

Small Business Notes

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Minnesota's Corporate Net Operating Loss Deduction Changes...and May Change Again

In a July 27, 2023, release the Minnesota Department of Revenue noted that the 2023 tax bill reduced the corporate net operating loss deduction from 80 percent to 70 percent for tax years beginning after December 31, 2022. In that same release Revenue indicated that the effective date may change to December, 31, 2023 since the legislature has given the Commissioner of Revenue a letter of intent to accomplish that change to the later date.

Internal Revenue Service (IRS) Cautions on Increased Compliance Scrutiny for Employee Stock Ownership Plans (ESOPs)

An important subset of the possible mechanisms for small business succession planning is the formation of an ESOP allowing a retiring business owner to avoid income, estate and gift taxes on the exchange of the stock for ownership interests. The ESOP themselves have become popular employee benefit plans for closely held, non-publicly traded S corporations.

On August 9, 2023 the IRS released notice [IR-2023-144](#) cautioning that that agency was increasing its scrutiny of ESOPs especially "prohibited transactions" where shares in the plan are allocated to "disqualified persons" which the Internal Revenue Code defines at [Section 4975\(e\)\(2\)](#) to include:

- A fiduciary;
- A person providing services to the plan;
- An employer any of whose employees are covered by the plan;
- An employee organization any of whose members are covered by the plan;
- A direct or indirect owner of 50 percent or more of all classes of stock entitled to vote or 50 percent or more of the capital interest of a partnership;
- An officer, director, or highly compensated employee of the business.

The IRS rules also prohibits any direct or indirect sale, exchange, loans or extensions of credit by the ESOP to a "disqualified person." A mandatory five percent excise tax is imposed on the amount involved in the prohibited transaction; this is to be paid by the "disqualified person."

As clear from the above, the formation of an ESOP involves very complicated legal and valuation issues that a small business owner should discuss with professional counsel and advisors.

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