HOUSE RESEARCH | **Short Subjects**

Joel Michael **Updated: June 2015**

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, and "S" corporations); the owners of these entities (shareholders, partners, or LLC members) pay tax on their respective shares of the business entity's income under the individual income tax. The entities are subject to the minimum fee (see below). By contrast, shareholders of C corporations must pay tax under the individual income tax when the corporate profits are distributed as dividends, in addition to the corporate entity paying tax at the entity level when the profits are earned.
- Insurance companies (Insurers pay a premium tax instead)
- Credit unions (Federal law prohibits taxing federally chartered credit unions; state law extends the exemption to state-chartered 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 various ways. It taxes some income that is exempt under federal law, such as state and local bond interest, and does not allow percentage depletion.

Tax rate is 9.8 percent

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

Income is apportioned to Minnesota based on the percentage of sales made to Minnesota buyers

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 based on the proportion of corporation's sales made to buyers located in Minnesota. For unitary businesses operating through several corporations (e.g., parent-subsidiary), 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 2014 actual revenues were $1.28 billion or about 6 percent of general fund revenues. Revenues are deposited in the general fund. Minnesota Management and Budget estimated in February 2015 that corporate franchise tax collections will be $1.32 billion in fiscal year 2015 and $1.30 billion in fiscal year 2016.

Revenues are very volatile

Revenues under the tax are the most volatile of the major state taxes. When the economy goes into recession, corporate profits and the franchise tax revenues can drop quite precipitously. For example, in fiscal year 2007 (an expansion year), revenues were $1.17 billion; by fiscal year 2010 (a recession year) they had dropped to $663 million (a reduction of 43 percent reduction from 2007), and by fiscal year 2012 they had recovered to $1.04 billion (an increase of 57 percent from 2010).

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 2013 Legislature increased these fee amounts and provided that they would be annually adjusted for inflation in the future.

Fee Schedule – Tax Year 2015

Minnesota Property, Payroll, and Sales	Fee
Less than $960,000	0
$960,000 - $1,929,999	$200
$1,930,000 - $9,649,999	$580
$9,650,000 - $19,299,999	$1,930
$19,300,000 - $38,589,999	$3,860
$38,590,000 or more	$9,650

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* and *Apportionment of Corporate Franchise Tax*.

House Research Department | 600 State Office Building | St. Paul, MN 55155 | 651-296-6753 | www.house.mn/hrd/