

Subject C-option tax
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Date March 4, 2020

Overview

H.F. 871 would allow a pass-through entity (partnership, LLC, or S corporation) to elect to be taxed as a C corporation under the state's corporate franchise tax. Unlike individuals who are owners of a pass-through business who pay their share of a business's taxes under the individual income tax, a C corporation pays the corporate franchise tax at the entity level. Under federal tax rules, taxes paid by a business at the entity level are deductible as a business expense, while taxes paid by a business at the individual level are subject to the federal cap on the state and local tax deduction. The cap on this deduction, enacted by Congress in 2017, is \$10,000 and will expire in 2026.

Summary

Section	Description
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| 1 | <p>Election to file as a C corporation.</p> <ul style="list-style-type: none">▪ Paragraph (a) allows a qualifying entity to file and pay tax as a C corporation. The election would require the entity's tax to be calculated under the corporate franchise tax and would be binding for four years (unless revoked).▪ Paragraph (b) defines a "qualifying entity" as a pass-through entity (that is, a partnership, LLC, or S corporation) and a "C-option corporation" as a qualifying entity that has elected to be taxed as a C corporation.▪ Paragraph (c) only allows persons holding more than 50 percent ownership to make the election, which is then binding on all persons with an ownership interest.▪ Paragraph (d) imposes a rate of 9.85 percent on a qualifying entity's taxable income.▪ Paragraph (e) requires a partner's (or member's or shareholder's) adjusted basis in the qualifying entity to be determined as if the election to pay tax as a C-option corporation is not made. |
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Section	Description
	<ul style="list-style-type: none">▪ Paragraph (f) allows the commissioner to prescribe the content, format, and manner of a C-option corporation's return.▪ Paragraph (g) prohibits a qualifying entity from having a partnership, LLC, or corporation as a member or partner. <p>Effective date: Taxable years beginning after December 31, 2019.</p>
2	<p>Income of partners, members, or shareholders.</p> <p>Allows a subtraction for an individual for an amount of the tax paid by a C-option corporation. An individual that is a partner, member, or shareholder of a qualifying entity may claim the subtraction, which is equal to the amount of the partner's, member's, or shareholder's pro rata share of the entity's Minnesota-apportioned income.</p> <p>Effective date: Taxable years beginning after December 31, 2019.</p>
3	<p>Schedules of rates for individuals, estates, and trusts.</p> <p>Amends the rules for computing a nonresident's tax by subtracting the amount of the subtraction in section 2 from the nonresident's numerator and denominator in the fraction by which the nonresident's tax liability is multiplied.</p> <p>Effective date: Taxable years beginning after December 31, 2019.</p>
4	<p>Definitions; alternative minimum tax.</p> <p>Includes the subtraction in section 2 in the list of subtractions that may be taken when calculating alternative minimum taxable income under the individual AMT.</p> <p>Effective date: Taxable years beginning after December 31, 2019.</p>
5	<p>Withholding by partnerships.</p> <p>Exempts a partnership from the withholding rules if it has elected to be taxed as a C-option corporation.</p> <p>Effective date: Taxable years beginning after December 31, 2019.</p>
6	<p>Withholding by S corporations.</p> <p>Exempts an S corporation from the withholding rules if it has elected to be taxed as a C-option corporation.</p> <p>Effective date: Taxable years beginning after December 31, 2019.</p>



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