DEPARTMENT OF REVENUE

INDIVIDUAL INCOME TAX
Apportioning Board Member Income

February 14, 2019

	Yes	No
DOR Administrative Costs/Savings	X	

Revised to Clarify Current Law Description

Department of Revenue
Analysis of H.F. 156 (Davids) / S.F. 656 (Rest)

	Fund Impact			
	F.Y. 2020	**F.Y. 2021**	**F.Y. 2022**	**F.Y. 2023**
	(000's)			
General Fund	($5,600)	($5,800)	($6,000)	($6,300)

Effective beginning with tax year 2019.

EXPLANATION OF THE BILL

Current Law: A nonresident must file a Minnesota individual income tax return if their Minnesota-source income meets the filing requirements and must report any income earned in Minnesota. If the income is earned in a trade or business, the share of income earned in Minnesota is calculated by multiplying total income by a sales apportionment percentage. The apportionment percentage is Minnesota sales divided by sales everywhere. Receipts from the sale of goods and services sold to a Minnesota customer are considered Minnesota sales. In most cases, the taxpayer's state of residence would allow a credit against that state's income tax for the tax paid to Minnesota.

Nonresidents who are members of boards of directors must also compute an apportionment percentage to determine how much of their total board compensation is earned in Minnesota. These nonresident board members are outside board members who are not employees of the corporation which they serve as board members. Board members are considered to be independent contractors who are selling their board member services to their customer, the corporation which they serve as board members.

As a general rule, the location where the customer receives the service determines whether a sale is or is not a Minnesota sale. For board member services, the location where the customer receives the service is not readily determinable. In such cases, the location where the customer receives the service is the location of the office ordering the services.

The formula to compute the dollar value of Minnesota sales from board member compensation is the ratio of days participating in board meetings in Minnesota to total board meeting days.

In the case of board meetings in locations outside Minnesota, the location of the office ordering the service is considered to be outside Minnesota only if the corporation has a fixed place of business in that state.

An alternative calculation may be used by nonresidents who are members of only one or two boards of directors. Under Revenue Notice #14-02, the dollar value of Minnesota sales from board member compensation is the ratio of time spent working for the board in Minnesota to total time spent working for the board.

Proposed Law: This bill allows all nonresident board members to compute their Minnesota sales by the time spent method. As compared to current law, the bill allows taxpayers who are members of more than two boards of directors to use the time spent method.

Since the unit of time spent is not specified in the bill, it is assumed that taxpayers will use the most advantageous unit of time to minimize the amount of time spent in Minnesota. When compared to current law, this will greatly reduce the dollar value of Minnesota sales and the apportionment percentage. As a result, a much smaller share of nonresident board members' income will be subject to Minnesota tax. Allowing taxpayers to use the most advantageous unit of time spent is consistent with court decisions that favor the taxpayer's interpretation of an undefined term.

REVENUE ANALYSIS DETAIL

- The starting point for the estimate is board member compensation paid in 2017 by the 100 largest Minnesota public companies. Analysis of Security Exchange Commission (SEC) filings by the 100 largest Minnesota public companies indicates that the average compensation for a board member is about $147,000. These companies have about 800 board members. Due to the complexity and scope of these companies, the boards select members to reflect their broad scope. It is assumed that the majority of board members are nonresidents.
- For these companies, it is assumed that 80% of nonresident board member compensation is not covered by the time spent method under Revenue Notice #14-02.
- For these companies, under current law between 60% and 70% of nonresident board member compensation is apportioned to Minnesota. The estimate uses the midpoint of that range, 65%. Under the bill, the percentage of income apportioned to Minnesota would likely drop from 65% to 5%.
- Unlike the public companies, the 100 largest Minnesota private companies do not file SEC reports on their board compensation. The estimate for these companies is based on their relative size in total sales as compared to the total sales of the 100 largest Minnesota public companies. The total sales of the largest Minnesota private companies is about 50% of the total sales from the largest public companies. The revenue loss from board member compensation of public companies is increased by 50% to account for the revenue loss from the largest private companies. The amount of board member compensation is assumed to be linked to measures of size such as total sales. Beyond the largest 40 public companies, the sales of Minnesota private companies are significantly larger than comparable public companies of an equal rank.
- The average tax rate is assumed to be 8%.
- Since 2010 the compensation paid to the highest-paid corporate boards has increased by an average of 4.2% per year. Compensation paid by all corporate boards is assumed to grow at a slightly lower rate of 4% per year.
- Beyond the largest 200 companies described above, it is very difficult to estimate the number of nonresident board members not covered by Revenue Notice #14-02. It is assumed that a majority of board members from these companies are Minnesota residents. The revenue loss from the top 200 Minnesota companies was increased by 20% to account for the revenue loss for board members of all other companies and board members of nonprofit organizations and foundations.
- Tax year revenue loss is allocated to the following fiscal year.

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Number of Taxpayers: About 800 nonresident taxpayers would pay less Minnesota tax.

Minnesota Department of Revenue
Tax Research Division
www.revenue.state.mn.us/research_stats/Pages/Revenue-Analyses.aspx

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