MINNESOTA · REVENUE

CORPORATE FRANCHISE
INDIVIDUAL INCOME TAX
Foreign Operating Corporations
Foreign Royalty Subtraction
Deferred Compensation

April 20, 2005

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

Department of Revenue
Analysis of S.F. 254 (Berglin), Article 3 Only
Analysis Revised for February 2005 Forecast
and Correction of Fiscal Year Allocation

	Fund Impact			
	F.Y. 2006	**F.Y. 2007**	**F.Y. 2008**	**F.Y. 2009**
	(000's)			
Foreign Operating Corporation Change	$63,300	$47,200	$47,300	$48,300
Repeal of Foreign Royalty Subtraction	$67,600	$50,400	$50,500	$51,600
Interaction	$1,200	$900	$900	$900
Corporate Franchise Tax	$132,100	$98,500	$98,700	$100,800
Individual Income Tax	$1,900	$2,000	$2,100	$2,300
General Fund Total	$134,000	$100,500	$100,800	$103,100

Effective for tax years beginning after December 31, 2004.

EXPLANATION OF THE BILL

Corporate Franchise Tax – Foreign Operating Corporations

Minnesota allows certain income of a unitary group to be classified as the income of a foreign operating corporation (FOC). This income is considered a deemed dividend, and up to 80% of this income may be claimed as a dividend received deduction. In effect, 20% of the deemed dividends from an FOC is subject to taxation.

The bill redefines an FOC. Under this new definition, a corporation with foreign operations will still be classified as an FOC. Current Minnesota law allows a corporation to be classified as an FOC if the average of its domestic property and payroll is 20% or less. Under the bill, the percent of foreign property and payroll must be 80% or more to qualify as an FOC. Also, the FOC must have at least $2 million of property and at least than $1 million of payroll.

In addition, the bill disallows a dividend received deduction from an FOC if the deemed dividend includes dividends, interest, royalties, or capital gains income (i.e. income other than income from ongoing operations).

EXPLANATION OF THE BILL (Continued)

Corporate Franchise Tax – Foreign Royalty Subtraction

Under Minnesota law, corporations are allowed a subtraction against their net income equal to 80% of foreign royalty income received from an FOC or a foreign corporation. Royalty income is defined as royalties, fees, or other like income. The foreign royalty subtraction would be repealed under this bill.

Individual Income Tax

Under current law, there is an exemption from the individual income tax for wage income that was earned while the taxpayer was a resident but is received in a year that the taxpayer was a nonresident for the full year. The bill would eliminate this exemption.

REVENUE ANALYSIS DETAIL

Corporate Franchise Tax Provisions

- The revenue estimates are based on data from returns received by the Department of Revenue in calendar year 2003.
- **For the revised estimates**, growth in overall corporate tax collections as projected by the Department of Finance in the February 2005 forecast is used to project future revenue gains.
- **For the revised estimates**, due to the tax year 2005 effective date, the tax year 2005 impact that would normally occur in fiscal year 2005 was shifted to fiscal year 2006. Generally, tax year impact is allocated 30%/ 70% to fiscal years.
- Compared to previous estimates, analysis of the most recent data indicates that a higher portion of FOC income would not be eligible for the dividend received deduction under this bill.
- Runs of tax calculation programs against corporate data were used to calculate the revenue effect from disallowing the foreign royalty subtraction and from disallowing the dividend received deduction if the FOC deemed dividend includes non-operating income such as dividends, interest, royalties and capital gains.
- About 1,600 corporations will be affected by the bill.

REVENUE ANALYSIS DETAIL (Continued)

Individual Income Tax Provision

- The estimates are based on information that was developed following the Minnesota Supreme Court decision in *Victor C. Benda v. James Girard in His Capacity as Commissioner of Revenue, et al*.
- Amended returns filed in response to the court case were the primary source of information, supplemented with a sample of 1997 individual income tax returns of nonresidents.
- Annual growth of 6% was assumed.

Source: Minnesota Department of Revenue
Tax Research Division
http://www.taxes.state.mn.us/taxes/legal_policy

sf0254_2/dkd