

Single Sales Apportionment of Corporate Franchise Tax

Apportionment is a key feature of state corporate taxes

Apportionment formulas are important features of state corporate income taxes. They determine how much of a business's income is taxable and affect the incidence and competitiveness of the tax. Minnesota apportions corporate income using the Minnesota proportions of the corporation's sales, payroll, and property factors to determine corporate franchise tax.

Minnesota is phasing in single sales apportionment

Under legislation enacted in 2005, Minnesota is phasing in single sales apportionment over an eight-year period beginning in tax year 2007. The table shows the phase-in schedule for the transition to single sales apportionment from 2011 to 2014.

Tax year	Sales	Property	Payroll
2011	90%	5.0%	5.0%
2012	93%	3.5%	3.5%
2013	96%	2.0%	2.0%
2014	100%	0.0%	0.0%

Effects vary by type of business

The effects of adopting single sales apportionment vary by business. The crucial variables are the business's Minnesota apportionment factors:

- The taxes of businesses with all of their property, payroll, and sales in Minnesota will be unaffected.
- Minnesota businesses whose Minnesota sales factor is lower than the average of their Minnesota property and payroll factors will receive a tax cut. The larger the disparity, the bigger the benefit is. A classic example is a business with most of its operations (headquarters, plants, and so forth) in Minnesota, but most of its sales outside of Minnesota.
- Businesses with higher Minnesota sales factors than their average Minnesota property and payroll factors will have tax increases. One example is a national consumer products company with few facilities in Minnesota.

Rationale for single sales apportionment: improve competitiveness

The principal rationale for single sales apportionment is an economic development argument: It makes Minnesota more competitive in attracting investment in plant and equipment. Sales are determined by the buyer's location. All other things being equal, increasing non-Minnesota sales will reduce the amount of Minnesota taxable income, since more income will be attributed to or apportioned outside of Minnesota. Thus, increasing the weight for the sales factor creates an incentive for companies to invest in Minnesota property or to hire more employees (or reduces the tax's disincentive to do so) to sell products outside of Minnesota. Empirical studies have found some support for the idea that single sales apportionment encourages in-state investment.

Policy concerns with single sales apportionment: equity and tax theory

Opponents of single sales apportionment argue that it shifts the burden of the tax from capital (the property factor) to consumption, reducing the progressivity of the tax. Some also question as an empirical matter whether it has the desired effects on competitiveness. Tax theorists argue that if the corporate tax is to be a benefits tax (i.e., based on businesses' use of government services) or if it is to be based on production of income, apportionment should take into account where the business's property and employees are located. These factors are important contributors both to the production of income and the consumption of government services.

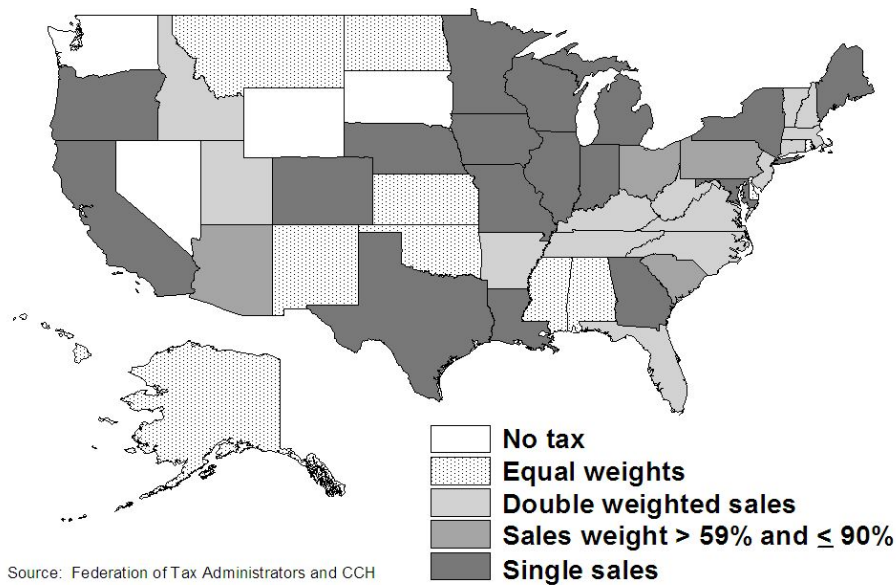
Sales-weighted apportionment reduces revenues

Compared with equally weighting each of the apportionment factors, weighting sales more heavily reduces Minnesota tax revenues. The Department of Revenue's *Tax Expenditure Budget* (February 2010) shows an expenditure cost of \$153 million for fiscal year 2011, rising to \$214 million in 2013.

Trend in other states to heavier sales weighting

States have been increasingly shifting their apportionment formulas to more heavily weighted sales. Effective for tax year 2011, 16 states use or allow single sales as their apportionment formula for manufacturers. This is up from 14 states for tax year 2010. Many of Minnesota's neighboring states use single sales apportionment: Illinois, Indiana, Iowa, Michigan, Missouri, Nebraska, and Wisconsin. South Carolina and New Jersey are scheduled to use single sales in 2013, Virginia (in addition to Minnesota) in 2014, and Arizona in 2017. The map below shows the apportionment formulas for manufacturers as of tax year 2011. Some states allow elections between two formulas. The map shows these with the highest permitted sales weighting.

**Apportionment of Corporate Income
Applicable to Manufacturers**



For more information: Contact legislative analyst Joel Michael at 651-296-5057. Also see the House Research publication *Apportionment of Corporate Franchise Tax*, October 2011.

The Research Department of the Minnesota House of Representatives is a nonpartisan office providing legislative, legal, and information services to the entire House.