HOUSE RESEARCH

Bill Summary

FILE NUMBER: H.F. 665 **DATE:** March 7, 2011
Version: As introduced

Authors: Hornstein

Subject: Corporate franchise tax - foreign source income provisions

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Overview

This bill eliminates the foreign operating corporation (FOC) provisions of the corporate franchise tax and repeals the subtraction for foreign royalties. Under present law, 80 percent of the income of an FOC and 80 percent of income that qualifies as foreign royalties are exempt from taxation. As a result, this bill would result in this income being taxed on the same basis as other income of C corporations. In addition, the bill requires the income and factors of corporations that are incorporated in or that derive 20 percent of their income from tax haven countries to be included in the combined report of the unitary business. This will subject this income to tax based on the unitary business's Minnesota factors (property, payroll, and sales) under the apportionment formula. These changes are effective beginning for tax year 2011.

1 **FOCs filing requirement.** Eliminates the exemption for FOCs from the corporate return filing requirement. The bill effectively subjects FOCs to tax on the same basis as other corporations.

2 **Domestic corporation definitions.** Expands the definition of "domestic corporation" to include the following foreign corporations (i.e., corporations or other entities organized under the laws of a foreign country):

- Incorporated in a tax haven (defined in section 3),
- Doing sufficient business in a tax haven to be subject to tax by the tax haven and 20 percent or more of its income is attributable to the tax haven, or
- With 20 percent or more of the average of their property, payroll, and sales in the United States.

Domestic corporations that are part of a unitary business must be included on the combined report. As a result, this will require the income and apportionment factors of these foreign corporations to be reflected in the combined report and will subject them to Minnesota corporate franchise tax. Present Minnesota law excludes all foreign corporations from the combined report, except foreign sales corporations.

Effective date: tax year 2011

3 **Tax haven.** Defines "tax haven" as a list of foreign countries that have been publicly identified by both the Organization of Economic Cooperation and Development (OECD) and by the Internal Revenue Services (based on federal court documents). (Originally, these countries were on the OECD's "black list," but are now on its "gray list" because the countries have agreed to expanded tax information exchanges.) Countries are removed from the list, if the United States enters into a tax treaty or similar agreement with the country that provides for sharing tax information with the Internal Revenue Service.

Effective date: tax year 2011

4 **Additions to FTI for corporations.** Repeals the corporate franchise tax additions to federal taxable income for foreign operating corporations' (FOCs) deemed dividends. Sections 6 and 7 repeal FOCs deemed dividend treatment. This provision eliminates the corresponding addition to income for the deemed dividend.

Effective date: tax year 2011

5 **Subtractions from FTI for corporations.** Repeals the subtraction from federal taxable income for foreign royalties.

Effective date: tax year 2011

6 **FOC deemed dividends.** Eliminates the authority to exclude the income and apportionment factors of FOCs from the combined report and eliminates the deemed dividend deduction for 80 percent of FOC income. In addition, the intention of the legislature is that if the inclusion of foreign corporations treated as domestic corporations under the provisions of sections 2 and 3 is invalid, the legislature intends these provisions to be nonseverable from the exclusion of all foreign corporations from the combined report.

Effective date: tax year 2011

7 **Repealer.** Repeals the definition of foreign operating corporations and the modification to alternative minimum tax for FOCs.