

Code of Massachusetts Regulations

Department 830 CMR. DEPARTMENT OF REVENUE

Title 830 CMR 63.00. Taxation of corporations (§§ 63.29.1 to 63.42.1)

Section 63.38.1. Apportionment of Income

(1) Purpose, General Rule, Sham Transactions, and Outline.

(a) Purpose. The purpose of 830 CMR 63.38.1 is to explain the allocation and apportionment of income of business corporations, as provided in M.G.L. c. 63, § 38. 830 CMR 63.38.1 also governs the calculation of an apportionment percentage by other taxable entities when such entities are permitted or required to use the income apportionment method set out in M.G.L. c. 63, § 38. For example, 830 CMR 63.38.1 applies to manufacturing corporations; to S corporations and their shareholders, as described under M.G.L. c. 63, § 32D and M.G.L. c. 62, § 17A; and to nonresident individuals when permitted or required by 830 CMR 62.5A.1. However, except as expressly stated, 830 CMR 63.38.1 does not apply to income derived from mutual fund sales received by mutual fund service corporations within the meaning of M.G.L. c. 63, § 38(m). See 830 CMR 63.38.7. 830 CMR 63.38.1 also applies to corporations that are subject to combined reporting within the meaning of M.G.L. c. 63, § 32B, provided, however, that additional apportionment rules that apply in that context are set forth in 830 CMR 63.32B.2. Also, 830 CMR 63.38.1 applies to determine the apportionment percentage to be used to calculate, on a separate company basis, a corporation's non-income measure excise.

(b) General Rule. All of a taxpayer's taxable net income is allocated to Massachusetts if the taxpayer does not have income from business activity which is taxable in another state. If a taxpayer has income from business activity which is taxable both in Massachusetts and in another state, then the part of its net income derived from business carried on in Massachusetts is determined by multiplying all of its taxable net income by the three factor apportionment percentage as provided in M.G.L. c. 63, § 38(c) through (g) and 830 CMR 63.38.1. If a taxpayer with a Massachusetts commercial domicile has income from business activity which is taxable both in Massachusetts and in another state but also has an income stream that is prohibited from being taxed in another non-domiciliary state by reason of the U.S. Constitution, that income stream shall be allocated in full to Massachusetts.

(c) Exceptions to the General Rule. Notwithstanding the general rule set forth in 830 CMR 63.38.1(1)(b), the following taxpayers shall determine the part of their net income derived from business carried on in Massachusetts in the following manner:

1. Section 38 Manufacturers. If a section 38 manufacturer has income from business activity which is taxable both in Massachusetts and in another state, then the part of its net income derived from business carried on in Massachusetts is determined by multiplying all of its taxable net income, other than taxable net income derived from mutual fund sales received by a mutual fund service corporation, by the apportionment percentage provided in M.G.L. c. 63, § 38(l) and 830 CMR 63.38.1(10).

2. Mutual Fund Service Corporations. Regardless of whether it has income from business activity which is taxable both in Massachusetts and in another jurisdiction, a mutual fund service corporation shall apportion its taxable net income derived from mutual fund sales as provided in M.G.L. c. 63, § 38(m). Where a mutual fund service corporation has both taxable net income derived from mutual fund sales and other taxable net income, then the mutual fund service corporation shall allocate or apportion such other taxable net income as provided in 830 CMR 63.38.1 provided that the mutual fund service corporation shall determine such other taxable net income by taking into account only those deductions that are attributable to income from sources other than mutual fund sales.

(d) Sham Transactions. All transactions that determine a taxpayer's ability to apportion or determine the composition of a taxpayer's apportionment percentage are subject to the sham transaction doctrine and the related tax doctrines as set forth in M.G.L. c. 62C, § 3A.

(e) Outline. 830 CMR 63.38.1, is organized as follows:

1. Purpose, General Rule, Sham Transactions, and Outline
2. Definitions
3. Income Subject to Apportionment
4. Related Business Activities
5. Taxpayer and Taxpayer's Income Taxable in Another State
6. Consistent Accounting Method
7. Property Factor
8. Payroll Factor
9. Sales Factor
10. Section 38 Manufacturers
11. One or More Factors Inapplicable
12. Corporate Partners
13. Alternative Apportionment Methods
14. Effective Date

(2) Definitions. For the purposes of 830 CMR 63.38.1 the following terms have the following meanings unless the context requires otherwise:

Agent, any person whose actions would be imputed to a taxpayer under the standards of 830 CMR 63.39.1 for purposes of determining whether the taxpayer is doing business in Massachusetts (or another state). In general, any taxpayer employee or other representative acting under the direction and control of the taxpayer is an agent, provided that *bona fide* independent contractors retained by a taxpayer are not agents of the taxpayer.

Allocable Item of Income, in the instance of a taxpayer with income from business activity taxable in more than one state, income from a transaction or activity that, consistent with the U.S. Constitution, can only be taxed in the state of the taxpayer's commercial domicile, because the item of income was not derived from a unitary business or from transactions that serve an operational function.

Base of Operations, the taxpayer's place of business from which an employee customarily begins work or to which the employee customarily returns at some other time to receive instructions, direction, and supervision from the taxpayer or communications from customers or other persons, to replenish stock or other materials, to repair equipment, or to perform any other function necessary to the exercise of the employee's trade or profession.

Business Activity, all of a taxpayer's transactions and activities, regardless of classification or labels, occurring in the course of a taxpayer's trade or business, including, but not limited to "incidents" as described in M.G.L. c. 63, § 39(1) through (3). Business activities of an agent conducted on behalf of a principal are deemed to be the business activities of the principal.

Capital Asset, an asset as defined in 26 U.S. Code § 1221, as modified by M.G.L. c. 62, § 1(m) and 830 CMR 63.38.1(2). For purposes of 830 CMR 63.38.1, Capital Asset includes property used in a trade or business within the meaning of U.S. Code § 1231(b) without regard to the holding period requirement in U.S. Code § 1231(b), and property held in connection with a trade or business entered into for profit within the meaning of U.S. Code § 1231(a)(3)(A)(ii)(II) without regard to the holding period requirement in U.S. Code § 1231(a)(3)(A)(ii)(II).

Code, the Federal Internal Revenue Code in effect for the taxable year.

Commissioner, the Commissioner of Revenue or the Commissioner's duly authorized representative.

Corporate Partner, any corporation that is a partner in a partnership.

Corporation, a business corporation as defined in M.G.L. c. 63, § 30.1.

Documentary Evidence, journals, books of account, invoices, expense reports, or other records that are maintained by the taxpayer in the regular course of its business. Generally, an affidavit or other document prepared in anticipation of, or in connection with, a tax audit, examination, or litigation is not documentary evidence.

Domicile (or commercial domicile), the principal place from which the business activities of a taxpayer are directed or managed, or, in the case of a shareholder of a RIC, the domicile as described in 830 CMR 63.38.7(4)(c). If it is not possible to determine the principal place from which the business activities of a taxpayer are directed or managed, the state of the taxpayer's incorporation shall be considered to be its state of domicile.

Employee, in general, any officer of a corporation, or any person who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee. Generally, a person will be presumed to be an employee if such person is included by the taxpayer as an employee for purposes of the payroll taxes imposed by the Federal Insurance Contributions Act. However, for purposes of 830 CMR 63.38.1, a leased employee is an employee of the client (lessee) organization, and not an employee of the employee leasing company.

Employee Leasing Company, a business that contracts with a client company to supply workers to perform services for the client company; provided that, Employee Leasing Company does not include private employment agencies that provide workers to employers on a temporary help basis or entities such as driver-leasing companies which lease employees to another business to perform a specific service. See 430 CMR 5.07 through 5.13.

Income, taxable net income as defined in M.G.L. c. 63, § 38(a). Income encompasses both positive income and losses.

Independent Contractor, any person who performs services for a taxpayer but who is not an employee of the taxpayer, and who is not otherwise subject to the supervision or control of the taxpayer in the performance of the services. In general, a person is treated as an independent contractor with respect to a taxpayer if that person's actions would not be imputed to the taxpayer under the standards of 830 CMR 63.39.1 for purposes of determining whether the taxpayer is doing business in Massachusetts (or another state).

Leased Employee, a person who performs services for a client company pursuant to a contract between the client

company and an employee leasing company.

Manufacture, Manufacturing or Manufacturing Activity, the process of transforming raw or finished physical materials by hand or machinery, and through human skill and knowledge, into a new product possessing a new name, nature and adapted to a new use. In determining whether a process constitutes manufacture, manufacturing or manufacturing activity, the Commissioner will examine the facts and circumstances of each case in the manner set forth in the Manufacturing Corporation Regulation, *830 CMR 58.2.1(6)(b) and (c)*.

Mobile Property, motor vehicles, construction equipment, or other tangible personal property that an owner or lessee regularly moves from place to place in the course of its business. Property normally used in a fixed location is not mobile property merely because it happens to be moved into or out of Massachusetts or another state during the taxable year.

Mutual Fund Sales, mutual fund sales within the meaning of M.G.L. c. 63, § 38 and § 38(m)(1).

Mutual Fund Service Corporation, a mutual fund service corporation within the meaning of M.G.L. c. 63, § 38(m)(1).

Partnership and Partner, as a general rule, Partnership and Partner have the same meaning as in 26 U.S. Code § 7701, provided that Partnership and Partner shall also apply to other entities and their members treated as partnerships and partners for purposes of M.G.L. c. 62, § 17. Partnership does not include any trust or estate subject to taxation under M.G.L. c. 62 or any entity taxed as a corporation under M.G.L. c. 63.

Person, a natural or legal person, including, but not limited to, an individual, corporation, corporate trust, limited liability company, partnership, or S corporation.

Presumption, a conclusion of law or fact that is assumed to apply to a taxpayer unless the Commissioner or the taxpayer affirmatively rebuts the presumption by presenting contrary evidence of the actual facts and circumstances applicable to the taxpayer.

Receipts, consideration or value of any kind received from a taxpayer's business activity, including but not limited to cash, cash equivalents, payments in kind, and boot, that the taxpayer obtains from selling or providing property or services to another party. In the case of a sale, exchange or other disposition of a capital asset, including a transaction with respect to a capital asset that is deemed to be a sale or exchange under 26 U.S. Code, Receipts as used in 830 CMR 63.38.1 refers to the amount of the gain from the transaction. Receipts are subject to the Commissioner's adjustments under M.G.L. c. 63, § 39A.

Regulated Investment Company (RIC), a regulated investment company within the meaning of M.G.L. c. 63, § 38(m)(1).

Section 38 Manufacturer, a corporation that is engaged in manufacturing during the taxable year, and whose manufacturing activities during the taxable year are substantial within the meaning of 830 CMR 63.38.1(10)(b)2. and 3., regardless of whether the corporation is a manufacturing corporation under M.G.L. c. 63, § 42B, and regardless of whether the corporation is classified as a manufacturing corporation under M.G.L. c. 58, § 2 and 830 CMR 58.2.1: Manufacturing Corporations. As used in 830 CMR 63.38.1, Section 38 Manufacturer refers to a corporation that is a manufacturing corporation within the meaning of M.G.L. c. 63, § 38(l)1.

Security, any interest or instrument commonly treated as a "security," as well as other instruments which are customarily sold in a public or secondary market or on a recognized exchange, including, but not limited to, transferable shares of beneficial interest in any corporation or other entity, bonds, debentures, notes, and other evidences of indebtedness, accounts receivable and notes receivable, cash and cash equivalents including foreign

currencies, and futures contracts. A partnership interest will be treated as a security for purposes of 830 CMR 63.38.1 only in the case of a limited partnership whose activity is not attributed to its corporate limited partners under the provisions of 830 CMR 63.39.1(8) (Corporate Nexus). Security shall not be applied to the determination of security corporation classification under M.G.L. c. 63, § 38B.

State, any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or a political subdivision of any of the foregoing. M.G.L. c. 63, § 30.13.

State of the Purchaser, the state to which tangible personal property sold by a taxpayer is ultimately shipped or delivered. In the case of a third party recipient who receives the tangible personal property by direct shipment from the taxpayer at the direction of the purchaser, the "state of the purchaser" is the state of the third party recipient.

Tax or Taxes, with regard to Massachusetts, any tax or excise, including the corporate excise imposed under M.G.L. c. 63, § 39 or the personal income tax imposed under M.G.L. c. 62, § 4 as it applies under M.G.L. c. 62, § 5A for nonresidents, M.G.L. c. 62, § 17 for partners of partnerships, and M.G.L. c. 62, § 17A for shareholders of S corporations.

Taxable Net Income, the part of the net income of a taxpayer derived from the taxpayer's business activities carried on in Massachusetts and which is adjusted as required by the applicable provisions of M.G.L. c. 63, § 38(a) or M.G.L. c. 62, §§ 5A, 17, or 17A, or by regulation, in order to determine the base amount of income to be multiplied by the apportionment percentage.

Taxpayer, any person as defined in 830 CMR 63.38.1(2) who is entitled or required to allocate or apportion income under M.G.L. c. 63, § 38 and 830 CMR 63.38.1. In the case of a combined group within the meaning of M.G.L. c. 63 § 32B and 830 CMR 63.32B.2, any member of the group who is entitled or required to allocate or apportion income under M.G.L. c. 63, § 38 and 830 CMR 63.38.1 is a taxpayer.

Three Factor Apportionment Percentage, a fraction, the numerator of which consists of the property factor, payroll factor, and sales factor, and the denominator of which is the total number of factors utilized in the numerator. In the case of a taxpayer subject to tax under M.G.L. c. 63, § 38(c), or M.G.L. c. 62, §§ 5A, 17 or 17A, the numerator of the fraction is the property factor plus the payroll factor plus twice the sales factor, and the denominator of the fraction is four. The factors are computed in accordance with the provisions of 830 CMR 63.38.1.

Unrelated Business Activities, (or Unrelated Activities), two or more of a taxpayer's business activities that are not related business activities as defined in 830 CMR 63.38.1(4).

(3) Income Subject to Apportionment.

(a) General Rule. A taxpayer with income from business activity which is taxable both within and outside of Massachusetts must apportion its taxable net income to Massachusetts by multiplying its taxable net income, determined under M.G.L. c. 63, § 38(a), by the apportionment percentage determined under M.G.L. c. 63, § 38 and 830 CMR 63.38.1. For Massachusetts tax purposes, a taxpayer's income subject to apportionment is its entire income derived from its related business activities within and outside of Massachusetts not including any allocable items of income that either are or are not subject to the tax jurisdiction of Massachusetts.

(b) Corporations Subject to Combined Reporting. Corporations subject to combined reporting are subject to the apportionment rules in 830 CMR 63.31.1 and the apportionment provisions of 830 CMR 63.32B.2.

(c) Treatment of an Allocable Item of Income. An allocable item of income is allocated to Massachusetts and

therefore not subject to apportionment if the taxpayer's commercial domicile is in the Commonwealth. Consequently, in such cases, any property or payroll utilized in, or sales that derive from, activity or transactions that generate an allocable item of income are excluded from the taxpayer's apportionment factors, in the case of property or payroll, to the extent that the property or payroll generated the item of income and, in the case of sales, to the extent that the sales derived from the item of income. An allocable item of income is not allocated to Massachusetts if the taxpayer's commercial domicile is outside the Commonwealth.

(d) Treatment of Income Derived from Unrelated Activities. If a taxpayer has one or more items of income derived from unrelated business activities, as determined under 830 CMR 63.38.1(4), the items of income will be excluded from the taxpayer's taxable net income and will not be apportioned to Massachusetts if Massachusetts does not have jurisdiction to tax the items of income under the constitution of the United States. A taxpayer must disclose on its return the nature and amount of any item of income that is derived from unrelated business activities and is excluded from (or is excludable from) taxable net income. The taxpayer must also disclose and exclude expenses allocable in whole or part to such unrelated business activities. M.G.L. c. 63, § 30.4. Any property or payroll utilized in, or sales that derive from, unrelated business activity are excluded from the taxpayer's apportionment factors if the income from the unrelated activity is not subject to tax in Massachusetts, in the case of property or payroll, to the extent that the property or payroll generated the item of income and, in the case of sales, to the extent that the sales derived from the item of income.

Example 1. Famous Corporation is a corporation doing business in Massachusetts but domiciled in another state. Famous acquires a minority interest in the shares of Unknown Corporation as a long-term investment. The operations of Famous and Unknown are not related business activities. Any gain or loss on the sale of the Unknown stock is excluded from Famous' taxable net income and is not apportioned to Massachusetts. Famous must disclose the nature and amount of the excluded gain or loss on its Massachusetts return.

Example 2. Local Corporation is a corporation doing business and domiciled in Massachusetts. Local acquires a minority interest in the shares of Distant Corporation as a long-term investment. The operations of Local and Distant are not related business activities. Any gain or loss on the sale of Distant stock is included in Local's taxable net income and is allocated to Massachusetts.

(4) Related Business Activities.

(a) Definition.

1. General Rule. Related business activities are activities where there is a sharing or exchange of value between the segments of a single entity or multiple entities such that the activities are mutually beneficial, interdependent, integrated, or such that they otherwise contribute to one another. In general, any two segments or activities of a single corporation (or other taxpayer) are related business activities unless the two segments or activities are not unitary under U.S. constitutional principles. In addition, some activities are related business activities notwithstanding the absence of a unitary relationship, *e.g.*, the short term investment of capital in a non-unitary business segment or activity.

2. Income from Cash, Cash Equivalents, and Short-term Securities. Interest or other income from cash deposits, cash equivalents, and short-term securities is considered related business income if such capital serves or performs an operational function. Without limitation, examples of operational functions include: the use or holding of funds as working capital or reserves; the use or holding of funds to maintain a favorable credit rating (*e.g.* by maintaining a strong current or quick asset ratio); the use or holding of funds to self-insure against business risks; and the interim investment of funds pending their future use in the taxpayer's business.

(b) Determination of Related Business Activities. The determination of whether business activities are related will turn on the facts and circumstances of each case. The presence of related business activities between two business entities may be demonstrated by the vertical or horizontal integration of the two entities, or by other indicia of related business activity including, but not limited to: sales, exchanges, or transfers between the entities; common marketing; transfer or pooling of technical information; common purchasing; other common operations or systems; or centralized management. In determining the presence of related business activities, a taxpayer's business activities, both within and outside of Massachusetts, its organizational structure, and the underlying economic realities applicable to its business, must be considered as a whole.

(c) Burden of Proof. Except as provided in 830 CMR 63.38.1(4)(d) (relating to corporate limited partners), all income of a single taxpayer (whether derived directly or through agents, partnerships, or other entities whose activities are attributed to the taxpayer) is presumed to be income from related business activities until the contrary is established. Either the taxpayer or the Commissioner may assert that an item of a taxpayer's income is derived from unrelated business activities. The party making such an assertion must prove by clear and cogent evidence that, in the aggregate, the related business factors at 830 CMR 63.38.1(4)(b), do not reasonably warrant a finding that the business activities are related. To demonstrate that income from cash, cash equivalents, or short-term securities is derived from unrelated business activities, a taxpayer must prove by clear and cogent evidence that the underlying assets and their acquisition, maintenance, and management were, in fact, unrelated to the taxpayer's business activities in the Commonwealth.

(d) Presumption of Unrelated Business Activity of Corporate Limited Partners. In cases where a corporate limited partner owns, either directly or indirectly (including all interests of any party whose direct or indirect stock ownership would be attributed to the corporate limited partner under the provisions of 26 U.S. Code § 318), less than 50% of either the capital or profit interests of a partnership and the business activity of the limited partnership is attributed to the corporate limited partner under 830 CMR 63.39.1(8), the business activity of the limited partnership is presumed to be unrelated to the corporation's other business activities unless the Commissioner or the taxpayer rebuts this presumption. If the business activities of the partnership and the corporate limited partner are unrelated, then the corporate limited partner must separately account for its income from the holding or disposition of its limited partnership interest and its other business income and must separately apportion to Massachusetts income from each unrelated activity (to the extent that Massachusetts has jurisdiction to tax income from each such activity), using only the apportionment factors applicable to that activity. The separate accounting shall apply both to the determination of income subject to apportionment under M.G.L. c. 63, § 2A, 38 or 42, and to the determination of the non-income measure under M.G.L. c. 63, § 39(a)(1).

Either the Commissioner or a taxpayer may rebut the presumption of unrelated business activity by demonstrating that the corporate limited partner and the partnership are engaged in a unitary business. If a corporate limited partner has engaged in a unitary business with the partnership in one or more taxable years, the corporate limited partner may not separately account in any such taxable year for the income it derives from the partnership. Instead, the corporate limited partner shall apportion to Massachusetts all income derived from business activity carried on within the commonwealth, including income derived from its partnership interest, in accordance with the rules of M.G.L. c. 63, § 2A, 38 or 42 using the corporate limited partner's own property, payroll, and sales plus its *pro rata* portion of the partnership's property, payroll, and sales to determine an apportionment percentage.

Example 1. Corporation A, which is domiciled outside of Massachusetts, owns a minority limited partnership interest in Partnership A. Partnership A conducts business in Massachusetts. Apart from this partnership holding, Corporation A does not conduct business in Massachusetts. Neither Corporation A nor the Commissioner rebuts the presumption that the business activities of Corporation A and Partnership A are

unrelated. Corporation A must separately apportion to Massachusetts income from the holding or disposition of its interest in Partnership A, using the apportionment factors derived from the partnership's activity. Income from Corporation A's other activities is not subject to Massachusetts tax jurisdiction and is excluded from the Corporation's taxable net income.

Example 2. Corporation B, which is domiciled outside of Massachusetts, conducts business in Massachusetts and, in addition, owns a minority limited partnership interest in Partnership B. Partnership B does not conduct business in Massachusetts. Neither Corporation B nor the Commissioner rebuts the presumption that the business activities of Corporation B and Partnership B are unrelated. Income from Corporation B's holding or disposition of its interest in Partnership B is not subject to Massachusetts tax jurisdiction and is excluded from the Corporation's taxable net income. Corporation B must apportion the balance of its income to Massachusetts using the apportionment factors derived from its other activities.

Example 3. Corporation C is domiciled in Massachusetts and holds a minority limited partnership interest in Partnership C. Partnership C may or may not be engaged in business in Massachusetts. Neither Corporation C nor the Commissioner rebuts the presumption that the activities of Corporation C and Partnership C are unrelated. Corporation C must separately apportion to Massachusetts income derived from its interest in Partnership C, using the apportionment factors derived from the partnership's activity. Corporation C must apportion the balance of its income to Massachusetts using the apportionment factors derived from its other activities. The taxable net income of Corporation C is the sum of these separately apportioned amounts.

(e) Evidentiary Matters. In determining whether two business activities conducted by a taxpayer are related, the Commissioner will apply the following evidentiary rules.

1. Production of Evidence. Failure by the taxpayer to produce evidence that is in the control of either the taxpayer or an entity controlled by the taxpayer gives rise to an inference that the evidence is unfavorable.

2. Reporting Consistency. A taxpayer must assert claims of unrelated business activity consistently from year to year on its Massachusetts returns. A taxpayer must also consistently treat items of income as constitutionally apportionable or non-apportionable on returns filed in various states where the taxpayer is subject to tax unless such consistency is precluded by differences in the statutory allocation and apportionment rules of the various states in which the taxpayer is subject to tax. The provisions of 830 CMR 63.38.1(4)(b) notwithstanding, if a taxpayer claims on a return filed with Massachusetts or another state in any taxable year that income from a particular activity is apportionable income, such claims may be considered as evidence that the income is from a related business activity and is subject to apportionment in Massachusetts in the current taxable year.

3. Disallowance of Expenses. In each taxable year in which expenses are allocable to two or more business activities, the taxpayer must disclose and distinguish expenses allocable in whole or part to each business activity. If the business activity to which an expense is allocable is not subject to tax in Massachusetts, the expense must be excluded. M.G.L. c. 63, § 30.4. The Commissioner may consider a taxpayer's failure, in any taxable year, to disclose and distinguish the expenses associated with specific business activities as evidence that those activities are not, in fact, unrelated to the taxpayer's business activities in Massachusetts.

(5) Taxpayer or Taxpayer's Income Taxable in Another State. A taxpayer is required to apportion its income when it has income from business activity that is taxable both in Massachusetts and at least one other state. For purposes of 830 CMR 63.38.1(5), taxable has the meaning set forth in 830 CMR 63.38.1(5) (b). This standard is not satisfied as to such other state merely because the taxpayer is incorporated in such state or files a return in that state that relates to a capital stock tax or a franchise tax for the privilege of doing business.

For purposes of determining a taxpayer's apportionment percentage under 830 CMR 63.38.1(9)(c)2., pertaining to throwback sales, a taxpayer is taxable in another state if it meets either test set forth in 830 CMR 63.38.1(5)(a) or (b) for all or part of the taxable year.

The provisions in 830 CMR 63.38.1(5) also applies to corporate partners as set forth in 830 CMR 63.38.1(12).

(a) Subject to Tax. A taxpayer is considered taxable in another state if the taxpayer is "subject to" a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax imposed by that state. Whether or not a taxpayer is subject to any such tax depends upon the nature and substance of the tax and not upon its form or title.

1. Evidence That Corporation is Subject to Tax. Any taxpayer that claims it is subject to one of the taxes described in M.G.L. c. 63, § 38(b)(1) and 830 CMR 63.38.1(5)(a) in another state must furnish to the Commissioner upon request documentary evidence to support the claim. The documentary evidence should include proof that the taxpayer has filed the requisite tax return and has paid the tax due. A taxpayer that does not establish that it has filed a return and paid the tax due in a particular state is presumed not to be subject to tax in that state.

2. Voluntary Filing Insufficient. A voluntary filing in another state not required by the law of such other state does not cause the taxpayer to be subject to tax in that state.

3. Abatements. A taxpayer that has filed a return in another state and paid tax to that state nevertheless is presumed not to be subject to tax in that state if the taxpayer has filed an abatement application or similar claim in that state alleging that it is not subject to tax in such state.

(b) Jurisdiction to Tax. A taxpayer is considered taxable in another state if that other state has jurisdiction to subject the taxpayer to a net income tax, regardless of whether, in fact, the state does or does not impose such a tax on the taxpayer.

1. Standard Used. Another state has jurisdiction to subject the taxpayer to a tax with respect to a business activity if, under the Constitution and laws of the United States, the taxpayer's business activity could be taxed in Massachusetts under the same facts and circumstances that exist in the other state. A state does not have such jurisdiction where, inter alia, the state is prohibited from imposing the tax by reason of the provisions of P.L. 86-272, 15 U.S.C. §§ 381 through 384.

2. Evidence of Jurisdiction to Tax. The Commissioner will presume that any activities of a corporation in another state are protected from the other state's tax jurisdiction by federal law, including P.L. 86-272, if the corporation does not file returns in that jurisdiction. Any taxpayer that claims to be subject to the tax jurisdiction of another state must furnish evidence to the Commissioner upon request to substantiate the claim. Documentary evidence contemporaneous with the events in question will be given greater weight than affidavits or other evidence not contemporaneous with those events in determining whether the taxpayer's activities subject it to another state's jurisdiction.

In addition to documentary evidence, the Commissioner will generally recognize that another state has jurisdiction to subject a particular taxpayer to a net income tax if the state has issued a written opinion to the taxpayer to that effect, provided that:

- a. the opinion is issued by a competent governmental authority in the other state;
- b. the opinion identifies the particular taxpayer and tax period to which it applies; and

c. the opinion is based on an evaluation of the activities of the taxpayer viewed as a separate entity, rather than upon activities that may be conducted by unitary affiliates of the taxpayer in the other state.

The following examples illustrate the application of 830 CMR 63.38.1(5)(a) and (b).

Example 1. In Year 1, a corporation that is incorporated in Massachusetts ("Corporation") and has business activities in Massachusetts is also engaged in the solicitation of sales of tangible personal property in Nevada, which does not impose a corporate income tax. In addition, if Nevada imposed a corporate income tax, the imposition of that tax would be proscribed by the provisions of the Federal law, Public Law 86-272. Although Corporation is engaged in business activity in both Massachusetts and one other state, it does not have income from business activity in a state other than Massachusetts that is taxable in such state. Therefore, all of Corporation's income from its business activities is allocated to Massachusetts. (Note that if Corporation were entitled to apportion its income by reason of its activities in an additional state, it would not be taxable in Nevada for purposes of determining its throwback sales under 830 CMR 63.38.1(9)(c)2. See 830 CMR 63.38.1(5)(a) and (b).)

Example 2. Same facts as in Example 1, except that in Year 2, Corporation undergoes an F reorganization under the Code and, as a result of this reorganization, is re-incorporated in Delaware. Merely as a result of this re-incorporation, Corporation is required to file a franchise tax return for the privilege of doing business in Delaware. Although Corporation is required to make a franchise tax filing in Delaware, Corporation is not engaged in business activity in that state. It continues to be the case that Corporation does not have income from business activity in a state other than Massachusetts that is taxable in such state. Therefore, all of Corporation's income from its business activities is allocated to Massachusetts. (Note that if Corporation were entitled to apportion its income by reason of its activities in an additional state, it would not be taxable in Nevada but would be taxable in Delaware for purposes of determining its throwback sales under 830 CMR 63.38.1(9)(c)2. See 830 CMR 63.38.1(5)(a) and (b).)

Example 3. Same facts as in Example 2, except that in Year 3, apart from its Massachusetts business activities, Corporation is also engaged in the solicitation of sales of tangible personal property in both Nevada and Pennsylvania. Although Pennsylvania imposes an income tax on corporations, Corporation is protected from the imposition of this tax by the application of the Federal law, Public Law 86-272. Pennsylvania also imposes a capital stock tax, which that state does impose upon Corporation. Although Corporation is subject to the Pennsylvania capital stock tax, this tax is not a tax on the Corporation's income from business activity in Pennsylvania. It continues to be the case that Corporation does not have income from business activity in a state other than Massachusetts that is taxable in such state. Therefore, all of Corporation's income from its business activities is allocated to Massachusetts. (Note that if Corporation were entitled to apportion its income by reason of its activities in an additional state, it would not be taxable in Nevada but would be taxable in Delaware and Pennsylvania for purposes of determining its throwback sales under 830 CMR 63.38.1(9)(c)2. See 830 CMR 63.38.1(5)(a) and (b).)

Example 4. Same facts as in Example 3, except that in Year 4, apart from its Massachusetts business activities and its sales solicitation activities in Nevada and Pennsylvania, Corporation also opens a sales office in Nevada. Nevada does not impose a corporate income tax. However, if Nevada imposed a corporate income tax, Corporation would no longer be protected from the imposition of this tax by the application of the Federal law, Public Law 86-272. Therefore, Corporation has income from business activity that is taxable in one state other than Massachusetts,

and is required to apportion its income. For purposes of determining Corporation's throwback sales under 830 CMR 63.38.1(9)(c)2., Corporation is taxable in Nevada and also Pennsylvania and Delaware. See 830 CMR 63.38.1(5)(a) and (b).

3. "States" Outside the United States.

a. In the case of any foreign country or any other "state" as defined in M.G.L. c. 63, § 30.13 and 830 CMR 63.38.1(2), other than a state of the United States or political subdivision of a state of the United States, the determination of whether such state has jurisdiction to subject the taxpayer to a net income tax is made as though the federal jurisdictional standards of the United States applied in that state. If jurisdiction to tax is otherwise present, a foreign state is not considered to lack jurisdiction by reason of the provisions of a treaty between the foreign state and the United States or by reason of the provisions of P.L. 86-272, 15 U.S.C. §§ 381 through 384.

b. For purposes of determining whether a taxpayer must allocate its income to Massachusetts under M.G.L. c. 63, § 38(b), or apportion its income to Massachusetts under M.G.L. c. 63, § 38(c), a taxpayer is not subject to tax in a foreign state merely by virtue of the taxpayer's sales of tangible personal property to purchasers in the foreign state. However, if a taxpayer engaged in making such sales is otherwise entitled to apportion its income under M.G.L. c. 63, § 38(c), and must therefore calculate a sales factor under M.G.L. c. 63, § 38(f), then solely for purposes of calculating its sales factor, such taxpayer will be deemed to be taxable in a foreign state whenever it ships or delivers the tangible personal property sold to a purchaser in that foreign state. See 830 CMR 63.38.1(9)(c)2.b.ii. The deemed taxability applies only where a taxpayer is engaged in making sales of tangible personal property in a foreign state and, for example, does not apply where a taxpayer is engaged only in selling services or licensing intangible property in a foreign state. In the latter cases, 830 CMR 63.38.1(5)(b)3.a applies.

(c) Separate Company Determination; Combined Reporting. Except as otherwise provided herein, an individual corporation is subject to tax in another state or subject to the tax jurisdiction of another state for purposes of 830 CMR 63.38.1(5)(a) or (b) only on the basis of the separate activities of that individual corporation, including without limitation activities attributed to that corporation through partnerships engaged in related business activities with the corporate partner, as described in 830 CMR 63.39.1 (Corporate Nexus). In the instance of a taxpayer that is a taxable member of a combined group within the meaning of M.G.L. c. 63 § 32B and 830 CMR 63.32B.2, such taxable member is considered taxable in any state in which any member of its combined group is subject to tax with respect to income derived from the group's unitary business (or, in the case of an affiliated group election, in any state in which a member of the combined group is taxable). See 830 CMR 63.32B.2(7)(c). The rule in the preceding sentence applies only if at least one member of the combined group is entitled to apportion its income under M.G.L. c. 63 for the taxable year in question. *Id.*

(6) Consistent Accounting Method.

(a) To the extent not inconsistent with the provisions of M.G.L. c. 63, § 38, or 830 CMR 63.38.1, amounts included in the factors of the apportionment percentage must be determined by the same accounting method as the taxpayer uses in determining its federal taxable income for the same taxable period. If a taxpayer changes its accounting methods for Massachusetts tax purposes but does not simultaneously change its federal accounting methods, the taxpayer shall take into account adjustments necessary to prevent amounts from being duplicated or omitted from the taxpayer's taxable net income and apportionment factors, utilizing the rules and principles of 26 U.S. Code § 481(a) ("Adjustments required in method of accounting").

(b) A taxpayer's taxable year for Massachusetts tax purposes is any fiscal or calendar year or period for which the

taxpayer is required to file a federal return. A taxpayer that engages in business in Massachusetts for all or part of its taxable year must file a Massachusetts return for the full federal year or period, and the apportionment factors must reflect the full year or period. In the case of a "short" federal tax year for which a separate federal return is required, the taxpayer must file a Massachusetts return for the same short year, and the apportionment factors on the return shall reflect the taxpayer's activity during only the short year. The non-income measure of excise is prorated for short taxable years under M.G.L. c. 63, § 39, but the excise attributable to income earned during a short taxable year is not prorated.

(7) Property Factor. The property factor is a fraction the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in Massachusetts during the taxable year and the denominator of which is the average value of all of its real and tangible personal property owned or rented and used during the taxable year.

(a) Real and Tangible Personal Property. Real and Tangible Personal Property includes land, buildings, machinery, stock of goods, equipment, and other real and tangible personal property, but does not include coin and currency unless held as a stock of goods for resale. Leaseholds and leasehold improvements, whether located within or without Massachusetts, are included within the meaning of "real and tangible personal property", regardless of whether the taxpayer is entitled to remove the improvements or the improvements revert to the lessor upon expiration of the lease. In general, any real or tangible property whose cost is not capitalized, but is directly expensed, for federal income tax purposes is excluded from the numerator and denominator of the property factor, provided that this exclusion shall not apply to otherwise depreciable property whose cost is expensed pursuant to an election under the Code, such as the election to expense under 26 U.S. Code § 179.

(b) Property Used During the Taxable Year. Real or tangible personal property owned or leased by a taxpayer during the taxable year is included in the property factor if it is used directly or indirectly during the taxable year for the production of business income. Real or tangible personal property of a type that is depreciable under 26 U.S. Code § 167 is considered to be used by the taxpayer for the production of business income when it has been placed in service within the meaning of Treas. Reg. § 1.167(a) through 10(b), provided that the property has not been retired within the meaning of Treas. Reg. § 1.167(a) through 8. Property or equipment under construction shall be included in the property factor of a construction contractor to the extent that the work completed exceeds progress payments received by the contractor. Real or tangible personal property of a type that is not depreciable under 26 U.S. Code § 167 is presumed to be used directly or indirectly for the production of business income unless the taxpayer or the Commissioner rebuts this presumption under the facts of a particular case.

(c) Property in Transit. Property in transit between locations of the taxpayer to which it belongs shall be considered to be at its destination for purposes of the property factor. Property in transit between a buyer and seller which is included by a taxpayer in the denominator of its property factor in accordance with its regular accounting practices shall be included in the numerator according to the state of destination. If goods in transit to a buyer are included in the property factor of a seller, such state of destination for property factor purposes shall be the state in which the seller's possession and control of the property is transferred to the buyer. (830 CMR 63.38.1(9)(c)1.a.i through iv. shall not apply to the property factor).

(d) Mobile Property. If a taxpayer owns or rents mobile property, as defined in 830 CMR 63.38.1(2), and such property is used both within and outside of Massachusetts during the taxable year, the numerator of the taxpayer's property factor shall include the value of the property multiplied by a percentage which represents the use of the property in Massachusetts relative to its use everywhere during the taxable year. Except as otherwise required by special apportionment regulations promulgated under the authority of M.G.L. c. 63, § 38(j), a taxpayer may elect to use any reasonable method for determining the percentage of use of its mobile property in Massachusetts. The election is made by filing a return that employs the chosen method for the first tax year, ending on or after August

11, 1995 (the date on which the first version of 830 CMR 63.38.1 was promulgated), in which the taxpayer owns or rents mobile property and apportions income to Massachusetts. The taxpayer must attach a statement to its return describing the method chosen and must use the same method consistently from year to year. The taxpayer must maintain records adequate to substantiate its calculations. Once a taxpayer elects a particular method, it may supplement its election prospectively with respect to new types of mobile property that it may acquire in future years, but the Commissioner generally will not allow a change in any method, once elected, either upon application for abatement or upon filing of returns for future years, unless the former method does not reasonably reflect the taxpayer's use of mobile property in Massachusetts. In the case of a lease or rental of mobile property, the rules of assignment set forth in 830 CMR 63.38.1(7)(d) apply to both the lessor and the lessee of the property.

The Commissioner will presume that the methods stated in 830 CMR 63.38.1(7)(d)1. through 4. reasonably approximate the use of mobile property in Massachusetts.

1. A taxpayer may determine the use of mobile property in Massachusetts based upon the proportion of time during the taxable year that the property is owned or rented by a taxpayer and in actual use in Massachusetts relative to the total time during the taxable year that the property is owned or rented by the taxpayer and in actual use in jurisdictions where the taxpayer is subject to tax.

2. A taxpayer may attribute the use of on-road vehicles owned or rented by the taxpayer to Massachusetts by a fraction, the numerator of which is the miles such vehicles were driven in Massachusetts during the taxable year, and the denominator of which is the number of miles that the vehicles were driven during the taxable year in jurisdictions where the taxpayer is subject to tax. A taxpayer may maintain mileage records on a per-vehicle basis or, if a taxpayer owns or rents a fleet of vehicles that is located both within and outside of Massachusetts, on a fleet basis, provided that all vehicles in a fleet must be of a substantially similar type and value.

3. A taxpayer may attribute the use of an automobile assigned to a traveling employee to the state in which the automobile is registered, provided that the taxpayer uses this method for all of its automobiles assigned to traveling employees.

4. A taxpayer may attribute the entire use of an item of mobile property owned or rented by the taxpayer to the state in which the property is located for 80% or more of the taxable year, provided that any taxpayer electing this method must use it with respect to all items of mobile property that it owns or rents during the taxable year and that are located in any one state for at least 80% of the taxable year.

(e) Valuation of Property Owned. Property owned by the taxpayer is valued at its original cost. Without limitation, property owned by a taxpayer includes property leased to another, provided that the transaction is treated as a lease, rather than as a conditional sale, for federal income tax purposes.

1. Original Cost. As a general rule, Original Cost means the basis of the property for federal income tax purposes (prior to any federal adjustments) at the time of acquisition by the taxpayer and adjusted by subsequent capital additions or improvements thereto and partial disposition thereof, as, for example, by reason of sale, exchange, or abandonment, but not adjusted for subsequent depreciation. However, 830 CMR 63.38.1(7)(e)1.a. through d. shall apply.

a. If the original cost of property is not ascertainable, the property is included in the factor at its fair market value on the date of acquisition by the taxpayer.

b. Generally, if a taxpayer acquires assets in a transaction in which the transferor does not recognize gain or loss under 26 U.S. Code, such as a reorganization, liquidation, gift, or contribution to capital, and if

under 26 U.S. Code the acquiring taxpayer carries over the transferor's basis (or adjusted basis), then the original cost to the acquiring taxpayer is the same as the original cost to the transferor.

c. If a taxpayer acquires assets in a transaction in which, under 26 U.S. Code, there is a step-up in basis, (e.g. 26 U.S. Code § 338 election), then the original cost to the acquiring taxpayer for purposes of valuation of property is the stepped-up basis.

d. The original cost of property acquired by a taxpayer in a like-kind exchange is the original cost of the property transferred by the taxpayer, plus any gain that 26 U.S. Code requires the taxpayer to recognize on account of the exchange.

2. Inventory or Stock of Goods. Inventory or stock of goods is included in the property factor in accordance with the valuation method used for federal income tax purposes. Consigned inventory owned by the taxpayer is included in the property factor.

3. Averaging Property Values. As a general rule, the average value of property owned by a taxpayer is determined by averaging the values at the beginning and end of the taxable year. However, the Commissioner may require averaging by monthly values if such method is required to reflect properly the average value of the taxpayer's property for the tax period. Averaging by monthly values will generally be applied if substantial changes or fluctuations in the values of the property occur during the taxable year or where property is acquired after the beginning of the taxable year or disposed of before the end of the taxable year. When a corporation makes a final disposition of its assets or liquidates, thus terminating its taxable year (and the last month of such year), the value of its items of property for such end of year (and month) shall be the value of such items at the commencement of business on such day of final disposition or liquidation.

(f) Valuation of Rented Property. Property rented by the taxpayer is valued at eight times its net annual rent, provided that such rate reflects the fair rental value of the property as of the date of the rental agreement.

1. Items Included in Rent. Rent is the actual sum in money or other consideration payable directly or indirectly by the taxpayer or for its benefit for the use of property, regardless of how such amounts may be designated. Rents include amounts that are calculated as a percentage of sales or profits, and amounts payable as additional rent or in lieu of rent, such as interest, taxes, insurance, repairs, or any other items which are required to be paid by the terms of the rental agreement. Rent does not include travel expenses such as hotel or motel accommodations, or amounts paid to a lessor as *bona fide* service charges, such as payments for separately metered utilities, janitorial services, or other *bona fide* services provided to a lessee that the lessee might, in regular commercial practice, obtain from a party other than the lessor. If a payment includes rent and *bona fide* service charges, and the amounts are not segregated, the amount of the rental shall be determined on the basis of the relative fair market values of the property and the services provided.

The following examples illustrate the application of 830 CMR 63.38.1(7)(f)1.:

Example 1. Pursuant to the terms of a lease of real property, a taxpayer pays the lessor \$12,000 a year rent, which includes a \$1,200 fee for janitorial services. Additionally, the taxpayer pays taxes in the amount of \$2,000 and interest in the amount of \$1,000. The annual rent is \$13,800.

Example 2. A taxpayer stores part of its inventory in a public warehouse. Under the terms of the contract, the total charge for the year is \$1,000, of which \$700 was for the exclusive use of a designated storage space and \$300 for inventory insurance, handling and shipping charges, and C.O.D. collections. The annual rent is \$700.

2. Annual Rent. As a general rule, the annual rental is the amount paid as rent for property for a 12-month period. Where property is rented for less than a 12-month period, the amount paid for the actual rental period shall be considered to be the annual rent for the tax period. However, in the case of a short taxable year, the rent paid for the short tax period shall be annualized.

3. Net Annual Rent. Net annual rent is the annual rental paid by the taxpayer, less the aggregate annual subrentals paid by subtenants of the taxpayer. The net annual rent may not be less than an amount which bears the same relation to the annual rent paid by the taxpayer as the property used by the taxpayer bears to the total property.

The following example illustrates the application of 830 CMR 63.38.1(7)(f)3.:

A corporation rents a ten-story building at an annual rent of \$1,000,000. It occupies two stories and sublets eight stories for \$1,000,000 a year. The net annual rent of the corporation must not be less than two-tenths of the corporation's annual rent for the entire year, or \$200,000.

4. Property Used at No Charge or Nominal Rent. If property owned by others is used by the taxpayer at no charge or rented by the taxpayer for a nominal amount, the net annual rent for such property shall be the fair market rental value for such property, as determined on the basis of rentals of substantially similar properties in the same market in transactions negotiated at arm's length. However, all rentals of property from federal or state governmental entities shall be deemed to be at fair value.

(g) Property Reporting Consistency. A taxpayer must use the same rules for valuing property or for including or excluding types of property in both the numerator and the denominator of the property factor. If a taxpayer changes its method of valuing property, or of excluding or including property in the property factor, from the method used in its return in the prior year, the taxpayer must disclose in the return for the current year the presence of such change, the nature and extent of the change, and the reason for the change. The Commissioner may disregard changes in the current year or in future tax years if they have not been adequately disclosed.

(8) Payroll Factor. The payroll factor is a fraction the numerator of which is the total amount paid for compensation in Massachusetts during the taxable year by the taxpayer and the denominator of which is the total amount paid for compensation everywhere during the taxable year.

(a) Effect of Method of Accounting.

1. General Rule. The total amount paid for compensation is computed on the cash basis, as reported for unemployment compensation purposes.

2. Alternative Accrual Method Election. Notwithstanding 830 CMR 63.38.1(8)(a)1., a taxpayer that uses the accrual method of accounting in computing its taxable net income may elect for purposes of 830 CMR 63.38.1(8) to use the accrual method in determining the total amount of compensation paid in Massachusetts during the taxable year.

a. Election. In order to elect the accrual method, a taxpayer must properly complete and file its return reporting the total compensation accrued during the taxable year along with an electing statement that "pursuant to 830 CMR 63.38.1(8)(a)2.a., the taxpayer is electing the accrual method of accounting for purposes of computing the payroll factor." An election by the taxpayer is binding for all subsequent taxable years except as provided at 830 CMR 63.38.1(8)(a)2.b.

b. Revocation of Election. A taxpayer may not revoke an election under 830 CMR 63.38.1(8)(a)2. to use

the accrual method of accounting for determining the payroll factor except with the prior written approval of the Commissioner. The Commissioner may grant such approval for any taxable year upon the written request of the taxpayer for a letter ruling, under 830 CMR 62C.3.2, if the request is submitted to the Commissioner on or before the due date, including extensions, for the filing of the taxpayer's return, as determined under M.G.L. chs. 62, 62C, or 63, as applicable. Permission to change accounting methods under 830 CMR 63.38.1(8) will be granted only for a valid business purpose other than a reduction in tax.

(b) Compensation Paid in Massachusetts. Compensation is paid in Massachusetts if any one of the following tests is met:

1. The employee's service is performed entirely within Massachusetts;
2. The employee's service is performed both within and without Massachusetts, but the service performed outside Massachusetts is incidental to the employee's service within Massachusetts. Service is incidental if it is temporary or transitory in nature, or it is rendered in connection with an isolated transaction;
3. Some of the employee's service is performed in Massachusetts; and a. the employee's base of operations is in Massachusetts; or b. there is no base of operations in any state, but the place from which the employee's service is directed or controlled is in Massachusetts; or c. the base of operations or the place from which the employee's service is directed or controlled is not in any state in which some part of the service is performed, but the employee's primary residence is in Massachusetts.

(c) Items Included. Compensation included in the payroll factor includes wages, salaries, commissions, and any other form of remuneration paid to employees for personal services rendered. Amounts will generally be considered to be paid if they are treated as wages under M.G.L. c. 151A, § 1. However, in the event of any ambiguity in the treatment of a particular item under M.G.L. c. 151A, § 1, the amount shall be treated as paid to an employee if the amount constitutes income to the employee under 26 U.S. Code during the taxable year or if the amount would constitute income to the employee during the taxable year if the employee were subject to 26 U.S. Code.

Inclusion of items in the payroll factor depends upon the particular facts and circumstances. In determining whether compensation is includible in the payroll factor, the following guidelines will be employed:

1. Compensation is includible in the payroll factor if the compensation is paid for personal services rendered by the employee to the taxpayer during the taxable year. Compensation is not limited to payments described by the taxpayer as salary, wages, commissions, or bonuses. For example, compensation would generally include employee travel or other allowances in excess of expenses, or the value of board, housing, or the personal use of an automobile, provided that 26 U.S. Code includes these benefits in the gross income of the recipient.
2. Employer contributions under a qualified cash or deferred arrangement as defined in 26 U.S. Code § 401(k) and employer contributions to nonqualified deferred compensation plans are generally included in the payroll factor. See M.G.L. c. 151A, § 1(s)(B).

(d) Items Excluded. For purposes of the payroll factor, compensation excludes payments that are not made by a taxpayer to its employees for personal services rendered, including any amount specifically excluded from the definition of "wages" under M.G.L. c. 151A, § 1(s)(A). The following items are excluded without limitation (subject to the amendment of M.G.L. c. 151A):

1. Payments to or on behalf of employees (including amounts paid for insurance or annuities) for sickness or accident disability, hospitalization, or death, as provided by M.G.L. c. 151A, § 1(s)(A).

2. Payments to or from qualified trusts under 26 U.S. Code § 401(a) (other than employer contributions under qualified cash or deferred arrangements as defined in 26 U.S. Code § 401(k)), payments to or from qualified annuity plans or contracts under 26 U.S. Code § 403, and payments to or from simplified employee pensions under 26 U.S. Code § 408(k).
3. Employer's payments of employee's FICA taxes.
4. Tips paid in any medium other than cash, and cash tips which are less than \$20 a month and not reported to the employer pursuant to 26 U.S. Code § 6053(a).
5. Non-cash payments to employees for services not in the course of the taxpayer's trade or business.
6. Payments made to independent contractors, retirees, or other persons not properly classified as employees.

(e) Treatment of Leased and Temporary Employees.

1. Leased Employees. Compensation paid for personal services rendered by leased employees is includible in the payroll factor of the taxpayer if the taxpayer is the recipient of the services of the leased employee. Compensation for personal services rendered by leased employees to client companies is excluded from the payroll factor of employee leasing companies.
2. Temporary Employees. Compensation paid for personal services rendered to client companies by employees of temporary help agencies is included in the payroll factor of the temporary agency and is generally excluded from the payroll factor of the client company. However, the Commissioner may require the inclusion of compensation paid to temporary employees that perform services under the direction and control of a client company in the payroll factor of that client company in any taxable year in which all compensation paid to temporary employees performing such services in Massachusetts for the client company exceeds 50% of the client company's Massachusetts payroll, as calculated without the inclusion of compensation paid to officers or shareholders of the client company. For purposes of 830 CMR 63.38.1(8)(e)2., if compensation paid to temporary employees is included in the payroll factor of a client company, such compensation shall be 85% of the payments during the taxable year by the client company to the temporary help agency or agencies providing the temporary employees. Any adjustment to the payroll factor of a client company shall not affect the payroll factor of the temporary help agency or agencies providing the temporary employees.

(f) Affiliated Corporations. In order to prevent distortions in the payroll factor, the Commissioner may require compensation paid to an employee of a corporation that is a member of an affiliated group, as defined in 26 U.S. Code, § 1504, to be included in the payroll factor of the group member for which the employee performed an amount of services greater than the amount of services the employee performed for any other group member, regardless of which group member actually paid the compensation.

(g) Payroll Consistency. A taxpayer must use the same rules for determining compensation paid in both the numerator and the denominator of the payroll factor. If a taxpayer changes its method of determining compensation paid, including, but not limited to, its method of accounting of such compensation, from the method used in its return for the prior year, the taxpayer must disclose in the return for the current year the presence of the change, the nature and extent of the change, and the reason for the change. The Commissioner may disregard changes in the current year or in future tax years if they have not been adequately disclosed.

(9) **Sales Factor.** The sales factor is a fraction whose numerator is **total sales of the taxpayer in Massachusetts** during the taxable year and whose denominator is total sales of the taxpayer everywhere during the taxable year. In general, a taxpayer's total sales are its gross receipts. However, certain items, as more particularly referenced in 830 CMR

63.38.1(9)(a), are specifically excluded from this computation. Also, in the case of the sale, exchange or other disposition of a capital asset used in a taxpayer's trade or business the sales to be included are measured by the gain from the transaction and not the gross receipts. In the case of a transaction that is deemed to be a sale or exchange under the provisions of 26 U.S. Code, the sales are the deemed receipts or gain from the transaction under 26 U.S. Code, as the case may be, depending upon whether the deemed transaction is a deemed sale or exchange of a capital asset.

(a) Items Excluded From Sales. Sales do not include the following items:

1. Interest.
2. Dividends.
3. Gross receipts from the maturity, redemption, sale, exchange, or other disposition of securities as defined at 830 CMR 63.38.1(2).
4. Gross receipts from the sale of business "good will" or similar intangible value, including, without limitation, "going concern value" or "workforce in place" (*i.e.*, in the case of a sale or deemed sale of a business).
5. Gross receipts that result in an allocable item of income, irrespective as to whether that allocable item of income is allocated to Massachusetts.

(b) Items Included in Sales. Sales include (but are not limited to) the following items:

1. Manufacturing and Selling, Purchasing and Reselling, Goods or Products. Sales include gross sales, less returns and allowances, of goods or products (or other property of a kind which would properly be included in inventory if on hand at the close of the taxable year) which a taxpayer manufactures and sells or purchases and resells. Sales also include all service charges, carrying charges, and other non-interest charges incidental to sales. Federal excises and state excises are included as part of sales if the taxes are passed on to the buyer or included as part of the selling price of the product.
2. Cost-plus Contracts. In the case of a cost-plus-fee contract, such as certain contracts for the operation of government-owned plants, sales include the entire reimbursed cost, plus the fee. Receipts or gain attributable to the sale of tangible personal property designed or constructed and sold under a cost-plus-fee or similar arrangement are treated as receipts from the sale of tangible personal property, and may not be treated as receipts from personal services.
3. Providing Services. Sales include gross receipts from the performance of services including commissions, fees, management charges, and similar items. (See 830 CMR 63.38.1(9)(b)8. regarding proper amount of service fees in certain intercompany transactions.)
4. Lease or Rental of Real or Tangible Personal Property. Sales include the gross receipts from renting, leasing, or licensing the use of real or tangible personal property except in cases in which the lease, rental, or license of the asset in question is treated, for purposes of M.G.L. c. 63, as a sale, exchange, or other disposition of a capital asset used in a taxpayer's trade or business, in which case sales include only the gain from the disposition of the property in question.
5. Sale, Licensing, or Assignment of Intangible Property other than Securities. Sales generally include gross receipts from the sale, licensing, or assignment of intangible property other than securities or business "good will" or similar intangible value, see 830 CMR 63.38.1(9)(a), except in cases in which the sale, licensing or

assignment of the property in question is treated, for purposes of M.G.L. c. 63, as a sale, exchange, or other disposition of a capital asset used in a taxpayer's trade or business, in which case the sales include the gain (and not the gross receipts) from the disposition of the property in question. For detailed rules pertaining to the sales factor rules that pertain to the license and sale of intangible property see 830 CMR 63.38.1(9)(d)5. and 6.

6. Capitalized Leases. Property subject to a capitalized lease for federal income tax purposes is treated as subject to a capitalized lease for purposes of the corporate excise, and sales include income or gain derived from a capitalized lease transaction to the extent that the income or gain from such transaction is included in the federal gross income of the taxpayer.

7. Sale, Exchange, or Other Disposition of Fixed Assets. In the case of the sale, exchange or other disposition of a fixed asset used in a taxpayer's trade or business, such as property, plant or equipment, sales are measured by the gain from such transaction. Gain from the disposition of a fixed asset shall include (but is not limited to) deemed gain from a transaction that is treated under 26 U.S. Code as a sale of a taxpayer's assets and that results in the taxpayer's recognition of income for Massachusetts purposes. For example, gain from the deemed sale of assets (other than securities) by a target corporation under 26 U.S. Code § 338 is included in a target's sales factor. Similarly, the gain that results from a payment of a dividend (other than securities) by a subsidiary corporation to its parent that is deemed to be a sale of assets by the subsidiary under 26 U.S. Code § 311(b) is included in the subsidiary's sales factor.

8. Intercompany Sales. Sales between affiliated corporations, to the extent otherwise includible in the sales factor under M.G.L. c. 63, § 38(f) and 830 CMR 63.38.1(9)(a) and (b), are generally included in the sales factor of the selling corporation except as described in 830 CMR 63.38.1(9)(b)8. In the case of intercompany transactions included in the sales factor under 830 CMR 63.38.1(9)(b)8., the amount of gross receipts included in the sales factor shall reflect the fair market value of the property or services provided in an arms-length transaction, subject to adjustments or rules adopted by the Commissioner pursuant to M.G.L. c. 63, § 39A.

a. Where Corporations Are Members of the Same Combined Group. In general, transactions between affiliates that are members of the same combined group within the meaning of M.G.L. c. 63, § 32B and 830 CMR 63.32B.2 are not included in the sales factor for purposes of the income measure. See 830 CMR 63.32B.2(7)(g). However, when computing the non-income measure, a taxpayer shall include in its sales factor any sales to affiliates that are members of the same combined group. See 830 CMR 63.32B.2(6)(b)3.

b. Where Corporations Are Not Members of the Same Combined Group. When a taxpayer makes sales to an affiliate and the two corporations are not members of the same combined group within the meaning of M.G.L. c. 63, § 32B and 830 CMR 63.32B.2, the taxpayer's sales include the gross receipts from such sales transactions, irrespective of whether the two corporations are members of the same federal consolidated group.

c. Exclusion of Dividends. A payment from a subsidiary corporation to its parent will be excluded from the numerator and denominator of the parent's sales factor if, in substance, the payment represents a dividend, even if the payment would otherwise be included in the parent's sales factor under 830 CMR 63.38.1(9)(b)8.b.

(c) When Sales of Tangible Personal Property are in Massachusetts. There are two rules for determining whether a sale of tangible personal property is in Massachusetts. Under the primary (destination) rule, a sale is in Massachusetts if the property is delivered or shipped to a purchaser, including the United States government, who takes possession within Massachusetts, regardless of the F.O.B. point or other conditions of sale. Under the

secondary (throwback) rule, a sale is in Massachusetts if the selling taxpayer is not taxable in the state where the property sold is delivered to the purchaser, and the property is not sold by an agent of the taxpayer who is chiefly situated at, connected with, or sent out from the taxpayer's owned or rented business premises outside of Massachusetts.

1. Destination Sales. Sales are in Massachusetts if the property is delivered or shipped to a purchaser in Massachusetts regardless of the F.O.B. point or other condition of sale. Tangible property is deemed to have been shipped or delivered to a purchaser within Massachusetts if:

- a. the property is delivered directly by the vendor to the possession and control of the purchaser or its agent within Massachusetts unless the vendor can substantiate that no use is made of the property in Massachusetts other than immediate transshipment; or
- b. the property is delivered to the possession and control of the purchaser by the vendor or by a carrier outside of Massachusetts, if the property is immediately transshipped to Massachusetts;
- c. the property is diverted to a purchaser in Massachusetts while *en route* to a third-party consignee in another state; or
- d. the third-party recipient of the tangible personal property is located in Massachusetts, even if the property is ordered from outside the state.

The following example illustrates the application of 830 CMR 63.38.1(9)(c)1.:

Example. Office Objects, Inc. ("Objects") manufactures office furniture in Massachusetts. Objects will either ship furniture from its Massachusetts manufacturing facility to its customers by common carrier, or it will allow customers to pick up their purchase at its Massachusetts facility. Empty Environment, Inc., ("Empty"), a Rhode Island corporation, purchases some office furniture from Objects. If Objects hires a common carrier to ship the furniture to Rhode Island, the sale is not a Massachusetts sale under the destination rule of 830 CMR 63.38.1(9)(c)1. because Objects did not transfer possession and control of the furniture to Empty in Massachusetts. If Empty uses its own truck and driver or hires its own carrier to pick up the furniture from Object's Massachusetts facility and transport it to Rhode Island, the sale will not be a Massachusetts sale under the destination rule if the taxpayer substantiates that no use is made of the property in Massachusetts other than the immediate transshipment.

2. Throwback Sales. Where tangible personal property is delivered or shipped to a purchaser outside of Massachusetts, sales are in Massachusetts if the taxpayer is not taxable in the state where the property is delivered to the purchaser and the property is not sold by an agent of the taxpayer who is chiefly situated at, connected with, or sent out from the taxpayer's owned or rented business premises outside of Massachusetts.

- a. Burden of Proof. If tangible personal property is delivered or shipped to a purchaser outside of Massachusetts, the taxpayer has the burden of proving either that the taxpayer is taxable in the state of the purchaser or that the tangible personal property was sold by an agent of the taxpayer who is chiefly situated at, connected with, or sent out from the taxpayer's owned or rented business premises outside of Massachusetts.
- b. Taxable in the State of the Purchaser. For purposes of the sales factor, the following special rules apply in determining whether a taxpayer is considered taxable in the state of the purchaser.

i. **Taxable in Another State.** A taxpayer is taxable in the state of the purchaser if it meets either test set out in 830 CMR 63.38.1(5). *See* 830 CMR 63.38.1(5), Examples 1 through 4.

ii. **Foreign Sales.** A taxpayer is taxable in the state of the purchaser if tangible personal property is delivered or shipped to a purchaser in a foreign country.

c. **Property Not Sold by Agent Who Is Chiefly Situated at, Connected with or Sent out from Taxpayer's Owned or Rented Business Premises Outside of Massachusetts.** Where the taxpayer is not taxable in the state of the purchaser, sales that are not the direct result of the efforts of an agent of the taxpayer who is chiefly situated at, connected with, or sent out from the taxpayer's owned or rented business premises outside of Massachusetts are sales in Massachusetts. For purposes of the sales factor, the following rules apply in determining whether tangible personal property is considered sold by an agent chiefly situated at, connected with or sent out from the taxpayer's owned or rented business premises outside of Massachusetts.

i. **Independent Contractors.** Independent contractors as defined at 830 CMR 63.38.1(2), control their own activities and, in general, are chiefly associated with their own offices. They are not agents chiefly situated at, connected with or sent out from a taxpayer's owned or rented business premises. In most cases, sales of a taxpayer's goods by independent contractors are therefore included in the numerator of the taxpayer's sales factor. However, if substantially all of a taxpayer's contacts with an independent contractor are conducted and controlled by an agent or employee of the taxpayer who is chiefly situated at, connected with or sent out from the taxpayer's owned or rented business premises outside of Massachusetts, then sales made by the independent contractor will be regarded as made by that agent or employee.

ii. **Determining Who "Sold" Property.** The person who actually negotiates and effects an order is the person who sells the property. The person who sells the property is generally not the person who performs mere clerical approval acceptance, or processing, including a routine credit check of the purchaser. The taxpayer has the burden of proving who sold the property.

Reorders of property originating from the efforts of a person who negotiated and effected the original order are treated the same as the original order unless this treatment is not reasonable in light of material changes in the taxpayer's business operations after the time the original order was placed.

A taxpayer's catalog sales, made when a customer, who has received mail-order solicitations from the taxpayer, telephones or sends a written order to a Massachusetts location of the taxpayer, are not sales made by an agent from premises outside Massachusetts.

iii. **Determining Location of Taxpayer's Owned or Rented Business Premises.** The determination of the particular business premises owned or rented by a taxpayer that an agent is chiefly situated at, or that an agent is chiefly connected with, or that an agent is chiefly sent out from, is a factual determination. In making the determination, the following guidelines will be employed:

Business Premises. For purposes of the sales factor, the taxpayer's owned or rented premises for the transaction of business ("business premises") is the taxpayer's owned or rented sales office that the selling agent customarily uses to receive instructions, directions, or supervision from the taxpayer, or communications from customers; to replenish stock or other materials; to repair equipment; or to perform any other function necessary to the selling of the taxpayer's

tangible personal property. Facilities used exclusively as warehouses or manufacturing facilities are not sales offices. The presence of company employees receiving orders and shipping tangible personal property will not, by itself, change a facility from a warehouse to a sales office.

Chiefly Situated at. In the case of an agent who spends 50% or more of his or her time at a taxpayer's owned or rented business premises, the agent is chiefly situated at that business location.

Chiefly Sent out from. In the case of an agent who spends more than 50% of his or her working hours away from a fixed business premises, the agent is chiefly sent out from that business premises where the agent customarily returns for various paperwork, correspondence and administrative matters, such as participation in office meetings and conferences, meetings with supervisors or managers, and preparation of sales materials, contracts and the like.

Chiefly Connected With. In the case of an agent who does not fall within the rules described above in - Chiefly Situated at or - Chiefly Sent out From, the agent is chiefly connected with the business premises that exercises supervision and control over the agent's activities.

The following example illustrates the application of 830 CMR 63.38.1(9)(c)2.c.iii.

Taxpayer A has its executive office, sales office, and factory in New York. Taxpayer A also rents a branch sales office in Massachusetts and a warehouse in Rhode Island. Taxpayer A has four sales representatives in the New England region.

Saleswoman Barbara Resides in Massachusetts. She works daily at the branch sales office in Massachusetts where she meets with customers, receives telephone orders, approves and transmits approved orders to the warehouse personnel in Rhode Island for shipment. Barbara is "situated at" the Massachusetts branch sales office, and all sales made by Barbara are attributed to Massachusetts.

Salesman Bob operates out of his New Hampshire residence and solicits orders throughout New Hampshire and Maine. Bob regularly visits, reports to, and sends orders for approval to Saleswoman Barbara at the branch office in Massachusetts. Based on the facts, Bob is "sent out from" the taxpayer's rented branch sales office in Massachusetts. Assuming Taxpayer A is not taxable in New Hampshire and Maine, all sales of tangible personal property made by Bob to purchasers in New Hampshire and Maine are attributed to Massachusetts.

Salesman John operates out of his Vermont residence and solicits orders in Vermont. John was hired by, makes weekly reports to, and receives instructions from, the Vice President of Sales who operates out of the New York office. Although John routes his orders through the Massachusetts branch office where they are approved, he has no other contacts with that office. Based on the facts, John is "connected with" the taxpayer's owned New York office. Whether or not Taxpayer A is taxable in Vermont, none of the John's sales of tangible personal property to purchasers in Vermont are attributed to Massachusetts.

Salesman Tom resides in Rhode Island and solicits orders in Connecticut. Although Tom regularly visits the warehouse in Rhode Island, he reports to, and sends orders for approval to Saleswoman Barbara at the branch office in Massachusetts. Based on the facts, Tom is "connected with" the taxpayer's rented branch sales office in Massachusetts. Assuming that Taxpayer A is not taxable in Connecticut, all sales of tangible personal property made by Tom

to purchasers in Connecticut are attributed to Massachusetts.

3. Resale to Foreign Government. Sales of tangible personal property to the United States or any of its agencies or instrumentalities for resale to a foreign government or an agency or instrumentality of a foreign government are not sales in Massachusetts.

(d) When Sales Other than Sales of Tangible Personal Property Are in Massachusetts.

1. General Rules.

a. **Market-based Sourcing.** Sales, other than sales of tangible personal property, are in Massachusetts within the meaning of 830 CMR 63.38.1 if and to the extent that the corporation's market for the sales is in Massachusetts as more fully set forth in M.G.L. c, 63, § 38(f) and 830 CMR 63.38.1(9)(d). In general, the provisions of 830 CMR 63.38.1(9)(d)4. through 7. establish uniform rules for:

- i. determining whether and to what extent the market for a sale other than the sale of tangible personal property is in Massachusetts;
- ii. reasonably approximating the state or states of assignment where such state or states cannot be determined; and
- iii. excluding the sale where the state or states of assignment cannot be determined or reasonably approximated.

b. Outline of Topics. The provisions in 830 CMR 63.38.1(9)(d) are organized as follows.

i. General Rules.

- a. Market-based Sourcing
- b. Outline of Topics
- c. Definitions
- d. General Principles of Application; Contemporaneous Records
- e. Rules of Reasonable Approximation
- f. Rules with respect to Exclusion of Sales from the Sales Factor
- g. Changes in Methodology; Commissioner Review
- h. Industry-specific Alternative Apportionment Rules
- i. Application to Services Provided Directly or Indirectly to a RIC
- j. Further Guidance

ii. Sale, Rental, Lease or License of Real Property.

iii. Rental, Lease or License of Tangible Personal Property.

iv. Sale of a Service.

- a. General Rule
- b. In-person Services
- c. Services Delivered to the Customer or on Behalf of the Customer, or Delivered Electronically Through the Customer
- d. Professional Services
- v. License or Lease of Intangible Property
 - a. General Rules
 - b. License of a Marketing Intangible
 - c. License of a Production Intangible
 - d. License of a Mixed Intangible
 - e. License of Intangible Property where Substance of the Transaction Resembles a Sale of Goods or Services
 - f. Examples
- vi. Sale of Intangible Property.
 - a. Assignment of Sales
 - b. Examples
- vii. Special Rules.
 - a. Software Transactions
 - b. Sales or Licenses of Digital Goods and Services
 - c. Enforcement of Legal Rights

c. Definitions. For the purposes of 830 CMR 63.38.1(9)(d) the following terms have the following meanings.

Billing Address means the location indicated in the books and records of the taxpayer as the primary mailing address relating to a customer's account as of the time of the transaction as kept in good faith in the normal course of business and not for tax avoidance purposes.

Business Customer means a customer that is a business operating in any form, including an individual that operates a business through the form of a sole proprietorship. Sales to a non-profit organization, to a trust, to the U.S. Government, to any foreign, state or local government, or to any agency or instrumentality of such government shall be treated as sales to a business customer and shall be assigned consistent with the rules that apply to such sales.

Individual Customer means any customer that is not a business customer.

Intangible Property, generally includes, without limitation, copyrights; patents; trademarks; trade names; brand names; franchises; licenses; trade secrets; trade dress; information; know-how; methods; programs; procedures; systems; formulae; processes; technical data; designs; licenses; literary, musical, or artistic compositions; information; ideas; contract rights including broadcast rights; agreements not to compete; goodwill and going concern value; securities (see 830 CMR 63.38.1(2) (definition of "security")); and, except as otherwise provided in 830 CMR 63.38.1, computer software. In the case of a sale of intangible property, such sale may or may not be includable in the numerator and denominator of the taxpayer's sales factor, depending upon the application of 830 CMR 63.38.1(9)(d)6.

Place of Order, means the physical location from which a customer places an order for a sale other than a sale of tangible personal property from a taxpayer, resulting in a contract with the taxpayer.

State Where a Contract of Sale is Principally Managed by the Customer, means the primary location at which an employee or other representative of a customer serves as the primary contact person for the taxpayer with respect to the implementation and day-to-day execution of a contract entered into by the taxpayer with the customer.

d. General Principles of Application; Contemporaneous Records. In order to satisfy the requirements of 830 CMR 63.38.1(9)(d), a taxpayer's assignment of sales of other than tangible personal property must be consistent with the following principles:

i. A taxpayer's application of 830 CMR 63.38.1(9)(d) shall be based on objective criteria and shall consider all sources of information reasonably available to the taxpayer at the time of its tax filing including, without limitation, the taxpayer's books and records kept in the normal course of business. A taxpayer's method of assigning its sales shall be determined in good faith, applied in good faith, and applied consistently with respect to similar transactions and year to year. A taxpayer shall retain contemporaneous records that explain the determination and application of its method of assigning its sales, including its underlying assumptions, and shall provide such records to the Commissioner upon request.

ii. The provisions of 830 CMR 63.38.1(9)(d)4. through 7. provide for various assignment rules that apply sequentially in a hierarchy. For each sale to which a hierarchical rule applies, a taxpayer must make a reasonable effort to apply the primary rule applicable to the sale before seeking to apply the next rule in the hierarchy (and must continue to do so with each succeeding rule in the hierarchy, where applicable). For example, in some cases, the applicable rule first requires a taxpayer to determine the state or states of assignment, and where the taxpayer cannot do so, the rule then requires the taxpayer to reasonably approximate such state or states. In such cases, the taxpayer must in good faith and with reasonable effort attempt to determine the state or states of assignment (*i.e.*, apply the primary rule in the hierarchy) before it may reasonably approximate such state or states.

iii. A taxpayer's method of assigning its sales, including the use of a method of approximation, where applicable, must reflect an attempt to obtain the most accurate assignment of sales consistent with the regulatory standards set forth in 830 CMR 63.38.1(9)(d), rather than an attempt to lower the taxpayer's tax liability. A method of assignment that is reasonable for one taxpayer may not necessarily be reasonable for another taxpayer, depending upon the applicable facts.

e. Rules of Reasonable Approximation.

i. In General. In general, the provisions of 830 CMR 63.38.1(9)(d)4. through 7. establish uniform rules for determining whether and to what extent the market for a sale other than the sale of tangible personal property is in Massachusetts. The provisions of 830 CMR 63.38.1(9)(d)4. through 7. also set forth rules of reasonable approximation, which apply where the state or states of assignment cannot be determined. In some instances, the reasonable approximation must be made in accordance with specific rules of approximation prescribed by 830 CMR 63.38.1. *See, e.g., 830 CMR 63.38.1(9)(d)4.d.* (pertaining to professional services). In other cases, the applicable rule in 830 CMR 63.38.1(9)(d) permits a taxpayer to reasonably approximate the state or states of assignment, using a method that reflects an effort to approximate the results that would be obtained under the applicable rules or standards set forth in 830 CMR 63.38.1(9)(d).

ii. Approximation Based Upon Known Sales. In any instance where, applying the applicable rules in 830 CMR 63.38.1(9)(d)4., pertaining to sales of services, a taxpayer can ascertain the state or states of assignment of a substantial portion of its sales of substantially similar services ("assigned sales"), but not all of such sales, and the taxpayer reasonably believes, based on all available information, that the geographic distribution of some or all of the remainder of such sales generally tracks that of the assigned sales, it shall include those sales which it believes tracks the geographic distribution of the assigned sales in its sales factor in the same proportion as its assigned sales. 830 CMR 63.38.1(9)(a)1.e.ii. also applies in the context of licenses and sales of intangible property where the substance of the transaction resembles a sale of goods or services. *See 830 CMR 63.38.1(9)(d)5.e. and 6.a.v.*

f. Rules With respect to Exclusion of Sales from the Sales Factor.

i. In any case in which a taxpayer cannot ascertain the state or states to which a sale is to be assigned pursuant to the applicable rules set forth in 830 CMR 63.38.1(9)(d) (including through the use of a method of reasonable approximation, where relevant) using a reasonable amount of effort undertaken in good faith, the sale shall be excluded from the numerator and the denominator of the taxpayer's sales factor.

ii. In any case in which a taxpayer can ascertain the state or states to which a sale is to be assigned pursuant to the applicable rules set forth in 830 CMR 63.38.1(9)(d), but the taxpayer is not taxable in one or more such states, the sales that would otherwise be assigned to such states where the taxpayer is not taxable shall be excluded from the numerator and denominator of the taxpayer's sales factor. The rules to determine whether a taxpayer is taxable in a state are set forth at 830 CMR 63.38.1(5).

g. Changes in Methodology; Commissioner Review.

i. General Rules Applicable to Original Returns. In any case in which a taxpayer files an original return for a taxable year in which it properly assigns its sales using a method of assignment, including a method of reasonable approximation, in accordance with 830 CMR 63.38.1(9)(d), the application of such method of assignment shall be deemed to be a correct determination by the taxpayer of the state or states of assignment to which the method is properly applied. In such cases, neither the Commissioner nor the taxpayer (through the form of an audit adjustment, amended return, abatement application or otherwise) may modify the taxpayer's methodology as applied for assigning such sales for such taxable year. However, the Commissioner and the taxpayer may each subsequently, through the applicable administrative process, correct either factual errors or calculation errors with respect to the taxpayer's application of its filing methodology.

ii. Commissioner Authority to Adjust a Taxpayer's Return. The Commissioner's ability to review and adjust a taxpayer's assignment of sales on a return to more accurately assign such sales consistent with the rules or standards of 830 CMR 63.38.1(9)(d), includes, but is not limited to, each of the following potential actions.

(A) In any case in which a taxpayer fails to properly assign a sale in accordance with the rules set forth in 830 CMR 63.38.1(9)(d), including the failure to properly apply a hierarchy of rules consistent with the principles of 830 CMR 63.38.1(9)(d)1.d.ii., the Commissioner may adjust the assignment of such sales in accordance with the applicable rules in 830 CMR 63.38.1(9)(d).

(B) In any case in which a taxpayer uses a method of approximation to assign its sales and the Commissioner determines that the method of approximation employed by the taxpayer is not reasonable, the Commissioner may substitute a method of approximation that the Commissioner determines is appropriate or may exclude the sales from the taxpayer's numerator and denominator, as appropriate.

(C) In any case in which the Commissioner determines that a taxpayer's method of approximation is reasonable, but has not been applied in a consistent manner with respect to similar transactions or year to year, the Commissioner may require that the taxpayer apply its method of approximation in a consistent manner.

(D) In any case in which a taxpayer excludes sales from the numerator and denominator of its sales factor on the theory that the assignment of such sales cannot be reasonably approximated, the Commissioner may determine that the exclusion of such sales is not appropriate, and may instead substitute a method of approximation that the Commissioner determines is appropriate.

(E) In any case in which a taxpayer fails to retain contemporaneous records that explain the determination and application of its method of assigning its sales, including its underlying assumptions, or fails to provide such records to the Commissioner upon request, the Commissioner may treat the taxpayer's assignment of sales as unsubstantiated, and may adjust the assignment of such sales in a manner consistent with the applicable rules in 830 CMR 63.38.1(9)(d).

(F) In any case in which the Commissioner concludes that a taxpayer's customer's billing address was selected for tax avoidance purposes, the Commissioner may adjust the assignment of sales to such customer in a manner consistent with the applicable rules in 830 CMR 63.38.1(9)(d).

iii. Taxpayer Authority to Change a Method of Assignment on a Prospective Basis. In filing its original return for a tax year, a taxpayer may change its method of assigning its sales under 830 CMR 63.38.1(9)(d) from the method it used in the preceding year, including changing its method of approximation from that used on previous returns. However, the taxpayer may only make such change for purposes of improving the accuracy of assigning its sales consistent with the 830 CMR 63.38.1(9)(d), including, for example, to address the circumstance where there is a change in the information that is available to the taxpayer as relevant for purposes of complying with such rules. Further, a taxpayer that seeks to change its method of assigning its sales must disclose, in the original return filed for the year of the change, the fact that it has made the change, and must retain and provide to the Commissioner upon request documents that explain the nature and extent

of the change, and the reason for the change. If a taxpayer fails to adequately disclose such change or retain and provide such records upon request, the Commissioner may disregard the taxpayer's change and substitute an assignment method that the Commissioner determines is appropriate.

iv. Commissioner Authority to Change a Method of Assignment on a Prospective Basis. The Commissioner may direct a taxpayer to change its method of assigning its sales in tax returns that have not yet been filed, including changing the taxpayer's method of approximation, if upon reviewing the taxpayer's filing methodology applied for a prior tax year, the Commissioner determines that such change is appropriate to reflect a more accurate assignment of the taxpayer's sales within the meaning of 830 CMR 63.38.1(9)(d), and determines that such change can be reasonably adopted by the taxpayer. The Commissioner will provide the taxpayer with a written explanation as to the reason for making such change. In any case in which a taxpayer fails to comply with the Commissioner's direction on subsequently filed returns, the Commissioner may deem the taxpayer's method of assigning its sales on such returns to be unreasonable, and may substitute an assignment method that the Commissioner determines is appropriate.

h. Industry-specific Alternative Apportionment Rules. Prior to the enactment of St. 2013, c. 46, § 37, the Commissioner promulgated six industry-specific alternative apportionment regulations to address industries where the application of the provisions of M.G.L. c. 63, § 38 were not reasonably adapted to approximate the net income derived from business carried on within Massachusetts. See M.G.L. c. 63, § 38(j). Following the enactment of St. 2013, c. 46, § 37, the Commissioner reviewed those six industry-specific alternative apportionment regulations, and determined for each industry that the provisions of M.G.L. c. 63, § 38 as a whole continue not to be reasonably adapted to approximate the net income derived from business carried on within Massachusetts. However, in the case of three of the industries, the Commissioner determined that industry-specific alternative sales factor rules were no longer needed in light of St. 2013, c. 46, § 37. In the case of the other three industries, the Commissioner determined that the industry-specific alternative sales factor rules remain necessary.

i. Industry-specific Sales Factor Provisions that Remain in Effect. Prior to the enactment of St. 2013, c. 46, § 37 the Commissioner promulgated industry-specific alternative apportionment regulations for pipeline companies, corporations engaged in the electricity industry, and corporations engaged in the telecommunications industry. See 830 CMR 63.38.8 (pipeline companies); 830 CMR 63.38.10 (electricity industry) and 830 CMR 63.38.11 (telecommunications industry). These industry-specific regulations remain fully in effect and are not superseded in whole or in part by 830 CMR 63.38.1(9)(d), as these regulations continue to address circumstances where the provisions of M.G.L. c. 63, § 38, including M.G.L. c. 63, § 38(f), are not reasonably adapted to approximate the net income derived from business carried on within Massachusetts. However, a special rule pertaining to taxpayers that provide telecommunications services that are also engaged in the sale or license of digital goods and services shall apply notwithstanding the rules set forth in 830 CMR 63.38.11. See 830 CMR 63.38.1(9)(d)7.b.ii.

ii. Industry-specific Sales Factor now Determined under 830 CMR 63.38.1.(9)(d). Prior to the enactment of St. 2013, c. 46, § 37 the Commissioner promulgated industry-specific alternative apportionment regulations for motor carriers, airlines, and courier and package delivery services. See 830 CMR 63.38.2 (airlines); 830 CMR 63.38.3 (motor carriers); 830 CMR 63.38.4 (courier and package delivery services). In each of these cases, the sales factor is now determined pursuant to 830 CMR 63.38.1(9)(d). The industry-specific property and payroll factor rules for those industries remain fully in effect.

i. Application to Services Provided Directly or Indirectly to a RIC. Nothing in 830 CMR 63.38.1(9)(d) shall be construed to supersede or affect the application of 830 CMR 63.38.7 that apply to mutual fund service corporations. See M.G.L. c. 63, § 38(m). However, rules with respect to mutual fund sales, as defined at 830 CMR 63.38.1(2), as made by a taxpayer that is not a mutual fund service corporation, are set forth at 830 CMR 63.38.1(9)(d)4.d.iii.(D).

j. Further Guidance. The Commissioner may issue further public written statements with respect to the rules set forth in 830 CMR 63.38.1(9)(d). Such further guidance may, among other things, include guidance with respect to:

- i. what constitutes a reasonable method of approximation within the meaning of such rules; and
- ii. the circumstances in which a filing change with respect to a taxpayer's method of reasonable approximation will be deemed appropriate.

2. Sale, Rental, Lease or License of Real Property. In the case of a sale, rental, lease or license of real property, the sale is in Massachusetts if and to the extent that the property is in Massachusetts.

3. Rental, Lease or License of Tangible Personal Property. In the case of a rental, lease or license of tangible personal property, the sale is in Massachusetts if and to the extent that the property is in Massachusetts. If property is mobile property that is located both within and without Massachusetts during the period of the lease or other contract, the receipts assigned to Massachusetts shall be the receipts from the contract period multiplied by the fraction used by the taxpayer for property factor purposes under 830 CMR 63.38.1(7)(d) (as adjusted when necessary to reflect differences between usage during the contract period and usage during the taxable year).

4. Sale of a Service.

a. General Rule. The sale of a service is in Massachusetts if and to the extent that the service is delivered at a location in Massachusetts. In general, the term "delivered" shall be construed to refer to the location of the taxpayer's market for the service provided and is not to be construed by reference to the location of the property or payroll of the taxpayer as otherwise determined for corporate apportionment purposes pursuant to 830 CMR 63.38.1(7) and (8). The rules to determine the location of the delivery of a service in the context of several specific types of service transactions are set forth at 830 CMR 63.38.1(9)(d)4.b. through d.

b. In-person Services.

i. In General. Except as otherwise provided in 830 CMR 63.38.1(9)(d)4.b., in-person services are services that are physically provided in person by the taxpayer, where the customer or the customer's real or tangible property upon which the services are performed is in the same location as the service provider at the time the services are performed. 830 CMR 63.38.1(9)(d)4.b. includes situations where the services are provided on behalf of the taxpayer by a third-party contractor. Examples of in-person services include, without limitation, warranty and repair services; cleaning services; plumbing services; carpentry; construction contractor services; pest control; landscape services; medical and dental services, including medical testing and x-rays and mental health care and treatment; child care; hair cutting and salon services; live entertainment and athletic performances; and in-person training or lessons. In-person services include services within the description above that are performed at:

(A) a location that is owned or operated by the service provider; or

(B) a location of the customer, including the location of the customer's real or tangible personal property.

Various professional services, including legal, accounting, financial and consulting services, and other such services as described in 830 CMR 63.38.1(9)(d)4.d., although they may involve some amount of in-person contact, are not treated as in-person services within the meaning of 830 CMR 63.38.1(9)(d)4.b.

ii. Assignment of Sales. Except as otherwise provided in 830 CMR 63.38.1(9)(d)4.b., where the service provided by the taxpayer is an in-person service, the delivery of the service is at the location where the service is received. Therefore, the sale is in Massachusetts if and to the extent the customer receives the in-person service in Massachusetts. In assigning its sales of in-person services, a taxpayer shall first attempt to determine the location where a service is received, as follows:

(A) Where the service is performed with respect to the body of an individual customer in Massachusetts (*e.g.* hair cutting or x-ray services) or in the physical presence of the customer in Massachusetts (*e.g.* live entertainment or athletic performances), the service is received in Massachusetts.

(B) Where the service is performed with respect to the customer's real estate in Massachusetts or where the service is performed with respect to the customer's tangible personal property at the customer's residence or in the customer's possession in Massachusetts, the service is received in Massachusetts.

(C) Where the service is performed with respect to the customer's tangible personal property and the tangible personal property is to be shipped or delivered to the customer, whether the service is performed in Massachusetts or outside Massachusetts, the service is received in Massachusetts if such property is shipped or delivered to the customer in Massachusetts.

In any instance in which the state or states where a service is actually received cannot be determined, but the taxpayer has sufficient information regarding the place of receipt from which it can reasonably approximate the state or states where the service is received, the taxpayer shall reasonably approximate such state or states. In any instance where the state to which the sale is to be assigned can be determined or reasonably approximated, but the taxpayer is not taxable in such state, the sale that would otherwise be assigned to such state shall be excluded from the numerator and denominator of the taxpayer's sales factor. See 830 CMR 63.38.1(9)(d)1.f.ii.

iii. Transportation and Delivery Services.

(A) In General. Transportation and delivery services, involving the physical transportation of people or tangible personal property from one destination to another, are in-person services within the meaning of 830 CMR 63.38.1(9)(d)4.b. Special rules of assignment apply to receipts from the provision of transportation and delivery services. The assignment of receipts from such services depends upon whether such services are provided by air or by other means as provided in 830 CMR 63.38.1(9)(d)4.b.iii.(B) and (C). Receipts from a taxpayer's sale of transportation and delivery services are assigned pursuant to this section whether the

transportation and delivery services are provided directly by the taxpayer or indirectly by another entity under common ownership with the taxpayer as defined in 830 CMR 63.32B.2. If a taxpayer provides transportation and delivery services exclusively by air, the rule in 830 CMR 63.38.1(9)(d)4.b.iii(B) applies to receipts from such services. **If a taxpayer provides transportation and delivery services both by air and by means other than air, the rule in 830 CMR 63.38.1(9)(d)4.b.iii(C) applies to receipts from such services.** If a taxpayer that provides transportation and delivery services also derives receipts from activities other than transportation and delivery services, such other receipts are apportioned according to the applicable rules under 830 CMR 63.38.1(9).

(B) Transportation and Delivery Services Provided **Exclusively by Air.** Transportation and delivery services provided exclusively by air are assigned to the state or states of the **aircraft departures** associated with such services. Therefore, the receipts assigned to Massachusetts shall be determined by multiplying the taxpayer's total receipts from such services by the percentage of the aircraft departures occurring in Massachusetts relative to the aircraft departures that take place everywhere. In any case where the services are provided by multiple aircraft types, the calculation shall be **weighted by the values of the aircraft types** as provided in 830 CMR 63.38.2(3)(a). 830 CMR 63.38.1(9)(d)4.b.iii.(B) supersedes the rules set forth in 830 CMR 63.38.2 to the extent of any inconsistency.

(C) Transportation and Delivery Services Provided by Means other than Exclusively by Air.

1. Except as otherwise provided by 830 CMR 63.38.1(9)(d)4.b.iii(C), **transportation and delivery services (other than exclusively by air) are assigned to the state or states of the departures and arrivals (in the case of the transportation of people), or pickups and deliveries (in the case of the transportation of tangible personal property), associated with such services. Therefore, the receipts assigned to Massachusetts shall be determined by multiplying the taxpayer's total receipts from such services by the percentage of the total departures (or pickups) and arrivals (or deliveries) that take place in Massachusetts relative to the departures (or pickups) and arrivals (or deliveries) that take place everywhere.** Transportation and delivery services to which 830 CMR 63.38.1(9)(d)4.b.iii(C) applies include, without limitation, such services as provided by cars, buses, trains, and trucks, and with respect to a taxpayer that provides transportation and delivery services by both air and means other than air, **all of such transportation services. 830 CMR 63.38.1(9)(d)4.b.iii.C. supersedes the rules set forth in 830 CMR 63.38.3 (motor carriers) and 830 CMR 63.38.4 (courier and package delivery services) to the extent of any inconsistency.** 830 CMR 63.38.1(9)(d)4.b.iii(C), does not apply to transportation and delivery services as provided through the means of pipelines, which are governed by the industry-specific alternative apportionment rules in 830 CMR 63.38.8.

2. For purposes of 830 CMR 63.38.1(9)(d)4.b.iii(C):

- i. The location of a "pickup" shall be the location at which an item of tangible personal property is transferred from the customer or the customer's designee for transportation and subsequent delivery; and
- ii. The location of a "delivery" shall be the location at which an item of tangible personal property that has been transported is transferred to the customer or the customer's designee.

iv. Examples. Assume in each of these examples that the taxpayer that provides the service is taxable in Massachusetts and is to apportion its income pursuant to M.G.L. c. 63, § 38. Also, assume, where relevant, unless otherwise stated, that the taxpayer is taxable in each state other than Massachusetts to which its sale or sales would be assigned, so that there is no requirement in such examples that such sale or sales be eliminated from the numerator and denominator of the taxpayer's sales factor. See 830 CMR 63.38.1(9)(d)1.f.ii. Note that for purposes of the examples it is irrelevant whether the services are performed by an employee of the taxpayer or by an independent contractor acting on the taxpayer's behalf.

Example 1. Salon Corp. has retail locations in Massachusetts and in other states where it provides hair cutting services to individual and business customers, the latter of whom are paid for through the means of a company account. The sales of services provided at Salon Corp.'s Massachusetts locations are in Massachusetts. The sales of services provided at Salon Corp.'s locations outside Massachusetts, even when provided to Massachusetts residents, are not Massachusetts sales.

Example 2. Landscape Corp. provides landscaping and gardening services in Massachusetts and in neighboring states. Landscape Corp. provides landscaping services at the Massachusetts vacation home of an individual who is a resident of another state and who is located outside Massachusetts at the time the services are performed. The sale of services provided at the Massachusetts location is in Massachusetts.

Example 3. Same facts as in Example 2, except that Landscape Corp. provides the landscaping services to Retail Corp., a corporation with retail locations in several states, and the services are with respect to such locations of Retail Corp. that are in Massachusetts and in other states. The sale of services provided to Retail Corp. is in Massachusetts to the extent the services are provided in Massachusetts.

Example 4. Camera Corp. provides camera repair services at a Massachusetts retail location to walk-in individual and business customers. In some cases, Camera Corp. actually repairs a camera that is brought to its Massachusetts location at a facility that is in another state. In such cases, the repaired camera is then returned to the customer at Camera Corp.'s Massachusetts location. The sale of such services is in Massachusetts.

Example 5. Same facts as in Example 4, except that a customer located in Massachusetts mails the camera directly to the out-of-state facility owned by Camera Corp. to be fixed, and receives the repaired camera back in Massachusetts by mail. The sale of the service is in Massachusetts.

Example 6. Teaching Corp. provides seminars in Massachusetts to individual and business customers. The seminars and the materials used in connection with the seminars are prepared outside the state, the teachers who teach the seminars include teachers that are resident outside the state, and the students who attend the seminars include students that are resident outside the state. Because the seminars are taught in Massachusetts the sales of the services are in Massachusetts.

Example 7. Bus Corp. sells **bus tickets** to individual and business customers at bus depots located in Massachusetts and in other states, and also through phone and Internet sales. The bus tickets are for travel to locations in Massachusetts and to locations in other states. During

the taxable year, Bus Corp. sells 150,000 bus tickets. Each ticket has a departure location and an arrival location, for a total of 300,000 departure and arrival locations. Of these bus tickets, 25,000 have a departure location in Massachusetts and 20,000 have an arrival location in Massachusetts. The sale of such transportation services shall be assigned by multiplying Bus Corp.'s total revenues from such services by the percentage of Bus Corp.'s total departures and arrivals that take place in Massachusetts relative to Bus Corp.'s total number of departures and arrivals. Therefore, Bus Corp. must determine the amount of its ticket sales that are to be assigned to Massachusetts by multiplying its total such sales by a fraction equal to 45,000 divided by 300,000, or .15. For purposes of the analysis it is irrelevant where and how the bus tickets are sold or whether the customer is an individual or business customer.

c. **Services Delivered to the Customer or on Behalf of the Customer, or Delivered Electronically Through the Customer.**

i. In General. **Where the service provided by the taxpayer is not an in-person service** within the meaning of 830 CMR 63.38.1(9)(d)4.b. or a professional service within the meaning of 830 CMR 63.38.1(9)(d)4.d., and the service is delivered to or on behalf of the customer, or delivered electronically through the customer, the sale is in Massachusetts if and to the extent that the service is delivered in Massachusetts. **For purposes of 830 CMR 63.38.1(9)(d)4.c., a service that is delivered "to" a customer is a service in which the customer and not a third party is the recipient of the service. A service that is delivered "on behalf of" a customer is one in which a customer contracts for a service but one or more third parties, rather than the customer, is the recipient of the service, such as fulfillment services (see 830 CMR 63.38.1(9)(d)4.c.ii.(A)) or the direct or indirect delivery of advertising to the customer's intended audience (see 830 CMR 63.38.1(9)(d)4.c.ii.(C)).** A service that is delivered electronically "through" a customer is a service that is delivered electronically to a customer for purposes of resale and subsequent electronic delivery in substantially identical form to an end user or other third-party recipient. Except in the instance of a service that is delivered through a customer (where the service must be delivered electronically), a service is included within the meaning of 830 CMR 63.38.1(9)(d)4.c., irrespective of the method of delivery, *e.g.*, whether such service is delivered by a physical means or through an electronic transmission.

ii. Assignment of Sales. The assignment of a sale to a state or states in the instance of a service that is delivered to the customer or on behalf of the customer, or delivered electronically through the customer, depends upon the method of delivery of the service and the nature of the customer. Separate rules of assignment apply to services delivered by physical means and services delivered by electronic transmission. (For purposes of 830 CMR 63.38.1(9)(d)4.c., a service delivered by an electronic transmission shall not be considered a delivery by a physical means). In any instance where, applying the rules set forth in 830 CMR 63.38.1(9)(d)4.c., the rule of assignment depends on whether the customer is an individual or a business customer, and the taxpayer acting in good faith cannot reasonably determine whether the customer is an individual or business customer, the taxpayer shall treat the customer as a business customer. In any instance where the state to which the sale is to be assigned can be determined or reasonably approximated, but the taxpayer is not taxable in such state, the sale that would otherwise be assigned to such state shall be excluded from the numerator and denominator of the taxpayer's sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

(A) Delivery to or on Behalf of a Customer by Physical Means, Whether to an Individual or Business Customer. Services delivered to a customer or on behalf of a customer through a physical means include, for example, **product delivery services** where property is delivered to

the customer or to a third party **on behalf of the customer**; the delivery of brochures, fliers or other direct mail services; the delivery of advertising or advertising-related services to the customer's intended audience in the form of a physical medium; and the sale of custom software (e.g., where software is developed for a specific customer in a case where the transaction is properly treated as a service transaction for purposes of M.G.L. c. 63) where the taxpayer installs the custom software at the customer's site. 830 CMR 63.38.1(9)(d)4.c.ii.(i) applies whether the taxpayer's customer is an individual customer or a business customer.

1. Rule of Determination. In assigning the sale of a service delivered to a customer or on behalf of a customer through a physical means, a taxpayer must first attempt to determine the state or states where such services are delivered. Where the taxpayer is able to determine the state or states where the service is delivered, it shall assign the sale to such state or states.

2. Rule of Reasonable Approximation. Where the taxpayer cannot determine the state or states where the service is actually delivered, but has sufficient information regarding the place of delivery from which it can reasonably approximate the state or states where the service is delivered, it shall reasonably approximate such state or states.

3. Examples. Assume in each of these examples that the taxpayer that provides the service is taxable in Massachusetts and is to apportion its income pursuant to M.G.L. c. 63, § 38. Also, assume, where relevant, unless otherwise stated, that the taxpayer is taxable in each state other than Massachusetts to which its sale or sales would be assigned, so that there is no requirement in such examples that such sale or sales must be eliminated from the numerator and denominator of the taxpayer's sales factor. See 830 CMR 63.38.1(9)(d)1.f.ii.

Example 1. Direct Mail Corp., a corporation based outside Massachusetts, provides direct mail services to its customer, Business Corp. Business Corp. transacts with Direct Mail Corp. to deliver printed fliers to a list of customers that is provided to it by Business Corp. Some of Business Corp.'s customers are in Massachusetts and some of those customers are in other states. Direct Mail Corp. will use the postal service to deliver the printed fliers to Business Corp.'s customers. The sale of Direct Mail Corp.'s services to Business Corp. is assigned to Massachusetts to the extent that the services are delivered on behalf of Business Corp. to Massachusetts customers (*i.e.*, to the extent that the fliers are delivered on behalf of Business Corp. to Business Corp.'s intended audience in Massachusetts).

Example 2. Ad Corp. is a corporation based outside Massachusetts that provides advertising and advertising-related services in Massachusetts and in neighboring states. Ad Corp. enters into a contract at a location outside Massachusetts with an individual customer who is not a Massachusetts resident to design advertisements for billboards to be displayed in Massachusetts, and to design fliers to be mailed to Massachusetts residents. All of the design work is performed outside Massachusetts. The sale of the design services is in Massachusetts because the service is physically delivered on behalf of the customer to the customer's intended audience in Massachusetts.

Example 3. Same facts as Example 2, except that the contract is with a business

customer that is based outside Massachusetts. The sale of the design services is in Massachusetts because the services are physically delivered on behalf of the customer to the customer's intended audience in Massachusetts.

Example 4. Fulfillment Corp., a corporation based outside Massachusetts, provides product delivery fulfillment services in Massachusetts and in neighboring states to Sales Corp., a corporation located outside Massachusetts that sells tangible personal property through a mail order catalog and over the Internet to customers. In some cases when a customer purchases tangible personal property from Sales Corp. to be delivered in Massachusetts, Fulfillment Corp. will, pursuant to its contract with Sales Corp., deliver that property from its fulfillment warehouse located outside Massachusetts. The sale of the fulfillment services of Fulfillment Corp. to Sales Corp. is assigned to Massachusetts to the extent that Fulfillment Corp.'s deliveries on behalf of Sales Corp. are to recipients in Massachusetts.

Example 5. Software Corp., a software development corporation, enters into a contract with a business customer, Buyer Corp., which is physically located in Massachusetts, to develop custom software to be used in Buyer Corp.'s business. Software Corp. develops the custom software outside Massachusetts, and then physically installs the software on Buyer Corp.'s computer hardware located in Massachusetts. The development and sale of the custom software is properly characterized as a service transaction, and the sale is assigned to Massachusetts because the software is physically delivered to the customer in Massachusetts.

Example 6. Same facts as Example 5, except that Buyer Corp. has offices in Massachusetts and several other states, but is commercially domiciled outside Massachusetts and orders the software from a location outside Massachusetts. The receipts from the development and sale of the custom software service are assigned to Massachusetts because the software is physically delivered to the customer in Massachusetts.

(B) Delivery to a Customer by Electronic Transmission. Services delivered by electronic transmission include, without limitation, services that are transmitted through the means of wire, lines, cable, fiber optics, electronic signals, satellite transmission, audio or radio waves, or other similar means, whether or not the service provider owns, leases or otherwise controls the transmission equipment. In the case of the delivery of a service by electronic transmission to a customer, the following rules apply.

1. Services Delivered by Electronic Transmission to an Individual Customer.

- a. Rule of Determination. In the case of the delivery of a service to an individual customer by electronic transmission, the service is delivered in Massachusetts if and to the extent that the taxpayer's customer receives the service in Massachusetts. If the taxpayer can determine the state or states where the service is received, it shall assign the sale to such state or states.
- b. Rules of Reasonable Approximation. If the taxpayer cannot determine the state or states where the customer actually receives the service, but has sufficient information regarding the place of receipt from which it can reasonably approximate the state or

states where the service is received, it shall reasonably approximate such state or states. Where a taxpayer does not have sufficient information from which it can determine or reasonably approximate the state or states in which the service is received, it shall reasonably approximate such state or states using the customer's billing address.

2. Services Delivered By Electronic Transmission to a Business Customer.

a. Rule of Determination. In the case of the delivery of a service to a business customer by electronic transmission, the service is delivered in Massachusetts if and to the extent that the taxpayer's customer receives the service in Massachusetts. If the taxpayer can determine the state or states where the service is received, it shall assign the sale to such state or states. For purposes of 830 CMR 63.38.1(9)(d)4.c.ii.(B)2., it is intended that the state or states where the service is received reflect the location at which the service is directly used by the employees or designees of the customer.

b. Rule of Reasonable Approximation. If the taxpayer cannot determine the state or states where the customer actually receives the service, but has sufficient information regarding the place of receipt from which it can reasonably approximate the state or states where the service is received, it shall reasonably approximate such state or states.

c. Secondary Rule of Reasonable Approximation. In the case of the delivery of a service to a business customer by electronic transmission where a taxpayer does not have sufficient information from which it can determine or reasonably approximate the state or states in which the service is received, such state or states shall be reasonably approximated as set forth in 830 CMR 63.38.7(a). In such cases, unless the taxpayer can apply the safe harbor set forth in 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.d. the taxpayer shall reasonably approximate the state or states in which the service is received as follows: first, by assigning the sale to the state where the contract of sale is principally managed by the customer; second, if the state where the customer principally manages the contract is not reasonably determinable, by assigning the sale to the customer's place of order; and third, if the customer's place of order is not reasonably determinable, by assigning the sale using the customer's billing address; provided, however, that in any instance in which the taxpayer derives more than 5% of its sales of services from a customer, the taxpayer is required to identify the state in which the contract of sale is principally managed by that customer.

d. Safe Harbor. In the case of the delivery of a service to a business customer by electronic transmission a taxpayer may not be able to determine, or reasonably approximate under 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.b., the state or states in which the service is received. In these cases, the taxpayer may, in *lieu* of the rule stated at 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.c., apply the safe harbor stated in 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.d. Under this safe harbor, a taxpayer may assign its sales to a particular customer based upon the customer's billing address in any taxable year in which the taxpayer (1) engages in substantially similar service transactions with more than 250 customers, whether business or individual, and (2) does not derive more than 5% of its sales of services from such customer. This safe harbor applies only for

purposes of 830 CMR 63.38.1(9)(d)4.c.ii.(B)2., to services delivered by electronic transmission to a business customer, and not otherwise.

3. Examples. Assume in each of these examples that the taxpayer that provides the service is taxable in Massachusetts and is to apportion its income pursuant to M.G.L. c. 63, § 38. Also, assume, where relevant, unless otherwise stated, that the taxpayer is taxable in each state other than Massachusetts to which its sale or sales would be assigned, so that there is no requirement in such examples that such sale or sales must be eliminated from the numerator and denominator of the taxpayer's sales factor. See 830 CMR 63.38.1(9)(d)1.f.ii. Further, assume where relevant, unless otherwise stated, that the safe harbor set forth at 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.d., does not apply.

Example 1. Support Corp., a corporation that is based outside Massachusetts, provides software support and diagnostic services to individual and business customers that have previously purchased certain software from third-party vendors. These individual and business customers are located in Massachusetts and other states. Support Corp. supplies its services on a case by case basis when directly contacted by its customer. Support Corp. generally provides these services through the Internet but sometimes provides these services by phone. In all cases, Support Corp. verifies the customer's account information before providing any service. Using the information that Support Corp. verifies before performing a service, Support Corp. can determine where its services are received, and therefore must assign its sales to these locations. The sales made to Support Corp.'s individual and business customers are in Massachusetts to the extent that Support Corp.'s services are received in Massachusetts. See 830 CMR 63.38.1(9)(d)4.c.ii.(B)1. and 2.

Example 2. Online Corp., a corporation based outside Massachusetts, provides web-based services through the means of the Internet to individual customers who are resident in Massachusetts and in other states. These customers access Online Corp.'s web services primarily in their states of residence, and sometimes, while traveling, in other states. For a substantial portion of its sales, either Online Corp. can determine the state or states where such services are received, or, where it cannot determine such state or states, it has sufficient information regarding the place of receipt to reasonably approximate such state or states. However, Online Corp. cannot determine or reasonably approximate the state or states of receipt for all of such sales. Assuming that Online Corp. reasonably believes, based on all available information, that the geographic distribution of the sales for which it cannot determine or reasonably approximate the location of the receipt of its services generally tracks those for which it does have this information, Online Corp. must assign to Massachusetts the sales for which it does not know the customers' location in the same proportion as those sales for which it has this information. See 830 CMR 63.38.1(9)(d)1.e.ii.

Example 3. Same facts as in Example 2, except that Online Corp. reasonably believes that the geographic distribution of the sales for which it cannot determine or reasonably approximate the location of the receipt of its web-based services do not generally track the sales for which it does have this information. Online Corp. must assign the sales of its services for which it lacks information as provided to its

individual customers using the customers' billing addresses. See 830 CMR 63.38.1(9)(d)4.c.ii.(B)1.b.

Example 4. Same facts as in Example 3, except that Online Corp. is not taxable in one state to which some of its sales would be otherwise assigned. The sales that would be otherwise assigned to that state are to be excluded from the numerator and denominator of Online Corp.'s sales factor. See 830 CMR 63.38.1(9)(d)4.c.ii.(B); 830 CMR 63.38.1(9)(d)1.f.ii.

Example 5. Net Corp., a corporation based outside Massachusetts, provides web-based services to a business customer, Business Corp., a company with offices in Massachusetts and two neighboring states. Particular employees of Business Corp. access the services from computers in each Business Corp. office. Assume that Net Corp. determines that Business Corp. employees in Massachusetts were responsible for 75% of Business Corp.'s use of Net Corp.'s services, and Business Corp. employees in other states were responsible for 25% of Business Corp.'s use of Net Corp.'s services. In such case, 75% of the sale is received in Massachusetts, and therefore 75% of the sale is in Massachusetts. See 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.a. Assume alternatively that Net Corp. lacks sufficient information regarding the location or locations where Business Corp.'s employees used the services to determine or reasonably approximate such location or locations. Under these circumstances, if Net Corp. derives 5% or less of its sales from Business Corp., Net Corp. must assign the sale under 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.c. to the state where Business Corp. principally managed the contract, or if that state is not reasonably determinable, to the state where Business Corp. placed the order for the services, or if that state is not reasonably determinable, to the state of Business Corp.'s billing address. If Net Corp. derives more than 5% of its sales of services from Business Corp., Net Corp. is required to identify the state in which its contract of sale is principally managed by Business Corp. and must assign the receipts to that state.

Example 6. Net Corp., a corporation based outside Massachusetts, provides web-based services through the means of the Internet to more than 250 individual and business customers in Massachusetts and in other states. Assume that for each customer Net Corp. cannot determine the state or states where its web services are actually received, and lacks sufficient information regarding the place of receipt to reasonably approximate such state or states. Also assume that Net Corp. does not derive more than 5% of its sales of services from any single customer. Net Corp. may apply the safe harbor stated in 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.d., and may assign its sales using each customer's billing address. If Net Corp. is not taxable in one or more states to which some of its sales would be otherwise assigned, it must exclude those sales from the numerator and denominator of its sales factor. See 830 CMR 63.38.1(9)(d)1.f.ii.

(C) Services Delivered Electronically Through or on Behalf of an Individual or Business Customer. A service delivered electronically "on behalf of" the customer is one in which a customer contracts for a service to be delivered electronically but one or more third parties, rather than the customer, is the recipient of the service, such as the direct or indirect delivery of advertising on behalf of a customer to the customer's intended audience. A service delivered

electronically "through" a customer to third-party recipients is a service that is delivered electronically to a customer for purposes of resale and subsequent electronic delivery in substantially identical form to end users or other third-party recipients.

1. Rule of Determination. In the case of the delivery of a service by electronic transmission, where the service is delivered electronically to end users or other third-party recipients through or on behalf of the customer, the service is delivered in Massachusetts if and to the extent that the end users or other third-party recipients are in Massachusetts. For example, in the case of the direct or indirect delivery of advertising on behalf of a customer to the customer's intended audience by electronic means, the service is delivered in Massachusetts to the extent that the audience for such advertising is in Massachusetts. In the case of the delivery of a service to a customer that acts as an intermediary in reselling the service in substantially identical form to third-party recipients, the service is delivered in Massachusetts to the extent that the end users or other third-party recipients receive such services in Massachusetts. 830 CMR 63.38.1(9)(d)4.c.ii.(C) apply whether the taxpayer's customer is an individual customer or a business customer and whether the end users or other third-party recipients to which the services are delivered through or on behalf of the customer are individuals or businesses.

2. Rule of Reasonable Approximation. If the taxpayer cannot determine the state or states where the services are actually delivered to the end users or other third-party recipients either through or on behalf of the customer, but has sufficient information regarding the place of delivery from which it can reasonably approximate the state or states where the services are delivered, it shall reasonably approximate such state or states.

3. Select Secondary Rules of Reasonable Approximation.

i. Where a taxpayer's service is the direct or indirect electronic delivery of advertising on behalf of its customer to the customer's intended audience, if the taxpayer lacks sufficient information regarding the location of the audience from which it can determine or reasonably approximate such location, the taxpayer shall reasonably approximate the audience in a state for such advertising using the following secondary rules of reasonable approximation. Where a taxpayer is delivering advertising directly or indirectly to a known list of subscribers, the taxpayer shall reasonably approximate the audience for advertising in a state using a percentage that reflects the ratio of the state's subscribers in the specific geographic area in which the advertising is delivered relative to the total subscribers in such area. For a taxpayer with less information about its audience, the taxpayer shall reasonably approximate the audience in a state using the percentage that reflects the ratio of the state's population in the specific geographic area in which the advertising is delivered relative to the total population in such area.

ii. Where a taxpayer's service is the delivery of a service to a customer that then acts as the taxpayer's intermediary in reselling such service to end users or other third-party recipients, if the taxpayer lacks sufficient information regarding the location of the end users or other third-party recipients from which it can determine or reasonably approximate such location, the taxpayer shall reasonably approximate the extent to which the service is received in a state by using the percentage that reflects the ratio of the state's population in the specific geographic area in which the taxpayer's

intermediary resells such services, relative to the total population in such area.

4. Examples. Assume in each of these examples that the taxpayer that provides the service is taxable in Massachusetts and is to apportion its income pursuant to M.G.L. c. 63, § 38. Also, assume, where relevant, unless otherwise stated, that the taxpayer is taxable in each state other than Massachusetts to which its sale or sales would be assigned, so that there is no requirement in such examples that such sale or sales must be eliminated from the numerator and denominator of the taxpayer's sales factor. See 830 CMR 63.38.1(9)(d)1.f.ii.

Example 1. Cable TV Corp., a corporation that is based outside of Massachusetts, has two revenue streams. First, Cable TV Corp. sells advertising time to business customers pursuant to which the business customers' advertisements will run as commercials during Cable TV Corp.'s televised programming. Some of these business customers, though not all of them, have a physical presence in Massachusetts. Second, Cable TV Corp. sells monthly subscriptions to individual customers in Massachusetts and in other states. Cable TV Corp.'s sale of advertising time to its business customers is assigned to Massachusetts to the extent that the audience for Cable TV Corp.'s televised programming during which the advertisements run is in Massachusetts. See 830 CMR 63.38.1(9)(d)4.c.ii.(C)1. If Cable TV Corp. is unable to determine the actual location of its audience for the programming, and lacks sufficient information regarding audience location to reasonably approximate such location, Cable TV Corp. must approximate its Massachusetts audience using the percentage that reflects the ratio of its Massachusetts subscribers in the geographic area in which Cable TV Corp.'s televised programming featuring such advertisements is delivered relative to its total number of subscribers in such area. See 830 CMR 63.38.1(9)(d)4.c.ii.(C)3.i. To the extent that Cable TV Corp.'s sales of monthly subscriptions represent the sale of a service, such sales are properly assigned to Massachusetts in any case in which the programming is received by a customer in Massachusetts. See 830 CMR 63.38.1(9)(d)4.c.ii.(B)1. In any case in which Cable TV Corp. cannot determine the actual location where the programming is received, and lacks sufficient information regarding the location of receipt to reasonably approximate such location, such sales of Cable TV Corp.'s monthly subscriptions are assigned to Massachusetts where its customer's billing address is in Massachusetts. See 830 CMR 63.38.1(9)(d)4.c.ii.(B)1.b. Note that whether and to the extent that the monthly subscription fee represents a fee for a service or for a license of intangible property does not affect the analysis or result as to the state or states to which the sales are properly assigned. See 830 CMR 63.38.1(9)(d)5.e.

Example 2. Network Corp., a corporation that is based outside of Massachusetts, sells advertising time to business customers pursuant to which the customers' advertisements will run as commercials during Network Corp.'s televised programming as distributed by unrelated cable television and satellite television transmission companies. Network Corp.'s sale of advertising time to its business customers is assigned to Massachusetts to the extent that the audience for Network Corp.'s televised programming during which the advertisements will run is in Massachusetts. See 830 CMR 63.38.1(9)(d)4.c.ii.(C)1. If Network Corp. cannot determine the actual location of the audience for its programming during which the

advertisements will run, and lacks sufficient information regarding audience location to reasonably approximate such location, Network Corp. must approximate the amount of the sales that constitutes Massachusetts sales by multiplying the amount of such sales by a percentage that reflects the ratio of the Massachusetts population in the specific geographic area in which the televised programming containing the advertising is run relative to the total population in such area. See 830 CMR 63.38.1(9)(d)4.c.ii.(C)3.i. In any case in which Network Corp.'s sales would be assigned to a state in which Network Corp. is not taxable, such sales shall be excluded from the numerator and denominator of Network Corp.'s sales factor. See 830 CMR 63.38.1(9)(d)1.f.ii.

Example 3. Web Corp., a corporation that is based outside Massachusetts, provides Internet content to viewers in Massachusetts and other states. Web Corp. sells advertising space to business customers pursuant to which the customers' advertisements will appear in connection with Web Corp.'s Internet content. Web Corp. receives a fee for running the advertisements that is determined by reference to the number of times the advertisement is viewed or clicked upon by the viewers of its website. Web Corp.'s sale of advertising space to its business customers is assigned to Massachusetts to the extent that the viewers of the Internet content are in Massachusetts, as measured by viewings or clicks. See 830 CMR 63.38.1(9)(d)4.c.ii.(C)1. If Web Corp. is unable to determine the actual location of its viewers, and lacks sufficient information regarding the location of its viewers to reasonably approximate such location, Web Corp. must approximate the amount of its Massachusetts sales by multiplying the amount of such sales by a percentage that reflects the Massachusetts population in the specific geographic area in which the content containing the advertising is delivered relative to the total population in such area. See 830 CMR 63.38.1(9)(d)4.c.ii.(C)3.i. In any case in which Web Corp.'s sales would be assigned to a state in which Web Corp. is not taxable, such sales shall be excluded from the numerator and denominator of Web Corp.'s sales factor. See 830 CMR 63.38.1(9)(d)1.f.ii.

Example 4. Retail Corp., a corporation that is based outside of Massachusetts, sells tangible property through its retail stores located in Massachusetts and other states, and through a mail order catalog. Answer Co., a corporation that operates call centers in multiple states, contracts with Retail Corp. to answer telephone calls from individuals placing orders for products found in Retail Corp.'s catalogs. In this case, the phone answering services of Answer Co. are being delivered to Retail Corp.'s customers and prospective customers. Therefore, Answer Co. is delivering a service electronically to Retail Corp.'s customers or prospective customers on behalf of Retail Corp., and must assign the proceeds from this service to the state or states from which the phone calls are placed by such customers or prospective customers. If Answer Co. cannot determine the actual locations from which phone calls are placed, and lacks sufficient information regarding the locations to reasonably approximate such locations, Answer Co. must approximate the amount of its Massachusetts sales by multiplying the amount of its fee from Retail Corp. by a percentage that reflects the Massachusetts population in the specific geographic area from which the calls are placed relative to the total population in such area. See 830 CMR 63.38.1(9)(d)4.c.i.; 830 CMR 63.38.1(9)(d)4.c.ii.(C). Answer Co.'s sales shall also be excluded from the

numerator and denominator of its sales factor in any case in which such sales would be assigned to a state in which Answer Co. is not taxable. See 830 CMR 63.38.1(9)(d).1.f.ii.

Example 5. Web Corp., a corporation that is based outside of Massachusetts, sells tangible property to customers via its Internet website. Design Co. designed and maintains Web Corp.'s website, including making changes to the site based on customer feedback received through the site. Design Co.'s services are delivered to Web Corp., the proceeds from which are assigned pursuant to 830 CMR 63.38.1(9)(d)4.c.ii(B). The fact that Web Corp.'s customers and prospective customers incidentally benefit from Design Co.'s services, and may even interact with Design Co. in the course of providing feedback, does not transform the service into one delivered "on behalf of" Web Corp. to Web Corp.'s customers and prospective customers.

Example 6. Wholesale Corp., a corporation that is based outside Massachusetts, develops an Internet-based information database outside Massachusetts and enters into a contract with Retail Corp. whereby Retail Corp. will market and sell access to this database to end users. Depending on the facts, the provision of database access may be either the sale of a service or the license of intangible property or may have elements of both. Assume that on the particular facts applicable in this example Wholesale Corp. is selling database access in transactions properly characterized as involving the performance of a service. When an end user purchases access to Wholesale Corp.'s database from Retail Corp., Retail Corp. in turn compensates Wholesale Corp. in connection with that transaction. In this case, Wholesale Corp.'s services are being delivered through Retail Corp. to the end user. Wholesale Corp. must assign its sales to Retail Corp. to the state or states in which the end users receive access to Wholesale Corp.'s database. If Wholesale Corp. cannot determine the state or states where the end users actually receive access to Wholesale Corp.'s database, and lacks sufficient information regarding the location from which the end users access the database to reasonably approximate such location, Wholesale Corp. must approximate the extent to which its services are received by end users in Massachusetts by using a percentage that reflects the ratio of the Massachusetts population in the specific geographic area in which Retail Corp. regularly markets and sells Wholesale Corp.'s database relative to the total population in such area. See 830 CMR 63.38.1(9)(d)4.c.ii.(C)3.ii. Note that it does not matter for purposes of the analysis whether Wholesale Corp.'s sale of database access constitutes a service or a license of intangible property, or some combination of both. See 830 CMR 63.38.1(9)(d)5.e. In any case in which Wholesale Corp.'s sales would be assigned to a state in which Wholesale Corp. is not taxable, such sales shall be excluded from the numerator and denominator of Wholesale Corp.'s sales factor. See 830 CMR 63.38.1(9)(d).1.f.ii.

d. Professional Services.

i. In General. Except as otherwise provided in 830 CMR 63.38.1(9)(d)4.d.ii, professional services are services that require specialized knowledge and in some cases require a professional certification, license or degree. Professional services include, without limitation, management services, bank and financial services, financial custodial services, investment and brokerage services, fiduciary services,

tax preparation, payroll and accounting services, lending and credit card services, legal services, consulting services, video production services, graphic and other design services, engineering services, and architectural services.

ii. Overlap with Other Categories of Services.

(A) Certain services that fall within the definition of "professional services" set forth in 830 CMR 63.38.1(9)(d)4.d.i. are nevertheless treated as "in-person services" within the meaning of 830 CMR 63.38.1(9)(d)4.b., and are assigned under 830 CMR 63.38.1(9)(d)4.b. Specifically, professional services that are physically provided in person by the taxpayer such as carpentry, certain medical and dental services or child care services, where the customer or the customer's real or tangible property upon which the services are provided is in the same location as the service provider at the time the services are performed, are "in-person services" and are assigned as such, notwithstanding that they may also be considered to be "professional services". However, professional services where the service is of an intellectual or intangible nature, such as legal, accounting, financial and consulting services, are assigned as professional services under 830 CMR 63.38.1(9)(d)4.d.iii., notwithstanding the fact that such services may involve some amount of in-person contact.

(B) Professional services may in some cases include the transmission of one or more documents or other communications by mail or by electronic means. However, in such cases, despite this transmission, the assignment rules that apply are those set forth in 830 CMR 63.38.1(9)(d)4.d.iii., and not those set forth in 830 CMR 63.38.1(9)(d)4.c., pertaining to services delivered to a customer or through or on behalf of a customer.

iii. Assignment of Sales. In the case of a professional service, it is generally possible to characterize the location of delivery in multiple ways by emphasizing different elements of the service provided, no one of which will consistently represent the market for the services. Therefore, for purposes of consistent application of the market sourcing rule stated in M.G.L. c. 63, § 38(f), the Commissioner has concluded that the location of delivery in the case of professional services is not susceptible to a general rule of determination, and must be reasonably approximated. The assignment of a sale of a professional service depends in many cases upon whether the customer is an individual or business customer. In any instance in which the taxpayer, acting in good faith, cannot reasonably determine whether the customer is an individual or business customer, the taxpayer shall treat the customer as a business customer. For purposes of assigning the sale of a professional service, a taxpayer's customer is the person who contracts for such service, irrespective of whether another person pays for or also benefits from the taxpayer's services. Except as provided in 830 CMR 63.38.1(9)(d)4.d.iii.(D) (mutual fund sales), in any instance in which the taxpayer is not taxable in the state to which a sale shall be assigned, the sale shall be excluded from the numerator and denominator of the taxpayer's sales factor. See 830 CMR 63.38.1(9)(d)1.f.ii.

(A) General Rule. Sales of professional services other than those services described in 830 CMR 63.38.1(9)(d)4.d.iii.(B) (architectural and engineering services), 830 CMR 63.38.1(9)(d)4.d.iii.(C) (services provided by a financial institution) and 830 CMR 63.38.1(9)(d)4.d.iii.(D) (certain services provided to RICs)), are assigned in accordance with 830 CMR 63.38.1(9)(d)4.d.iii.(A).

1. Professional Services Delivered to Individual Customers. Except as otherwise provided in 830 CMR 63.38.1(9)(d)4.d., in any instance in which the service provided is a

professional service and the taxpayer's customer is an individual customer, the state or states in which the service is delivered shall be reasonably approximated as set forth in 830 CMR 63.38.1(9)(d)4.d.iii.(A)1. In particular, the taxpayer shall assign the sale to the customer's state of primary residence, or, if the taxpayer cannot reasonably identify the customer's state of primary residence, to the state of the customer's billing address; provided, however, in any instance in which the taxpayer derives more than 5% of its sales of services from an individual customer, the taxpayer is required to identify the customer's state of primary residence and must assign the receipts from the service or services provided to that customer to that state.

2. Professional Services Delivered to Business Customers. Except as otherwise provided in 830 CMR 63.38.1(9)(d)4.d., in any instance in which the service provided is a professional service and the taxpayer's customer is a business customer, the state or states in which the service is delivered shall be reasonably approximated as set forth in 830 CMR 63.38.1(9)(d)4.d.iii.(A)2. In particular, unless the taxpayer may use the safe harbor set forth at 830 CMR 63.38.1(9)(d)4.d.iii.(A)3., the taxpayer shall assign the sale as follows: first, by assigning the receipts to the state where the contract of sale is principally managed by the customer; second, if such place of customer management is not reasonably determinable, to the customer's place of order; and third, if such customer place of order is not reasonably determinable, to the customer's billing address; provided, however, in any instance in which the taxpayer derives more than 5% of its sales of services from a customer, the taxpayer is required to identify the state in which the contract of sale is principally managed by the customer.

3. Safe Harbor; Large Volume of Transactions. Notwithstanding 830 CMR 63.38.1(9)(d)4.d.iii.(A)1. and 2., a taxpayer may assign its sales to a particular customer based on the customer's billing address in any taxable year in which the taxpayer (1) engages in substantially similar service transactions with more than 250 customers, whether individual or business, and (2) does not derive more than 5% of its sales of services from such customer. This safe harbor applies only for purposes of 830 CMR 63.38.1(9)(d)4.d.iii.(A), and not otherwise.

(B) Architectural and Engineering Services with Respect to Real or Tangible Personal Property. Architectural and engineering services with respect to real or tangible personal property are professional services within the meaning of 830 CMR 63.38.1(9)(d)4.d. However, unlike in the case of the general rule that applies to professional services, (1) the sale of such an architectural service is assigned to a state or states if and to the extent that the services are with respect to real estate improvements located, or expected to be located, in such state or states; and (2) the sale of such an engineering service is assigned to a state or states if and to the extent that the services are with respect to tangible or real property located in such state or states, including real estate improvements located in, or expected to be located in, such state or states. 830 CMR 63.38.1(9)(d)4.d. applies whether or not the customer is an individual or business customer. In any instance in which architectural or engineering services are not described in 830 CMR 63.38.1(9)(d)4.d.iii.(B), the sale of such services shall be assigned under the general rule for professional services. See 830 CMR 63.38.1(9)(d)4.d.iii.(A).

(C) Services Provided by a Financial Institution. The apportionment rules that apply to financial institutions are set forth at M.G.L. c. 63, § 2A. M.G.L. c. 63, § 2A includes specific rules to

determine a financial institution's sales factor. See M.G.L. c. 63, § 2A(d). However, M.G.L. c. 63, § 2A also provides that receipts from sales, other than sales of tangible personal property, including service transactions, that are not otherwise apportioned under M.G.L. c. 63, § 2A(d), are to be assigned pursuant to M.G.L. c. 63, § 38(f). See M.G.L. c. 63, § 2A(d)(xi). In any instance in which a financial institution performs services that are to be assigned pursuant to M.G.L. c. 63, § 38(f), including, for example, financial custodial services, those services shall be considered professional services within the meaning of 830 CMR 63.38.1(9)(d)4.d., and shall be assigned according to the general rule for professional service transactions as set forth at 830 CMR 63.38.1(9)(d)4.d.iii.(A).

(D) Mutual Fund Sales. Mutual fund sales within the meaning of 830 CMR 63.38.1, generally are sales of professional services for purposes of 830 CMR 63.38.1(9)(d)4.d. See 830 CMR 63.38.1(2) (definition of mutual fund sales). However, the rules to assign mutual fund sales made by a mutual fund service corporation are those set forth in 830 CMR 63.38.7, and not those set forth in 830 CMR 63.38.1. Also, in the case of mutual fund sales made by a taxpayer that is not a mutual fund service corporation, such mutual fund sales shall be assigned by applying the sourcing methodology described in 830 CMR 63.38.7(4)(c)4. to such sales. In these cases, consistent with the rules of M.G.L. c. 63, § 38(f) and 830 CMR 63.38.7, the mutual fund sales made by the taxpayer directly or indirectly to the RIC are included in the numerator and denominator of the taxpayer's sales factor irrespective as to whether the taxpayer is taxable in one or more of the states in which the RIC's shareholders are domiciled.

iv. Examples. Unless otherwise stated, assume in each of these examples, where relevant:

(a) that the taxpayer that provides the service is taxable in Massachusetts and is to apportion its income pursuant to M.G.L. c. 63, § 38;

(b) that the taxpayer is taxable in each state other than Massachusetts to which its sale or sales would be assigned, so that there is no requirement in such examples that such sale or sales must be excluded from the numerator and denominator of the taxpayer's sales factor, see 830 CMR 63.38.1(9)(d)1.f.ii.;

(c) that the safe harbor set forth at 830 CMR 63.38.1(9)(d)4.ii.(A).3 does not apply; and

(d) that the taxpayer's service at issue is not provided directly or indirectly to a RIC, see 830 CMR 63.38.1(9)(d)4.d.iii.(D).

Example 1. Broker Corp. provides securities brokerage services to individual customers who are resident in Massachusetts and in other states. Assume that Broker Corp. knows the state of primary residence for many of its customers, and where it does not know this state of primary residence, it knows the customer's billing address. Also assume that Broker Corp. does not derive more than 5% of its sales of services from any one individual customer. Where Broker Corp. knows its customer's state of primary residence, it shall assign the sale to that state. Where Broker Corp. does not know its customer's state of primary residence, but rather knows the customer's billing address, it shall assign the sale to that state. See 830 CMR 63.38.1(9)(d)4.d.iii.(A)1.

Example 2. Same facts as in Example 1, except that Broker Corp. has several individual customers from whom it derives, in each instance, more than 5% of its sales of services.

Sales to customers from whom Broker Corp. derives 5% or less of its sales of services shall be assigned as described in example 1. For each customer from whom it derives more than 5% of its sales of services, Broker Corp. is required to determine the customer's state of primary residence and must assign the receipts from the services provided to that customer to that state. In any case in which a 5% customer's state of primary residence is Massachusetts, a sale made to that customer must be assigned to Massachusetts; in any case in which a 5% customer's state of primary residence is not Massachusetts a sale made to that customer is not assigned to Massachusetts. Where a sale is assigned to a state other than Massachusetts, if the state of assignment (*i.e.*, the state of primary residence of the individual customer) is a state in which Broker Corp. is not taxable, receipts from the sales shall be excluded from the numerator and denominator of Broker Corp.'s sales factor. See 830 CMR 63.38.1(9)(d)4.d.iii.(A); 830 CMR 63.38.1(9)(d)1.f.ii.

Example 3. Architecture Corp. provides building design services as to buildings located, or expected to be located, in Massachusetts to individual customers who are resident in Massachusetts and other states, and to business customers that are based in Massachusetts and other states. Architecture Corp.'s sales are assigned to Massachusetts because the locations of the buildings to which its design services relate are in Massachusetts, or are expected to be in Massachusetts. For purposes of assigning these sales, it is not relevant where, in the case of an individual customer, the customer primarily resides or is billed for such services, and it is not relevant where, in the case of a business customer, the customer principally manages the contract, placed the order for the services or is billed for such services. Further, such sales are assigned to Massachusetts even if Architecture Corp.'s designs are either physically delivered to its customer in paper form in a state other than Massachusetts or are electronically delivered to its customer in a state other than Massachusetts. See 830 CMR 63.38.1(9)(d)4.d.iii.(B).

Example 4. Law Corp. provides legal services to individual clients who are resident in Massachusetts and in other states. In some cases, Law Corp. may prepare one or more legal documents for its client as a result of these services and/or the legal work may be related to litigation or a legal matter that is ongoing in a state other than where the client is resident. Assume that Law Corp. knows the state of primary residence for many of its clients, and where it does not know this state of primary residence, it knows the client's billing address. Also assume that Law Corp. does not derive more than 5% of its sales of services from any one individual client. Where Law Corp. knows its client's state of primary residence, it shall assign the sale to that state. Where Law Corp. does not know its client's state of primary residence, but rather knows the client's billing address, it shall assign the sale to that state. For purposes of the analysis it is irrelevant whether the legal documents relating to the service are mailed or otherwise delivered to a location in another state, or the litigation or other legal matter that is the underlying predicate for the services is in another state. See 830 CMR 63.38.1(9)(d)4.d.ii.(B) and iii.(A)1.

Example 5. Same facts as in Example 4, except that Law Corp. provides legal services to several individual clients who it knows have a primary residence in a state where Law Corp. is not taxable. Receipts from these services shall be excluded from the numerator and denominator of Law Corp.'s sales factor even if the billing address of one or more of these clients is in a state in which Law Corp. is taxable, including Massachusetts. See 830 CMR 63.38.1(9)(d)4.d.iii.(A)1.; 830 CMR 63.38.1(9)(d)1.f.ii.

Example 6. Law Corp. provides legal services to several multistate business clients. In each case, Law Corp. knows the state in which the agreement for legal services that governs the client relationship is principally managed by the client. In one case, the agreement is principally managed in Massachusetts; in the other cases, the agreement is principally managed in a state other than Massachusetts. Where the agreement for legal services is principally managed by the client in Massachusetts the sale of the services shall be assigned to Massachusetts; in the other cases, the sale is not assigned to Massachusetts. In the case of the sale that is assigned to Massachusetts, the sale shall be so assigned even if (1) the legal documents relating to the service are mailed or otherwise delivered to a location in another state, or (2) the litigation or other legal matter that is the underlying predicate for the services is in another state. See 830 CMR 63.38.1(9)(d)4.d.ii.(B) and iii.(A)2.

Example 7. Same facts as in example 6, except that Law Corp. is not taxable in one of the states other than Massachusetts in which Law Corp.'s agreement for legal services that governs the client relationship is principally managed by the business client. Receipts from these latter services shall be excluded from the numerator and denominator of Law Corp.'s sales factor. See 830 CMR 63.38.1(9)(d)4.d.iii. and iii.(A)2.; 830 CMR 63.38.1(9)(d)1.f.ii.

Example 8. Consulting Corp., a company that provides consulting services to law firms and other customers, is hired by Law Corp. in connection with legal representation that Law Corp. provides to Client Co. Specifically, Consulting Corp. is hired to provide expert testimony at a trial being conducted by Law Corp. on behalf of Client Co. Client Co. pays for Consulting Corp.'s services directly. Assuming that Consulting Corp. knows that its agreement with Law Co. is principally managed by Law Corp. in Massachusetts, the sale of Consulting Corp.'s services shall be assigned to Massachusetts. It is not relevant for purposes of the analysis that Client Co. is the ultimate beneficiary of Consulting Corp.'s services, or that Client Co. pays for Consulting Corp.'s services directly. See 830 CMR 63.38.1(9)(d)4.d.iii.(A)2.

Example 9. Bank Corp. provides financial custodial services to 100 individual customers who are resident in Massachusetts and in other states, including the safekeeping of some of its customers' financial assets. Assume for purposes of this example that Bank Corp. knows the state of primary residence for many of its customers, and where it does not know this state of primary residence, it knows the customer's billing address. Also assume that Bank Corp. does not derive more than 5% of its sales of all of its services from any single customer. Note that because Bank Corp. does not have more than 250 customers, it may not apply the safe harbor for professional services stated in 830 CMR 63.38.1(9)(d)4.d.iii.(A)3. Where Bank Corp. knows its customer's state of primary residence, it must assign the sale to that state. Where Bank Corp. does not know its customer's state of primary residence, but rather knows the customer's billing address, it must assign the sale to that state. Bank Corp.'s sales are assigned to Massachusetts if the customer's state of primary residence (or billing address, in cases where it does not know the customer's state of primary residence) is in Massachusetts, even if Bank Corp.'s financial custodial work, including the safekeeping of the customer's financial assets, takes place in a state other than Massachusetts. See 830 CMR 63.38.1(9)(d)4.d.iii.(A)1. and (C).

Example 10. Same facts as Example 9, except that Bank Corp. has more than 250

customers, individual or business. Bank Corp. may apply the safe harbor for professional services stated in 830 CMR 63.38.1(9)(d)4.d.iii.(A)3., and may assign its sales to a state or states using each customer's billing address. If Bank Corp is not taxable in one or more states to which some of its sales would be assigned, it must exclude the sales that would be assigned to those states from the numerator and denominator of its sales factor. See 830 CMR 63.38.1(9)(d)4.d.iii., iii.(C); 830 CMR 63.38.1(9)(d)1.f.ii.

Example 11. Same facts as Example 10, except that Bank Corp. derives more than 5% of its sales from a single individual customer. As to the sales made to this customer, Bank Corp. is required to determine the individual customer's state of primary residence and must assign the receipts from the service or services provided to that customer to that state. See 830 CMR 63.38.1(9)(d)4.d.iii.(A)1., iii.(C). Sales to all other customers are assigned as described in Example 10.

Example 12. Advisor Corp., a corporation that provides investment advisory services, provides such advisory services to Investment Co. Investment Co. is a multistate business client of Advisor Corp. that uses Advisor Corp.'s services in connection with investment accounts that it manages for individual clients, who are the ultimate beneficiaries of Advisor Corp.'s services. Assume that Investment Co.'s individual clients are persons that are resident in numerous states, which may or may not include Massachusetts. Assuming that Advisor Corp. knows that its agreement with Investment Co. is principally managed by Investment Co. in Massachusetts, the sale of Advisor Corp.'s services shall be assigned to Massachusetts. It is not relevant for purposes of the analysis that the ultimate beneficiaries of Advisor Corp.'s services may be Investment Co.'s clients, who are residents of numerous states. See 830 CMR 63.38.1(9)(d)4.d.iii.(A)2.

Example 13. Same facts as Example 12, except that in addition to providing investment advisory services to Investment Co., Advisor Corp. also provides its advisory services to Mutual Fund Co., a regulated investment company with shareholders that are resident in numerous states, including Massachusetts. Advisor Corp. is not a mutual fund service corporation; however Advisor Corp.'s services provided to Mutual Fund Co. constitute mutual fund sales within the meaning of 830 CMR 63.38.1. See 830 CMR 63.38.1(2). Advisor Corp.'s mutual fund sales to Mutual Fund Co. shall be assigned to Massachusetts to the extent that Mutual Fund Co.'s shareholders of record are domiciled in Massachusetts. See 830 CMR 63.38.1(9)(d)4.d.iii.(D). However, unlike in the rule set forth generally in 830 CMR 63.38.1(9)(d), there shall be no exclusion of such sales from the numerator and denominator of Advisor Corp.'s sales factor in any case in which such shareholders of record are domiciled in a state in which Advisor Corp. is not taxable. See *id.* In contrast to its mutual fund sales made to Mutual Fund Co., Advisor Corp.'s advisory services provided to Investment Co. are assigned as stated in Example 12, and its sales to Investment Co. shall be excluded from the numerator and denominator of Advisor Corp.'s sales factor if such sales would be assigned to a state in which Advisor Corp. is not taxable. See 830 CMR 63.38.1(9)(d)4.d.iii. and iii.(A)2.

Example 14. Advisor Corp. provides investment advisory services to Investment Fund LP, a partnership that invests in securities and other assets. Assuming that Advisor Corp. knows that its agreement with Investment Fund LP is principally managed by Investment Fund LP in Massachusetts, the sale of Advisor Corp.'s services shall be assigned to

Massachusetts. See 830 CMR 63.38.1(9)(d)4.d.iii.(A)2. Note that, unlike in the case of mutual fund sales (see 830 CMR 63.38.1(9)(d)4.d.iii.(D)), it is not relevant for purposes of the analysis that the partners in Investment Fund LP are residents of numerous states.

Example 15. Design Corp. is a corporation based outside Massachusetts that provides graphic design and similar services in Massachusetts and in neighboring states. Design Corp. enters into a contract at a location outside Massachusetts with an individual customer to design fliers for the customer. Assume that Design Corp. does not know the individual customer's state of primary residence and does not derive more than 5% of its sales of services from the individual customer. All of the design work is performed outside Massachusetts. The sale is in Massachusetts if the customer's billing address is in Massachusetts. See 830 CMR 63.38.1(9)(d)4.d.iii.(A)1.

5. License or Lease of Intangible Property.

a. General Rules.

i. The receipts from the license of intangible property are in Massachusetts if and to the extent the intangible is used in Massachusetts. In general, the term "use" shall be construed to refer to the location of the taxpayer's market for the use of the intangible property that is being licensed and is not to be construed to refer to the location of the property or payroll of the taxpayer as otherwise determined for corporate apportionment purposes pursuant to 830 CMR 63.38.1(7) and (8). 830 CMR 63.38.1(7) and (8) determines the location of the use of intangible property in the context of several specific types of licensing transactions are set forth at 830 CMR 63.38.1(9)(d)5.b. through e. For purposes of the rules set forth in 830 CMR 63.38.1(9)(d)5., a lease of intangible property is to be treated the same as a license of intangible property.

ii. In general, a license of intangible property that conveys all substantial rights in such property is treated as a sale of intangible property for tax purposes. See 830 CMR 63.38.1(9)(d)6. Note, however, that for purposes of 830 CMR 63.38.1(9)(d)5. and 6., a sale or exchange of intangible property is treated as a license of such property where the receipts from the sale or exchange derive from payments that are contingent on the productivity, use or disposition of the property

iii. Intangible property licensed as part of the sale or lease of tangible property is treated under 830 CMR 63.38.1(9) as the sale or lease of tangible property.

iv. In any instance in which the taxpayer is not taxable in the state to which the receipts from the license of intangible property are assigned, the receipts shall be excluded from the numerator and denominator of the taxpayer's sales factor. See 830 CMR 63.38.1(9)(d)1.f.ii.

v. To the extent that the transfer of either a security, as defined in 830 CMR 63.38.1(2), or business "goodwill" or similar intangible value, including, without limitation, "going concern value" or "workforce in place," may be characterized as a license or lease of intangible property, receipts from such transaction shall be excluded from the numerator and the denominator of the taxpayer's sales factor.

b. License of a Marketing Intangible. Where a license is granted for the right to use intangible property in connection with the sale, lease, license, or other marketing of goods, services, or other items (*i.e.*, a marketing intangible), the royalties or other licensing fees paid by the licensee for such right are assigned to Massachusetts to the extent that the fees are attributable to the sale or other provision of goods,

services, or other items purchased or otherwise acquired by customers in Massachusetts. Examples of a license of a marketing intangible include, without limitation, the license of a service mark, trademark, or trade name; certain copyrights; the license of a film, television or multimedia production or event for commercial distribution; and a franchise agreement. In each of these instances the license of the marketing intangible is intended to promote consumer sales. In the case of the license of a marketing intangible, where a taxpayer has actual evidence of the amount or proportion of its receipts that is attributable to Massachusetts, it shall assign such amount or proportion to Massachusetts. In the absence of actual evidence of the amount or proportion of the licensee's receipts that are derived from Massachusetts customers, the portion of the licensing fee to be assigned to Massachusetts shall be reasonably approximated by multiplying the total fee by a percentage that reflects the ratio of the Massachusetts population in the specific geographic area in which the licensee makes material use of the intangible property to regularly market its goods, services or other items relative to the total population in such area. Where the license of a marketing intangible is for the right to use the intangible property in connection with sales or other transfers at wholesale rather than directly to retail customers, the portion of the licensing fee to be assigned to Massachusetts shall be reasonably approximated by multiplying the total fee by a percentage that reflects the ratio of the Massachusetts population in the specific geographic area in which the licensee's goods, services, or other items are ultimately marketed using the intangible property relative to the total population of such area.

c. License of a Production Intangible. Where a license is granted for the right to use intangible property other than in connection with the sale, lease, license, or other marketing of goods, services, or other items, and the license is to be used in a production capacity (a "production intangible"), the licensing fees paid by the licensee for such right are assigned to Massachusetts to the extent that the use for which the fees are paid takes place in Massachusetts. Examples of a license of a production intangible include, without limitation, the license of a patent, a copyright, or trade secrets to be used in a manufacturing process, where the value of the intangible lies predominately in its use in such process. In the case of a license of a production intangible, it shall be presumed that the use of the intangible property takes place in the state of the licensee's commercial domicile (where the licensee is a business) or the licensee's state of primary residence (where the licensee is an individual) unless the taxpayer or the Commissioner can reasonably establish the location(s) of actual use. Where the Commissioner can reasonably establish that the actual use of intangible property pursuant to a license of a production intangible takes place in part in Massachusetts, it shall be presumed that the entire use is in Massachusetts except to the extent that the taxpayer can demonstrate that the actual location of a portion of the use takes place outside Massachusetts.

d. License of a Mixed Intangible. Where a license of intangible property includes both a license of a marketing intangible and a license of a production intangible (a "mixed intangible") and the fees to be paid in each instance are separately and reasonably stated in the licensing contract, the Commissioner will accept such separate statement for purposes of 830 CMR 63.38.1 if it is reasonable. Where a license of intangible property includes both a license of a marketing intangible and a license of a production intangible and the fees to be paid in each instance are not separately and reasonably stated in the contract, it shall be presumed that the licensing fees are paid entirely for the license of the marketing intangible except to the extent that the taxpayer or the Commissioner can reasonably establish otherwise.

e. License of Intangible Property where Substance of Transaction Resembles a Sale of Goods or Services.

i. In General. In some cases, the license of intangible property will resemble the sale of an

electronically-delivered good or service rather than the license of a marketing intangible or a production intangible. In such cases, the receipts from the licensing transaction shall be assigned by applying 830 CMR 63.38.1(9)(d)4.c.ii.(B) and (C), as if the transaction were a service delivered to an individual or business customer or delivered electronically through an individual or business customer, as applicable. Examples of transactions to be assigned under 830 CMR 63.38.1(9)(d)5.e. include, without limitation, the license of database access, the license of access to information, the license of digital goods (*see* 830 CMR 63.38.1(9)(d)7.b.), and the license of certain software (*e.g.*, where the transaction is not the license of pre-written software that is treated as the sale of tangible personal property, *see* 830 CMR 63.38.1(9)(d)7.a.).

ii. Sublicenses. Pursuant to 830 CMR 63.38.1(9)(d)5.e.i., 830 CMR 63.38.1(9)(d)4.c.ii.(C) may apply where a taxpayer licenses intangible property to a customer that in turn sublicenses the intangible property to end users as if the transaction were a service delivered electronically through a customer to end users. In particular, 830 CMR 63.38.1(9)(d)4.c.ii.(C) that apply to services delivered electronically to a customer for purposes of resale and subsequent electronic delivery in substantially identical form to end users or other recipients may also apply with respect to licenses of intangible property for purposes of sublicense to end users, provided that for this purposes. the intangible property sublicensed to an end user shall not fail to be substantially identical to the property that was licensed to the sublicensor merely because the sublicense transfers a reduced bundle of rights with respect to such property (*e.g.*, because the sublicensee's rights are limited to its own use of the property and do not include the ability to grant a further sublicense), or because such property is bundled with additional services or items of property.

f. Examples. Assume in each of these examples that the taxpayer that licenses the intangible property is taxable in Massachusetts and is to apportion its income pursuant to M.G.L. c. 63, § 38. Also, assume, where relevant, unless otherwise stated, that the taxpayer is taxable in each state other than Massachusetts to which its sale or sales would be assigned, so that there is no requirement in such examples that such sale or sales must be eliminated from the numerator and denominator of the taxpayer's sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

Example 1. Crayon Corp. and Dealer Co. enter into a license contract under which Dealer Co. as licensee is permitted to use trademarks that are owned by Crayon Corp. in connection with Dealer Co.'s sale of certain products to retail customers. Under the contract, Dealer Co. is required to pay Crayon Corp. a licensing fee that is a fixed percentage of the total volume of monthly sales made by Dealer Co. of products using the Crayon Corp. trademarks. Under the contract, Dealer Co. is permitted to sell the products at multiple store locations, including store locations that are both within and without Massachusetts. Further, the licensing fees that are paid by Dealer Co. are broken out on a per-store basis. The licensing fees paid to Crayon Corp. by Dealer Co. represent fees from the license of a marketing intangible. The portion of the fees to be assigned to Massachusetts shall be determined by multiplying the fees by a percentage that reflects the ratio of Dealer Co.'s receipts that are derived from its Massachusetts stores relative to Dealer Co.'s total receipts. *See* 830 CMR 63.38.1(9)(d)5.b.

Example 2. Program Corp., a corporation that is based outside Massachusetts, licenses programming that it owns to licensees, such as cable networks, that in turn will offer the programming to their customers on television or other media outlets in Massachusetts and in all other U.S. states. Each of these licensing contracts constitutes the license of a marketing intangible. For each licensee, assuming that Program Corp. lacks evidence of the actual number of viewers of

the programming in Massachusetts, the component of the licensing fee paid to Program Corp. by the licensee that constitutes Program Corp.'s Massachusetts sales is determined by multiplying the amount of the licensing fee by a percentage that reflects the ratio of the Massachusetts audience of the licensee for the programming relative to the licensee's total U.S. audience for the programming. See 830 CMR 63.38.1(9)(d)5.b. If Program Corp. is not taxable in any state in which the licensee's audience is located, the sales that would be assigned to such state shall be excluded from the numerator and denominator of Program Corp.'s sales factor. See 830 CMR 63.38.1(9)(d)1.f.ii. Note that the analysis and result as to the state or states to which sales are properly assigned would be the same to the extent that the substance of Program Corp.'s licensing transactions may be determined to resemble a sale of goods or services, instead of the license of a marketing intangible. See 830 CMR 63.38.1(9)(d)5.e.

Example 3. Moniker Corp. enters into a license contract with Wholesale Co. Pursuant to the contract Wholesale Co. is granted the right to use trademarks owned by Moniker Corp. to brand sports equipment that is to be manufactured by Wholesale Co. or an unrelated entity, and to sell the manufactured equipment to unrelated companies that will ultimately market the equipment to consumers in a specific geographic region, including a foreign country. The license agreement confers a license of a marketing intangible, even though the trademarks in question will be affixed to property to be manufactured. In addition, the license of the marketing intangible is for the right to use the intangible property in connection with sales to be made at wholesale rather than directly to retail customers. The component of the licensing fee that constitutes the Massachusetts sales of Moniker Corp. is determined by multiplying the amount of the fee by a percentage that reflects the ratio of the Massachusetts population in the specific geographic region relative to the total population in such region. See 830 CMR 63.38.1(9)(d)5.b. If Moniker Corp. is not taxable in any state (including a foreign country, see 830 CMR 63.38.1(2)) in which Wholesale Co.'s ultimate consumers are located, the sales that would be assigned to such state shall be excluded from the numerator and denominator of Moniker Corp.'s sales factor. See 830 CMR 63.38.1(9)(d)1.f.ii.

Example 4. Formula, Inc and Appliance Co. enter into a license contract under which Appliance Co. is permitted to use a patent owned by Formula, Inc. to manufacture appliances. The license contract specifies that Appliance Co. is to pay Formula, Inc. a royalty that is a fixed percentage of the gross receipts from the products that are later sold. The contract does not specify any other fees. The appliances are both manufactured and sold in Massachusetts and several other states. Assume the licensing fees are paid for the license of a production intangible, even though the royalty is to be paid based upon the sales of a manufactured product (*i.e.*, the license is not one that includes a marketing intangible). Because the Commissioner can reasonably establish that the actual use of the intangible property takes place in part in Massachusetts, the royalty is assigned based to the location of such use rather than to location of the licensee's commercial domicile, in accordance with 830 CMR 63.38.1(9)(d)5.c. It is presumed that the entire use is in Massachusetts except to the extent that the taxpayer can demonstrate that the actual location of some or all of the use takes place outside Massachusetts. Assuming that Formula, Inc. can demonstrate the percentage of manufacturing that takes place in Massachusetts using the patent relative to such manufacturing in other states, that percentage of the total licensing fee paid to Formula, Inc. under the contract will constitute Formula, Inc.'s Massachusetts sales. See 830 CMR 63.38.1(9)(d)5.c.

Example 5. Axel Corp. enters into a license agreement with Biker Co. in which Biker Co. is granted the right to produce motor scooters using patented technology owned by Axel Corp., and also to sell such scooters by marketing the fact that the scooters were manufactured using the special

technology. The contract is a license of both a marketing and production intangible, *i.e.*, a mixed intangible. The scooters are manufactured outside Massachusetts. Assume that Axel Corp. lacks actual information regarding the proportion of Biker Co.'s receipts that are derived from Massachusetts customers. Also assume that Biker Co. is granted the right to sell the scooters in a U.S. geographic region in which the Massachusetts population constitutes 25% of the total population during the period in question. The licensing contract requires an up front licensing fee to be paid by Biker Co. to Axel Corp. and does not specify what percentage of the fee derives from Biker Co.'s right to use Axel Corp.'s patented technology. Because the fees for the license of the marketing and production intangible are not separately and reasonably stated in the contract, it is presumed that the licensing fees are paid entirely for the license of a marketing intangible, unless either the taxpayer or Commissioner reasonably establishes otherwise. Assuming that neither party establishes otherwise, 25% of the licensing fee constitutes Massachusetts sales. See 830 CMR 63.38.1(9)(d)5.b. and d.

Example 6. Same facts as Example 5, except that the license contract specifies separate fees to be paid for the right to produce the motor scooters and for the right to sell the scooters by marketing the fact that the scooters were manufactured using the special technology. The licensing contract constitutes both the license of a marketing intangible and the license of a production intangible. Assuming that the separately stated fees are reasonable, the Commissioner will:

- (1) assign no part of the licensing fee paid for the production intangible to Massachusetts, and
- (2) assign 25% of the licensing fee paid for the marketing intangible to Massachusetts. See 830 CMR 63.38.1(9)(d)5.d.

Example 7. Better Burger Corp., which is based outside Massachusetts, enters into franchise contracts with franchisees who agree to operate Better Burger restaurants as franchisees in various states. Several of the Better Burger Corp. franchises are in Massachusetts. In each case, the franchise contract between the individual and Better Burger provides that the franchisee is to pay Better Burger Corp. an upfront fee for the receipt of the franchise and monthly franchise fees, which cover, among other things, the right to use the Better Burger name and service marks, food processes and cooking know-how, as well as fees for management services. The upfront fees for the receipt of the Massachusetts franchises constitute fees paid for the licensing of a marketing intangible. These fees constitute Massachusetts sales because the franchises are for the right to make Massachusetts sales. The monthly franchise fees paid by Massachusetts franchisees constitute fees paid for (1) the license of marketing intangibles (the Better Burger name and service marks), (2) the license of production intangibles (food processes and know-how) and (3) personal services (management fees). The fees paid for the license of the marketing intangibles and the production intangibles constitute Massachusetts sales because in each case the use of the intangibles is to take place in Massachusetts. See 830 CMR 63.38.1(9)(d)5.b. and c. The fees paid for the personal services are to be assigned pursuant to 830 CMR 63.38.1(9)(d)4.

Example 8. Online Corp., a corporation based outside Massachusetts, licenses an information database through the means of the Internet to individual customers that are resident in Massachusetts and in other states. These customers access Online Corp.'s information database primarily in their states of residence, and sometimes, while traveling, in other states. The license is a license of intangible property that resembles a sale of goods or services and shall be assigned in accordance with 830 CMR 63.38.1(9)(d)5.e. If Online Corp. can determine

or reasonably approximate the state or states where its database is accessed, then it must do so. Assuming that Online Corp. cannot determine or reasonably approximate the location where its database is accessed, Online Corp. must assign the sales made to the individual customers using the customers' billing addresses to the extent known. Assume for purposes of this example that Online Corp. knows the billing address for each of its customers. In this case, Online Corp.'s sales made to its individual customers are in Massachusetts in any case in which the customer's billing address is in Massachusetts. See 830 CMR 63.38.1(9)(d)4.c.ii.(B)1.

Example 9. Net Corp., a corporation based outside Massachusetts, licenses an information database through the means of the Internet to a business customer, Business Corp., a company with offices in Massachusetts and two neighboring states. The license is a license of intangible property that resembles a sale of goods or services and shall be assigned in accordance with 830 CMR 63.38.1(9)(d)5.e. Assume that Net Corp. cannot determine where its database is accessed but reasonably approximates that 75% of Business Corp.'s database access took place in Massachusetts, and 25% of Business Corp.'s database access took place in other states. In such case, 75% of the receipts from database access is in Massachusetts. Assume alternatively that Net Corp. lacks sufficient information regarding the location where its database is accessed to reasonably approximate such location. Under these circumstances, if Net Corp. derives 5% or less of its receipts from database access from Business Corp., Net Corp. must assign the sale under 830 CMR 63.38.1(9)(d)4.c.ii.(B)2. to the state where Business Corp. principally managed the contract, or if that state is not reasonably determinable to the state where Business Corp. placed the order for the services, or if that state is not reasonably determinable to the state of Business Corp.'s billing address. If Net Corp. derives more than 5% of its receipts from database access from Business Corp., Net Corp. is required to identify the state in which its contract of sale is principally managed by Business Corp. and must assign the receipts to that state. See 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.

Example 10. Net Corp., a corporation based outside Massachusetts, licenses an information database through the means of the Internet to more than 250 individual and business customers in Massachusetts and in other states. The license is a license of intangible property that resembles a sale of goods or services and shall be assigned in accordance with 830 CMR 63.38.1(9)(d)5.e. Assume that Net Corp. cannot determine or reasonably approximate the location where its information database is accessed. Also assume that Net Corp. does not derive more than 5% of its sales of database access from any single customer. Net Corp. may apply the safe harbor stated in 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.d., and may assign its sales to a state or states using each customer's billing address. If Net Corp. is not taxable in one or more states to which some of its sales would be otherwise assigned, it must exclude those sales from the numerator and denominator of its sales factor. See 830 CMR 63.38.1(9)(d)1.f.ii.

Example 11. Web Corp., a corporation based outside of Massachusetts, licenses an Internet-based information database to business customers who then sublicense the database to individual end users that are resident in Massachusetts and in other states. These end users access Web Corp.'s information database primarily in their states of residence, and sometimes, while traveling, in other states. Web Corp.'s license of the database to its customers includes the right to sublicense the database to end users, while the sublicenses provide that the rights to access and use the database are limited to the end users' own use and prohibit the individual end users from further sublicensing the database. Web Corp. receives a fee from each customer based upon the number of sublicenses issued to end users. The license is a license

of intangible property that resembles a sale of goods or services and shall be assigned by applying the rules set forth in 830 CMR 63.38.1(9)(d)4.c.ii.(C). See 830 CMR 63.38.1(9)(d)5.e. If Web Corp. can determine or reasonably approximate the state or states where its database is accessed by end users, then it must do so. Assuming that Web Corp. lacks sufficient information from which it can determine or reasonably approximate the location where its database is accessed by end users, Web Corp. must approximate the extent to which its database is accessed in Massachusetts using a percentage that represents the ratio of the Massachusetts population in the specific geographic area in which Web Corp.'s customer sublicenses the database access relative to the total population in such area. See 830 CMR 63.38.1(9)(d)4.c.ii.(C)3.ii.

6. Sale of Intangible Property.

a. Assignment of Sales. The assignment of a sale to a state or states in the instance of a sale or exchange of intangible property depends upon the nature of the intangible property sold. For purposes of 830 CMR 63.38.1(9)(d)6., a sale or exchange of intangible property includes a license of such property where the transaction is treated for tax purposes as a sale of all substantial rights in the property and the receipts from transaction are not contingent on the productivity, use or disposition of the property. For the rules that apply where the consideration for the transfer of rights is contingent on the productivity, use or disposition of the property, see 830 CMR 63.38.1(9)(d)5.a. and 6.a.iv.

i. Contract Right or Government License that Authorizes Business Activity in Specific Geographic Area. In the case of a sale or exchange of intangible property where the property sold or exchanged is a contract right, government license or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area, the sale is assigned to a state if and to the extent that the intangible property is used or otherwise associated with the state. Where the intangible property is used in, or otherwise associated with, only Massachusetts the taxpayer shall assign the sale to Massachusetts. Where the intangible property is used in or is otherwise associated with Massachusetts and one or more other states, the taxpayer shall assign the sale to Massachusetts to the extent that the intangible property is used in, or associated with, Massachusetts, through the means of a reasonable approximation.

ii. Agreement Not to Compete. An agreement or covenant not to compete in a specified geographic area requires the contract party to refrain from conducting certain business activity in that specified area. In the case of an agreement or covenant not to compete the receipts are to be assigned to a state based upon the percentage that reflects the state's population in the U.S. geographic area specified in the contract relative to the total population in such area.

iii. Taxpayer Not Taxable in State of Assignment. In any instance in which, pursuant to 830 CMR 63.38.1(9)(d)6.a.i. and ii., the state to which the sale is to be assigned can be determined or reasonably approximated, but where the taxpayer is not taxable in such state, the sale that would otherwise be assigned to such state shall be excluded from the numerator and denominator of the taxpayer's sales factor. See 830 CMR 63.38.1(9)(d)1.f.ii.

iv. Sale that Resembles a License (Receipts are Contingent on Productivity, Use or Disposition of the Intangible Property). In the case of a sale or exchange of intangible property where the receipts from the sale or exchange are contingent on the productivity, use or disposition of the property, the receipts from the sale shall be assigned by applying 830 CMR 63.38.1(9)(d)5. (pertaining to the license or lease of intangible property).

v. Sale that Resembles a Sale of Goods and Services. In the case of a sale or exchange of intangible property where the substance of the transaction resembles a sale of goods or services and where the receipts from the sale or exchange do not derive from payments contingent on the productivity, use or disposition of the property, the receipts from the sale shall be assigned by applying 830 CMR 63.38.1(9)(d)5.e. (relating to licenses of intangible property that resemble sales of goods and services). Examples of such transactions include those that are analogous to the license transactions cited as examples in 830 CMR 63.38.1(9)(d)5.e.

vi. Excluded Sales. The sale of a security as defined at 830 CMR 63.38.1(2) and the sale of business "goodwill" or similar intangible value, including, without limitation, "going concern value" and "workforce in place," shall be excluded from the numerator and denominator of a taxpayer's sales factor. See M.G.L. c. 63, § 38(f). Also, except as otherwise provided in 830 CMR 63.38.1(9)(d), the sale of intangible property that is not referenced in 830 CMR 63.38.1(9)(d)6.a.i., ii., iv., or v., shall be excluded from the numerator and the denominator of the taxpayer's sales factor. The sale of intangible property that is not referenced in 830 CMR 63.38.1(9)(d)6.a.i., ii., iv., or v., and that therefore is excluded from the numerator and denominator of the taxpayer's sales factor includes, without limitation, the sale of a partnership interest that is not otherwise a security within the meaning of 830 CMR 63.38.1(2).

b. Examples. Assume in each of these examples that the taxpayer that provides the service is taxable in Massachusetts and is to apportion its income pursuant to M.G.L. c. 63, § 38. Also, assume, where relevant, unless otherwise stated, that the taxpayer is taxable in each state other than Massachusetts to which some of its sales would be assigned, so that there is no requirement in such examples that such sales to other states must be excluded from the taxpayer's numerator and denominator. See 830 CMR 63.38.1(9)(d)1.f.ii.

Example 1. Airline Corp., a corporation based outside Massachusetts, sells its rights to use several gates at an airport located in Massachusetts to Buyer Corp., a corporation that is based outside Massachusetts. The contract of sale is negotiated and signed outside of Massachusetts. The sale is in Massachusetts because the intangible property sold is a contract right that authorizes the holder to conduct a business activity solely in Massachusetts. See 830 CMR 63.38.1(9)(d)6.a.i.

Example 2. Wireless Corp., a corporation based outside Massachusetts, sells a license issued by the Federal Communications Commission (FCC) to operate wireless telecommunications services in a designated area in Massachusetts to Buyer Corp., a corporation that is based outside Massachusetts. The contract of sale is negotiated and signed outside of Massachusetts. The sale is in Massachusetts because the intangible property sold is a government license that authorizes the holder to conduct business activity solely in Massachusetts. See *id.*

Example 3. Same facts as in Example 2 except that Wireless Corp. sells to Buyer Corp. an FCC license to operate wireless telecommunications services in a designated area in Massachusetts and an adjacent state. Wireless Corp. must attempt to reasonably approximate the extent to which the intangible property is used in or associated with Massachusetts. For purposes of making this reasonable approximation, Wireless Corp. may rely upon credible data that identifies the percentage of persons that use wireless telecommunications in the two states covered by the license. See *id.*

Example 4. Same facts as in Example 3 except that Wireless Corp. is not taxable in the adjacent state in which the FCC license authorizes it to operate wireless telecommunications services. The receipts paid to Wireless Corp. that would be assigned to the adjacent state must be excluded from

the numerator and denominator of Wireless Corp's sales factor. See 830 CMR 63.38.1(9)(d)6.a.i.; 830 CMR 63.38.1(9)(d)1.f.ii.

Example 5. Sports League Corp., a corporation that is based outside Massachusetts, sells the rights to broadcast the sporting events played by the teams in its league in all 50 U.S. states to Network Corp. Although the games played by Sports League Corp. will be broadcast in all 50 states, the games are of greater interest in the northeast region of the country, including Massachusetts. Because the intangible property sold is a contract right that authorizes the holder to conduct a business activity in a specified geographic area, Sports League Corp. must attempt to reasonably approximate the extent to which the intangible property is used in or associated with Massachusetts. For purposes of making this reasonable approximation, Sports League Corp. may rely upon audience measurement information that identifies the percentage of the audience for its sporting events in Massachusetts and the other states. See 830 CMR 63.38.1(9)(d)6.a.i.

Example 6. Same facts as in Example 5, except that Sports League Corp. is not taxable in one state. The receipts paid to Sports League Corp. that would be assigned to that state must be excluded from the numerator and denominator of Sports League Corp.'s sales factor. See 830 CMR 63.38.1(9)(d)6.a.i.; 830 CMR 63.38.1(9)(d)1.f.ii.

Example 7. Business Corp., a corporation based outside Massachusetts engaged in business activities in Massachusetts and other states, enters into a covenant not to compete with Competition Corp., a corporation that is based outside Massachusetts, in exchange for a fee. The agreement requires Business Corp. to refrain from engaging in certain business activity in Massachusetts and other states. The component of the fee that constitutes a Massachusetts sale is determined by multiplying the amount of the fee by a fraction represented by the percentage of the Massachusetts population over the total population in the specified geographic region. See 830 CMR 63.38.1(9)(d)6.a.ii. In any case in which a portion of the fee would be assigned to a state in which Business Corp. is not taxable, such portion shall be excluded from the numerator and denominator of Business Corp.'s sales factor. See 830 CMR 63.38.1(9)(d)1.f.ii.

Example 8. Business Corp., a corporation that is commercially domiciled in Massachusetts, sells all of its assets including its business goodwill, to a business customer that is based in Massachusetts. The sale of the goodwill shall be excluded from the numerator and denominator of Business Corp.'s sales factor. See 830 CMR 63.38.1(9)(d)6.a.vi.

Example 9. Inventor Corp., a corporation that is based outside Massachusetts, sells patented technology that it has developed to Buyer Corp., a business customer that is based in Massachusetts. Assume that the sale is not one in which the receipts derive from payments that are contingent on the productivity, use or disposition of the property. See 830 CMR 63.38.1(9)(d)6.a.iv. Inventor Corp. understands that Buyer Corp. is likely to use the patented technology in Massachusetts, but the patented technology can be used anywhere (*i.e.*, the rights sold are not rights that authorize the holder to conduct a business activity in a specific geographic area). The sale of the patented technology shall be excluded from the numerator and denominator of Inventor Corp.'s sales factor. See 830 CMR 63.38.1(9)(d)6.a.vi.

7. Special Rules.

- a. Software Transactions. A license or sale of pre-written software for purposes other than commercial reproduction (or other exploitation of the intellectual property rights), when transferred on a tangible

medium, is treated as the sale of tangible personal property, rather than as either the license or sale of intangible property or the performance of a service. In such cases, the receipts are in Massachusetts as determined under the rules for the sale of tangible personal property set forth at 830 CMR 63.38.1(9)(c). In all other cases, the receipts from a license or sale of software are to be assigned to Massachusetts as determined otherwise under 830 CMR 63.38.1 (e.g., depending on the facts, as the development and sale of custom software, see 830 CMR 63.38.1(9)(d)4.c., as a license of a marketing intangible, see 830 CMR 63.38.1(9)(d)5.b., as a license of a production intangible, see 830 CMR 63.38.1(9)(d)5.c., as a license of intangible property where the substance of the transaction resembles a sale of goods or services, see 830 CMR 63.38.1(9)(d)5.e., or as a sale of intangible property, see 830 CMR 63.38.1(9)(d)6).

b. Sales or Licenses of Digital Goods or Services.

i. In General. In the case of a sale or license of digital goods or services, including, among other things, the sale of various video, audio and software products or similar transactions, the receipts from the sale or license shall be assigned by applying 830 CMR 63.38.1(9)(d)4.c.ii.(B) or (C), as if the transaction were a service delivered to an individual or business customer or delivered through or on behalf of an individual or business customer. For purposes of the analysis, it is not relevant what the terms of the contractual relationship are or whether the sale or license might be characterized, depending upon the particular facts, as, for example, the sale or license of intangible property or the performance of a service. See 830 CMR 63.38.1(9)(d)5.e. and (6)a.v.

ii. Telecommunications Companies. In the case of a taxpayer that provides telecommunications or ancillary services and that is thereby subject to the provisions of 830 CMR 63.38.11, the sale or license of digital goods or services not otherwise assigned for apportionment purposes pursuant to 830 CMR 63.38.11 shall be assigned pursuant to 830 CMR 63.38.1(9)(d)7.b.ii., by applying 830 CMR 63.38.1(9)(d)4.c.ii.(B) or (C) as if the transaction were a service delivered to an individual or business customer or delivered through or on behalf of an individual or business customer. See 830 CMR 63.38.11(3). However, in applying such rules, if the taxpayer cannot determine the state or states where a customer receives the purchased product it may reasonably approximate this location using the customer's place of "primary use" of the purchased product, applying the definition of "primary use" set forth in 830 CMR 63.38.11.

c. Enforcement of Legal Rights. Receipts attributable to the protection or enforcement of legal rights of a taxpayer through litigation, arbitration, or settlement of legal disputes or claims, including the filing and pursuit of claims under insurance contracts, shall be excluded from the numerator and denominator of the taxpayer's sales factor. For purposes of 830 CR 63.38.1, in the case of a settlement agreement, it shall not be relevant how the parties to the agreement characterize the payment made under the agreement.

(e) Exclusion of Factors Related to Items Excluded from Federal Gross Income. Where items of gross income are excluded from the federal gross income of a taxpayer, the gross receipts to which such items of gross income are directly attributable are similarly excluded from the numerator and denominator of the taxpayer's sales factor. Also, any property or payroll (or appropriate portion thereof) that relate to such receipts are similarly excluded from the property or payroll factors of the taxpayer. See also 830 CMR 63.32B.2(7)(f).

(f) Sales Factor Consistency. A taxpayer must use the same rules for excluding or including gross receipts in both the numerator and the denominator of the sales factor. If the taxpayer changes its method of excluding or including gross receipts in the sales factor from the method used in its return in the prior year, the taxpayer must disclose in the return for the current year the fact of such change, the nature and extent of the change, and the reason for the

change. The Commissioner may disregard changes in the current year or in future tax years if they have not been adequately disclosed. *See also* 830 CMR 63.38.1(9)(d)1.g.

(10) Section 38 Manufacturers.

(a) General. A section 38 manufacturer that has income from business activity which is taxable both in Massachusetts and in another state shall determine the part of its net income derived from business carried on in Massachusetts by applying an apportionment percentage that shall be a fraction that is equal to the corporation's sales factor, determined under 830 CMR 63.38.1(9).

(b) Section 38 Manufacturer Defined.

1. General. A corporation is a section 38 manufacturer for any taxable year if (i) it is engaged in manufacturing during the taxable year and (ii) its manufacturing activity during the taxable year is substantial. A corporation that is so engaged in manufacturing and whose manufacturing activities are substantial is a section 38 manufacturer for the taxable year regardless of whether, or to what extent, it conducts its manufacturing activities in Massachusetts. The principles set forth in 830 CMR 58.2.1(6)(b): *Manufacturing* apply for purposes of determining whether a process constitutes manufacturing.

2. Substantial Manufacturing. A corporation's manufacturing activity is substantial for any taxable year if the corporation meets any of the following tests:

- a. The corporation derives 25% or more of its receipts for the taxable year from the sale of manufactured goods that the corporation manufactures;
- b. The corporation pays 25% or more of its payroll for the taxable year to employees working in manufacturing operations and derives 15% or more of its receipts for the taxable year from the sale of manufactured goods that the corporation manufactures;
- c. The corporation uses 25% or more of its tangible property in manufacturing during the taxable year and derives 15% or more of its receipts for the taxable year from the sale of manufactured goods that the corporation manufactures;
- d. The corporation uses 35% or more of its tangible property in manufacturing during the taxable year.

3. Coordination with 830 CMR 58.2.1: Manufacturing Corporations. For purposes of 830 CMR 63.38.1(10) b.2., the following shall apply.

- a. For any taxable year, the percentage of receipts derived from a corporation's sale of manufactured goods that it manufactures shall be equal to the gross receipts fraction determined for that taxable year under 830 CMR 58.2.1(6)(e)1.: *Gross Receipts Fraction*, except that gross receipts attributable to business activities (including manufacturing activities) performed outside Massachusetts shall be taken into account in the fraction;
- b. For any taxable year, the percentage of payroll paid to employees working in manufacturing operations shall be equal to the employees fraction determined for that taxable year under 830 CMR 58.2.1(6)(e)3.: *Employees Fraction*, except that payroll attributable to business activities (including manufacturing activities) performed outside Massachusetts shall be taken into account in the fraction; and
- c. For any taxable year, the percentage of tangible property used in manufacturing operations shall be equal to the tangible property fraction determined for that taxable year under 830 CMR 58.2.1(6)(e)2.:

Tangible Property Fraction, except that tangible property used in business activities (including manufacturing activities) performed outside Massachusetts shall be taken into account in the fraction.

(11) One or More Factors Inapplicable.

(a) Three Factor Apportionment. Where a taxpayer is required to determine the part of its net income derived from business carried on in Massachusetts using an apportionment percentage that employs three factors, the following shall apply:

1. Two Factors Applicable. In cases where only two of the three apportionment factors (property, payroll, sales) are applicable, the taxable net income of the taxpayer is apportioned by a fraction, the numerator of which is the remaining two factors with their respective weights and the denominator of which is the number of times that such factors are used in the numerator.

2. One Factor Applicable. In cases where only one of the three apportionment factors (property, payroll, sales) is applicable, the taxable net income of the taxpayer is apportioned solely by that factor with its respective weight, and the denominator is the number of times the factor is used in the numerator.

3. No Factors Applicable. In cases where none of the three apportionment factors (property, payroll, sales) is applicable, the taxable net income of the taxpayer is presumed to be 100% apportioned to Massachusetts unless the taxpayer demonstrates that such apportionment will not reasonably approximate its income derived from business carried on within Massachusetts. Where none of the three apportionment factors is applicable to a taxpayer's activities, the taxpayer is encouraged to apply for alternative apportionment under M.G.L. c. 63, § 42.

4. Determination of Applicability. For purposes of determining whether a factor is applicable, the following shall apply:

a. A factor is not inapplicable merely because the numerator of the factor is zero. However, a factor is inapplicable if both its numerator and denominator are zero.

b. A factor is inapplicable and, consequently, is not used to calculate a taxpayer's apportionment percentage if the denominator of the factor is less than 3.33% of the taxpayer's taxable net income, or if the factor is otherwise determined to be insignificant in producing income.

(b) Single Factor Apportionment. Where (i) a taxpayer is required to determine the part of its net income derived from business carried on in Massachusetts using its sales factor only and (ii) the sales factor is inapplicable, then the taxable net income of the taxpayer is presumed to be 100% apportioned to Massachusetts unless the taxpayer demonstrates that such apportionment will not reasonably approximate its income derived from business carried on within Massachusetts. Under these circumstances, the taxpayer is encouraged to apply for alternative apportionment under M.G.L. c. 63, § 42. In the instance of a Section 38 manufacturer the sales factor is inapplicable if the denominator of the factor is less than 3.33% of the taxpayer's taxable net income, or if the factor is otherwise determined to be insignificant in producing income.

(12) Corporate Partners. A corporation with an interest in a partnership must include its distributive share of the partnership income, loss, or deduction in calculating its income, in accordance with 26 U.S. Code and M.G.L. c. 63. The character of any item included in the distributive share is determined as if it were realized or incurred directly by the corporation. Except as otherwise provided, the trade or business of the partnership is treated as the trade or business of the corporation. For purposes of determining whether the corporation is a mutual fund service corporation or a Section 38 manufacturer, the corporation's *pro rata* share (as defined in 830 CMR 63.38.1(12)(f)) of all of the partnership's

items, factors and activities shall be taken into account to the extent relevant to the determination, whether or not the corporation and the partnership are engaged in related business activities. If the partnership and corporate partner are engaged in related business activities, the corporation's *pro rata* share (as defined in 830 CMR 63.38.1(12)(f)) of partnership property, payroll, and sales are included in the partner's apportionment factors, subject to the special rules provided in 830 CMR 63.38.1(12)(d). (Except as otherwise expressly stated, the partnership rules provided in 830 CMR 63.38.1(12) presume that a partnership and corporate partner are engaged in related business activities.)

(a) Taxable in Massachusetts.

1. A corporation that is not otherwise subject to Massachusetts tax jurisdiction is nevertheless taxable in Massachusetts if it is a general partner in a partnership whose activities, if conducted directly by the corporation, would subject the corporation to the excise under M.G.L. c. 63, § 39. See 830 CMR 63.39.1(8).
2. In general, a corporation that is not otherwise subject to Massachusetts tax jurisdiction is taxable in Massachusetts if it is a limited partner in a partnership whose activities, if conducted directly by the corporation, would subject the corporation to the excise under M.G.L. c. 63, § 39. However, as provided in 830 CMR 63.38.1(4)(d), the business activities of the partnership and the corporate limited partner are, in certain circumstances, presumed to be unrelated, so that unless the presumption is rebutted, such partner is taxable in Massachusetts only with respect to the partnership activity. Moreover, under the circumstances described in 830 CMR 63.39.1(8)(b) through (d) (relating to certain partnerships dealing in securities, publicly traded partnerships, and certain de minimis limited partnership holdings), the activities of the partnership are not attributed to the corporation, and the corporation is not taxable in Massachusetts merely by virtue of holding such a limited partnership interest.

(b) Taxable in Another State. A corporation is taxable in another state within the meaning of 830 CMR 63.38.1(5) if the corporation is a general partner in a partnership with business activities in that state that cause either the partnership or its partners to be taxable in that state described in 830 CMR 63.38.1(5). A corporation that is a limited partner in a partnership with business activity in another state is taxable in another state within the meaning of 830 CMR 63.38.1(5) if and to the extent that the corporation would be taxed in Massachusetts under the same facts and circumstances that exist in the other state. A corporation holding a limited partnership interest in a partnership that does business in another state is taxable in the other state for purposes of apportioning its partnership income, but not for purposes of apportioning income from its other business activities, unless the corporate partner and the partnership are engaged in related business activities, or unless the corporate partner is separately taxable in the other state on the basis of its other (unrelated) business activities.

(c) Income Measure of the Excise. When computing its net income for the taxable year, a corporation must include its distributive share of partnership items for any partnership year ending with or within its taxable year. The following examples illustrate the application of 830 CMR 63.38.1(12)(c):

1. Corporation C holds a 20% profits interest in Partnership P. C's income for the year was \$1,000,000 and P's income for the same year was \$800,000. The income of C is \$1,160,000 (\$1,000,000 plus 20% of \$800,000).
2. Corporation C holds a 90% profits interest in Partnership P. C incurred a loss of \$500,000 for the year but P's income was \$1,000,000. The income of C is \$400,000 (90% of \$1,000,000 = \$900,000 less the loss of \$500,000).

(d) Special Apportionment Rules. In general, if a corporate partner is taxable in another state, it must apportion its taxable net income using the apportionment percentage in M.G.L. c. 63, § 38. However, the following shall apply:

1. Property Factor. In determining the denominator of its property factor, a corporate partner must include its

pro rata share of the total value of the partnership's real and tangible personal property, owned or rented, used during the partnership's taxable year. In determining the numerator of its property factor, a corporate partner must include its *pro rata* share of the value of such property located in Massachusetts.

a. In order to avoid duplication, however, certain adjustments must be made to the value of any property leased or rented by the corporation to the partnership or vice versa.

i. Where a corporation rents property to the partnership, it must include the original cost of the property in its property factor. No portion of the value of this property as rental property of the partnership is included.

ii. Where the partnership rents property to the corporation, the corporation includes in its property factor the sum of:

A. the original cost of the property multiplied by the corporation's percentage of interest in the partnership; plus

B. eight times the net annual rental rate of the property, multiplied by the difference between 100% and the corporation's percentage of interest in the partnership.

b. The following examples illustrate the application of 830 CMR 63.38.1(12)(d)1.:

i. Corporation C has a 20% profits interest in Partnership P. C owns a building (original cost \$100,000) which it rents to P at a fair market rate of \$12,000 per year. C must include the \$100,000 original cost of the building in its property factor. No portion of the value of the property as rental property of the partnership is included in C's property factor.

ii. The facts are the same as in the previous example except that P owns the building and rents it to C. C will include \$20,000 (20% of \$100,000) in its property factor because of its interest in P. C will also include \$76,800 ($[\$12,000 \times 8] \times 80\%$) in its property factor to account for the rented building used in its operations. Thus, the building's value in C's property factor is \$96,800 (\$20,000, plus \$76,800).

2. Payroll Factor. In determining the denominator of its payroll factor, a corporate partner must include its *pro rata* share of the total compensation paid by the partnership during the partnership's taxable year. In determining the numerator of its payroll factor, a corporate partner must include its *pro rata* share of such compensation paid in Massachusetts during the taxable year. The following example illustrates the application of 830 CMR 63.38.1(12)(d)2.:

Corporation C has a 20% profits interest in Partnership P. C's own payroll is \$1,000,000, half of which is attributable to Massachusetts employees, and P's payroll is \$800,000, one quarter of which is attributable to Massachusetts employees. The denominator of C's payroll factor is \$1,160,000 (\$1,000,000, plus 20% of \$800,000, or \$160,000). The numerator of C's payroll factor is \$540,000 (50% of \$1,000,000 plus 25% of \$160,000).

3. Sales Factor. In determining the denominator of its sales factor, a corporate partner must include its *pro rata* share of the partnership's total sales during the partnership's taxable year. In determining the numerator of its sales factor, a corporate partner must include its *pro rata* share of such sales in Massachusetts.

a. In order to avoid duplication, however, the following sales must be eliminated from both the numerator

and denominator of the sales factor:

- i. sales by the corporation to the partnership in an amount equal to the total of such sales multiplied by the corporation's profits interest in the partnership; and
- ii. sales by the partnership to the corporation in an amount not to exceed the total of all sales made by the partnership multiplied by the corporation's profits interest in the partnership.

b. The following examples illustrate the application of 830 CMR 63.38.1(12)(d)3.

- i. Corporation C's profits interest in Partnership P is 20%. C's sales were \$20,000,000 for the year, \$5,000,000 of which were made to P. P made sales of \$10,000,000 during the same year, none of which were to C or the other partners.

The denominator of C's sales factor is \$21,000,000 determined as follows:

Sales by Corporation C	.....	20,000,000
Add: Corporation C's interest		
(20%) in Partnership P's sales	.....	2,000,000
Less: Corporation C's interest		
(20%) in Corporation C's sales to		
Partnership P	..... 1,000,000 .....	..... 1,000,000
Denominator of sales factor	.....	21,000,000

- ii. The following facts apply to examples A. through C. below. Corporation C's profits interest in Partnership P is 20%, and Corporation D's profits interest is 80%.

A. The sales made by C, D, and P are as follows:

Corporation C	.....	20,000, 000
Corporation D	.....	60,000, 000
Partnership P:		
To Corporation C	.....	2,000, 000
To Corporation D	.....	8,000, 000
		10,000, 000

The denominator of Corporation C's sales factor is \$20,000,000 determined as follows:

Sales by Corporation C	.....	20, 000, 000	
Add: Corporation C's interest			
(20%) in Partnership P's sales	.....	2, 000, 000	
Less: Partnership P's sales to Corporation C	.....	2, 000, 000	-0-

The denominator of Corporation D's sales factor is \$60,000,000 determined as follows:

Sales by Corporation D	.....	60,000,000
Add: Corporation D's interest (80%) in Partnership P's sales	..... 8,000,000	
Less: Partnership P's sales to Corporation D	.....8,000,000	-0-
		60,000,000

B. The sales made by Corporation C, Corporation D, and Partnership P are as follows:

Corporation C	.....	20,000,000
Corporation D	.....	60,000,000
Partnership P:		
To Corporation C	.....	1,000,000
To Corporation D	.....	9,000,000
		10,000,000

The denominator of Corporation C's sales factor is \$21,000,000 determined as follows:

Sales by Corporation C	.....	20,000,000
Add: Corporation C's	..... 2,000,	

interest (20%) in Partnership P's sales	000	
Less: Partnership P's sales to Corporation C	.....1,000,000	1,000,000
Denominator of Corporation C's sales factor	.....	21,000,000

The denominator of Corporation D's sales factor is \$60,000,000 determined as follows:

Sales by Corporation D	.....	60,000,000
Add: Corporation D's interest (80%) in Partnership P's sales	..... 8,000,000	
Less: Intercompany sales between Partnership P and Corporation D	..... 8,000,000 ¹	-0-
Denominator of Corporation		
D's sales factor.....		60,000,000

C. The sales made by Corporation C, Corporation D, and Partnership P are as follows:

Corporation C	.....	20,000,000
Corporation D	.....	80,000,000
Partnership P:		

To Corporation C	.....3,000,000	
To Corporation D	.....6,000,000	
To Corporation X	.....1,000,000	10,000,000

¹ Not to exceed taxpayer's interest in Partnership P's sales.

The denominator of Corporation C's sales factor is \$20,200,000 determined as follows:

Sales by Corporation C	.....	20,000,000
Add: Corporation C's interest in Partnership P's sales to nonpartner X Corporation (20% x \$1,000,000)	.....	200,000
Corporation C's interest in Partnership P's sales to Partners (20% x \$9,000,000)	.....1,800,000	
Less: Intercompany sales from Partnership P to Corporation C	.....1,800,000 ²	-0-
Denominator of Corporation C's sales factor	.....	20,200,000

The denominator of Corporation D's sales factor is \$82,000,000 determined as follows:

Sales by Corporation D	.....	80,000,000
Add: Corporation D's interest in Partnership P's sales		

to nonpartner X Corporation		
(80% x \$1,000,000)	.....	800, 000
Corporation D's interest in Partnership P's sales to Partners (80% x \$9,000,000)	..... 7, 200,000	
Less: Intercompany sales from Partnership P to Corporation D	..... 6,000,000	82, 000, 000

(e) For purposes of the non-income measure of the excise, the classification and valuation of a general or limited partnership interest shall be determined by the books and records of the corporation, as maintained under generally accepted accounting principles (GAAP), as provided as follows:

1. Where (i) a corporation's ownership interest in a general or limited partnership (as determined under GAAP) is less than 20% and (ii) the corporation and the partnership are not required to be included in the same consolidated or combined financial statement under GAAP, the corporation shall use the cost method of accounting for its investment in the partnership.
2. Where (i) a corporation's ownership interest in a general or limited partnership (as determined under GAAP) is 20% or more and (ii) the corporation and the partnership are not required to be included in the same consolidated or combined financial statement under GAAP, the corporation shall use the equity method of accounting for its investment in the partnership.
3. Where (i) a corporation owns any interest in a general or limited partnership and (ii) the corporation and the partnership are required to be included in the same consolidated or combined financial statement under GAAP, the corporation may account for its investment in the partnership either (i) by using the equity method or (ii) by consolidating or combining its assets and activities with those of the partnership in the manner required by GAAP; provided that the corporation must use the same method to report its interest in partnerships consistently from taxable year to taxable year.

² Not to exceed taxpayer's interest in Partnership P's sales.

(f) Pro Rata Share. For purposes of 830 CMR 63.38.1(12), a partner's *pro rata* share of a partnership's items, factors and activities shall be its percentage interest in partnership profit or loss for the taxable year, as stated on the partner's Schedule K-1, provided however, that if, under the partnership agreement, a partner's share of gain or loss from the sale of particular partnership assets is specially allocated in a manner different from its profit or loss ratio stated on Schedule K-1, and such special allocation has "substantial economic effect" as defined in Treas. Reg. § 1.704-1(b)(2), gross receipts from sales of such assets shall be assigned to its sales factor in the same proportion as the partner's interest in gain or loss from the sale. In the event of a termination or other change in a

partner's interest during the taxable year, the partner's *pro rata* share of payroll and sales must be modified to reflect partnership payroll and sales during the actual period that the partner held its interest.

(13) Alternative Apportionment Methods.

(a) If a taxpayer claims that the allocation or apportionment provisions of 830 CMR 63.38.1 are not reasonably adapted to approximate the net income derived from business carried on in Massachusetts, a taxpayer may apply to the Commissioner to have such income determined by an alternative apportionment method pursuant to the provisions of M.G.L. c. 63, § 42 and 830 CMR 63.42.1.

(b) The provisions of 830 CMR 63.38.1(13)(a), notwithstanding, if the Commissioner determines that the apportionment provisions of 830 CMR 63.38.1 are not reasonably adapted to approximate the net income derived from business carried on in Massachusetts by certain industries, the Commissioner may, by regulation, adopt alternative apportionment provisions for such industries. To the extent the Commissioner adopts alternative apportionment regulations for certain industries, the rules contained in the alternative apportionment regulations will supersede the provisions of 830 CMR 63.38.1 to the extent provided.

(14) Effective Dates. The provisions in 830 CMR 63.38.1 generally shall apply to tax years beginning on or after January 2, 2015, except to the extent that a provision (i) is subject to a specific effective date provided in 830 CMR 63.38.1, (ii) is subject to a specific effective date created by legislation (including the rules enacted pursuant to St. 2013, c. 46, § 37, pertaining to the sales factor apportionment of sales of other than tangible personal property, which are effective for taxable years beginning on or after January 1, 2014, *see* 830 CMR 63.38.1(9)(d)) , or (iii) reflects a position appearing in a prior public written statement or other Department of Revenue publication, including electronic publication. All rules that antedate 830 CMR 63.38.1, whether appearing in a prior public written statement or other Department of Revenue publication, continue in force and effect except to the extent any such rules are revised or altered by 830 CMR 63.38.1. 830 CMR 63.38.1 notwithstanding, for periods prior to January 2, 2015, the Commissioner reserves the right to assert a position reflected in this regulation that is not inconsistent with a prior public written statement, and that otherwise is consonant with the law in effect at that time.

Date of Promulgation: 8/11/95

New Regulation Promulgated: 2/5/99

Amended: 3/31/00 - sections (12)(e)3; (14)(d)

Amended: 12/21/01 - section (9)(b)7

New Regulation Promulgated: 10/20/06 Amended by Mass Register Issue S1277, eff. 1/2/2015.

REGULATORY AUTHORITY

830 CMR 63.38.1: M.G.L. c. 14, § 6(1); M.G.L. c. 62C, § 3; M.G.L. c. 63, § 38(j),(k),(l),(m)(n).