Hearing Officer Report

Synopsis and Recommendations on Proposed Draft Amendments to the Commission’s Model General Allocation and Apportionment Regulations

5/1/2016

This report of the Hearing Officer, Brian Hamer, is prepared pursuant to Compact, Art. VII and Commission Bylaw 7.
Proposed Draft Amendments to the Model General Allocation and Apportionment Regulations
PREFACE

For nearly 50 years, the Multistate Tax Commission has drafted model state tax rules. The proposed amendments that are the subject of this report relate to regulations first developed by the newly formed Commission, starting in 1968, to implement UDITPA—the Uniform Division of Income for Tax Purposes Act. Although UDITPA had been proposed ten years earlier by the Uniform Law Commission (ULC), states had not rushed to adopt it. In part, policymakers found some of its provisions to be flawed. But they also recognized uniform tax statutes would be ineffective without uniform regulations to implement them.

Nor were state policymakers alone in this recognition. The Willis Committee, formed by Congress in 1960 to study state taxes, came to this same conclusion. It found that, even if Congress enacted a national apportionment regime, there would still be a critical need for uniform state tax rule-making and other administrative functions. So, the Committee proposed federal legislation that assigned this important regulatory role to the U.S. Treasury Department.

It was in response to this unprecedented proposal that the Multistate Tax Commission was formed. It had support not only from the states, but from many in the business community (who, perhaps, had their own reasons for opposing a new state-focused tax bureaucracy next door to the IRS). One of the Commission’s core purposes is to “promote uniformity or compatibility in significant components of tax systems.” To accomplish this goal, it draws on the expertise of its members—state tax administrators.

In its early days, the Commission did its work without the benefit of the Internet, personal computers, email, conference calling, fax machines, or even copiers. More critically, since UDITPA’s provisions were new, the Commission had to work without the benefit of the expertise and experience that exists today. Despite these challenges, it produced a draft of comprehensive allocation and apportionment regulations in three years. That draft was then put through a rigorous public hearing process and eventually adopted in revised form, incorporating changes suggested by taxpayers and practitioners. These general regulations are the cornerstone of the Commission’s uniformity efforts and have been adopted in whole or in part by many states. They have also been updated and amended as necessary.

But UDITPA itself was never amended or updated, despite persistent problems created by certain provisions. Ambiguities in some of its definitions generated substantial litigation, and states had also long been troubled by UDITPA’s failure to provide a workable method for market-based sourcing of receipts from services and intangibles. (To be fair, the ULC drafting group that produced UDITPA had not been composed of tax experts.) When it finally became clear that the ULC had abandoned any update of UDITPA, the Commission stepped in. In 2014 and 2015, after substantial work by the Commission’s Uniformity Committee and recommendations by the Hearing Officer, Professor Pomp, the Commission finally adopted needed changes. The amendments to the general regulations that are the subject of this report have been proposed to implement some of those changes.
INTRODUCTION

This is the report of the commission’s hearing officer, Brian Hamer, on proposed draft amendments to the commission’s model General Allocation and Apportionment Regulations. The amendments as proposed are included with this report as Appendix A. The proposed amendments implement changes to Compact, Art. IV (UDITPA) adopted by the commission in 2014 and 2015. The changes to Compact, Art. IV are included in this report as Appendix B.

PROCEDURAL SUMMARY

Pursuant to Compact Art. VII.(2) and commission Bylaw 7, the commission will hold a public hearing before recommending any model regulation to the states. The commission’s executive committee may preside over that hearing or may appoint a hearing officer who will then report to the executive committee on the proceedings and make any recommendations.

On January 29, 2016, the executive committee met by phone to consider the uniformity committee’s draft amendments to the model General Allocation and Apportionment Regulations. The executive committee referred the draft amendments for public hearing. Brian Hamer, the ex-director of the Illinois Department of Revenue, agreed to act as hearing officer. Notice of the hearing was provided February 4, 2016. The hearing was held March 9, 2016, at the Hall of the States in Washington, DC, providing the public the ability to participate in person or by phone. Written and oral comments were received from the Council on State Taxation, the ABA Section of Taxation State and Local Tax Committee, Jamie Yesnowitz on his own behalf, and Wood Miller on his own behalf. In addition, the hearing officer extended the period for comments until March 16, 2016. During that period, the hearing officer received additional written comments from Benjamin Miller (formerly of the California Franchise Tax Board), on his own behalf. The hearing officer also consulted with commission staff and took notice of certain information from the work group which developed the amendments. A summary of the written comments is provided with this report in Appendix C.
DEVELOPMENT OF THE DRAFT AMENDMENTS AT ISSUE

At its annual meeting July 30, 2014, the commission adopted changes to Compact, Art. IV, UDITPA. (See Appendix B for a copy of those changes.) At its July 31, 2014, meeting, the executive committee directed the uniformity committee to develop regulations (or amendments to existing regulations) to implement changes to Art. IV. The uniformity committee subsequently met by phone to establish two work groups to do the research and drafting.

The first group drafted amendments to the General Allocation and Apportionment Regulations to implement changes to the definition of “receipts” and “apportionable income” under Art. IV, Sec. 1 (referred to here as the Section 1 work group). The second group drafted regulations to replace the entire Section 17 (cost-of-performance sourcing) portion of the regulations with rules for the sourcing of receipts from services and intangibles under the commission’s changes to Art. IV, Sec. 17 (referred to here as the Section 17 work group). The work groups met regularly (generally weekly) by phone and those meetings were conducted according to the commission’s Public Participation Policy. After the work groups completed their drafting, the proposed amendments were combined into a single working draft.

Certain critical decisions made by the uniformity committee and the work groups are summarized below:

SECTION 1 WORK GROUP

- **CONFORMING CHANGES IN TERMINOLOGY:** The Section 1 work group began work in November of 2014 by analyzing whether it was appropriate to substitute the terms “apportionable” and “non-apportionable” for the terms “business” and “nonbusiness,” or the term “receipts” for “sales” in instances where those terms appeared throughout the draft—and to make other conforming changes necessitated by changes in language used in the definitions.

- **SUBSTANTIVE AMENDMENTS TO REGULATIONS DUE TO CHANGES IN DEFINITIONS:** The work group also recognized that other substantive amendments would be necessary as a result of changes to the definitions of “apportionable income” and “receipts.”

- **IDENTIFICATION OF ISSUES FOR THE UNIFORMITY COMMITTEE:** The work group requested uniformity committee guidance on certain issues and that guidance was provided at the July 2015 meeting, as follows:
  - The committee directed the work group to retain the five-year rule for transitioning property from apportionable to nonapportionable income.
The committee instructed the work group to eliminate the reserved language within the “Determination of a Unitary Business” portion of the regulations considering the proposed MTC passive holding company regulation has not been promulgated.

The committee indicated that the draft amendments could appropriately include lists of income which are, or are not, receipts. The work group elected to formulate exclusions from “receipts” as presumptions.

The committee directed that definitions be included for terms such as “hedging” and “securities.”

The committee indicated that it was appropriate to remove Section 18 language from the draft, pending the drafting of new Section 18 language.

The committee discussed treatment of insubstantial amounts of gross receipts. The work group retained existing language addressing such receipts, but solely as a description of a specific situation following the definition of “receipts.”

The committee directed the work group to consider the inclusion of foreign entities’ receipts under tax haven rules.

SECTION 17 WORK GROUP

- **USE OF MASSACHUSETTS MARKET SOURCING REGULATIONS AS A STARTING DRAFT:** At the December in-person meeting in 2014, the uniformity committee voted to use Massachusetts’ market-based sourcing regulations as a starting draft for the model regulations. The work group walked through the regulations in detail and made a number of changes, including several minor changes and a few more substantive changes, based on discussions of the rules and their general effect. The work group materials are archived in the commission’s website under the project tab.

- **IDENTIFICATION OF ISSUES FOR THE UNIFORMITY COMMITTEE:** The work group requested uniformity committee guidance on certain issues and that guidance was provided at the July 2015 meeting, as follows:

  - The committee recommended that the examples remain in the body of the regulation under their appropriate topics.

  - The committee approved an amendment to the rules that included “Credit Card Processing Services” with examples of “Professional Services.”
The committee declined to approve any *de minimis* exception for sourcing of certain categories of service receipts, although it instructed the work group to continue to look into the subject.

The committee asked the work group to look into the possibility of modifying “doing business/subject to tax” standards to take international jurisdictional standards into account.

The committee approved language providing that: (1) Section 18 remained fully applicable to receipts sourced under Section 17, and (2) Section 18 regulations would take precedence over more general Section 17 regulations.

The committee instructed the work group to form a special subgroup of interested separate filing states to draft rules for transactions with related parties.

Note that the uniformity committee has adopted the Uniform Law Commission Drafting Rules and the draft amendments have been conformed, to the extent feasible to do so, to those rules.
SUMMARY OF THE DRAFT AMENDMENTS

SECTION 1

The Section 1 amendments were necessitated by the change in the definition of "business" (now “apportionable”) income and in the definition of "sales" (now “receipts”). See Appendix B. Throughout the document, conforming changes were made to reflect both the change in terms and the change in the language of the definitions. In addition, because the definition of "receipts" was narrowed to include only transactional receipts (that is, receipts that meet the transactional provision of the definition of apportionable income, as opposed to those that only meet the functional provision), a number of substantive changes also had to be made. It should be noted that the regulations previously interpreted the definition of “sales” narrowly, so some changes were made to reflect that this narrow interpretation is now explicitly reflected in the language of the Art. IV definition.

The changes to the definition of apportionable income affected the “functional test” in particular. Some examples were modified to conform to the new language in the Art. IV definition. Other terms in the definitions were defined. And, as discussed above, Section 18 regulations no longer applicable were removed.

SECTION 17

The amendments to Section 17 are comprehensive and so they are sometimes referred to as draft regulations (rather than amendments).

The draft regulations begin with a “General Rules” section which outlines the basic approach to market-based sourcing, provides definitions, sets out general principles of application including rules for reasonably approximating the location of delivery to the marketplace, the ability of taxpayers and tax authorities to make adjustments to returns, and the interaction of Section 17 rules with equitable apportionment rules. The draft includes certain rules for related party transactions.

The draft regulations address receipts from real property as well as rental or lease receipts. The draft follows the language of the changes to Section 17 as well as the commission’s existing regulations in assigning real property receipts to the location of the real property by specifying that the “market” for that property is co-extensive with its location. Similarly, the draft follows the changes to Section 17 existing model regulations in assigning those receipts to the location(s) of the property; in the case of mobile property, the assignment is accomplished by prorating the time spent in each jurisdiction.
For services, the draft begins with a general statement that services are sourced based on the taxpayer’s market, not the taxpayer’s own location, and identifies three categories of services with different rules of assignment for each.

In-person services are sourced to the place of delivery to the customer. The working group recommended removing sections on “delivery” and “transportation” services from the Massachusetts model since these industries are subject to special industry regulation in most states and under commission rules. Services “Delivered to the Customer or on Behalf of the Customer, or Delivered Electronically Through the Customer” is the second category of services but essentially includes all services other than in-person or professional services. Sourcing of these services depends on the nature of the service, the nature of the customer, and the means of delivery. The third category of services is “professional services.” In the case of professional services delivered to a business, the receipts are assigned to the place where the contract is managed, and if that is not determinable, to the place where the order was placed, and if that is not determinable, to the customer’s billing address.

The draft addresses intangibles that are effectively the sales of goods or services (e.g. electronic or digital goods) as well as “marketing” intangibles and “production” intangibles. Marketing intangibles are defined as the right to use intangible property in connection with the sale of goods or services to customers, and are assigned to the place where that ultimate sale occurs. Production intangibles are defined as property primarily valuable for its use in a production capacity. The draft also prescribes rules for “mixed intangibles.” Only receipts of certain types of intangible property sales are sourced. All other sales receipts are excluded from the receipts factor, following the changes made to Section 17. The treatment of software will depend on its underlying characteristics.
HEARING OFFICER COMMENTS/RECOMMENDATIONS

COMMENTS RECEIVED AND CONSIDERED

Written or oral comments were submitted by five different parties. All of the comments were well-considered and address serious issues. The written comments are attached to this Report in Appendix C. I will address each of them in turn. Note that all references to page numbers are to this report and its appendices.

A. Comments by Council on State Taxation (COST) - The Vice President and General of COST, Karl Frieden, on behalf of COST, proposed that various provisions be modified, first in a letter dated December 9, 2015 and then in a letter dated March 7, 2016 in which he also proposed changes to the regulation language to effectuate the modifications.

1. Reg. IV.17.(a)(7)(B) [pages 66-67]. This provision states generally that, if a taxpayer files an original return for a taxable year in which it properly assigns its receipts using a method of assignment in accordance with section 17, neither the tax administrator nor the taxpayer may subsequently modify the taxpayer’s methodology for that taxable year.

COST essentially argues that taxpayers should be allowed to change the sourcing methodology they have used, by amending open returns, so long as the replacement methodology also comports with section 17. At the hearing, Mr. Frieden explained that, particularly in the early years after adoption of market-based sourcing rules by a state, taxpayers will find sourcing challenging and should be accorded the freedom to revise their initial methodology even if it were reasonable and reflected the law.

I do not find subsection (a)(7)(B) as drafted unreasonable. First, section 17 is generally taxpayer-friendly and gives taxpayers flexibility to source receipts. Second, although applying market-based sourcing principles can be complicated, states give taxpayers substantial time to prepare and file returns. As I expressed at the hearing, there is a value to finality. In addition, allowing sourcing methodology to be revised after a return is filed may encourage some taxpayers to take the process of preparing their return less seriously than they should.

COST asserts that prohibiting taxpayers from modifying the sourcing methodology they have utilized in preparing their return is “one sided” because tax agencies are allowed to challenge sourcing methodologies on audit. But subsection (a)(7)(B) expressly states that neither the taxpayer nor the tax agency may modify a proper methodology. It is the case that tax agencies may adjust a taxpayer’s assignment of
receipts under certain circumstances: if the taxpayer did not act in accordance with section 17, used a method of approximation which was not reasonable or was not applied in a consistent manner, excluded receipts from the denominator of its receipts factor inappropriately, has failed to retain contemporaneous records, or engaged in certain tax avoidance activities. See subsection (a)(7)(C) [page 67]. However, none of these situations authorizes a tax agency to modify a lawful sourcing methodology used by a taxpayer because there may be an alternative methodology that in some sense is better.

For these reasons, I do not recommend that the commission adopt COST’s proposed change to subsection (a)(7)(B). However, to avoid confusion regarding the authority of tax agencies to modify the methodology utilized by a taxpayer, I recommend that the following sentence be added to the end of the introductory sentence contained in subsection (a)(7)(C): “The provisions contained in this Reg.IV.17.(a)(7)(C) are subject to Reg. IV.17.(a)(7)(B).

2. Reg. IV.17.(a)(7)(D) [page 68]. This provision authorizes a taxpayer to change the method of sourcing receipts from the methodology it used in previous years but only “for purposes of improving the accuracy of assigning its receipts . . . including for example to address the circumstance where there is a change in the information that is available to the taxpayer.” COST argues that this condition places an undue burden on taxpayers. Not only would taxpayers be required to demonstrate that the new methodology satisfies the general requirements of section 17, but they also would need to demonstrate that the new methodology is an improvement over the methodology they used previously.

I suspect that COST’s concerns are overblown because revenue departments typically would not challenge a methodology that meets the general requirements of section 17, even if it diverges from the methodology used by the taxpayer in prior years. Moreover, the draft language I quote in the previous paragraph gives taxpayers substantial room to make adjustments.

Nevertheless, I think it is reasonable to allow taxpayers to adjust their methodology without in effect having to justify the change so long as the new methodology meets the general requirements of section 17. What is essential is that the methodology used in any year is lawful, and I see no compelling reason to require taxpayers to in effect jump through another hoop because of a decision made in a prior year. If the commission and the states adopt this change proposed by COST and then observe over time that taxpayers are changing methodologies so frequently as to suggest some form of manipulation, they can either restore the condition to the regulation or adopt some more narrow limitation to prevent
taxpayers from changing their sourcing methodology from year to year. I therefore recommend that the commission delete the condition contained in subsection (a)(7)(D) that I quote above.

COST also proposes that language be stricken from this provision that requires taxpayers to retain and provide to the tax administrator documents that explain the nature and extent of any change, and the reason for the change. This suggestion also seems reasonable to me. If a taxpayer can defend its sourcing methodology in any year under the requirements of the statute and regulations, that ought to be sufficient.

3. Reg. IV.17 Subsections: (d)(3)(B)2.b.iii [pages 76-77]; (d)(3)(B)2.b.iv [page 77]; (d)(4)(C)(1)(a) [page 87]; (d)(4)(C)(1)(b) [page 87]; (d)(4)(C)(1)(c) [pages 87-88]. These provisions prevent a taxpayer from assigning receipts to a customer’s billing address if the taxpayer derives more than 5% of its receipts from sales to that customer or from relying on certain safe harbors if it derives more than 5% of its receipts with respect to a customer. In its written submission, COST argues that this restriction places an undue constraint on the use of billing address, a rule that otherwise encourages flexibility and ease of compliance. During the oral hearing, Mr. Frieden suggested that a higher threshold, say 25%, might be reasonable.

I am of the opinion that the 5% threshold is a reasonable restriction and reflects a sensible compromise between two compelling principles. On the one hand, allowing the use of billing address to assign receipts reduces what otherwise might be a significant burden on taxpayers. But on the other hand, billing addresses can be easily manipulated. Requiring taxpayers to engage a maximum of twenty major customers in order to determine where a service is actually used or to obtain other information described in section 17, although not ideal, is a reasonable middle ground to protect the integrity of the tax system.

4. Reg. IV.17.(d)(e)(3) [page 95]. This subsection sets forth the rule for assigning fees paid by a licensee for the right to use a so-called production intangible. COST argues that the rule, which incorporates two different presumptions, is unfair and burdensome to taxpayers because it creates a presumption that 100% of the use of a production intangible occurs in the state if the tax administrator can establish that any use of the intangible takes place there.

As I expressed at the hearing, I find that this subsection is confusing because it contains both the presumption criticized by COST and also a second presumption that looks to the state of the licensee’s commercial domicile, and it is unclear how they relate. However, I do not find the presumption criticized by COST to be
unreasonable, in as much as it is just a presumption. Tax administrators often will not be in a position to determine where production intangibles are used. Placing the burden on the taxpayer to determine where use occurs, in cases where there is evidence that some use takes place in the state, seems like the best and perhaps only reasonable way to allocate the burden of gathering the relevant facts.

Here is possible substitute language to clarify the language contained in the draft amendments:

(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. 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). 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.

B. Comments by the American Bar Association Tax Section - By letter dated March 1, 2016, the Section of Taxation of the American Bar Association proposed that an additional provision be added to the draft amendments. This provision states that “[w]henever a taxpayer is subjected to different sourcing methodologies regarding intangibles or services by the [State Tax Agency] and one or more other state taxing authorities, the taxpayer may petition for, and the [State Tax Agency] shall participate in, and encourage the other state taxing authorities” to participate in non-binding mediation.

This proposal obviously responds to the possibility of multiple taxation, given that states have in place different sourcing rules and that the risk of multiple taxation may be
particularly high at the present time since some but not all states have moved from a cost of performance regime to market based sourcing.

Arguably, states should have little reason to oppose nonbinding mediation because by definition it would not impose any outcome on them. However, I am hesitant to recommend that this provision be adopted. First, I am not convinced mediation is practical. In many situations, fewer than all of the relevant states having nexus over a taxpayer will have adopted the mediation provision, leading to cases where some states but not others would be required to participate in a mediation. I assume that in many instances states will be at different stages of the audit process with respect to a taxpayer, or some states may not have commenced an audit, or may not even be contemplating an audit, yet the taxpayer may feel that all of the states must participate in mediation if it is to be useful.

In the absence of evidence that unfair, multiple taxation is occurring to any material degree (evidence that was not presented at the hearing and which has not come to my attention), I am of the opinion that the best approach is for tax administrators to consider claims by taxpayers of multiple taxation as part of current formal and informal procedures, and then to consider relief when compelling. The best solution is for states to adopt uniform sourcing rules in order to minimize the possibility of multiple taxation. In the interim, mediation can be reconsidered if multiple taxation becomes a real problem. Second, it is not clear to me how mediation can address multiple taxation if the cause arises from tax statutes that impose conflicting sourcing rules.

C. Comments of Wood Miller - Wood Miller, member of the Missouri Department of Revenue, speaking for himself, identified a drafting error in Reg. IV.17.(d)(3)(B)(2)(b)(v) [page 52 of the redlined version] The staff of the MTC has informed me that this language has been corrected.

D. Comments of Benjamin Miller - Benjamin Miller submitted a letter to me, dated March 14, 2016, identifying a number of concerns.

I recommend that the language change he proposes to Reg. IV.17.(d)(3)(B)(1)(c) [page 73] be adopted (replacing “transacts” with “contracts”). I also recommend that Example vi contained in Reg. IV.17.(d)(3)(B)(3)(d) [page 84] be revised as follows to address the confusion he mentions:

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, but for purposes of analysis it does not matter. See Reg. IV.17.(e).(5) . . . [remainder as written].

Mr. Miller’s points regarding Reg. IV.17.(a)(3)(G) [page 63] (regarding use of population data) are well taken. However, staff of the commission has indicated to me that the working group was not able to find useable population data from sources other than the U.S. Census Bureau. With respect to Mr. Miller’s point that it is necessary to limit geographical areas outside of the United States, in the absence of population data to effectuate this idea, the drafters have relied upon language that allows for some flexibility. See, e.g., Reg.17.(d)(3)(c)(i) [page 81] (“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.”); Reg.17.(e)(2) [page 95] (“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.”). Alternative apportionment under section 18 also may provide a solution.

I disagree with Mr. Miller’s comment that Reg. IV.17.(a)(7)C)(6) [page 68] should be deleted. This subsection states that if the tax administrator concludes that a customer’s billing address was selected by the taxpayer for “tax avoidance purposes,” he or she may adjust the assignment of receipts to that customer. He argues inter alia that this provision is unnecessary and also that tax administrators will find it very difficult to apply because it lacks a standard. As I discussed above, given that billing addresses can be manipulated with relative ease, I recommend that the tool contained in this subsection be retained.

With respect to his proposal that services involving some type of hearing be sourced to the location of the hearing, I am not persuaded that it is superior to the sourcing rule relating to legal services contained in the proposed amendments. See IV.17.(d)(4)(B)(1) and (C) [pages 85-87 and 90-91].

E. Comments of Jamie Yesnowitz - At the hearing, Jamie Yesnowitz presented oral comments on his own behalf. He raised the question of whether the tendency of the draft amendments to narrow the receipts to be included in the apportionment factor may cause distortion and even constitutional concerns. I asked Helen Hecht, MTC General Counsel, to react to this comment during the hearing, and she responded that it is in part to address this subject that a working group to examine Section 18 has been formed. In light of her response, I defer to the Section 18 working group to address Mr. Yesnowitz’s concern.

Mr. Yesnowitz also expressed a concern about the complexity of the draft amendments and the possibility that taxpayers will as a result disregard them and instead “use billing
address, and just wait for consequences.” The amendments are indeed complex, but I think unavoidably so given the complexity of the modern economy. Certainly a growing number of states, and now the commission, have concluded that cost of performance is no longer as a satisfactory way to apportion income. My hope is that taxpayers and their representatives will see the amendments as a guide that addresses their real world transactions and in relatively short order internalize them. Perhaps the relatively small number of comments that have been submitted to the hearing officer in this proceeding reflects a consensus that there is no other realistic way to apportion income arising from the sale of services and the licensing or sale of intangibles.

General Recommendation

Although I am not recommending that the commission adopt all of the revisions that have been submitted, I recognize that experience may well show that the amendments do not address all scenarios in an optimal way. Indeed, given the complexities of the modern economy, it seems likely that some parts of the section 17 rules will be found wanting. I therefore encourage the commission to commit to reexamining these sourcing rules after a reasonable period of time passes.

SUMMARY OF RECOMMENDED CHANGES

Change Reg. IV.17.(a)(7)(C) [page 67] as follows:

(C) [Tax Administrator] Authority to Adjust a Taxpayer’s Return. The provisions contained in this Reg. IV.17.(a)(7)(C) are subject to Reg. IV. 17.(a)(7)(B). 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.

Change Reg. IV.17.(a)(7)(D) [page68] as follows:

(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.

Change Reg. IV.17 (d)(e)(3) [page 95] as follows:

(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). 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.

Change Reg. IV.17.(d)(3)(B)(1)(c) Example (i) [page 73] as follows:

Example (i). Direct Mail Corp, a corporation based outside [state], provides direct mail services to its customer, Business Corp. Business Corp transacts contracts 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]).

Change Reg. IV.17.(d)(3)(B)(3)(d) [page 84] as follows:

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 but for purposes of analysis it does not matter. See Reg. IV.17.(e).(5). 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.c.ii. Note that it does not matter for purposes of the analysis whether Wholesale Corp’s sale of database access constitutes a service or a license of intangible property, or some combination of both. See 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).
APPENDIX A.

Multistate Tax Commission
Allocation and Apportionment Regulations


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

(2) **Business Apportionable Income.** Business**Apportionable** 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), 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, non-operating income, etc., is of no aid in determining whether income is business**apportionable** or non-business**apportionable** income.

(3) **Terms Used in Definition of Business Income and in Application of Definition.** “Trade or business,” as used in the definition of business**apportionable**
income and/or in the application of the 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, 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 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 or business, each part of which gave value was used to every other part, in a manner which materially contributed to the production of business income. Direct or indirectly, without regard to the materiality of the contribution.

(A) Under the functional test, business income need 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. It was not directly employed in the operation of the taxpayer’s trade or business.

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 by the taxpayer’s trade or business exclusively and is held solely for unrelated investment purposes has lost its character as a business asset and is not subject to the rule of the preceding sentence. 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 business-apportionable income, if the property is or was used unrelated 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 business-apportionable 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 business-apportionable 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, 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 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.

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**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 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 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).

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 business apportionable 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 short-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.

Example (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
(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 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 business apportionable 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 business apportionable 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 business apportionable income.

Example (iv): Same as (ii) except that the plant was rented while being held for sale. The rental income is business apportionable income and the gain on the sale of the plant is business apportionable 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 business apportionable 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 business apportionable 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 business apportionable 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 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 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 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 apportional 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 business apportionable 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 business apportionable income arising from a
particular trade or business or to a particular item of nonbusiness non-apportionable income. In some cases, an allowable deduction may be applicable to the business apportionable incomes of more than one trade or business and/or to several items of nonbusiness non-apportionable income. In such cases, the deduction shall be prorated among those trades or businesses and those items of nonbusiness non-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 business apportionable income between states by the use of a formula containing apportionment factors.

(3) "Allocation" refers to the assignment of nonbusiness non-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 [and includes] the acquisition, employment, development, management, and/or disposition of property that constitute integral parts [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 have been recognized under the Internal Revenue Code if the transaction 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.

(F) 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;
2) property acquired by an agent on behalf of another;
3) tax refunds and other tax benefit recoveries;
4) pension reversions;
5) contributions to capital (except for sales of securities by securities dealers);
6) income from forgiveness of indebtedness; or
7) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code; or
8) 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.

(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] of this state upon his/her request evidence to support that assertion. The [tax administrator] 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 business apportionable 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 sales receipts 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 nonbusiness non-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 nonbusiness non-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.


(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.


(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.


(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 business apportionable 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 business apportionable 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 integral related to the operation of the taxpayer's trade or business. Since the subrents are business apportionable 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 nonbusiness non-apportionable income they are to be deducted from not included in the rent paid by the 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 x 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 x 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.
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(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 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:

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<td>$25,000</td>
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<tr>
<td>Total</td>
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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).

(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 sales 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 sales 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) 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). SalesFactor: Denominator. The denominator of the sales 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.(c).these regulations.

*** Reg. IV.15.(c). SalesFactor: Numerator. The numerator of the sales 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). SalesFactor: 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.

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**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 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
[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).


(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. 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). 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.ii. 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.


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.i. 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.c.ii. Reg. IV.17(d).(3)(B)3.bReg. IV.17(d).(3)(B)3.bReg. IV.17(d).(3)(B)3.bReg. 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).**¹ 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 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).**² 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).**³ 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. *See Rule re: Financial Institutions, Reg. IV.17.(d).(4)(C)3, p. 26.*

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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]. 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.
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 Regs. 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.

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.

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).

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.

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 multipl
plying 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.


(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).(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).(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 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 c), 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.

Example (ii). 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.
APPENDIX B.

NOTE: The revisions below are as of July 30, 2015, after conforming amendments and certain amendments to Art. IV, Sec. 18 had been approved by the commission.

Article IV. Division of Income.

1. As used in this Article, unless the context otherwise requires:

   (a) “Business income” “Apportionable income” means:

      (i) all income that is apportionable under the Constitution of the United States and is not allocated under the laws of this state, including:

         (A) income arising from transactions and activity in the regular course of the taxpayer’s trade or business and includes,

         and

         (B) income arising from tangible and intangible property if the acquisition, management, employment, development and disposition of the property constitute integral parts is or was related to the operation of the taxpayer’s regular trade or business; and

      (ii) 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.

   (b) “Commercial domicile” means the principal place from which the trade or business of the taxpayer is directed or managed.

   (c) “Compensation” means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

   (d) “Financial organization” means any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank, small loan company, sales finance company, investment company, or any type of insurance company.
(e) “Nonbusiness income” means all income other than business income.

(f) “Public utility” means any business entity (1) which owns or operates any plant, equipment, property, franchise, or license for the transmission of communications, transportation of goods or persons, except by pipeline, or the production, transmission, sale, delivery, or furnishing of electricity, water or steam; and (2) whose rates of charges for goods or services have been established or approved by a Federal, State or local government or governmental agency.

(g) “Sales Receipts” means all gross receipts of the taxpayer that are not allocated under paragraphs of this article, and that are received from transactions and activity in the regular course of the taxpayer’s trade or business; except that 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.

(h) “State” means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any Territory or Possession of the United States, and any foreign country or political subdivision thereof.

(i) “This State” means the State in which the relevant tax return is filed or, in the case of application of this Article to the apportionment and allocation of income for local tax purposes, the subdivision or local taxing district in which the relevant tax return is filed.

2. Any taxpayer having income from business activity which is taxable both within and without this State, other than activity as a financial organization or public utility or the rendering of purely personal services by an individual, shall allocate and apportion his net income as provided in this Article. If a taxpayer has income from business activity as a public utility but derives the greater percentage of his income from activities subject to this Article, the taxpayer may elect to allocate and apportion his entire net income as provided in this Article.

3. For purposes of allocation and apportionment of income under this Article, a taxpayer is taxable in another State if (1) in that State he is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that State has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the State does or does not do so.

4. Rents and royalties from real or tangible personal property, capital gains, interest, dividends or patent or copyright royalties, to the extent that they constitute
5. (a) Net rents and royalties from real property located in this State are allocable to this State.

(b) Net rents and royalties from tangible personal property are allocable to this State: (1) if and to the extent that the property is utilized in this State, or (2) in their entirety if the taxpayer’s commercial domicile is in this State and the taxpayer is not organized under the laws of or taxable in the State in which the property is utilized.

(c) The extent of utilization of tangible personal property in a State is determined by multiplying the rents and royalties by a fraction the numerator of which is the number of days of physical location of the property in the State during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, tangible personal property is utilized in the State in which the property was located at the time the rental or royalty payer obtained possession.

6. (a) Capital gains and losses from sales of real property located in this State are allocable to this State.

(b) Capital gains and losses from sales of tangible personal property are allocable to this State if (1) the property had a situs in this State at the time of the sale, or (2) the taxpayer’s commercial domicile is in this State and the taxpayer is not taxable in the State in which the property had a situs.

(c) Capital gains and losses from sales of intangible personal property are allocable to this State if the taxpayer’s commercial domicile is in this State.

7. Interest and dividends are allocable to this State if the taxpayer’s commercial domicile is in this State.

8. (a) Patent and copyright royalties are allocable to this State: (1) if and to the extent that the patent or copyright is utilized by the payer in this State, or (2) if and to the extent that the patent or copyright is utilized by the payer in a State in which the taxpayer is not taxable and the taxpayer’s commercial domicile is in this State.

(b) A patent is utilized in a State to the extent that it is employed in production, fabrication, manufacturing, or other processing in the State or to the extent that a patented product is produced in the State. If the basis of receipts from patent
royalties does not permit allocation to States or if the accounting procedures do not reflect States of utilization, the patent is utilized in the State in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized in a State to the extent that printing or other publication originates in the State. If the basis of receipts from copyright royalties does not permit allocation to States or if the accounting procedures do not reflect States of utilization, the copyright is utilized in the State in which the taxpayer's commercial domicile is located.

9. All business apportionable income shall be apportioned to this State by multiplying the income by a fraction, [State should define its factor weighting fraction here. Recommended definition: “the numerator of which is the property factor plus the payroll factor plus two times the sales receipts factor, and the denominator of which is three-four.”]

10. The property factor is a fraction the numerator of which is the average value of the taxpayer’s real and tangible personal property owned or rented and used in this State during the tax period and the denominator of which is the average value of all of the taxpayer’s real and tangible personal property owned or rented and used during the tax period.

11. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

12. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period; but the tax administrator may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer’s property.

13. The payroll factor is a fraction the numerator of which is the total amount paid in this State during the tax period by the taxpayer for compensation and the denominator of which is the total compensation paid everywhere during the tax period.

14. Compensation is paid in this State if:

(a) the individual’s service is performed entirely within the State;

(b) the individual’s service is performed both within and without the State, but the service performed without the State is incidental to the individual’s service within the State; or
(c) some of the service is performed in the State and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the State, or (2) 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 individual’s residence is in this State.

15. The sales receipts factor is a fraction the numerator of which is the total sales receipts of the taxpayer in this State during the tax period and the denominator of which is the total sales receipts of the taxpayer everywhere during the tax period.

16. Sales Receipts from the sale of tangible personal property are in this State if:

(a) the property is delivered or shipped to a purchaser, other than the United States Government, within this State regardless of the f.o.b. point or other conditions of the sale; or

(b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this State and (1) the purchaser is the United States Government or (2) the taxpayer is not taxable in the State of the purchaser.

17. Sales, other than sales of tangible personal property, are in this State if:

(a) the income-producing activity is performed in this State; or

(a) the income-producing activity is performed both in and outside this State and a greater proportion of the income-producing activity is performed in this State than in any other State, based on costs of performance.

(a) Receipts, other than receipts described in Section 16, are in this State if the taxpayer’s market for the sales is in this state. The taxpayer’s market for sales is in this state:

(1) in the case of sale, rental, lease or license of real property, if and to the extent the property is located in this state;

(2) in the case of rental, lease or license of tangible personal property, if and to the extent the property is located in this state;

(3) in the case of sale of a service, if and to the extent the service is delivered to a location in this state; and

(4) in the case of intangible property.
(i) that is rented, leased, or licensed, if and to the extent the property is used in this state, provided that intangible property utilized in marketing a good or service to a consumer is “used in this state” if that good or service is purchased by a consumer who is in this state; and

(ii) that is sold, if and to the extent the property is used in this state, provided that:

(A) a contract right, government license, or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area is “used in this state” if the geographic area includes all or part of this state;

(B) receipts from intangible property sales that are contingent on the productivity, use, or disposition of the intangible property shall be treated as receipts from the rental, lease or licensing of such intangible property under subsection (a)(4)(i); and

(C) all other receipts from a sale of intangible property shall be excluded from the numerator and denominator of the receipts factor.

(b) If the state or states of assignment under subsection (a) cannot be determined, the state or states of assignment shall be reasonably approximated.

(c) If the taxpayer is not taxable in a state to which a receipt is assigned under subsection (a) or (b), or if the state of assignment cannot be determined under subsection (a) or reasonably approximated under subsection (b), such receipt shall be excluded from the denominator of the receipts factor.

(d) [The tax administrator may prescribe regulations as necessary or appropriate to carry out the purposes of this section.]

18. (a) If the allocation and apportionment provisions of this Article 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.

(b)

(1) If the allocation and apportionment provisions of this Article do not fairly represent the extent of business activity in this State of taxpayers engaged in a particular industry or in a particular transaction or activity, the tax administrator may, in addition to the authority provided in section (a), establish appropriate rules or regulations for determining alternative allocation and apportionment methods for such taxpayers.

(2) A regulation adopted pursuant to this section shall be applied uniformly, except that with respect to any taxpayer to whom such regulation applies, the taxpayer may petition for, or the tax administrator may require, adjustment pursuant to Section 18(a).

(c) The party petitioning for, or the [tax administrator] requiring, the use of any method to effectuate an equitable allocation and apportionment of the taxpayer’s income pursuant to subsection (a) must prove by [Drafter’s note: insert standard of proof here]:

(1) that the allocation and apportionment provisions of this Article do not fairly represent the extent of the taxpayer’s business activity in this State; and

(2) that the alternative to such provisions is reasonable.

The same burden of proof shall apply whether the taxpayer is petitioning for, or the [tax administrator] is requiring, the use of any reasonable method to effectuate an equitable allocation and apportionment of the taxpayer’s income. Notwithstanding the previous sentence, if the tax administrator can show that in any two of the prior five tax years, the taxpayer had used an allocation or apportionment method at variance with its allocation or apportionment method or methods used for such other tax years, then the tax administrator shall not bear the burden of proof in imposing a different method pursuant to (a).

(d) If the [tax administrator] requires any method to effectuate an equitable allocation and apportionment of the taxpayer’s income, the [tax administrator] cannot impose any civil or criminal penalty with reference to the tax due that is attributable to the
taxpayer's reasonable reliance solely on the allocation and apportionment provisions of this Article.

(e) A taxpayer that has received written permission from the [tax administrator] to use a reasonable method to effectuate an equitable allocation and apportionment of the taxpayer's income shall not have that permission revoked with respect to transactions and activities that have already occurred unless there has been a material change in, or a material misrepresentation of, the facts provided by the taxpayer upon which the [tax administrator] reasonably relied.
APPENDIX C.

The written comments received are reproduced in the following pages.
March 7, 2016

Via E-Mail

Brian Hamer
Hearing Officer

Multistate Tax Commission
444 N. Capitol Street, NW
Suite 425
Washington, DC 20001

Re: COST Comments on Proposed Section 17 Model Market Sourcing Regulations

Dear Hearing Officer Hamer,

This letter is a follow up to the comments submitted on behalf of the Council On State Taxation (COST) during the MTC Fall Committee Meetings in December. At the time I expressed our concerns regarding certain provisions within the Section 17 model market-sourcing regulations drafted by the UDITPA Section 17 Work Group. This letter provides some suggested language changes to the draft regulations that would address our concerns. Please share our comments and suggested language changes with the members of the Executive Committee.

Even-Handedness in Tax Administration

The COST Board of Directors has also adopted a formal policy statement on fair, efficient, and customer-focused tax administration. That policy statement position is:

Fair, efficient and customer-focused tax administration is critical to the effectiveness of our voluntary system of tax compliance. A burdensome, unfair, or otherwise biased administrative system negatively impacts tax compliance and hinders economic competitiveness.
INTRODUCTION

At its January 29, 2016 meeting, the Multistate Tax Commission’s (“MTC”) Executive Committee directed that a public hearing be held on the proposed draft amendments to the MTC’s model general allocation and apportionment regulations (the “Proposed Draft Amendments”). The Proposed Draft Amendments had been approved by the MTC’s Uniformity Committee on December 11, 2015 and referred to the Executive Committee for its consideration.

COMMENTS

The SALT Committee appreciates the opportunity to comment on the Proposed Draft Amendments. Our Comments are limited to a recommendation that the amended model regulations include a provision to facilitate the resolution of apportionment issues where the same receipts from sales of services or intangibles are sourced to multiple states due to differences in those states’ apportionment methods.

We recommend an addition of the following provision to the Proposed Draft Amendments:

Whenever a taxpayer is subjected to different sourcing methodologies regarding intangibles or services, by the [State Tax Agency] and one or more other state taxing authorities, the taxpayer may petition for, and the [State Tax Agency] shall participate in, and encourage the other state taxing authorities to participate in, non-binding mediation in accordance with the alternative dispute resolution rules promulgated by the Multistate Tax Commission from time to time, regardless of whether all the state taxing authorities are members of the Multistate Tax Compact.

This recommendation is based on an identical provision in Alabama Admin. Code r. 810-27-1-4.17.01(d). (Alabama has also amended § 17 of its version of the Uniform Division of Income for Tax Purposes Act (“UDITPA”) based on MTC’s new model § 17 sourcing statute.) The goal is to provide a mechanism for both taxpayers and states to address the impact of non-uniform state apportionment methodologies.

We believe such a mechanism is needed and strongly desirable. There is now greater non-uniformity among states with respect to sourcing receipts from intangibles and services than at any time since states adopted UDITPA. While the majority of states still apply the cost-of-performance method to source these receipts, numerous states have moved to some form of market-based sourcing. Further, states that have adopted market-based sourcing have chosen a number of different sourcing methodologies. Some states now source these receipts based on where services are provided or intangibles used, others on where the benefit of the service or intangible is received, and still others on where the taxpayer’s billing or main office is located. As a result, the same receipts from the sale of services or intangibles could be sourced to multiple states.

The proposed mediation provision furthers the MTC’s goals of promoting state income tax uniformity and facilitating the settlement of apportionment disputes, while respecting the right and authority of states to adopt their own apportionment methodologies.²

Any mediation would be nonbinding. However, nearly all states have the statutory authority to apply alternate apportionment methodology in appropriate circumstances. The avoidance of duplicate taxation is a key and laudatory goal.³ Nonbinding mediation does not mandate uniformity or ensure that the receipts will not be sourced to more than one state. It does, however, provide a mechanism to address these issues and for the affected states and taxpayers to discuss and attempt to resolve them in a manner satisfactory to all parties. That is entirely consistent with, and would further, the MTC’s mission.

² See Multistate Tax Compact Article I, §§ 1 and 2.
³ See Multistate Tax Compact Article I, § 4.
March 14, 2016

Dear Mr. Hamer

Pursuant to the extension of time to March 16, 2016, I am submitting these comments as an individual who has worked in the area of state income taxation for over 45 years. Page references are to the Redline version of the proposed regulations dated January 6, 2016.

Pg 40 (a)(3)(G)

Population is defined solely by reference to data maintained by the United States Census Bureau. Multijurisdictional taxpayers do not necessarily confine their activities to areas which the United States Census Bureau maintains statistics. It may be necessary to provide a resource for population statistics for other areas. If the data is expanded to include country data there may also, be a need for limiting the geographic areas to subsets. For example, several of the Asian countries have populations in the billions but only a portion of their populations might represent a market for taxpayers. If the total population of these countries were included in any assignment rules based upon population data they would likely result in an over-weighting of their contribution to the market for the taxpayers goods or services.

Pg 43 (a)(7)(C)(6)

Adjustments are allowed when a tax administrator concludes that the billing address was selected by the taxpayer for “tax avoidance purposes.” This subsection should be struck.

It is unnecessary.
No standard is provided for making this determination. It is not clear whether it must be the exclusive purpose, the primary purpose, or a minor purpose. Without a standard it will be difficult to enforce. Depending on the standard, which almost certainly will be subjective, it may be extremely difficult for the tax administrator to meet it.

Finally, it is inappropriate to include the language “tax avoidance” in a general rule not designed to address improper conduct by a taxpayer.

Pg 49  (d)(3)(B)(1)(c) Example(i) end of second line
Replace “transacts” with “contracts”

Pg 50  (d)(3)(B)(2)(a)((ii)
Suggest breaking this up into two parts a (ii) and a (iii). With (iii) being the last sentence of the current (ii)

Pg 53  (d)(3)(B)(2)(c) Examples
Suggest making Example (iii) and (iv) subsets of (ii)

Pg 55  (d)(3)(B)(3)(c)(i) and (ii)
The term “area” is used here and in several other places without a definition of area. It appears the intent is that “area” is meant to mean the content is defined in the agreement as being deliverable just to a defined geographic area. Perhaps it is the area serviced by the service that is delivering the content.

Pg 56  (d)(3)(B)(3)(d)Example (i)
The example starts with a “first” and a “second.” Clarity should be provided as to whether the assignment rule applies to both the first and second or perhaps the words “first” and “second” should be stricken with an “and” inserted between the two sentences.
MTC Hearing Officer Report – May 1, 2016
Proposed Draft Amendments to the Model General Allocation and Apportionment Regulations

Pg 58  (d)(3)(B)(3)(d)Example (vi)

Seems to be confused. The second sentence says it could one of two things. The next sentence says assume it is one of those. Then further down in a sentence starting with "Note" it says it does not matter.

Pg 59  (d)(4)(B)1 and (C)

I suggest there should be another category of professional services which need their own assignment rule. Services which are involved in some type of hearing that is specific to a location. An example would be contesting a state tax assessment in either an administrative or judicial proceeding which is held a specific state. The service should be assigned to that specific state.

This is something that is frequently encountered in state taxation of multijurisdictional taxpayers. State A makes a tax assessment against a taxpayer located in State B who is represented by a legal firm or accounting firm with an office in state C. The adjudication of the matter will occur in State A.

This rule should apply in the context of any administrative or judicial proceeding. Arguably it might be classified as an “in-person” proceeding but this should be made clear. The last sentence of this provision takes various professional services, including legal and accounting, out of the in-person service.

Pg 62  (d)(4)(B)5. Examples

Should this be (d)(4)(C)? The examples involve appear to involve all of (d)(4). They are not limited to only the things described in (d)(4)(B).

Pg 78  IV.18(c)

Is there anything left. All that is shown is strike-out of the substantive rules.

Respectfully yours

Benjamin F. Miller
March 1, 2016

Brian Hamer
Hearing Officer
Multistate Tax Commission
444 North Capitol Street, N.W., Suite 425
Washington, DC  20001

Re: Comments on Proposed Draft Amendments to General Allocation and Apportionment Regulations

Dear Mr. Hamer:

Enclosed please find comments on the Multistate Tax Commission’s proposed draft amendments to its model general allocation and apportionment regulations (“Comments”). These Comments are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss the Comments with you or your staff if that would be helpful.

Sincerely,

George C. Howell, III
Chair, Section of Taxation

Enclosure

CCs: Gregory S. Matson, Executive Director, Multistate Tax Commission
Helen Hecht, General Counsel, Multistate Tax Commission
Elliott Dubin, Director of Policy Research, Multistate Tax Commission
These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation (the “Section”). They have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by John H. Gadon and Shirley K. Sicilian, Co-chairs, Task Force on Apportionment & Mediation of the State and Local Tax Committee of the Section of Taxation (the “SALT Committee”). The Comments were authorized by the Executive Committee of the SALT Committee and reviewed by Jaye Calhoun, Chair of the SALT Committee, John Barrie of the Section’s Committee on Government Submissions, Stewart Weintraub, Council Director for the Committee, and Peter Blessing, the Section’s Vice Chair (Government Relations).

Although the members of the Section of Taxation who participated in preparing these Comments have clients who would be affected by the principles addressed by the Comments or have advised clients on the application of such rules, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: March 1, 2016
INTRODUCTION

At its January 29, 2016 meeting, the Multistate Tax Commission’s (“MTC”) Executive Committee directed that a public hearing be held on the proposed draft amendments to the MTC’s model general allocation and apportionment regulations (the “Proposed Draft Amendments”). The Proposed Draft Amendments had been approved by the MTC’s Uniformity Committee on December 11, 2015 and referred to the Executive Committee for its consideration.

COMMENTS

The SALT Committee appreciates the opportunity to comment on the Proposed Draft Amendments. Our Comments are limited to a recommendation that the amended model regulations include a provision to facilitate the resolution of apportionment issues where the same receipts from sales of services or intangibles are sourced to multiple states due to differences in those states’ apportionment methods.

We recommend an addition of the following provision to the Proposed Draft Amendments:

Whenever a taxpayer is subjected to different sourcing methodologies regarding intangibles or services, by the [State Tax Agency] and one or more other state taxing authorities, the taxpayer may petition for, and the [State Tax Agency] shall participate in, and encourage the other state taxing authorities to participate in, non-binding mediation in accordance with the alternative dispute resolution rules promulgated by the Multistate Tax Commission from time to time, regardless of whether all the state taxing authorities are members of the Multistate Tax Compact.

This recommendation is based on an identical provision in Alabama Admin. Code r. 810-27-1-4.17.01(d). (Alabama has also amended § 17 of its version of the Uniform Division of Income for Tax Purposes Act (“UDITPA”) based on MTC’s new model § 17 sourcing statute.1) The goal is to provide a mechanism for both taxpayers and states to address the impact of non-uniform state apportionment methodologies.

We believe such a mechanism is needed and strongly desirable. There is now greater non-uniformity among states with respect to sourcing receipts from intangibles and services than at any time since states adopted UDITPA. While the majority of states still apply the cost-of-performance method to source these receipts, numerous states have moved to some form of market-based sourcing. Further, states that have adopted market-based sourcing have chosen a number of different sourcing methodologies. Some states now source these receipts based on where services are provided or intangibles used, others on where the benefit of the service or intangible is received, and still others on where the taxpayer’s billing or main office is located. As a result, the same receipts from the sale of services or intangibles could be sourced to multiple states.

The proposed mediation provision furthers the MTC’s goals of promoting state income tax uniformity and facilitating the settlement of apportionment disputes, while respecting the right and authority of states to adopt their own apportionment methodologies. ²

Any mediation would be nonbinding. However, nearly all states have the statutory authority to apply alternate apportionment methodology in appropriate circumstances. The avoidance of duplicate taxation is a key and laudatory goal. ³ Nonbinding mediation does not mandate uniformity or ensure that the receipts will not be sourced to more than one state. It does, however, provide a mechanism to address these issues and for the affected states and taxpayers to discuss and attempt to resolve them in a manner satisfactory to all parties. That is entirely consistent with, and would further, the MTC’s mission.

² See Multistate Tax Compact Article I, §§ 1 and 2.
³ See Multistate Tax Compact Article I, § 4.