



Tax Considerations for State Frontline Worker Pay

August 24, 2021

- Federal taxability of state payments is determined by the Internal Revenue Service and U.S. Treasury. States can try to predict taxability based on past rulings, but this does not provide certainty. States can only control whether the payments are subject to state tax.
- **Tax Analysis:**
 - Does a federal exclusion apply to payments?
 - If no, federal and state income tax applies, unless a state exclusion exists.
 - If yes, payments are exempt from federal income tax.
 - Does Minnesota conform to the federal exclusion?
 - If yes, the payments are exempt from state and federal income tax.
 - If no, the payments are subject to state tax, unless a state exclusion exists.
 - Does a state exclusion apply to payments? If yes, payments are exempt from state income tax.

Gross Income

- Internal Revenue Code (“IRC”) section 61 broadly defines gross income for income tax purposes as “all income from whatever source derived.”
- Any income received is gross income for both federal and state income tax purposes unless an exclusion applies.
- If a federal exclusion applies, the payments will not be subject to federal or state tax, if Minnesota is in conformity with the Internal Revenue Code.

Qualified Disaster Payments

- Internal Revenue Code section 139 excludes from gross income amounts received by an individual as a “qualified disaster relief payment” that is attributable, in connection with, or the result of a “qualified disaster.”

General Welfare Exclusion

- Payments made under a legislatively provided social benefit program for the promotion of general welfare are not includible in an individual’s gross income.

Qualified Disaster Payment Exclusion

- A presidentially declared disaster may trigger a qualified disaster exclusion (COVID-19 pandemic was presidentially declared a disaster on March 13, 2020)
- Income replacement payments are NOT considered qualified disaster relief payments. (IRS Publication 3833 (Rev. 12-2014))
- Payments must meet the definition of “qualified disaster relief payment”
 - Payments made to an individual for expenses incurred as a result of COVID-19 pandemic
 - Payments by a federal, state, or local government, or their agencies or instrumentalities, to persons affected by a qualified disaster in order to promote general welfare are also considered to be qualified disaster relief payments.

General Welfare Exclusion

- To qualify under the general welfare exclusion, the payment must:
 - Be made pursuant to a governmental program
 - Be for the promotion of the general welfare (that is, based on need); and
 - Not represent compensation for services

State Exclusion

- Minnesota conforms with the federal qualified disaster payment or general welfare exclusions. There are no state specific exclusions under Minnesota law that apply.
- If the federal exclusions do not apply to payments, statutory change would be needed to provide a state exclusion.
 - **State income tax-** Exclusion would only apply to state income tax. The payment may still be considered taxable at the federal level.
 - **Household Income-** Consider whether to exclude the payment from being included in eligibility calculations for Property Tax Refund or K-12 Education Credit.
 - **Other state programs-** Consider whether to exclude the payment from being included eligibility calculations for other state programs, such as health care and food assistance.
 - **Withholding-** Consider exempting the payment from withholding and estimated tax requirements.

Other Considerations

- Treatment as premium pay with ARPA funds
- Taxable payments may require the payment issuer to provide 1099 form to recipient under federal requirements.

Questions?