

HOUSE RESEARCH

Bill Summary

FILE NUMBER: H.F. 335

DATE: February 7, 2001

Version: As introduced

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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. Present law (effective tax year 2001) uses a three factor formula that weights sales at 75 percent and property and payroll at 12.5 percent each.

Section

1 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 must 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 75 percent, while property and payroll are each weighted at 12.5 percent.

2 Apportionment for financial institutions. Adopts 100 percent sales apportionment for financial institutions.

Historical background. Minnesota's corporate tax originally used arithmetic apportionment (i.e., property, payroll, and sales were given equal or 1/3rd 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 lowered the rate. In 1999, the legislature adopted the current weighting

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 2000, 21 states used double weighted sales, while 16 (and the District of Columbia) 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.) The information is displayed graphically on the next page.

More states have begun to adopt 100 percent sales apportionment. Iowa has long used this method. Illinois, 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.

3 Repealer. Repeals the law allowing certain Minnesota based direct marketing firms to use single sales apportionment. This provision would be obsolete, if 100 percent sales apportionment is adopted as the general rule.

4 Effective date. Provides the change is effective for tax year 2001.