

## Corporate Franchise Tax

### *Corporate franchise tax applies to “C” corporations*

The corporate franchise tax, also frequently referred to as the corporate income tax, applies to “C” corporations (i.e., corporations and some partnerships) that are taxable under subchapter “C” of the Internal Revenue Code. Entities exempt from the tax include the following:

- “Pass-through entities” (e.g., most partnerships and Limited Liability Companies, “S” corporations, and other entities that do not pay entity level taxes); the owners of these entities (shareholders, partners, or LLC members) only pay tax on their respective shares of the business entity’s income. These entities are subject to the minimum fee (see below).
- Insurance companies (Insurers pay a premium tax instead)
- Credit unions
- Charitable organizations and other entities exempt from the federal income tax

### *Tax base is profits*

The tax base is taxable income, essentially the profits of C corporations. State law defines the tax base by reference to the definition of taxable income under the federal corporate income tax. For example, federal depreciation rules are generally followed, except “bonus depreciation” and section 179 expensing are subject to special Minnesota rules. Minnesota deviates from the federal rules in some important ways. In particular, it provides a partial exemption for some types of foreign source income and for certain payments from foreign operating corporations. The Minnesota tax also taxes some income exempt under federal law, such as state and local bond interest.

### *Tax rate is 9.8 percent*

A flat tax rate of 9.8 percent applies to Minnesota taxable income.

### *Income is apportioned to Minnesota using a weighted three-factor formula of property, payroll, and sales*

Many corporations operate in more than one state. Under the U.S. Constitution, a state can legally tax only the income of a business that is “fairly apportioned” to its activity in the state. All states do this using formula apportionment (i.e., based on the in-state percentage of one or more factors).

Minnesota apportions a multistate corporation’s income using a weighted three-factor formula of sales (90 percent weight), property (5 percent), and payroll (5 percent). (These weights are for tax year 2011. Minnesota is moving to apportionment solely based on the sales factor, effective for tax year 2014.) The Minnesota percentage for each factor is multiplied by the weight and the three factors added to determine the Minnesota percentage of the corporation’s total income. For unitary businesses operating through several corporations (e.g., parent-subsiary), all of their income is combined. This is referred to as the

“combined reporting” method of apportionment. (For more information on apportionment, see the separate Short Subject, *Apportionment of Corporate Franchise Tax*.)

***Various tax credits apply***

The corporate franchise tax is reduced by various tax credits. These include credits for the following:

- Research and development
- Tax paid to another state
- Historic structure rehabilitation credit
- Jobs credit under the JOBZ program

***Revenues go to the general fund***

Fiscal year 2010 actual revenues were \$664 million or about 5 percent of general fund revenues. Revenues from the corporate franchise tax are deposited in the general fund. The Department of Management and Budget estimated in February 2011 that corporate franchise tax collections will be \$990 million in fiscal year 2011 and \$772 million in fiscal year 2012.

***Revenues are elastic but very volatile***

Revenues under the tax are elastic; they grow as the size of the economy grows. But they are also the most volatile of the major taxes imposed by the state. When the economy slows down or goes into recession, corporate profits and the franchise tax can drop quite precipitously. For example, in fiscal year 2006 (an expansion year) the state collected \$1,062 million in corporate franchise tax. In fiscal year 2009 (a recession year), corporate franchise tax revenues dropped to \$659 million or 38 percent less than 2006.

***A minimum tax applies***

An alternative minimum tax or AMT applies under the franchise tax. This tax closely follows the similar federal AMT. A corporation must compute its tax under the AMT, using a broader tax base (e.g., less generous depreciation rules) and lower tax rate (5.8 percent). If the AMT results in a higher tax, the corporation must pay this amount.

***A minimum fee applies to most entities***

All corporations (both S and C corporations), partnerships, and LLCs must pay a minimum fee based on the sum of their Minnesota property, payroll, and sales. This fee is an “add-on” fee that is paid in addition to the tax computed under the regular tax or AMT. The schedule for the fee is shown to the right. The dollar amounts of the fee schedule have not been changed since the fee was enacted in 1990. In 2011, Governor Dayton proposed increasing and indexing the amounts for inflation, but these changes were not enacted into law.

<b>Fee Schedule</b>	
<b>Minnesota Property, Payroll, and Sales</b>	<b>Fee</b>
Less than \$500,000	0
\$500,000 - \$999,999	\$100
\$1,000,000 - \$4,999,999	\$300
\$5,000,000 - \$9,999,999	\$1,000
\$10,000,000 - \$19,999,999	\$2,000
\$20,000,000 or more	\$5,000

**For more information:** Contact legislative analyst Joel Michael at joel.michael@house.mn. Also see the House Research publications *Single Sales Apportionment of Corporate Franchise Tax*, October 2011, and *Apportionment of Corporate Franchise Tax*, October 2011.

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