxpayer filing his returns on a calendar year basis maintains a group account to which a five-year life and a 40 percent declining balance rate are applicable. Original investment, additions, retirements, and salvage recoveries are the same as those set forth in part 8009.5100, subpart 2, item C. Although salvage value is not taken into consideration in computing a declining balance rate, it must be recognized and accounted for when assets are retired.

DEPRECIABLE ASSET ACCOUNT AND DEPRECIATION COMPUTATION USING AVERAGE ASSET AND RESERVE BALANCES

Year	Asset Balance Jan. 1	Current Additions	Current Retirements	Asset Balance Dec. 31	Average Balance	Average Reserve Before Depreciation	Net Depreciable Balance	Rate (percent)	Allowable Depreciation
1958		$12,000		$12,000	$ 6,000		$6,000	40	$2,400
1959	$12,000			12,000	12,000	$2,400	9,600	40	3,840
1960	12,000			12,000	12,000	6,240	5,760	40	2,304
1961	12,000		$2,000	10,000	11,000	7,644	3,356	40	1,342
1962	10,000		2,000	8,000	9,000	7,186	1,814	40	726
1963	8,000	10,000	4,000	14,000	11,000	5,212	5,788	40	2,315
1964	14,000		2,000	12,000	13,000	4,727	8,273	40	3,309
1965	12,000		2,000	10,000	11,000	6,036	4,964	40	1,986

DEPRECIATION RESERVE

Year	Reserve Jan. 1	Current Retirements	Salvage Realized	Reserve Dec. 31, Before Depreciation	Average Reserve Before Depreciation	Allowable Depreciation	Reserve Dec. 31, After Depreciation
1958						$2,400	$2,400
1959	$2,400			$2,400	$2,400	3,840	6,240
1960	6,240			6,240	6,240	2,304	8,544
1961	8,544	$2,000	$200	6,744	7,644	1,342	8,086
1962	8,086	2,000	200	6,286	7,186	726	7,012
1963	7,012	4,000	400	3,412	5,212	2,315	5,727
1964	5,727	2,000		3,727	4,727	3,309	7,036
1965	7,036	2,000		5,036	6,036	1,986	7,022

Where separate depreciation accounts are maintained by year of acquisition and there is an unrecovered balance at the time of the last retirement, such unrecovered balance may be deducted as part of the depreciation allowance for the year of such retirement. Thus, if the taxpayer had kept separate depreciation accounts by year of acquisition and all the retirements shown in the example were from 1958 acquisitions, depreciation would be computed on the 1958 and 1963 acquisitions as follows:

1958 ACQUISITIONS

Year	Asset Balance Jan. 1	Acquisitions	Current Retirements	Asset Balance Dec. 31	Average Balance	Average Reserve Before Depreciation	Net Depreciable Balance	Rate (percent)	Allowable Depreciation
1958.....	....	$12,000	....	$12,000	$ 6,000	....	$6,000	40	$2,400
1959.....	$12,000	....	....	12,000	12,000	$2,400	9,600	40	3,840
1960.....	12,000	....	....	12,000	12,000	6,240	5,760	40	2,304
1961.....	12,000	....	$2,000	10,000	11,000	7,644	3,356	40	1,342
1962.....	10,000	....	2,000	8,000	9,000	7,186	1,814	40	726
1963.....	8,000	....	4,000	4,000	6,000	5,212	788	40	315
1964.....	4,000	....	2,000	2,000	3,000	2,727	273	40	109
1965.....	2,000	....	2,000	....	1,000	836	164	....	[1] 164

[1]Balance allowable as depreciation in the year of retirement of the last survivor of the 1958 acquisitions.

DEPRECIATION RESERVE FOR 1958 ACQUISITIONS

Year	Reserve Jan. 1	Current Retirements	Salvage Realized	Reserve Dec. 31, Before Depreciation	Average Reserve Before Depreciation	Allowable Depreciation	Reserve Dec. 31, After Depreciation
1958...........	....	....	....	....	....	$2,400	$2,400
1959...........	$2,400	....	....	$2,400	$2,400	3,840	6,240
1960...........	6,240	....	....	6,240	6,240	2,304	8,544
1961...........	8,544	$2,000	$200	6,744	7,644	1,342	8,086
1962...........	8,086	2,000	200	6,286	7,186	726	7,012
1963...........	7,012	4,000	400	3,412	5,212	315	3,727
1964...........	3,727	2,000	....	1,727	2,727	109	1,835
1965...........	1,836	2,000	....	(164)	836	164	....

1963 ACQUISITIONS

Year	Asset Balance Jan. 1	Acquisition	Asset Balance Dec. 31	Average Balance	Reserve Dec. 31, Before Depreciation	Net Depreciable Balance	Rate (percent)	Allowable Depreciation	Reserve Dec. 31, After Depreciation
1963.....	....	$10,000	$10,000	$ 5,000	None	$5,000	40	$2,000	$2,000
1964.....	$10,000	....	10,000	10,000	$2,000	8,000	40	3,200	5,200
1965.....	10,000	....	10,000	10,000	5,200	4,800	40	1,920	7,120

In the above example, the allowable depreciation on the 1958 acquisitions totals $11,200. This amount when increased by salvage realized in the amount of $800, equals the entire cost or other basis of the 1958 acquisitions ($12,000).

Subp. 3. **Change in estimated useful life.** In the declining balance method when a change is justified in the useful life estimated for an account, subsequent computations shall be made as though the revised useful life had been originally estimated. For example, assume that an account has an estimated useful life of ten years and that a declining balance rate of 20 percent is applicable. If, at the end of the sixth year, it is determined that the remaining useful life of the account is six years, computations shall be made as though the estimated useful life was originally determined as 12 years. Accordingly, the applicable depreciation rate will be 16-2/3 percent. This rate is thereafter applied to the unrecovered cost or other basis.

Statutory Authority: *MS s 290.52*

8009.5300 SUM OF THE YEARS-DIGITS METHOD.

Subpart 1. **Applied to single asset; general rule.** Under the sum of the years-digits method annual allowances for depreciation are computed by applying changing fractions to the cost or other basis of the property reduced by estimated salvage. The numerator of the fraction changes each year to a number which corresponds to the remaining useful life of the asset (including the year for which the allowance is being computed), and the denominator which remains constant is the sum of all the years digits corresponding to the estimated useful life of the asset. See Minnesota Statutes, section 290.09, subdivision 7, (A)(c) and part 8009.5500 for restrictions on the use of the sum of the years-digits methods.

A. Computation of depreciation allowances on a single asset under the sum of the years-digits method is illustrated by the following examples:

(1) A new asset having an estimated useful life of five years was acquired on January 1, 1958, for $1,750. The estimated salvage is $250. For a taxpayer filing his returns on a calendar year basis, the annual depreciation allowances are as follows:

Year	Cost or Other Basis less Salvage	Fraction	Allowable Depreciation	Depreciation Reserve
1958	$1,500	5/15	$500	$ 500
1959	1,500	4/15	400	900
1960	1,500	3/15	300	1,200
1961	1,500	2/15	200	1,400
1962	1,500	1/15	100	1,500

The denominator of the fraction is the sum of the digits representing the years of useful life, i.e., 5, 4, 3, 2, and 1, or 15.

(2) Assume in connection with an asset acquired in 1958 that three-fourths of a year's depreciation is allowable in that year.

The following illustrates a reasonable method of allocating depreciation:

		Allowable Depreciation		
	Depreciation for 12 months	1958	1959	1960
1st year	$500	(3/4) $375	(1/4) $125	
2nd year	400		(3/4) 300	(1/4) $100
3rd year	300			(3/4) 225
		375	425	325

B. Where in the case of a single asset, a change is justified in the useful life, subsequent computations shall be made as though the remaining useful life at the beginning of the taxable year of change were the useful life of a new asset acquired at such time and with a basis equal to the unrecovered cost or other basis of the asset at that time. For example, assume that a new asset with an estimated useful life of ten years is purchased in 1958. At the time of making out his return for 1963, the taxpayer finds that the asset has a remaining useful life of seven years from January 1, 1963. Depreciation for 1963 should then be computed as though 1963 were the first year of the life of an asset estimated to have a useful life of seven years, and the allowance for 1963 would be 7/28 of the unrecovered cost or other basis of the asset after adjustment for salvage.

C. Under the sum of the years-digits method, annual allowances for depreciation may also be computed by applying changing fractions to the unrecovered cost or other basis of the asset reduced by estimated salvage. The numerator of the fraction changes each year to a number which corresponds to the remaining useful life of the asset (including the year for which the allowance is being computed), and the denominator changes each year to a number which represents the sum of the digits corresponding to the years of estimated remaining useful life of the asset. For decimal equivalents of such fractions see the table below. For example, a new asset with an estimated useful life of ten years is purchased January 1, 1958, for $6,000. Assuming a salvage value of $500, the depreciation allowance for 1958 is $1,000 ($5,500 x 0.1818, the applicable rate from the table). For 1959 the unrecovered balance is $4,500, and the remaining life is nine years. The depreciation allowance for 1959 would then be $900 ($4,500 x 0.2000, the applicable rate from the table).

The following table shows decimal equivalents to sum of the years-digits fractions corresponding to remaining lives from one to 100 years.

Remaining life (years)	Decimal equivalent
100.0	0.0198
99.9	.0198
99.8	.0198
99.7	.0199
99.6	.0199
99.5	.0199
99.4	.0199
99.3	.0199
99.2	.0200
99.1	.0200
99.0	.0200
98.9	.0200
98.8	.0200
98.7	.0201
98.6	.0201
98.5	.0201
98.4	.0201
98.3	.0201
98.2	.0202
98.1	.0202
98.0	.0202
97.9	.0202
97.8	.0202
97.7	.0203
97.6	.0203
97.5	.0203
97.4	.0203
97.3	.0203
97.2	.0204
97.1	.0204
97.0	.0204
96.9	.0204
96.8	.0204
96.7	.0205

96.6	.0205
96.5	.0205
96.4	.0205
96.3	.0206
96.2	.0206
96.1	.0206
96.0	.0206
95.9	.0206
95.8	.0207
95.7	.0207
95.6	.0207
95.5	.0207
95.4	.0207
95.3	.0208
95.2	.0208
95.1	.0208
95.0	.0208
94.9	.0209
94.8	.0209
94.7	.0209
94.6	.0209
94.5	.0209
94.4	.0210
94.3	.0210
94.2	.0210
94.1	.0210
94.0	.0211
93.9	.0211
93.8	.0211
93.7	.0211
93.6	.0211
93.5	.0212
93.4	.0212
93.3	.0212
93.2	.0212
93.1	.0213
93.0	.0213
92.9	.0213
92.8	.0213
92.7	.0213
92.6	.0214
92.5	.0214
92.4	.0214
92.3	.0214
92.2	.0215
92.1	.0215
92.0	.0215
91.9	.0215
91.8	.0216
91.7	.0216
91.6	.0216
91.5	.0216
91.4	.0216
91.3	.0217
91.2	.0217
91.1	.0217
91.0	.0217

90.9	.0218
90.8	.0218
90.7	.0218
90.6	.0218
90.5	.0219
90.4	.0219
90.3	.0219
90.2	.0219
90.1	.0220
90.0	.0220
89.9	.0220
89.8	.0220
89.7	.0221
89.6	.0221
89.5	.0221
89.4	.0221
89.3	.0221
89.2	.0222
89.1	.0222
89.0	.0222
88.9	.0222
88.8	.0223
88.7	.0223
88.6	.0223
88.5	.0223
88.4	.0224
88.3	.0224
88.2	.0224
88.1	.0224
88.0	.0225
87.9	.0225
87.8	.0225
87.7	.0225
87.6	.0226
87.5	.0226
87.4	.0226
87.3	.0226
87.2	.0227
87.1	.0227
87.0	.0227
86.9	.0228
86.8	.0228
86.7	.0228
86.6	.0228
86.5	.0229
86.4	.0229
86.3	.0229
86.2	.0229
86.1	.0230
86.0	.0230
85.9	.0230
85.8	.0230
85.7	.0231
85.6	.0231
85.5	.0231
85.4	.0231
85.3	.0232

85.2	.0232
85.1	.0232
85.0	.0233
84.9	.0233
84.8	.0233
84.7	.0233
84.6	.0234
84.5	.0234
84.4	.0234
84.3	.0234
84.2	.0235
84.1	.0235
84.0	.0235
83.9	.0236
83.8	.0236
83.7	.0236
83.6	.0236
83.5	.0237
83.4	.0237
83.3	.0237
83.2	.0238
83.1	.0238
83.0	.0238
82.9	.0238
82.8	.0239
82.7	.0239
82.6	.0239
82.5	.0240
82.4	.0240
82.3	.0240
82.2	.0240
82.1	.0241
82.0	.0241
81.9	.0241
81.8	.0242
81.7	.0242
81.6	.0242
81.5	.0242
81.4	.0243
81.3	.0243
81.2	.0243
81.1	.0244
81.0	.0244
80.9	.0244
80.8	.0244
80.7	.0245
80.6	.0245
80.5	.0245
80.4	.0246
80.3	.0246
80.2	.0246
80.1	.0247
80.0	.0247
79.9	.0247
79.8	.0248
79.7	.0248
79.6	.0248

79.5	.0248
79.4	.0249
79.3	.0249
79.2	.0249
79.1	.0250
79.0	.0250
78.9	.0250
78.8	.0251
78.7	.0251
78.6	.0251
78.5	.0252
78.4	.0252
78.3	.0252
78.2	.0253
78.1	.0253
78.0	.0253
77.9	.0253
77.8	.0254
77.7	.0254
77.6	.0254
77.5	.0255
77.4	.0255
77.3	.0255
77.2	.0256
77.1	.0256
77.0	.0256
76.9	.0257
76.8	.0257
76.7	.0257
76.6	.0258
76.5	.0258
76.4	.0258
76.3	.0259
76.2	.0259
76.1	.0259
76.0	.0260
75.9	.0260
75.8	.0260
75.7	.0261
75.6	.0261
75.5	.0261
75.4	.0262
75.3	.0262
75.2	.0262
75.1	.0263
75.0	.0263
74.9	.0264
74.8	.0264
74.7	.0264
74.6	.0265
74.5	.0265
74.4	.0265
74.3	.0266
74.2	.0266
74.1	.0266
74.0	.0267
73.9	.0267

73.8	.0267
73.7	.0268
73.6	.0268
73.5	.0268
73.4	.0269
73.3	.0269
73.2	.0270
73.1	.0270
73.0	.0270
72.9	.0271
72.8	.0271
72.7	.0271
72.6	.0272
72.5	.0272
72.4	.0272
72.3	.0273
72.2	.0273
72.1	.0274
72.0	.0274
71.9	.0274
71.8	.0275
71.7	.0275
71.6	.0275
71.5	.0276
71.4	.0276
71.3	.0277
71.2	.0277
71.1	.0277
71.0	.0278
70.9	.0278
70.8	.0279
70.7	.0279
70.6	.0279
70.5	.0280
70.4	.0280
70.3	.0280
70.2	.0281
70.1	.0281
70.0	.0282
69.9	.0282
69.8	.0282
69.7	.0283
69.6	.0283
69.5	.0284
69.4	.0284
69.3	.0284
69.2	.0285
69.1	.0285
69.0	.0286
68.9	.0286
68.8	.0287
68.7	.0287
68.6	.0287
68.5	.0288
68.4	.0288
68.3	.0289
68.2	.0289

68.1	.0289
68.0	.0290
67.9	.0290
67.8	.0291
67.7	.0291
67.6	.0292
67.5	.0292
67.4	.0292
67.3	.0293
67.2	.0293
67.1	.0294
67.0	.0294
66.9	.0295
66.8	.0295
66.7	.0295
66.6	.0296
66.5	.0296
66.4	.0297
66.3	.0297
66.2	.0298
66.1	.0298
66.0	.0299
65.9	.0299
65.8	.0299
65.7	.0300
65.6	.0300
65.5	.0301
65.4	.0301
65.3	.0302
65.2	.0302
65.1	.0303
65.0	.0303
64.9	.0303
64.8	.0304
64.7	.0304
64.6	.0305
64.5	.0305
64.4	.0306
64.3	.0306
64.2	.0307
64.1	.0307
64.0	.0308
63.9	.0308
63.8	.0309
63.7	.0309
63.6	.0310
63.5	.0310
63.4	.0311
63.3	.0311
63.2	.0312
63.1	.0312
63.0	.0313
62.9	.0313
62.8	.0313
62.7	.0314
62.6	.0314
62.5	.0315

62.4	.0315
62.3	.0316
62.2	.0316
62.1	.0317
62.0	.0317
61.9	.0318
61.8	.0318
61.7	.0319
61.6	.0319
61.5	.0320
61.4	.0320
61.3	.0321
61.2	.0322
61.1	.0322
61.0	.0323
60.9	.0323
60.8	.0324
60.7	.0324
60.6	.0325
60.5	.0325
60.4	.0326
60.3	.0326
60.2	.0327
60.1	.0327
60.0	.0328
59.9	.0328
59.8	.0329
59.7	.0329
59.6	.0330
59.5	.0331
59.4	.0331
59.3	.0332
59.2	.0332
59.1	.0333
59.0	.0333
58.9	.0334
58.8	.0334
58.7	.0335
58.6	.0336
58.5	.0336
58.4	.0337
58.3	.0337
58.2	.0338
58.1	.0338
58.0	.0339
57.9	.0340
57.8	.0340
57.7	.0341
57.6	.0341
57.5	.0342
57.4	.0342
57.3	.0343
57.2	.0344
57.1	.0344
57.0	.0345
56.9	.0345
56.8	.0346

56.7	.0347
56.6	.0347
56.5	.0348
56.4	.0348
56.3	.0349
56.2	.0350
56.1	.0350
56.0	.0351
55.9	.0351
55.8	.0352
55.7	.0353
55.6	.0353
55.5	.0354
55.4	.0355
55.3	.0355
55.2	.0356
55.1	.0356
55.0	.0357
54.9	.0358
54.8	.0358
54.7	.0359
54.6	.0360
54.5	.0360
54.4	.0361
54.3	.0362
54.2	.0362
54.1	.0363
54.0	.0364
53.9	.0364
53.8	.0365
53.7	.0366
53.6	.0366
53.5	.0367
53.4	.0368
53.3	.0368
53.2	.0369
53.1	.0370
53.0	.0370
52.9	.0371
52.8	.0372
52.7	.0372
52.6	.0373
52.5	.0374
52.4	.0374
52.3	.0375
52.2	.0376
52.1	.0377
52.0	.0377
51.9	.0378
51.8	.0379
51.7	.0379
51.6	.0380
51.5	.0381
51.4	.0382
51.3	.0382
51.2	.0383
51.1	.0384

51.0	.0385
50.9	.0385
50.8	.0386
50.7	.0387
50.6	.0388
50.5	.0388
50.4	.0389
50.3	.0390
50.2	.0391
50.1	.0391
50.0	.0392
49.9	.0393
49.8	.0394
49.7	.0394
49.6	.0395
49.5	.0396
49.4	.0397
49.3	.0398
49.2	.0398
49.1	.0399
49.0	.0400
48.9	.0401
48.8	.0402
48.7	.0402
48.6	.0403
48.5	.0404
48.4	.0405
48.3	.0406
48.2	.0406
48.1	.0407
48.0	.0408
47.9	.0409
47.8	.0410
47.7	.0411
47.6	.0411
47.5	.0412
47.4	.0413
47.3	.0414
47.2	.0415
47.1	.0416
47.0	.0417
46.9	.0418
46.8	.0418
46.7	.0419
46.6	.0420
46.5	.0421
46.4	.0422
46.3	.0423
46.2	.0424
46.1	.0425
46.0	.0426
45.9	.0426
45.8	.0427
45.7	.0428
45.6	.0429
45.5	.0430
45.4	.0431

45.3	.0432
45.2	.0433
45.1	.0434
45.0	.0435
44.9	.0436
44.8	.0437
44.7	.0438
44.6	.0439
44.5	.0440
44.4	.0440
44.3	.0441
44.2	.0442
44.1	.0443
44.0	.0444
43.9	.0445
43.8	.0446
43.7	.0447
43.6	.0448
43.5	.0449
43.4	.0450
43.3	.0451
43.2	.0452
43.1	.0453
43.0	.0455
42.9	.0456
42.8	.0457
42.7	.0458
42.6	.0459
42.5	.0460
42.4	.0461
42.3	.0462
42.2	.0463
42.1	.0464
42.0	.0465
41.9	.0466
41.8	.0467
41.7	.0468
41.6	.0469
41.5	.0471
41.4	.0472
41.3	.0473
41.2	.0474
41.1	.0475
41.0	.0476
40.9	.0477
40.8	.0478
40.7	.0480
40.6	.0481
40.5	.0482
40.4	.0483
40.3	.0484
40.2	.0485
40.1	.0487
40.0	.0488
39.9	.0489
39.8	.0490
39.7	.0491

39.6	.0493
39.5	.0494
39.4	.0495
39.3	.0496
39.2	.0497
39.1	.0499
39.0	.0500
38.9	.0501
38.8	.0502
38.7	.0504
38.6	.0505
38.5	.0506
38.4	.0508
38.3	.0509
38.2	.0510
38.1	.0511
38.0	.0513
37.9	.0514
37.8	.0515
37.7	.0517
37.6	.0518
37.5	.0519
37.4	.0521
37.3	.0522
37.2	.0524
37.1	.0525
37.0	.0526
36.9	.0528
36.8	.0529
36.7	.0530
36.6	.0532
36.5	.0533
36.4	.0535
36.3	.0536
36.2	.0538
36.1	.0539
36.0	.0541
35.9	.0542
35.8	.0543
35.7	.0545
35.6	.0546
35.5	.0548
35.4	.0549
35.3	.0551
35.2	.0552
35.1	.0554
35.0	.0556
34.9	.0557
34.8	.0559
34.7	.0560
34.6	.0562
34.5	.0563
34.4	.0565
34.3	.0566
34.2	.0568
34.1	.0570
34.0	.0571

33.9	.0573
33.8	.0575
33.7	.0576
33.6	.0578
33.5	.0580
33.4	.0581
33.3	.0583
33.2	.0585
33.1	.0586
33.0	.0588
32.9	.0590
32.8	.0592
32.7	.0593
32.6	.0595
32.5	.0597
32.4	.0599
32.3	.0600
32.2	.0602
32.1	.0604
32.0	.0606
31.9	.0608
31.8	.0610
31.7	.0611
31.6	.0613
31.5	.0615
31.4	.0617
31.3	.0619
31.2	.0621
31.1	.0623
31.0	.0625
30.9	.0627
30.8	.0629
30.7	.0631
30.6	.0633
30.5	.0635
30.4	.0637
30.3	.0639
30.2	.0641
30.1	.0643
30.0	.0645
29.9	.0647
29.8	.0649
29.7	.0651
29.6	.0653
29.5	.0656
29.4	.0658
29.3	.0660
29.2	.0662
29.1	.0664
29.0	.0667
28.9	.0669
28.8	.0671
28.7	.0673
28.6	.0675
28.5	.0678
28.4	.0680
28.3	.0682

28.2	.0685
28.1	.0687
28.0	.0690
27.9	.0692
27.8	.0694
27.7	.0697
27.6	.0699
27.5	.0702
27.4	.0704
27.3	.0707
27.2	.0709
27.1	.0712
27.0	.0714
26.9	.0717
26.8	.0719
26.7	.0722
26.6	.0724
26.5	.0727
26.4	.0730
26.3	.0732
26.2	.0735
26.1	.0738
26.0	.0741
25.9	.0743
25.8	.0746
25.7	.0749
25.6	.0752
25.5	.0754
25.4	.0757
25.3	.0760
25.2	.0763
25.1	.0766
25.0	.0769
24.9	.0772
24.8	.0775
24.7	.0778
24.6	.0781
24.5	.0784
24.4	.0787
24.3	.0790
24.2	.0793
24.1	.0797
24.0	.0800
23.9	.0803
23.8	.0806
23.7	.0809
23.6	.0813
23.5	.0816
23.4	.0819
23.3	.0823
23.2	.0826
23.1	.0830
23.0	.0833
22.9	.0837
22.8	.0840
22.7	.0844
22.6	.0847

22.5	.0851
22.4	.0854
22.3	.0858
22.2	.0862
22.1	.0866
22.0	.0870
21.9	.0873
21.8	.0877
21.7	.0881
21.6	.0885
21.5	.0888
21.4	.0892
21.3	.0896
21.2	.0901
21.1	.0905
21.0	.0909
20.9	.0913
20.8	.0917
20.7	.0921
20.6	.0925
20.5	.0930
20.4	.0934
20.3	.0939
20.2	.0943
20.1	.0948
20.0	.0952
19.9	.0957
19.8	.0961
19.7	.0966
19.6	.0970
19.5	.0975
19.4	.0980
19.3	.0985
19.2	.0990
19.1	.0995
19.0	.1000
18.9	.1005
18.8	.1010
18.7	.1015
18.6	.1020
18.5	.1025
18.4	.1030
18.3	.1036
18.2	.1041
18.1	.1047
18.0	.1053
17.9	.1058
17.8	.1063
17.7	.1069
17.6	.1074
17.5	.1080
17.4	.1086
17.3	.1092
17.2	.1098
17.1	.1105
17.0	.1111
16.9	.1117

16.8	.1123
16.7	.1129
16.6	.1135
16.5	.1142
16.4	.1148
16.3	.1155
16.2	.1162
16.1	.1169
16.0	.1176
15.9	.1183
15.8	.1190
15.7	.1197
15.6	.1204
15.5	.1211
15.4	.1218
15.3	.1226
15.2	.1234
15.1	.1242
15.0	.1250
14.9	.1257
14.8	.1265
14.7	.1273
14.6	.1281
14.5	.1289
14.4	.1297
14.3	.1306
14.2	.1315
14.1	.1324
14.0	.1333
13.9	.1342
13.8	.1350
13.7	.1359
13.6	.1368
13.5	.1378
13.4	.1387
13.3	.1397
13.2	.1407
13.1	.1418
13.0	.1429
12.9	.1438
12.8	.1448
12.7	.1458
12.6	.1469
12.5	.1479
12.4	.1490
12.3	.1502
12.2	.1514
12.1	.1526
12.0	.1538
11.9	.1549
11.8	.1561
11.7	.1573
11.6	.1585
11.5	.1597
11.4	.1610
11.3	.1624
11.2	.1637

11.1	.1652
11.0	.1667
10.9	.1680
10.8	.1693
10.7	.1707
10.6	.1721
10.5	.1736
10.4	.1751
10.3	.1767
10.2	.1783
10.1	.1800
10.0	.1818
9.9	.1833
9.8	.1849
9.7	.1865
9.6	.1882
9.5	.1900
9.4	.1918
9.3	.1938
9.2	.1957
9.1	.1978
9.0	.2000
8.9	.2018
8.8	.2037
8.7	.2057
8.6	.2077
8.5	.2099
8.4	.2121
8.3	.2145
8.2	.2169
8.1	.2195
8.0	.2222
7.9	.2244
7.8	.2267
7.7	.2292
7.6	.2317
7.5	.2344
7.4	.2372
7.3	.2401
7.2	.2432
7.1	.2465
7.0	.2500
6.9	.2527
6.8	.2556
6.7	.2587
6.6	.2619
6.5	.2653
6.4	.2689
6.3	.2727
6.2	.2768
6.1	.2811
6.0	.2857
5.9	.2892
5.8	.2929
5.7	.2969
5.6	.3011
5.5	.3056

5.4	.3103
5.3	.3155
5.2	.3210
5.1	.3269
5.0	.3333
4.9	.3379
4.8	.3429
4.7	.3481
4.6	.3538
4.5	.3600
4.4	.3667
4.3	.3739
4.2	.3818
4.1	.3905
4.0	.4000
3.9	.4063
3.8	.4130
3.7	.4205
3.6	.4286
3.5	.4375
3.4	.4474
3.3	.4583
3.2	.4706
3.1	.4844
3.0	.5000
2.9	.5088
2.8	.5185
2.7	.5294
2.6	.5417
2.5	.5556
2.4	.5714
2.3	.5897
2.2	.6111
2.1	.6364
2.0	.6667
1.9	.6786
1.8	.6923
1.7	.7083
1.6	.7273
1.5	.7500
1.4	.7778
1.3	.8125
1.2	.8571
1.1	.9167
1.0	1.0000

Note: For determination of decimal equivalents of remaining lives falling between those shown in the above table, the taxpayer may use the next longest life shown in the table, interpolate from the table, or use the following formula from which the table was derived.

$$D = \frac{2R}{(W + 2F)(W + 1)}$$

where:

D = Decimal equivalent.

R = Remaining life.

W = Whole number of years in remaining life.

F = Fractional part of year in remaining life.

If the taxpayer desires to carry his calculations of decimal equivalents to a greater number of decimal places than is provided in the table, he may use the formula. The procedure adopted must be consistently followed thereafter.

Subp. 2. **Applied to group, classified, or composite accounts; general rule.** The sum of the years-digits method may be applied to group, classified, or composite accounts in accordance with the plan described in item A or in accordance with other plans as explained in item B.

A. The remaining life plan as applied to a single asset is described in subpart 1, item C. This plan may also be applied to group, classified, or composite accounts. Under this plan the allowance for depreciation is computed by applying changing fractions to the unrecovered cost or other basis of the account reduced by estimated salvage. The numerator of the fraction changes each year to a number which corresponds to the remaining useful life of the account (including the year for which the allowance is being computed), and the denominator changes each year to a number which represents the sum of the years-digits corresponding to the years of estimated remaining useful life of the account. Decimal equivalents of such fractions can be obtained by use of the table in item B. The proper application of this method requires that the estimated remaining useful life of the account be determined each year.

This determination, of course, may be made each year by analysis, i.e., by determining the remaining lives for each of the components in the account, and averaging them. The estimated remaining life of any account, however, may also be determined arithmetically. For example, it may be computed by dividing the unrecovered cost or other basis of the account, as computed by straight line depreciation, by the gross cost or other basis of the account, and multiplying the result by the average life of the assets in the account. Salvage value is not a factor for the purpose of determining remaining life. Thus, if a group account with an average life of ten years had at January 1, 1958, a gross asset balance of $12,600 and a depreciation reserve computed on the straight line method of $9,450, the remaining life of the account at January 1, 1958, would be computed as follows:

$$\frac{\$12{,}600 - \$9{,}450}{\$12{,}600} \text{ times 10 years equals 2.50 years.}$$

Example. The use of the sum of the years-digits method with group, classified, or composite accounts under the remaining life plan is illustrated by the following example: A calendar year taxpayer maintains a group account to which a five-year life is applicable. Original investment, additions, retirements, and salvage recoveries are the same as those set forth in the example in part 8009.5100, subpart 2, item C.

DEPRECIATION COMPUTATIONS ON A GROUP ACCOUNT UNDER REMAINING LIFE PLAN

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14
											Sum of the Years Digits Depreciation			
	Asset Balance Jan. 1	Current Additions	Current Retirements	Average Asset Balance	Straight Line Amount	Straight Line Reserve	Remaining Life	Asset Balance Reduced by Salvage	Current Additions reduced by Salvage	Salvage Realized	Accumulated Reserve Jan. 1	Unrecovered Jan. 1	Rate Based on Col. (7) from Table I	Allowable Depreciation
					Col. (4) ÷ Life	Col. (5) − Col. (3) Accumulated Jan. 1	[Col. (1) − Col. (6) + Col. (1)] × Average Service Life	Col. (1) × (100% − 6.67%)	Col. (2) × (100% − 6.67%)		Prior Reserve + Col. (14) + Col. (10) − Col. (3)	Col. (8) − Col. (11)		Col. (12) × Col. (13) + ½ Col. (9) × F[2]
1958		$12,000		$ 6,000	[1]$1,200		5.00		$11,200				0.3333	$1,866
1959	$12,000			12,000	2,400	$1,200	4.50	$11,200			$1,866	$9,334	.3600	3,360
1960	12,000			12,000	2,400	3,600	3.50	11,200			5,226	5,974	.4375	2,614
1961	12,000		$2,000	11,000	2,200	6,000	2.50	11,200		$200	7,840	3,360	.5556	1,867
1962	10,000		2,000	9,000	1,800	6,200	1.90	9,333		200	7,907	1,426	.6786	968
1963	8,000	10,000	4,000	11,000	2,200	6,000	1.25	7,466	9,333	400	7,075	391	.8125	1,874
1964	14,000		2,000	13,000	2,600	4,200	3.50	13,066			5,349	7,717	.4375	3,376
1965	12,000		2,000	11,000	2,200	4,800	3.00	11,200			6,725	4,475	.5000	2,238
1966						5,000					6,963			

[1] ½ year's amount.
[2] F = Rate based on average service life (0.3333 in this example).

B. Other plans for application of the sum of the years-digits method. Taxpayers who wish to use the sum of the years-digits method in computing depreciation for group, classified, or composite accounts in accordance with a sum of the years-digits plan other than the remaining life plan described herein may do so only with the consent of the commissioner. Request for permission to use plans other than that described shall be addressed to the Commissioner of Revenue, Saint Paul, Minnesota.

Statutory Authority: *MS s 290.52*

8009.5400 OTHER METHODS.

Subpart 1. **Limitation.** Under Minnesota Statutes, section 290.09, subdivision 7, (A)(b)(4), a taxpayer may use any consistent method of computing depreciation, such as the sinking fund method, provided depreciation allowances computed in accordance with such method do not result in accumulated allowances at the end of any taxable year greater than the total of the accumulated allowances which could have resulted from the use of the declining balance method described in Minnesota Statutes, section 290.09, subdivision 7, (A)(b)(2). This limitation applies only during the first two-thirds of the useful life of the property. For example, an asset costing $1,000 having a useful life of six years may be depreciated under the declining balance method in accordance with part 8009.5200 at a rate of 33-1/3 percent. During the first four years or two-thirds of its useful life, maximum depreciation allowances under the declining balance method would be as follows:

	Current depreciation	Accumulated depreciation	Balance
Cost of asset			$1,000
First year	$333	$333	667
Second year	222	555	445
Third year	148	703	297
Fourth year	99	802	198

An annual allowance computed by any other method under Minnesota Statutes, section 290.09, subdivision 7, (A)(b)(4), could not exceed $333 for the first year, and at the end of the second year the total allowances for the two years could not exceed $555. Likewise, the total allowances for the three years could not exceed $703 and for the four years could not exceed $802. This limitation would not apply in the fifth and sixth years. See Minnesota Statutes, section 290.09, subdivision 7, (A)(c), and part 8009.5500 for restrictions on the use of certain methods.

Subp. 2. **Reasonable and consistent.** It shall be the responsibility of the taxpayer to establish to the satisfaction of the commissioner that a method of depreciation under Minnesota Statutes, section 290.09, subdivision 7, (A)(b)(4), is both a reasonable and consistent method and that it does not produce depreciation allowances in excess of the amount permitted under the limitations provided in such section.

Statutory Authority: *MS s 290.52*

8009.5500 LIMITATIONS ON METHODS OF COMPUTING DEPRECIATION UNDER MINNESOTA STATUTES, SECTION 290.09, SUBDIVISION 7, (A)(B)(2), (3), AND (4).

Subpart 1. **In general; examples.** Minnesota Statutes, section 290.09, subdivision 7, (A)(c) provides limitations on the use of the declining balance method described in Minnesota Statutes, section 290.09, subdivision 7, (A)(b)(2), the sum of the years-digits method described in Minnesota Statutes, section 290.09, subdivision 7, (A)(b)(3), and certain other methods authorized by Minnesota Statutes, section 290.09, subdivision 7, (A)(b)(4). These methods are applicable only to tangible property having a useful life of three years or more. These methods apply only to that portion of the basis of the property which is properly attributable to such construction, reconstruction, or erection after December 31, 1958. Property is considered as constructed, reconstructed, or erected by the taxpayer if the work is done for him in accordance with specifications. The portion of the basis of such property attributable to construction, reconstruction, or erection after December 31, 1958, consists of all costs of the property allocable to the period after December 31, 1958, including the cost or other basis of materials entering into such work. It is not necessary that such materials be acquired after December 31, 1958, or that they be new in use. If construction or erection by the taxpayer began after December 31, 1958, the entire cost or other basis of such construction or erection qualifies for these methods of depreciation. In the case of reconstruction of property, these methods do not apply to any part of the adjusted basis of such property on December 31, 1958. For purposes of this part, construction, reconstruction, or erection by the taxpayer begins when physical work is started on such construction, reconstruction, or erection.

If the property was not constructed, reconstructed, or erected by the taxpayer, these methods apply only if it was acquired after December 31, 1958, and if the original use of the property commences with the taxpayer and commences after December 31, 1958. For the purpose of the preceding sentence, property shall be deemed to be acquired when reduced to physical possession or control. The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use for such property by the taxpayer. For example, a reconditioned or rebuilt machine acquired after December 31, 1958, will not be treated as being put to original use by the taxpayer even though it is put to a different use, nor will a horse acquired for breeding purposes be treated as being put to original use by the taxpayer if prior to the purchase the horse was used for racing purposes. See parts 8009.5200, 8009.5300, and 8009.5400 for application of the various methods.

Assets having an estimated average useful life of less than three years shall not be included in a group, classified, or composite account to which the methods described in parts 8009.5200, 8009.5300, and 8009.5400 are applicable. However, an incidental retirement of an asset from such account prior to the expiration of a useful life of three years will not prevent the application of these methods to such an account.

See Minnesota Statutes, section 290.138, subdivision 1, paragraph (c), clause (6) and the rules thereunder for rules covering the use of depreciation methods by acquiring corporations in the case of certain corporate acquisitions.

Except in the cases described in this subpart, the methods of depreciation described in parts 8009.5200, 8009.5300, and 8009.5400 are not applicable to property in the hands of a distributee, vendee, transferee, donee, or grantee unless the original use of the property begins with such person and the conditions required by Minnesota Statutes, section 290.09, subdivision 7, (A)(c) and this part are otherwise met.

For example, these methods of depreciation may not be used by a corporation with respect to property which it acquires from an individual or partnership in exchange for its stock. Similarly, if an individual or partnership receives property in a distribution upon dissolution of a corporation, these methods of depreciation may not be used with respect to property so acquired by such individual or partnership. As a further example, these methods of depreciation may not be used by a partnership with respect to contributed property, nor by a partner with respect to partnership property distributed to him. Moreover, where a partnership is entitled to use these depreciation methods, and the optional adjustment to basis of partnership property provided by Minnesota Statutes, section 290.31, subdivision 20 is applicable, (1) in the case of an increase in the adjusted basis of the partnership property under such section, the transferee partner with respect to whom such adjustment is applicable shall not be entitled to use such methods with respect to such increase, and (2) in the case of a decrease in the adjusted basis of the partnership property under such section, the transferee partner with respect to whom such adjustment is applicable shall include in his income an amount equal to the portion of the depreciation deducted by the partnership which is attributable to such decrease.

Subp. 2. **Illustrations; 1959 and after.** The application of these methods to property constructed, reconstructed, or erected by the taxpayer after December 31, 1958, may be illustrated by the following examples:

A. If a building with a total cost of $100,000 is completed after December 31, 1958, and the portion attributable to construction after December 31, 1958, is determined by engineering estimates or by cost accounting records to be $30,000, the methods referred to in subpart 1, are applicable only to the $30,000 portion of the total.

B. In 1958, a taxpayer has an old machine with an unrecovered cost of $1,000. If he contracts to have it reconditioned, or reconditions it himself, at a cost of an additional $5,000, only the $5,000 may be depreciated under the methods referred to in subpart 1, whether or not the materials used for reconditioning are new in use.

C. A taxpayer who acquired a building in 1940 makes major maintenance or repair expenditures in 1958 of a type which must be capitalized. For these expenditures the taxpayer may use a method of depreciation different from that used on the building, for example, the methods referred to in subpart 1, only if he accounts for such expenditures separately from the account which contained the original building. In such case, the unadjusted basis on any parts replaced shall be removed from the asset account and shall be charged to the appropriate depreciation reserve account. In the alternative he may capitalize such expenditures by charging them to the depreciation reserve account for the building.

Subp. 3. **Illustrations; through 1958.** The application of these methods to property which was not constructed, reconstructed, or erected by the taxpayer but which was acquired after December 31, 1958, may be illustrated by the following examples:

A. A taxpayer contracted in 1958 to purchase a new machine which he acquired in 1959 and put into first use in that year. He may use the methods referred to in subpart 1 in recovering the cost of the new machine.

B. A taxpayer instead of reconditioning his old machine buys a factory reconditioned machine in 1958 to replace it. He cannot apply the methods referred to in subpart 1 to any part of the cost of the reconditioned machine since he is not the first user of the machine.

C. In 1958, a taxpayer buys a house for $20,000 which had been used as a personal residence and thus had not been subject to depreciation allowances. He makes a capital addition of $5,000 and rents the property to another. The taxpayer may use the methods referred to in subpart 1 only with respect to the $5,000 cost of the addition.

Subp. 4. **Election to use methods.** Subject to the limitations set forth in subpart 1, the methods of computing the allowance for depreciation specified in Minnesota Statutes, section 290.09, subdivision 7, (A)(b)(2), (3), and (4) may be adopted without permission and no formal election is required. In order for a taxpayer to elect to use these methods for any property described in subpart 1, he need only compute depreciation thereon under any of these methods for any taxable year ending after December 31, 1958, in which the property may first be depreciated by him. The election with respect to any property shall not be binding with respect to acquisitions of similar property in the same year or subsequent years which are set up in separate accounts.

Statutory Authority: *MS s 290.52*

8009.5600 AGREEMENT AS TO USEFUL LIFE AND RATES OF DEPRECIATION.

For taxable years beginning after December 31, 1958, a taxpayer may enter into an agreement with respect to the estimated useful life, method, and rate of depreciation and treatment of salvage of any property which is subject to the allowance for depreciation. An application for such agreement may be made to the commissioner of taxation. Such application shall be filed in quadruplicate and shall contain in such detail as may be practical the following information:

A. the character and location of the property;

B. the original cost or other basis and date of acquisition;

C. proper adjustments to the basis including depreciation accumulated to the first taxable year to be covered by the agreement;

D. estimated useful life and estimated salvage value;

E. method and rate of depreciation;

F. any other facts and circumstances pertinent to making a reasonable estimate of the useful life of the property and its salvage value.

The agreement must be in writing and must be signed by the taxpayer and by the commissioner of taxation or by his agent. The agreement must be signed in quadruplicate, and two of the signed copies will be returned to the taxpayer. The agreement shall set forth its effective date, the estimated remaining useful life, the estimated salvage value, and rate and method of depreciation of the property and the facts and circumstances taken into consideration in adoption of the agreement, and shall relate only to depreciation allowances for such property on and after the effective date of the agreement. Such an agreement shall be binding on both parties until such time as facts and circumstances which were not taken into account in making the agreement are shown to exist. The party wishing to modify or change the agreement shall have the responsibility of establishing the existence of such facts and circumstances. Any change in the useful life or rate specified in such agreement shall be effective only prospectively, that is, it shall be effective beginning with the taxable year in which notice of the intention to change, including facts and circumstances warranting the adjustment of useful life and rate, is sent by registered mail by the party proposing the change to the other party. A copy of the agreement (and any modification thereof) shall be filed with the taxpayer's return for the first taxable year which is affected by the agreement (or any modification thereof). A signed copy should be retained with the permanent records of the taxpayer. For rules relating to changes in method of depreciation, see part 8009.5700 and Minnesota Statutes, section 290.07, subdivision 2 and the rules thereunder.

Statutory Authority: *MS s 290.52*

8009.5700 CHANGE IN METHOD.

Subpart 1. **In general.** Any change in the method of computing the depreciation allowances with respect to a particular account is a change in method of accounting, and such a change will be permitted only with the consent of the commissioner, except that the change from the declining balance method to the straight line method as provided in Minnesota Statutes, section 290.09, subdivision 7, (A)(e) shall be permitted without consent. See subpart 2. A change in method of computing depreciation will be permitted only with respect to all the assets contained in a particular account as defined in part 8009.4600. Any change in the percentage of the current straight line rate under the declining balance method, as for example, from 200 percent of the straight line rate to any other percent of the straight line rate, or any change in the interest factor used in connection with a compound interest or sinking fund method will constitute a change in method of depreciation and will require the consent of the commissioner. Any request for a change in method of depreciation shall be made in accordance with Minnesota Statutes, section 290.07, subdivision 2 and the rules thereunder and shall state the character and location of the property, method of depreciation being used and the method proposed, the date of acquisition, the cost or other basis and adjustments thereto, amounts recovered through depreciation and other allowances, the estimated salvage value, the estimated remaining life of the property, and such other information as may be required. For rules covering the use of depreciation methods by acquiring corporations in the case of certain corporate acquisitions, see Minnesota Statutes, section 290.138, subdivision 1, paragraph (c), clause (6) and the rules thereunder.

Subp. 2. **Declining balance to straight line.** In the case of an account to which the method described in Minnesota Statutes, section 290.09, subdivision 7, (A)(b)(2) is applicable, a taxpayer may change without the consent of the commissioner, from the declining balance method of depreciation to the straight line method at any time during the useful life of the property under the following conditions. Such a change may not be made if a provision prohibiting such a change is contained in an agreement under Minnesota Statutes, section 290.09, subdivision 7, (A)(d). When the change is made, the unrecovered cost or other basis (less a reasonable estimate for salvage) shall be recovered through annual allowances over the estimated remaining useful life determined in accordance with the circumstances existing at that time. With respect to any account, this change will be permitted only if applied to all the assets in the account as defined in part 8009.4600. The taxpayer shall furnish a statement, with respect to the property which is the subject of the change, showing the date of acquisition, cost or other basis, amounts recovered through depreciation and other allowances, the estimated salvage value, the character of the property, the remaining useful life of the property, and such other information as may be required. The statement shall be attached to the taxpayer's return for the taxable year in which the change is made. A change to the straight line method must be adhered to for the entire taxable year of the change and for all subsequent taxable years unless, with the consent of the commissioner, a change to another method is permitted.

Statutory Authority: *MS s 290.52*

8009.5800 BASIS FOR DEPRECIATION.

The basis upon which the allowance for depreciation is to be computed with respect to any property shall be the adjusted basis provided in Minnesota Statutes, section 290.16, subdivisions 5 and 6 for the purpose of determining gain on the sale or other disposition of such property. In the case of property which has not been used in the trade or business or held for the production of income and which is thereafter converted to such use, the fair market value on the date of such conversion, if less than the adjusted basis of the property at that time, is the basis for computing depreciation.

Statutory Authority: *MS s 290.52*

8009.5900 LIFE TENANTS AND BENEFICIARIES OF TRUSTS AND ESTATES.

Subpart 1. **Life tenants.** In the case of property held by one person for life with remainder to another person, the deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property so that he will be entitled to the deduction during his life, and thereafter the deduction, if any, shall be allowed to the remainderman.

Subp. 2. **Trusts.** If property is held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee on the basis of the trust income allocable to each, unless the governing instrument (or local law) requires or permits the trustee to maintain a reserve for depreciation in any amount. In the latter case, the deduction is first allocated to the trustee to the extent that income is set aside for a depreciation reserve, and any part of the deduction in excess of the income set aside for the reserve shall be apportioned between the income beneficiaries and the trustee on the basis of the trust income (in excess of the income set aside for the reserve) allocable to each. For example:

A. If under the trust instrument or local law the income of a trust computed without regard to depreciation is to be distributed to a named beneficiary, the beneficiary is entitled to the deduction to the exclusion of the trustee.

B. If under the trust instrument or local law the income of a trust is to be distributed to a named beneficiary, but the trustee is directed to maintain a reserve for depreciation in any amount the deduction is allowed to the trustee (except to the extent that income set aside for the reserve is less than the allowable deduction). The same result would follow if the trustee sets aside income for a depreciation reserve pursuant to discretionary authority to do so in the governing instrument.

No effect shall be given to any allocation of the depreciation deduction which gives any beneficiary or the trustee a share of such deduction greater than his pro rata share of the trust income, irrespective of any provisions in the trust instrument, except as otherwise provided in this subpart when the trust instrument or local law requires or permits the trustee to maintain a reserve for depreciation.

Subp. 3. **Estates.** In the case of an estate, the allowable deduction shall be apportioned between the estate and the heirs, legatees, and devisees on the basis of income of the estate which is allocable to each.

Statutory Authority: *MS s 290.52*

8009.6500 DEPLETION.

Subpart 1. **Depletion defined.** "Depletion" is the exhaustion of natural resources such as mines, oil and gas wells, other natural deposits, and timber, through the consumption or use of such resources.

Subp. 2. **Depletion basis.** The capital sum recoverable through depletion allowances shall be determined by the basis specified in Minnesota Statutes, sections 290.14 and 290.15 for the purpose of computing the loss or gain on the sale or other disposition of property. In cases where a taxpayer uses a basis other than cost, the fair market value shall be determined by the commissioner in accordance with the conditions known to exist on the valuation date, and when once established shall not be altered except in case of erroneous information or gross error.

Subp. 3. **Who is entitled to depletion.** In accordance with Minnesota Statutes, section 290.05, subdivision 1, paragraph (a), "corporations, individuals, estates and trusts engaged in the business of mining or producing iron ore" are exempt from the act in so far as their income from these operations are concerned.

A. No value for depletion purposes need be ascertained in case of a fee owner operator.

B. In cases where the owner in fee as of January 1, 1933, has leased mineral properties prior to that date, a value of these properties for depletion purposes shall be established on the basis of the income tax cost or the value as of that date of the royalties to be received; and in case of mineral properties leased after January 1, 1933, the value shall be based on the facts known to exist on January 1, 1933, with adjustments for ore removed or paid for subsequent to that date, with a waiting period from the basic date to the date of the lease.

C. In accordance with Minnesota Statutes, section 290.05, subdivision 1, paragraph (a), "corporations, individuals, estates, and trusts engaged in the business of mining or producing iron ore" are exempt from the act, in so far as their income from these operations are concerned, but this does not preclude the consideration of their interests in the valuation of the property for depletion purposes.

D. In cases where the lessee of mineral properties has re-leased the property to others prior to January 1, 1933, the value for depletion purposes shall be established in the same manner as for a fee owner lessor based on the amount of royalty to be received in excess of the amount of royalty to be paid on the entire property.

In the case of mineral properties leased after January 1, 1933, the value shall be based on the facts known to exist on January 1, 1933, with adjustments for ore removed or paid for subsequent to that date, with a waiting period from the basic date to the date of the lease.

In case of properties leased from the fee owner after January 1, 1933, and leased to others the value to the lessee-lessor shall be the cost.

The values of the equities of the lessor and lessee shall be computed separately, but, when determined as of the same basic date, shall together never exceed the value at that date of the property in fee simple.

Subp. 4. **Information required.** Form 137 is to be used to furnish information on which to base valuation calculations.

Annual information covering the amount of royalties received and the number of tons of ore paid for should accompany the return of each taxpayer claiming depletion.

Subp. 5. **Depletion deductions where units paid for in advance of extraction.** Where the owner has leased a mineral property for a term of years with a requirement in the lease that the lessee shall extract and pay for, annually, a specified number of tons, or other agreed units of measurement, of such mineral, or shall pay, annually, a specified sum of money which shall be applied in payment of the purchase price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the leased premises, the value established for purposes of depletion, of the number of units so paid for in advance of extraction will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year on account of the extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

If for any reason any such mineral lease shall be terminated or abandoned before the mineral which has been paid for in advance has been extracted and removed, and the lessor repossesses the leased property, the lessor shall adjust his capital accounts by restoring to the capital sum of the property the depletion deductions made in prior years on account of royalties on minerals paid for but not removed, and his income account shall be adjusted so as to include the amount so restored to capital sum as income of the year such lease is terminated or the property repossessed, and the tax thereon paid.

Upon the expiration, termination, or abandonment of the lease, without the removal of any or all of the minerals contemplated by the lease, the lessor shall be required to restore to capital account the excess of the depletion theretofore allowable in respect of the royalty payments over the actual depletion or loss in value sustained as a result of the operations under the lease, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned.

Subp. 6. **Depletion of timber.** For the purpose of computing the allowance for depletion of timber for a given period, the number of units cut during the year shall be multiplied by the income tax cost per unit. To determine the unit cost, the taxpayer should ascertain:

A. the income tax cost at the beginning of the period;

B. additions at cost during the period;

C. the number of units on hand at the beginning of the taxable period; and

D. the number of units acquired during the period.

Divide the sum of item A and item B by the sum of item C and item D. The income tax cost means the basis as determined under Minnesota Statutes, sections 290.14 and 290.15 plus subsequent additions at cost, less depletion and cost or other basis of timber sold, deducted, and allowed for income tax purposes to the beginning of the period under consideration.

If the taxpayer's estimate of the quality of timber known to have existed at the basic date subsequently is shown to be in error, a new estimate may be made, subject to the approval of the commissioner, and such new estimate shall thereafter constitute the basis for the depletion deduction.

For the purpose of establishing the fair market value of timber as the basis for depletion deductions, careful consideration will be given to purchases and sales of similar property which were made within a reasonable period prior or subsequent to the basic date.

The term "basic date" means the date as of which valuation is determined.

Allowable depletion of timber may be deducted by the owner of the fee, or, in the case of leases, the deduction on a fee simple basis shall be equitably apportioned between the lessor and the lessee; where property is held in trust, the deduction shall be apportioned between the income beneficiaries, and the trustees in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. If the property is held by one person for life with remainder to another person, the life tenant shall be treated as the absolute owner for the purpose of the deduction for depletion.

Subp. 7. **Information required for deduction for depletion of timber.** Every taxpayer claiming a deduction for depletion of timber shall attach to his income tax return a map and statement for the taxable year covered by the return. The map shall show the timber and land acquired, timber cut, and timber and land sold. The statement shall contain the following information:

A. description of, cost of, terms of purchase or lease of timber and land acquired;

B. proof of profit or loss from sale of capital assets;

C. description of timber with respect to which claim for loss, if any, is made;

D. record of timber cut;

E. changes in each timber account as the result of purchase, sale, cutting, reestimate, or loss;

F. changes in physical property accounts as the result of additions to or deductions from capital and depreciation;

G. operation data with respect to raw and finished material handled and inventoried;

H. unit production costs; and

I. any other data which will be helpful in determining deductions claimed in the return.

Statutory Authority: *MS s 290.52*

TENTATIVE CARRYBACKS

8009.7000 TENTATIVE CARRYBACK ADJUSTMENTS.

Subpart 1. **In general.** Any corporation who has a net operating loss under Minnesota Statutes, section 290.095 may file an application for a tentative carryback adjustment of the taxes for taxable years prior to the taxable year of the loss which are affected by the net operating loss carryback resulting from such loss.

Subp. 2. **Contents of application.** The application for tentative carryback adjustment shall be filed on form 519. The application shall be filled out in accordance with the instructions on the form and all information required by the form must be furnished by the taxpayer.

An application for a tentative carryback adjustment does not constitute a claim for refund. If such application is disallowed by the commissioner in whole or in part, no suit may be maintained in any court for the recovery of any tax based on such application. The filing of an application for a tentative carryback adjustment will not constitute the filing of a claim for refund within the meaning of Minnesota Statutes, section 290.50 for purposes of determining whether a claim for refund was filed prior to the expiration of the applicable period of limitation. The taxpayer, however, may file a claim for refund under Minnesota Statutes, section 290.50 at any time prior to the expiration of the applicable period of limitation, and may maintain a suit based on such claim if it is disallowed or if the commissioner does not act on the claim within six months from the date it is filed. Such claim may be filed before, simultaneously with, or after the filing of an application for a tentative carryback adjustment. A claim for refund under Minnesota Statutes, section 290.50 filed after the filing of an application for a tentative carryback adjustment is not to be considered an amendment of such application. Such claim, however, in proper cases may constitute an amendment to a prior claim filed under Minnesota Statutes, section 290.50.

Subp. 3. **Time and place for filing application.** The application for a tentative carryback adjustment shall be filed on or after the date of the filing of the return for the taxable year of the net operating loss and shall be filed within the period of 12 months from the end of such taxable year. Any application filed prior to the date the return for the taxable year of the loss is filed shall be considered to have been filed on the date such return is filed. Application shall be filed with the commissioner of revenue, Saint Paul, Minnesota.

Statutory Authority: *MS s 290.52*

8009.7100 COMPUTATION OF TENTATIVE CARRYBACK ADJUSTMENT.

Subpart 1. **Tax previously determined.** The taxpayer is to determine the amount of decrease, attributable to the carryback, in tax previously determined for each taxable year before the taxable year of the net operating loss. Thus, the tax previously determined will be the tax shown on the return as filed, increased by any amounts assessed (or collected without assessment) as deficiencies before the date of the filing of the application for a tentative carryback adjustment, and decreased by any amounts abated, refunded, or otherwise repaid prior to such date. Any items as to which the Department of Revenue and the taxpayer are in disagreement at the time of filing of the application shall be taken into account in ascertaining the tax previously determined only if, and to the extent that, they were reported in the return, or were reflected in any amounts assessed (or collected without assessment) as deficiencies, or in any amounts abated, credited, refunded, or otherwise repaid, before the date of filing the application.

Subp. 2. **Decrease attributable to carryback.** The decrease in tax previously determined which is affected by the carryback or any related adjustments, is to be determined, except for such carryback and related adjustments, on the basis of the items which entered into the computation of such tax as previously determined; the tax previously determined being ascertained in the manner described in this part. In determining any such decrease, items shall be taken into account only to the extent that they were reported in the return, or were reflected in amounts assessed (or collected without assessment) as deficiencies, or in amounts abated, refunded, or otherwise repaid, before the date of filing the application for a tentative carryback adjustment. If the Department of Revenue and the taxpayer are in disagreement as to the proper treatment of any item, it shall be assumed for purposes of determining the decrease in tax previously determined that such item was correctly reported by the taxpayer unless, and to the extent that, the disagreement has resulted in the assessment of a deficiency (or the collection of an amount without an assessment), or the allowing or making of an abatement, refund, or other repayment, before the date of filing the application. Thus, if the taxpayer claimed a deduction on its return of $50,000 for salaries paid to its officers, but the commissioner asserts that such deduction should not exceed $20,000, and the Department of Revenue and the taxpayer have not agreed on the amount properly deductible before the date the application for a tentative carryback adjustment is filed, $50,000 shall be considered as the amount properly deductible, for purposes of determining the decrease in tax previously determined in respect of the application for a tentative carryback adjustment. In determining the decrease in tax previously determined, any items, which are affected by the carryback must be adjusted to reflect such carryback.

Statutory Authority: *MS s 290.52*

8009.7200 ALLOWANCE OF ADJUSTMENTS.

Subpart 1. **Time prescribed.** The commissioner shall act upon any application for a tentative carryback adjustment filed, under Minnesota Statutes, section 290.095, subdivision 7 within a period of 90 days from whichever of the following two dates is the later:

A. the date the application is filed; or

B. the last day of the month in which falls the last date prescribed by law (including any extension of time granted the taxpayer) for filing the return for the taxable year of the net operating loss from which the carryback results.

Subp. 2. **Examination.** Within the 90-day period described in subpart 1, the commissioner shall make to the extent he deems practicable in such period, an examination of the application to discover omissions and errors of computation. He shall determine within such period the decrease in tax previously determined, affected by the carryback or any related adjustments, upon the basis of the application and such examination. The commissioner, however, may correct any errors of computation or omissions he may discover upon examination of the application. In determining the decrease in tax previously determined which is affected by the carryback or any related adjustment, he accordingly may correct any mathematical error appearing on the application and he may likewise correct any modification required by the law and incorrectly made by the taxpayer in computing its net operating loss, the resulting carrybacks, or its net operating loss deduction. If the required modification has not been made by the taxpayer and the commissioner has available the necessary information to make such modification within the 90-day period, he may in his discretion, make such modification. In determining such decrease, however, the commissioner will not, for example, change the amount claimed on the return as a deduction for depreciation because he believes that the taxpayer has claimed an excessive amount; likewise he will not include in gross income any amount not so included by the taxpayer, even though the commissioner believes that such amount is subject to tax and properly should be included in gross income.

Subp. 3. **Disallowance in whole or in part.** If the commissioner finds that an application for a tentative carryback adjustment contains material omissions or errors of computation, he may disallow such application in whole or in part without further action. If, however, he deems that any error of computation can be corrected by him within the 90-day period, he may do so and allow the application in whole or in part. The commissioner's determination as to whether he can correct any error of computation within the 90-day period shall be conclusive. Similarly, his action in disallowing, in whole or in part, any application for a tentative carryback adjustment shall be final and may not be challenged in any proceeding. The taxpayer in such case, however, may file a claim for credit or refund under Minnesota Statutes, section 290.50, and may maintain a suit based on such claim if it is disallowed or if the commissioner does not act upon the claim within six months from the date it is filed.

Subp. 4. **Application of decrease.** Each decrease determined by the commissioner in any previously determined tax which is affected by the carryback or any related adjustments shall first be applied against any unpaid amount of the tax with respect to which such decrease was determined. Such unpaid amount of tax may include one or more of the following:

A. an amount with respect to which the taxpayer is delinquent; and

B. an amount the time for payment of which has been extended under Minnesota Statutes, section 290.45, subdivision 2 and which is due and payable on or after the date of the allowance of the decrease.

Subp. 5. **Action by commissioner.** In case the unpaid amount of tax includes more than one of such amounts, the commissioner, in his discretion, shall determine against which amount or amounts, and in what proportion, the decrease is to be applied. In general, however, the decrease will be applied against any amounts described in subpart 4 in the order named. The unpaid amount of tax against which a decrease may be applied under subpart 4 may not include any amount of tax for any taxable year other than the year of the decrease. After making such application, the commissioner will credit any remainder of the decrease against any unsatisfied amount of tax for the taxable year of the net operating loss, which resulted in the carryback.

Any remainder of the decrease after such application and credits may, within the 90-day period, in the discretion of the commissioner, be credited against any tax or installment thereof then due from the taxpayer, and if not so credited, shall be refunded to the taxpayer within such 90-day period. For the purposes of refunding any such decrease or portion thereof, the overpayment of tax resulting from the carryback for purposes of this part shall be deemed not to have been made prior to the end of the taxable year, in which the net operating loss occurs.

Statutory Authority: *MS s 290.52*

8009.7300 SPECIAL PERIOD OF LIMITATIONS WITH RESPECT TO NET OPERATING LOSS CARRYBACKS.

Subpart 1. **Refund claims; time periods, amount limits, barred claims.** Refund claims; time periods, amount limits, and barred claims are as follows:

A. If the claim for refund relates to an overpayment of income tax attributable to a net operating loss carryback, provided in Minnesota Statutes, section 290.095, subdivision 2, then in lieu of the period prescribed in Minnesota Statutes, section 290.50, the claim may be filed, or refund allowed, as prescribed in Minnesota Statutes, section 290.46 or 290.50 within either of the following two periods whichever is the later:

(1) the period which ends with the expiration of the 15th day of the 45th month following the end of the taxable year of the net operating loss which resulted in the carryback; or

(2) the period which ends with the expiration of the period prescribed in Minnesota Statutes, section 290.46 or 290.50 within which a claim for refund may be filed with respect to the taxable year of the net operating loss which resulted in the carryback.

B. In the case of a claim for refund involving a net operating loss carryback described in item A, the amount of the refund may exceed the portion of the tax paid within the period provided in Minnesota Statutes, section 290.50 to the extent of the amount of the overpayment attributable to the carryback. If the claim involves an overpayment based not only on a net operating loss carryback described in item A but based also on other items, the refund cannot exceed the sum of the following:

(1) the amount of the overpayment which is attributable to the net operating loss carryback; and

(2) the balance of such overpayment up to a limit of the portion, if any, of the tax paid within the period provided in Minnesota Statutes, section 290.50 or within the period provided in any other applicable provisions of law.

C. If the claim involves an overpayment based not only on a net operating loss carryback described in item A but based also on other items, and if the claim with respect to any items is barred by the expiration of any applicable period of limitation, the portion of the overpayment attributable to the items not so barred shall be determined by treating the allowance of such items as the first adjustment to be made in computing such overpayment. If a claim for refund is not filed, and if refund is not allowed, within the period prescribed in this paragraph, then refund may be allowed or made only if claim therefor is filed, or if such refund is allowed, within the period prescribed in Minnesota Statutes, section 290.46 or 290.50 subject to the provisions thereof limiting the amount of refund in the case of a claim filed, or if no claim was filed, in case of refund allowed, within such applicable period.

Subp. 2. **Court determinations.** If the allowance of a refund of an overpayment of tax attributable to a net operating loss carryback is otherwise prevented by the operation of any law or rule of law such refund may be allowed or made under the provisions of Minnesota Statutes, section 290.095, subdivision 7, paragraph (c) if a claim therefor is filed within the period therein provided and subpart 1 for filing a claim for refund of an overpayment attributable to a carryback. Similarly, if the allowance of an application, or refund of a decrease in tax determined under Minnesota Statutes, section 290.095, subdivision 7, paragraph (b) is otherwise prevented by the operation of any law or rule of law, such application, or refund may be allowed or made if an application for a tentative carryback adjustment is filed within the period provided in Minnesota Statutes, section 290.095, subdivision 7, paragraph (a). Thus, for example, even though the tax liability (not including the net operating loss deduction or the effect of such deduction) for a given taxable year has previously been litigated before the Tax Court of Appeals, refund or an overpayment may be allowed or made if claim for such refund is filed within the period provided in Minnesota Statutes, section 290.095, subdivision 7, paragraph (c) and subpart 1. In the case of a claim for refund of an overpayment attributable to a carryback, or in the case of an application for a tentative carryback adjustment, the determination of any court, including the Tax Court of Appeals, in any proceeding in which the decision of the court has become final, shall be conclusive except with respect to the net operating loss deduction, and the effect of such deduction, to the extent that such deduction is affected by a carryback which was not in issue in such proceeding.

Statutory Authority: *MS s 290.52*

8009.7400 AUDIT AND REVIEW.

The commissioner in examining the books and records of the taxpayer relating to the income tax return for a taxable year, which except for the provisions of Minnesota Statutes, section 290.095, subdivision 7, paragraph (c) would be outlawed by the normal limitation period, will limit such examination and consideration in accordance with the provisions of this rule. The procedure outlined will be followed with respect to such returns in cases where either a claim for refund has been filed by the taxpayer or where an application for a tentative carryback adjustment has been filed. The commissioner will make appropriate adjustments as a result of such examination up to the amount of the tentative adjustment or the amount of the carryback but will in no event assess additional taxes for the year of carryback.

In the event that such examination discloses that the amount refunded to the taxpayer pursuant to application under Minnesota Statutes, section 290.095, subdivision 7, paragraph (a) was improper, the commissioner shall issue his order assessing a tax which assessment shall in no event exceed the amount of the erroneous refund made for the year in question. Such assessment shall be made in accordance with the provisions of Minnesota Statutes, section 290.46, and the provisions of Minnesota Statutes, chapter 290, dealing with notice, appeal, and collection, applicable to Minnesota Statutes, section 290.46 assessments shall be equally applicable to assessments under this part.

Statutory Authority: *MS s 290.52*