CORPORATE FRANCHISE
Foreign Operating Corporations

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. 1080 (Pogemiller)/ H.F. 1388 (Hornstein)

	Fund Impact			
	F.Y. 2006	**F.Y. 2007**	**F.Y. 2008**	**F.Y. 2009**
	(000's)			
General Fund	$1,800	$1,300	$900	$500

Changes to FOC requirements effective for tax years beginning after December 31, 2004. Provisions related to the commissioner's authority effective July 1, 2005.

EXPLANATION OF THE BILL

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 located outside the United States.

In addition, the bill provides the Commissioner of Revenue the authority to disqualify a corporation as an FOC and to disallow the foreign royalty and fee subtraction provided that the source of the transaction is an FOC. The commissioner may use this authority in the following situations: transactions whose only purpose is tax reduction; the income of the FOC is fairly attributable to domestic operations or sources; or transactions without economic substance.

REVENUE ANALYSIS DETAIL

Change Qualifications for Foreign Operating Corporations

- The revenue estimates are based on data from returns received by the Department of Revenue in calendar year 2003.
- Annual percentage changes in overall corporate tax collections as projected by the Department of Finance in the February 2005 forecast are used to project future revenue gains.
- Runs of tax calculation programs against corporate data were used to calculate the revenue effect from changing the property and payroll qualifications that must be met in order to qualify as a FOC.
- It is assumed that the revenue gain would decrease over time as corporations make changes to meet the proposed requirements for an FOC.
- About 20-40 corporations will be affected by the bill.

Commissioner's Authority Related to Foreign Operating Corporations

- It is not known to what extent these provisions would result in additional revenue.

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

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