Department of Revenue

Income Tax Division

Adoption of New and Amended Rules and the Repeal of a Rule of the Department of Revenue Relating to the Taxation of a Unitary Business and Formula Apportionment

Rules as Adopted

13 MCAR S 1.6501 Definition of unitary business.

A. Definitions. The term "corporation" does not include an S corporation. The term "United States" includes any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any possession of the United States, or any political subdivision of any of the foregoing.

B. Unitary business defined. Business activities or operations carried on by more than one corporation are unitary in nature when the corporations are related through common ownership and when the trade or business activities of each of the corporations are of mutual benefit, dependent upon, or contributory to one another, individually or as a group. Unity is presumed whenever there is the unity of common ownership, the unity of operation evidenced generally by staff functions such as centralized advertising, accounting, financing, management, or centralized, group, or committee purchasing, and the unity of use evidenced generally by line functions, centralized executive force, and general system of operation. All of the examples are not needed to show the unity of operation or unity of use. The unitary nature of the business activities or operations is also evidenced by contributions to income resulting from functional integration, centralized management, and economies of scale. Examples of functional integration are centralized manufacturing, warehousing, accounting, legal staff, personnel training, financing, or centralized, group, or committee purchasing. Examples of centralized management are common officers or directors, exchange of personnel, frequent communication between management of the corporations, or where

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the parent must approve of major financial decisions. All of the examples are not needed to show functional integration or centralized management. The term "unitary business" for purposes of filing a combined report includes only those corporations created or organized in the United States or under the laws of the United States or any state. The mere ownership of as much as 100 percent of the stock of another corporation does not, in the absence of other indicia of a unitary business, mean that the business of the group is unitary in nature. The presence of any one of the factors contained in C.-E. below creates a strong presumption that the activities of the corporations constitute a unitary trade or business.

C. Horizontal type of business. Business activities or operations carried on by more than one corporation, related through common ownership, are generally unitary when the activities of the corporations are in the same general line of business and exhibit functional integration and economies of scale. For example, separately incorporated grocery stores, related through common ownership, will usually be engaged in a unitary trade or business if they are functionally integrated, and have centralized management and economies of scale.

D. Steps in a vertical process. Business activities or operations carried on by more than one corporation, related through common ownership, are unitary in nature when the various members are engaged in a vertically structured enterprise. For example, assuming that the common ownership requirement is met, a trade or business that is functionally integrated and which benefits from centralized management and controlled interaction which involves the exploration and mining of copper ore by one of the related corporations; the smelting and refining of the copper ore by another of the related corporations; and the fabrication of the refined copper into consumer products by another of the related corporations, is unitary in nature.

E. Strong centralized management. A group of corporations, related through common ownership, which might otherwise be considered to be carrying on separate trades or businesses are considered engaged in a unitary trade or business when there is strong centralized management in determining the policies of each corporation respecting its primary business activities, coupled with the existence of centralized offices for such functions as financing, advertising, research, or purchasing. Thus, some groups of corporations are considered as carrying on a unitary trade or business when the executive officers of one of the corporations in the group are normally involved in determining the policies respecting the primary business activities of the other corporations in the group, and there are centralized units which perform for some or all of the corporations functions which truly independent corporations would perform for themselves, such as accounting, personnel, insurance, legal, purchasing, advertising, or financing. A finding of "strong centralized management" is not supported merely by showing that the requisite ownership percentage exists or that there is incidental economic benefit accruing to a group because such ownership improves its financial position. Both elements of strong centralized management, that is strong centralized management authority and the exercise of that authority through centralized operations, must exist in order to justify a conclusion that the operations of otherwise seemingly separate trades or businesses are significantly integrated so as to constitute a unitary business.

F. Common ownership. Common ownership does not exist unless the corporation is one which is a member of a group of two or more corporations and more than 50 percent of the voting stock of each member is directly or indirectly owned by a common owner or by common owners, either corporate or noncorporate, or by one or more of the member corporations of the group. The term "common owner" includes the constructive ownership of stock by related taxpayers as provided in Minnesota Statutes, section 290.10, clause (6). Examples of common ownership are:

1. Corporation P owns 51 percent of the voting stock of corporation R1 and corporation R1 owns 51 percent of the voting stock of each of corporations R2 and R3. Common ownership

exists among P, R1, R2, and R3.

2. Corporation P owns 51 percent of the voting stock of corporation R1, corporation R1 owns 49 percent of the voting stock of corporation R2 and corporation R2 owns 51 percent of the voting stock of R3. Common ownership exists among P and R1 and will be identified as group A. Common ownership exists among R2 and R3 and will be identified as group B. There is no common ownership between group A and group B.

G. Examples. The provisions of A.-F. may be illustrated by examples 1.-3.

1. Sales corporation owns 51 percent of the outstanding voting stock in each of four subsidiaries - refining corporation, drilling corporation, transport corporation, and research corporation. Sales corporation markets and sells petroleum products in the United States and abroad. Some of the petroleum products are obtained from refining corporation which acquires some of the crude oil from drilling corporation. Transport corporation operates pipeline facilities to transport crude oil from drilling corporation's storage facilities to refining corporation's refineries. Research corporation conducts research and development for both sales and refining corporations. Since the corporations are operating a vertically integrated business and since there is common ownership, the five corporations are conducting a unitary business.

2. Corporation A owns 60 percent of the outstanding voting stock in each of three corporations; B, C, and D. Corporation B, in turn, owns 100 percent of the outstanding voting stock in corporation E. Corporation A is primarily engaged in operating multiline department stores in Minnesota and other midwestern states. Corporation B operates a chain of department stores in the northwestern portion of the United States. B's stores sell only high quality, top grade consumer items. Corporation C operates a chain of discount stores throughout the southwestern portion of the United States. Corporation D is a finance company, handling all of the consumer credit and financing arrangements of purchases at the stores

owned by corporations A, B, and C. Corporation E is the purchasing agent for corporations A, B, and C and maintains warehouses for the stores' inventories. Corporation A provides management services for all of the other corporations and maintains overall control in determining the policies respecting the primary business activities of the other corporations, including their budgetary and financial affairs. All of these corporations are engaged in the conduct of a unitary business since they are operating a horizontally integrated business and since they have common ownership.

3. Corporation K was incorporated in 1945 and thereafter was engaged primarily in activities connected with the manufacture and sale of canned goods. In 1960, K embarked upon a diversification campaign designed to insulate its profits from fluctuations in the demand for canned goods. One hundred percent of the voting stock of corporation L was acquired. Corporation L operated a chain of department stores throughout the United States. In 1961, K purchased 80 percent of the voting stock of corporation M which was engaged primarily in the manufacture and sale of household goods. In 1962, K acquired 75 percent of the voting stock of corporation N which developed and marketed computer software and programs. There was no significant flow of goods between any of the corporations. While these subsidiaries were relatively autonomous in their day-to-day operations, each subsidiary did not operate as a distinct business enterprise at the level of full time management. Corporation K involved itself in policy determinations respecting the primary business activities of all the corporations. The subsidiaries were required to submit annual budgets to K for approval. Capital expenditures in excess of $500,000 needed approval from K. All of the financing arrangements for the subsidiaries were made by or with the approval of K's management team which authorized and directed intercompany loans when feasible. Tax matters were supervised by K's tax department which prepared the subsidiaries' federal income tax returns. Corporation K also performed centralized

warehousing and accounting functions for itself and its subsidiaries. A uniform system of inventory control for corporation K and the subsidiaries was developed and managed by corporation N. Due to the control that corporation K exerted over policy determinations respecting the primary business activities of the subsidiaries and the integration and interdependence occasioned by the centralization of various business functions, all of the corporations are engaged in a unitary business.

13 MCAR S 1.6502 Intercompany transfers within unitary business.

Elimination of income, loss, expense, or deduction items arising from transactions between members of a unitary group must be made to avoid distortion of:

1. the group's income, loss, expenses, or deductions;

2. the denominator used by all members of the group in calculating apportionment factors; or

3. the numerator used by any particular member of the group in calculating its apportionment factors.

Where a corporation can show that no distortion of income, loss, expense, or deduction will result where intercompany transactions are not eliminated, a corporation may elect to not eliminate intercompany transactions for 1. only. All intercompany transactions must be eliminated when calculating the factors as provided in 2. and 3.

13 MCAR S 1.6503 Unitary business, reporting.

A. Minnesota business. A unitary business which conducts its entire business within Minnesota may file a combined report for each corporation. The income or loss must be allocated among the corporations on the report by use of the equally weighted arithmetic average of the property, payroll, and sales factors. Each corporation on the report is entitled to have its first $25,000 of income taxed at the lower tax rate as provided in Minnesota Statutes, section 290.06, subdivision 1. These provisions also apply to banks and bank holding companies.

B. Required if Minnesota nexus. Except as provided in this rule, a combined report is required from every corporation that has a nexus with Minnesota and is part of a unitary business as defined in 13 MCAR S 1.6501 other than insurance companies subject to the provisions of Minnesota Statutes, section 290.35, investment companies subject to the provisions of Minnesota Statutes, section 290.36, or mining companies as provided in Minnesota Statutes, section 290.05, subdivision 1.

C. Farm income. Farm income is specifically excluded from combined reporting. Therefore, a unitary business must exclude farm income when figuring its combined income or loss and assign that income or loss to the state in which the farm is located. Where a Minnesota farm is a part of a unitary farming business which is located within and without Minnesota, the product from the Minnesota farm which is transferred outside of Minnesota for use in the unitary farming business must be treated as if it was sold at fair market value on the day of the transfer. Expenses connected with the farm are allowed under separate accounting.

D. Deductions. A corporation is allowed a charitable deduction which is subtracted from that corporation's apportioned unitary business income as determined on that corporation's combined report. The charitable contribution deduction is only allowed to a corporation which has a nexus with Minnesota and is determined as follows. The corporation is allowed to deduct:

1. those contributions it makes to an entity carrying on substantially all of its activities in Minnesota; and

2. a percentage of the charitable contributions made by the entire unitary group after reduction for all contributions qualifying under 1. made by a corporation with a Minnesota nexus. The percentage to be used is the ratio of Minnesota taxable net income of the corporation to the total net income of the unitary group.

E. Credits. Any refundable or nonrefundable credits allowed on the Minnesota return are allowed only to a corporation that has a nexus with Minnesota and must be based on that corporation's expenditures. These credits must be taken into consideration after computing the income or loss of a unitary business on the combined report.

F. Minimum tax. The minimum tax liability must be determined by using 40 percent of the corporation's federal minimum tax liability as computed on its federal return, multiplied by a fraction the numerator of which is the taxpayer's preference item income allocated to this state and the denominator of which is the taxpayer's total preference item income for federal purposes. If the corporation filed a separate federal return the minimum tax must be based on that, or if a federal consolidated return was filed the minimum tax must be based on that to the extent all corporations on the consolidated return are also on the combined return.

G. Business acquisition. When a corporation acquires another corporation and starts a unitary business with that corporation, the new corporation must be included on the combined report and its income or loss reported starting with the first taxable year of the acquiring corporation that begins on or after the date of acquisition. Acquiring another corporation does not include creating the corporation from a part of a corporation's unitary business group as it previously existed.

H. Unitary banking business. When a bank, including a bank holding company, is part of a unitary business that is doing business within and without Minnesota, a combined report must be filed for that bank as part of the unitary business. Receipts from intangible personal property must be included in the sales factor as follows:

1. Interest and other receipts from assets in the nature of loans, including federal funds sold, and installment obligations must be attributed to the state where the office is located at which the customer applied for the loan except in cases where the loan is recognized by appropriate banking regulatory authority as being made from and as an asset of an office located in another state, in which case it must be attributed to the state where that office is located. For

purposes of this paragraph the word "applied" means initial inquiry, including customer assistance in preparing the loan application, or submission of a completed loan application, whichever occurs first in time.

2. Interest or service charges from bank, travel, and entertainment credit card receivables and credit card holders' fees must be attributed to the state in which the credit card holder resides in the case of an individual or, if a corporation, to the state of the corporation's commercial domicile provided the taxpayer is taxable in that state. If the taxpayer is not taxable in the state of the individual card holder's residence or commercial domicile of the corporate card holder, the receipts must be attributed to the state of the taxpayer's commercial domicile.

3. Merchant discount income derived from bank and financial corporation credit card holder transactions with a merchant must be attributed to the state in which the merchant is located, provided the taxpayer is taxable in that state. If the taxpayer is not taxable in the state in which the merchant is located, the merchant discount income must be attributed to the state in which the taxpayer's commercial domicile is located.

4. Receipts from investments of a bank in securities must be attributed to its commercial domicile with the following two exceptions. Receipts from securities used to maintain reserves against deposits to meet federal and state reserve deposit requirements must be attributed to each state based upon the ratio that total deposits in the state bear to total deposits everywhere. Receipts from securities owned by a bank but held by a state treasurer or other public official or pledged to secure public or trust funds deposited in such bank must be attributed to the banking office at which such secured deposit is maintained.

5. Receipts (fees or charges) from the issuance of travelers checks and money orders must be attributed to the state where the taxpayer's office is located that issued the travelers checks. If the travelers checks are issued by an

independent representative or agent of the taxpayer, the following rules apply. If the taxpayer is taxable in the state in which the independent representative or agent issues the travelers checks or money orders, the receipts (fees or charges) must be attributed to that state. If the taxpayer is not taxable in the state in which the independent representative or agent issues the travelers checks or money orders, the receipts (fees or charges) must be attributed to the state of commercial domicile of the taxpayer.

6. Receipts from investments of a financial corporation must be attributed to its commercial domicile unless the securities have acquired a business situs elsewhere.

I. Accounting periods. Where members of the unitary group employ different accounting periods, the income must be reported on the combined report using one of the following methods. The income or loss and factors of all the corporations involved are those amounts for the same common months contained in the accounting period of the parent corporation, or the corporation filing the Minnesota return. If there is no parent corporation, the members of the unitary group may select one corporation to be the parent corporation for purposes of this part. Once a method is selected, it must not be changed without the consent of the commissioner. For the first taxable year beginning after June 30, 1981, income or loss and the factors attributable to a month or months which were previously reflected on the corporation's separate income tax return shall not be again reflected on the corporation's combined report. For the first taxable year beginning after June 30, 1981, if all the months are not included on a combined report or on a separate return, a separate return shall be filed reflecting the income or loss and factors for those months which are omitted. The due date of the return continues to be determined with reference to the actual accounting period of the corporation.

J. Net operating loss. The provisions of Minnesota Statutes, section 290.095, subdivision 3, clause (c) must be applied as if the corporation was not included on a combined report for that year when a corporation is included on a combined report for that year, and it is carrying over a net operating loss from a taxable year which began before July 1, 1981. This provision shall apply only if the corporation was a member of the unitary group prior to July 1, 1981.

K. Factors. Where members of a unitary business employ different methods of apportioning their income to Minnesota, the method used by the predominant business activity shall be used by all members of the unitary group.

2019 Apportionment of net income of business conducted partly within Minnesota.

(a) Applicability of Minnesota Statutes, section 290.19. The formulae prescribed by the provisions of Minnesota Statutes, section 290.19 shall be applied to the apportionable net income of a trade or business where the business carried on within this state is a part of a unitary business carried on both within and without this state.

(b) Apportionment of net income under Minnesota Statutes, section 290.19, subdivision 1, clause (1). If the business consists of the manufacture of personal property and sale of said property within and without Minnesota the formula shall be as follows:

(1) Under Minnesota Statutes, section 290.19, subdivision 1, clause (1)(a), (b), (c).

$$\left(\frac{\text{Minn. Sales}}{\text{Total Sales}} + \frac{\text{Minn. Payroll}}{\text{Total Payroll}} + \frac{\text{Minn. Tangible Prop.}}{\text{Total Tangible Prop.}}\right) \div 3 = \%\text{ to Minn.}$$

Using hypothetical percentages we secure a percent to Minnesota thus:

	Within Minn.	Without Minn.	Total Percent
Sales	40%	60%	100%
Payroll	50%	50%	100%
Tangible Property	70%	30%	100%
Divide by Three	160%/3		
Percent to Minnesota ..	53-1/3%		

(2) Under Minnesota Statutes, section 290.19, subdivision 1, clause (1)(d). ~~In-the-alternative~~ The following alternative formula ~~may-be~~ is employed if a lesser percentage to Minnesota results by its use:

$$70\%\text{ of }\frac{\text{Minn. Sales}}{\text{Total Sales}} + 15\%\text{ of }\frac{\text{Minn. Payroll}}{\text{Total Payroll}} + 15\%\text{ of }\frac{\text{Minn. Tang. Prop.}}{\text{Total Tang. Prop.}} = \%\text{ to Minn.}$$

An illustration of the weighing of the factors in the alternative formula as provided in Minnesota Statutes, section 290.19, subdivision 1, clause (1)(d) appears thus:

	Within Minn.	Weighted	Weighted Percentage
Sales	40%	70%	28.
Payroll	50%	15%	7.5
Tangible Property ...	70%	15%	10.5
Weighted averages percentage to Minnesota			46.0%

Since under the fact situation used in this illustration, the weighted average formula determines a lesser Minnesota percentage ratio, the weighted ratio ~~may-be~~ is used.

(c) Apportionment of net income under Minnesota Statutes, section 290.19, subdivision 1, clause (2). If the business does not consist of the manufacture and sale of personal property within and without the state, the taxable net income from such business shall be assigned to Minnesota on the basis of the percentage obtained by taking the arithmetic average of the three factors of (1) tangible property, (2) payroll, and (3) sales, gross earnings, or receipts, or on the basis of the percentage obtained by taking the weighted average of these three factors (15 percent of the Minnesota property percentage, 15 percent of the Minnesota payroll percentage, and 70 percent of the Minnesota sales, gross earnings, or receipts percentage), whichever is the lesser. The methods prescribed in this paragraph are presumed to properly reflect the taxable net income assignable to this state.

The single factor of sales, gross earnings, or receipts may be used only if (1) the use of the arithmetic average of the three factors or the use of the weighted average of those factors, whichever is the lesser, will not properly reflect the taxable net income assignable to this state, and (2) the use of the single factor of sales, gross earnings, or receipts will properly and fairly reflect such income.

The separate or segregated accounting method may be used only where the business carried on within this state is not a part of a unitary business carried on both within and without this state. If this method is used, it is subject to the same limitations as those set forth in the preceding paragraph.

(d) Definition of terms.

(1) Manufacture. Generally, the word "manufacture" is defined as the production of an article for use from raw or prepared materials by giving such materials new forms, qualities, or combinations, whether by hand labor or machine. Whether a taxpayer's business consists of manufacture of personal property is a question of fact to be determined in each individual case.

(2) The property element of the apportionment formula considered above shall include land, buildings, machinery, and equipment, inventories, and other tangible personal property

actually used by the taxpayer during the taxable year in carrying on the business activities of the taxpayer. Tangible property which is to be separately allocated under Minnesota Statutes, sections 290.17 and 290.18 may not be considered as property includible in the apportionment factor. Cash on hand or in banks, shares of stock, notes, bonds, accounts receivable, or other evidences of indebtedness, special privileges, franchises, and good will, are specifically excluded from the property factor. The value of tangible property which is owned by the taxpayer and which is to be used in the apportionment fraction shall be the original cost adjusted for any subsequent capital additions or improvements and partial disposition by reason of sale, exchange, or abandonment. Property which is rented by the taxpayer is valued at eight times the net annual rental ~~rate~~. Net annual rental ~~rate~~ is the annual rental ~~rate~~ paid by the taxpayer less any annual rental ~~rate~~ received by the taxpayer from subrentals. If the subrents taken into account in determining the net annual rental produce a negative or clearly inaccurate value for any item of property, another method which will properly reflect the value of rented property may be required by the Department of Revenue or requested by the taxpayer. In no case however shall such value be less than an amount which bears the same ratio to the annual rental paid by the taxpayer for such property as the fair market value of that portion of the property used by the taxpayer bears to the total fair market value of the rented property. The valuations of property both within and without Minnesota shall be the averages during the year and must be on a commensurate basis. Rents paid during the year must not be averaged. The changes made in this paragraph concerning the property factor are effective for taxable years beginning after December 31, 1982. A person filing a combined report shall use this method of calculating the property factor for all members of the group.

(3) The payroll element of the apportionment formula considered above shall be the payrolls paid or incurred by the taxpayer for the taxable year under review and wages or salaries

paid or incurred in Minnesota shall be determined to be paid or incurred in Minnesota provided the individual with respect to whom such wages or salaries are paid is either employed within this state or is actually engaged in work in the territorial confines of this state or, if working without this state, is identified with or accountable to an office within this state.

The wages or salaries paid to officers and employees working from Minnesota offices are considered as Minnesota payroll even though their employment requires them to spend working time without this state. Officers and employees whose employment requires them to work without the state entirely and who are assigned to an office without Minnesota, are not considered Minnesota employees for the purpose of apportionment even though their salaries are paid from the taxpayer's general offices in Minnesota.

13 MCAR S 1.6004 Minnesota gross income for individuals who are part-year residents or nonresidents of Minnesota (Federal Adjusted Gross Income).

A. Gross income.

1.-2. [Unchanged.]

3. The following types of income received by a nonresident in Minnesota are to be included in that individual's Minnesota gross income and are assignable to Minnesota:

a.-c. [Unchanged.]

d. Business income or losses.

(1) [Unchanged.]

(2) Business conducted within Minnesota and which has a nexus within Minnesota so that the business is subject to Minnesota income tax would include income or losses from sales whose destination is within Minnesota and a business dealing in personal and professional services where such services were performed in this state. Trade or business income or loss assignable to Minnesota and earned by a nonresident individual as a proprietorship or partnership which was carried on partly within and partly without Minnesota is subject to the three-factor apportionment formula contained in Minnesota

Statutes, section 290.19 or apportionment under Minnesota Statutes, section 290.20 , except for farm income or income from personal or professional services.

B.-H. [Unchanged.]

Repealer. Income tax rule 2017 (3) is repealed.

Effective date. The repeal of the last paragraph of income tax rule 2017 (3) relating to construction projects is effective for taxable years beginning after June 30, 1981.