MEMORANDUM

To: Robynn Wilson, Chairperson,
    Income and Franchise Tax Uniformity Subcommittee

From: Bruce Fort, MTC Counsel
       Lila Disque, MTC Counsel

Date: February 22, 2013

Re: Possible Uniformity Project: Applying State “IRC §482” Authority to Adjust Income and Expenses of Related Parties to Clearly Reflect Income; Summary of Existing State Statutes and Regulations

The Income and Franchise Tax Uniformity Subcommittee continues to consider whether to undertake a uniformity project addressed to the states’ use of explicit or inherent authority to adjust income and expenses among related parties. Internal Revenue Code (“IRC”) § 482 gives authority to the IRS to “distribute, apportion or allocate” gross income or deductions among related entities in order to “prevent evasion of taxes or clearly to reflect the income” of those entities. Although the statute does not limit the means by which such adjustments can be accomplished, the Service has issued extensive regulations governing the use of § 482 authority which are premised on arms-length accounting principles. See 26 C.F.R. §1.482-1-6.¹

A number of states have adopted statutes or regulations allowing for reallocation of income and expenses which employ the language of IRC § 482. At the federal level, § 482 disputes are often resolved with the use of expert testimony and “transfer pricing reports” to establish arms-length prices for multiple inter-company transactions, a process which would constitute a significant

¹ The federal regulations issued under IRC § 482 recognize that in some situations, determination of a fair “transfer price” for goods, services and intangible property is not possible, and in such circumstances authorizes alternative means to estimate taxable income arising from transactions between related parties, including the profit split method and industry averages for profitability. The party seeking to utilize such alternative means has a substantial burden of proof, however, in demonstrating accurate transfer prices cannot be estimated.
administrative and financial burden for many states.\(^2\) In the absence of specific regulatory or statutory guidance, states may believe they are bound by federal arms-length accounting standards and procedures in implementing their statutory authority to reallocate income and deductions among related entities.

A second issue is whether states which have not adopted a separate statute authorizing reallocations of income and deductions may nonetheless have implicit authority to make § 482 reallocations by virtue of their adoption of the federal tax code as their starting point for determining the state tax base.\(^3\)

A model regulation could address when and how states should exercise their explicit or implicit authority to reallocate income and deductions among related parties.

Staff has reviewed statutes and regulations in several states addressing the state’s authority to reallocate income and deductions in order to provide the subcommittee with a picture of the current legal landscape, as summarized below. The relevant statutes and regulations identified by staff are attached as Appendix A.

In total, 31 jurisdictions were identified in which statutes or regulations have addressed the jurisdiction’s authority to adjust reported income and expenses.\(^4\) While there are substantial variations among these statutes and regulations, it is possible to categorize and summarize various aspects of their operations.\(^5\)

1. Twenty-Six States Have Broadly Applicable Authority to Adjust Income and Expenses Among Related Parties.

Staff has identified 26 states (including the District of Columbia as “state” for these purposes) with broadly applicable statutes and/or regulations addressing state authority to adjust income and expenses between related parties. Twelve of those states are considered “separate-entity” states, designated by a (“SE”) in the chart below.

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\(^3\) The state of Idaho appears to have based its regulation asserting the Commission’s authority to adjust income and deductions among related entities solely on its adoption of the federal tax code.

\(^4\) Regulations issued by Ohio and Texas have not been included on this list since the income and franchise taxes in those states have been replaced by other tax programs.

\(^5\) Because this memorandum is intended only as a general guide to the current legal landscape, it should not be considered a definitive exposition of all states’ authority to make adjustment to income and deductions. It is entirely possible that some state authority to make adjustments has been overlooked or mistakenly characterized. Please see the attached Appendix to read the applicable statute or regulation itself for the states discussed.
Two jurisdictions, New York City and the State of Delaware, have granted their tax commissioners authority to make “IRC 482” adjustments in limited circumstances (financial institutions in New York City, City Bus. Incorp. Tax § 19 McK.Consol.Laws, Book 20 App., and Headquarters’ tax in Delaware, Del. Code Ann., Title 30 § 6403).

In the great majority of jurisdictions in which the authority to reallocate income and deductions is explicitly identified, states have chosen to adopt the language of IRC § 482 in whole or in part (using some variation of the phrase “to prevent evasion or taxes or clearly to reflect income”). States which have varied significantly from IRC § 482’s language include New Jersey, North Carolina, Georgia, Montana and Iowa. The statutes in the latter states require adjustments to reflect “fair profits” derived from within the state.

2. Three State Statutes Authorizing Changes to “Accounting Methods” May Provide Authority to Adjust Income and Deductions to Clearly Reflect Income.

Three states (Minnesota, Missouri and Pennsylvania) do not appear to have explicit “482-type” authority but do give tax commissioners the ability to change the “accounting methods” used by a taxpayer to “more clearly reflect” taxable income generated within the state. These statutory provisions sometimes include a grant of authority for the state to calculate taxable income where the taxpayer has failed to file a federal return. The statutes do not address issues such as misalignment of income and deductions arising from transactions between related entities, and similar statutes are found in many states that also have separate “482-type” authority.

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6 Statutes limited to allowing for federal income tax computations in the absence of a federal filing are not addressed in this memo.
3. A Plurality of States Allow Combined or “Consolidated” Reporting as a Means of Reallocating Income and Expenses Among Related Entities.

The states listed in the chart below explicitly recognize that combination or consolidation of related parties is an appropriate means to ensure an equitable reallocation of income and deductions in order to more clearly reflect income. In Kansas, Utah and Colorado, that recognition arose from case law. In Arizona, a presumption exists that a unitary relationship requires combination of income in order to clearly reflect income generated in the state. In Connecticut and New Jersey, the states’ “§482” statutes recognize that combination may be allowed in order to clearly reflect income, but the states’ regulations appear to favor if not require use of arms-length accounting pursuant to federal regulations. In Georgia, regulations specifically contemplate use of “consolidated” reporting to reallocate income and expenses despite a 1972 court decision holding that the statute could not be used to require corporations to file on a unitary combined reporting method.

In Indiana and, to a lesser extent in North Carolina, the state is required to demonstrate that combined reporting is the only practical means of reallocating income and deductions in order to reflect “true income” or prevent evasion of tax.

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<tr>
<td>Louisiana: LSA-R.S. 47:287.480</td>
<td>Massachusetts: G.L. Ch. 63, § 39A</td>
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<td>Mississippi: Miss. Code Ann. § 27-7-37</td>
<td>New Jersey: 54:10A-10</td>
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<td>North Carolina: N.C.G.S.A. § 105-130.5A</td>
<td>Tennessee: T. C. A. § 67-4-2014</td>
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4. Six States Appear to Require Use of Arms-Length Accounting to Reallocate Income and Expenses.

Statutes in California, Maryland and Delaware, and regulations in Alaska, appear to require use of arms-length accounting methodologies in reallocating income and deductions between related parties, with Maryland explicitly requiring use of 26 CFR § 1.482.1 regulations. As set forth above, regulations in New Jersey and Connecticut appear to strongly favor use of federal regulations as well.

In two combined filing states, Hawaii and North Dakota, use of world-wide combined reporting is explicitly forbidden as a means of either preventing tax evasion or reflecting income clearly.
5. The Statutes and Regulations in Six States Do Not Address Whether Combined Filing is an Allowable Means of Reallocation of Income and Deductions.

Staff did not locate guidance specifically stating that combined filing is or is not an appropriate means of implementing the § 482 statutes in the states listed below. In a recent decision by the District of Columbia Office of Administrative Hearings, the administrative law judge held that the District could not use an industry profits methodology allowed by federal regulations because the District had failed to identify specific controlled and uncontrolled transactions which had distorted the taxpayer’s gross income.


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<tr>
<th>State</th>
<th>Statute/Regulation</th>
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<tr>
<td>Alabama</td>
<td>A.R.S. § 43-941</td>
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<tr>
<td>Arkansas</td>
<td>A.C.A. § 26-51-805</td>
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<td>District of Columbia</td>
<td>DC ST § 47-1810.03</td>
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<td>Idaho</td>
<td>Idaho Regs. § 35.01.01.015.02.</td>
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<td>Iowa</td>
<td>2013 Iowa Code, Title X, Ch. 422</td>
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<tr>
<td>Wisconsin</td>
<td>W.S.A. 71.10</td>
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We hope this summary and the attached Appendix will be helpful to the subcommittee.
Appendix A
Excerpts of State Statutes and Regulations Addressing State Authority to Re-Allocate Income, Expenses and Deductions Among Related Parties

Alabama:


§ 40-2A-17. Allocation, etc., of gross income, deductions, etc., between entities controlled by the same interests; improper contingent fees.
(a) In any case of two or more organizations, trades, or businesses (whether or not affiliated within the meaning of 26 U.S.C. § 1504) owned or controlled directly or indirectly by the same interests, the Commissioner of the Alabama Department of Revenue may distribute, apportion, or allocate gross income, deductions, credits, or allowances, if the commissioner determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of Alabama income taxes or to clearly reflect the income of any such organization, trade, or business.

Alaska:

Alaska Admin. Code tit. 15, § 20.355

(a) The department will, in its discretion, adjust the transfer price of any goods or services transferred to or from a water's edge combined group corporation and an affiliate not in the water's edge combined group as follows:

(1) if the transferor corporation had more than 10 percent of its transfers during the tax year to nonaffiliated corporations, the department will, in its discretion, use the average price at which the goods or services were sold to nonaffiliated corporations; and

(2) if the transferor corporation had 10 percent or less of its transfers during the tax year to nonaffiliated corporations, the department will, in its discretion, require that the net income attributable to the transfers be apportioned to the transferor and the transferee based on book inventory costs.

(b) If the department determines that a transfer between affiliated corporations was intended to decrease or increase a corporation’s factors, the department will, in its discretion, attribute the sales, property, or payroll of the corporation to the affiliated corporation which, if not for the transfer, would have reported the factors.

(c) Nothing in this section precludes adjustments by the department under Internal Revenue Code Section 482 (26 U.S.C. 482) or AS 43.19.010, Article IV, sec. 18.

Authority - AS 43.05.080, AS 43.19.010, Art. IV, Sec. 18, AS 43.20.021, AS 43.20.073

Arizona:

A.R.S. § 43-941

§ 43-941. Allocation in the case of affiliated taxpayers
A. In any case of two or more persons, organizations, trades or businesses, whether or not organized in the United States and whether or not affiliated, owned or controlled directly or indirectly by the same interests, the department may distribute, apportion or allocate gross income, deductions, credits or allowances between or among such taxpayers, if it determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such taxpayer.

B. For the purpose of enforcing this section, the department may require the filing of a combined report and such other information as it deems necessary unless the taxpayer has elected or is required to file a consolidated return pursuant to § 43-947.

§ 43-942. Allocation in the case of controlled corporations

A. In any case of two or more corporations owned or controlled directly or indirectly by the same interests, the department may distribute, apportion or allocate gross income, deductions, credits or allowances between or among such taxpayers, if it determines that such distributions, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such taxpayer.

B. For the purpose of enforcing this section, the department may require the filing of a combined report and such other information as it deems necessary unless the taxpayer has elected or is required to file a consolidated return pursuant to § 43-947.

Arkansas:

A.C.A. § 26-51-805

§ 26-51-805. Affiliated corporations

(e) In any case of two (2) or more corporations, whether or not affiliated, owned, or controlled directly or indirectly by the same interests, the director may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such corporations if he or she determines that the distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income to any such corporation. This subsection is based upon the concept of 26 U.S.C. § 482 as of January 1, 1989, as that section applies to corporations.

California:

§ 25114. Examination of returns filed; distributions, apportionments and allocations among businesses controlled by the same interests; adoption of federal regulations and procedures; presumptions

(a) The Franchise Tax Board, for purposes of administering the provisions of this article, shall examine all returns filed by taxpayers subject to these provisions.

(b)(1) In any case of two or more organizations, trades, or businesses, whether or not organized in the United States and whether or not affiliated, owned or controlled directly
or indirectly by the same interests, the Franchise Tax Board may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among these organizations, trades, or businesses, if the board determines that the distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of these organizations, trades, or businesses. In the case of any transfer, or license, of intangible property, within the meaning of Section 936(h) (3)(B) of the Internal Revenue Code, the income with respect to that transfer or license shall be commensurate with the income attributable to the intangible property.

(2) In making distributions, apportionments, and allocations under this section, the Franchise Tax Board shall generally follow the rules, regulations, and procedures of the Internal Revenue Service in making audits under Section 482 of the Internal Revenue Code. Any of these rules, regulations, and procedures adopted by the Franchise Tax Board shall not be subject to review by the Office of Administrative Law.

(3) If the Internal Revenue Service has conducted a detailed audit pursuant to Section 482 of the Internal Revenue Code [FN1] or Subchapter N of Chapter 1 of Subtitle A of the Internal Revenue Code and has made adjustments pursuant to those provisions, it shall be presumed, to the extent that the provisions relate to the determination of the amount of income and factors required to be taken into account pursuant to Section 25110, that no further adjustments are necessary for this state's purposes. If the Internal Revenue Service has conducted a detailed audit pursuant to Section 482 of the Internal Revenue Code or Subchapter N of Chapter 1 of Subtitle A of the Internal Revenue Code and has made or proposed no adjustments to the transactions examined, it shall be presumed, to the extent that the provisions relate to the determination of the amount of income and factors required to be taken into account pursuant to Section 25110, that no adjustment is necessary for this state's purposes. These presumptions apply to all Internal Revenue Service audit determinations, including determinations made by the Appeals and Competent Authority. These presumptions shall be overcome if the Franchise Tax Board or the taxpayer demonstrates that an adjustment or a failure to make an adjustment was erroneous, if it demonstrates that the results of such an adjustment would produce a minimal tax change for federal purposes because of correlative or offsetting adjustments or for other reasons, or if substantially the same federal tax result was obtained under other sections of the Internal Revenue Code. No inference shall be drawn from an Internal Revenue Service failure to audit international transactions pursuant to Section 482 of the Internal Revenue Code or Subchapter N of Chapter 1 of Subtitle A of the Internal Revenue Code and it shall not be presumed that any of those transactions were correctly reported.

(c) The amendments made to this section by the act [FN2] adding this subdivision shall apply to examinations commenced by the Franchise Tax Board on or after the effective date of that act. An examination will be considered commenced when a taxpayer is first contacted by the Franchise Tax Board concerning any examination with respect to the taxpayer's return.

**Regulations:**

**California Reg. 25114**

25114(a)(1)In general.—

The Franchise Tax Board shall examine the tax returns of all taxpayers that have made an election pursuant to Revenue and Taxation Code section 25110. In those cases in which such review or inspection reveals that there may be potential noncompliance with arm's-length standards involving the transfer of goods, services or intangibles, or the lending of money between those entities whose income and apportionment factors are
required to be considered pursuant to Revenue and Taxation Code section 25110 and other affiliated corporations, an examination of such transactions may be conducted unless the taxpayer has been, or is currently, under examination by the Internal Revenue Service with respect to the same year on the same issue.

25114(a)(2)

Principles under which a transfer pricing examination is to be conducted The Franchise Tax Board shall use the principles and procedures followed by the Internal Revenue Service in conducting examinations under Internal Revenue Code section 482 to prevent the evasion of taxes or to clearly reflect the income of two or more organizations, trades, or businesses.

Colorado:

C.R.S.A. § 39-22-305

§ 39-22-305. Consolidated returns

(1) An affiliated group of C corporations, as defined in section 1504 of the internal revenue code, [FN1] may elect to make a consolidated return with respect to the corporate income tax imposed by section 39-22-301(1) for the taxable year in lieu of separate returns. The making of a consolidated return shall be upon the condition that all C corporations which at any time during the taxable year have been members of the affiliated group consent to be included in such return. The making of a consolidated return shall be considered as such consent. Such election may not be revoked in less than four years unless approved by the executive director.

(2) The executive director shall prescribe such regulations as the executive director may deem necessary in order that the tax liability of any affiliated group of C corporations making a consolidated return and of each C corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income tax liability and the various factors necessary for the determination of such liability and as the executive director may deem necessary in order to prevent avoidance of the tax liability.

C.R.S.A. § 39-22-303

§ 39-22-303. Dividends in a combined report--foreign source income--affiliated groups--definitions

(6) In the case of two or more C corporations, whether domestic or foreign, owned or controlled directly or indirectly by the same interests, the executive director may, to avoid abuse, on a fair and impartial basis, distribute or allocate the gross income and deductions between or among such C corporations in order to clearly reflect income.

Regulations:

Colorado Reg. 39-22-303.6. Even though subsection 39-22-303(6), C.R.S., has been superseded by subsection 39-22-303(11), C.R.S., as a vehicle for requiring combined reporting for affiliated C corporations, subsection 39-22-303(6) is still available for use by
the Department of Revenue or by the taxpayer for determining Colorado taxable income by use of methodology such as that contained in section 482 of the Internal Revenue Code in applying “arm's length pricing” procedures.

Court Case: Department of Revenue may require corporations owned or controlled by the same interests to file a consolidated return if it deems that one is necessary in order to prevent evasion of taxes and clearly to reflect income. Joslin Dry Goods Co. v. Dolan, 1980, 615 P.2d 16, 200 Colo. 291. Taxation 3541

Connecticut:

Sec. 12-226a. Adjustments by the commissioner. Regulations. If it appears to the Commissioner of Revenue Services that any agreement, understanding or arrangement exists between the taxpayer and any other corporation or any person or firm, whereby the activity, business, income or capital of the taxpayer within the state is improperly or inaccurately reflected, the Commissioner of Revenue Services is authorized and empowered, in his or her discretion, provided such discretion is not arbitrarily, capriciously or unreasonably exercised, and in such manner as he or she may determine, to adjust items of income, deductions and capital, and to eliminate assets in computing any apportionment percentage under this chapter, provided any income directly traceable thereto shall also be excluded from entire net income, so as equitably to determine the tax. Where (1) any taxpayer conducts its activity or business under any agreement, arrangement or understanding in such manner as either directly or indirectly to benefit its members or stockholders, or any of them, or any person or persons directly or indirectly interested in such activity or business, by entering into any transaction at more or less than a fair price which, but for such agreement, arrangement or understanding, might have been paid or received therefor, or (2) any taxpayer, a substantial portion of whose capital stock is owned either directly or indirectly by another corporation, enters into any transaction with such other corporation on such terms as to create an improper loss or to reflect inaccurate net income, the Commissioner of Revenue Services may include in the entire net income of the taxpayer the fair profits, which, but for such agreement, arrangement or understanding, the taxpayer might have derived from such transaction. Not later than January 1, 1995, the commissioner shall adopt regulations, in accordance with the provisions of chapter 54, setting forth standards for taking the actions authorized under this section.

Regulations:

Conn. Agencies Regs. § 12-226a-1

(a) In general.

All that is necessary in order for the Commissioner to make adjustments under section 12-226a of the general statutes is an agreement, arrangement or understanding between the company and another person that, whether by inadvertence or design, results in an improper or inaccurate reflection of income. The Commissioner is not required to establish improper accounting, fraudulent, colorable, or sham transactions, or arrangements designed to reduce or avoid tax by shifting or distorting income, deductions or capital. Nor is the Commissioner required to establish that the agreement, arrangement or understanding are consistent with the economic substance of the underlying transactions and the actual conduct of the parties. Said section 12-226a requires the Commissioner to adopt a regulation that sets forth standards for taking the actions that are authorized under section 12-226a. This regulation sets forth those standards.

(b) Transactions at more or less than a fair price with related persons.
(1) Section 12-226a of the general statutes authorizes the Commissioner to make adjustments where a company has entered into a transaction with a related person at more or less than a fair price which, but for such agreement, arrangement, or understanding, might have been paid or received therefor, and there is a significant deviation between the amount actually paid or received and the amount which, but for such agreement, arrangement, or understanding, might have been paid or received. The standard that the Commissioner adopts under this subsection of this regulation is arm's-length consideration, as defined in subdivision (4) of subsection (g) of this regulation. Adjustments made by the Commissioner under section 12-226a to reflect arm's-length consideration have no effect on other Connecticut taxes (e.g., sales and use taxes, real estate conveyance tax, etc.) where the amount paid or received - - not the amount which, but for such agreement, arrangement, or understanding, might have been paid or received - - is the measure of the tax.

(2) The following subparagraphs are by way of example and not of limitation.

(A) Transfers of tangible property. Where one person sells or otherwise disposes of tangible property to a related person at other than an arm's-length price, the Commissioner may make proper adjustments to reflect arm's-length consideration for that property.

(B) Loans and advances. Where one person makes a bona fide loan or advance directly or indirectly to, or otherwise becomes a creditor of, a related person, and either charges no interest, or charges interest at a rate which is not equal to an arm's-length rate of interest with respect to the loan or advance, the Commissioner may make proper adjustments to reflect and arm's-length interest for that loan or advance.

(C) Services. Where one person performs marketing, managerial, administrative, technical, or other services for the benefit of, or on behalf of, a related person either without charge, or at a charge which is not equal to an arm's-length charge, the Commissioner may make proper adjustments to reflect an arm's-length charge for such services. However, a parent corporation providing supervisory services (also known as stewardship or overseeing functions) to a subsidiary need not charge the subsidiary for those services, which are regarded as providing the parent corporation with a benefit relating to the conservation and protection of its investment. (This is due to the fact that a parent corporation often coordinates and oversees major policy decisions and sets strategic direction for its subsidiaries.) A parent corporation is required to make an arm's-length charge only for managerial services that would have provided the subsidiary with a benefit had they been provided by a third party.

(D) Use of tangible property. Where possession, use or occupancy of tangible property owned or leased by one person is transferred by lease or other arrangement to a related person either without charge or at a charge which is not equal to an arm's-length rental charge, the Commissioner may make appropriate adjustments to reflect an arm's-length rental charge.

(E) Transfer or use of intangible property. Where intangible property or an interest therein is transferred, sold, assigned, loaned or otherwise made available in any manner by one person to a related person for other than arm's-length consideration for such property or its use, the Commissioner may make appropriate adjustments to reflect an arm's-length consideration for such property or its use.

(c) Arrangements with little or no business purpose.

(1) Section 12-226a of the general statutes authorizes the Commissioner to disregard an arrangement under which related companies may operate where one company so dominates and controls the other that income of the companies is improperly or
inaccurately reflected, and it is neither realistic nor feasible to reconstruct the transactions between them using the arm's-length consideration standard.

(2) In determining whether an arrangement under which related companies may operate results in the improper or inaccurate reflection of the activity, business, income or capital of the companies, the Commissioner shall consider whether (A) the companies are motivated by business purposes other than tax avoidance or are principally motivated by tax avoidance purposes; (B) the separate businesses of the companies have economic substance because a reasonable possibility of obtaining a profit exists, apart from achieving tax benefits; and (C) one company has a significant amount of capital gains, interest, dividend, or similar income, with only minimal capital, activity, or expenses, because essential corporate functions are performed for the company by other company without arm's-length charges.

(3) In determining whether related companies are motivated by business purposes other than tax avoidance or are principally motivated by tax avoidance purposes and whether the separate businesses of the companies have economic substance, the Commissioner shall consider whether (A) the related person has an identifiable place of business with supporting business records; (B) the related person maintains books and related accounting records; (C) the related person has a staff of employees or engaged contractors adequate in number and with sufficient expertise to conduct its business affairs; (D) the company so controls and dominates the finances, policy and business activities of the related person that the related person has virtually no separate existence; (E) the form employed for doing business is a sham; and (F) the separate businesses have economic substance because a reasonable possibility of obtaining a profit exists, apart from achieving tax benefits. No one factor is controlling in determining whether the company and the related person are motivated by business purposes and whether the arrangements have economic substance. An arrangement between a foreign sales corporation, as defined in 26 U.S.C. section 922 and meeting the requirements of 26 U.S.C. sections 921 to 927, and its shareholders shall not be considered and arrangement that is principally motivated by tax avoidance purposes.

(4) The following examples illustrate the application of this subsection.

Example 1: Company A carries on business in Connecticut and is subject to corporation business tax. Company B, a wholly-owned subsidiary of Company A, is a company that is exempt from the Delaware Corporation Income Tax, under Del. Code Ann. tit. 30, section 1902(b) (8), because its activities within Delaware are confined to the maintenance and management of its intangible investments. Company B leases an office for its exclusive use in Delaware where it has a staff of employees adequate in number to conduct all of its business affairs. All of Company B’s assets are located in Delaware, and all its business activities, including all day-to-day decision-making and management functions, are conducted by its own officers and employees in Delaware, who have appropriate authority and expertise commensurate with their responsibilities. Company B received its intangible assets from Company A in transfer by Company A under 26 U.S.C. section 351 solely in exchange for stock in Company B.

Based on these facts, the Commissioner shall determine that the arrangement under which Company A and Company B operate does not result in the improper or inaccurate reflection of the activity, business, income or capital of the companies.

Example 2: Company G carries on business in Connecticut and is subject to corporation business tax. Company H, a wholly-owned subsidiary of Company G, is a company that is exempt from the Delaware Corporation Income Tax, under Del. Code Ann. tit. 30, section 1902(b) (8), because its activities within Delaware are confined to the maintenance and management of its intangible investments. Company H does not lease an office for its
exclusive use in Delaware and it does not have adequate staff to conduct its business affairs. Not all of Company H’s assets are located in Delaware, and some or all its business activities, including all day-to-day decision-making and management functions, are conducted by Company G in Connecticut. Company H received its intangible assets from Company G in a transfer by Company G under 26 U.S.C. section 351 solely in exchange for stock in Company H.

Based on these facts, the Commissioner shall determine that the arrangement under which Company G and Company H operate results in the improper or inaccurate reflection of the activity, business, income or capital of the companies, because Company G controls and dominates the business activities of Company H. Therefore, the Commissioner may shift income from Company H, to reflect income properly or accurately.

(d) Transfers for tax avoidance purposes.

(1) Section 12-226a of the general statutes authorizes the Commissioner to make adjustments to items of income deduction or capital in order to prevent the avoidance, in whole or in part, of corporation business tax, where property is transferred between a company and a related person in anticipation of a sale to an unrelated person. The Commissioner shall weigh, as a factor in determining whether a transfer was made to avoid, in whole or in part, corporation business tax, the interval of time between the transfer by the company to the related person and the sale to the unrelated person. This subsection may apply even if arm’s-length consideration is paid or received between the company and the related person. However, this subsection shall not apply to any transfer to which the provisions of subsection (c) of this regulation also apply.

(2) The following examples illustrate the application of this subsection.

Example 1: Company J carries on business in Connecticut and is subject to corporation business tax. Company K, a wholly-owned subsidiary of Company J, does not carry on business in Connecticut. In anticipation of a sale of certain of its property that is situated in Connecticut to an unrelated person, Company J transfers the property to Company K, which then promptly sells the property to the unrelated person for the sales price for which Company J itself could have sold the property directly to the unrelated person.

Based on these facts, the Commissioner shall determine that the arrangement between Company J and Company K with respect to the property results in the improper or inaccurate reflection of the net income of Company J, and shall include in the net income of Company J the fair profits which, but for such arrangement, Company J might have derived from the sale of the property.

Example 2: The facts are the same as in Example 1, except that Company K holds the property for a considerable length of time, making use of it in the interim in its own business, before eventually reselling it to the unrelated person.

Based on these facts, the Commissioner shall determine that the arrangement between Company J and Company K with respect to the property does not result in the improper or inaccurate reflection of the net income of Company J (assuming that arm’s-length consideration was paid by Company K on the transfer of the property to it by Company J).

(e) Nonrecognition provisions may not bar adjustments.

Section 12-226a of the general statutes authorizes the Commissioner to disregard statutory nonrecognition provisions when necessary to prevent the avoidance of taxes or to reflect income properly or accurately.
(f) Use of section 12-226a by a company.

A company has no right to apply section 12-226a of the general statutes at will or to compel its application by the Commissioner. However, section 12-226a of the general statutes does not limit a company's ability properly or accurately to reflect its activity, business, income or capital on its corporation business tax return. Thus, if a company has conducted its activity or business under any agreement, arrangement or understanding in such manner as either directly or indirectly to benefit its members or stockholders, or any other persons directly or indirectly interested in such activity or business, by entering into any transaction at more or less than a fair price which, but for such agreement, arrangement, or understanding, might have been paid or received therefor, the company may report the results of such transaction based upon a price different from that actually paid or received if necessary to reflect an arm's length result. (If reported results differ from transactional results recorded in the regular books and records of the company, such difference must be accounted for in the same manner as such difference would be accounted for federal income tax purposes.)

(g) Definitions.

For purposes of this regulation, unless the context otherwise requires:

(1) “Person” means person, as defined in section 12-1 of the general statutes;

(2) “Commissioner” means the Commissioner of Revenue Services;

(3) “Arm's-length consideration” is the amount of consideration that would be paid or received (or the profits that would have been earned) in a transaction between unrelated persons, where neither person is under any compulsion to enter into the transaction and each person has reasonable knowledge of all relevant facts.

(4) “Arm's-length price” or “arm's-length charge” is the price or charge, respectively, that would be paid or received (or the profits that would have been earned) in a transaction between unrelated persons, where neither person is under any compulsion to enter into the transaction and each person has reasonable knowledge of all relevant facts.

(5) “Arm's-length rental charge” is the rental charge that would be paid or received (or the profits that would have been earned) in a rental transaction between unrelated persons, where neither person is under any compulsion to enter into the transaction and each person has reasonable knowledge of all relevant facts.

Delaware:


(c) If, in the discretion of the Secretary of Finance, the application of the allocation or apportionment provisions of this section would result in an unfair or inequitable proportion of the taxpayer's Headquarters Management Corporation taxable income being assigned to this State, the Secretary of Finance or the Secretary's delegate may permit or require the exclusion or alteration of the weight to be given to 1 or more of the factors in the formula specified in subsection (b) of this section or the use of separate accounting or other method to produce a fair and equitable result. For purposes of this chapter and of § 2061 of this title, the Director may, in the Director's discretion, redistribute, reallocate, or reapportion items of gross income or deduction on account of the providing of headquarters services if the Director determines that such items are disproportionate.
to their fair market value compared to arm's length transactions between similar but unrelated companies.

District of Columbia:

DC ST § 47-1810.03

§ 47-1810.03. Distribution, apportionment, or allocation of income or deductions between or among organizations, trades, or businesses.

In any of 2 or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the District, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Mayor is authorized to distribute, apportion, or allocate gross income or deductions between or among such organizations, trades, or businesses, whenever in his opinion such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. The provisions of this section shall apply, but shall not be limited in application, to any case of a common carrier by railroad subject to the Interstate Commerce Act and jointly owned or controlled directly or indirectly by 2 or more common carriers by railroad subject to said Act.


Georgia:

Ga. Code Ann., § 48-7-58

§ 48-7-58. Shifting of income

(a) When the commissioner has reason to believe that any taxpayer conducts his or her trade or business so as to evade taxes, distort directly or indirectly his or her true net income, or distort directly or indirectly the net income properly attributable to this state, whether by the arbitrary shifting of income, through price fixing, charges for service, or otherwise, as a result of which the net income is arbitrarily assigned to a person related to the taxpayer, the commissioner may require the facts as he or she deems necessary for the proper computation of the entire net income and the net income properly attributable to this state. In determining the computation, the commissioner shall consider the fair profit which would normally arise from the conduct of the trade or business. The commissioner shall by regulation provide when to apply this subsection.

(b)(1) Additionally, the commissioner may determine the amount of taxable income of any one or more corporations for a calendar or fiscal year when a corporation:

(A) Subject to taxation under this chapter conducts its business in such manner as to benefit either directly or indirectly the members or stockholders of the corporation or any person interested in the business of the corporation by selling its products or the goods or commodities in which it deals at less than the fair price which might be obtained for the goods or commodities;
(B) A substantial portion of whose capital stock is directly or indirectly owned by another corporation acquires and disposes of the products of the corporation so owning a substantial portion of its stock in such a manner as to create a loss or improper net income for either of the corporations; or

(C) Directly or indirectly owning a substantial portion of the stock of another corporation acquires and disposes of the products of the corporation of which it so owns a substantial portion of the stock in such a manner as to create a loss or improper net income for either of the corporations.

(2) In his or her determination, the commissioner shall consider the reasonable profits which, but for the arrangement or understanding, might or could have been obtained by the corporation or corporations subject to taxation under this chapter from dealing in such products, goods, or commodities.

Regulation:

Sec. 560-7-8-.07. Shifting of Income.

(1) This section of the Act was enacted for the purpose of preventing diversion of profits in an arbitrary manner between corporations and their stockholders or between affiliated corporations. There has been a tendency on the part of some corporations operating both within and without the State to form separate corporations to engage in the several activities, all of which form a part of the overall operation. If, for example, a manufacturing company operates in Georgia it may sell its products to an affiliated selling company outside Georgia at prices which may or may not result in a proper profit for manufacturing the products. Or if a sales company operates within Georgia it may buy products from a manufacturing affiliate outside Georgia at prices which may or may not result in proper profit from selling activities. Some common forms of diversion of income are:

(a) Sales at more or less than fair value.

(b) Purchases at more or less than fair value.

(c) Fixing profits in advance by contract, such as a parent corporation, guaranteeing costs and expenses of a subsidiary, plus a fixed fee, or percentage.

(d) Payment of unreasonable officers’ salaries, rents, royalties, interest, and other charges against income.

(e) Billing a product to an affiliate at factory cost. There are other methods by which affiliates not dealing at arms-length may distort or divert profits.

(2) When any method which distorts net income among and between affiliates is used, the Commissioner will require the consolidation of income of all such affiliates and then proceed to compute the entire net income in accordance with the provisions in Section 92-3113, which relates to apportionment of income within and without the State. The tax imposed by this law shall apply to the correct apportioned income of all affiliates as consolidated.

(3) The Commissioner will have due regard for fair profits, and for prices which products would ordinarily sell for between non-affiliates, and if it is found that affiliates are in fact dealing at arms length, operating, buying and selling, and otherwise dealing with each other as if they were not affiliated, consolidation will not apply.
Discretionary authority under corporation income tax statute relating to shifting of income may be applied to taxpayers operating wholly within the state, or within and without the state, who are shifting income, but statute contains no authority for combining income of related corporations. Code, § 92-3209. Blackmon v. Campbell Sales Co., 1972, 125 Ga.App. 859, 189 S.E.2d 474.

Hawaii

Haw. Stat. § 18-235-38-04(a):

If two or more organizations, trades, or businesses, whether or not incorporated or organized in Hawaii, are owned or controlled directly or indirectly by the same interests, the director may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among the organizations, trades, or businesses if the director determines that the distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or to clearly reflect the income attributable to any taxpayer’s activity in Hawaii.

18-235-38-04(b)

This section shall not be construed to permit the filing of consolidated returns by two or more affiliated corporations except as provided by section 235-92, HRS.

18-235-38-04(c)

The director shall not allocate or apportion income to Hawaii in excess of what is considered just and reasonable under the circumstances.

Idaho:


(b) Provisions of the Internal Revenue Code amended, deleted, or added prior to the effective date of the latest amendment to this section shall be applicable for Idaho income tax purposes on the effective date provided for such amendments, deletions, or additions, including retroactive provisions.

Regulation:

Idaho Regs. § 35.01.01.015.02. Tax Commission Granted Discretion in Determining Correctness of Tax Return. Discretion granted to the Secretary of the Treasury to determine or reallocate items of income or adjustments to income, deductions, expenses, credits or other subjects of taxation by the Internal Revenue Code may also be exercised by the Tax Commission and its authorized agents, employees and deputies to enforce and administer the Idaho Income Tax Act and these rules.

Indiana:

Ind. Code Sec. 58.1-6-2-2.
58.1-6-2-2(m) In the case of two (2) or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests, the department shall distribute, apportion, or allocate the income derived from sources within the state of Indiana between and among those organizations, trades, or businesses in order to fairly reflect and report the income derived from sources within the state of Indiana by various taxpayers.

(n) For purposes of allocation and apportionment of income under this article, a taxpayer is taxable in another state if:

(1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; 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.

(o) Notwithstanding subsections (l) and (m), the department may not, under any circumstances, require that income, deductions, and credits attributable to a taxpayer and another entity be reported in a combined income tax return for any taxable year, if the other entity is:

(1) a foreign corporation; or

(2) a corporation that is classified as a foreign operating corporation for the taxable year by section 2.4 of this chapter.

(p) Notwithstanding subsections (l) and (m), the department may not require that income, deductions, and credits attributable to a taxpayer and another entity not described in subsection (o)(1) or (o)(2) be reported in a combined income tax return for any taxable year, unless the department is unable to fairly reflect the taxpayer's adjusted gross income for the taxable year through use of other powers granted to the department by subsections (l) and (m).

Iowa:

2013 Iowa Code, Title X, Ch. 422

422.36 Returns. Where the director has reason to believe that any person or corporation so conducts a trade or business as either directly or indirectly to distort the person’s or corporation’s true net income and the net income properly attributable to the state, whether by the arbitrary shifting of income, through price fixing, charges for services, or otherwise, whereby the net income is arbitrarily assigned to one or another unit in a group of taxpayers carrying on business under a substantially common control, the director may require such facts as are necessary for the proper computation of the entire net income and the net income properly attributable to the state, and shall determine the same, and in the determination thereof the director shall have regard to the fair profits which would normally arise from the conduct of the trade or business.

Kansas:

K.S.A. 79-32,141

79-32,141. Allocation of income and deductions

The director may allocate gross income, deductions, credits, or allowances between two or more organizations, trades or businesses (whether or not incorporated, or organized in the United States or affiliated) owned or controlled directly or indirectly by the same interests, if the director determines such allocation is necessary to prevent evasion of taxes or to clearly reflect income of the organizations, trades or businesses.
K.S.A. 79-1135

**Article 11.** Banks, Banking Businesses, Trust Companies and Savings and Loan Associations

**79-1135. Consolidated returns or combined reports required, when**

(c) For taxpayers described in K.S.A. 79-1106 and amendments thereto, the secretary of revenue may require returns on a consolidated basis or combined reporting and may distribute or allocate gross income, deductions, credits, or allowances between two or more organizations, trades or businesses, whether or not incorporated, or organized in the United States or Kansas or affiliated, owned or controlled directly or indirectly by the same interests, if the secretary of revenue determines such allocation is necessary to prevent evasion of taxes or to clearly reflect income of the organizations, trades or businesses.

**Court case:** Statute authorizes Director of Taxation to require use of the combined report method of allocation of income and expenses when it is properly determined that two or more corporations are engaged in a multistate unitary business. K.S.A. 79-32,141. *Pioneer Container Corp. v. Beshears*, 1984, 235 Kan. 745, 684 P.2d 396. Taxation

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**Louisiana:**

LSA-R.S. 47:287.480

§ 287.480. **Special adjustments by the secretary**

Notwithstanding any other provisions of this Part to the contrary, the secretary is authorized to require the use of inventories and to allocate income and deductions among taxpayers and require such returns as follows:

(1) Inventories. Whenever in the opinion of the secretary the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer on such basis as the secretary may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

(2) Allocation between related businesses. In any case of two or more organizations, trades, or businesses, whether or not incorporated, whether or not organized in the United States, and whether or not affiliated, owned or controlled directly or indirectly by the same interests, the secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

(3) Consolidated returns.

(a) Consolidated or combined returns are not allowed under this Part except as required by the secretary pursuant to this Paragraph.
(b) For purposes of this Section, whenever a corporation which is required to file an income tax return, is affiliated with or related to any other corporation through stock ownership by the same interests or as parent or subsidiary corporations, or whose income is regulated through contract or other arrangement, the secretary may require such consolidated statements as in his opinion are necessary, if any, in order to determine the taxable income received by any one of the affiliated or related corporations.

Maryland:

MD Code, Tax - General, § 10-109

§ 10-109. Distribution, apportionment, and allocation of gross income, deductions, credits, or allowances

In general

(a) The Comptroller may distribute, apportion, or allocate gross income, deductions, credits, or allowances between and among two or more organizations, trades, or businesses, whether or not incorporated, whether or not organized in the United States, and whether or not affiliated, if:

(1) the organizations, trades, or businesses are owned or controlled directly or indirectly by the same interests within the meaning of § 482 of the Internal Revenue Code; and

(2) the Comptroller determines that the distribution, apportionment, or allocation is necessary in order to reflect an arm's length standard within the meaning of § 1.482-1 of the Regulations of the Internal Revenue Service of the U.S. Treasury and to reflect clearly the income of those organizations, trades, or businesses.

Administrative and judicial interpretations

(b) The Comptroller shall apply the administrative and judicial interpretations of § 482 of the Internal Revenue Code in administering this section.

Massachusetts:

G.L. Ch. 63, § 39A:

Section 39A. The net income of a foreign corporation which is a subsidiary or parent corporation of another corporation or closely affiliated therewith by stock ownership shall be determined by eliminating all payments to the parent corporation or subsidiary or affiliated corporations in excess of fair value, and by including fair compensation to such foreign corporation for all commodities sold to or services performed for the parent corporation or subsidiary or affiliated corporations. For the purposes of determining such net income, the commissioner may, in the absence of satisfactory evidence to the contrary, presume that an apportionment by reasonable rules of the consolidated net income of corporations participating in the filing of a consolidated return of net income to the federal government fairly reflects the net income taxable under this chapter, or may
otherwise equitably determine such net income by reasonable rules of apportionment of
the combined income of the subsidiary, its parent and affiliates or any thereof.

M.G.L.A. 62 § 62 (limited authority)

§ 62. Methods of accounting; fiscal years

Income taxable under this chapter shall be determined in accordance with the method of
accounting regularly employed in keeping the books of the taxpayer unless it is
established that such method does not clearly reflect income. If a taxpayer does not keep
books of account, his income shall be determined on the cash receipts and disbursements
method of accounting. Any taxpayer who changes the method of accounting regularly
employed by him in keeping his books shall not be permitted to report his income on a
method different from that used for the preceding year without obtaining the consent of
the commissioner. The period for which income is to be computed shall be on the basis of
a calendar year unless a taxpayer actually keeps his books of account on the basis of a
fiscal year and has obtained permission from the commissioner to report his income on
such a basis.

Minnesota (limited to timing of deductions):

M.S.A. § 290.07

⇒ 290.07. Net income; computation, accounting period

Subd. 7. Deductions, credits; time for taking. The deductions and credits provided
for in this chapter shall be taken for a taxable year in which “paid or accrued” or “paid
and incurred,” dependent upon the method of accounting upon the basis of which the net
income is computed, unless in order to clearly reflect the income the deductions or
credits should be taken as of a different period.

The provisions of sections 461 to 468A of the Internal Revenue Code shall determine the
taxable year for which a deduction or credit may be taken.

Mississippi:

Miss. Code Ann. § 27-7-37

⇒ § 27-7-37. Returns of corporation

(2)(a) Two (2) or more members of an affiliated group of corporations, each taxable in
Mississippi, may elect to file a combined income tax return. Corporations electing to file
combined returns under this section shall determine the Mississippi net business income
(or loss) on an individual corporate member basis as required in Section 27-7-23 and, if
applicable, Sections 27-7-24, 27-7-24.1, 27-7-24.3, 27-7-24.5 and 27-7-24.7. The
Mississippi net business income (or loss) so computed for each individual member shall
be combined to determine the Mississippi net business income (or loss) of the combined
group of affiliated corporations. To the amount so determined shall be added nonbusiness
income of the combined members directly allocable to Mississippi to determine Mississippi taxable income.

The commissioner may require a corporation taxable under this article that is affiliated with one or more corporations that are not taxable under this article to file a combined return with the affiliated corporation or corporations if he believes that the intercompany transactions of such taxable corporation have resulted in the shifting of taxable income from itself to another member or members of its affiliated group not subject to tax under this article. Also, the commissioner may require a group of affiliated corporations taxable under this article to file a combined return if he believes that the intercompany transactions of such corporations have resulted in the shifting of taxable income between members of the included affiliated group. In the event that such a combined return is required, the net income or loss of each member of the group required to be combined, shall be combined pursuant to regulations prescribed by the commissioner to determine the total combined taxable income and the Mississippi taxable income of the group. The tax imposed by this article shall be computed and assessed upon the Mississippi taxable income of the combined group which shall be treated as the taxpayer.

(c) The commissioner shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a combined return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected and adjusted, in such manner as clearly to reflect the income tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability.

Missouri: (may be limited to accounting methods):

V.A.M.S. 148.040

148.040. Definitions and computation of net and gross income

3. In computing net income there shall be allowed as deductions all ordinary and necessary expenses paid or incurred by the taxpayer during the income period in carrying on its trade or business. Without limiting the generality of the foregoing, there shall be allowed as deductions a reasonable allowance for salaries and other compensation for personal services actually rendered; rents, repairs, and bad debts and debts ordered to be charged off by the director of finance or the comptroller of the currency or their respective examiners as the case may be; interest; cost of insurance and advertising; all taxes paid or accrued during the income period to the United States and all taxes paid or accrued on real estate or tangible personal property owned by the taxpayer and held for lease or rental to others, to the state of Missouri or any political subdivision thereof; all contributions paid or accrued pursuant to the unemployment compensation law of Missouri; reasonable allowances for depreciation and depletion; amortization of premiums on bonds, debentures, notes or other securities or evidences of indebtedness; a reasonable allowance for payments or contributions to or on account of any pension or retirement fund or plan for its officers or employees; contributions to any corporation, association or fund organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, no part of the net earnings of which inure to the benefit of any private shareholder or individual to an amount which does not exceed five percent of the taxpayer's net income as computed without the benefit of this deduction; losses from the sale or disposition of any property, real or personal, tangible or intangible; and all other losses sustained during the income period not compensated for by insurance.
4. Net income shall be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer, unless such method does not clearly reflect the income, in which case the computation shall be made in accordance with such method as in the opinion of the director does clearly reflect the income.

Montana:

Mont. Code Ann. 15-31-505

15-31-505. Subpoenas -- investigation of income, and shifting. (1) Jurisdiction is hereby conferred upon the district court of the first judicial district of the state of Montana in and for the county of Lewis and Clark to compel attendance of witnesses to testify before the department of revenue, together with the production of books and such other testimony by appropriate process. (2) When the department has reason to believe that the business of any corporation is so conducted as either directly or indirectly to distort the true net income of the corporation and the net income properly attributable to this state, whether by the arbitrary shifting of income through price fixing, charges for service, or otherwise, whereby the net income is arbitrarily assigned to one or another corporation carrying on business under a substantially common control, it may require the disclosure of such facts as it deems necessary for the proper computation of the entire net income and the net income properly attributable to this state, and in determining the same, the department shall have regard to the fair profits which would normally arise from the conduct of the business.

Regulation (2012) 42.26.208 ALLOCATION OF INCOME AND DEDUCTIONS: (1) through (3) remain the same.

(4) If two or more entities, whether or not organized or doing business in this state, are owned or controlled directly or indirectly by the same interest, the taxpayer may petition or the department may require adjustments that distribute, apportion, or allocate gross income or deductions between or among such entities, if it determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes, or to fairly represent the income of any such entities.

New Jersey:

54:10A-10 Evasion of tax; adjustments and redeterminations; obtaining information.

10. a. Whenever it shall appear to the director that any taxpayer fails to maintain its records in accordance with sound accounting principles or conducts its business or maintains its records in such manner as either directly or indirectly to distort its true entire net income or its true entire net worth under this act or the proportion thereof properly allocable to this State, or whenever any taxpayer maintains a place of business outside this State, or whenever any agreement, understanding or arrangement exists between a taxpayer and any other corporation or any person or firm, for the purpose of evading tax under this act, or whereby the activity, business, receipts, expenses, assets, liabilities, income or net worth of the taxpayer are improperly or inaccurately reflected, the director is authorized and empowered, in the director’s discretion and in such manner as the director may determine, to adjust and redetermine such items, and to adjust items of gross receipts, tangible or intangible property and payrolls within and without the
State and the allocation of entire net income or entire net worth or to make any other adjustments in any tax report or tax returns as may be necessary to make a fair and reasonable determination of the amount of tax payable under this act.

b. Where (1) any taxpayer conducts its activity or business under any agreement, arrangement or understanding in such manner as either directly or indirectly to benefit its members or stockholders, or any of them, or any person or persons directly or indirectly interested in such activity or business, by entering into any transaction at more or less than a fair price which, but for such agreement, arrangement or understanding, might have been paid or received therefor, or (2) any taxpayer, a substantial portion of whose capital stock is owned either directly or indirectly by or through another corporation, enters into any transaction with such other corporation on such terms as to create an improper loss or net income, the director may include in the entire net income of the taxpayer the fair profits which, but for such agreement, arrangement or understanding, the taxpayer might have derived from such transaction. The director may require any person or corporation to submit such information under oath or affirmation, or to permit such examination of its books, papers and documents, as may be necessary to enable the director to determine the existence, nature or extent of an agreement, understanding or arrangement to which this section relates, whether or not such person or corporation is subject to the tax imposed by this act.

c. The entire net income of a taxpayer exercising its franchise in this State that is a member of an affiliated group or a controlled group pursuant to section 1504 or 1563 of the federal Internal Revenue Code of 1986, 26 U.S.C. s.1504 or 1563, shall be determined by eliminating all payments to, or charges by, other members of the affiliated or controlled group in excess of fair compensation in all inter-group transactions of any kind. Notwithstanding the elimination of all inter-group transactions in excess of fair compensation, if the taxpayer cannot demonstrate by clear and convincing evidence that a report by a taxpayer discloses the true earnings of the taxpayer on its business carried on in this State, the director may, at the director's discretion, require the taxpayer to file a consolidated return of the entire operations of the affiliated group or controlled group, including its own operations and income to the extent permitted under the Constitution and statutes of the United States. The director shall determine the true amount of entire net income earned by the taxpayer in this State. The consolidated entire net income of the taxpayer and of the other members of its affiliated group or controlled group shall be allocated to this State by use of the applicable allocation formula that the director requires pursuant to P.L.1945, c.162 (C.54A:10A-1 et seq.) be used by the taxpayer. The return shall include in the allocation formula the property, payrolls, and sales of all corporations for which the return is made. The director may require a consolidated return under this section without regard to whether the other members of the affiliated or controlled group, other than the taxpayer, are or are not exercising their franchises in this State.

A consolidated return required by this section shall be filed within 60 days after it is demanded, subject to the penalties of the State Uniform Tax Procedure Law, R.S.54:48-1 et seq.

The member of an affiliated group or a controlled group shall incorporate in its return required under this section information needed to determine under this section its taxable entire net income, and shall furnish any additional information the director requires, subject to the penalties of the State Uniform Tax Procedure Law, R.S.54:48-1 et seq. A taxpayer shall furnish any additional information requested within 30 days after it is demanded, subject to the penalties of the State Uniform Tax Procedure Law, R.S.54:48-1 et seq.
New Jersey Regulations:

N.J. Admin. Code tit. 18 §7-5.10. Right of Director to correct distortions of net income allocation factors; adjustments and redeterminations.

(a) Whenever it shall appear to the Director that any taxpayer fails to maintain its records in accordance with sound accounting principles or conducts its business or maintains its records in a manner so as either directly or indirectly to distort its true entire net income or the proportion thereof properly allocable to this State, or whenever any taxpayer maintains a place of business outside this State, or whenever any agreement, understanding or arrangement exists between a taxpayer and any other corporation or any person or firm, for the purpose of evading tax under the Act, or whereby the activity, business, receipts, expenses, assets, liabilities, or net income of the taxpayer are improperly or inaccurately reflected, the Director is authorized and empowered, in his or her discretion and in whatever manner he or she may determine, to adjust and redetermine such items, and to adjust items of gross receipts, tangible or intangible property and payrolls within and without the State and the allocation of entire net income or to make any other adjustments in any tax report or tax return as may be necessary to make a fair and reasonable determination of the amount of tax payable under the Act.

1. Where any taxpayer conducts its activity or business under any agreement, arrangement or understanding in such manner as either directly or indirectly to benefit its members or stockholders, or any of them, or any person or persons directly or indirectly interested in such activity or business, by entering into any transaction at more or less than a fair price which, but for such agreement, arrangement or understanding, might have been paid or received therefor: or

2. Any taxpayer, a substantial portion of whose capital stock is owned either directly or indirectly by or through another corporation, enters into any transaction with such other corporation on such terms as to create an improper loss or net income, the Director may include in the entire net income of the taxpayer the fair profits which, but for such agreement, arrangement or understanding, the taxpayer might have derived from the transaction.

3. For purposes of this section, “fair and reasonable tax” is the tax that would have been payable by a taxpayer reporting the same transaction(s) on a separate entity basis where the parties to the transaction(s) had independent economic interests.

4. For purposes of this section, “substantial portion of stock” is the direct or indirect ownership of 20 percent or more of the outstanding shares of any class of stock. For purposes of arriving at this level of ownership the stock attribution rules of IRC section 318 will be used.

5. Under N.J.S.A. 54:10A-10(b) interest should be charged on loans or advances made by one related party to another from the day after the debt arises until the debt is satisfied. With respect to intercompany trade receivables of related taxpayers, interest is not required to be charged on an intercompany trade receivable before the first day of the third calendar month.

i. If the creditor is regularly engaged in the business of making loans or advances, the arm's length interest rate should be charged. Upon failure to do so, the Division of Taxation can determine what interest should have been charged. Where the creditor is not in the business of loaning money or making advances, either an arm's length rate based on the facts and circumstances or a safe haven rate is acceptable. However, the
safe haven rule does not apply to any loan or advance in which the interest or principal amount is expressed in a currency other than U.S. dollars.

ii. For interest paid or accrued on a loan or advance, a safe haven rate is one that is between 100 percent and 130 percent of the Applicable Federal Rate (AFR) as determined under Internal Revenue Code Section 1274(d) in effect on the date that the loan or advance is made. Adjustments for inadequate interest would be made at 100 percent of the AFR and adjustments for excessive interest would be made at 130 percent of the AFR. In the case of a sale-leaseback transaction, the lower limit would be 110 percent of the AFR. In determining the rate of interest actually charged on a written loan or advance, any original issue discount included in income by the lender or any bond premium deducted by the lender is to be taken into account.

6. Where a service by one member of a group to another member is rendered for less than an arm's length charge, the Division of Taxation may make appropriate allocations to reflect an arm’s length charge for that service. The arm's length charge is equal to the costs or deductions incurred by the member performing the service, except in cases where the service is an integral part of the business activity of either member.

7. If tangible property is made available by one member of the group to another, the latter should be charged the arm's length rental charge.

8. Where one member of a group of controlled entities sells or otherwise disposes of tangible property to another at other than an arm's length price, a proper allocation will be made between the seller and the buyer using the following methods.

i. Comparable uncontrolled price method: This method must be used if there are comparable uncontrolled sales (sales between outsiders or a member and an outsider where the property sold and the circumstances involved are identical, or nearly identical, to those in the controlled sale), to the extent they are not identical, adjustments are made.

ii. Resale price method: If there are not comparable uncontrolled sales, the resale price method must be used if the standards for its application are met. A typical situation where this method is required is where a manufacturer sells products to a related distributor which, without further processing, resells the products to unrelated parties.

iii. Cost plus method: If the standards for application of the resale price method are not satisfied, either that method or the cost plus method is used, depending on which is more feasible and will produce a more accurate arm's length price. Normally, the cost plus method is appropriate where a manufacturer sells products to a related entity which performs substantial manufacturing, assembly, or other processing of the product or adds significant value by use of its intangible property (trademark, for example) before resale.

iv. Comparable profits method: In general, the comparable profits method evaluates whether the amount charged in a controlled transaction is arm's length based on objective measures of profitability (profit level indicators) derived from uncontrolled taxpayers that engage in similar business activities under similar instances.

v. Profit split method: In general, the profit split method evaluates whether the application of the combined operating profit or loss attributable to one or more controlled transactions is arm's length by reference to the relative value of each controlled taxpayer's contribution to that combined operating profit or loss. The combined operating profit or loss must be derived from the most narrowly identifiable business activity of the controlled taxpayers for which data is available that includes the controlled transactions (relevant business activity).
vi. Unspecified methods: In general, methods not specified in (a)8i, ii, iii, iv, and v above may be used to evaluate whether the amount charged in a controlled transaction is arm's length. Any method used under this paragraph should be applied in accordance with the provisions of U.S. Treas. Reg. 1.482-1.

9. Under both the comparable uncontrolled price method and the resale price method, market conditions faced by the affiliate are taken into account. Thus, goods may be sold, for a period, at a price which is below the full cost of manufacture in order to establish or maintain a market.

i. Assuming that the requirements of one of the methods in (a)8 above are met, it must be used unless the taxpayer can show that some other method is clearly more appropriate. Where none of the first five methods listed can reasonably be applied, some other appropriate method can be used.

ii. Where a taxpayer makes controlled sales of many different products or many sales of the same product and it is impractical to calculate an arm's length price for each product or sale, it is permissible to apply the proper method of pricing to product lines or other groupings. Also, the Division of Taxation may use statistical sampling techniques to verify or determine the arm's length price of all sales to a related entity.

10. The Division will apply equitable principles to prevent unjust situations from occurring.

(b) The application of this section is not limited to an agreement, understanding or arrangement existing between a taxpayer and any other corporation or any person or firm for the purpose of avoiding or evading tax under the Act. It is also applicable where adjustments and redeterminations relate to transfer pricing and other transactions between related persons or entities where evasion or tax avoidance are not a consideration. The Director may initiate adjustments under this section solely in the interests of determining a fair and reasonable tax, and without respect to any benefit arising out of inter-corporate relationships or the relationships of any person holding a substantial portion of the stock of a taxpayer. The Division shall not be limited to indices, trade practices, cost sheets, Internal Revenue Reports or any other factor in determining the appropriate transfer price for goods, services, intangibles or other dispositions made to related parties. Where the Director determines that there is an adjustment to net income under this section, he or she may also make a corresponding adjustment to the allocation factor.

(c) Where any taxpayer conducts its activity or business under any agreement, arrangement or understanding in such manner as either directly or indirectly to benefit its members or stockholders, or any person or persons directly or indirectly interested in such activity or business, by entering into any transaction at more or less than a fair price which, but for such agreement, arrangement or understanding, might have been paid or received therefor, the Director may adjust and redetermine items on any affected taxpayer report or return as may be necessary properly to reflect the taxpayer's adjusted entire net income apportionable to New Jersey. The following example is an illustration only and in no way shall be interpreted as a standard for calculating wages in a particular case.

Example: Corporation D entered into an employment agreement with its sole shareholder's spouse for the performance of services as an accounting clerk. The agreement called for the shareholder's spouse to monitor 10 accounts. For the service performed, the spouse is to receive an annual salary of $100,000 along with a substantial benefit package. The Director, upon audit, learns that the spouse works only five hours per week in completely performing the duties. The Director, based upon the going wage for such services, determines that the total compensation package would not exceed...
$10,000 a year and adjusts the taxpayer's expense to determine properly the net income and the taxpayer's wage fraction of the allocation factor and to provide dividend treatment for the disallowed wage compensation.

(d) Where any taxpayer, 20 percent or more of whose capital stock is owned either directly or indirectly by or through the same interests as those of the taxpayer, conducts any activity, transaction, or business with such interests which either directly or indirectly creates an artificial loss, net income, or allocation factor, the Director may adjust and redetermine such items on any taxpayer report or return as may be necessary properly to reflect the taxpayer's adjusted entire net income apportionable to New Jersey.

Example 1: Corporation E, the great grandparent of the taxpayer, borrows $1 million from the taxpayer. The agreement calls for the principal and interest at the rate of two percent per annum to be paid at the end of one year. Upon audit, the Director determines that a market interest rate given the economic conditions at the time of the loan and the circumstances of the borrower is 13 percent per annum. Therefore, he adds the additional income to the taxpayer's net income as reported, and adjusts the expense on the great grandparent's return, if it files in New Jersey.

Example 2: Corporation F is the parent company of over 10 subsidiaries and provides all administrative services for the 10 subsidiaries. Corporation F receives dividend income from its subsidiaries, interest income from other investments, and service fee income from the subsidiaries for the administrative services it performs on their behalf which are an integral part of the business activity of the parent. All costs incurred by the parent are charged to the subsidiaries based solely upon the total assets of each subsidiary. Upon audit, the Director determines that the service fee includes no profit element and that the allocation of the costs of the administrative services bears no relationship to the services provided to each subsidiary. Accordingly, the Director imputes an element of profit, and assigns the charges to each subsidiary by a method reflecting the actual costs incurred in providing the services to each subsidiary.

(e) The following examples are merely illustrative and are in no way intended to limit the scope of the Director's discretion to inquire into transfer pricing or the determination of a fair and reasonable tax:

Example 1: K Corporation, the manufacturer of a proprietary product, sells goods to its distributors and wholesale customers at a 50 percent profit. It also sells goods to related foreign corporations at a 5 percent gross profit for marketing by them overseas.

On a separate entity basis, in an arm's length transaction these sales would yield a 50 percent gross profit and the price which might have been paid or received for the goods includes an amount sufficient to reflect that 50 percent gross profit.

The Director may include additional profits in entire net income sufficient to reflect the arm's length price which might have been paid or received.

Example 2: L Corporation is the parent corporation in a vertically integrated oil company. Its marketing subsidiary is a taxpayer. The marketing corporation reports a significantly lower gross profit than other taxpayers selling the same generic products in volume.

L Corporation has set its transfer prices to its marketing subsidiary at a price $0.02 per gallon higher than published New York tanker port prices for its product because it deems, in good faith, that its brand name value and economies of scale are more properly attributable to the parent corporation. It also uses this transfer price to sell its product to all its independent retailers.
The fair price which might have been paid for the product sold by the marketing subsidiary would not be based upon "New York tanker prices" plus the lesser of representative contract carrier costs or the actual costs incurred for delivery. The Director would recognize the $0.02 per gallon higher price since that is the same price used for comparable sales to all uncontrolled entities for the audit period.

(f) Whenever the Director deems it necessary, in order properly to reflect entire net income of the taxpayer, he or she may determine the year or period in which an item of income, deduction, asset or liability shall be included, without regard to the method of accounting used by the taxpayer.

(g) The Director may require any person or corporation to submit whatever information under oath or affirmation, or to permit whatever examination of its books, papers and documents, as may be necessary to enable him or her to determine the existence, nature or extent of an agreement, understanding or arrangement to which this section relates, whether or not the person or corporation is subject to the tax imposed by the Act.

New York City:


Subpart 1. Tax on State Banks, Trust Companies, Financial Corporations and Savings and Loan Associations

§ 19. Computation of net income

The net income shall be computed in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the director of finance does clearly reflect the income. In determining net income, war losses, taxation of property recovered, and basis of property shall be treated in substantially the same manner as such losses, recoveries and basis are treated under the applicable provisions of section thirteen hundred thirty-one of the internal revenue code. [FN1]

§ 632-a. Personal service corporations and S corporations formed or availed of to avoid or evade New York State income tax

(a) General. If (1) substantially all of the services of a personal service corporation or S corporation are performed for or on behalf of another corporation, partnership, or other entity and (2) the effect of forming or availing of such personal service corporation or S corporation is the avoidance or evasion of New York income tax by reducing the income of, or in the case of a nonresident, reducing the New York source income of, or securing the benefit of any expense, deduction, credit, exclusion, or other allowance for, any employee-owner which would not otherwise be available, then the commissioner may allocate all income, deductions, credits, exclusions, and other allowances between such personal service corporation or S corporation (even if such personal service corporation or S corporation is taxed under article nine-A of this chapter or is not subject to tax in this state) and its employee-owners, provided such allocation is necessary to prevent avoidance or evasion of New York state income tax or to clearly reflect the source and the amount of the income of the personal service corporation or S corporation or any of its employee-owners.
§ 105-130.5A. Secretary's authority to adjust net income or require a combined return

(a) Notice.--When the Secretary has reason to believe that any corporation so conducts its trade or business in such manner as to fail to accurately report its State net income properly attributable to its business carried on in the State through the use of transactions that lack economic substance or are not at fair market value between members of an affiliated group of entities, the Secretary may, upon written notice to the corporation, require any information reasonably necessary to determine whether the corporation's intercompany transactions have economic substance and are at fair market value and for the accurate computation of the corporation's State net income properly attributable to its business carried on in the State. The corporation must provide the information requested within 90 days of the date of the notice.

(b) Adjust Net Income.--If upon review of the information provided, the Secretary finds as a fact that the corporation's intercompany transactions lack economic substance or are not at fair market value, the Secretary may redetermine the State net income of the corporation properly attributable to its business carried on in the State under this section by (i) adding back, eliminating, or otherwise adjusting intercompany transactions to accurately compute the corporation's State net income properly attributable to its business carried on in the State, or, if such adjustments are not adequate under the circumstances to redetermine State net income, (ii) requiring the corporation to file a return that reflects the net income on a combined basis of all members of its affiliated group that are conducting a unitary business. The Secretary shall consider and be authorized to use any reasonable method proposed by the corporation for redetermining its State net income attributable to its business carried on in the State. In determining whether the corporation's intercompany transactions lack economic substance or are not at fair market value, the Secretary shall consider each taxable year separately.

(c) Voluntary Redetermination.--In addition to the authority granted under subsection (b) of this section, if the Secretary has reason to believe that any corporation's State net income properly attributable to its business carried on in this State is not accurately reported on a separate return required by this Part because of intercompany transactions, without making a finding that those transactions lack economic substance or are not at fair market value, the Secretary and the corporation may jointly determine and agree to an alternative filing methodology that accurately reports State net income. The Secretary is authorized to allow any reasonable method for redetermining the corporation's State net income attributable to its business carried on in this State.

Prior Law Notes: S.L. 2011-390, § 3, rewrote subsec. (a), which prior thereto read:

"(a) The net income of a corporation shall be computed in accordance with the method of accounting it regularly employs in keeping its books. The method must be consistent with respect to both income and deductions. If this method does not clearly reflect the income, the computation shall be made in accordance with a method that, in the
Secretary's opinion, does clearly reflect the income, but shall follow as nearly as practicable the federal practice, unless contrary to the context and intent of this Part.

“The Secretary may adopt the rules and regulations and any guidelines administered or established by the Internal Revenue Service unless contrary to any provisions of this Part.”

North Dakota:

NDCC, 57-38.4-03

§ 57-38.4-03. Conditions imposed by tax commissioner

The tax commissioner may impose necessary conditions other than the imposition of worldwide combination to prevent tax avoidance or to clearly reflect income in accordance with chapter 57-38.1.

Oklahoma:

68 Okl.St.Ann. § 2366

The Tax Commission may allocate gross income, gains, losses, deductions, credits or allowances between two or more organizations, trades or businesses (whether or not incorporated, or organized in the United States or affiliated) owned or controlled directly or indirectly by the same interests, if the Tax Commission reasonably determines such allocation is necessary to prevent evasion of taxes or to clearly reflect income of the organizations, trades or businesses. Each such organization shall be deemed to be transacting business in Oklahoma and subject to all the provisions of this act. This section shall apply only with respect to related organizations, trades or businesses which in the aggregate derive income both within and outside the State of Oklahoma and then only with respect to such income, deductions, credits or allowances related thereto.

AG Opinion:

Oklahoma Tax Commission has authority to make adjustments between two or more taxpayers owned or controlled directly or indirectly by same interests when it “reasonably determines such allocation is necessary to prevent evasion of taxes or to clearly reflect income of the organizations, trades or businesses.” Op.Atty.Gen. Opinion No. 07-25, (August 28, 2007), 2007 WL 2670035

Oregon:

O.R.S. § 314.295

interests314.295. Allocation where two or more entities owned or controlled by the same
In any case of two or more organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Department of Revenue may distribute, apportion or allocate gross income, deductions, credits or allowances between or among such organizations, trades or businesses, if it determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades or businesses.

CREDIT(S)


Cases:
ORS 314.295 applies to the taxpayer in the conduct of “a trade or business.” Moser v. Department of Revenue, 1970, 1970 WL 616, Unreported. Taxation ☞3467

2. Partnerships

Allowing taxpayers to claim their proportionate shares of partnership income, depreciation, and interest to extent of limited partnership's basis in property was inappropriate in the absence of business purpose and some economic substance for sale and leaseback transaction. Baisch v. Department of Revenue, 1993, 316 Or. 203, 850 P.2d 1109. Taxation ☞3487

Pennsylvania:

72 P.S. § 3402-302

§ 3402-302. Manner of computing net income

The net income shall be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer; but if no such method of accounting has been so employed, or if the method employed, does not clearly reflect the income, the computation shall be made upon such basis, and in such manner, as in the opinion of the department does clearly reflect the income.

Tennessee:

T. C. A. § 67-4-2014

§ 67-4-2014. Variances to standard determination of apportionment

(a) If the tax computation, allocation or apportionment provisions of this part or chapter 2 of this title do not fairly represent the extent of the taxpayer's business activity in this state, or the taxpayer's net earnings, the taxpayer may petition for, or the department through its delegates 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 (1) or more of the formula factors;
(3) The inclusion of one (1) or more additional apportionment formula factors that will fairly represent the taxpayer's business activity in this state;

(4) The use of any other method to source receipts for purposes of the receipts factor or factors of the apportionment formula numerator or numerators; or

(5) The employment of any other method to effectuate an equitable computation, allocation and apportionment of the taxpayer's net earnings or losses that fairly represents the extent of the business entity's activities in Tennessee.

(b) If any factors are excluded from or added to the statutory apportionment formula, an appropriate change shall be made in the number used as the denominator of the fraction.

(c)(1) In any case of two (2) or more persons, organizations, trades or businesses, whether or not incorporated and whether or not affiliated, owned or controlled directly or indirectly by the same interests, the commissioner through delegates may distribute, apportion, or allocate income, deductions, credits, or allowances between or among such persons, organizations, trades or businesses, if the commissioner determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes, excessive use or abuse of exemptions, or to clearly reflect the income of such persons, organizations, trades or businesses. In addition, the commissioner through delegates may require combined reports utilizing a common apportionment formula covering members of an affiliated group. It is the intent of the general assembly that the federal regulations, rulings, and court implementations with respect to 26 U.S.C. § 482 be used as guidance in the administration of this provision.

(2) In the case of two (2) or more entities owned or controlled directly or indirectly by the same persons, including, but not limited to, affiliated groups, the commissioner, through the commissioner's delegates, may require combined reports and, if applicable, the utilization of a common apportionment formula covering such entities.

(3) The commissioner may apply federal taxation concepts, including, but not limited to, "assignment of income," "arms length," and "fair market value" to dealings between and among affiliates.

(4) The commissioner may disregard any entity created or transaction made that has no business purpose or is created or made with the primary purpose of evading either the federal income tax or the excise tax.

Utah:

U.C.A. 1953 § 59-7-113

§ 59-7-113. Allocation of income and deductions between several corporations controlled by same interests

If two or more corporations (whether or not organized or doing business in this state, and whether or not affiliated) are owned or controlled directly or indirectly by the same interests, the commission is authorized to distribute, apportion, or allocate gross income or deductions between or among such corporations, if it determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such corporations.

Virginia:

Virginia Code Ann. Sec. 58.1-446.

§ 58.1-446. Price manipulation; inter-corporate transactions; parent corporations and subsidiaries.

When any corporation liable to taxation under this chapter by agreement or otherwise conducts the business of such corporation in such manner as either directly or indirectly to benefit the members or stockholders of the corporation, or any of them, or any person or persons directly or indirectly interested in such business, by either buying or selling its products or the goods or commodities in which it deals at more or less than a fair price which might be obtained therefor, or when such a corporation sells its products, goods or commodities to another corporation or acquires and disposes of the products, goods or commodities of another corporation in such manner as to create a loss or improper taxable income, and such other corporation by stock ownership, agreement or otherwise controls or is controlled by the corporation liable to taxation under this chapter, the Department may require such facts as it deems necessary for the proper computation provided by this chapter and may for the purpose determine the amount which shall be deemed to be the Virginia taxable income of the business of such corporation for the taxable year. In determining such income, the Department shall have regard to the fair profits which, but for any agreement, arrangement or understanding, might be, or could have been, obtained from dealing in such products, goods or commodities.

Any corporation liable to taxation under this chapter and either owned or controlled by or owning or controlling, either directly or indirectly, another corporation may be required by the Department to make a report consolidated with such other corporation showing the combined gross and net income and such other information as the Department may require, but excluding intercorporate stockholdings and the intercorporate accounts. In case it appears to the Department that any arrangements exist in such a manner as improperly to reflect the business done or the Virginia taxable income earned from business done in this Commonwealth, the Department may, in such manner as it may determine, equitably adjust the tax. In all cases mentioned in this paragraph, such other corporations not otherwise liable to taxation under this chapter shall, for the purposes of this chapter, be deemed to be doing business in Virginia through the agency of the corporation liable to taxation under this chapter.

Virginia Regulations:

23VAC10-120-350.A.


This section allows the Department of Taxation to consolidate the accounts of two or more related trades or businesses which are owned or controlled directly or indirectly by the same interests and liable to taxation under this chapter, if the Department determines such consolidation is necessary to accurately distribute or apportion gains, profits, income, deductions or capital between or among such trades or businesses.
If related trades or businesses have been conducted in such a manner that income is inaccurately stated, the Internal Revenue Service will usually apply IRC §482 to make necessary adjustments. This section applies to situations in which the federal taxable income is accurately stated but the income from Virginia sources taxable by Virginia is inaccurate.

If one of the related trades or businesses is a corporation, §58.1-446 of the Code of Virginia may also apply.

23VAC10-120-350.B.

“Trades or businesses” means any trade or business which keeps its own accounting records and which is required to make a separate report of its income to the Department of Taxation or any other taxing authority.

“Related.” Trades or businesses are related if they are doing business with each other directly or indirectly. Such business dealings may consist of buying and selling of goods, services or other property, or borrowing or lending money or other property.

“Liable to taxation under this chapter.” A trade or business is liable to taxation under this chapter if:

in the case of a sole proprietorship, the owner is subject to Virginia income tax;

in the case of a partnership, any of the partners is subject to Virginia income tax;

in the case of a corporation, it is subject to Virginia income tax;

in the case of an electing small business under Subchapter S of the Internal Revenue Code, any of the shareholders is subject to Virginia income tax;

23VAC10-120-350.B.3.e.
in any case where an owner, partner or shareholder is an estate or trust, either the estate or trust is subject to Virginia income tax or any beneficiary is subject to Virginia income tax on distributions from such estate or trust.

“Owned or controlled directly or indirectly.” A trade or business is owned or controlled directly or indirectly by another person or entity if such other person or entity has
substantial influence over the manner in which the business is conducted. Substantial influence may be exerted by owners, shareholders, partners and others depending upon the facts and circumstances of each case.


“Same interests.” Two or more related trades or businesses are owned or controlled directly or indirectly by the same interests if any one person or entity, or group of persons or entities acting together, has enough ownership or control of each trade or business to have substantial influence over the manner in which the business is conducted. The nature of the ownership or control interest does not have to be identical for each trade or business.


“Accurate distribution or apportionment.” The purpose of this section is to assure that items of income, gain, profit, deductions and capital are properly distributed or apportioned between taxpayers who may be taxable at different rates, by different methods or in different states.


“Consolidate the accounts.” If the Department finds it necessary to consolidate the accounts of two or more related trades or businesses then the accounts will be adjusted in order to accurately distribute or apportion gains, profits, income, deductions or losses of such trades or businesses.


“Request of the taxpayer.” A taxpayer may request permission to consolidate accounts of related trades or businesses by filing an amended return using the proposed consolidation and shall attach an explanation of nature and cause of the distortion of income from Virginia sources and an explanation of why the consolidation of accounts is necessary in order to make an accurate distribution or apportionment of gains, profits, income, deductions or capital between or among such related trades or businesses. If the Department finds that consolidation is necessary, the tax shall be adjusted accordingly.


Historical Notes: Derived from VR 630-3-445; eff. January 1, 1985.

Wisconsin:

W.S.A. 71.10

71.10. General provisions

(1) Allocation of gross income, deductions, credits between 2 or more businesses. In any case of 2 or more organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States, whether or not affiliated, and whether or not unitary) owned or controlled directly or indirectly by the same interests, the secretary or the secretary's delegate may distribute, apportion or allocate gross income, deductions, credits or allowances between or among such organizations, trades or businesses, if the secretary determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades or businesses. The authority granted under
this subsection is in addition to, and not a limitation of or dependent on, the provisions of ss. 71.05(6)(a)24. and (b)45., 71.26(2)(a)7. and 8., 71.34(1k)(j) and (k), 71.45(2)(a)16. and 17., and 71.80(23).

(1m) Transactions without economic substance. (a) If any person, directly or indirectly, engages in a transaction or series of transactions without economic substance to create a loss or to reduce taxable income or to increase credits allowed in determining Wisconsin tax, the department shall determine the amount of a taxpayer's taxable income or tax so as to reflect what would have been the taxpayer's taxable income or tax if not for the transaction or transactions without economic substance causing the reduction in taxable income or tax.

(b) A transaction has economic substance only if the taxpayer shows all of the following:

1. The transaction changes the taxpayer's economic position in a meaningful way, apart from federal, state, local, and foreign tax effects.

2. The taxpayer has a substantial nontax purpose for entering into the transaction and the transaction is a reasonable means of accomplishing the substantial nontax purpose. A transaction has a substantial nontax purpose if it has substantial potential for profit, disregarding any tax effects.

(c) With respect to transactions between members of a controlled group as defined in section 267(f)(1) of the Internal Revenue Code, such transactions shall be presumed to lack economic substance and the taxpayer shall bear the burden of establishing by clear and convincing evidence that a transaction or a series of transactions between the taxpayer and one or more members of the controlled group has economic substance.

71.30. General provisions

(1) Accounting method. (a) A corporation shall use a method of accounting authorized under the internal revenue code and shall use the same method used for federal income tax purposes if that method is authorized under the internal revenue code.

(b) A corporation that changes its method of accounting while subject to taxation under this chapter shall make the adjustments required under the internal revenue code, except that in the last year that a corporation is subject to taxation under this chapter it shall take into account all of the remaining adjustments required by this chapter because of a change in method of accounting.

(2) Allocation of gross income, deductions, credits between 2 or more businesses. In any case of 2 or more organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States, whether or not affiliated, and whether or not unitary) owned or controlled directly or indirectly by the same interests, the secretary or his or her delegate may distribute, apportion or allocate gross income, deductions, credits or allowances between or among such organizations, trades or businesses, if he or she determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades or businesses. The authority granted under this subsection is in addition to, and not a limitation of or dependent on, the provisions of ss. 71.05(6)(a)24. and (b)45., 71.26(2)(a)7. and 8., 71.34(1k)(j) and (k), 71.45(2)(a)16. and 17., and 71.80(23).
Transactions without economic substance. (a) If any person, directly or indirectly, engages in a transaction or series of transactions without economic substance to create a loss or to reduce taxable income or to increase credits allowed in determining Wisconsin tax, the department shall determine the amount of a taxpayer's taxable income or tax so as to reflect what would have been the taxpayer's taxable income or tax if not for the transaction or transactions without economic substance causing the reduction in taxable income or tax.

(b) A transaction has economic substance only if the taxpayer shows both of the following:

1. The transaction changes the taxpayer's economic position in a meaningful way, apart from federal, state, local, and foreign tax effects.

2. The taxpayer has a substantial nontax purpose for entering into the transaction and the transaction is a reasonable means of accomplishing the substantial nontax purpose. A transaction has a substantial nontax purpose if it has substantial potential for profit, disregarding any tax effects.

(c) With respect to transactions between members of a controlled group as defined in section 267(f)(1) of the Internal Revenue Code, such transactions shall be presumed to lack economic substance and the taxpayer shall bear the burden of establishing by clear and convincing evidence that a transaction or a series of transactions between the taxpayer and one or more members of the controlled group has economic substance.

Pricing effect on taxable income. (a) When any corporation liable to taxation under this chapter conducts its business in such a manner as either directly or indirectly to benefit the members or stockholders thereof or any person interested in such business, by selling its products or the goods or commodities in which it deals at less than the fair price which might be obtained therefor, or where a corporation, a substantial portion of whose capital stock is owned either directly or indirectly by another corporation, acquires and disposes of the products of the corporation so owning a substantial portion of its stock in such a manner as to create a loss or improper net income, the department may determine the amount of taxable income to such corporation for the calendar or fiscal year, having due regard to the reasonable profits which but for such arrangement or understanding might or could have been obtained from dealing in such products, goods or commodities.

(b) For the purpose of this chapter, if a corporation which is required to file an income or franchise tax return is affiliated with or related to any other corporation through stock ownership by the same interests or as parent or subsidiary corporations or has income that is regulated through contract or other arrangement, the department of revenue may require such consolidated statements as in its opinion are necessary in order to determine the taxable income received by any one of the affiliated or related corporations or to determine whether the corporations are a unitary business.

W.S.A. 71.80

71.80. General administrative provisions

Department duties and powers. (a) The department shall assess incomes as provided in this chapter and in performance of such duty the department shall possess all
powers now or hereafter granted by law to the department in the assessment of personal property and also the power to estimate incomes.

(b) In any case of 2 or more organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States, whether or not affiliated, and whether or not unitary) owned or controlled directly or indirectly by the same interests, the secretary or the secretary's delegate may distribute, apportion or allocate gross income, deductions, credits or allowances between or among such organizations, trades or businesses, if the secretary determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades or businesses. The authority granted under this subsection is in addition to, and not a limitation of or dependent on, the provisions of sub. (23) and ss. 71.05(6)(a)24. and (b)45., 71.26(2)(a)7. and 8., 71.34(1k)(j) and (k), and 71.45(2)(a)16. and 17.