This notice was revoked and replaced on July 29, 2013 by Revenue Notice # 13-01. Please see Revenue Notice # 13-01.

Minnesota revenue notice number 98-09

Corporate Franchise Tax - Minnesota Taxation of Qualified Subchapter S Subsidiaries (QSSS)

General Information

For federal income tax purposes, the Small Business Job Protection Act of 1996 permitted "S" corporations to own subsidiaries if the parent "S" corporation elects to treat such a subsidiary as a "Qualified Subchapter 'S' Subsidiary" (QSSS). This federal law change is effective for tax years beginning after December 31, 1996. For federal tax purposes, a QSSS is not treated as a separate corporation. The assets, liabilities, income, deductions, and credits of a QSSS are treated as though they were the assets, liabilities, income, deductions, and credits of the "S" corporation parent. Minnesota will conform to this federal treatment and accommodate the filing of a single return for "S" corporations and QSSSs as described in this revenue notice.

The Small Business Job Protection Act of 1996 also permitted certain banks to elect "S" corporation status. Minnesota does not permit either banks or bank holding companies to be treated as "S" corporations, but does allow a series of credits and deductions on the state tax.

Non-Resident Shareholders

In determining the amount of income to be included on a non-resident shareholder's Minnesota individual income tax return, a determination must be made as to whether the "S" Corporation and the QSSS are engaged in a single unitary business

Non-resident shareholders must report to Minnesota an apportioned share of the combined income for those entities that are part of the same unitary business. The weighted three-factor formula, determined under Minnesota Statutes, § 290.191, must be used to apportion the combined income of the "S" corporation and QSSS. The apportionment formula is computed by adding the apportionment percentages of all unitary entities with nexus in Minnesota. The numerators of these apportionment factors would include the property, payroll and sales (or receipts) attributed to Minnesota for each entity having nexus (a sufficient connection to the state in order for the state to have jurisdiction to tax the entity) with Minnesota. The denominators of the apportionment factors include the property, payroll and sales (or receipts) in all locations for all the entities in the unitary business. A separate minimum fee computation must also be computed for each entity having nexus with Minnesota.

If the "S" corporation parent or any of the QSSS's are not engaged in a single unitary business, a non-resident shareholder is only subject to tax on an apportioned share of the income earned by those entities that have nexus with Minnesota. The income from such entities for non-resident shareholders is apportioned to Minnesota using the weighted three-factor apportionment formula determined under Minnesota Statutes, § 290.191. A separate apportionment formula is calculated for each entity with nexus in Minnesota. Only the property, payroll and sales (receipts) numerators and denominators for that entity are used to apportion the shareholder's income for that entity.

An "S" corporation parent that owns a QSSS must file a single M-3S-4 reporting the income, deductions and credits for both the "S" corporation and the QSSS. The filing of "S" Corporation returns is governed by Minnesota Statutes, § 289A.12. The return is due on the 15th day of the third month following the close of the business year. The return must be filed using the parent "S" corporation's federal and state identification number if the parent has nexus with Minnesota. If the parent does not have nexus with Minnesota, the return must be filed under the federal and state identification number of a QSSS with nexus in Minnesota. In any event, a complete copy of the Federal Form 1120S must be attached to the filing. In addition, a worksheet should be attached to Schedule A of the Minnesota return, separately identifying the income and factors of all the entities included in the filing, along with an explanation of how the factors on schedule A were determined. A schedule M-KS must be completed for each non-resident shareholder.

Resident Shareholder

The above section does not apply to shareholders who are residents of Minnesota. Under Minnesota law, the entire income of Minnesota residents is subject to Minnesota income tax.

This revenue notice is effective for tax years beginning after December 31, 1996.

Dated: 1 June 1998

Jennifer L. Engh
Assistant Commissioner for Tax Policy