Minnesota Bill Would Expand Mutual Fund Services Tax

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By Aaron Davis

A Minnesota bill would expand a tax on mutual fund services performed by corporations so that it also applies to individuals and passthrough entities.

"Apparently, there is this loophole where we are capturing it for corporations but not individuals or partnerships, and they are using that to reduce tax liability in Minnesota," according to Rep. Jennifer Schultz (DFL), House Taxes Committee member and author of the bill, H.F. 1829. "These services are being provided in Minnesota, and they should be subject to taxation," she told *Tax Notes* March 6.

The state has market-based apportionment of receipts for services such as management of fund assets, accounting, distribution, and other administrative services. Under current law, "a corporation that sells management, distribution, or administrative services to an investment company such as a mutual fund must apportion its sales to Minnesota in proportion to the percentage of the fund's shareholders in the state," whereas the same services provided by an entity not organized as a corporation are apportioned "based on where the mutual fund is located," according to the bill's summary.

H.F. 1829 would specify that the law applies to services performed by a corporation or a person — which would include entities operating as passthroughs — for a fund of a corporation or a person.

The disparity in taxation for different types of entities following a state's move to market-based sourcing isn't unique to Minnesota. In general, the problem arises when there are different sourcing methods for corporations and individuals that are contained in different statutory sections, according to Tim Noonan, a partner with Hodgson Russ LLP.

"In fact, we have the same problem in New York. And it doesn't just impact mutual fund companies; it affects everybody. . . . When New York moved toward market sourcing in 2015 for corporations, it needed to make a corresponding change to the personal income tax law in order for a similar result to apply for passthroughs, and it failed to do so," Noonan told *Tax Notes*.

According to Minnesota Department of Revenue data, mutual fund service providers that operate as a partnership control an estimated 20 percent of all assets under management by mutual funds. Schultz said H.F. 1829 would affect 1,600 units and generate $6.3 million in fiscal 2020 and $12.5 million in fiscal 2022.

Changing the apportionment of noncorporate entities will reduce the tax liability for in-state businesses. "The move to what Minnesota is doing, and the move to market-based sourcing in general, is designed to export the tax base. You don't punish in-state companies for being based in your state," according to Noonan. "By changing it to where the customers are located, they bring in a lot more sources of revenue — all the companies that provide services to companies in the state."

A 2017 proposal by then-Gov. Mark Dayton would have closed the loophole, and a similar provision was included in a tax conformity omnibus bill legislators passed that year, but the bill was ultimately vetoed by the governor, according to Schultz.

"We don't know why they're not in the current governor's budget," she added.

H.F. 1829 is cosponsored by Reps. Jamie Becker-Finn (DFL), Aisha Gomez (DFL), Diane Loeffler (DFL), and Cheryl Youakim (DFL), also members of the House Taxes Committee.