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Multistate Tax
EXTERNAL ALERT

Minnesota Tax Court disallows "Compact" apportionment election

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Overview

In *Kimberly-Clark Corporation & Subsidiaries v. Commissioner of Revenue*, the Minnesota Tax Court (Tax Court) recently determined that the Minnesota Legislature's 1987 repeal of Articles III and IV of the Multistate Tax Compact (Compact) was valid and did not substantially impair a binding contractual obligation.[1] Therefore, the court held that Kimberly-Clark Corporation & Subsidiaries could not elect to compute their Minnesota corporate income tax liability for the 2007 through 2009 tax years pursuant to the equally weighted, three-factor apportionment formula (property, payroll, and sales) provided by Article III of the Compact (Compact election) in lieu of the three-factor formula with the sales factor more heavily weighted as provided under Minn. Stat. §290.191, Subd. 2(b).[2]

In this Tax Alert we summarize the Tax Court's decision in *Kimberly-Clark* and provide taxpayer considerations.

Background

The Compact, which became effective in 1967, was created by the states in response to federal proposals to regulate state taxation through the adoption of a uniform method of apportionment for state net income tax purposes. As part of the Compact, Article IV incorporates—almost verbatim—the provisions of the Uniform Division of Income for Tax Purposes Act, which provide for an equally weighted, three-factor apportionment formula. In addition, Article III of the Compact permits taxpayers to elect to use the income apportionment provisions of Article IV in lieu of other income tax apportionment rules that may be adopted by the member states.

In 1983 Minnesota enacted and codified the Compact, including Articles III and IV, in Minn. Stat. §290.171.[3] In 1987 Minnesota amended its version of the Compact to repeal Articles III and IV, with the remaining provisions of §290.171 continuing in effect.[4] Minnesota remained a Compact member state until 2013, when Minnesota withdrew from the Compact through the enactment of legislation repealing §290.171 in its entirety.[5]

In *Kimberly-Clark*, the taxpayer had filed its original corporate income tax returns for tax years 2007 through 2009 using the statutory Minnesota apportionment formula in effect during those years—namely, a three-factor formula with the sales factor more heavily weighted than the other two factors.[6] The taxpayer subsequently filed amended returns for the 2007 through 2009 tax years, electing to apportion its income under the Compact's equally weighted, three-factor apportionment formula provided in Article IV. The Minnesota Department of Revenue (Department) denied the taxpayer's Compact election and the taxpayer appealed the matter to the Tax Court.

Minnesota Tax Court decision—Compact election invalid

In the opinion written by Justices Delapena and Haluska (concurrence by Justice Turner), the Tax Court considered whether the Minnesota Legislature's 1987 repeal of Articles III and IV substantially impaired a contractual obligation arising from Minnesota's original enactment of the Compact in 1983, and whether such repeal was unconstitutional as a violation of the state and federal contracts clauses. In describing the applicable

[1] *Kimberly-Clark Corporation & Subsidiaries v. Commissioner of Revenue*, Minn. Tax Court Docket No. 8670-R (Jun. 19, 2015), slip op. at 57. A copy of this decision is accessible **here**.
[2] *Id.*
[3] Minn. Stat. §290.171; Laws 1983, Chapter 342, Article 16.
[4] H.F. 529, Chap. 268, Art. 1, Sec. 74, amending Minn. Stat. (1986), §290.171.
[5] H.F. 677, Chap. 143, Art. 13, Sec. 24, repealing Minn. Stat. (2012), §290.171.
[6] Minn. Stat. §290.191, Subd. 2(b).

standard of review, the court stated: "It is well settled that acts of the legislature are presumed to be constitutional and will not be declared unconstitutional unless their invalidity appears clearly or unless it is shown beyond a reasonable doubt that they violate some constitutional provisions."[7]

In its decision, the Tax Court noted a number of factors and concepts relevant to determining whether binding contractual obligations arising from the Compact were impaired, including:

- Initially assuming "(without deciding) that the Compact was a contract among Minnesota and the other States that adopted it and that the Compact created binding obligations."[8]
- "The rule of contract construction requiring that government contracts must be strictly construed against the relinquishment of sovereign powers, known as the 'unmistakability doctrine'[,]" applies to interstate compacts, including the Compact.[9]
- In the absence of language in the Compact clearly surrendering sovereign power to alter the apportionment election, extrinsic evidence, such as the Compact's history and the member states' course of performance, may be considered.[10]
- The question of whether the drafters of the Compact "would have considered an agreement surrendering the States' sovereign taxing powers" in order to achieve increased uniformity.[11]

Taking into account these and other relevant considerations, the Tax Court concluded that no Compact provision "constitutes a clear and unmistakable promise to refrain from using the State's sovereign power to alter the apportionment election provided by Articles III and IV."[12] In addition, the court determined that extrinsic evidence—notably that neither the Multistate Tax Commission nor any Compact member state has sought to pursue action against Compact member states that have altered or eliminated Article III and IV—"independently supports the conclusion that the Legislature's 1983 Compact enactment did not constitute a relinquishment of the State's sovereign power to alter or repeal the Compact's apportionment election."[13] Finally, the court found that the 1987 repeal of the Compact election and the apportionment provisions set forth in Articles III and IV, if overturned, would "retroactively block the Legislature's sovereign act of repealing the election[,]" and "would prevent the Commissioner from enforcing existing Minnesota law, which does not include the election."[14]

Based on the foregoing, and finding an absence of any clear Compact provision that would provide taxpayers a reasonable expectation that the Legislature would not alter or eliminate the apportionment election contained in Articles III and IV, the Tax Court concluded the Legislature's 1987 repeal of Articles III and IV did not substantially impair a contractual obligation.[15] The court concluded further that the taxpayer "has failed to carry its heavy burden to prove beyond a reasonable doubt that the Legislature's 1987 repeal of Articles III and IV was unconstitutional as a violation of the state and federal contract clauses."[16]

Considerations

The taxpayer has 60 days from the date of the Tax Court's decision to file a motion for reconsideration with the Minnesota Supreme Court.[17] Accordingly, the case is not yet final.

Taxpayers that have timely filed Minnesota tax returns seeking to make the Compact election may have received notices from the Department placing their claims in abeyance pending the decision in *Kimberly-Clark*. With respect to these taxpayers, it is presently unclear how the Tax Court's decision will affect the pending claims. It is possible that formal communication from the Department may be forthcoming in this regard.

[7] *Kimberly-Clark*, slip op. at 19.
[8] *Id*. at 26.
[9] *Id*.
[10] *Id*. at 41-42
[11] *Id*. at 45.
[12] *Id*. at 40.
[13] *Id*. at 55.
[14] *Id*. at 32.
[15] *Id*. at 57.
[16] *Id*.
[17] Minn. Stat. §271.10, Subd. 2.

Contacts

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