**CORPORATE FRANCHISE TAX**
**100% Sales Weighting**

February 27, 2002

| | Yes | No |
|---|---|---|
| Separate Official Fiscal Note Requested | | X |
| **Fiscal Impact** | | |
| DOR Administrative Costs/Savings | | X |

Department of Revenue
Analysis of H.F. 2937 (Abrams) / S.F. 2928 (Rest)

| | Revenue Gain or (Loss) | | | |
|---|---|---|---|---|
| | **F.Y. 2002** | **F.Y. 2003** | **F.Y. 2004** | **F.Y. 2005** |
| | (000's) | | | |
| General Fund | ($0) | ($2,200) | ($10,100) | ($20,700) |

Effective for tax years beginning after December 31, 2002 and fully phased in for tax years beginning after December 31, 2006.

**EXPLANATION OF THE BILL**

**Current Law:** The total income of a corporation is apportioned to Minnesota based on the weighting of percentages from a three-factor formula. The three factors are based on the percentages of a corporation's total payroll, property, and sales that are attributable to Minnesota. The sales factor receives a 75 percent weight versus a 12.5 percent weight each for the payroll and property factors. The result of summing the weighted percentages is the apportionment percentage. A corporation's apportioned income is the product of its total income multiplied by the apportionment percentage.

Mail order businesses with 99 percent of their property and payroll in Minnesota are allowed to apportion income based on a single factor of sales.

**Proposed Law:** Effective for tax years beginning after December 31, 2002, the weights on the property and payroll factors will decrease and the weight on the sales factor will increase (see table 1). In tax years beginning after December 31, 2006 the ratio of Minnesota sales to sales everywhere will be the apportionment percentage. When a single factor is used to compute the apportionment percentage, the factor is said to be weighted at 100 percent.

In addition the special provision for mail order businesses is repealed for tax years beginning after December 31, 2006.

**Table 1. Weights of Property, Payroll and Sales Factors under H.F. 2937/ S.F. 2928**

| Time Period | Property | Payroll | Sales |
|---|---|---|---|
| Tax year beginning after 12/31/2002 | 11.0% | 11.0% | 78% |
| Tax year beginning after 12/31/2003 | 9.0% | 9.0% | 82% |
| Tax year beginning after 12/31/2004 | 6.5% | 6.5% | 87% |
| Tax year beginning after 12/31/2005 | 3.5% | 3.5% | 93% |
| Tax year beginning after 12/31/2006 | 0.0% | 0.0% | 100% |

## REVENUE ANALYSIS DETAIL

- The revenue estimate is based on data from returns received in calendar year 1998.
- The program used to edit corporate data is also able to calculate the revenue change from changing the current law weighting to the series of weightings shown in table 1.
- No change in revenue is assumed from corporations that have 100% of their economic activity in Minnesota.
- Growth in overall corporate tax collections as projected by the Department of Finance in the February 2002 forecast is used to project future revenue losses.
- Estimates are allocated to fiscal years using 30% / 70% ratio.
- This law change also affects the apportionment of income generated by entities other than C corporations, mainly S corporations. The estimate was adjusted to include these other businesses.
- The model was adjusted to reflect changes in tax law made by the 2001 legislature.
- If the bill were fully phased in for tax years beginning after December 31, 2002, the net effect is a $51.5 million revenue loss.

**Number of Taxpayer Affected:** This bill has an overall effect of changing the tax liability, including both increases and decreases, on about 12,000 corporations.

When the bill is fully phased in during tax year 2007, approximately 230 corporations will have tax changes greater than $100,000, including both tax increases and decreases. These corporations account for over 65% of the revenue change associated with the bill, and the average revenue change is approximately $250,000.

**Effect of H.F. 2937 / S.F. 2928 on**
**Minnesota and Non-Minnesota Corporations**
$(000's)

| Tax Year | Minnesota Corporations | Non-Minnesota Corporations | Net Effect |
|---|---|---|---|
| 2003 | (9,600) | 2,400 | (7,200) |
| 2004 | (22,900) | 5,900 | (17,000) |

**ADMINISTRATIVE/OPERATIONAL IMPACT**

There will be no significant administrative or operational costs or savings to DOR in administration of this bill.

Source: Minnesota Department of Revenue
Tax Research Division
http://www.taxes.state.mn.us/polic.html#analyses

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