

STATE OF MINNESOTA  
DEPARTMENT OF REVENUE

In the Matter of the Proposed Adoption of  
New Rules Governing Administration of  
Income and Excise Taxes; Petition  
for Application of Other Than the  
Prescribed Apportionment Formula,  
Apportionment Formulas Required by  
the Commissioner

**STATEMENT OF  
NEED AND  
REASONABLENESS**

This document has been prepared as a verbatim affirmative presentation of the facts necessary to establish the statutory authority, need for, and reasonableness of the proposed new rule. It is submitted pursuant to Minnesota Statutes, section 14.23, and Minnesota Rules Part 1400.0500 requiring a Statement of Need and Reasonableness.

A Notice of Intent to Solicit Outside Opinion regarding the administration of income and excise taxes, petition for application of other than the prescribed apportionment formula was published in the State Register on September 23, 1991. The notice specifically mentioned this rule and invited interested persons to submit comments or suggestions orally or in writing to the Department by October 30, 1991. No one has commented either in writing or orally.

Proposed Minnesota Rule 8020.0100 sets forth the procedure by which a taxpayer may petition for a deviation from the statutory method of apportioning net income required by Minnesota Statutes, section 290.191. Proposed Rule 8020.0150 sets forth the procedure by which the commissioner may require a different method of apportioning income.

The duty is imposed upon the commissioner of revenue to indicate what form a taxpayer's petition should take. The rule states the form of the petition, the period of time that the commissioner has to act on a petition, and what relief is available if a petition is not accepted or acted upon.

The rule does not include a description of what constitutes unfairness for the purposes of Minn. Stat. sec. 290.20. The Commissioner is bound by constitutional due process and commerce clause standards enunciated by the Minnesota Supreme Court and the United States Supreme Court when determining whether the statutory method which is required for apportioning income is fair. (See analysis of Subpart 3) The Commissioner of Revenue is granted the authority to determine that "the methods prescribed by section 290.191 do not fairly reflect all or any part of taxable net income allocable to this state.." Minn. Stat. sec 290.20 (1992). As the Minnesota Supreme Court has upheld the commissioner of public safety's judgment interpreting a rule which is general in its terms where "it is impracticable to promulgate a definite comprehensive rule, as where application of a rule turns upon questions of qualifications of personal fitness", so this rule is proper because it is impracticable to describe the situations which can give rise to Constitutional levels of distortion of income. Askildson v. Commissioner of Public Safety, 403 N.W. 2d 674 (Min. App. 1897). It is impracticable for the proposed rule to include definitive applications of the rule to fact situations because the department does not have the ability to anticipate the facts and circumstances that will be included in each petition for an alternative method of apportioning income.

Proposed Rule 8020.0150 also sets forth the requirements the commissioner must fulfill when imposing an alternative method of apportioning income on taxpayers under the same statutory section.

### **IMPACT ON SMALL BUSINESS.**

The impact of these rules on small business has been considered. The proposed rules are distinct. The first the proposed rule, which sets forth the method and form for petitioning for a method of apportioning income, is not mandatory and therefore is not expected to place any financial or administrative burden on small business. Small businesses which apportion income and which do not petition to have an method of apportionment applied to them under this rule will not be subject to this rule.

When promulgating any proposed rule to apply an alternative method of apportioning income, the commissioner must consider the impact on small business, as required by Minnesota Statutes, sec. 14.115.

### **IMPACT ON LOCAL PUBLIC BODIES AND AGRICULTURAL LAND**

The impact of this rule on local public bodies and agricultural land has been considered. The proposed rule governs the petition for application of other methods of apportionment than the formula for apportionment of income prescribed in Minn. Stat., section 290.191 to taxpayers. The proposed rule is not expected to have any impact on local public bodies or agricultural land.

## **AUTHORITY TO ADOPT RULES.**

Minnesota Statutes, section 270.06, subd. 13 grants the commissioner of revenue statutory authority to promulgate rules concerning state tax laws, including the income and franchise tax law.

## **ANALYSIS OF PROPOSED RULES.**

The following is an analysis of each subpart of proposed rule 8020.0100:

Rule 8020.0100, subpart 1. This subpart is necessary because it references the statutory provision which permits a taxpayer to depart from the statutory apportionment provisions of Minnesota Statutes, section 290.191, and the statutory requirements of Minnesota statutes, section 290.20, which permits the petition for application of other than the prescribed apportionment formula.

Rule 8020.0100, subpart 2. This subpart is reasonable and necessary because if the result of applying the statutory apportionment formula is so unfair as to require apportionment of income by an alternative method set forth in Minnesota statutes section 290.20, the unfairness demonstrated must reach constitutionally prohibited levels. Because of this, the taxpayer may file its petition at any time when it is not barred from raising the claim.

The proposed rule provides that a taxpayer can file a petition at any time when its tax year is open, so it would not be required to use an unfair method to allocate income. The commissioner, for purposes of tax administration, would like the petition in advance of the start of the tax

year. The reason for this is that tax payments are required over the course of the year. Both the taxpayer and the commissioner need to know how the tax payments are calculated. Further, in most instances the taxpayer can anticipate whether a particular method of allocating net income to the state is unfair prior to the tax year which is covered by the petition. However, the petition is not required prior to the start of the tax year however.

Rule 8020.0100, subpart 3. This subpart is reasonable and necessary because it sets forth the required parts of the petition. The required parts allow the commissioner:

1. To identify the petitioning taxpayer;
2. To identify the tax period(s) covered by the petition;
3. To ascertain the nature of the business activity which the petitioner believes is not fairly allocated under the statutory formula;
4. To review the taxpayer's reasons for asserting that the statutory method of allocating income is unfair. The commissioner is required to apply the general standard alluded to in the statute and enunciated in various court cases to any petition for an alternative apportionment formula. Minnesota intends to assess its income and franchise tax to the Constitutional limits of the due process and commerce clauses. Absent compelling circumstances resulting in

Constitutional unfairness, the statutory apportionment formula must be applied. See NCR Corporation v. Commissioner of Revenue, 438 N.W. 2d 86 at 90. Those limits are expressed in the Container Corporation case (Container Corporation of America v. Franchise Tax Board, 463 U.S. 159, 169, 103 S. Ct. 2933, 2942), where the U.S. Supreme Court stated clearly the two constitutional tests of fairness of an apportionment formula:

A. Internal consistency "the formula must be such that, if applied in every jurisdiction, it would result in no more than all of the unitary businesses income being taxed," and;

B. External consistency "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how the income is generated."

Computation of taxes which will be due at the end of the year is not necessary to demonstrate the unfairness of the method. Indeed, in most instances actual tax results will not demonstrate that the method of allocation is unfair. The standard for review of the petition is whether formula apportionment is constitutionally unfair when applied to the taxpayer. Formula apportionment is intended and required only to approximately measure income allocable to the state. As, the Minnesota Supreme Court has stated: "However, a state need not show that its statute results in the precise allocation of income resulting from activities of the taxpayer occurring within its jurisdiction". NCR Corporation v. Commissioner of Revenue, 438 N.W. 2d 86 (Minn. 1989) at 91. If the statutory apportionment method fairly reflects the extent of

the taxpayer's business activity in the state and allocates net income on that basis, it is fair without regard to the actual tax result. The rule does not equate an unfair method to a particular tax result.

A petitioner cannot rely on a showing that a method of apportionment proposed in a petition more accurately allocates income or that it results in less tax. The proposed rule does not equate an unfair method of apportionment to a particular tax result unless that result is Constitutionally unfair. The petitioner must show that the constitutional standards of fairness are not met when the statutory apportionment formula is applied, and;

5. To examine the example of the taxpayer's proposed alternative method of allocating income for both theoretical and practical application.

Each of these requirements is essential to fair and proper tax administration and the commissioner's duty to enforce the tax statutes of Minnesota.

Rule 8020.0100, subpart 4. This subpart is reasonable because it sets forth the method for the commissioner to obtain additional information necessary to determine whether the statutory apportionment is unfair, and whether the method of apportioning income proposed by the taxpayer is fair. It is incumbent on the taxpayer to demonstrate the unfairness of the statutory apportionment and to show the result of the method of

apportionment proposed. If the petition is unclear, incomplete or lacking information necessary to determine fairness, the commissioner can request additional information under this subpart. The alternative would be for the commissioner to reject the petition out-of-hand for failure to meet the statutory burden. Further, it is reasonable and necessary to suspend the period for approval or rejection of the petition when the taxpayer has been required to provide additional information and has not done so. The commissioner will still need time to review the petition after the required information is supplied.

Rule 8020.0100, subpart 5. This subpart is reasonable because it sets forth the period of time during which the commissioner may review and consider a petition. The forty-five (45) day period, if the petition is filed before the start of the taxpayer's tax year, allows the taxpayer adequate time to prepare and file the first estimated tax payment of the year, which is due on the 15th day of the third month of the tax year. The requirement that the taxpayer file a copy of its approved petition with its first payment is reasonable to ensure that its petition is included in the file of the corporation.

Although a forty-five (45) day limit is set for approval or rejection by the commissioner, the petitions address the circumstances of taxpayers which are not ordinary. Ordinary circumstances would lead to fair allocation of net income applying the statutory three-factor formula. Technical analysis of the petition, obtaining additional facts, or review of the proposed alternative allocation method, among other factors, could delay the commissioner's decision. Therefore, silence by the



commissioner does not constitute approval of petition. If there is a delayed decision on a petition by the commissioner, which is later approved, the rule contains relief provisions. This subpart allows amended filings so the taxpayer will not be injured by delays if they occur.

Rule 8020.0100, subpart 6. This subpart is necessary because it clarifies that the rejection of a taxpayer's petition is an order appealable to Tax Court. Minnesota Statutes, section 271.06, subdivision 1, states that a person directly interested in or affected by an order of the commissioner of revenue respecting any tax, fee, or assessment, or any matter pertaining thereto may appeal that order to the Tax Court. An order of the commissioner of revenue denying a petition to allocate income under a method other than that prescribed by statute is a matter pertaining to tax, and the taxpayer may appeal.

Rule 8020.0150. This part is reasonable and necessary because it sets forth the converse of Rule 8020.0100, that the commissioner may require a taxpayer to use a method of apportionment other than the statutory method. The commissioner is authorized by Minnesota Statutes, section 290.20 to require another method of apportionment if the statutory method set forth in Minnesota statutes, section 290.191 do not fairly reflect net income allocable to this state. Before the commissioner requires an alternative method, the commissioner is required by statute to determine that the result of following the statutory apportionment method does not fairly reflect net taxable income apportionable to Minnesota and that the method of apportionment required by the

commissioner would fairly apportion income from the taxpayer's business in the state.

The commissioner is not precluded from finding that the statutory formula is unfair when applied to specific industries as a class of taxpayers. This section of the Minnesota law is modeled on the Uniform Division of Income for Tax Purposes Act (UDITPA), which was approved by the National Conference of Commissioners on Uniform State Laws in 1958. Section 18 of UDITPA read as follows:

"Section 18. If the allocation and apportionment provisions of this Act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for, or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting;

(b) the exclusion of any one or more of the factors;

(c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state;  
or

(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income."

Minnesota enacted similar provisions in 1987 (Laws of Minnesota 1987, chapter 268, art. 1, sections 76 and 77); Minn. Stat., section 290.20, subd. 1, reads as follows:

Subdivision 1. The methods prescribed by section 290.191 shall be presumed to determine fairly and correctly the taxpayer's taxable net income allocable to this state. If the methods prescribed by section 290.191 do not fairly reflect all or any part of taxable net income allocable to this state, the taxpayer may petition for or the commissioner may require the determination of net income by the use of another method, if that method fairly reflects net income. These other methods may include:

- (1) separate accounting;
- (2) excluding any one or more of the factors;
- (3) including one or more additional factors; or
- (4) some other method.

Subd. 1a. A petition within the meaning of this section must be filed by the taxpayer in the form required by the commissioner.

Pursuant to UDITPA provisions, Article IV of the Multistate Tax Compact, the Multistate Tax Commission has adopted special industry regulations. These regulations cover the trucking, airline, and radio and

television broadcasting industries. Of the 23 states that have adopted the UDITPA provision, 18 have adopted rules applying special formulas to industries not fairly taxed under the three-factor formula.

Nothing in the statute prohibits the commissioner from finding the statutory apportionment method is unfair when applied to a defined class of taxpayers and then applying a fair method of apportionment to those taxpayers by rule. This result is similar to the rules promulgated for particular industries pursuant to the similar statutory language of UDITPA. A rule for apportioning income, which applies to a specific class of taxpayers, has been promulgated. See Minn. R., part 8017.6000, Apportionment of Net Income of Air Carriers.

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