NOTICE OF PUBLIC HEARINGS
Regarding
Proposed Model Statute Requiring the Add-back of
Certain Intangible and Interests Expenses

The MULTISTATE TAX COMMISSION will conduct a public hearing to obtain comments from interested parties on a Proposed Model Statute Requiring the Add-back of Certain Intangible and Interests Expenses setting forth the circumstances under which the deduction of certain intangibles expenses and interest costs paid to a related party will be disallowed and these expenses will be required to be added back to the taxpayer's net income. The Proposal is appended to this Notice as Attachment A.

The hearing on the Proposal is scheduled for:

MONDAY, JULY 18, 2005, 1:30 P.M.
Hall of the States, Room 231
444 North Capitol Street NW
Washington, DC 20001

All comments received as part of the hearing process will be set forth in a hearing officer's report that will be submitted to the MTC Executive Committee. The Committee will read what you say and then will consider the Proposal for appropriate action. *See* MTC's Uniformity Recommendation Development Process step seven, available at www.mtc.gov/uniform/9steps.htm

The hearing officer for this matter is Frank D. Katz. Please submit all questions, comments and correspondence regarding this hearing matter to: Frank D. Katz, Multistate Tax Commission, 444 N. Capitol Street, N.W., Suite 425, Washington, D.C. 20001-1538, Phone: (505) 982 4351, Fax: (505) 982 4379, E-mail: fkatz@mtc.gov

All interested parties are invited to participate in these public hearings. Parties wishing to make formal oral presentations are requested to notify the hearing officer in writing at least two (2) working days prior to the hearing date. Written comments are acceptable and encouraged. They may be submitted at any time prior to or on the hearing dates or by such later date as may be announced at the closing of the public hearings. Interested parties may participate by telephone. Please contact the hearing officer for specific instructions on how to connect by telephone.

Attachment A

Proposed Model Statute Requiring the Add-back of Certain Intangible and Interests Expenses

Draft Approved by Executive Committee 4-28-05

Section 1.

(a) As used in this section, the following words shall, unless the context requires otherwise, have the following meanings:

(i) "Aggregate effective rate of tax" means the sum of the effective rates of tax imposed by a state or U.S. possession or any combination thereof on a related member.

(ii) "Code" means the federal Internal Revenue Code as amended and in effect for the taxable year.

(iii) "Effective rate of tax" means, as to any state or U.S possession, the maximum statutory rate of tax imposed by the state or possession on a related member's net income multiplied by the apportionment percentage, if any, applicable to the related member under the laws of said jurisdiction. For purposes of this definition, the effective rate of tax as to any state or U.S. possession is zero where the related member's net income tax liability in said jurisdiction is reported on a combined or consolidated return including both the taxpayer and the related member where the reported transactions between the taxpayer and the related member are eliminated or offset. Also, for purposes of this definition, when computing the effective rate of tax for a jurisdiction in which a related member's net income is eliminated or offset by a credit or similar adjustment that is dependent upon the related member either maintaining or managing intangible property or collecting interest income in that jurisdiction, the maximum statutory rate of tax imposed by said jurisdiction shall be decreased to reflect the statutory rate of tax that applies to the related member as effectively reduced by such credit or similar adjustment.

(iv) "Intangible expense" includes (1) expenses, losses and costs for, related to, or in connection directly or indirectly with the direct or indirect acquisition, use, maintenance or management, ownership, sale, exchange, or any other disposition of intangible property to the extent such amounts are allowed as deductions or costs in determining taxable income before operating loss deductions and special deductions for the taxable year under the Code; (2) amounts directly or indirectly allowed as deductions under section 163 of the Code for purposes of determining taxable income under the Code to the extent such expenses and costs are directly or indirectly for, related to, or in connection with the expenses, losses and costs referenced in (1); (3) losses related to, or incurred in connection directly or indirectly with, factoring transactions or discounting transactions; (4) royalty, patent, technical and copyright fees; (5) licensing fees; and (6) other similar expenses and costs.

(v) "Intangible property" includes patents, patent applications, trade names, trademarks, service marks, copyrights, mask works, trade secrets and similar types of intangible assets.

(vi) "Related entity" means (1) a stockholder who is an individual, or a member of the stockholder's family set forth in section 318 of the Code if the stockholder and the members of the stockholder's family own, directly, indirectly, beneficially or constructively, in the aggregate, at least 50 per cent of the value of the taxpayer's outstanding stock; (2) a stockholder, or a stockholder's partnership, limited liability company, estate, trust or corporation, if the stockholder and the stockholder's partnerships, limited liability companies, estates, trusts and corporations own directly, indirectly, beneficially or constructively, in the aggregate, at least 50 per cent of the value of the taxpayer's outstanding stock; or (3) a corporation, or a party related to the corporation in a manner that would require an attribution of stock from the corporation to the party or from the party to the corporation under the attribution rules of the Code if the taxpayer owns, directly, indirectly, beneficially or constructively, at least 50 per cent of the value of the corporation's outstanding stock. The attribution rules of the Code shall apply for purposes of determining whether the ownership requirements of this definition have been met.

(vii) "Related member" means a person that, with respect to the taxpayer during all or any portion of the taxable year, is: (1) a related entity, (2) a component member as defined in subsection (b) of section 1563 of the Code; (3) a person to or from whom there is attribution of stock ownership in accordance with subsection (e) of section 1563 of the Code; or (4) a person that, notwithstanding its form of organization, bears the same relationship to the taxpayer as a person described in (1) to (3), inclusive.

(viii) “Valid business purpose” means one or more business purposes, other than the avoidance or reduction of taxation, which alone or in combination constitute the primary motivation for a business activity or transaction, which activity or transaction changes in a meaningful way, apart from tax effects, the economic position of the taxpayer. The economic position of the taxpayer includes an increase in the market share of the taxpayer or the entry by the taxpayer into new business markets.

(b) For purposes of computing its net income under this chapter, a taxpayer shall add back otherwise deductible intangible expense directly or indirectly paid, accrued or incurred in connection with one or more direct or indirect transactions with one or more related members.

(c) (i) The adjustment required in subsection (b) shall not apply if the taxpayer establishes by clear and convincing evidence of the type and in the form specified by the commissioner that (A) the related member was subject to tax on its net income in this state or another state or possession of the United States or some combination thereof; (B) the tax base for said tax included the intangible expense paid, accrued or incurred by the taxpayer; and (C) the aggregate effective rate of tax applied to the related member is no less than [__%] [the statutory rate of tax applied to the taxpayer under this chapter minus __ percentage points].

(ii) The adjustment required in subsection (b) shall not apply if the taxpayer establishes by clear and convincing evidence of the type and in the form specified by the commissioner that (A) the intangible expense was paid, accrued or incurred to a related member organized under the laws of a country other than the United States; (B) the related member's income from the transaction was subject to a comprehensive income tax treaty between such country and the United States, (C) the related member's income from the transaction was taxed in such country at a tax rate at least equal to that imposed by this state; and (D) the intangible expense was paid, accrued or incurred pursuant to a transaction that was undertaken for a valid business purpose and using terms that reflect an arm's length relationship.

(iii) The adjustment required in subsection (b) shall not apply to the portion of the intangible expense that the taxpayer establishes by clear and convincing evidence meets both of the following requirements: (A) the related member during the same taxable year directly or indirectly paid, accrued or incurred such portion to a person that is not a related member, and (B) the transaction giving rise to the intangible expense between the taxpayer and the related member was undertaken for a valid business purpose.

(iv) The adjustment required in subsection (b) shall not apply if the corporation and the commissioner agree in writing to the application or use of alternative adjustments or computations. The commissioner may, in his/her discretion, agree to the application or use of alternative adjustments or computations when he/she concludes that in the absence of such agreement the income of the taxpayer would not be properly reflected.

(d) Nothing in this subsection shall be construed to limit or negate the commissioner's authority to otherwise enter into agreements and compromises otherwise allowed by law.

(e) Nothing in this section shall be construed to limit or negate the commissioner's authority to make adjustments under section __ [i.e., the state's transfer pricing authority, if any].

Section 2.

(a) As used in this section, the following words shall, unless the context requires otherwise, have the following meanings:-

(i) "Aggregate effective rate of tax" means the sum of the effective rates of tax imposed by a state or U.S. possession or any combination thereof on a related member.

(ii) "Code" means the federal Internal Revenue Code as amended and in effect for the taxable year.

(iii) "Effective rate of tax" means, as to any state or U.S possession, the maximum statutory rate of tax imposed by the state or possession on a related member's net income multiplied by the apportionment percentage, if any, applicable to the related member under the laws of said jurisdiction. For purposes of this definition, the effective rate of tax as to any state or U.S. possession is zero where the related member's net income tax liability in said jurisdiction is reported on a combined or consolidated return including both the taxpayer and the related member where the reported transactions between the

taxpayer and the related member are eliminated or offset. Also, for purposes of this definition, when computing the effective rate of tax for a jurisdiction in which a related member's net income is eliminated or offset by a credit or similar adjustment that is dependent upon the related member either maintaining or managing intangible property or collecting interest income in that jurisdiction, the maximum statutory rate of tax imposed by said jurisdiction shall be decreased to reflect the statutory rate of tax that applies to the related member as effectively reduced by such credit or similar adjustment.

(iv) "Interest expense" means amounts directly or indirectly allowed as deductions under section 163 of the Code for purposes of determining taxable income under the Code.

(v) "Valid business purpose" means one or more business purposes, other than the avoidance or reduction of taxation, which alone or in combination constitute the primary motivation for a business activity or transaction, which activity or transaction changes in a meaningful way, apart from tax effects, the economic position of the taxpayer. The economic position of the taxpayer includes an increase in the market share of the taxpayer or the entry by the taxpayer into new business markets.

(b) For purposes of computing its net income under this chapter, a taxpayer shall add back otherwise deductible interest paid, accrued or incurred to a related member, as defined in section 1, during the taxable year.

(c) (i) The adjustment required in subsection (b) shall not apply the if taxpayer establishes by clear and convincing evidence of the type and in the form specified by the commissioner that (A) the related member was subject to tax on its net income in this state or another state or possession of the United States or some combination thereof; (B) the tax base for said tax included the interest expense paid, accrued or incurred by the taxpayer; and (C) the aggregate effective rate of tax applied to the related member is no less than [__%] [the statutory rate of tax applied to the taxpayer under this chapter minus __ percentage points].

(ii) The adjustment required in subsection (b) shall not apply if the taxpayer establishes by clear and convincing evidence of the type and in the form specified by the commissioner that (A) the interest expense is paid, accrued or incurred to a related member organized under the laws of a country other than the United States; (B) the related member's income from the transaction is subject to a comprehensive income tax treaty between such country and the United States; (C) the related member's income from the transaction is taxed in such country at a tax rate at least equal to that imposed by this state; and (D) the interest expense was paid, accrued or incurred pursuant to a transaction that was undertaken for a valid business purpose and using terms that reflect an arm's length relationship.

(iii) The adjustment required in subsection (b) shall not apply if the taxpayer establishes by clear and convincing evidence, of the type and in the form determined by the commissioner, that (A) the transaction giving rise to interest expense between the taxpayer and the related member was undertaken for a valid business purpose, and (B)

the interest expense was paid, accrued or incurred using terms that reflect an arm's length relationship.

(iv) The adjustment required in subsection (b) shall not apply if the corporation and the commissioner agree in writing to the application or use of alternative adjustments or computations. The commissioner may, in his/her discretion, agree to the application or use of alternative adjustments or computations when he/she concludes that in the absence of such agreement the income of the taxpayer would not be properly reflected.

(d) Nothing in this subsection shall be construed to limit or negate the commissioner's authority to otherwise enter into agreements and compromises otherwise allowed by law.

(e) Nothing in this section shall be construed to limit or negate the commissioner's authority to make adjustments under section ___ [i.e., the state's transfer pricing authority, if any].