

# Recommended Formula for the Apportionment and Allocation Of Net Income of Financial Institutions

*Adopted November 17, 1994*

*DRAFT Amendments –for Discussion Purposes Only  
August 26, 2009*

## **Section 1. Apportionment and Allocation.**

(a) Except as otherwise specifically provided, a financial institution whose business activity is taxable both within and without this state shall allocate and apportion its net income as provided in this [Act]. All items of nonbusiness income (income which is not includable in the apportionable income tax base) shall be allocated pursuant to the provisions of [ ]. A financial institution organized under the laws of a foreign country, the Commonwealth of Puerto Rico, or a territory or possession of the United States whose effectively connected income (as defined under the Federal Internal Revenue Code) is taxable both within this state and within another state, other than the state in which it is organized, shall allocate and apportion its net income as provided in this [Act].

(b) All business income (income which is includable in the apportionable income tax base) shall be apportioned to this state by multiplying such income by the apportionment percentage. The apportionment percentage is determined by adding the taxpayer's receipts factor (as described in Section 3 of this article), property factor (as described in Section 4 of this article), and payroll factor (as described in Section 5 of this article) together and dividing the sum by three. If one of the factors is missing, the two remaining factors are added and the sum is divided by two. If two of the factors are missing, the remaining factor is the apportionment percentage. A factor is missing if both its numerator and denominator are zero, but it is not missing merely because its numerator is zero.

(c) Each factor shall be computed according to the method of accounting (cash or accrual basis) used by the taxpayer for the taxable year.

(d) If the allocation and apportionment provisions of this [Act] do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the [State Tax Administrator] may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

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

## **Section 2. Definitions.**

As used in this [Act], unless the context otherwise requires:

(a) "**Billing address**" means the location indicated in the books and records of the taxpayer on the first day of the taxable year (or on such later date in the taxable year when the customer relationship began) as the address where any notice, statement and/or bill relating to a customer's account is mailed.

(b) "**Borrower or credit card holder located in this state**" means:

- (1) a borrower, other than a credit card holder, that is engaged in a trade or business which maintains its commercial domicile in this state; or
- (2) a borrower that is not engaged in a trade or business or a credit card holder whose billing address is in this state.

(c) "**Commercial domicile**" means:

- (1) the headquarters of the trade or business, that is, the place from which the trade or business is principally managed and directed; or
- (2) if a taxpayer is organized under the laws of a foreign country, or of the Commonwealth of Puerto Rico, or any territory or possession of the United States, such taxpayer's commercial domicile shall be deemed for the purposes of this [Act] to be the state of the United States or the District of Columbia from which such taxpayer's trade or business in the United States is principally managed and directed. It shall be presumed, subject to rebuttal, that the location from which the taxpayer's trade or business is principally managed and directed is the state of the United States or the District of Columbia to which the greatest number of employees are regularly connected or out of which they are working, irrespective of where the services of such employees are performed, as of the last day of the taxable year.

(d) "**Compensation**" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services that are included in such employee's gross income under the Federal Internal Revenue Code. In the case of employees not subject to the Federal Internal Revenue Code, e.g., those employed in foreign countries, the determination of whether such payments would constitute gross income to such employees under the Federal Internal Revenue Code shall be made as though such employees were subject to the Federal Internal Revenue Code.

(e) "**Credit card**" means credit, travel or entertainment card.

(f) "**Credit card issuer's reimbursement fee**" means the fee a taxpayer receives from a merchant's bank because one of the persons to whom the taxpayer has issued a credit card has charged merchandise or services to the credit card.

(g) "**Employee**" means, with respect to a particular taxpayer, any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee of that taxpayer.

(h) "**Financial institution**" means: [insert state's definition here][*for a starting point for the development of a definition, see Appendix A.*]

(i) "**Gross rents**" means the actual sum of money or other consideration payable for the use or possession of property. "Gross rents" shall include, but not be limited to:

- (1) any amount payable for the use or possession of real property or tangible property whether designated as a fixed sum of money or as a percentage of receipts, profits or otherwise,
- (2) any amount payable as additional rent or in lieu of rent, such as interest, taxes, insurance, repairs or any other amount required to be paid by the terms of a lease or other arrangement, and
- (3) a proportionate part of the cost of any improvement to real property made by or on behalf of the taxpayer which reverts to the owner or lessor upon termination of a lease or other arrangement. The amount to be included in gross rents is the amount of amortization or depreciation allowed in computing the taxable income base for the taxable year. However, where a building is erected on leased land by or on behalf of the taxpayer, the value of the land is determined by multiplying the gross rent by eight and the value of the building is determined in the same manner as if owned by the taxpayer.

(4) The following are not included in the term "gross rents":

- (A) reasonable amounts payable as separate charges for water and electric service furnished by the lessor;
- (B) reasonable amounts payable as service charges for janitorial services furnished by the lessor;
- (C) reasonable amounts payable for storage, provided such amounts are payable for space not designated and not under the control of the taxpayer; and
- (D) that portion of any rental payment which is applicable to the space subleased from the taxpayer and not used by it.

(j) "**Loan**" means any extension of credit resulting from direct negotiations between the taxpayer and its customer, and/or the purchase, in whole or in part, of such extension of credit from another. Loans include participations, syndications, and leases treated as loans for federal income tax purposes. Loans shall not include: properties treated as loans under Section 595 of the Federal Internal Revenue Code; futures or forward contracts; options; notional principal contracts such as swaps; credit card receivables, including purchased credit card relationships; non-interest bearing balances due from depository institutions; cash items in the process of collection; federal funds sold; securities purchased under agreements to resell; assets held in a trading account; securities; interests in a REMIC, or other mortgage-backed or asset-backed security; and other similar items.

(k) "**Loan secured by real property**" means that fifty percent or more of the aggregate value of the collateral used to secure a loan or other obligation, when valued at fair market value as of the time the original loan or obligation was incurred, was real property.

(l) "**Merchant discount**" means the fee (or negotiated discount) charged to a merchant by the taxpayer for the privilege of participating in a program whereby a credit card is accepted in payment for merchandise or services sold to the card holder.

(m) "**Participation**" means an extension of credit in which an undivided ownership interest is held on a *pro rata* basis in a single loan or pool of loans and related collateral. In a loan participation, the credit originator initially makes the loan and then subsequently resells all or a portion of it to other lenders. The participation may or may not be known to the borrower.

(n) "**Person**" means an individual, estate, trust, partnership, corporation and any other business entity.

(o) "**Principal base of operations**" with respect to transportation property means the place of more or less permanent nature from which said property is regularly directed or controlled. With respect to an employee, the "principal base of operations" means the place of more or less permanent nature from which the employee regularly (1) starts his or her work and to which he or she customarily returns in order to receive instructions from his or her employer or (2) communicates with his or her customers or other persons, or (3) performs any other functions necessary to the exercise of his or her trade or profession at some other point or points.

(p) "**Real property owned**" and "**tangible personal property owned**" mean real and tangible personal property, respectively, (1) on which the taxpayer may claim depreciation for federal income tax purposes, or (2) property to which the taxpayer holds legal title and on which no other person may claim depreciation for federal income tax purposes (or could claim depreciation if subject to federal income tax). Real and tangible personal property do not include coin, currency, or property acquired in lieu of or pursuant to a foreclosure.

(q) "**Regular place of business**" means an office at which the taxpayer carries on its business

in a regular and systematic manner and which is continuously maintained, occupied and used by employees of the taxpayer.

(r) "**State**" means a state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States or any foreign country.

(s) "**Syndication**" means an extension of credit in which two or more persons fund and each person is at risk only up to a specified percentage of the total extension of credit or up to a specified dollar amount.

(t) "**Taxable**" means either:

(1) that a taxpayer is subject in another state to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, a corporate stock tax (including a bank shares tax), a single business tax, or an earned surplus tax, or any tax which is imposed upon or measured by net income; or

(2) that another state has jurisdiction to subject the taxpayer to any of such taxes regardless of whether, in fact, the state does or does not.

(u) "**Transportation property**" means vehicles and vessels capable of moving under their own power, such as aircraft, trains, water vessels and motor vehicles, as well as any equipment or containers attached to such property, such as rolling stock, barges, trailers or the like.

### **Section 3. Receipts Factor.**

(a) **General.** The receipts factor is a fraction, the numerator of which is the receipts of the taxpayer in this state during the taxable year and the denominator of which is the receipts of the taxpayer within and without this state during the taxable year. The method of calculating receipts for purposes of the denominator is the same as the method used in determining receipts for purposes of the numerator. The receipts factor shall include only those receipts described herein which constitute business income and are included in the computation of the apportionable income base for the taxable year.

(b) **Receipts from the lease of real property.** The numerator of the receipts factor includes receipts from the lease or rental of real property owned by the taxpayer if the property is located within this state or receipts from the sublease of real property if the property is located within this state.

(c) **Receipts from the lease of tangible personal property.**

(1) Except as described in paragraph (2) of this subsection, the numerator of the receipts factor includes receipts from the lease or rental of tangible personal property owned by the taxpayer if the property is located within this state when it is first placed in service by the lessee.

(2) Receipts from the lease or rental of transportation property owned by the taxpayer are included in the numerator of the receipts factor to the extent that the property is used in this state. The extent an aircraft will be deemed to be used in this state and the amount of receipts that is to be included in the numerator of this state's receipts factor is determined by multiplying all the receipts from the lease or rental of the aircraft by a fraction, the numerator of which is the number of landings of the aircraft in this state and the denominator of which is the total number of landings of the aircraft. If the extent of the use of any transportation property within this state cannot be determined, then the property will be deemed to be used wholly in the state in which the property has its principal base of operations. A motor vehicle will be deemed to be used wholly in the state in which it is registered.

(d) **Interest from loans secured by real property.**

(1) The numerator of the receipts factor includes interest and fees or penalties in the

nature of interest from loans secured by real property if the property is located within this state. If the property is located both within this state and one or more other states, the receipts described in this subsection are included in the numerator of the receipts factor if more than fifty percent of the fair market value of the real property is located within this state. If more than fifty percent of the fair market value of the real property is not located within any one state, then the receipts described in this subsection shall be included in the numerator of the receipts factor if the borrower is located in this state.

- (2) The determination of whether the real property securing a loan is located within this state shall be made as of the time the original agreement was made and any and all subsequent substitutions of collateral shall be disregarded.

(e) **Interest from loans not secured by real property.** The numerator of the receipts factor includes interest and fees or penalties in the nature of interest from loans not secured by real property if the borrower is located in this state.

(f) **Net gains from the sale of loans.** The numerator of the receipts factor includes net gains from the sale of loans. Net gains from the sale of loans includes income recorded under the coupon stripping rules of Section 1286 of the Internal Revenue Code.

- (1) The amount of net gains (but not less than zero) from the sale of loans secured by real property included in the numerator is determined by multiplying such net gains by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to subsection (d) of this section and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans secured by real property.
- (2) The amount of net gains (but not less than zero) from the sale of loans not secured by real property included in the numerator is determined by multiplying such net gains by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to subsection (e) of this section and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans not secured by real property.

(g) **Receipts from credit card receivables.** The numerator of the receipts factor includes interest and fees or penalties in the nature of interest from credit card receivables and receipts from fees charged to card holders, such as annual fees, if the billing address of the card holder is in this state.

(h) **Net gains from the sale of credit card receivables.** The numerator of the receipts factor includes net gains (but not less than zero) from the sale of credit card receivables multiplied by a fraction, the numerator of which is the amount included in the numerator of the receipts factor pursuant to subsection (g) of this section and the denominator of which is the taxpayer's total amount of interest and fees or penalties in the nature of interest from credit card receivables and fees charged to card holders.

(i) **Credit card issuer's reimbursement fees.** The numerator of the receipts factor includes all credit card issuer's reimbursement fees multiplied by a fraction, the numerator of which is the amount included in the numerator of the receipts factor pursuant to subsection (g) of this section and the denominator of which is the taxpayer's total amount of interest and fees or penalties in the nature of interest from credit card receivables and fees charged to card holders.

(j) **Receipts from merchant discount.** Such receipts shall be computed net of any cardholder charge backs, but shall not be reduced by any interchange transaction fees or by any issuer's reimbursement fees paid to another for charges made by its card holders.

- (1) If the financial institution has readily available information regarding the location of the merchant, then the numerator of the receipts factor includes receipts from

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merchant discount if the location of the merchant is in this state.

(2) If the financial institution does not have readily available information regarding the location of the merchant, then the numerator of the receipts factor includes receipts from merchant discount multiplied by a fraction, the numerator of which is the amount included in the numerator of the receipts factor pursuant to subsection (g) of this section and the denominator of which is the taxpayer's total amount of interest and fees or penalties in the nature of interest from credit card receivables and fees charged to card holders.

(3) The method used for sourcing merchant discount must be consistently applied in all states that have adopted provisions (1) and (2) above and also must be used on all subsequent returns unless the taxpayer receives prior permission from the State Tax Administrator to use a different method.

**(k) Receipts from ATM fees.** The numerator of the receipts factor includes ATM fees charged for use of an ATM card within this state. For purposes of this regulation, an ATM card is used within this state if the ATM machine at which the transaction took place is in this state.

**(l) Loan servicing fees.**

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(A) The numerator of the receipts factor includes loan servicing fees derived from loans secured by real property multiplied by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to subsection (d) of this section and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans secured by real property.

(B) The numerator of the receipts factor includes loan servicing fees derived from loans not secured by real property multiplied by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to subsection (e) of this section and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans not secured by real property.

(2) In circumstances in which the taxpayer receives loan servicing fees for servicing either the secured or the unsecured loans of another, the numerator of the receipts factor shall include such fees if the borrower is located in this state.

**(m) Receipts from services.** The numerator of the receipts factor includes receipts from services not otherwise apportioned under this section if the service is performed in this state. If the service is performed both within and without this state, the numerator of the receipts factor includes receipts from services not otherwise apportioned under this section, if a greater proportion of the income-producing activity is performed in this state based on cost of performance. [Continuing discussion on this section.](#)

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**(n) Receipts from taxpayer's investment assets and activities and its trading assets and activities.**

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(1) This subsection applies to receipts from the taxpayer's own investment and trading assets and activities.

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(2) Interest, dividends, net gains (but not less than zero) and other income from investment assets and activities and from trading assets and activities shall be included in the receipts factor. Investment assets and activities and trading assets and activities include but are not limited to: investment securities; trading account assets; federal funds; securities purchased and sold under agreements to resell or

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repurchase; options; futures contracts; forward contracts; notional principal contracts such as swaps; equities; and foreign currency transactions. With respect to the investment and trading assets and activities described in subparagraphs (A) and (B) of this paragraph, the receipts factor shall include the amounts described in such subparagraphs.

(A) The receipts factor shall include the amount by which interest from federal funds sold and securities purchased under resale agreements exceeds interest expense on federal funds purchased and securities sold under repurchase agreements.

(B) The receipts factor shall include the amount by which interest, dividends, gains and other income from trading assets and activities, including but not limited to assets and activities in the matched book, in the arbitrage book, and foreign currency transactions, exceed amounts paid in lieu of interest, amounts paid in lieu of dividends, and losses from such assets and activities.

(3) The numerator of the receipts factor includes interest, dividends, net gains (but not less than zero) and other income from investment assets and activities and from trading assets and activities described in paragraph (1) of this subsection that are attributable to this state.

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(A) The amount of interest, dividends, net gains (but not less than zero) and other income from investment assets and activities in the investment account to be attributed to this state and included in the numerator is determined by multiplying all such income from such assets and activities by a fraction, the numerator of which is the average value of such assets which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the average value of all such assets.

(B) The amount of interest from federal funds sold and purchased and from securities purchased under resale agreements and securities sold under repurchase agreements attributable to this state and included in the numerator is determined by multiplying the amount described in subparagraph (A) of paragraph (1) of this subsection from such funds and such securities by a fraction, the numerator of which is the average value of federal funds sold and securities purchased under agreements to resell which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the average value of all such funds and such securities.

(C) The amount of interest, dividends, gains and other income from trading assets and activities, including but not limited to assets and activities in the matched book, in the arbitrage book and foreign currency transactions (but excluding amounts described in subparagraphs (A) or (B) of this paragraph), attributable to this state and included in the numerator is determined by multiplying the amount described in subparagraph (B) of paragraph (1) of this subsection by a fraction, the numerator of which is the average value of such trading assets which are properly assigned to a regular place of business

of the taxpayer within this state and the denominator of which is the average value of all such assets.

(D) For purposes of this paragraph, average value shall be determined using the rules for determining the average value of tangible personal property set forth in subsections (c) and (d) of Section 4.

~~(4) In lieu of using the method set forth in paragraph (2) of this subsection, the taxpayer may elect, or the [State Tax Administrator] may require in order to fairly represent the business activity of the taxpayer in this state, the use of the method set forth in this paragraph.~~

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(A) The amount of interest, dividends, net gains (but not less than zero) and other income from investment assets and activities in the investment account to be attributed to this state and included in the numerator is determined by multiplying all such income from such assets and activities by a fraction, the numerator of which is the gross income from such assets and activities which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the gross income from all such assets and activities.

(B) The amount of interest from federal funds sold and purchased and from securities purchased under resale agreements and securities sold under repurchase agreements attributable to this state and included in the numerator is determined by multiplying the amount described in subparagraph (A) of paragraph (1) of this subsection from such funds and such securities by a fraction, the numerator of which is the gross income from such funds and such securities which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the gross income from all such funds and such securities.

(C) The amount of interest, dividends, gains and other income from trading assets and activities, including but not limited to assets and activities in the matched book, in the arbitrage book and foreign currency transactions (but excluding amounts described in subparagraphs (A) or (B) of this paragraph), attributable to this state and included in the numerator is determined by multiplying the amount described in subparagraph (B) of paragraph (1) of this subsection by a fraction, the numerator of which is the gross income from such trading assets and activities which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the gross income from all such assets and activities.

~~(5) If the taxpayer elects or is required by the [State Tax Administrator] to use the method set forth in paragraph (3) of this subsection, it shall use this method on all subsequent returns unless the taxpayer receives prior permission from the [State Tax Administrator] to use, or the [State Tax Administrator] requires a different method.~~

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~~(6) The taxpayer shall have the burden of proving that an investment asset or activity or~~

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trading asset or activity was properly assigned to a regular place of business outside of this state by demonstrating that the day-to-day decisions regarding the asset or activity occurred at a regular place of business outside this state. Where the day-to-day decisions regarding an investment asset or activity or trading asset or activity occur at more than one regular place of business and one such regular place of business is in this state and one such regular place of business is outside this state, such asset or activity shall be considered to be located at the regular place of business of the taxpayer where the investment or trading policies or guidelines with respect to the asset or activity are established. Unless the taxpayer demonstrates to the contrary, such policies and guidelines shall be presumed to be established at the commercial domicile of the taxpayer.

**(n) Receipts from investment and trading activities conducted on behalf of third parties.** (1) This subsection applies to receipts from investment and trading activities on assets owned by third parties for which the taxpayer conducts the investment and trading activities on behalf of that third party.

**(2) (Continuing discussion on how to apportion these receipts.)** Receipts from investment and trading assets and activities conducted by the taxpayer on behalf of third parties are attributable to this state by multiplying the investment and trading receipts by the fraction determined under Section 5.

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**(o) All other receipts.** The numerator of the receipts factor includes all other receipts pursuant to the rules set forth in [insert your state's regular situsing rules for the receipts not covered by this section]. [Continuing discussion on this section.](#)

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**(p) Attribution of certain receipts to commercial domicile.** All receipts which would be assigned under this section to a state in which the taxpayer is not taxable shall be included in the numerator of the receipts factor, if the taxpayer's commercial domicile is in this state.

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#### Section 4. Property Factor.

(a) **General.** The property factor is a fraction, the numerator of which is the average value of real property and tangible personal property rented to the taxpayer that is located or used within this state during the taxable year, the average value of the taxpayer's real and tangible personal property owned that is located or used within this state during the taxable year, and the average value of the taxpayer's loans and credit card receivables that are located within this state during the taxable year, and the denominator of which is the average value of all such property located or used within and without this state during the taxable year.

(b) **Property included.** The property factor shall include only property the income or expenses of which are included (or would have been included if not fully depreciated or expensed, or depreciated or expensed to a nominal amount) in the computation of the apportionable income base for the taxable year.

(c) **Value of property owned by the taxpayer.**

(1) The value of real property and tangible personal property owned by the taxpayer is the original cost or other basis of such property for Federal income tax purposes without regard to depletion, depreciation or amortization.

(2) Loans are valued at their outstanding principal balance, without regard to any reserve for bad debts. If a loan is charged-off in whole or in part for Federal income

tax purposes, the portion of the loan charged off is not outstanding. A specifically allocated reserve established pursuant to regulatory or financial accounting guidelines which is treated as charged-off for Federal income tax purposes shall be treated as charged-off for purposes of this section.

- (3) Credit card receivables are valued at their outstanding principal balance, without regard to any reserve for bad debts. If a credit card receivable is charged-off in whole or in part for Federal income tax purposes, the portion of the receivable charged-off is not outstanding.

(d) **Average value of property owned by the taxpayer.** The average value of property owned by the taxpayer is computed on an annual basis by adding the value of the property on the first day of the taxable year and the value on the last day of the taxable year and dividing the sum by two. If averaging on this basis does not properly reflect average value, the [State Tax Administrator] may require averaging on a more frequent basis. The taxpayer may elect to average on a more frequent basis. When averaging on a more frequent basis is required by the [State Tax Administrator] or is elected by the taxpayer, the same method of valuation must be used consistently by the taxpayer with respect to property within and without this state and on all subsequent returns unless the taxpayer receives prior permission from the [State Tax Administrator] or the [State Tax Administrator] requires a different method of determining average value.

(e) **Average value of real property and tangible personal property rented to the taxpayer.**

- (1) The average value of real property and tangible personal property that the taxpayer has rented from another and which is not treated as property owned by the taxpayer for Federal income tax purposes, shall be determined annually by multiplying the gross rents payable during the taxable year by eight.
- (2) Where the use of the general method described in this subsection results in inaccurate valuations of rented property, any other method which properly reflects the value may be adopted by the [State Tax Administrator] or by the taxpayer when approved in writing by the [State Tax Administrator]. Once approved, such other method of valuation must be used on all subsequent returns unless the taxpayer receives prior approval from the [State Tax Administrator] or the [State Tax Administrator] requires a different method of valuation.

(f) **Location of real property and tangible personal property owned by or rented to the taxpayer.**

- (1) Except as described in paragraph (2) of this subsection, real property and tangible personal property owned by or rented to the taxpayer is considered to be located within this state if it is physically located, situated or used within this state.
- (2) Transportation property is included in the numerator of the property factor to the extent that the property is used in this state. The extent an aircraft will be deemed to be used in this state and the amount of value that is to be included in the numerator of this state's property factor is determined by multiplying the average value of the aircraft by a fraction, the numerator of which is the number of landings of the aircraft in this state and the denominator of which is the total number of landings of the aircraft everywhere. If the extent of the use of any transportation property within this state cannot be determined, then the property will be deemed to be used wholly in the state in which the property has its principal base of operations. A motor vehicle will be deemed to be used wholly in the state in which it is registered.

(g) **Location of loans.**

(1) Loans shall be assigned to the state in which the preponderance of substantive contacts related to the loan occurred.

- (A) To determine the preponderance of substantive contacts related to loans, loans may be grouped by classes of like instruments. For example, loans could be grouped as consumer loans, real property loans and commercial loans. The method of grouping should be consistent with the method of tracking loans within the taxpayer's own books and records. If a taxpayer cannot group loans together into classes, the preponderance of substantive contacts shall be determined on a loan by loan basis.
- (B) To determine the state in which the preponderance of substantive contacts relating to a loans ~~have~~ has occurred, the facts and circumstances regarding the loans at issue shall be reviewed ~~on a case by case basis~~ and consideration shall be given to such activities as the solicitation, investigation, negotiation, approval and administration of the loans.
- (C) The determination of "preponderance of substantive contacts" shall be made by determining the costs associated with each activity for the loan or group of loans, by state. The state with the highest costs incurred will be the state to which the loans are assigned.
  - a. Example: Taxpayer makes commercial loans in states A,B, and C. The taxpayer has employees who solicit customers and negotiate loans with customers in all three states but the investigation, approval and administration of the loans all occurs in state A. The taxpayer determines that for the class of loans, it incurs costs of \$5,000 for solicitation in each state, \$3,000 for negotiations in each state and \$10,000 in State A due to the approval and administration of the loans. The class of loans shall be assigned in full to State A as State A has the preponderance of substantive contacts as demonstrated by incurred costs of \$18,000.

The terms "solicitation", "investigation", "negotiation", "approval" and "administration" are defined as follows:

(A) *Solicitation.* Solicitation is either active or passive. Active solicitation occurs when an employee of the taxpayer initiates the contact with the customer. Such activity is located at the regular place of business which the taxpayer's employee is regularly connected with or working out of, regardless of where the services of such employee were actually performed. Passive solicitation occurs when the customer initiates the contact with the taxpayer. If the customer's initial contact was not at a regular place of business of the taxpayer, the regular place of business, if any, where the passive solicitation occurred is determined by the facts in each case.

(B) *Investigation.* Investigation is the procedure whereby employees of the taxpayer determine the credit-worthiness of the customer as well as the degree of risk involved in making a particular agreement. Such activity is located at the regular place of business which the taxpayer's employees are regularly connected with or working out of, regardless of where the services of such employees were actually performed.

(C) *Negotiation.* Negotiation is the procedure whereby employees of the taxpayer and its customer determine the terms of the agreement (e.g., the amount, duration, interest rate, frequency of repayment, currency denomination and security required). Such activity is located at the regular place of business which the taxpayer's employees are regularly connected with or working out of, regardless of where the services of such employees were actually performed.

(D) *Approval.* Approval is the procedure whereby employees or the board of directors of the taxpayer make the final determination whether to enter into the agreement. Such activity is located at the regular place of business which the taxpayer's employees are regularly connected with or working out of, regardless of where the services of such employees were actually performed. If the board of directors makes the final determination, such activity is located at the commercial domicile of the taxpayer.

(E) Administration. Administration is the process of managing the account. This process includes bookkeeping, collecting the payments, corresponding with the customer, reporting to management regarding the status of the agreement and proceeding against the borrower or the security interest if the borrower is in default. Such activity is located at the regular place of business which oversees this activity.

**(h) Special Rule for automated loans programs**

If the substantive contacts are performed primarily through the use of automated systems, such as computerized investigation and approval processes, the loans shall be assigned to the location where these activities are undertaken by the bank.

1. Example. Taxpayer makes credit card loans to consumers in all 50 states. The process by which these cards are solicited is through the mail and the Internet. The process of approving the applications for the cards and administering the accounts all takes place utilizing a centralized computer system in State A. The loans will all be assigned to State A.
2. Example. Customers in State A pick up applications for the loans at their local branches and submit them back to local branches in State A. All substantive decisions regarding approval, investigation and administration of the loans are performed in State B. The loans are assigned to State B as the preponderance of substantive contacts occur in State B.

(h) (i) Location of credit card receivables. For purposes of determining the location of credit card receivables, credit card receivables shall be treated as loans and shall be subject to the provisions of subsections (g) and (h) of this section.

(i) (j) Period for which properly assigned loan remains assigned. A loan that has been properly assigned to a state shall, absent any change of material fact, remain assigned to said state for the length of the original term of the loan. Thereafter, said loan may be properly assigned to another state if said loan has a preponderance of substantive contacts to a regular place of business there.

(1) The sale of a loan, or a pool of loans, to another entity that is within the same controlled group of corporations, as the seller shall not be considered as a material change of fact.

(2) For purposes of this subsection, “controlled group of corporations” means “controlled group of corporations” as defined in Section 1563(a) of the Internal Revenue Code, except that:

(a) “More than 50 percent” shall be substituted for “at least 80 percent” each place it appears in Section 1563(a)(1) of the Internal Revenue Code.

(b) The determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of Section 1563 of the Internal Revenue Code.

**Section 5. Payroll Factor.**

(a) **General.** The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the taxable year by the taxpayer for compensation and the denominator of which is the total compensation paid both within and without this state during the taxable year. The payroll factor shall include only that compensation which is included in the computation of the apportionable income tax base for the taxable year.

(b) **Compensation relating to nonbusiness income and independent contractors.** The compensation of any employee for services or activities which are connected with the production of

**Deleted:** (1) (A) A loan is considered to be located within this state if it is properly assigned to a regular place of business of the taxpayer within this state. ¶ (B) A loan is properly assigned to the regular place of business with which it has a preponderance of substantive contacts. A loan assigned by the taxpayer to a regular place of business without the state shall be presumed to have been properly assigned if-¶ (i) the taxpayer has assigned, in the regular course of its business, such loan on its records to a regular place of business consistent with Federal or state regulatory requirements; ¶ (ii) such assignment on its records is based upon substantive contacts of the loan to such regular place of business; and ¶ (iii) the taxpayer uses said records reflecting assignment of loans for the filing of all state and local tax returns for which an assignment of loans to a regular place of business is required. ¶ (C) The presumption of proper assignment of a loan provided in subparagraph (B) of paragraph (1) of this subsection may be rebutted upon a showing by the [State Tax Administrator], supported by a preponderance of the evidence, that the preponderance of substantive contacts regarding such loan did not occur at the regular place of business to which it was assigned on the taxpayer's records. When such presumption has been rebutted, the loan shall then be located within this state if (i) the taxpayer had a regular place of business within this state at the time the loan was made; and (ii) the taxpayer fails to show, by a preponderance of the evidence, that the preponderance of substantive contacts regarding such loan did not occur within this state. ¶ (2) In the case of a loan which is assigned by the taxpayer to a place without this state which is not a regular place of business, it shall be presumed, subject to rebuttal by the taxpayer on a showing supported by the preponderance of evidence, that the preponderance of substantive contacts regarding the ... [1]

**Deleted:** <#>(h) **Location of credit card receivables.** For purposes of determining the location of credit card receivables, credit card receivables shall be treated as loans and shall be subject to the provisions of subsection (g) of this section. ¶ <#>(i) **Period for which properly assigned loan remains assigned.** **Proposal – CHANGE this section to create a clearer rule following CA proposal.** A loan that has been properly assigned to a state shall, absent any change of material fact, remain assigned to said state for the length of the original term of the loan. Thereafter, said loan may be properly assigned to another state if said loan has a preponderance of substantive contact to a regular place of business there. ¶

nonbusiness income (income which is not includable in the apportionable income base) and payments made to any independent contractor or any other person not properly classifiable as an employee shall be excluded from both the numerator and denominator of the factor.

(c) **When compensation paid in this state.** Compensation is paid in this state if any one of the following tests, applied consecutively, is met:

- (1) The employee's services are performed entirely within this state.
- (2) The employee's services are performed both within and without the state, but the service performed without the state is incidental to the employee's service within the state. The term "incidental" means any service which is temporary or transitory in nature, or which is rendered in connection with an isolated transaction.
- (3) If the employee's services are performed both within and without this state, the employee's compensation will be attributed to this state:

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

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

(C) if the principal base of operations and the place from which the services are directed or controlled are not in any state in which some part of the service is performed but the employee's residence is in this state.

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**Appendix A — Definition of Financial Institution.**

The following definition of a financial institution or a variation thereof could be made part of a statutory proposal or could be adopted by regulation if the state legislature has already delegated the authority to do so to the State Tax Administrator or other administrative officer. Again, the following provides a *starting point* for discussion purposes, and the lack of a uniformly adopted definition by all of the states, while affecting competitive balance, is not critical to the main thrust of the apportionment proposal.

**"Financial institution"** means:

(1) Any corporation or other business entity registered under state law as a bank holding company or registered under the Federal Bank Holding Company Act of 1956, as amended, or registered as a savings and loan holding company under the Federal National Housing Act, as amended;

(2) A national bank organized and existing as a national bank association pursuant to the provisions of the National Bank Act, 12 U.S.C. §§21 et seq.;

(3) A savings association or federal savings bank as defined in the Federal Deposit Insurance Act, 12 U.S.C. § 1813(b)(1);

(4) Any bank or thrift institution incorporated or organized under the laws of any state;

(5) Any corporation organized under the provisions of 12 U.S.C. §§611 to 631.

(6) Any agency or branch of a foreign depository as defined in 12 U.S.C. §3101;

(7) A state credit union the loan assets of which exceed \$50,000,000 as of the first day of its

taxable year;

(8) A production credit association organized under the Federal Farm Credit Act of 1933, all of whose stock held by the Federal Production Credit Corporation has been retired;

(9) Any corporation whose voting stock is more than fifty percent (50%) owned, directly or indirectly, by any person or business entity described in subsections (1) through (8) above other than an insurance company taxable under [insert applicable state statute] or a company taxable under [insert applicable state statute];

(10) A corporation or other business entity that derives more than fifty percent (50%) of its total gross income for financial accounting purposes from finance leases. For purposes of this subsection, a "finance lease" shall mean any lease transaction which is the functional equivalent of an extension of credit and that transfers substantially all of the benefits and risks incident to the ownership of property. The phrase shall include any "direct financing lease" or "leverage lease" that meets the criteria of Financial Accounting Standards Board Statement No. 13, "Accounting for Leases" or any other lease that is accounted for as a financing by a lessor under generally accepted accounting principles.

(11) An "investment bank." As used in this regulation, an investment bank is any corporation or other business entity which acts as an underwriter or agent for corporations and municipalities issuing securities. The term "investment bank" includes an institution that maintains broker/dealer operations, maintains markets for previously issued securities, offers advisory services to investors and facilitates mergers and acquisitions, private equity placements and corporate restructurings.

For this classification to apply,

(a) the average of the gross income in the current tax year and immediately preceding two tax years must satisfy the more than fifty percent (50%) requirement; and

(b) gross income from incidental or occasional transactions shall be disregarded;

or

(12) Any other person or business entity, other than [an insurance company taxable under \_\_\_\_\_], [a real estate broker taxable under \_\_\_\_\_], [a securities dealer taxable under \_\_\_\_\_] or [a \_\_\_\_\_ company taxable under \_\_\_\_\_], which derives more than fifty percent (50%) of its gross income from activities that a person described in subsections (2) through (8) and (10) above is authorized to transact. For the purpose of this subsection, the computation of gross income shall not include income from non-recurring, extraordinary items.

Deleted: (11)

(12) The [State Tax Administrator] is authorized to exclude any person from the application of subsection (11) upon such person proving, by clear and convincing evidence, that the income-producing activity of such person is not in substantial competition with those persons described in subsections (2) through (8) and (10) above.

- (1) (A) A loan is considered to be located within this state if it is properly assigned to a regular place of business of the taxpayer within this state.
  - (B) A loan is properly assigned to the regular place of business with which it has a preponderance of substantive contacts. A loan assigned by the taxpayer to a regular place of business without the state shall be presumed to have been properly assigned if-
    - (i) the taxpayer has assigned, in the regular course of its business, such loan on its records to a regular place of business consistent with Federal or state regulatory requirements;
    - (ii) such assignment on its records is based upon substantive contacts of the loan to such regular place of business; and
    - (iii) the taxpayer uses said records reflecting assignment of loans for the filing of all state and local tax returns for which an assignment of loans to a regular place of business is required.
  - (C) The presumption of proper assignment of a loan provided in subparagraph (B) of paragraph (1) of this subsection may be rebutted upon a showing by the [State Tax Administrator], supported by a preponderance of the evidence, that the preponderance of substantive contacts regarding such loan did not occur at the regular place of business to which it was assigned on the taxpayer's records. When such presumption has been rebutted, the loan shall then be located within this state if (i) the taxpayer had a regular place of business within this state at the time the loan was made; and (ii) the taxpayer fails to show, by a preponderance of the evidence, that the preponderance of substantive contacts regarding such loan did not occur within this state.
- (2) In the case of a loan which is assigned by the taxpayer to a place without this state which is not a regular place of business, it shall be presumed, subject to rebuttal by the taxpayer on a showing supported by the preponderance of evidence, that the preponderance of substantive contacts regarding the loan occurred within this state if, at the time the loan was made the taxpayer's commercial domicile, as defined by subsection (c) of Section 2, was within this state.
  - (3) To determine the state in which the preponderance of substantive contacts relating to a loan have occurred, the facts and circumstances regarding the loan at issue shall be reviewed on a case-by-case basis and consideration shall be given to such activities as the solicitation,

investigation, negotiation, approval and administration of the loan. The terms "solicitation", "investigation", "negotiation", "approval" and "administration" are defined as follows:

- (A) *Solicitation*. Solicitation is either active or passive. Active solicitation occurs when an employee of the taxpayer initiates the contact with the customer. Such activity is located at the regular place of business which the taxpayer's employee is regularly connected with or working out of, regardless of where the services of such employee were actually performed. Passive solicitation occurs when the customer initiates the contact with the taxpayer. If the customer's initial contact was not at a regular place of business of the taxpayer, the regular place of business, if any, where the passive solicitation occurred is determined by the facts in each case.
- (B) *Investigation*. Investigation is the procedure whereby employees of the taxpayer determine the credit-worthiness of the customer as well as the degree of risk involved in making a particular agreement. Such activity is located at the regular place of business which the taxpayer's employees are regularly connected with or working out of, regardless of where the services of such employees were actually performed.
- (C) *Negotiation*. Negotiation is the procedure whereby employees of the taxpayer and its customer determine the terms of the agreement (e.g., the amount, duration, interest rate, frequency of repayment, currency denomination and security required). Such activity is located at the regular place of business which the taxpayer's employees are regularly connected with or working out of, regardless of where the services of such employees were actually performed.
- (D) *Approval*. Approval is the procedure whereby employees or the board of directors of the taxpayer make the final determination whether to enter into the agreement. Such activity is located at the regular place of business which the taxpayer's employees are regularly connected with or working out of, regardless of where the services of such employees were actually performed. If the board of directors makes the final determination, such activity is located at the commercial domicile of the taxpayer.
- (E) *Administration*. Administration is the process of managing the account. This process includes bookkeeping, collecting the payments, corresponding with the customer, reporting to management regarding the status of the agreement and proceeding against the borrower or the security interest if the



borrower is in default. Such activity is located at the regular place of business which oversees this activity.