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Subject: Corporate franchise tax - foreign operating corporations

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Overview

This bill modifies the deemed dividend deduction allowed to foreign operating corporations (FOC) to exclude income from dividends, interest, royalties, capital gains, and similar types of income.

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1 **Foreign operating corporations.** Disallows the deemed dividend deduction for the income an FOC derives from dividends, interest, royalties, capital gains or similar income.

Effective date: Tax year 2007.

Background information. Under present law, to qualify as an FOC, an entity must:

- Be a domestic corporation that is part of a unitary group, one member of which is taxable in Minnesota
- Have 80% or more of its average property and payroll outside of the U.S. (excluding Puerto Rico or possessions) or be a "936 corporation" (these are corporations qualifying under special federal tax rules that provide an incentive for operating in Puerto Rico and other U.S. possessions)
- Not be a Foreign Sales Corporation (this is a now obsolete federal tax provision that provided export incentives)
- Have $1 million in foreign payroll and $2 million in foreign property (the payroll requirement can also be satisfied by having $1 million of foreign contract

Section

work done).

The income and factors of an FOC are excluded from the combined return of the unitary group and its income is taxed as a "deemed dividend received" by the unitary group. This income qualifies for the 80 percent dividend received deduction. Thus, this income is taxed at an effective tax rate of 1.96 percent, rather than the statutory rate of 9.8 percent. If the FOC has losses, these losses cannot offset other income of the unitary group.