CORPORATE FRANCHISE
Foreign Operating Corporations
Foreign Royalty Subtraction

April 6, 2006

	Yes	No
DOR Administrative Costs/Savings		X

Department of Revenue
Analysis of S.F. 3716 (Pogemiller)

	Fund Impact			
	F.Y. 2006	**F.Y. 2007**	**F.Y. 2008**	**F.Y. 2009**
		(000's)		
General Fund	($)	$160,600	$123,200	$122,600

Effective for tax years beginning after December 31, 2005.

EXPLANATION OF THE BILL

Current Law: Minnesota allows certain income of a unitary group to be classified as the income of a foreign operating corporation (FOC). In order to qualify for FOC status a corporation must have 80% or more of the average of its property and payroll factors located outside the United States. Also, a corporation must have $1 million of payroll and $2 million of property located outside the U.S.

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.

Proposed Law: The bill says a corporation qualifies as an FOC if at least 80% of its income is from active foreign business income. The bill relies on definitions in the Internal Revenue Code to determine whether income is from foreign sources.

The bill reduces the income of a foreign operating corporation if its intangible income is classified as from domestic sources according to the Internal Revenue Code. Also, the foreign royalty subtraction is not allowed if the royalty is classified as from domestic sources according to the Internal Revenue Code.

REVENUE ANALYSIS DETAIL

- Sections 1 through 3 reduce the usage of the foreign operating corporation (FOC) tax regime and the foreign royalty subtraction.
- The estimates of current law against which the proposal is measured reflect the February 2006 forecast and include the estimated impact of the June 2005 decision by the Minnesota Supreme Court in *Hutchinson Technology, Inc., vs. Commissioner of Revenue*.

REVENUE ANALYSIS DETAIL (cont.)

- Generally, tax year impact is allocated 30/70 to fiscal years. Due to the tax year 2006 effective date, the tax year 2006 impact that would normally occur in fiscal year 2006 is shifted to fiscal year 2007.

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

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