MN HOUSE RESEARCH

Apportionment of Corporate Franchise Tax

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Minnesota determines how much of a corporation's total domestic income is subject to tax in this state based on the corporation's percentage sales in Minnesota. This applies to most corporations, including unitary corporations.

Apportionment is constitutionally required

A state can constitutionally tax only the income of a multistate corporation that is "fairly apportioned" to the state. The reason for this requirement seems obvious: if a business operates in several states and each state could tax all of its income, the business could easily be subject to multiple taxation. Aside from being unfair, this would discourage a business from operating in multiple states; it would interfere with interstate commerce.

Minnesota uses single sales apportionment

All states apportion income using some type of formula (the percentage of a business's in-state property, payroll, and sales to its total property, payroll, and sales) to determine a corporation's in-state income. Since tax year 2014, Minnesota has apportioned income using "single sales" apportionment, which excludes consideration of property and payroll. Minnesota's apportionment formula therefore only looks to the percentage that Minnesota sales comprise of the total sales of the corporation when determining the percentage used to determine Minnesota-source income (i.e., the percentage of Minnesota sales is multiplied by the corporation's total domestic income). Most states use or allow single-sales apportionment.

Sales are defined on a destination basis; that is, the location of the buyer generally determines whether the sale is a Minnesota sale. Prior to tax year 2014, Minnesota used three-factor apportionment, based on combination of the Minnesota percentage of property, payroll, and sales. Since the early 1950s, Minnesota has either allowed or mandated weighting sales more heavily before adopting single sales apportionment.

These apportionment rules also apply under the individual income tax—e.g., to pass-through entities—that operate in multiple states. Resident individuals, however, are subject to Minnesota tax on all of their income.

Weighting sales more heavily generally encourages export businesses. Since sales are assigned to the buyer's location and there is no throwback rule (see below), export or non-Minnesota sales will reduce the amount of income taxable by Minnesota. Thus, using single sales apportionment may create an incentive for companies to invest in Minnesota property or to hire more employees to sell products outside of Minnesota. The property and payroll factors, by contrast, would assign more income to Minnesota, increasing the tax, because the investment increases Minnesota property and payroll.

Compared with equally weighting each apportionment factor, weighting sales more heavily reduces tax revenues. The Department of Revenue's *Tax Expenditure Budget* (February 2022) showed an expenditure cost of $340 million for fiscal year 2023.

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Special rules apply to financial institutions

Special rules apply to determine sales (receipts) for financial institutions and investment companies (e.g., companies operating or managing mutual funds).

No throwback rule applies

Less than half of the states with corporate taxes use "throwback rules" in defining the sales factor. Throwback rules treat sales to out-of-state buyers as in-state sales, if the buyer's state cannot tax the business/seller or if the purchaser is a federal government agency. These "thrown-back" sales increase in-state sales factor and corporate tax, decreasing the benefits to the taxpayer of single sales apportionment. Minnesota does not have a throwback rule.

Minnesota uses combined reporting for "complex" corporations

Special rules apply to complex corporations (i.e., those with multiple corporations, such parent-subsidiary corporations). If these corporations are part of a "unitary business," Minnesota requires them to file a combined report. Under combined reporting, each corporation in the unitary group calculates its tax using the total income of the unitary group and its own factors as the numerator and the total group's factors as the denominator. Under a 2013 change, sales made by domestic corporations that are part of the unitary group, but that do not have Minnesota nexus, must be included in the numerator of a corporation with nexus.

Combined reporting prevents most transactions among related corporations in the unitary group from affecting the tax liability of the group. In effect, the apportionment formula divides the unitary business's income among the states without regard to how the business allocates the income among its various corporate entities.

For more information, see the House Research publication Corporate Franchise Taxation*, August 2024.*

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