HOUSE RESEARCH

Bill Summary

FILE NUMBER: H.F. 703 DATE: March 8, 1999

Version: With author's amendment

Authors: Van Dellen and others

Subject: Corporate Franchise Tax Single Factor Sales Apportionment

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Overview

This bill adopts 100 percent sales apportionment for multi-state businesses under the corporate franchise and income taxes. The author's amendment would also apply single factor sales apportionment to financial institutions. Present law uses a three-factor formula that weights sales at 70 percent and property and payroll at 15 percent each.

Section

Apportionment formula. Requires multi-state businesses to apportion their income under the corporate franchise tax based on the percentage Minnesota sales comprise of total sales. Under present law, most corporations are required to use a three factor formula, based on property, payroll, and sales. (The law allows certain Minnesota based mail order sales corporations to use single factor sales apportionment.) The sales factor is weighted at 70 percent, while property and payroll are each weighted at 15 percent. Under the author's amendment, financial institutions would also qualify to use single factor sales apportionment.

Historical background. Minnesota's corporate tax originally used arithmetic apportionment (i.e., property, payroll, and sales were given equal or one-third weight). In 1939, manufacturing corporations were allowed to elect to use the weighted apportionment (i.e., the current method of 15-15-70 weights). This election allowed the corporation to select whichever method provided the lowest Minnesota tax. (The Minnesota apportionment method does not affect liability for tax in another state.) In 1953, this option was extended in all corporations. In 1987, the option was eliminated and all corporations were required to use the weighted formula. This was done in conjunction with comprehensive changes in the tax that expanded the base and lower the rate.

Other states. Most states use three factor apportionment. For many years, most states used arithmetic or equal weights. This is the method provided under the Uniform Division of Income for Tax Purposes Act (commonly referred to as UDITPA). In recent years, many states have adopted double weighted sales (i.e., 25-25-50 weights for property, payroll, and sales). Double

weight sales is the most common formula used. For 1999, 22 states used double weighted sales, while 16 used equally weighted factor. The rest of the sales used other formulas that weighted sales more heavily. (This information is from Federation of Tax Administrators.)

More states have begun to adopt 100 percent sales apportionment. Iowa has long used this method. Recently, Illinois (to be effect in 2000), Nebraska, and Texas have recently adopted 100 percent sales apportionment. Michigan recently adopted a 90-5-5 apportionment method.

Effects on tax burdens. Since the bill makes no other changes in the tax, the apportionment formula change will reduce the tax of businesses whose Minnesota sales factor is lower than the average of their property and payroll factors. Conversely, businesses whose Minnesota sales factor is higher than the average of their property and payroll factors will pay higher tax.

Effective date. Provides the change is effective for tax year 1999.