

## Multistate Tax Commission Allocation and Apportionment Regulations

### •• Reg. IV.1.(a). Apportionable and Non-apportionable~~Business and Nonbusiness~~ Income Defined.

(1) **Apportionment and Allocation.** Article IV.1(a) and (e) require that every item of income be classified either as businessapportionable income or ~~nonbusinessnon-~~apportionable income. Income for purposes of classification as businessapportionable or ~~nonbusinessnon-~~apportionable includes gains and losses. BusinessApportionable income is apportioned among jurisdictions by use of a formula. NonbusinessNon-apportionable income is specifically assigned or allocated to one or more specific jurisdictions pursuant to express rules. An item of income is classified as businessapportionable income if it falls within the definition of businessapportionable income. An item of income is ~~nonbusinessnon-~~apportionable income only if it does not meet the definitional requirements for being classified as businessapportionable income.

(2) **BusinessApportionable Income.** BusinessApportionable income means all income that is apportionable under the Constitution of any type or class, the United States and is not allocated under the laws of this state, including:

(A) income arising from any transactions and activity, that meets the relationship described either in IV.1.(the regular course of the taxpayer's trade or business; and

(B) income arising from tangible and intangible property if the acquisition, management, employment, development<sup>4</sup>), the "transactional test", or (5), the "functional test". disposition of the property is or was related to the operation of the taxpayer's trade or business; and

(C) any income that would be allocable to this state under the Constitution of the United States, but that is apportioned rather than allocated pursuant to the laws of this state.

The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, income derived from accounts receivable, operating income, ~~nonoperatingnon-~~operating income, *etc.*, is of no aid in determining whether income is businessapportionable or non-businessapportionable income.

(3) **Terms Used in Definition of Business Income and in Application of Definition.** "Trade or business," as used in the definition of businessapportionable income and ~~or~~ in the application of thethat definition, ~~(A)~~ "Trade or business" means the unitary business of the taxpayer, part of which is conducted within [this State].

~~(B) "To contribute materially" includes, without limitation, "to be used operationally in the taxpayer's trade or business." Whether property materially~~

~~contributes is not determined by reference to the property's value or percentage of use. If an item of property materially contributes to the taxpayer's trade or business, the attributes, rights or components of that property are also operationally used in that business. However, property that is held for mere financial betterment is not operationally used in the taxpayer's trade or business.~~

(4) **Transactional Test.** Business Apportionable income includes income arising from transactions and activity in the regular course of the taxpayer's trade or business.

(A) If the transaction or activity is in the regular course of the taxpayer's trade or business, part of which trade or business is conducted within [this State], the resulting income of the transaction or activity is business apportionable income for [this State]. Income may be business apportionable income even though the actual transaction or activity that gives rise to the income does not occur in [this State].

(B) For a transaction or activity to be in the regular course of the taxpayer's trade or business, the transaction or activity need not be one that frequently occurs in the trade or business. Most, but not all, frequently occurring transactions or activities will be in the regular course of that trade or business and will, therefore, satisfy the transactional test. It is sufficient to classify a transaction or activity as being in the regular course of a trade or business, if it is reasonable to conclude transactions of that type are customary in the kind of trade or business being conducted or are within the scope of what that kind of trade or business does. However, even if a taxpayer frequently or customarily engages in investment activities, if those activities are for the taxpayer's mere financial betterment rather than for the operations of the trade or business, such activities do not satisfy the transactional test. The transactional test includes, but is not limited to, income from sales of inventory, property held for sale to customers, and services which are commonly sold by the trade or business. The transactional test also includes, but is not limited to, income from the sale of property used in the production of business apportionable income of a kind that is sold and replaced with some regularity, even if replaced less frequently than once a year.

(5) **Functional test.** Business Apportionable income also includes income from tangible and intangible property, if the acquisition, management, ~~and employment,~~ development, or disposition of the property constitute integral parts is or was related to the operation of the taxpayer's ~~regular~~ trade or business ~~operations~~. "Property" includes any direct or indirect interest in, control over, or use ~~in of real~~ property ~~(whether the interest is held directly, beneficially, by contract, or otherwise) that materially contributes to the production of business income.~~ "Acquisition" refers to the act of ~~obtaining an interest in,~~ tangible personal property. "Management" refers to the ~~oversight, direction, or control (directly or by delegation) of the~~ and intangible property ~~for the use or benefit of the trade or business.~~ "Disposition" refers to the act, or the power, to ~~relinquish or transfer an interest in or control over property to another, in whole or in part.~~ Integral part by the taxpayer

Property that is "related to the operation of the trade or business" refers to property that

~~constituted a part of the composite whole of the trade~~is or business, each part of which gave value~~was used to every other part, in a manner which materially contributed~~contribute to the production of ~~business~~apportionable income directly or indirectly, without regard to the materiality of the contribution.

~~(A) Under the functional test, business income need~~Property that is held merely for investment purposes is not be derived from transactions or activities that are in the regular course of the taxpayer's own particular-related to the operation of the trade or business. ~~It is sufficient,~~

“Acquisition, management, employment, development or disposition” refers to a taxpayer’s activities in acquiring property, exercising control and dominion over property and disposing of property, including dispositions by sale, lease or license. Income arising from the disposition or other utilization of property which was acquired or developed in the course of the taxpayer’s trade or business constitutes apportionable income, even if the property from which the income is derived is or was an integral, functional, or operative component used in the taxpayer's trade or business operations, or otherwise materially contributed to the production of business income~~was not directly employed in the operation~~ of the taxpayer’s trade or business, ~~part.~~

Income from the disposition or other utilization of property which ~~trade or business is or was conducted within this State. Property that has been converted to nonbusiness~~withdrawn from use through the passage of a sufficiently lengthy period of time (generally, five years is sufficient) or that has been removed as an operational asset and is instead held byin the taxpayer’s trade or business exclusivelyand is instead held solely for unrelated investment purposes ~~has lost its character as a business asset and is is not subject to the rule of the preceding sentence~~apportionable. Property that was ~~an integral part~~related to the operation of the taxpayer’s trade or business is not considered converted to investment purposes merely because it is placed for sale, but any property which has been withdrawn from use in the taxpayer’s trade or business for five years or more is presumed to be held for investment purposes.

*Example (i):* Taxpayer purchases a chain of 100 retail stores for the purpose of merging those store operations with its existing business. Five of the retail stores are redundant under the taxpayer’s business plan and are sold six months after acquisition. Even though the five stores were never integrated into the taxpayer’s trade or business, the income is apportionable because the property’s acquisition was related to the taxpayer’s trade or business.

*Example (ii):* Taxpayer is in the business of developing adhesives for industrial and construction uses. In the course of its business, it accidentally creates a weak but non-toxic adhesive and patents the formula, awaiting future applications. Another manufacturer uses the formula to create temporary body tattoos. Taxpayer wins a patent infringement suit against the other manufacturer. The entire damages award, including interest and punitive damages, constitutes apportionable income.

*Example (iii):* Taxpayer is engaged in the oil refining business and

maintains a cash reserve for buying and selling oil on the spot market as conditions warrant. The reserve is held in overnight “repurchase agreement” accounts of U.S. treasuries with a local bank. The interest on those amounts is apportionable income because the reserves are necessary for the taxpayer’s business operations. Over time, the cash in the reserve account grows to the point that it exceeds any reasonably expected requirement for acquisition of oil or other short-term capital needs and is held pending subsequent business investment opportunities. The interest received on the excess amount is non-apportionable income.

Example (iv): A manufacturer decides to sell one of its redundant factories to a real estate developer and transfers the ownership of the factory to a special purpose subsidiary, SaleCo (Taxpayer) immediately prior to its sale to the real estate developer. The parties elect to treat the sale as a disposition of assets under IRC 338(h)(10), resulting in Taxpayer recognizing a capital gain on the sale. The capital gain is apportionable income. Note: although the gain is apportionable, application of the standard apportionment formula in Section 17 may not fairly reflect the taxpayer’s business presence in any state, necessitating resort to equitable apportionment pursuant to Section 18.

(A) Under the functional test, income from the disposition or other utilization of property is apportionable if the property is or was related to the operation of the taxpayer’s trade or business. This is true even though the transaction or activity from which the income is derived did not occur in the regular course of the taxpayer’s trade or business.

(B) Income that is derived from isolated sales, leases, assignments, licenses, and other infrequently occurring dispositions, transfers, or transactions involving property, including transactions made in the full or partial liquidation or the winding-up of business any portion of the trade or business, is businessapportionable income, if the property is or was used inrelated to the taxpayer’s trade or business-operations. (Property that has been converted to nonbusiness use (see IV.1.a.(4)(A)) has lost its character as a business asset and is not subject to the rule of the preceding sentence.) Income from the licensing of an intangible asset, such as a patent, copyright, trademark, service mark, know-how, trade secrets, or the like, that was developed or acquired for use by the taxpayer in its trade or business-operations, constitutes businessapportionable income whether or not the licensing itself constituted the operation of a trade or business, and whether or not the taxpayer remains in the same trade or business from or for which the intangible asset was developed or acquired.

(C) Under the functional test, income from intangible property is businessapportionable income when the intangible property serves an operational function as opposed to solely an investment function. The relevant inquiry focuses on whether the property is or was held in furtherance of the taxpayer’s trade or business, that is, on the objective characteristics of the intangible property’s use or acquisition and its relation to the taxpayer and the taxpayer’s activities. The functional test is not satisfied where the holding of the property is limited to solely an investment function

~~as is the case where the holding of the property is limited to mere financial betterment of the taxpayer in general.~~

(D) If the ~~acquisition, management, employment, development, or disposition of the property is or was held in furtherance~~ related to the operation of the taxpayer's trade or business ~~beyond mere financial betterment~~, then income from that property ~~may be business~~ is apportionable income even though the actual transaction or activity involving the property that gives rise to the income does not occur in [this State].

(E) Examples.

*Example (i):* A manufacturer purchases raw materials to be incorporated into the product it offers for sale. The nature of the raw materials is such that the purchase price is subject to extreme price volatility. In order to protect itself from extreme price increases (or decreases), the manufacturer enters into future contracts pursuant to which the manufacturer can either purchase a set amount of the raw materials for a fixed price, within a specified time period, or resell the future contracts. Any gain on the sale of the future contracts would be considered apportionable income, regardless of whether the contracts were either made or resold in [this State].

*Example (ii):* A national retailer produces substantial revenue related to the operation of its trade or business. It invests a large portion of the revenue in fixed income securities which are divided into three categories; (a) short-term securities held pending use of the funds in the taxpayer's trade or business; (b) short-term securities held pending acquisition of other companies or favorable developments in the long-term money market, and (c) long-term securities held as an investment. Interest income on the short-term securities held pending use of the funds in the taxpayer's trade or business (a) is apportionable because the funds represent working capital necessary to the operations of the taxpayer's trade or business. Interest income derived from the other investment securities ((b) and (c)) is not apportionable as those securities were not held in furtherance of the taxpayer's trade or business.

(F) If with respect to an item of property a taxpayer (i) takes a deduction from ~~business~~ income that is apportioned to [this State] or (ii) includes the original cost in the property factor, it is presumed that the item or property is or was ~~integral~~ related to the operation of the taxpayer's trade or business ~~operations~~. No presumption arises from the absence of any of these actions.

(FG) Application of the functional test is generally unaffected by the form of the property (*e.g.*, tangible or intangible property, real or personal property). Income arising from an intangible interest, as, for example, corporate stock or other intangible interest in ~~a business~~ an entity or a group of assets, is business apportionable income when the intangible itself or the property underlying or associated with the intangible is or was ~~an integral, functional, or operative~~

~~component related to the operation of the taxpayer's trade or business operations. (Property that has been converted to nonbusiness use (see IV.1.(a).(4)(A)) has lost its character as a business asset and is not subject to the rule of the preceding sentence.)~~ Thus, while apportionment of income derived from transactions involving intangible property ~~as business income~~ may be supported by a finding that the issuer of the intangible property and the taxpayer are engaged in the same trade or business, *i.e.*, the same unitary business, establishment of such a relationship is not the exclusive basis for concluding that the income is subject to apportionment. It is sufficient to support the finding of apportionable income if the holding of the intangible interest served an operational rather than an investment function ~~of mere financial betterment.~~

(6) **Relationship of transactional and functional tests to U.S. Constitution.** The Due Process Clause and the Commerce Clause of the U.S. Constitution restrict states from apportioning income ~~as business income~~ that has no rational relationship with the taxing state. The protection against extra-territorial state taxation afforded by these Clauses is often described as the “unitary business principle.” The unitary business principle requires apportionable income to be derived from the same unitary business that is being conducted at least in part in [this State]. The unitary business that is conducted in [this State] includes both a unitary business that the taxpayer alone may be conducting and a unitary business the taxpayer may conduct with any other person or persons. Satisfaction of either the transactional test or the functional test complies with the unitary business principle, because each test requires that the transaction or activity (in the case of the transactional test) or the property (in the case of the functional test) ~~to~~ be tied to the same trade or business that is being conducted within [this State]. Determination of the scope of the unitary business being conducted in [this State] is without regard to extent to which [this State] requires or permits combined reporting.

(7) ~~Nonbusiness~~**Non-apportionable income.** ~~Nonbusiness~~**Non-apportionable** income means all income other than ~~business~~**apportionable** income.

••• **Reg. IV.1.(b). Principles for Determining the Existence of a Unitary Business.**

**(1) Unitary Business Principle.**

(A) *The Concept of a Unitary Business.* A unitary business is a single economic enterprise that is made up either of separate parts of a single ~~business~~ entity or of a commonly controlled group of ~~business~~ entities that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts. This flow of value to ~~a business~~ an entity located in this state that comes from being part of a unitary business conducted both within and without this state is what provides the constitutional due process "definite link and minimum connection" necessary for this state to apportion ~~business~~**apportionable** income of the unitary business, even if that income arises in part from activities conducted outside the state. The ~~business~~**apportionable** income of the unitary business is then apportioned to this state using an apportionment percentage provided by [insert your state statute].

This sharing or exchange of value may also be described as requiring that the operation of one part of the business be dependent upon, or contribute to, the operation of another part of the business. Phrased in the disjunctive, the foregoing means that if the activities of one business either contributes to the activities of another business *or* are dependent upon the activities of another business, those businesses are part of a unitary business.

- (B) *Constitutional Requirement for a Unitary Business.* The sharing or exchange of value described in subsection (A) that defines the scope of a unitary business requires more than the mere flow of funds arising out of a passive investment or from the financial strength contributed by a distinct business undertaking that has no *operational* relationship to the unitary business.

In this state, the unitary business principle shall be applied to the fullest extent allowed by the U.S. Constitution. The unitary business principle shall not be applied to result in the combination of business activities or entities under circumstances where, if it were adverse to the taxpayer, the combination of such activities or entities would not be allowed by the U.S. Constitution.

- (C) *Separate Trades or Businesses Conducted within a Single Entity.* A single entity may have more than one unitary business. In such cases it is necessary to determine the ~~business, or~~ apportionable, income attributable to each separate unitary business as well as its ~~nonbusiness~~ non-apportionable income, which is specifically allocated. The ~~business~~ apportionable income of each unitary business is then apportioned by a formula that takes into consideration the in-state and the out-of-state factors that relate to the respective unitary business whose income is being apportioned.

- (D) *Unitary Business Unaffected by Formal Business Organization.* A unitary business may exist within a single ~~business~~ entity or among a commonly controlled group of ~~business~~ entities. The scope of what is included in a commonly controlled group of ~~business~~ entities is set forth in Section V below.

## (2) Determination of a Unitary Business

- (A) A unitary business is characterized by significant flows of value evidenced by factors such as those described in *Mobil Oil Corp. v. Vermont*, 445 U.S. 425 (1980): functional integration, centralization of management, and economies of scale. These factors provide evidence of whether the business activities operate as an integrated whole or exhibit substantial mutual interdependence. ~~[RESERVED: See regulation concerning passive holding companies for special rules that govern the determination of whether a pure or passive holding company constitutes a part of a unitary business with one or more affiliates conducting active business operations.]~~ Facts suggesting the presence of the factors mentioned above should be analyzed in combination for their cumulative effect and not in isolation. A particular business operation may be suggestive of one or more of the factors

mentioned above.

*(B) Description and Illustration of Functional Integration, Centralization of Management and Economies of Scale.*

1. *Functional integration:* Functional integration refers to transfers between, or pooling among, business activities that significantly affect the operation of the business activities. Functional integration includes, but is not limited to, transfers or pooling with respect to the unitary business's products or services, technical information, marketing information, distribution systems, purchasing, and intangibles such as patents, trademarks, service marks, copyrights, trade secrets, know-how, formulas, and processes. There is no specific type of functional integration that must be present. The following is a list of examples of business operations that can support the finding of functional integration. The order of the list does not establish a hierarchy of importance.
  - a. Sales, exchanges, or transfers (collectively "sales") of products, services, and/or intangibles between business activities provide evidence of functional integration. The significance of the intercompany sales to the finding of functional integration will be affected by the character of what is sold and/or the percentage of total sales or purchases represented by the intercompany sales. For example, sales among ~~business~~ entities that are part of a vertically integrated unitary business are indicative of functional integration. Functional integration is not negated by the use of a readily determinable market price to effect the intercompany sales, because such sales can represent an assured market for the seller or an assured source of supply for the purchaser.
  - b. *Common Marketing.* The sharing of common marketing features among ~~business~~ entities is an indication of functional integration when such marketing results in significant mutual advantage. Common marketing exists when a substantial portion of the ~~business~~ entities' products, services, or intangibles are distributed or sold to a common customer, when the ~~business~~ entities use a common trade name or other common identification, or when the ~~business~~ entities seek to identify themselves to their customers as a member of the same enterprise. The use of a common advertising agency or a commonly owned or controlled in-house advertising office does not by itself establish common marketing that is suggestive of functional integration. (Such activity, however, is relevant to determining the existence of economies of scale and/or centralization of management.)
  - c. *Transfer or Pooling of Technical Information or Intellectual Property.* Transfers or pooling of technical information or intellectual property, such as patents, copyrights, trademarks and service marks, trade secrets, processes or formulas, know-how, research, or development, provide evidence of functional integration when the matter transferred is significant



to the businesses' operations.

- d. *Common Distribution System.* Use of a common distribution system by the ~~business~~ entities, under which inventory control and accounting, storage, trafficking, and/or transportation are controlled through a common network provides evidence of functional integration.
- e. *Common Purchasing.* Common purchasing of substantial quantities of products, services, or intangibles from the same source by the ~~business~~ entities, particularly where the purchasing results in significant cost savings or where the products, services or intangibles are not readily available from other sources and are significant to each entity's operations or sales, provides evidence of functional integration.
- f. *Common or Intercompany Financing.* Significant common or intercompany financing, including the guarantee by, or the pledging of the credit of, one or more ~~business~~ entities for the benefit of another ~~business~~ entity or entities provides evidence of functional integration, if the financing activity serves an operational purpose of both borrower and lender. Lending which serves an investment purpose of the lender does not necessarily provide evidence of functional integration. (See below for discussion of centralization of management.)

- 2. *Centralization of Management.* Centralization of management exists when directors, officers, and/or other management employees jointly participate in the management decisions that affect the respective business activities and that may also operate to the benefit of the entire economic enterprise. Centralization of management can exist whether the centralization is effected from a parent entity to a subsidiary entity, from a subsidiary entity to a parent entity, from one subsidiary entity to another, from one division within a single ~~business~~ entity to another division within a ~~business~~ entity, or from any combination of the foregoing. Centralization of management may exist even when day-to-day management responsibility and accountability has been decentralized, so long as the management has an ongoing operational role with respect to the business activities. An operational role can be effected through mandates, consensus building, or an overall operational strategy of the business, or any other mechanism that establishes joint management.

- a. *Facts Providing Evidence of Centralization of Management.* Evidence of centralization of management is provided when common officers participate in the decisions relating to the business operations of the different segments. Centralization of management may exist when management shares or applies knowledge and expertise among the parts of the business. Existence of common officers and directors, while relevant to a showing of centralization of management, does not alone provide evidence of centralization of management. Common officers are more likely to provide evidence of centralization of management than are

common directors.

- b. *Stewardship Distinguished.* Centralized efforts to fulfill stewardship oversight are not evidence of centralization of management. Stewardship oversight consists of those activities that any owner would take to review the performance of or safeguard an investment. Stewardship oversight is distinguished from those activities that an owner may take to enhance value by integrating one or more significant operating aspects of one business activity with the other business activities of the owner. For example, implementing reporting requirements or mere approval of capital expenditures may evidence only stewardship oversight.
3. *Economies of Scale.* Economies of scale refers to a relation among and between business activities resulting in a significant decrease in the average per unit cost of operational or administrative functions due to the increase in operational size. Economies of scale may exist from the inherent cost savings that arise from the presence of functional integration or centralization of management. The following are examples of business operations that can support the finding of economies of scale. The order of the list does not establish a hierarchy of importance.
- a. *Centralized Purchasing.* Centralized purchasing designed to achieve savings due to the volume of purchases, the timing of purchases, or the interchangeability of purchased items among the parts of the business engaging in the purchasing provides evidence of economies of scale.
  - b. *Centralized Administrative Functions.* The performance of traditional corporate administrative functions, such as legal services, payroll services, pension and other employee benefit administration, in common among the parts of the business may result in some degree of economies of scale. ~~A~~ business ~~An~~ entity that secures savings in the performance of corporate administrative services due to its affiliation with other ~~business~~ entities that it would not otherwise reasonably be able to secure on its own because of its size, financial resources, or available market, provides evidence of economies of scale.

### (3) Indicators of a Unitary Business.

- (A) *Same Type of Business.* Business activities that are in the same general line of business generally constitute a single unitary business, as, for example, a multistate grocery chain.
- (B) *Steps in a Vertical Process.* Business activities that are part of different steps in a vertically structured business almost always constitute a single unitary business. For example, a business engaged in the exploration, development, extraction, and processing of a natural resource and the subsequent sale of a product based upon the extracted natural resource, is engaged in a single unitary business, regardless

of the fact that the various steps in the process are operated substantially independently of each other with only general supervision from the business's executive offices.

(C) *Strong Centralized Management.* Business activities which might otherwise be considered as part of more than one unitary business may constitute one unitary business when there is a strong central management, coupled with the existence of centralized departments for such functions as financing, advertising, research, or purchasing. Strong centralized management exists when a central manager or group of managers makes substantially all of the operational decisions of the business. For example, some businesses conducting diverse lines of business may properly be considered as engaged in only one unitary business when the central executive officers are actively involved in the operations of the various business activities and there are centralized offices which perform for the business activities the normal matters which a truly independent business would perform for itself, such as personnel, purchasing, advertising, or financing.

**(4) Commonly Controlled Group of Business Entities.**

(A) Separate corporations can be part of a unitary business only if they are members of a commonly controlled group.

(B) A "commonly controlled group" means any of the following:

1. A parent corporation and any one or more corporations or chains of corporations, connected through stock ownership (or constructive ownership) with the parent, but only if--
  - a. The parent owns stock possessing more than 50 percent of the voting power of at least one corporation, and, if applicable,
  - b. Stock cumulatively possessing more than 50 percent of the voting power of each of the corporations, except the parent, is owned by the parent, one or more corporations described in subparagraph a, or one or more other corporations that satisfy the conditions of this subparagraph.
2. Any two or more corporations, if stock possessing more than 50 percent of the voting power of the corporations is owned, or constructively owned, by the same person.
3. Any two or more corporations that constitute stapled entities.
  - a. For purposes of this paragraph, "stapled entities" means any group of two or more corporations if more than 50 percent of the ownership or beneficial ownership of the stock possessing voting power in each corporation consists of stapled interests.

- b. Two or more interests are stapled interests if, by reason of form of ownership, restrictions on transfer, or other terms or conditions, in connection with the transfer of one of the interests the other interest or interests are also transferred or required to be transferred.
4. Any two or more corporations, if stock possessing more than 50 percent of the voting power of the corporations is cumulatively owned (without regard to the constructive ownership rules of paragraph 1 of subsection (E)) by, or for the benefit of, members of the same family. Members of the same family are limited to an individual, his or her spouse, parents, brothers or sisters, grandparents, children and grandchildren, and their respective spouses.
- (C) 1. If, in the application of subsection (B), a corporation is a member of more than one commonly controlled group of corporations, the corporation shall elect to be treated as a member of only the commonly controlled group (or part thereof) with respect to which it has a unitary business relationship. If the corporation has a unitary business relationship with more than one of those groups, it shall elect to be treated as a member of only one of the commonly controlled groups with respect to which it has a unitary business relationship. This election shall remain in effect until the unitary business relationship between the corporation and the rest of the members of its elected commonly controlled group is discontinued, or unless revoked with the approval of the [state tax agency].
2. Membership in a commonly controlled group shall be treated as terminated in any year, or fraction thereof, in which the conditions of subsection (B) are not met, except as follows:
- a. When stock of a corporation is sold, exchanged, or otherwise disposed of, the membership of a corporation in a commonly controlled group shall not be terminated, if the requirements of subsection (B) are again met immediately after the sale, exchange, or disposition.
  - b. The [state tax agency] may treat the commonly controlled group as remaining in place if the conditions of subsection B are again met within a period not to exceed two years.
- (D) A taxpayer may exclude some or all corporations included in a "commonly controlled group" by reason of paragraph 4 of subsection (B) by showing that those members of the group are not controlled directly or indirectly by the same interests, within the meaning of the same phrase in Section 482 of the Internal Revenue Code. For purposes of this subsection, the term "controlled" includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised.
- (E) Except as otherwise provided, stock is "owned" when title to the stock is directly

held or if the stock is constructively owned.

1. An individual constructively owns stock that is owned by any of the following:
    - a. His or her spouse.
    - b. Children, including adopted children, of that individual or the individual's spouse, who have not attained the age of 21 years.
    - c. An estate or trust, of which the individual is an executor, trustee, or grantor, to the extent that the estate or trust is for the benefit of that individual's spouse or children.
  2. Stock owned by a corporation, or a member of a controlled group of which the corporation is the parent corporation, is constructively owned by any shareholder owning stock that represents more than 50 percent of the voting power of the corporation.
  3. In the application of paragraph 4 of subsection (B) (dealing with stock possessing voting power held by members of the same family), if more than 50% of the stock possessing voting power of a corporation is, in the aggregate, owned by or for the benefit of members of the same family, stock owned by that corporation shall be treated as constructively owned by members of that family in the same ratio as the proportion of their respective ownership of stock possessing voting power in that corporation to all of such stock of that corporation.
  4. Except as otherwise provided, stock owned by a partnership is constructively owned by any partner, other than a limited partner, in proportion to the partner's capital interest in the partnership. For this purpose, a partnership is treated as owning proportionately the stock owned by any other partnership in which it has a tiered interest, other than as a limited partner.
  5. In any case where a member of a commonly controlled group, or shareholders, officers, directors, or employees of a member of a commonly controlled group, is a general partner in a limited partnership, stock held by the limited partnership is constructively owned by a limited partner to the extent of its capital interest in the limited partnership.
  6. In the application of paragraph 4 of subsection (B) (dealing with stock possessing voting power held by members of the same family), stock held by a limited partnership is constructively owned by a limited partner to the extent of the limited partner's capital interest in the limited partnership.
- (F) For purposes of the definition of a commonly controlled group, each of the following shall apply:

1. "Corporation" means a subchapter S corporation, any other incorporated entity, or any entity defined or treated as a corporation (including but not limited to a limited liability company) pursuant to [insert your State statute].
  2. "Person" means an individual, a trust, an estate, a qualified employee benefit plan, a limited partnership, or a corporation.
  3. "Voting power" means the power of all classes of stock entitled to vote that possess the power to elect the membership of the board of directors of the corporation.
  4. "More than 50 percent of the voting power" means voting power sufficient to elect a majority of the membership of the board of directors of the corporation.
  5. "Stock possessing voting power" includes stock where ownership is retained but the actual voting power is transferred in either of the following manners:
    - a. For one year or less.
    - b. By proxy, voting trust, written shareholder agreement, or by similar device, where the transfer is revocable by the transferor.
  6. In the case of an entity treated as a corporation under paragraph 1 of subsection (F), "stock possessing voting power" refers to an instrument, contract, or similar document demonstrating an ownership interest in that entity that confers power in the owner to cast a vote in the selection of the management of that entity.
  7. In the general application of this section, if an entity may elect to be treated as a partnership or as a corporation under the laws of this state (or under Section 7701 of the Internal Revenue Code), and elects to be treated as a partnership, that entity shall be treated as a general partnership. If, however, contractual agreements, member agreements, or other restrictions limit the power of some or all of the members to participate in the vote of stock possessing voting power owned by that entity (similar to the restrictions of limited partners in a limited partnership), the [state tax agency] may permit or require that entity to be treated as a limited partnership.
- (G)The [state tax agency] may prescribe any regulations as may be necessary or appropriate to carry out the purposes of this section, including, but not limited to, regulations that do the following:
1. Prescribe terms and conditions relating to the election described by subsection (C), and the revocation thereof.

2. Disregard transfers of voting power not described by paragraph 5 of subsection ~~(F)~~.  
~~(F)~~.
3. Treat entities not described by paragraph 2 of subsection (F) as a person.
4. Treat warrants, obligations convertible into stock, options to acquire or sell stock, and similar instruments as stock.
5. Treat holders of a beneficial interest in, or executor or trustee powers over, stock held by an estate or trust as constructively owned by the holder.
6. Prescribe rules relating to the treatment of partnership agreements which authorize a particular partner or partners to exercise voting power of stock held by the partnership.
7. Treat limited partners as constructive owners of stock possessing voting power held by the limited partnership, in proportion to their interest in the partnership.

••• **Reg. IV.1.(c). BusinessApportionable and NonbusinessNon-apportionable Income: Application of Definitions.** The following applies the foregoing principles for purposes of determining whether particular income is businessapportionable or nonbusinessnon-apportionable income. ~~{(The examples used throughout these regulations are illustrative only and are limited to the facts they contain-)}.~~

**(1) Rents from real and tangible personal property.** Rental income from real and tangible property is businessapportionable income if the property with respect to which the rental income was received is or was used in the taxpayer's trade or business and therefore is includable in the property factor under Regulation IV.10. ~~Property that has been converted to nonbusiness use (see IV.1.(a).(4)(A)) has lost its character as a business asset and is not subject to the rule of the preceding sentence.~~

*{Example (i):* The taxpayer operates a multistate car rental business. The income from car rentals is businessapportionable income.

*Example (ii):* The taxpayer is engaged in the heavy construction business in which it uses equipment such as cranes, tractors, and earth-moving vehicles. The taxpayer makes short-term leases of the equipment when particular pieces of equipment are not needed on any particular project. The rental income is businessapportionable income.

*Example (iii):* The taxpayer operates a multistate chain of men's clothing

stores. The taxpayer purchases a five-story office building for use in connection with its trade or business. It uses the street floor as one of its retail stores and the second and third floors for its general corporate headquarters. The remaining two floors are held for future use in the trade or business and are leased to tenants on a sort-term basis in the meantime. The rental income is business apportionable income.

*Example (iv):* The taxpayer operates a multistate chain of grocery stores. It purchases as an investment an office building in another state with surplus funds and leases the entire building to others. The net rental income is not business apportionable income of the grocery store trade or business. Therefore, the net rental income is nonbusiness non-apportionable income.

*Example (v):* The taxpayer operates a multistate chain of men's clothing stores. The taxpayer invests in a 20-story office building and uses the street floor as one of its retail stores and the second floor for its general corporate headquarters. The remaining 18 floors are leased to others. The rental of the eighteen floors is not done in furtherance of but rather is separate from the operation of the taxpayer's trade or business. The net rental income is not business apportionable income of the clothing store trade or business. Therefore, the net rental income is nonbusiness non-apportionable income.

*Example (vi):* The taxpayer constructed a plant for use in its multistate manufacturing business and 20 years later the plant was closed and put up for sale. The plant was rented for a temporary period from the time it was closed by the taxpayer until it was sold 18 months later. The rental income is business apportionable income and the gain on the sale of the plant is business apportionable income.

~~*vii):* The taxpayer operates a multistate chain of grocery stores. It owned an office building which it occupied as its corporate headquarters. Because of inadequate space, taxpayer acquired a new and larger building elsewhere for its corporate headquarters. The old building was rented to an investment company under a five year lease. Upon expiration of the lease, taxpayer sold the building at a gain (or loss). The net rental income received over the lease period is nonbusiness income and the gain (or loss) on the sale of the building is nonbusiness income.~~

**(2) Gains or losses from sales of assets.** Gain or loss from the sale, exchange or other disposition of real property or of tangible or intangible personal property constitutes business apportionable income if the property while owned by the taxpayer was ~~used in~~ related to the operation of the taxpayer's trade or business, or was otherwise properly included in the property factor of the taxpayer's trade or business. ~~However, if the property was utilized for the production of nonbusiness income or otherwise was removed from the property factor before its sale, exchange or other disposition, the gain or loss will constitute nonbusiness income. See Regulation IV.10.~~



~~{~~*Example (i):* In conducting its multistate manufacturing business, the taxpayer systematically replaces automobiles, machines, and other equipment used in the trade or business. The gains or losses resulting from those sales constitute businessapportionable income.

*Example (ii):* The taxpayer constructed a plant for use in its multistate manufacturing business and 20 years later sold the property at a gain while it was in operation by the taxpayer. The gain is businessapportionable income.

*Example (iii):* Same as (ii) except that the plant was closed and put up for sale but was not in fact sold until a buyer was found 18 months later. The gain is businessapportionable income.

*Example (iv):* Same as (ii) except that the plant was rented while being held for sale. The rental income is businessapportionable income and the gain on the sale of the plant is businessapportionable income.

~~*Example (v):* The taxpayer operates a multistate chain of grocery stores. It owned an office building which it occupied as its corporate headquarters. Because of inadequate space, taxpayer acquired a new and larger building elsewhere for its corporate headquarters. Because the taxpayer did not intend to reoccupy the old building, the taxpayer rented the old building to an unrelated investment company under a five year lease. Upon expiration of the lease, taxpayer sold the building at a gain (or loss). The gain (or loss) on the sale is nonbusiness income and the rental income received over the lease period is nonbusiness income.~~

**(3) Interest.** Interest income is businessapportionable income where the intangible with respect to which the interest was received arose out of or was created in the regular course of the taxpayer's trade or business operations, or ~~where the~~ purpose of acquiring and holding the intangible is an integral, ~~functional, or operative component~~ related to the operation of the taxpayer's trade or business ~~operations, or otherwise materially contributes to the production of business income of the trade or business operations.~~

~~{~~*Example (i):* The taxpayer operates a multistate chain of department stores, selling for cash and on credit. Service charges, interest, or time-price differentials and the like are received with respect to installment sales and revolving charge accounts. These amounts are businessapportionable income.

*Example (ii):* The taxpayer conducts a multistate manufacturing business. During the year the taxpayer receives a federal income tax refund pertaining to the taxpayer's trade or business and collects a judgment against a debtor of the business. Both the tax refund and the judgment bear interest. The interest income is businessapportionable income.

*Example (iii):* The taxpayer is engaged in a multistate manufacturing and

wholesaling business. In connection with that business, the taxpayer maintains special accounts to cover such items as workmen's compensation claims, rain and storm damage, machinery replacement, etc. The ~~moneys~~funds in those accounts ~~are invested at~~earned interest. Similarly, the taxpayer temporarily invests funds intended for payment of federal, state and local tax obligations pertaining to the taxpayer's trade or business. The interest income is business apportionable income.

*Example (iv):* The taxpayer is engaged in a multistate money order and traveler's check business. In addition to the fees received in connection with the sale of the money orders and traveler's checks, the taxpayer earns interest income by the investment of the funds pending their redemption. The interest income is business apportionable income.

*Example (v):* The taxpayer is engaged in a multistate manufacturing and selling business. The taxpayer usually has working capital and extra cash totaling \$200,000 which it regularly invests in short-term interest bearing securities. The interest income is business apportionable income.

*Example (vi):* In January, the taxpayer sold all of the stock of a subsidiary for \$20,000,000. The funds are placed in an interest-bearing account pending a decision by management as to how the funds are to be utilized. ~~The interest income is nonbusiness income.~~ The funds are not pledged for use in the business. The interest income for the entire period between the receipt of the funds and their subsequent utilization or distribution to shareholders is non-apportionable income.

**(4) Dividends.** Dividends are business apportionable income where the stock with respect to which the dividends was received arose out of or was acquired in the regular course of the taxpayer's trade or business ~~operations~~ or where the acquiring and holding the stock is ~~an integral, functional, or operative component~~ or was related to the operation of the taxpayer's trade or business ~~operations~~, or ~~otherwise materially~~ contributes to the production of business apportionable income of the trade or business ~~operations~~.

~~{~~*Example (i):* The taxpayer operates a multistate chain of stock brokerage houses. During the year, the taxpayer receives dividends on stock that it owns. The dividends are business apportionable income.

*Example (ii):* The taxpayer is engaged in a multistate manufacturing and wholesaling business. In connection with that business, the taxpayer maintains special accounts to cover such items as workmen's compensation claims, etc. A portion of the moneys in those accounts is invested in interest-bearing bonds. The remainder is invested in various common stocks listed on national stock exchanges. Both the interest income and any dividends are business apportionable income.

*Example (iii):* The taxpayer and several unrelated corporations own all of the stock of a corporation whose business ~~operations consist~~consists solely of acquiring and processing materials for delivery to the corporate owners. The taxpayer acquired the stock in order to obtain a source of supply of materials used in its manufacturing trade or business. The dividends are business apportionable income.

*Example (iv):* The taxpayer is engaged in a multistate heavy construction business. Much of its construction work is performed for agencies of the federal government and various state governments. Under state and federal laws applicable to contracts for these agencies, a contractor must have adequate bonding capacity, as measured by the ratio of its current assets (cash and marketable securities) to current liabilities. In order to maintain an adequate bonding capacity the taxpayer holds various stocks and interest-bearing securities. Both the interest income and any dividends received are business apportionable income.

*Example (v):* The taxpayer receives dividends from the stock of its subsidiary or affiliate which acts as the marketing agency for products manufactured by the taxpayer. The dividends are business apportionable income.

*Example (vi):* The taxpayer is engaged in a multistate glass manufacturing business. It also holds a portfolio of stock and interest-bearing securities, the acquisition and holding of which are unrelated to the manufacturing business. The dividends and interest income received are ~~nonbusiness non-~~apportionable income.

**(5) Patent and copyright royalties.** Patent and copyright royalties are business apportionable income where the patent or copyright with respect to which the royalties were received arose out of or was created in the regular course of the taxpayer's trade or business ~~operations~~ or where the acquiring and holding the patent or copyright is an integral, functional, or operative component or was related to the operation of the taxpayer's trade or business ~~operations~~, or ~~otherwise materially~~ contributes to the production of business apportionable income of the trade or business ~~operations~~.

*Example (i):* The taxpayer is engaged in the multistate business of manufacturing and selling industrial chemicals. In connection with that business, the taxpayer obtained patents on certain of its products. The taxpayer licensed the production of the chemicals in foreign countries, in return for which the taxpayer receives royalties. The royalties received by the taxpayer are business apportionable income.

*Example (ii):* The taxpayer is engaged in the music publishing trade or business and holds copyrights on numerous songs. The taxpayer acquires the assets of a smaller publishing company, including music copyrights. These

acquired copyrights are thereafter used by the taxpayer in its trade or business. Any royalties received on these copyrights are businessapportionable income.

~~*Example (iii): Same as example (ii), except that the acquired company also held the patent on a method of producing digital audio recordings. The taxpayer does not manufacture or sell digital audio recordings. Any royalties received on the patent would be nonbusiness income.*~~

•• **Reg. IV.1.(d). Proration of Deductions.** In most cases, an allowable deduction of a taxpayer will be applicable to only the businessapportionable income arising from a particular trade or business or to a particular item of ~~nonbusinessnon-apportionable~~ income. In some cases, an allowable deduction may be applicable to the businessapportionable incomes of more than one trade or business and ~~or~~ to ~~several~~ items of ~~nonbusinessnon-apportionable~~ income. In such cases, the deduction shall be prorated among those trades or businesses and those items of ~~nonbusinessnon-~~apportionable income in a manner which fairly distributes the deduction among the classes of income to which it is applicable.

(1) **Year to year consistency.** In filing returns with this state, if the taxpayer departs from or modifies the manner of prorating any such deduction used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

(2) **State to state consistency.** If the returns or reports filed by a taxpayer with all states to which the taxpayer reports under Article IV of this Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the application or proration of any deduction, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

•• **Reg. IV.2.(a). Definitions.**

(1) "Taxpayer" means [each state should insert the definition in Article II.3. or the definition in its own tax laws].

(2) "Apportionment" refers to the division of businessapportionable income between states by the use of a formula containing apportionment factors.

(3) "Allocation" refers to the assignment of ~~nonbusinessnon-~~apportionable income to a particular state.

(4) "Business activity" refers to the transactions and activities occurring in the regular course of a particular trade or business of a taxpayer ~~or to~~and includes the acquisition, employment, development, management, ~~and~~or disposition of property that ~~constitute integral partsis~~ or was related to the operation of the taxpayer's ~~regular~~ trade or business ~~operations~~.

~~[Ed. Note: The term "business activity" is used in the following MTC~~

## regulations:

- ~~IV.1.(b)., *example*;~~
- ~~IV.2.(b).(1);~~
- ~~IV.3.(a).;~~
- ~~IV.3.(a).(1);~~
- ~~IV.3.(a).(2);~~
- ~~IV.3.(b).(1);~~
- ~~IV.3.(b).(1)(A);~~
- ~~IV.3.(b).(1)(B);~~
- ~~IV.3.(b).(1)(B), *example*;~~
- ~~IV.3.(b).(2);~~
- ~~IV.3.(b).(2), *example (i)*;~~
- ~~IV.3.(b).(2), *example (iv)*;~~
- ~~IV.3.(c).;~~
- ~~IV.18.(a).;~~
- ~~a).(3);~~
- ~~IV.18.h.(4)(iii)A.2.;~~
- ~~).(1);~~
- ~~j).(3)(i)B.2.;~~
- ~~j).(3)(i)B.3.; and~~
- ~~The financial institution apportionment principles to the extent that States adopt the uniformity recommendation as a regulation that is folded into the existing MTC regulations and thereby picks up the floating definition of "business activity".]~~

(5) "Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest and dividends) in a transaction which produces business apportionable income; in which the income or loss is recognized ~~(or under the Internal Revenue Code, and, where the income of foreign entities is included in apportionable income, amounts which would behave been~~ recognized under the Internal Revenue Code if the ~~transaction relevant transactions or entities~~ were in the United States) ~~under the Internal Revenue Code.~~ Amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold. ~~Gross receipts, even if business income, do not include such items as, for example:~~

(6) "Receipts" means all gross receipts of the taxpayer that are not allocated under paragraphs of Article IV, and that are received from transactions and activity in the regular course of the taxpayer's trade or business. The following are additional rules for determining "receipts" in various situations:

(A) In the case of a taxpayer engaged in manufacturing and selling or purchasing and reselling goods or products, "receipts" includes all gross receipts from the sales of such goods or products (or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the tax

period) held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. Gross receipts for this purpose means gross sales less returns and allowances, and includes all interest income, service charges, carrying charges, or time-price differential charges incidental to such sales. Federal and state excise taxes (including sales taxes) shall be included as part of such receipts if the taxes are passed on to the buyer or included as part of the selling price of the product.

(B) In the case of cost plus fixed fee contracts, such as the operation of a government-owned plant for a fee, “1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument;  
2) the principal amount received under a repurchase agreement or other transaction properly characterized as a loan;  
3) proceeds from issuance of the taxpayer’s own stock or from sale of treasury stock;  
4) receipts” includes the entire reimbursed cost plus the fee.

(C) In the case of a taxpayer engaged in providing services, such as the operation of an advertising agency or the performance of equipment service contracts or research and development contracts, "receipts" includes the gross receipts from the performance of such services, including fees, commissions, and similar items.

(D) In the case of a taxpayer engaged in the sale of equipment used in the taxpayer’s trade or business, where the taxpayer disposes of the equipment under a regular replacement program, “receipts” includes the gross receipts from the sale of this equipment. For example, a truck express company that owns a fleet of trucks and sells its trucks under a regular replacement program the gross receipts from the sale of the trucks would be included in “receipts.”

(E) In the case of a taxpayer with insubstantial amounts of gross receipts arising from sales in the ordinary course of business, the insubstantial amounts may be excluded from the receipts factor unless their exclusion would materially affect the amount of income apportioned to this state.

(F7) Receipts of a taxpayer from hedging transactions and from the maturity, redemption, sale, exchange, loan or other disposition of cash or securities, shall be excluded. Receipts arising from a business activity are receipts from hedging, if the primary purpose of engaging in the business activity is to reduce the exposure to risk caused by other business activities. Whether events or transactions not involving cash or securities are hedging transactions shall be determined based on the primary purpose of the taxpayer engaging in the activity giving rise to the receipts, including the acquisition or holding of the underlying asset. Receipts from the maturity, redemption, sale, exchange, loan or other disposition of cash or securities are excluded from the definition of receipts whether or not those events or transactions are engaged in for the purpose of hedging. The taxpayer’s treatment of the receipts as hedging receipts for accounting or federal tax purposes may serve as indicia of the taxpayer’s primary purpose, but shall not be determinative.

(8G) Receipts, even if apportionable income, are presumed not to include such items as, for example:

- 1) damages and other amounts received as the result of litigation;
- ~~5~~2) property acquired by an agent on behalf of another;
- ~~6~~3) tax refunds and other tax benefit recoveries;
- ~~7~~ 7) pension reversions;
- ~~8~~4) contributions to capital ~~(except for sales of securities by securities dealers);~~;
- ~~9~~5) income from forgiveness of indebtedness; ~~or~~
- ~~10~~~~6~~) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code; or
- 7) Amounts realized as a result of factoring accounts receivable recorded on an accrual basis.

Exclusion of an item from the definition of “~~gross~~ receipts” is not determinative of its character as ~~business or nonbusiness income~~apportionable or non-apportionable income. Certain gross receipts that are “receipts” under the definition are excluded from the “receipts factor” under Section IV.17. Nothing in this definition shall be construed to modify, impair or supersede any provision of Section IV.18 or regulations promulgated thereunder.

(7) "Security" means any interest or instrument commonly treated as a security as well as other instruments which are customarily sold in the open market or on a recognized exchange, including, but not limited to, transferable shares of a 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 repurchase and futures contracts.

••• **Reg. IV.2.(b)(1). Application of Article IV: Apportionment.** If the business activity in respect to any trade or business of a taxpayer occurs both within and without this state, and if by reason of such business activity the taxpayer is taxable in another state, the portion of the net income (or net loss) arising from such trade or business which is derived from sources within this state shall be determined by apportionment in accordance with Article IV.9. to IV.17.

••• **Reg. IV.2.(b)(2). Application of Article IV: Combined Report.** If a particular trade or business is carried on by a taxpayer and one or more affiliated corporations, nothing in Article IV or in these regulations shall preclude the use of a "combined report" whereby the entire business apportionable income of such trade or business is apportioned in accordance with Article IV.9. to IV.17.

••• **Reg. IV.2.(b)(3). Application of Article IV: Allocation.** Any taxpayer subject to the taxing jurisdiction of this state shall allocate all of its nonbusiness non-apportionable income or loss within or without this state in accordance with Article IV.4. to IV.8.

••• **Reg. IV.2.(c). Consistency and Uniformity in Reporting.**

**(1) Year to year consistency.** In filing returns with this state, if the taxpayer departs from or modifies the manner in which income has been classified as ~~business~~apportionable income or ~~nonbusiness~~non-apportionable income in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification. [State should insert its requirements]

**(2) State to state consistency.** If the returns or reports filed by a taxpayer for all states to which the taxpayer reports under Article IV of this Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the classification of income as ~~business or nonbusiness~~apportionable or non-apportionable income, the taxpayer shall disclose in its return to this state the nature and extent of the variance. [State should insert its requirements]

••• **Reg. IV.3.(a). Taxable in Another State: In General.** Under Article IV.2. the taxpayer is subject to the allocation and apportionment provisions of Article IV if it has income from business activity that is taxable both within and without this state. A taxpayer's income from business activity is taxable without this state if the taxpayer, by reason of such business activity (i.e., the transactions and activity occurring in the regular course of a particular trade or business), is taxable in another state within the meaning of Article IV.3.

**(1) Applicable tests.** A taxpayer is taxable within another state if it meets either one of two tests: (1) By reason of business activity in another state, the taxpayer is subject to one of the types of taxes specified in Article IV.3.(1), namely: 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; or (2) By reason of such business activity, another state has jurisdiction to subject the taxpayer to a net income tax, regardless of whether or not the state imposes such a tax on the taxpayer.

**(2) Producing ~~nonbusiness~~non-apportionable income.** A taxpayer is not taxable in another state with respect to a particular trade or business merely because the taxpayer conducts activities in that other state pertaining to the production of ~~nonbusiness~~non-apportionable income or business activities relating to a separate trade or business.

••• **Reg. IV.3.(b).Taxable in Another State: When a Corporation Is "Subject to" a Tax under Article IV.3.(1).**

(1) A taxpayer is "subject to" one of the taxes specified in Article IV.3.(1) if it carries on business activities in a state and the state imposes such a tax thereon. Any taxpayer which asserts that it is subject to one of the taxes specified in Article IV.3.(1) in another state shall furnish to ~~the [tax administrator]~~[the tax administrator] of this state upon his/her request evidence to support that assertion. ~~The [tax administrator]~~[The tax administrator] of this state may request that such evidence include proof that the taxpayer has filed the requisite tax return in the other state and has paid any taxes imposed under the law of the other state; the taxpayer's failure to produce such proof may be taken into



account in determining whether the taxpayer in fact is subject to one of the taxes specified in Article IV.3.(1) in the other state.

**Voluntary tax payment.** If the taxpayer voluntarily files and pays one or more of such taxes when not required to do so by the laws of that state or pays a minimal fee for qualification, organization or for the privilege of doing business in that state, but

(A) does not actually engage in business activity in that state, or

(B) does actually engage in some business activity not sufficient for nexus and the minimum tax bears no relationship to the taxpayer's business activity within such state, the taxpayer is not "subject to" one of the taxes specified within the meaning of Article IV.3.(1).

*Example:* State A has a corporation franchise tax measured by net income for the privilege of doing business in that state. Corporation X files a return and pays the \$50 minimum tax, although it carries on no business activity in State A. Corporation X is not taxable in State A.

(2) The concept of taxability in another state is based upon the premise that every state in which the taxpayer is engaged in business activity may impose an income tax even though every state does not do so. In states which do not, other types of taxes may be imposed as a substitute for an income tax. Therefore, only those taxes enumerated in Article IV.3.(1) which may be considered as basically revenue raising rather than regulatory measures shall be considered in determining whether the taxpayer is "subject to" one of the taxes specified in Article IV.3.(1) in another state.

*Example (i):* State A requires all nonresident corporations which qualify or register in State A to pay to the Secretary of State an annual license fee or tax for the privilege of doing business in the state regardless of whether the privilege is in fact exercised. The amount paid is determined according to the total authorized capital stock of the corporation; the rates are progressively higher by bracketed amounts. The statute sets a minimum fee of \$50 and a maximum fee of \$500. Failure to pay the tax bars a corporation from utilizing the state courts for enforcement of its rights. State A also imposes a corporation income tax. Nonresident Corporation X is qualified in State A and pays the required fee to the Secretary of State but does not carry on any business activity in State A (although it may utilize the courts of State A). Corporation X is not "taxable" in State A.

*Example (ii):* Same facts as Example (i) except that Corporation X is subject to and pays the corporation income tax. Payment is prima facie evidence that Corporation X is "subject to" the net income tax of State A and is "taxable" in State A.

*Example (iii):* State B requires all nonresident corporations qualified or registered in State B to pay to the Secretary of State an annual permit fee or tax

for doing business in the state. The base of the fee or tax is the sum of (1) outstanding capital stock, and (2) surplus and undivided profits. The fee or tax base attributable to State B is determined by a three factor apportionment formula. Nonresident Corporation X which operates a plant in State B, pays the required fee or tax to the Secretary of State. Corporation X is "taxable" in State B.

*Example (iv):* State A has a corporation franchise tax measured by net income for the privilege of doing business in that state. Corporation X files a return based upon its business activity in the state but the amount of computed liability is less than the minimum tax. Corporation X pays the minimum tax. Corporation X is subject to State A's corporation franchise tax.

**•• Reg. IV.3.(c). Taxable in Another State: When a State Has Jurisdiction to Subject a Taxpayer to a Net Income Tax.** The second test, that of Article IV.3.(2), applies if the taxpayer's business activity is sufficient to give the state jurisdiction to impose a net income tax by reason of such business activity under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provisions of Public Law 86-272, 15 U.S.C.A. §§ 381-385. In the case of any "state" as defined in Article IV.1.(h), other than a state of the United States or political subdivision thereof, the determination of whether the "state" has jurisdiction to subject the taxpayer to a net income tax shall be made as though the jurisdictional standards applicable to a state of the United States applied in that "state." If jurisdiction is otherwise present, that "state" is not considered as being without jurisdiction by reason of the provisions of a treaty between that "state" and the United States.

*Example:* Corporation X is actively engaged in manufacturing farm equipment in State A and in foreign country B. Both State A and foreign country B impose a net income tax but foreign country B exempts corporations engaged in manufacturing farm equipment. Corporation X is subject to the jurisdiction of State A and foreign country B.

**•• Reg. IV.9. Apportionment Formula.** All [businessapportionable](#) income of each trade or business of the taxpayer shall be apportioned to this state by use of the apportionment formula set forth in Article IV.9. The elements of the apportionment formula are the property factor (see Regulation IV.10.), the payroll factor (see Regulation IV.13.) and the [salesreceipts](#) factor (see Regulation IV.15.) of the trade or business of the taxpayer.

**•• Reg. IV.10.(a). Property Factor: In General.** The property factor of the apportionment formula for each trade or business of the taxpayer shall include all real and tangible personal property owned or rented by the taxpayer and used during the tax period in the regular course of the trade or business. The term "real and tangible personal property" includes land, buildings, machinery, stocks of goods, equipment, and other real and tangible personal property but does not include coin or currency. Property used in connection with the production of [nonbusinessnon-apportionable](#) income shall be excluded from the property factor. Property used both in the regular course of the taxpayer's trade or business and in the production of [nonbusinessnon-apportionable](#)

income shall be included in the factor only to the extent that the property is used in the regular course of the taxpayer's trade or business. The method of determining that portion of the value to be included in the factor will depend upon the facts of each case. The property factor shall include the average value of property includable in the factor. See Regulation IV.12.

••• **Reg. IV.10.(b). Property Factor: Property Used for the Production of Business Apportionable Income.** Property shall be included in the property factor if it is actually used or is available for or capable of being used during the tax period in the regular course of the trade or business of the taxpayer. Property held as reserves or standby facilities or property held as a reserve source of materials shall be included in the factor. For example, a plant temporarily idle or raw material reserves not currently being processed are includable in the factor. Property or equipment under construction during the tax period (except inventoriable goods in process) shall be excluded from the factor until such property is actually used in the regular course of the trade or business of the taxpayer. If the property is partially used in the regular course of the trade or business of the taxpayer while under construction, the value of the property to the extent used shall be included in the property factor. Property used in the regular course of the trade or business of the taxpayer shall remain in the property factor until its permanent withdrawal is established by an identifiable event ~~such as that results in~~ its conversion to the production of ~~nonbusiness non-apportionable~~ income, its sale, or the lapse of an extended period of time (normally, five years) during which the property is no longer held for use in the trade or business.

*Example (i):* Taxpayer closed its manufacturing plant in State X and held the property for sale. The property remained vacant until its sale one year later. The value of the manufacturing plant is included in the property factor until the plant is sold.

*Example (ii):* Same as above except that the property was rented until the plant was sold. The plant is included in the property factor until the plant is sold.

~~*Example (iii):* Taxpayer closed its manufacturing plant and leased the building under a five year lease. The plant is included in the property factor until the commencement of the lease.~~

~~*Example (iv):* The taxpayer operates a chain of retail grocery stores. Taxpayer closed Store A, which was then remodeled into three small retail stores such as a dress shop, dry cleaning, and barber shop, which were leased to unrelated parties. The property is removed from the property factor on the date on which the remodeling of Store A commenced.~~

••• **Reg. IV.10.(c). Property Factor: Consistency in Reporting.**

**(1) Year to year consistency.** In filing returns with this state, if the taxpayer departs from or modifies the manner of valuing property or of excluding property from or

including property in the property factor used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

**(2) State to state consistency.** If the returns or reports filed by the taxpayer with all states to which the taxpayer reports under Article IV of this Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the valuation of property and in the exclusion of property from or the inclusion of property in the property factor, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

**••• Reg. IV.10.(d). Property Factor: Numerator.** The numerator of the property factor shall include the average value of the real and tangible personal property owned or rented by the taxpayer and used in this state during the tax period in the regular course of the trade or business of the taxpayer. Property in transit between locations of the taxpayer to which it belongs shall be considered to be at the 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. The value of mobile or movable property such as construction equipment, trucks or leased electronic equipment which are located within and without this state during the tax period shall be determined for purposes of the numerator of the factor on the basis of total time within the state during the tax period. An automobile assigned to a traveling employee shall be included in the numerator of the factor of the state to which the employee's compensation is assigned under the payroll factor or in the numerator of the state in which the automobile is licensed.

**••• Reg. IV.11.(a). Property Factor: Valuation of Owned Property.**

(1) Property owned by the taxpayer shall be valued at its original cost. As a general rule, "original cost" is deemed to be 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, by reason of sale, exchange, abandonment, etc. However, capitalized intangible drilling and development costs shall be included in the property factor whether or not they have been expensed for either federal or state tax purposes. [This last sentence was added on July 14, 1988.]

*Example (i):* The taxpayer acquired a factory building in this state at a cost of \$500,000 and, 18 months later, expended \$100,000 for major remodeling of the building. Taxpayer files its return for the current taxable year on the calendar-year basis. Depreciation deduction in the amount of \$22,000 was claimed with respect to the building on the return for the current taxable year. The value of the building includable in the numerator and denominator of the property factor is \$600,000; the depreciation deduction is not taken into account in determining the value of the building for purposes of the factor.

*Example (ii):* During the current taxable year, Corporation X merges into Corporation Y in a tax-free reorganization under the Internal Revenue Code. At the time of the merger, Corporation X owns a factory which X built five years

earlier at a cost of \$1,000,000. X has been depreciating the factory at the rate of two percent per year, and its basis in X's hands at the time of the merger is \$900,000. Since the property is acquired by Y in a transaction in which, under the Internal Revenue Code, its basis in Y's hands is the same as its basis in X's hands, Y includes the property in Y's property factor at X's original cost, without adjustment for depreciation, i.e. \$1,000,000.

*Example (iii):* Corporation Y acquires the assets of Corporation X in a liquidation by which Y is entitled to use its stock cost as the basis of the X assets under Section 334(b)(2) of the 1954 Internal Revenue Code (i.e. stock possessing 80 percent control is purchased and liquidated within two years). Under these circumstances, Y's cost of the assets is the purchase price of the X stock, prorated over the X assets.

If the original cost of property is unascertainable, the property is included in the factor at its fair market value as of the date of acquisition by the taxpayer.

(2) Inventory of stock of goods shall be included in the factor in accordance with the valuation method used for federal income tax purposes.

(3) Property acquired by gift or inheritance shall be included in the factor at its basis for determining depreciation for federal income tax purposes.

### ••• Reg. IV.11.(b). Property Factor: Valuation of Rented Property.

**(1) Multiplier and subrentals.** Property rented by the taxpayer is valued at eight times its net annual rental rate. The net annual rental rate for any item of rented property is the annual rental rate paid by the taxpayer for the property less the aggregate annual subrental rates paid by subtenants of the taxpayer. (See Regulation IV.18.(ab) for special rules when the use of such net annual rental rate produces a negative or clearly inaccurate value or when property is used by the taxpayer at no charge or is rented at a nominal rental rate.) Subrents are not deducted when they constitute [businessapportionable](#) income because the property which produces the subrents is used in the regular course of a trade or business of the taxpayer when it is producing such income. Accordingly there is no reduction in its value.

*Example (i):* The taxpayer receives subrents from a bakery concession in a food market operated by the taxpayer. Since the subrents are [businessapportionable](#) income, they are not deducted from rent paid by the taxpayer for the food market.

*Example (ii):* The taxpayer rents a 5-story office building primarily for use in its multistate business, uses three floors for its offices and subleases two floors to various other businesses on a short-term basis because it anticipates it will need those two floors for future expansion of its multistate business. The rental of all five floors is [integralrelated](#) to the operation of the taxpayer's trade or business. Since the subrents are [businessapportionable](#) income, they are not deducted from

the rent paid by the taxpayer.

*Example (iii):* The taxpayer rents a 20-story office building and uses the lower two stories for its general corporation headquarters. The remaining 18 floors are subleased to others. The rental of the eighteen floors is not incidental to but rather is separate from the operation of the taxpayer's trade or business. Since the subrents are ~~nonbusinessnon-apportionable~~ income they are ~~to be deducted from~~ not included in the ~~rent paid by the taxpayer.~~ taxpayer's property factor.

**(2) "Annual rental rate"** is the amount paid as rental for property for a 12-month period (i.e., the amount of the annual rent). Where property is rented for less than a 12-month period, the rent paid for the actual period of rental shall constitute the "annual rental rate" for the tax period. However, where a taxpayer has rented property for a term of 12 or more months and the current tax period covers a period of less than 12 months (due, for example, to a reorganization or change of accounting period), the rent paid for the short tax period shall be annualized. If the rental term is for less than 12 months, the rent shall not be annualized beyond its term. Rent shall not be annualized because of the uncertain duration when the rental term is on a month-to-month basis.

*Example (i):* Taxpayer A, which *ordinarily* files its returns based on a calendar year, is merged into Taxpayer B on April 30. The net rent paid under a lease with 5 years remaining is \$2,500 a month. The rent for the tax period January 1 to April 30 is \$10,000. After the rent is annualized the net rent is \$30,000 ( $\$2,500 \times 12$ ).

*Example (ii):* Same facts as in *Example (i)* except that the lease would have terminated on August 31. In this case, the annualized rent is \$20,000 ( $\$2,500 \times 8$ ).

**(3) "Annual rent"** is the actual sum of money or other consideration payable, directly or indirectly, by the taxpayer or for its benefit for the use of the property and includes:

(A) Any amount payable for the use of real or tangible personal property, or any part thereof, whether designated as a fixed sum of money or as a percentage of sales, profits or otherwise.

*Example:* A taxpayer, pursuant to the terms of a lease, pays a lessor \$1,000 per month as a base rental and at the end of the year pays the lessor one percent of its gross sales of \$400,000. The annual rent is \$16,000 ( $\$12,000$  plus one percent of \$400,000 or \$4,000).

(B) Any amount payable as additional rent or in lieu of rents, such as interest, taxes, insurance, repairs or any other items which are required to be paid by the terms of the lease or other arrangement, not including amounts paid as service charges, such as utilities, janitor services, etc. If a payment includes rent and other charges unsegregated, the amount of rent shall be determined by consideration of the relative

values of the rent and other items.

*Example (i):* A taxpayer, pursuant to the terms of a lease, pays the lessor \$12,000 a year rent plus taxes in the amount of \$2,000 and interest on a mortgage in the amount of \$1,000. The annual rent is \$15,000.

*Example (ii):* A taxpayer stores *part* of its inventory in a public warehouse. The total charge for the year was \$1,000 of which \$700 was for the use of storage space and \$300 for inventory insurance, handling and shipping charges, and C.O.D. collections. The annual rent is \$700.

**(4) Exclusions.** "Annual rent" does not include:

(A) Incidental day-to-day expenses such as hotel or motel accommodations, daily rental of automobiles, etc.; and

(B) Royalties based on extraction of natural resources, whether represented by delivery or purchase. For this purpose, a royalty includes any consideration conveyed or credited to a holder of an interest in property which constitutes a sharing of current or future production of natural resources from such property, irrespective of the method of payment or how such consideration may be characterized, whether as a royalty, advance royalty, rental or otherwise.

**(5) Leasehold improvements** shall, for the purposes of the property factor, be treated as property owned by the taxpayer **regardless** of whether the taxpayer is entitled to remove the improvements or the improvements revert to the lessor upon expiration of the lease. Hence, the original cost of leasehold improvements shall be included in the factor.

**••• Reg. IV.12. Property Factor: Averaging Property Values.** As a general rule, the average value of property owned by the taxpayer shall be determined by averaging the values at the beginning and ending of the tax period. However, ~~the [tax- administrator]~~[\[the tax administrator\]](#) may require or allow averaging by monthly values if that method of averaging is required to properly reflect the average value of the taxpayer's property for the tax period.

Averaging by monthly values will generally be applied if substantial fluctuations in the values of the property exist during the tax period or if property is acquired after the beginning of the tax period or disposed of before the end of the tax period.

*Example:* The monthly value of the taxpayer's property was as follows:

January	\$2,000	July	\$15,000
February	2,000	August	17,000
March	3,000	September	23,000
April	3,500	October	25,000

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Current as of January 6, 2016

May	4,500	November	13,000
June	<u>10,000</u>	December	<u>2,000</u>
	\$25,000		\$95,000
		Total	<u>\$120,000</u>

The average value of the taxpayer's property includable in the property factor for the income year is determined as follows:

$$\frac{\$120,000}{12} = \$10,000$$

Averaging with respect to rented property is achieved automatically by the method of determining the net annual rental rate of such property as set forth in Reg. IV.11.(b).

••• **Reg. IV.13.(a). Payroll Factor: In General.**

(1) The payroll factor of the apportionment formula for each trade or business of the taxpayer shall include the total amount paid by the taxpayer in the regular course of its trade or business for compensation during the tax period.

(2) The total amount "paid" to employees is determined upon the basis of the taxpayer's accounting method. If the taxpayer has adopted the accrual method of accounting, all compensation properly accrued shall be deemed to have been paid. Notwithstanding the taxpayer's method of accounting, compensation paid to employees may, at the election of the taxpayer, be included in the payroll factor by use of the cash method if the taxpayer is required to report such compensation under that method for unemployment compensation purposes. The compensation of any employee on account of activities which are connected with the production of ~~nonbusiness~~non-apportionable income shall be excluded from the factor.

*Example (i):* The taxpayer uses some of its employees in the construction of a storage building which, upon completion, is used in the regular course of the taxpayer's trade or business. The wages paid to those employees are treated as a capital expenditure by the taxpayer. The amount of those wages is included in the payroll factor.

*Example (ii):* The taxpayer owns various securities which it holds as an investment separate and apart from its trade or business. The management of the taxpayer's investment portfolio is the only duty of Mr. X, an employee. The salary paid to Mr. X is excluded from the payroll factor.

••• **Reg. IV.13.(b). Payroll Factor: Denominator.** The denominator of the payroll



factor is the total compensation paid everywhere during the tax period. Accordingly, compensation paid to employees whose services are performed entirely in a state where the taxpayer is immune from taxation, for example, by Public Law 86-272, is included in the denominator of the payroll factor.

*Example:* A taxpayer has employees in its state of legal domicile (State A) and is taxable in State B. In *addition* the taxpayer has other employees whose services are performed entirely in State C where the taxpayer is immune from taxation under the provisions of Public Law 86-272. As to these latter employees, the compensation will be assigned to State C where their services are performed (i.e., included in the denominator but not the numerator of the payroll factor) even though the taxpayer is not taxable in State C.

••• **Reg. IV.13.(c). Payroll Factor: Numerator.** The numerator of the payroll factor is the total amount paid in this state during the tax period by the taxpayer for compensation. The tests in Article IV.14. to be applied in determining whether compensation is paid in this state are derived from the Model Unemployment Compensation Act. Accordingly, if compensation paid to employees is included in the payroll factor by use of the cash method of accounting or if the taxpayer is required to report such compensation under that method for unemployment compensation purposes, it shall be presumed that the total wages reported by the taxpayer to this state for unemployment compensation purposes constitute compensation paid in this state except for compensation excluded under Regulation IV.13.(a). to IV.14. The presumption may be overcome by satisfactory evidence that an employee's compensation is not properly reportable to this state for unemployment compensation purposes.

••• **Reg. IV.14. Payroll Factor: Compensation Paid in This State.** Compensation is paid in this state if any one of the following tests, applied consecutively, are met:

(1) The employee's service is performed entirely within the state.

(2) The employee's service is performed both within and without the state, but the service performed without the state is incidental to the employee's service within the state. The word "incidental" means any service which is temporary or transitory in nature, or which is rendered in connection with an isolated transaction.

(3) If the employee's services are performed both within and without this state, the employee's compensation will be attributed to this state:

(A) if the employee's base of operations is in this state; or

(B) if there is no base of operations in any state in which some part of the service is performed, but the place from which the service is directed or controlled is in this state; or

(C) if the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed but the

employee's residence is in this state.

The term "place from which the service is directed or controlled" refers to the place from which the power to direct or control is exercised by the taxpayer.

The term "base of operations" is the place of more or less permanent nature from which the employee starts his work and to which he customarily returns in order to receive instructions from the taxpayer or communications from his customers or other persons or to replenish stock or other materials, repair equipment, or perform any other functions necessary to the exercise of his trade or profession at some other point or points.

••• Reg. IV.15.(a). Sales Receipts Factor: In General Additional Principles.

~~(1) Article IV.1.(g) defines the term "sales" to mean all gross receipts of the taxpayer not allocated under paragraphs (5) through (8) of Article IV. Thus, for the purposes of the sales factor of the apportionment formula for each trade or business of the taxpayer, the term "sales" means all gross receipts derived by the taxpayer from transactions and activity in the regular course of the trade or business. The following are rules for determining "sales" in various situations:-~~

~~(A) In the case of a taxpayer engaged in manufacturing and selling or purchasing and reselling goods or products, "sales" includes all gross receipts from the sales of such goods or products (or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the tax period) held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. Gross receipts for this purpose means gross sales less returns and allowances, and includes all interest income, service charges, carrying charges, or time-price differential charges incidental to such sales. Federal and state excise taxes (including sales taxes) shall be included as part of such receipts if the taxes are passed on to the buyer or included as part of the selling price of the product.~~

~~(B) In the case of cost plus fixed fee contracts, such as the operation of a government-owned plant for a fee, "sales" includes the entire reimbursed cost plus the fee.~~

~~(C) In the case of a taxpayer engaged in providing services, such as the operation of an advertising agency or the performance of equipment service contracts or research and development contracts, "sales" includes the gross receipts from the performance of such services, including fees, commissions, and similar items.~~

~~(D) In the case of a taxpayer engaged in renting real or tangible property, "sales" includes the gross receipts from the rental, lease, or licensing the use of the property.~~

~~(E) In the case of a taxpayer engaged in the sale, assignment, or licensing of intangible personal property such as patents and copyrights, "sales" includes the gross receipts therefrom.~~

~~(F) If a taxpayer derives receipts from the sale of equipment used in its business, those receipts constitute sales. For example, a truck express company owns a fleet of trucks and sells its trucks under a regular replacement program. The gross receipts from the sales of the trucks are included in the sales factor.~~

**(2) Exceptions.** In some cases certain gross receipts should be disregarded in determining the [salesreceipts](#) factor in order that the apportionment formula will operate fairly to apportion to this state the income of the taxpayer's trade or business. See Regulation IV.18.(c).

**(32) Year to year consistency.** In filing returns with this state, if the taxpayer departs from or modifies the basis for excluding or including gross receipts in the [salesreceipts](#) factor used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification. [\[Each state should insert its own reporting requirement\]](#).

**(4)43 State to state consistency.** If the returns or reports filed by the taxpayer with all states to which the taxpayer reports under Article IV of this Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the inclusion or exclusion of gross receipts, the taxpayer shall disclose in its return to this state the nature and extent of the variance. [\[Each state should insert its own reporting requirement\]](#).

•• **Reg. IV.15.(b). [SalesReceipts](#) Factor: Denominator.** The denominator of the [salesreceipts](#) factor shall include the ~~total~~ gross receipts derived by the taxpayer from transactions and activity in the regular course of its trade or business, except [gross](#) receipts excluded under [Regulation IV.18.\(e\); these regulations](#).

•• **Reg. IV.15.(c). [SalesReceipts](#) Factor: Numerator.** The numerator of the [salesreceipts](#) factor shall include gross receipts attributable to this state and derived by the taxpayer from transactions and activity in the regular course of its trade or business; [except gross receipts excluded under these regulations](#). All interest income, service charges, carrying charges, or time-price differential charges incidental to ~~such~~ gross receipts shall be included regardless of (1) the place where the accounting records are maintained or (2) the location of the contract or other evidence of indebtedness.

•• **Reg. IV.16.(a). [SalesReceipts](#) Factor: Sales of Tangible Personal Property in This State.**

(1) Gross receipts from sales of tangible personal property (except sales to the United States Government; see Regulation IV.16.(b)) are in this state:

(A) if the property is delivered or shipped to a purchaser within this state regardless of the f.o.b. point or other conditions of sale; or

(B) if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and the taxpayer is not taxable in the state of the purchaser.

(2) Property shall be deemed to be delivered or shipped to a purchaser within this state if the recipient is located in this state, even though the property is ordered from outside this state.

*Example:* The taxpayer, with inventory in State A, sold \$100,000 of its products to a purchaser having branch stores in several states, including this state. The order for the purchase was placed by the purchaser's central purchasing department located in State B. \$25,000 of the purchase order was shipped directly to purchaser's branch store in this state. The branch store in this state is the purchaser within this state with respect to \$25,000 of the taxpayer's sales.

(3) Property is delivered or shipped to a purchaser within this state if the shipment terminates in this state, even though the property is subsequently transferred by the purchaser to another state.

*Example:* The taxpayer makes a sale to a purchaser who maintains a central warehouse in this state at which all merchandise purchases are received. The purchaser reships the goods to its branch stores in other states for sale. All of the taxpayer's products shipped to the purchaser's warehouse in this state constitute property delivered or shipped to a purchaser within this state.

(4) The term "purchaser within this state" shall include the ultimate recipient of the property if the taxpayer in this state, at the designation of the purchaser, delivers to or has the property shipped to the ultimate recipient within this state.

*Example:* A taxpayer in this state sold merchandise to a purchaser in State A. Taxpayer directed the manufacturer or supplier of the merchandise in State B to ship the merchandise to the purchaser's customer in this state pursuant to purchaser's instructions. The sale by the taxpayer is in this state.

(5) When property being shipped by a seller from the state of origin to a consignee in another state is diverted while en route to a purchaser in this state, the sales are in this state.

*Example:* The taxpayer, a produce grower in State A, begins shipment of perishable produce to the purchaser's place of business in State B. While en route, the produce is diverted to the purchaser's place of business in this state in which state the taxpayer is subject to tax. The sale by the taxpayer is attributed to this state.

(6) If the taxpayer is not taxable in the state of the purchaser, the sale is attributed to this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state.

*Example:* The taxpayer has its head office and factory in State A. It

maintains a branch office and inventory in this state. Taxpayer's only activity in State B is the solicitation of orders by a resident salesman. All orders by the State B salesman are sent to the branch office in this state for approval and are filled by shipment from the inventory in this state. Since the taxpayer is immune under Public Law 86-272 from tax in State B, all sales of merchandise to purchasers in State B are attributed to this state, the state from which the merchandise was shipped.

(7) If a taxpayer whose salesman operates from an office located in this state makes a sale to a purchaser in another state in which the taxpayer is not taxable and the property is shipped directly by a third party to the purchaser, the following rules apply:

(A) If the taxpayer is taxable in the state from which the third party ships the property, then the sale is in that state.

~~(B) If the taxpayer is taxable in State B, the sale is in State B.~~ (B) If the taxpayer is not taxable in the state from which the property is shipped, then the sale is in this state.

*Example:* The taxpayer in this state sold merchandise to a purchaser in State A. Taxpayer is not taxable in State A. Upon direction of the taxpayer, the merchandise was shipped directly to the purchaser by the manufacturer in State B. If the taxpayer is taxable in State B, the sale is in State B. If the taxpayer is not taxable in State B, the sale is in this state.  
~~taxable in State B, the sale is in this state.~~

••• **Reg. IV.16.(b). Sales Receipts Factor: Sales of Tangible Personal Property to the United States Government in This State.** Gross receipts from sales of tangible personal property to the United States Government are in this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state. For the purposes of this regulation, only sales for which the United States Government makes direct payment to the seller pursuant to the terms of a contract constitute sales to the United States Government. Thus, as a general rule, sales by a subcontractor to the prime contractor, the party to the contract with the United States Government, do not constitute sales to the United States Government.

*Example (i):* A taxpayer contracts with General Services Administration to deliver X number of trucks which were paid for by the United States Government. The sale is a sale to the United States Government.

*Example (ii):* The taxpayer, as a subcontractor to a prime contractor with the National Aeronautics and Space Administration, contracts to build a component of a rocket for \$1,000,000. The sale by the subcontractor to the prime contractor is not a sale to the United States Government.

***The former Section 17 Regulations are repealed; in their place is the following:*****•• Reg. IV.17.(a). Receipts Factor: Sales Other Than Sales of Tangible Personal Property in This State: General Rules.**

In general, Article IV.17. provides for the inclusion in the numerator of the receipts factor of gross receipts arising from transactions other than sales of tangible personal property.

**(1) Market-Based Sourcing.**

Receipts, other than receipts described in Article IV.16 (from sales of tangible personal property) are in [state] within the meaning of Article IV.17 and this Reg. IV.17 if and to the extent that the taxpayer's market for the sales is in [state]. In general, the provisions in this section establish uniform rules for (1) determining whether and to what extent the market for a sale other than the sale of tangible personal property is in [state], (2) reasonably approximating the state or states of assignment where the state or states cannot be determined, (3) excluding receipts from the sale of intangible property from the numerator and denominator of the receipts factor pursuant to Article IV.17(a)(4)(ii)(c), and (4) excluding receipts from the denominator of the receipts factor, pursuant to Article IV.17(c) where the state or states of assignment cannot be determined or reasonably approximated, or where the taxpayer is not taxable in the state to which the receipts are assigned as determined under Article IV.3 and applicable regulations,

**(2) Outline of topics.**

The provisions in this Reg. IV.17 are organized as follows:

**(a) General Rules**

- (1) Market-Based Sourcing
- (2) Outline of Topics
- (3) Definitions
- (4) General Principles of Application; Contemporaneous Records
- (5) Rules of Reasonable Approximation
- (6) Rules with respect to Exclusion of Receipts from the Receipts Factor
- (7) Changes in Methodology; [tax administrator] Review
- (8) Further Guidance

**(b) Sale, Rental, Lease or License of Real Property****(c) Rental, Lease or License of Tangible Personal Property****(d) Sale of a Service**

- (1) General Rule
- (2) In-Person Services
- (3) Services Delivered to the Customer or on Behalf of the Customer, or Delivered Electronically Through the Customer
- (4) Professional Services

**(e) License or Lease of Intangible Property**

- (1) General Rules
- (2) License of a Marketing Intangible
- (3) License of a Production Intangible
- (4) License of a Mixed Intangible
- (5) License of Intangible Property where Substance of the Transaction Resembles a Sale of Goods or Services

- (f) Sale of Intangible Property
  - (1) Assignment of Receipts

- (g) Special Rules
  - (1) Software Transactions
  - (2) Sales or Licenses of Digital Goods and Services

### (3) Definitions.

For the purposes of this Reg. IV.17 these terms have the following meanings:

- (A) “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.
- (B) “Business customer” means a customer that is a business operating in any form, including a sole proprietorship. Sales to a non-profit organization, to a trust, to the U.S. Government, to a foreign, state or local government, or to an agency or instrumentality of that government are treated as sales to a business customer and must be assigned consistent with the rules for those sales.
- (C) “Code” means the Internal Revenue Code as currently written and subsequently amended.
- (D) “Individual customer” means a customer that is not a business customer.
- (E) “Intangible property” generally means property that is not physical or whose representation by physical means is merely incidental and 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; and, except as otherwise provided in Reg. IV.17, computer software. Receipts from the sale of intangible property may be excluded from the numerator and denominator of the taxpayer’s receipts factor pursuant to Article IV.17 and Reg. IV.17.(f).(1)(D).
- (F) “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.

(G) “Population” means the most recent population data maintained by the U.S. Census Bureau for the year in question as of the close of the taxable period.

(H) “Related party” means:

(1) a stockholder who is an individual, or a member of the stockholder's family set forth in section 318 of the Code if the stockholder and the members of the stockholder's family own, directly, indirectly, beneficially or constructively, in the aggregate, at least 50 per cent of the value of the taxpayer's outstanding stock;

(2) a stockholder, or a stockholder's partnership, limited liability company, estate, trust or corporation, if the stockholder and the stockholder's partnerships, limited liability companies, estates, trusts and corporations own directly, indirectly, beneficially or constructively, in the aggregate, at least 50 per cent of the value of the taxpayer's outstanding stock; or

(3) a corporation, or a party related to the corporation in a manner that would require an attribution of stock from the corporation to the party or from the party to the corporation under the attribution rules of the Code if the taxpayer owns, directly, indirectly, beneficially or constructively, at least 50 per cent of the value of the corporation's outstanding stock. The attribution rules of the Code shall apply for purposes of determining whether the ownership requirements of this definition have been met. [or insert state definition]

(I) “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 day-to-day execution and performance of a contract entered into by the taxpayer with the customer.

#### (4) General Principles of Application; Contemporaneous Records.

In order to satisfy the requirements of Reg. IV.17, a taxpayer's assignment of receipts from sales of other than tangible personal property must be consistent with the following principles:

(A) A taxpayer shall apply the rules set forth in Reg. IV.17 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 shall determine its method of assigning receipts in good faith, and apply it 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 receipts, including its underlying assumptions, and shall provide those records to the [Agency ] upon request.

(B) Reg. IV.17 provides 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 if the taxpayer cannot do so, the rule requires the taxpayer to reasonably approximate the state or states. In these cases, the taxpayer must attempt to determine the state or states of assignment (i.e., apply the primary rule in the hierarchy) in good faith and with reasonable effort before it may reasonably approximate the state or states.

- (C) A taxpayer's method of assigning its receipts, including the use of a method of approximation, where applicable, must reflect an attempt to obtain the most accurate assignment of receipts consistent with the regulatory standards set forth in Reg. IV.17, 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.

(5) Rules of Reasonable Approximation.

(A) In General. In general, Reg. IV.17 establishes uniform rules for determining whether and to what extent the market for a sale other than the sale of tangible personal property is in [state]. The regulation also sets forth rules of reasonable approximation, which apply if 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 in Reg. IV.17. In other cases, the applicable rule in Reg. IV.17 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 Reg. IV.17.

(B) Approximation Based Upon Known Sales. In an instance where, applying the applicable rules set forth in Reg. IV.17.(d). (Sale of a Service), a taxpayer can ascertain the state or states of assignment of a substantial portion of its receipts from sales of substantially similar services ("assigned receipts"), but not all of those sales, and the taxpayer reasonably believes, based on all available information, that the geographic distribution of some or all of the remainder of those sales generally tracks that of the assigned receipts, it shall include receipts from those sales which it believes tracks the geographic distribution of the assigned receipts in its receipts factor in the same proportion as its assigned receipts. This rule 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* Reg.s IV.17.(e).(5) and (f).(1)(C).

(C) Related-Party Transactions – Information Imputed from Customer to Taxpayer. Where a taxpayer has receipts subject to this Reg. IV.17 from transactions with a related-party customer, information that the customer has that is relevant to the sourcing of receipts from these transactions is imputed to the taxpayer.

(6) Rules with Respect to Exclusion of Receipts from the Receipts Factor

- (A) The receipts factor only includes those amounts defined as receipts under Article IV.1(g) and applicable regulations.
- (B) Certain receipts arising from the sale of intangibles are excluded from the numerator and denominator of the sales factor pursuant to Article IV.17(a)(4)(ii)(C). *See* Reg. IV.17.(f).(1)(D).
- (C) In a case in which a taxpayer cannot ascertain the state or states to which receipts of a sale are to be assigned pursuant to the applicable rules set forth in Reg. IV.17 (including through the use of a method of reasonable approximation, where relevant) using a reasonable amount of effort undertaken in good faith, the receipts must be excluded from the denominator of the taxpayer's receipts factor pursuant to Article IV. 17.(c). and these regulations.
- (D) In a case in which a taxpayer can ascertain the state or states to which receipts from a sale are to be assigned pursuant to the applicable rules set forth in Reg. IV.17, but the taxpayer is not taxable in one or more of those states, pursuant to Article IV.3 and applicable regulations, the receipts that would otherwise be assigned to those states where the taxpayer is not taxable must be excluded from the denominator of the taxpayer's receipts factor pursuant to Article IV.17.(c).

(7) Changes in Methodology; [tax administrator] Review

- (A) No Limitation on Article IV.18 or Reg. IV.18. Nothing in the regulations adopted here pursuant to Article IV.17 is intended to limit the application of Article IV.18 or the authority granted to [the tax administrator] under Section 18. To the extent that regulations adopted pursuant to Section 18 conflict with provisions of these regulations adopted pursuant to Section 17, the regulations adopted pursuant to Section 18 control. If the application of Section 17 or the regulations adopted pursuant thereto result in the attribution of receipts to the taxpayer's receipts factor that does not fairly represent the extent of the taxpayer's business activity in [state], the taxpayer may petition for or [the tax administrator] may require the use of a different method for attributing those receipts.
- (B) 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 receipts using a method of assignment, including a method of reasonable approximation, in accordance with the rules stated in Reg. IV.17., 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 those cases, neither [the tax administrator] 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 those receipts for the taxable year. However, [the tax administrator] and the taxpayer may each subsequently, through the applicable administrative process, correct factual errors or calculation errors with respect to the taxpayer's application of its filing methodology.

(C) [Tax Administrator] Authority to Adjust a Taxpayer's Return. The [tax administrator's] ability to review and adjust a taxpayer's assignment of receipts on a return to more accurately assign receipts consistently with the rules or standards of Reg. IV.17, includes, but is not limited to, each of the following potential actions.

1. In a case in which a taxpayer fails to properly assign receipts from a sale in accordance with the rules set forth in Reg. IV.17, including the failure to properly apply a hierarchy of rules consistent with the principles of Reg. IV.17.(a).(4)(B), [the tax administrator] may adjust the assignment of the receipts in accordance with the applicable rules in Reg. IV.17.
2. In a case in which a taxpayer uses a method of approximation to assign its receipts and [the tax administrator] determines that the method of approximation employed by the taxpayer is not reasonable, the [tax administrator] may substitute a method of approximation that the [tax administrator] determines is appropriate or may exclude the receipts from the taxpayer's numerator and denominator, as appropriate.
3. In a case in which [the tax administrator] 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 [tax administrator] may require that the taxpayer apply its method of approximation in a consistent manner.
4. In a case in which a taxpayer excludes receipts from the denominator of its receipts factor on the theory that the assignment of the receipts cannot be reasonably approximated, the [tax administrator] may determine that the exclusion of those receipts is not appropriate, and may instead substitute a method of approximation that the [tax administrator] determines is appropriate.
5. In a case in which a taxpayer fails to retain contemporaneous records that explain the determination and application of its method of assigning its receipts, including its underlying assumptions, or fails to provide those records to [the tax administrator] upon request, the [tax administrator] may treat the taxpayer's assignment of receipts as unsubstantiated, and may adjust the assignment of the receipts in a manner consistent with the applicable rules in Reg. IV.17.
6. In a case in which the [tax administrator] concludes that a customer's billing address was selected by the taxpayer for tax avoidance purposes, the [tax administrator] may adjust the assignment of receipts from sales to that customer in a manner consistent with the applicable rules in Reg. IV.17.

(D) 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 receipts under Reg. IV.17, including changing its method of

approximation, from that used on previous returns. However, the taxpayer may only make this change for purposes of improving the accuracy of assigning its receipts consistent with the rules set forth in Reg. IV.17, 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 these rules. Further, a taxpayer that seeks to change its method of assigning its receipts must disclose, in the original return filed for the year of the change, the fact that it is has made the change, and must retain and provide to the [tax administrator] 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 the change or retain and provide the required records upon request, the [tax administrator] may disregard the taxpayer's change and substitute an assignment method that the [tax administrator] determines is appropriate.

(E) [Tax administrator] Authority to Change a Method of Assignment on a Prospective Basis. The [tax administrator] may direct a taxpayer to change its method of assigning its receipts 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 tax administrator] determines that the change is appropriate to reflect a more accurate assignment of the taxpayer's receipts within the meaning of Reg. IV.17, and determines that the change can be reasonably adopted by the taxpayer. [the tax administrator] will provide the taxpayer with a written explanation as to the reason for making the change. In a case in which a taxpayer fails to comply with [the tax administrator]'s direction on subsequently filed returns, [the tax administrator] may deem the taxpayer's method of assigning its receipts on those returns to be unreasonable, and may substitute an assignment method that the [tax administrator] determines is appropriate.

(8) Further Guidance.

The [tax administrator] may issue further public written statements with respect to the rules set forth in Reg. IV.17. These statements may, among other things, include guidance with respect to: (1) what constitutes a reasonable method of approximation within the meaning of the rules, and (2) the circumstances in which a filing change with respect to a taxpayer's method of reasonable approximation will be deemed appropriate.

•• **Reg. IV.17.(b). Sale, Rental, Lease or License of Real Property..**

In the case of a sale, rental, lease or license of real property, the receipts from the sale are in [state] if and to the extent that the property is in [state].

•• **Reg. IV.17.(c). Rental, Lease or License of Tangible Personal Property.**

In the case of a rental, lease or license of tangible personal property, the receipts from the sale are in [state] if and to the extent that the property is in [state]. If property is mobile property that is located both within and without [state] during the period of the lease or

other contract, the receipts assigned to [state] are the receipts from the contract period multiplied by the fraction computed under Reg. IV.10.(d). (as adjusted when necessary to reflect differences between usage during the contract period and usage during the taxable year).

•• **Reg. IV.17.(d). Sale of a Service.**

(1) General Rule.

The receipts from a sale of a service are in [state] if and to the extent that the service is delivered to a location in [state]. In general, the term “delivered to a location” refers to the location of the taxpayer’s market for the service, which may not be the location of the taxpayer’s employees or property. 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 Reg.s IV.17.(d).(2)-(4).

(2) In-Person Services.

(A) In General.

Except as otherwise provided in this Reg. IV.17.(d).(2), 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. This rule 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, 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 (1) a location that is owned or operated by the service provider or (2) 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 similar services as described in Reg. IV.17.(d).(4), although they may involve some amount of in-person contact, are not treated as in-person services within the meaning of this Reg. IV.17.(d).(2).

(B) Assignment of Receipts.

1. Rule of Determination. Except as otherwise provided in this Reg. IV.17.(d).(2)(B), if the service provided by the taxpayer is an in-person service, the service is delivered to the location where the service is received. Therefore, the receipts from a sale are in [state] if and to the extent the customer receives the in-person service in [state]. In assigning its receipts from sales of in-person services, a taxpayer must first attempt to determine the location where a service is received, as follows:

- a. If the service is performed with respect to the body of an individual customer in [state] (e.g. hair cutting or x-ray services) or in the physical presence of the customer in [state] (e.g. live entertainment or athletic performances), the service is received in [state].
- b. If the service is performed with respect to the customer's real estate in [state] or if 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 [state], the service is received in [state].
- c. If 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 within or outside [state], the service is received in [state] if the property is shipped or delivered to the customer in [state].

(C) Rule of Reasonable Approximation. In an 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. If the state to which the receipts are to be assigned can be determined or reasonably approximated, but the taxpayer is not taxable in that state, the receipts that would otherwise be assigned to the state are excluded from the denominator of the taxpayer's receipts factor pursuant to Article IV.17.(c). and Reg. IV.17.(a).(6)(D).

(D) Examples.

In these examples assume, unless otherwise stated, that the taxpayer is taxable in each state to which its receipts would be assigned, so that there is no requirement that the receipts from the sale or sales be eliminated from the denominator of the taxpayer's receipts factor. See Article IV.17.(c). and Reg. IV.17.(a).(6)(D). 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 (i).* Salon Corp has retail locations in [state] 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 receipts from sales of services provided at Salon Corp's in-state locations are in [state]. The receipts from sales of services provided at Salon Corp's locations outside [state], even when provided to residents of [state], are not receipts from in-state sales.

*Example (ii).* Landscape Corp provides landscaping and gardening services in [state] and in neighboring states. Landscape Corp provides landscaping services at the in-state vacation home of an individual who is a resident of

another state and who is located outside [state] at the time the services are performed. The receipts from sale of services provided at the in-state location are in [state].

*Example (iii).* Same facts as in Example (ii), 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 those locations of Retail Corp that are in [state] and in other states. The receipts from the sale of services provided to Retail Corp are in [state] to the extent the services are provided in [state].

*Example (iv).* Camera Corp provides camera repair services at an in-state retail location to walk-in individual and business customers. In some cases, Camera Corp actually repairs a camera that is brought to its in-state location at a facility that is in another state. In these cases, the repaired camera is then returned to the customer at Camera Corp's in-state location. The receipts from sale of these services are in [state].

*Example (v).* Same facts as in Example (iv), except that a customer located in [state] mails the camera directly to the out-of-state facility owned by Camera Corp to be fixed, and receives the repaired camera back in [state] by mail. The receipts from sale of the service are in [state].

*Example (vi).* Teaching Corp provides seminars in [state] 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 [state] the receipts from sales of the services are in [state].

### (3) Services Delivered to the Customer or on Behalf of the Customer, or Delivered Electronically Through the Customer.

#### (A) In General.

If the service provided by the taxpayer is not an in-person service within the meaning of Reg. IV.17.(d).(2) or a professional service within the meaning of Reg. IV.17(d)(4), and the service is delivered to or on behalf of the customer, or delivered electronically through the customer, the receipts from a sale are in [state] if and to the extent that the service is delivered in [state]. For purposes of this Reg. IV.17.(d).(3), 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, or the direct or indirect delivery of advertising to the customer's intended audience (*see* Reg. IV.17.(d).(3)(B)1 and Example (iv) under (d).(3)(B)1.c.). A service can be delivered to or on behalf of a customer

by physical means or through electronic transmission. 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.

(B) Assignment of Receipts.

The assignment of receipts to a state or states in the instance of a sale 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 this Reg. IV.17.(d).(3), a service delivered by an electronic transmission is not a delivery by a physical means). If a rule of assignment set forth in this Reg. IV.17.(d).(3), 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. If the state to which the receipts from a sale are to be assigned can be determined or reasonably approximated, but the taxpayer is not taxable in that state, the receipts that would otherwise be assigned to that state are excluded from the denominator of the taxpayer’s receipts factor. *See* Article IV.17(c) and Reg. IV.17.(a).(6)(D).

1. 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 corporate taxation) where the taxpayer installs the custom software at the customer’s site. The rules in this Reg. IV.17.(d).(3)(B)1. apply whether the taxpayer’s customer is an individual customer or a business customer.
  - a. Rule of Determination. In assigning the receipts from a 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 the service is delivered. If the taxpayer is able to determine the state or states where the service is delivered, it shall assign the receipts to that state or states.
  - b. Rule of Reasonable Approximation. If 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 the state or states.



## c. Examples:

In these examples assume, unless otherwise stated, that the taxpayer is taxable in each state to which its receipts would be assigned, so that there is no requirement in these examples that the receipts must be eliminated from the denominator of the taxpayer's receipts factor. See Article IV.17.(c). and Reg. IV.17.(a).(6)(D).

*Example (i).* Direct Mail Corp, a corporation based outside [state], 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 [state] 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 receipts from the sale of Direct Mail Corp's services to Business Corp are assigned to [state] to the extent that the services are delivered on behalf of Business Corp to [state] customers (i.e., to the extent that the fliers are delivered on behalf of Business Corp to Business Corp's intended audience in [state]).

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

*Example (iii).* Same facts as example (ii), except that the contract is with a business customer that is based outside [state]. The receipts from the sale of the design services are in [state] because the services are physically delivered on behalf of the customer to the customer's intended audience in [state].

*Example (iv).* Fulfillment Corp, a corporation based outside [state], provides product delivery fulfillment services in [state] and in neighboring states to Sales Corp, a corporation located outside [state] 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 [state], Fulfillment Corp will, pursuant to its contract with Sales Corp, deliver that property from its fulfillment warehouse located outside [state]. The receipts from the sale of the fulfillment services of Fulfillment Corp to Sales Corp are assigned to [state] to the extent that Fulfillment Corp's deliveries on behalf of Sales Corp are to recipients in [state].

*Example (v).* Software Corp, a software development corporation, enters into a contract with a business customer, Buyer Corp, which is physically located in

[state], to develop custom software to be used in Buyer Corp's business. Software Corp develops the custom software outside [state], and then physically installs the software on Buyer Corp's computer hardware located in [state]. The development and sale of the custom software is properly characterized as a service transaction, and the receipts from the sale are assigned to [state] because the software is physically delivered to the customer in [state].

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

2. 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.

- a. Services Delivered By Electronic Transmission to an Individual Customer.

- i. Rule of Determination. In the case of the delivery of a service to an individual customer by electronic transmission, the service is delivered in [state] if and to the extent that the taxpayer's customer receives the service in [state]. If the taxpayer can determine the state or states where the service is received, it shall assign the receipts from that sale to that state or states.
- ii. 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 the state or states. If 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 the state or states using the customer's billing address.

- b. Services Delivered By Electronic Transmission to a Business Customer.

- i. Rule of Determination. In the case of the delivery of a service to a business customer by electronic transmission, the service is delivered in [state] if and to the extent that the taxpayer's customer receives the service in [state]. If the taxpayer can determine the state or states where the service is received, it shall assign the receipts from that sale to the state or states. For purposes of this Reg. IV.17.(d.)3)(B)2.b., 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.

- ii. **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 the state or states.
- iii. **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, the taxpayer shall reasonably approximate the state or states as set forth in this regulation. In these cases, unless the taxpayer can apply the safe harbor set forth in Reg. IV.17.(d).(3)(B)2.b.iv., the taxpayer shall reasonably approximate the state or states in which the service is received as follows: first, by assigning the receipts from 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 receipts from 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 receipts from the sale using the customer's billing address; provided, however, if the taxpayer derives more than 5% of its receipts from sales of services from any single customer, the taxpayer is required to identify the state in which the contract of sale is principally managed by that customer.
- iv. **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 Reg. IV.17.(d).(3)(B)2.b.ii., the state or states in which the service is received. In these cases, the taxpayer may, in lieu of the rule stated at Reg. IV.17.(d).(3)(B)2.b.iii., apply the safe harbor stated in this subsection. Under this safe harbor, a taxpayer may assign its receipts from sales to a particular customer based upon the customer's billing address in a 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 receipts from sales of all services from that customer. This safe harbor applies only for purposes of [omitted reference] services delivered by electronic transmission to a business customer, and not otherwise.

- v. Related Party Transactions. In the case of a sale of a service by electronic transmission to a business customer that is a related party, the taxpayer may not use the secondary rule of reasonable approximation in Reg. IV.17.(d).(3)(B)2.b.iii but may use the rule of reasonable approximation in Reg. IV.17.(d).(3)(B)2.b.ii, and the safe harbor in Reg. IV.17.(d).(3)(B)2.b.iv, provided that [the tax administrator] may aggregate sales to related parties in determining whether the sales exceed 5% of receipts from sales of all services under that safe harbor provision if necessary or appropriate to prevent distortion.

c. Examples:

In these examples, unless otherwise stated, assume that the taxpayer is not related to either the customer to which the service is delivered. Also, unless otherwise stated, assume that the taxpayer is taxable in each state to which its receipts would be assigned, so that there is no requirement in these examples that the receipts must be eliminated from the denominator of the taxpayer's receipts factor. *See* Article IV.17.(c). and Reg. IV.17.(a).(6)(D). Further, assume if relevant, unless otherwise stated, that the safe harbor set forth at Reg. IV.17.(d).(3)(B)2.b.iv does not apply.

*Example (i).* Support Corp, a corporation that is based outside [state], 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 [state] 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 receipts to these locations. The receipts from sales made to Support Corp's individual and business customers are in [state] to the extent that Support Corp's services are received in [state]. *See* Reg. IV.17.(d).(3)(B)2.a. and b.

*Example (ii).* Online Corp, a corporation based outside [state], provides web-based services through the means of the Internet to individual customers who are resident in [state] 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 receipts from the sale of services, Online Corp can either determine the state or states where the services are received, or, where it cannot determine the state or states, it has sufficient information regarding the place of receipt to reasonably approximate the

state or states. However, Online Corp cannot determine or reasonably approximate the state or states of receipt for all of the sales of its services. Assuming that Online Corp reasonably believes, based on all available information, that the geographic distribution of the receipts from 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 [state] the receipts from sales for which it does not know the customers' location in the same proportion as those receipts for which it has this information. *See* Reg. IV.17.(a).(5)(B).

*Example (iii).* Same facts as in Example (ii), except that Online Corp reasonably believes that the geographic distribution of the receipts from 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 receipts from sales of its services for which it lacks information as provided to its individual customers using the customers' billing addresses. *See* Reg. IV.17.(d).(3)(B)2.a.

*Example (iv).* Same facts as in Example (iii), except that Online Corp is not taxable in one state to which some of its receipts from sales would be otherwise assigned. The receipts that would be otherwise assigned to that state are to be excluded from the denominator of Online Corp's receipts factor. *See* Reg. IV.17.(d).(3)(B).

*Example (v).* Net Corp, a corporation based outside [state], provides web-based services to a business customer, Business Corp, a company with offices in [state] 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 [state] 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 this case, 75% of the receipts from the sale are received in [state]. *See* Reg. IV.17.(d).(3)(B)2.a.i. 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 the location or locations. Under these circumstances, if Net Corp derives 5% or less of its receipts from sales to Business Corp, Net Corp must assign the receipts under Reg. IV.17.(d).(3)(B)2.b.iii. 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 sales of services to 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 (vi).* Net Corp, a corporation based outside [state], provides web-based services through the means of the Internet to more than 250 individual and business customers in [state] 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 the state or states. Also assume that Net Corp does not derive more than 5% of its receipts from sales of services to a single customer. Net Corp may apply the safe harbor stated in Reg. IV.17.(d).(3)(B)2.b.iv., and may assign its receipts using each customer's billing address. If Net Corp is not taxable in one or more states to which some of its receipts would be otherwise assigned, it must exclude those receipts from the denominator of its receipts factor. *See* Article IV.17.(c). and Reg. IV.17.(a).(6)(D).

3. 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.
  - a. 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 [state] if and to the extent that the end users or other third-party recipients are in [state]. 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 [state] to the extent that the audience for the advertising is in [state]. 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 [state] to the extent that the end users or other third-party recipients receive the services in [state]. The rules in this subsection Reg. IV.17(d).(3)(B)3.a. 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.
  - b. 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 the state or states.

c. Select Secondary Rules of Reasonable Approximation.

- i. If a taxpayer's service is the direct or indirect electronic delivery of advertising on behalf of its customer to the customer's intended audience, and if the taxpayer lacks sufficient information regarding the location of the audience from which it can determine or reasonably approximate that location, the taxpayer shall reasonably approximate the audience in a state for the advertising using the following secondary rules of reasonable approximation. If 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 that 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 that area.
- ii. If a taxpayer's service is the delivery of a service to a customer that then acts as the taxpayer's intermediary in reselling that 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 that 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 the services, relative to the total population in that area.
- iii. When using the secondary reasonable approximation methods provided above, the relevant specific geographic area [of delivery] include only the areas where the service was substantially and materially delivered or resold. Unless the taxpayer demonstrates the contrary, it will be presumed that the area where the service was substantially and materially delivered or resold does not include areas outside the United States.

d. Examples:

In these examples, unless otherwise stated, assume that the taxpayer is taxable in each state to which its receipts would be assigned, so that there is no requirement in these examples that the receipts must be eliminated from the denominator of the taxpayer's receipts factor. *See* Article IV.17.(c). and Reg. IV.17.(a).(6)(D).

*Example (i).* Cable TV Corp, a corporation that is based outside of [state], 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 [state]. Second, Cable TV Corp sells monthly subscriptions to individual customers in [state] and in other states. The receipts from Cable TV Corp's sale of advertising time to its business customers are assigned to [state] to the extent that the audience for Cable TV Corp's televised programming during which the advertisements run is in [state]. See Reg. IV.17.(d).(3)(B)3.a. 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 the location, Cable TV Corp must approximate its [state] audience using the percentage that reflects the ratio of its [state] subscribers in the geographic area in which Cable TV Corp's televised programming featuring the advertisements is delivered relative to its total number of subscribers in that area. See Reg. IV.17.(d).(3)(B)3.c.i. To the extent that Cable TV Corp's sales of monthly subscriptions represent the sale of a service, the receipts from these sales are properly assigned to [state] in any case in which the programming is received by a customer in [state]. See Reg. IV.17.(d).(3)(B)2.a. 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 the location, the receipts from these sales of Cable TV Corp's monthly subscriptions are assigned to [state] where its customer's billing address is in [state]. See Reg. IV.17.(d).(3)(B)2.a.ii. 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 receipts are properly assigned. See Reg. IV.17.(e).(5).

*Example (ii).* Network Corp, a corporation that is based outside of [state], 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. The receipts from Network Corp's sale of advertising time to its business customers are assigned to [state] to the extent that the audience for Network Corp's televised programming during which the advertisements will run is in [state]. See Reg. IV.17.(d).(3)(B)3.a. 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 the location, Network Corp must approximate the receipts from sales of advertising that constitute [state] sales by multiplying the amount of advertising receipts by a



percentage that reflects the ratio of the [state] population in the specific geographic area in which the televised programming containing the advertising is run relative to the total population in that area. *See* Reg. IV.17.(d).(3)(B)3.c.ii. and iii. In any case in which Network Corp's receipts would be assigned to a state in which Network Corp is not taxable, the receipts must be excluded from the denominator of Network Corp's receipts factor. *See* Article IV.17(c) and Reg. IV.17.(a).(6)(D).

*Example (iii).* Web Corp, a corporation that is based outside [state], provides Internet content to viewers in [state] 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. The receipts from Web Corp's sale of advertising space to its business customers are assigned to [state] to the extent that the viewers of the Internet content are in [state], as measured by viewings or clicks. *See* Reg. IV.17.(d).(3)(B)3.a. 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 the location, Web Corp must approximate the amount of its [state] receipts by multiplying the amount of receipts from sales of advertising by a percentage that reflects the [state] population in the specific geographic area in which the content containing the advertising is delivered relative to the total population in that area. *See* Reg. IV.17.(d).(3)(B)3.c. In any case in which Web Corp's receipts would be assigned to a state in which Web Corp is not taxable, those receipts must be excluded from the denominator of Web Corp's receipts factor. *See* Article IV.17.(c). and Reg. IV.17.(a).(6)(D).

*Example (iv).* Retail Corp, a corporation that is based outside of [state], sells tangible property through its retail stores located in [state] 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 the 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 the locations, Answer Co must approximate the amount of its [state] receipts by multiplying the amount of its fee from Retail Corp by a percentage that reflects the [state] population in the specific geographic area from which the calls are placed relative to the total population in that area. *See*

Reg. IV.17.(d).(3)(B)3.c.i. Answer Co's receipts must also be excluded from the denominator of its receipts factor in any case in which the receipts would be assigned to a state in which Answer Co is not taxable. See Article IV.17(c) and Reg. IV.17.(a).(6)(D).

*Example (v).* Web Corp, a corporation that is based outside of [state], 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 Reg. IV.17.(d).(3)(B)2. 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 (vi).* Wholesale Corp, a corporation that is based outside [state], develops an Internet-based information database outside [state] 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 receipts from 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 the location, Wholesale Corp must approximate the extent to which its services are received by end users in [state] by using a percentage that reflects the ratio of the [state] population in the specific geographic area in which Retail Corp regularly markets and sells Wholesale Corp's database relative to the total population in that area. See Reg. IV.17(d).(3)(B)3.b. 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 Reg. IV.17.(e).(5). In any case in which Wholesale Corp's receipts would be assigned to a state in which Wholesale Corp is not taxable, the receipts must be excluded from the denominator of Wholesale Corp's receipts factor. See Article IV.17(c) and Reg. IV.17.(a).(6)(D).

(4) Professional Services.

(A) In General.

Except as otherwise provided in this Reg. IV.17.(d).(4), professional services are services that require specialized knowledge and in some cases require a professional certification, license or degree. These services include the performance of technical services that require the application of specialized knowledge. 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 services, credit card services (including credit card processing services), data processing services, legal services, consulting services, video production services, graphic and other design services, engineering services, and architectural services.

(B) Overlap with Other Categories of Services.

1. Certain services that fall within the definition of “professional services” set forth in this Reg. IV.17.(d).(4) are nevertheless treated as “in-person services” within the meaning of Reg. IV.17.(d).(2), and are assigned under the rules of that subsection. 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 the rules of this Reg. IV.17(d)(4), notwithstanding the fact that these services may involve some amount of in-person contact.
2. Professional services may in some cases include the transmission of one or more documents or other communications by mail or by electronic means. In some cases, all or most communications between the service provider and the service recipient may be by mail or by electronic means. However, in these cases, despite this transmission, the assignment rules that apply are those set forth in this Reg. IV.17(d)(4), and not those set forth in Reg. IV.17.(d).(3), pertaining to services delivered to a customer or through or on behalf of a customer.

(C) Assignment of Receipts.

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, 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 receipts from 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 receipts from a sale of a professional service, a taxpayer's customer is the person that contracts for the service, irrespective of whether another person pays for or also benefits from the taxpayer's services. In any instance in which the taxpayer is not taxable in the state to which receipts from a sale is assigned, the receipts are excluded from the denominator of the taxpayer's receipts factor. *See* Article IV.17(c) and Reg. IV.17.(a).(6)(D).

1. General Rule. Receipts from sales of professional services other than those services described in Reg. IV.17.(d).(4)(C)2. (architectural and engineering services), Reg. IV.17(d).(4)(C)3. (services provided by a financial institution) and Reg. IV.17(d).(4)(C)4. (transactions with related parties) are assigned in accordance with this Reg. IV.17.(d).(4)(C)1.

a. Professional Services Delivered to Individual Customers. Except as otherwise provided in Reg. IV.17(d)(4) (see in particular Reg. IV.17.(d).(4)(C)4, 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 must be reasonably approximated as set forth in this Reg. IV.17.(d).(4)(C)1.a. In particular, the taxpayer shall assign the receipts from a 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 receipts from sales of all services from an individual customer, the taxpayer shall identify the customer's state of primary residence and assign the receipts from the service or services provided to that customer to that state.

b. Professional Services Delivered to Business Customers. Except as otherwise provided in Reg. IV.17.(d).(4), 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 must be reasonably approximated as set forth in this section. In particular, unless the taxpayer may use the safe harbor set forth at Reg. IV.17.(d).(4)(C)1.c., the taxpayer shall assign the receipts from 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 the place of customer management is not reasonably determinable, to the customer's place of order; and third, if the 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 receipts from sales of all services from a customer, the taxpayer is required to identify the state in which the contract of sale is principally managed by the customer.

- c. Safe Harbor; Large Volume of Transactions. Notwithstanding the rules set forth in Reg. IV.17.(d).(4)(C)1.a. and b., a taxpayer may assign its receipts from 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 receipts from sales of all services from that customer. This safe harbor applies only for purposes of Reg. IV.17.(d).(4)(C)1. and not otherwise.
2. 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 this Reg. IV.17.(d)(4). However, unlike in the case of the general rule that applies to professional services, (1) the receipts from a sale of an architectural service are 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 the state or states; and (2) the receipts from a sale of an engineering service are assigned to a state or states if and to the extent that the services are with respect to tangible or real property located in the state or states, including real estate improvements located in, or expected to be located in, the state or states. These rules apply whether or not the customer is an individual or business customer. In any instance in which architectural or engineering services are not described in Reg. IV.17(d)(4)(C)2, the receipts from a sale of these services must be assigned under the general rule for professional services. *See* Reg. IV.17.(d).(4)(C)1.
3. Services Provided by a Financial Institution. The apportionment rules that apply to financial institutions are set forth at [financial institutions special apportionment statute or regulation]. [Drafter's Note: not all states have special industry rules or statutes for sourcing financial institution income.] That [financial institutions special apportionment statute or regulation] includes specific rules to determine a financial institution's receipts factor. However, [the statute or regulation] also provides that receipts from sales, other than sales of tangible personal property, including service transactions, that are not otherwise apportioned under [the statute or regulation], are to be assigned pursuant to Article IV.17. and these regulations. In any instance in which a financial institution performs services that are to be assigned pursuant to Article IV.17. and these regulations including, for example, financial custodial services, those services are considered professional services within the meaning of this Reg. IV.17(d)(4), and are assigned according to the general rule for professional service transactions as set forth at Reg. IV.17.(d).(4)(C)1.
4. Related Party Transactions. In any instance in which the professional service is sold to a related party, rather than applying the rule for professional services delivered to business customers in Reg. IV.17.(d).(4)(C)1.b, the state or states to which the service is assigned is the place of receipt by the related party as reasonably approximated using the following hierarchy: (1) if the service

primarily relates to specific operations or activities of a related party conducted in one or more locations, then to the state or states in which those operations or activities are conducted in proportion to the related party's payroll at the locations to which the service relates in the state or states; or (2) if the service does not relate primarily to operations or activities of a related party conducted in particular locations, but instead relates to the operations of the related party generally, then to the state or states in which the related party has employees, in proportion to the related party's payroll in those states. The taxpayer may use the safe harbor provided by Reg. IV.17.(d).(4)(C)1.c provided that [the tax administrator] may aggregate the receipts from sales to related parties in applying the 5% rule if necessary or appropriate to avoid distortion.

#### 5. Examples:

Unless otherwise stated, assume in each of these examples, where relevant, that the taxpayer is taxable in each state to which its receipts would be assigned, so that there is no requirement in the examples that the receipts must be excluded from the denominator of the taxpayer's receipts factor, *see* Article IV.17(c) and Reg. IV.17.(a).(6)(D). Assume also that the customer is not a related party and that the safe harbor set forth at Reg. IV.17.(d).(4)(C)1.c. does not apply.

*Example (i).* Broker Corp provides securities brokerage services to individual customers who are resident in [state] 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 receipts from sales of all services from any one individual customer. If Broker Corp knows its customer's state of primary residence, it shall assign the receipts to that state. If Broker Corp does not know its customer's state of primary residence, but rather knows the customer's billing address, it shall assign the receipts to that state. *See* Reg. IV.17.(d).(4)(C)1.a.

*Example (ii).* Same facts as in Example (i), except that Broker Corp has several individual customers from whom it derives, in each instance, more than 5% of its receipts from sales of all services. Receipts from sales to customers from whom Broker Corp derives 5% or less of its receipts from sales of all services must be assigned as described in example 1. For each customer from whom it derives more than 5% of its receipts from sales of all 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 [state], receipts from a sale made to that customer must be assigned to [state]; in any case in which a 5% customer's state of primary residence is not [state] receipts from a sale made to that customer are not assigned to [state]. Where receipts from a sale are assigned to a state other than [state], 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 must be excluded from the denominator of Broker Corp's receipts factor. *See* Reg. IV.17.(d).(4)(C)1, Article IV.17(c) and Reg. IV.17.(a).(6)(D).

*Example (iii).* Architecture Corp provides building design services as to buildings located, or expected to be located, in [state] to individual customers who are resident in [state] and other states, and to business customers that are based in [state] and other states. The receipts from Architecture Corp's sales are assigned to [state] because the locations of the buildings to which its design services relate are in [state], or are expected to be in [state]. For purposes of assigning these receipts, it is not relevant where, in the case of an individual customer, the customer primarily resides or is billed for the 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 the services. Further, these receipts are assigned to [state] even if Architecture Corp's designs are either physically delivered to its customer in paper form in a state other than [state] or are electronically delivered to its customer in a state other than [state]. *See* Reg. IV.17.(d).(4)(B)2. and (C)2.

*Example (iv).* Law Corp provides legal services to individual clients who are resident in [state] 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 receipts from sales of all services from any one individual client. If Law Corp knows its client's state of primary residence, it shall assign the receipts to that state. If Law Corp does not know its client's state of primary residence, but rather knows the client's billing address, it shall assign the receipts 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* Reg. IV.17.(d).(4)(B)2. and (C)1.

*Example (v).* Same facts as in Example (iv), 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 are excluded from the denominator of Law Corp's receipts factor even if the billing address of one or more of these clients is in a state in which Law Corp is taxable, including [state]. *See* Reg. IV.17.(d).(4)(C), Article IV.17(c) and Reg. IV.17.(a).(6)(D).

*Example (vi).* 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 [state]; in the other cases, the agreement is principally managed in a state other than [state]. If the agreement for legal services is principally managed by the client in [state] the receipts from sale of the services are assigned to [state]; in the other cases, the receipts are not assigned to [state]. In the case of receipts that are assigned to [state], the receipts are 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* Reg. IV.17.(d).(4)(B)2. and (C)1.

*Example (vii).* Same facts as in example 6, except that Law Corp is not taxable in one of the states other than [state] 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 are excluded from the denominator of Law Corp's receipts factor. *See* Reg. IV.17.(d).(4)(C); (C)1.b. and Article IV.17(c) and Reg. IV.17.(a).(6)(D).

*Example (viii).* 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 [state], the receipts from the sale of Consulting Corp's services are assigned to [state]. 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* Reg. IV.17.(d).(4)(C)1.b.

*Example (ix).*<sup>1</sup> Bank Corp provides financial custodial services to 100 individual customers who are resident in [state] 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 receipts from 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 Reg. IV.17.(d).(4)(C)1.c. If Bank Corp knows its customer's state of primary residence, it must assign the receipts to that state. If Bank Corp does not know its customer's state of primary residence, but rather knows the customer's billing address, it must assign the receipts to that state. Bank Corp's receipts are assigned to [state] 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 [state], even if Bank Corp's

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<sup>1</sup> See Rule re: Financial Institutions, Reg. IV.17.(d).(4)(C)3, p. 26.



financial custodial work, including the safekeeping of the customer's financial assets, takes place in a state other than [state]. *See* Reg. IV.17.(d).(4)(C)1.a.

*Example (x).*<sup>2</sup> Same facts as Example (ix), except that Bank Corp has more than 250 customers, individual or business. Bank Corp may apply the safe harbor for professional services stated in Reg. IV.17.(d).(4)(C)1.c., and may assign its receipts from sales to a state or states using each customer's billing address.

*Example (xi).*<sup>3</sup> Same facts as Example (x), except that Bank Corp derives more than 5% of its receipts from 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* Reg. IV.17.(d).(4)(C)1.a. and (C)3. Receipts from sales to all other customers are assigned as described in Example (x).

*Example (xii).* Advisor Corp, a corporation that provides investment advisory services, provides these 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 [state]. Assuming that Advisor Corp knows that its agreement with Investment Co is principally managed by Investment Co in [state], receipts from the sale of Advisor Corp's services are assigned to [state]. 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* Reg. IV.17.(d).(4)(C)1.b.

*Example (xiii).* 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 [state], receipts from the sale of Advisor Corp's services are assigned to [state]. *See* Reg. IV.17.(d).(4)(C)1.b. Note that it is not relevant for purposes of the analysis that the partners in Investment Fund LP are residents of numerous states.

*Example (xiv).* Design Corp is a corporation based outside [state] that provides graphic design and similar services in [state] and in neighboring states. Design Corp enters into a contract at a location outside [state] 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 receipts from sales of services from the individual customer. All of the design work is performed outside [state].

<sup>2</sup> See Rule re: Financial Institutions, Reg. IV.17.(d).(4)(C)3, p. 26.

<sup>3</sup> See Rule re: Financial Institutions, Reg. IV.17.(d).(4)(C)3, p. 26.

Receipts from the sale are in [state] if the customer's billing address is in [state]. *See* Reg. IV.17.(d).(4)(C)1.a.

••• **Reg. IV.17.(e). License or Lease of Intangible Property.**

(1) General Rules.

(A) The receipts from the license of intangible property are in [state] if and to the extent the intangible is used in [state]. In general, the term “use” is 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. The rules that apply to determine the location of the use of intangible property in the context of several specific types of licensing transactions are set forth at Reg. IV.17.(e).(2)-(5). For purposes of the rules set forth in this Reg. IV.17.(e)., a lease of intangible property is to be treated the same as a license of intangible property.

(B) In general, a license of intangible property that conveys all substantial rights in that property is treated as a sale of intangible property for purposes of Reg. IV.17. *See* Reg. IV.17.(f). Note, however, that for purposes of Reg.s IV.17.(e). and (f)., a sale or exchange of intangible property is treated as a license of that property where the receipts from the sale or exchange derive from payments that are contingent on the productivity, use or disposition of the property.

(C) Intangible property licensed as part of the sale or lease of tangible property is treated under Reg. IV.17 as the sale or lease of tangible property.

(D) 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 are excluded from the denominator of the taxpayer's receipts factor. *See* Article IV.17(c) and Reg. IV.17.(a).(6)(D).

(E) Nothing in this Reg. IV.17.(e). shall be construed to allow or require inclusion of receipts in the receipts factor that are not included in the definition of “receipts” pursuant to Article IV.1.(g). or related regulations, or that are excluded from the numerator and the denominator of the receipts factor pursuant to Article IV.17.(a).(4)(ii)(C). For examples of the types of intangibles that are excluded pursuant to Article IV.1(g), see Reg. IV [insert cross-reference]. For examples of the types of intangibles that are excluded pursuant to Article IV.17.(a).(4)(ii)(C), *see* Reg. IV.17.(f).(1)(D). So, to the extent that the transfer of either a security, as defined in [cross-reference], 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 receipts factor.

(2) 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) to a consumer, the royalties or other licensing fees paid by the licensee for that marketing intangible are assigned to [state] to the extent that those fees are attributable to the sale or other provision of goods, services, or other items purchased or otherwise acquired by consumers or other ultimate customers in [state]. 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 [state], it shall assign that amount or proportion to [state]. In the absence of actual evidence of the amount or proportion of the licensee's receipts that are derived from [state] consumers, the portion of the licensing fee to be assigned to [state] must be reasonably approximated by multiplying the total fee by a percentage that reflects the ratio of the [state] 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 that area. If 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 [state] must be reasonably approximated by multiplying the total fee by a percentage that reflects the ratio of the [state] population in the specific geographic area in which the licensee's goods, services, or other items are ultimately and materially marketed using the intangible property relative to the total population of that area. Unless the taxpayer demonstrates that the marketing intangible is materially used in the marketing of items outside the United States, the fees from licensing that marketing intangible will be presumed to be derived from within the United States.

(3) License of a Production Intangible.

If 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 that right are assigned to [state] to the extent that the use for which the fees are paid takes place in [state]. 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 that process. If the [tax administrator] can reasonably establish that the actual use of intangible property pursuant to a license of a production intangible takes place in part in [state], it is presumed that the entire use is in this state except to the extent that the taxpayer can demonstrate that the actual location of a portion of the use takes place outside [state]. In the case of a license of a production intangible to a related party, the taxpayer must assign the receipts to where the intangible property is actually used. In the case of a license of a production intangible to a party other than a related party where the location of actual use is unknown, it is

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).

(4) License of a Mixed Intangible.

If 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 [tax administrator] will accept that separate statement for purposes of Reg. IV.17. If 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 is presumed that the licensing fees are paid entirely for the license of the marketing intangible except to the extent that the taxpayer or the [tax administrator] can reasonably establish otherwise.

(5) License of Intangible Property where Substance of Transaction Resembles a Sale of Goods or Services.

(A) 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 these cases, the receipts from the licensing transaction are assigned by applying the rules set forth in Reg. IV.17.(d).(3)(B)2 and 3, 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 this Reg. IV.17.(e).(5) include, without limitation, the license of database access, the license of access to information, the license of digital goods (*see* Reg. IV.17.(g).(2)), 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* Reg. IV.17.(g).(1)).

(B) Sublicenses.

Pursuant to Reg. IV.17.(e).(5)(A), the rules of Reg. IV.17.(d).(3)(B)3. 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, the rules set forth at Reg. IV.17.(d).(3)(B)3. 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. For this purpose, 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 that 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 that property is bundled with additional services or items of property.

(C) Examples:

In these examples, unless otherwise stated, assume that the taxpayer is taxable in each state to which its receipts would be assigned, so that there is no requirement in these examples that the receipts must be eliminated from the denominator of the taxpayer's receipts factor. See Article IV.17.(c). and Reg. IV.17.(a).(6)(D). Also assume that the customer is not a related party.

*Example (i).* 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 [state]. 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 [state] are determined by multiplying the fees by a percentage that reflects the ratio of Dealer Co's receipts that are derived from its [state] stores relative to Dealer Co's total receipts. See Reg. IV.17.(e).(2).

*Example (ii).* Program Corp, a corporation that is based outside [state], 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 [state] 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 [state], the component of the licensing fee paid to Program Corp by the licensee that constitutes Program Corp's [state] receipts is determined by multiplying the amount of the licensing fee by a percentage that reflects the ratio of the [state] audience of the licensee for the programming relative to the licensee's total U.S. audience for the programming. See Reg. IV.17.(e).(5). If Program Corp is not taxable in any state in which the licensee's audience is located, the receipts are excluded from the denominator of Program Corp's receipts factor. See Article IV.17(c) and Reg. IV.17.(a).(6)(D). Note that the analysis and result as to the state or states to which receipts 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 Reg. IV.17.(e).(5).

*Example (iii).* 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 [state] receipts of Moniker Corp is determined by multiplying the amount of the fee by a percentage that reflects the ratio of the [state] population in the specific geographic region relative to the total population in that region. *See* Reg. IV.17.(e).(2). If Moniker Corp is able to reasonably establish that the marketing intangible was materially used throughout a foreign country, then the population of that country will be included in the population ratio calculation. However, if Moniker Corp is unable to reasonably establish that the marketing intangible was materially used in the foreign country in areas outside a particular major city; then none of the foreign country's population beyond the population of the major city is include in the population ratio calculation. If Moniker Corp is not taxable in any state (including a foreign country) in which Wholesale Co's ultimate consumers are located, the receipts that would be assigned to that state are excluded from the denominator of Moniker Corp's receipts factor. *See* Article IV.17(c) and Reg. IV.17.(a).(6)(D).

*Example (iv).* 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 [state] 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 [tax administrator] can reasonably establish that the actual use of the intangible property takes place in part in [state], the royalty is assigned based to the location of that use rather than to location of the licensee's commercial domicile, in accordance with Reg. IV.17.(e).(1). It is presumed that the entire use is in [state] except to the extent that the taxpayer can demonstrate that the actual location of some or all of the use takes place outside [state]. Assuming that Formula, Inc can demonstrate the percentage of manufacturing that takes place in [state] using the patent relative to the manufacturing in other states, that percentage of the total licensing fee paid to Formula, Inc under the contract will constitute Formula, Inc's [state] receipts. *See* Reg. IV.17.(e).(5).

*Example (v).* 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 the 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 [state]. Assume that Axel Corp lacks actual information regarding the proportion of Biker Co.'s receipts that are derived from [state] customers. Also assume that Biker Co is granted the right to sell the scooters in a U.S. geographic region in which the [state] population constitutes 25% of the total population during the period in question. The licensing contract requires an upfront 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 [tax administrator] reasonably establishes otherwise. Assuming that neither party establishes otherwise, 25% of the licensing fee constitutes [state] receipts. *See* Reg. IV.17.(e).(2), (e).(4).

*Example (vi).* 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 tax administrator] will: (1) assign no part of the licensing fee paid for the production intangible to [state], and (2) assign 25% of the licensing fee paid for the marketing intangible to [state]. *See* Reg. IV.17.(e).(4).

*Example (vii).* Better Burger Corp, which is based outside [state], enters into franchise contracts with franchisees that agree to operate Better Burger restaurants as franchisees in various states. Several of the Better Burger Corp franchises are in [state]. 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 [state] franchises constitute fees paid for the licensing of a marketing intangible. These fees constitute [state] receipts because the franchises are for the right to make [state] sales. The monthly franchise fees paid by [state] 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 [state] receipts because in each case the use of the intangibles is to take place in [state]. *See* Reg. IV.17.(e).(2)-(3). The fees paid for the personal services are to be assigned pursuant to Reg. IV.17.(d).

*Example (viii).* Online Corp, a corporation based outside [state], licenses an information database through the means of the Internet to individual customers that are resident in [state] 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 are assigned in accordance with Reg. IV.17.(e).(5). If Online Corp can determine or reasonably approximate the state or states where its database is accessed, 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 receipts 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 receipts from sales made to its individual customers are in [state] in any case in which the customer's billing address is in [state]. See Reg. IV.17.(d).(3)(B)2.a.

*Example (ix).* Net Corp, a corporation based outside [state], licenses an information database through the means of the Internet to a business customer, Business Corp, a company with offices in [state] and two neighboring states. The license is a license of intangible property that resembles a sale of goods or services and are assigned in accordance with Reg. IV.17.(e).(5). 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 [state], and 25% of Business Corp's database access took place in other states. In that case, 75% of the receipts from database access is in [state]. Assume alternatively that Net Corp lacks sufficient information regarding the location where its database is accessed to reasonably approximate the 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 receipts under Reg. IV.17.(d).(3)(B)2.b. 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 Reg. IV.17.(d).(3)(B)2.b.

*Example (x).* Net Corp, a corporation based outside [state], licenses an information database through the means of the Internet to more than 250 individual and business customers in [state] and in other states. The license is a license of intangible property that resembles a sale of goods or services and receipts from that license are assigned in accordance with Reg. IV.17.(e).(5). 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 receipts from sales of database access from any single customer. Net Corp may apply the safe harbor stated in Reg. IV.17.(d).(3)(B)2.b.iv., and may assign its receipts 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 receipts would be otherwise assigned, it must exclude those receipts from the denominator of its receipts factor. *See* Article IV.17(c) and Reg. IV.17.(a).(6)(D).

*Example (xi).* Web Corp, a corporation based outside of [state], licenses an Internet-based information database to business customers who then sublicense the database to individual end users that are resident in [state] 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 are assigned by applying the rules set forth in Reg. IV.17.(d).(3)(B)3. *See* Reg. IV.17.(e).(5). If Web Corp can determine or reasonably approximate the state or states where its database is accessed by end users, 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 [state] using a percentage that represents the ratio of the [state] population in the specific geographic area in which Web Corp's customer sublicenses the database access relative to the total population in that area. *See* Reg. IV.17.(d).(3)(B)3.c.

### •• Reg. IV.17.(f). Sale of Intangible Property.

#### (1) Assignment of Receipts.

The assignment of receipts 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 this Reg. IV.17(f), a sale or exchange of intangible property includes a license of that 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* Reg. IV.17.(e).(1).

#### (A) 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 receipts from the sale are assigned to a state if and to the extent that the intangible property is used or is authorized to be used within the state. If the intangible property

is used or may be used only in this state the taxpayer shall assign the receipts from the sale to [state]. If the intangible property is used or is authorized to be used in [state] and one or more other states, the taxpayer shall assign the receipts from the sale to [state] to the extent that the intangible property is used in or authorized for use in [state], through the means of a reasonable approximation.

(B) 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 are assigned by applying the rules set forth in Reg. IV.17.(e). (pertaining to the license or lease of intangible property).

(C) 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 are assigned by applying the rules set forth in Reg. IV.17.(e).(5) (relating to licenses of intangible property that resemble sales of goods and services). Examples of these transactions include those that are analogous to the license transactions cited as examples in Reg. IV.17.(e).(5).

(D) Excluded Receipts.

Receipts from the sale of intangible property are not included in the receipts factor in any case in which the sale does not give rise to receipts within the meaning of Article IV.1(g). In addition, in any case in which the sale of intangible property does result in receipts within the meaning of Article IV.1(g), those receipts are excluded from the numerator and the denominator of the taxpayer's receipts factor if the receipts are not referenced in Article IV.17(a)(4)(i), (ii)(A) or (ii)(B). *See* Article IV.17(a)(4)(ii)(C). The sale of intangible property that is excluded from the numerator and denominator of the taxpayer's receipts factor under this provision includes, without limitation, the sale of a partnership interest, the sale of business "goodwill," the sale of an agreement not to compete, or similar intangible value. Also, in any instance in which, the state to which the receipts from a sale is to be assigned can be determined or reasonably approximated, but where the taxpayer is not taxable in such state, the receipts that would otherwise be assigned to such state shall be excluded from the numerator and denominator of the taxpayer's receipts factor. *See* Reg. IV.17.(a).(6)(D).

(E) Examples.

In these examples, unless otherwise stated, assume that the taxpayer is taxable in each state to which some of its receipts would be assigned, so that there is no requirement in these examples that the receipts to other states must be excluded

from the taxpayer's denominator. See Article IV.17(c) and Reg. IV.17.(a).(6)(D).

*Example (i).* Airline Corp, a corporation based outside [state], sells its rights to use several gates at an airport located in [state] to Buyer Corp, a corporation that is based outside [state]. The contract of sale is negotiated and signed outside of [state]. The receipts from the sale are in [state] because the intangible property sold is a contract right that authorizes the holder to conduct a business activity solely in [state]. See Reg. IV.17.(f).(1).

*Example (ii).* Wireless Corp, a corporation based outside [state], sells a license issued by the Federal Communications Commission (FCC) to operate wireless telecommunications services in a designated area in [state] to Buyer Corp, a corporation that is based outside [state]. The contract of sale is negotiated and signed outside of [state]. The receipts from the sale are in [state] because the intangible property sold is a government license that authorizes the holder to conduct business activity solely in [state]. See Reg. IV.17.(f).(1)(A).

*Example (iii).* 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 [state] and an adjacent state. Wireless Corp must attempt to reasonably approximate the extent to which the intangible property is used in or may be used in [state]. 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 Reg. IV.17.(f).(1)(A).

*Example (iv).* 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 denominator of Wireless Corp's receipts factor. See Article IV.17(c) and Reg. IV.17.(a).(6)(D).

*Example (v).* Sports League Corp, a corporation that is based outside [state], 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 [state]. 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 may be used in [state]. 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 [state] and the other states. See Reg. IV.17.(f).(1)(A).

*Example (vi).* 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 denominator of Sports League Corp's receipts factor. See Article IV.17(c) and Reg. IV.17.(a).(6)(D).

*Example (vii).* Inventor Corp, a corporation that is based outside [state], sells patented technology that it has developed to Buyer Corp, a business customer that is based in [state]. 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 Reg. IV.17.(f).(1)(A). Inventor Corp understands that Buyer Corp is likely to use the patented technology in [state], 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 receipts from the sale of the patented technology are excluded from the numerator and denominator of Inventor Corp's receipts factor. See Article IV.17.(a).(4)(ii)(C), Reg. IV.17.(f).(1)(D).

### •• Reg. IV.17.(g). Special Rules.

#### (1) Software Transactions.

A license or sale of pre-written software for purposes other than commercial reproduction (or other exploitation of the intellectual property rights) 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 these cases, the receipts are in [state] as determined under the rules for the sale of tangible personal property set forth under Article IV.16. and related regulations. In all other cases, the receipts from a license or sale of software are to be assigned to [state] as determined otherwise under Reg. IV.17. (e.g., depending on the facts, as the development and sale of custom software, see Reg. IV.17.(d).(3), as a license of a marketing intangible, see Reg. IV.17.(e).(2), as a license of a production intangible, see Reg. IV.17.(e).(3), as a license of intangible property where the substance of the transaction resembles a sale of goods or services, see Reg. IV.17.(e).(5), or as a sale of intangible property, see Reg. IV.17.(f).

#### (2) Sales or Licenses of Digital Goods or Services.

##### (A) 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 are assigned by applying the same rules as are set forth in Reg. IV.17.(d).(3)(B)2. or 3., 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 Regs IV.17.(e).(5) and (f).(1)(C).*

(B) Telecommunications Companies.

In the case of a taxpayer that provides telecommunications or ancillary services and that is thereby subject to Reg. IV.18(i), receipts from the sale or license of digital goods or services not otherwise assigned for apportionment purposes pursuant to that regulation are assigned pursuant to this Reg. IV.17(g)(2)(B), by applying the rules set forth in Reg. IV.17.(d).(3)(B)2. or 3. 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. However, in applying these 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 [MTC Model Regulation for Sourcing Sales of Telecommunications and Ancillary Services].

•• **Reg. IV.18.(a). Special Rules: In General.** Article IV.18. provides that if the allocation and apportionment provisions of Article IV do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- (1) separate accounting;
- (2) the exclusion of any one or more of the factors;
- (3) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or
- (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Article IV.18. permits a departure from the allocation and apportionment provisions of Article IV only in limited and specific cases where the apportionment and allocation provisions contained in Article IV produce incongruous results.

In the case of certain industries such as air transportation, rail transportation, ship transportation, trucking, television, radio, motion pictures, various types of professional athletics, and so forth, the foregoing regulations in respect to the apportionment formula may not set forth appropriate procedures for determining the apportionment factors. Nothing in Article IV.18. or in this Regulation IV.18. shall preclude [the tax administrator] from establishing appropriate procedures under Article IV.10. to 17. for determining the apportionment factors for each such industry, but such procedures shall be applied uniformly.

••• **Reg. IV.18.(b). Special Rules: Property Factor.** The following special rules are established in respect to the property factor of the apportionment formula:

(1) If the subrents taken into account in determining the net annual rental rate under Regulation IV.11.(b) produce a negative or clearly inaccurate value for any item of property, another method which will properly reflect the value of rented property may be required by [the tax administrator] or requested by the taxpayer.

In no case, however, shall the value be less than an amount which bears the same ratio to the annual rental rate paid by the taxpayer for the property as the fair market value of that portion of the property used by the taxpayer bears to the total fair market value of the rented property.

*Example:* The taxpayer rents a 10-story building at an annual rental rate of \$1,000,000. Taxpayer occupies two stories and sublets eight stories for \$1,000,000 a year. The net annual rental rate of the taxpayer must not be less than two-tenths of the taxpayer's annual rental rate for the entire year, or \$200,000.

(2) If property owned by others is used by the taxpayer at no charge or rented by the taxpayer for a nominal rate, the net annual rental rate for the property shall be determined on the basis of a reasonable market rental rate for the property.

••• **Reg. IV.18.(c). Special Rules: SalesReceipts Factor.** The following special rules are established in respect to the salesreceipts factor of the apportionment formula:

~~(1) Where substantial amounts of gross receipts arise from an incidental or occasional sale of a fixed asset used in the regular course of the taxpayer's trade or business, those gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory or plant will be excluded.~~

~~(2) Insubstantial amounts of gross receipts arising from incidental or occasional transactions or activities may be excluded from the sales factor unless their exclusion would materially affect the amount of income apportioned to this state. For example, the taxpayer ordinarily may include in or exclude from the sales factor gross receipts from transactions such as the sale of office furniture, business automobiles, etc.~~

~~(3) Where the income producing activity in respect to business income from intangible personal property can be readily identified, the income is included in the denominator of the sales factor and, if the income producing activity occurs in this state, in the numerator of the sales factor as well. For example, usually the income producing activity can be readily identified in respect to interest income received on deferred payments on sales of tangible property (Regulation IV.15.(a)(1)(A)) and income from the sale, licensing or other use of intangible personal property (Regulation IV.17.(2)(D)).~~

~~Where business income from intangible property cannot readily be attributed to~~

~~any particular income-producing activity of the taxpayer, the income cannot be assigned to the numerator of the sales factor for any state and shall be excluded from the denominator of the sales factor. For example, where business income in the form of dividends received on stock, royalties received on patents or copyrights, or interest received on bonds, debentures or government securities results from the mere holding of the intangible personal property by the taxpayer, the dividends and interest shall be excluded from the denominator of the sales factor.~~

~~(4) (A) Where gains and losses on the sale of liquid assets are not excluded from the sales factor by other provisions under e), such gains or losses shall be treated as provided in this subsection. This subsection does not provide rules relating to the treatment of other receipts produced from holding or managing such assets. If a taxpayer holds liquid assets in connection with one or more treasury functions of the taxpayer, and the liquid assets produce business income when sold, exchanged or otherwise disposed, the overall net gain from those transactions for each treasury function for the tax period is included in the sales factor. For purposes of this subsection, each treasury function will be considered separately.~~

~~(B) For purposes of this subsection, a liquid asset is an asset (other than functional currency or funds held in bank accounts) held to provide a relatively immediate source of funds to satisfy the liquidity needs of the trade or business. Liquid assets include foreign currency (and trading positions therein) other than functional currency used in the regular course of the taxpayer's trade or business; marketable instruments (including stocks, bonds, debentures, options, warrants, futures contracts, etc.); and mutual funds which hold such liquid assets. An instrument is considered marketable if it is traded in an established stock or securities market and is regularly quoted by brokers or dealers in making a market. Stock in a corporation which is unitary with the taxpayer, or which has a substantial business relationship with the taxpayer is not considered marketable stock.~~

~~(C) For purposes of this subsection, a treasury function is the pooling and management of liquid assets for the purpose of satisfying the cash flow needs of the trade or business, such as providing liquidity for a taxpayer's business cycle, providing a reserve for business contingencies, business acquisitions, etc. A taxpayer principally engaged in the trade or business of purchasing and selling instruments or other items included in the definition of liquid assets set forth herein is not performing a treasury function with respect to income so produced.~~

~~(D) Overall net gain refers to the total net gain from all transactions incurred at each treasury function for the entire tax period, not the net gain from a specific transaction.~~

~~(E) Examples.~~

~~*Example (i).* A taxpayer manufactures various gift items. Because of seasonal variations, the taxpayer must keep liquid assets available for later inventory acquisitions. Because the manufacturer wants to obtain a return on available funds, the manufacturer acquires liquid assets, which are held and managed in State A. The net gain resulting from all gains and losses on the sale of the liquid assets for the tax year will be reflected in the denominator of the sales factor and in the numerator of State A.~~

~~). A stockbroker acts as a dealer or trader for its own account in its ordinary course of business. Some of the instruments sold are liquid assets. This subsection does not operate to classify those sales as attributable to a treasury function.~~