MULTISTATE TAX COMMISSION

To: **Multistate Tax Commission**

From: **Greg Matson, Executive Director**

Re: **Proposed REG. IV.18.(c). Receipts Factor**

Date: **July 25, 2018**

The model REG. IV.18.(c). Receipts Factor (attached) was approved by the Executive Committee on January 8, 2018 for public hearing pursuant to Compact Art. VII and Bylaw 7. On January 12, 2018 the Commission gave notice of the public hearing to be held at the Hall of the States, Room 231, 444 North Capitol Street, N.W., Washington, DC. The public hearing was held by Judge William L. (Bill) Thompson, retired chief judge of the Alabama Tax Tribunal. The Hearing Officer's Report was provided for the Executive Committee's consideration on April 26, 2018. The Executive Committee approved the model (with one recommended change) for Bylaw 7 survey of the Compact member states on that same day. That survey was conducted by the Commission and a majority of affected states have now responded that they would consider the model. Therefore, pursuant to Bylaw 7, the Chair has directed consideration of this model by the Commission and proper notice of has been provided according to Bylaw 4.

The Commission may take any action with respect to the model, including approving it for recommendation to the states under Art. VI(3)(b) of the Compact. Bylaw 5(c), governing approval of the Commission, requires an affirmative vote of: (1) at least 60% of the total number of member states, and (2) member states reflecting a majority of the total population of all member states according to the current United States Statistical Abstract. (If there are minority views, those views will be transmitted with any recommendations.) Pursuant to Bylaw 5(d), if the vote of the members present at the Commission meeting results in the model neither being approved nor rejected, voting shall remain open for 15 days to allow absent or abstaining members to submit a written vote.

MULTISTATE TAX COMMISSION

Resolution Adopting Recommended Amendments to the Model General Allocation and Apportionment Regulations Reg. IV. 18.(c) Gross Receipts

WHEREAS, changes to Article IV of the Compact (UIDTPA) necessitated changes be made in the model General Allocation and Apportionment Regulations; and

WHEREAS, following the Executive Committee's instructions to update those model regulations, the Uniformity Committee has considered changes to regulations under Article IV, Section 18 having to do with the treatment of certain gross receipts; and

WHEREAS, the Uniformity Committee the referred draft amendments to the Executive Committee, which voted to approve them for public hearing on January 8, 2018; and

WHEREAS, that hearing was duly noticed and was held on February 20, 2018 and the hearing officer's report was submitted to the Executive Committee on April 26, 2018; and

WHEREAS, the Executive Committee approved the draft amendments, with one change, for bylaw 7 survey; and

WHEREAS, the majority of affected member states have given an affirmative response to that survey;

Now, therefore, be it:

RESOLVED, this day, July 25, 2018, that the Commission hereby adopts the recommended amendments to the model General Allocation and Apportionment Regulations, Reg.IV.18.(c).

<u>REG. IV.18.(c). Receipts Factor</u>.

(1) Definitions. As used in this Reg. IV.18(c):

(A) "Receipts" means receipts as defined in [reference to Compact Article IV.1.g MTC Model Allocation and Apportionment Regulation IV.2.(a)(6) or other similar state law];

(B) "Gross receipts" means gross receipts as defined in [reference to MTC Model Allocation and Apportionment Regulation IV.2.(a)(5) or similar state regulation] that give rise to apportionable income included in the tax base;

(C) "MTC Financial Institutions Apportionment Model" means the Multistate Tax Commission's Recommended Formula for the Apportionment and Allocation of the Net Income of Financial Institutions, as amended July 29, 2015;

DRAFTER'S NOTE: IF YOUR STATE HAS ITS OWN FINANCIAL INSTITUTIONS APPORTIONMENT RULES, YOUR STATE MAY WISH TO REFERENCE THE SPECIFIC RULES OF ASSIGNMENT IN THOSE RULES FOR THESE TYPES OF GROSS RECEIPTS. SEE SUBPARAGRAPH (3)(c)(3).

(D) "Gross receipts from lending activities" means interest income and other gross receipts arising from the activities described in subsections 3(d) through 3(j) of the MTC Financial Institutions Apportionment Model; and,

(E) An entity's apportionment factor is "*de minimis*" if the denominator is less than 3.33 percent of the entity's apportionable gross receipts or if the factor is insignificant in producing income.

DRAFTER'S NOTE: SUBPARAGRAPH (1)(E) DOES NOT APPLY TO THE CALCULATION OF THE TAXPAYER'S RECEIPTS FACTOR UNDER PARAGRAPH (2), BELOW.

(2) This Reg. IV.18.(c) applies to the determination of the receipts factor if the taxpayer's receipts are less than 3.33 percent of the taxpayer's gross receipts. A taxpayer's receipts subject to assignment under Compact Art. IV, Sections 16 and 17 are assigned under those sections and are not assigned by this Regulation IV.18.(c).

(3) The following gross receipts are included in the receipts factor denominator and are assigned to the receipts factor numerator in this state as follows:

(A) Dividends paid by a related party, as defined in [reference to applicable state law], are assigned to the receipts factor numerator in this state as follows:

1. If paid from earnings that can be reasonably attributed to a particular year, the dividends are assigned to the receipts factor numerator in this state in a proportion equal to the dividend payor's apportionment factors in this state for that year as determined pursuant to [reference to state law].

2. If the dividends were paid from earnings that cannot reasonably be attributed to a particular year, the dividends are assigned to the receipts factor numerator in this state in a proportion equal to the dividend payor's average apportionment factors in this state for the current and preceding year as determined pursuant to [reference to state law].

EXAMPLE:

DRAFTER'S NOTE: TREATMENT OF DIVIDEND INCOME VARIES WIDELY AMONG THE STATES. STATES SHOULD CHECK THEIR TAX BASE WHEN ADOPTING THIS EXAMPLE TO AVOID CONFUSION.

Taxpayer Bigbox Holding, Inc. (Holding) is a domestic corporation, domiciled in Delaware, with numerous foreign and domestic subsidiaries. Holding has no "receipts," as defined under this state's apportionment statutes. Holding is the corporate parent of Bigbox Retailing, Inc. (Retailing), a domestic corporation with its commercial domicile in State X. During the tax year, Holding receives $100 million in dividends from Retailing and $100 million in dividends from Holding's foreign subsidiaries. Because the foreign-source dividends are excluded from this state's tax base pursuant to this state's laws, they are not "gross receipts" subject to apportionment and are not included in the receipts factor. In both the current tax year and the prior tax year, Retailing conducted operations in ten states, including this state. Retailing's apportionment factor in this state in the current year is 20%, and the factor was 18% in the prior year. The dividends received from Retailing cannot be reasonably attributed to that entity's earnings in any specific year. Therefore, pursuant to subparagraph (3)(A)(2), Holding's receipts factor in this state is calculated by including the $100 million of apportionable dividends received from Retailing in the denominator, and $19 million in the receipts factor numerator in this state, based on the average of Retailing's apportionment factors in this state in the current year (20%) and prior year (18%).

(B) Gains are assigned to the receipts factor numerator in this state as follows:

1. Gains (net of related losses, but not less than zero) from the disposition of stock (or other intangible property rights) representing at least a 20% ownership interest in an entity, are assigned to the receipts factor numerator in this state in a proportion equal to what the entity's separate apportionment factor was in this state for the tax year preceding the disposition as determined pursuant to state law.

2. Gains (net of related losses, but not less than zero) from the disposition of assets of an entity or segment of a business are assigned to the receipts factor numerator in this state in a proportion equal to what the entity's separate apportionment factor was in this state in the tax year preceding the disposition as determined pursuant to [ref. to state law].

3. In applying clauses 1 and 2 of this subparagraph (B), in any case in which the entity did not exist in the prior year, or had an apportionment factor of zero [or had only a *de minimis* apportionment factor], the gross receipts from the gain are attributed to the receipts factor numerator of this state under paragraphs (4), (5), or (6) of this Reg.IV.18.(c) as appropriate.

4. In applying this subparagraph (B), in the case of an entity which was not subject to entity-level taxation, the apportionment percentage shall be computed as if the entity were a C corporation.

EXAMPLES:

(i) Taxpayer, Nuclear Corp. (Nuclear) is a holding company with no "receipts" from transactions and activities in the ordinary course of business. In the prior tax year, Nuclear formed Target Corp. (Target) and transferred its stock ownership interest in three power plants, located in three states, one of which is in this state, to Target in exchange for the stock of Target. In the current tax year, Nuclear sells the stock of Target to Risky Investments for $500 million in cash, recognizing a gain of $100 million. In the tax year preceding the sale, Target's apportionment factor in this state was 30%. Based on Target's prior year apportionment factor, Nuclear would include $100 million in the denominator of its receipts factor and would assign $30 million to the receipts factor numerator in this state.

(ii) Same facts as (i) except during the current tax year Nuclear formed Target and then sold the Target stock on the same day. Because Target did not exist in the year preceding the disposition, Nuclear would have to use paragraph (4), (5) or (6), as appropriate, to assign a portion of the $100 million gain to its receipts factor numerator in this state.

(iii) Same facts as (i) except Nuclear makes an IRC 338(h)(10) election, which this state conforms to, so the sale is treated as the sale by Target of its assets. The sale of Target's assets in this state (the power plant) generated a gain of $150 million, and the sale of Target's remaining two power plants generated a loss of $50 million. Target would include $100 million of gain (the net amount) in the denominator of its receipts factor and would include 30% of that gain in the receipts factor in this state based on Target's apportionment factors in this state in the year preceding the sale.

DRAFTER'S NOTE: IF THE STATE HAS ADOPTED OTHER RULES FOR AOOPORTIONING AND ALLOCATING THE NET INCOME OF FINANCIAL INSTITUTIONS, THE FOLLOWING SUBSECTION AND THE EXAMPLES SHOULD REFERENCE THOSE RULES IN LIEU OF REFERENCING THE MTC'S FINANCIAL INSTITUTIONS APPORTIONMENT MODEL.

(C) Gross receipts from lending activities are included in the receipts factor denominator and assigned to the receipts factor numerator in this state to the extent those gross receipts would have been assigned to this state under the MTC Financial Institutions Apportionment Model (including the rule of assignment to commercial domicile under 3(p) of that model statute) [or your state's Financial Institutions Apportionment Rules] as if the taxpayer were a financial institution subject to the MTC Financial Institutions Apportionment Model [or your state's Financial Institutions Apportionment Rules], except that:

1. in the case of gross receipts derived from loans to a related party as defined by [reference to state law], which are not secured by real property, including interest, fees, and penalties, the gross receipts are included in this state's numerator in a proportion equal to the related party's apportionment factor in this state as determined by [reference to state law] in the year the gross receipts were included in apportionable income; and,

2. Gross receipts derived from accounts receivable previously sold to or otherwise transferred to the taxpayer are assigned under subparagraph (D).

EXAMPLES:

DRAFTER'S NOTE: TREATMENT OF DIVIDEND INCOME VARIES WIDELY AMONG THE STATES. STATES SHOULD CHECK THEIR TAX BASE WHEN ADOPTING THIS EXAMPLE TO AVOID CONFUSION.

(i) Taxpayer Bigbox Holding, Inc. (Holding) is a domestic corporation, domiciled in Delaware, with numerous foreign and domestic subsidiaries. Holding has no "receipts," as defined under this state's apportionment statutes. Holding is the corporate parent of Bigbox Retailing, Inc. (Retailing), a domestic corporation with its commercial domicile in state X. During the current tax year, Holding receives $100 million in dividends from Retailing and $100 million in dividends from Holding's foreign subsidiaries. Because the foreign-source dividends are excluded from this state's tax base pursuant to this state's laws, they are not "gross receipts" subject to apportionment and are not included in the receipts factor. In both the current tax year and the prior tax year, Retailing conducted operations in ten states, including this state. Retailing's apportionment factor in this state in the current year is 20%, and this factor was 18% in the prior year. In a prior year, Holding lent its excess capital to Retailing as an unsecured loan. In repayment of that loan, Holding received $40 million of interest income from Retailing in the current tax year, in addition to the $100 million of dividend income that Holding received from Retailing. Pursuant to subparagraph (3)(C), Holding's interest income would be included in its receipts factor denominator, and 20% of Holding's interest income ($8 million) would be included in its receipts factor numerator in this state because 20% of Retailing's apportionment factors were in this state in the year the interest income was included in taxable income. Assuming Holding had no other gross receipts, Holding's receipt factor numerator in this state is 19.28% ($27 million /$140 million).

(ii) Taxpayer Loan Participation Inc. (LPI) was formed to acquire and hold a participation in loans secured by real property originated by an unrelated financial institution. LPI has no employees or property and no other gross receipts except for payments of interest on the participation loan held. Even though LPI would not be considered a financial institution under the MTC's Financial Institutions Apportionment Model for purposes of this state's rules, LPI's gross receipts are included in the denominator and assigned to the receipts factor numerator in this state under subsection 3(d) of the MTC's Financial Institutions Apportionment Model, in proportion to the value of loans secured by real property in this state compared to the value of loans secured by real property everywhere.

(D) Gross receipts derived from accounts receivable previously sold to or otherwise transferred to the taxpayer-are included in the denominator and assigned to the receipts factor numerator in this state to the extent those accounts receivable are attributed to borrowers located in this state; provided however, that if the taxpayer is not taxable [as defined in Compact Article IV, section 3 or similar state law] in a state in which the borrowers are located, those gross receipts are excluded from the denominator of the taxpayer's receipts factor.

EXAMPLES:

(i) Taxpayer IH Factoring, Inc. (Factoring) is a Delaware corporation that has twenty employees all of whom are located in Delaware. Factoring purchases installment agreements (accounts receivable) from its parent corporation, Iron Horse Motorcycles, Inc. (Iron Horse). Factoring has access to information showing the addresses of the installment agreement customers. Factoring purchases installment agreements originating from Iron Horse's borrowers in States A and B, and this state. Factoring is taxable in State A and this state, but not State B. Factoring re-sells the agreements as securitized instruments to institutional investors. Factoring's gross receipts from selling the securitized instruments originating from Iron Horse's borrowers in State A and this state would be included in the receipts factor denominator, and Factoring's gross receipts from selling securitized instruments originating from Iron Horse's borrowers in this state would be assigned to the receipts factor numerator in this state.

(ii) Same facts as above, but IH Factoring retains its ownership in the installment agreements and receives principal, interest and related fees from Iron Horse's customers (borrowers). The principal, interest and related fees received by Factoring from borrowers in State A and this state would be included in Factoring's receipts factor denominator, and Factoring's receipts received from Iron Horse's customers (borrowers) in this state would be assigned to the receipts factor numerator in this state.

(E) The net amount, but not less than zero, of gross receipts not otherwise assigned under this paragraph (3) arising from investment activities, including the holding, maturity, redemption, sale, exchange, or other disposition of marketable securities or cash are assigned to the sales factor numerator in this state if the gross receipts would be assigned to this state under Subsections (3)(n) or (3)(p) of the MTC's Financial Institutions Apportionment Model [or similar state financial institutions receipts factor rules]; all other gross receipts from investment activities not otherwise assigned under this paragraph (3) are assigned to the receipts factor numerator in this state if the investments are managed in this state.

DRAFTER'S NOTE: THIS PROVISION IS FOR STATES THAT USE A MULTI-FACTOR FORMULA. STATES WITHOUT A MULTI-FACTOR FORMULA SHOULD EXCLUDE THIS PROVISION.

(4) Gross receipts, other than those included and assigned under paragraph (3), are included in the receipts factor denominator, and are assigned to the receipts factor numerator in this state in a proportion equal to the average of the taxpayer's other non-*de minimis* apportionment factors [or other non-*de minimis* apportionment factor] in this state as determined pursuant to [reference to state law].

EXAMPLES:

(i) Taxpayer Windfall, Inc. (Windfall) is a wholly-owned subsidiary of ABC Manufacturing Corp. (ABC). During the tax year, Windfall has 10% of its property and 20% of its payroll in this state, and neither its property nor its payroll factor is *de minimis*. Windfall's only gross receipt during the year is $1 billion received in settlement of ABC's patent infringement suit against a business competitor that has been ongoing for several years. Because this settlement amount is not assigned to the receipts factor in this state under paragraph (3), Windfall is to assign the gross receipts to its receipts factor numerator in a proportion equal to the average of its property and payroll factors. Therefore, Windfall would include $1 billion in its receipts factor denominator and would include 15% of that amount ($150 million) in the receipts factor numerator in this state, under this state's apportionment formula.

(ii) Same facts as above, except that Windfall's property and payroll factors are *de minimis.* Windfall would accordingly include the $1 billion settlement amount in the receipts factor denominator and would include a portion of that amount to the receipts factor numerator in this state in accordance with paragraphs (5) or (6) of this regulation, as appropriate.

DRAFTER'S NOTE – FROM THIS POINT – THE DRAFT'S NUMBERING ASSUMES THAT THE STATE INCLUDES PARAGRAPH (4). IF NOT – THE FOLLOWING PROVISIONS AND CROSS-REFERENCES TO THE PROVISIONS REFERENCED BELOW WILL HAVE TO BE RENUMBERED.

DRAFTER'S NOTE: THIS PROVISION IS FOR STATES THAT ALLOW OR REQUIRE STATE-LEVEL COMBINED FILINGS. IN PARAGRAPH (5), THE TERM "COMBINED REPORT" IS USED IN THE SAME SENSE AS THAT TERM IS USED IN THE MTC MODEL COMBINED FILING STATUTE.

(5) Except for gross receipts included and assigned under paragraphs (3) or (4), gross receipts of a taxpayer whose income and factors are included in a combined report in this state are included in the receipts factor denominator and are assigned to the receipts factor numerator in this state in the same proportion as the ratio of: (A) the total of the receipts factor numerators of all members of the combined group in this state, whether taxable or nontaxable, as determined pursuant to [reference to state law], to (B) the denominator of the combined group.

EXAMPLE:

Taxpayer Windfall, Inc. (Windfall) is a wholly-owned subsidiary of ABC Manufacturing Company (ABC). Windfall's only gross receipt during the year is $1 billion received in settlement of ABC's patent infringement suit against a business competitor that has been ongoing for several years. Windfall is included on a combined report filed by ABC on behalf of ABC, Windfall and other direct and indirect control subsidiaries of ABC (collectively, the Combined Subsidiaries). The ratio of the total numerators of ABC and Combined Subsidiaries in this state, as reported on the combined report, to the denominator of the combined group is 25 percent. Windfall would include $1 billion in its receipts factor denominator and would include $250 million in the receipts factor numerator in this state.

DRAFTER'S NOTE – FROM THIS POINT – THE DRAFT'S NUMBERING ASSUMES THAT THE STATE INCLUDES PARAGRAPHS (4) AND (5). IF NOT – THE FOLLOWING PROVISIONS AND CROSS-REFERENCES TO PROVISIONS REFERENCED BELOW WILL HAVE TO BE RENUMBERED.

(6) Except for those gross receipts included and assigned under paragraphs (3), (4) or (5), gross receipts of a taxpayer that files as part of a federal consolidated return are included in the receipts factor denominator and are assigned to the receipts factor numerator in this state in a proportion equal to a percentage (but not greater than 100%), the numerator of which is the total

of the consolidated group members' income allocated to or apportioned to this state pursuant to [ref. to state law], and the denominator of which is the total federal consolidated taxable income.

EXAMPLE:

DRAFTER'S NOTE: STATES SHOULD CHOOSE ONE OF THE FOLLOWING ALTERNATIVES AS NOTED.

[Alternative 1– States that adopt paragraph (5)]

Taxpayer Windfall, Inc. (Windfall) is a wholly-owned subsidiary of ABC Manufacturing Corp. (ABC). Windfall's only gross receipt is $1 billion received in settlement of ABC's patent infringement suit against a business competitor that has been ongoing for several years. Windfall is not included on a combined report filed in this state, but is included on a consolidated federal return filed by ABC on behalf of Windfall and other affiliated corporations that are included in such consolidated return. The total federal taxable income of that consolidated group is $5 billion, and the total amount of that income that is apportioned to this state by members of the consolidated group other than Windfall is $500 million. Because the percentage the consolidated group's income that would be apportioned to this state is 10%, Windfall would include $1 billion in its receipts factor denominator and would assign 10% of that amount ($100 million) to the receipts factor numerator in this state.

[Alternative 2 – States that do not adopt paragraph (5)] –

Taxpayer Windfall, Inc. (Windfall) is a wholly-owned subsidiary of ABC Manufacturing Corp. (ABC). Windfall's only gross receipt is $1 billion received in settlement of ABC's patent infringement suit against a business competitor that has been ongoing for several years. Windfall is included on a consolidated federal return filed by ABC on behalf of Windfall and other affiliated corporations that are included in such consolidated return. The total federal taxable income of that consolidated group is $5 billion, and the total amount of income of that income apportioned to this state by members of the consolidated group other than Windfall is $500 million. Because the percentage the consolidated group's income that would be apportioned to this state is 10%, Windfall would include $1 billion in its receipts factor denominator and would assign 10% of that amount ($100 million) to the receipts factor numerator in this state.

(7) Nothing in this Reg.IV.18.(c) shall prohibit the taxpayer from petitioning for, or the [state tax agency or administrator] from applying an alternative method to calculate the taxpayer's receipts factor in order to fairly represent the extent of the taxpayer's business activity in this state as provided for in [reference to Compact Article IV, Section 18 or similar state law], including the application of this rule in situations that do not meet the threshold of paragraph (2) of this Reg.IV.18.(c). Such alternative method may be appropriate, for example, in situations otherwise addressed under subparagraph (3)(A) where dividends were paid from earnings that were generated by the activities of a related party of the dividend payor, in which case the dividends may be more appropriately assigned to the receipts factor numerator in this state using the related party's average apportionment factors in this state.