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Updated: June 2015

Single Sales Apportionment of Corporate Franchise Tax

Apportionment is a key feature of state corporate taxes

Apportionment formulas are important features of state corporate income taxes. They determine how much of a business's income is taxable by the state and affect the incidence and competitiveness of the tax. Most states use a three-factor formula based on the in-state percentage of the corporation's sales, payroll, and property factors. Traditionally and under the Uniform Division of Income for Tax Purposes Act, each factor was equally weighted. However, the states have tended recently to increase the weight to the sales factor and more states are relying only on the sales factor ("single sales apportionment").

Minnesota uses single sales apportionment

Since 1940, Minnesota has provided for sales-weighted apportionment (70 percent sales), and between tax years 2007 and 2014, phased in single sales apportionment. (Minnesota's original weighted apportionment was optional; it became mandatory in tax year 1988.)

Effects vary by type of business

The effects of single sales apportionment vary by business. The crucial variables are the business's Minnesota apportionment factors:

- The taxes of businesses with all of their property, payroll, and sales in Minnesota are unaffected—all of their income is subject to tax in all cases.
- Minnesota businesses whose Minnesota sales factor is lower than the average of their Minnesota property and payroll factors receive a tax cut. The larger the disparity, the bigger the benefit. A classic example is a business with most of its operations (headquarters, plants, and so forth) in Minnesota, but most of its sales outside of Minnesota.
- Businesses with higher Minnesota sales factors than their average Minnesota property and payroll factors pay higher tax.

"Throwback rules" affect the benefit to taxpayers of single sales apportionment

Over half of the states with corporate taxes also use "throwback rules" in defining the sales factor. Throwback rules treat sales to out-of-state buyers as in-state sales, if the buyer's state cannot tax the business/seller or if the purchaser is a federal government agency. These "thrown-back" sales increase in-state sales factor and corporate tax, decreasing the benefits to the taxpayer of single sales apportionment. Minnesota does not have a throwback rule.

Rationale for single sales apportionment: improve competitiveness

The principal rationale for single sales apportionment is a competitiveness argument: It helps attract or retain investment in plant and equipment to the state. Sales are determined by the buyer's location. All other things being equal, increasing non-Minnesota sales will reduce the amount of Minnesota taxable income, since more income will be attributed to or apportioned outside of Minnesota. Thus, single sales apportionment creates an incentive for companies to invest in Minnesota property or to hire more employees (or reduces the tax's disincentive to do so) to sell their products outside of Minnesota. Empirical studies have found some support for this argument.

Policy concerns with single sales apportionment: equity and tax theory

Opponents of single sales apportionment argue that it shifts the tax burden from capital (the property factor) to consumption, reducing the tax's progressivity. Some also question as an empirical matter whether it has the desired effects on competitiveness. Tax theorists argue that if the corporate tax is to be a benefits tax (i.e., based on businesses' use of government services) or if it is to be based on production of income, apportionment should take into account where the business's property and employees are located. Both factors contribute to the production of income and the consumption of government services.

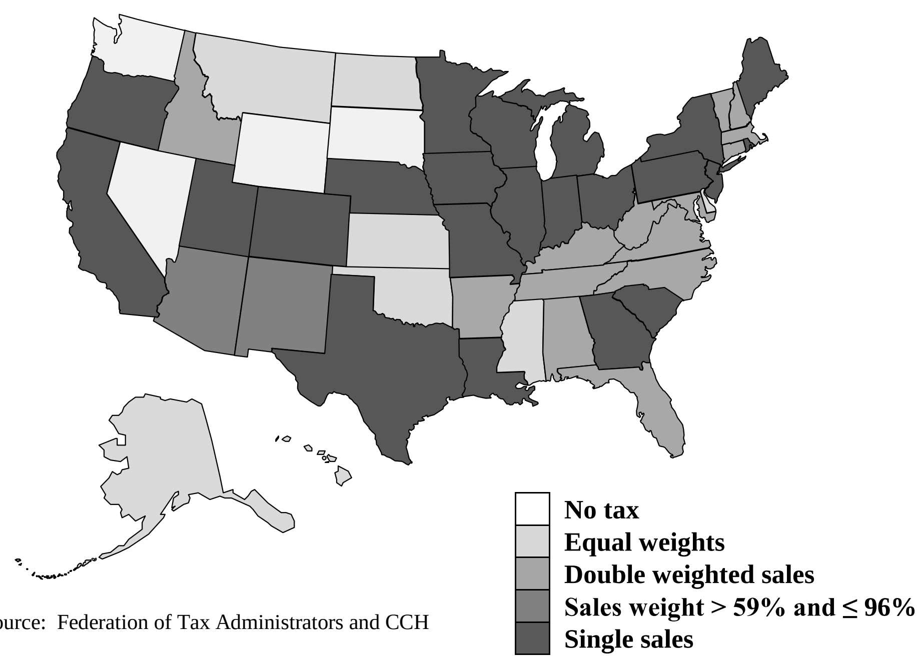
Sales-weighted apportionment reduces revenues

Compared with equally weighting each apportionment factor, weighting sales more heavily reduces tax revenues. The Department of Revenue's *Tax Expenditure Budget* (February 2014) shows an expenditure cost of $390 million for fiscal year 2015.

Trend in other states to heavier sales weighting

Effective for tax year 2015, 22 states use or allow single sales as their apportionment formula for manufacturers. Many of Minnesota's neighboring states use single sales apportionment: Illinois, Indiana, Iowa, Michigan, Missouri, Nebraska, and Wisconsin. Arizona is also scheduled to use single sales in 2017, and New Mexico and North Dakota in 2018. The map below shows the apportionment formulas for manufacturers as of tax year 2015. Some states allow elections between two formulas. The map shows these with the highest permitted sales weighting.

Apportionment of Corporate Income
Applicable to Manufacturers



Source: Federation of Tax Administrators and CCH

For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn. Also see the House Research publication *Apportionment of Corporate Franchise Tax*, June 2015.