

ADDITIONAL INFORMATION

I. Regarding interest, dividends and certain other receipts from securities:

The Committee should take note of the policy on interest, dividends and certain receipts from securities reflected in the Commission's existing model regulations, prior to any amendment being currently considered. Under Reg. IV.18.(c), dividends, interest and other receipts from holding intangible assets may be excluded in many cases and treasury function receipts are included only on a net (rather than gross) basis. In light of the changes to Art. IV (excluding receipts from hedging and certain receipts from securities and the loan of cash from the definition of "receipts") the Sec. 1 work group recommended deletion of these provisions in Reg. IV.18.(c). This recommendation reflected the understanding that amendments to Art. IV, Sec. 1 now excludes these receipts from the definition of "receipts," and so these regulations would be conceptually inconsistent with the model statute. In particular, Reg. IV.18.(c) provides:

Special Rules: Sales Factor. The following special rules are established in respect to the sales factor of the apportionment formula:

...

(3) Where the income producing activity in respect to business income from intangible personal property can be readily identified, the income is included in the denominator of the sales factor and, if the income producing activity occurs in this state, in the numerator of the sales factor as well. For example, usually the income producing activity can be readily identified in respect to interest income received on deferred payments on sales of tangible property (Regulation IV.15.(a)(1)(A)) and income from the sale, licensing or other use of intangible personal property (Regulation IV.17.(2)(D)). Where business income from intangible property cannot readily be attributed to any particular income producing activity of the taxpayer, the income cannot be assigned to the numerator of the sales factor for any state and shall be excluded from the denominator of the sales factor. **For example, where business income in the form of dividends received on stock, royalties received on patents or copyrights, or interest received on bonds, debentures or government securities results from the mere holding of the intangible personal property by the taxpayer, the dividends and interest shall be excluded from the denominator of the sales factor.**

(4) (A) Where gains and losses on the sale of liquid assets are not excluded from the sales factor by other provisions under Reg. IV.18.(c), such gains or losses shall be treated as provided in this subsection. This subsection does not provide rules relating to the treatment of other receipts produced from holding or managing such assets. **If a taxpayer holds liquid assets in connection with one or more treasury functions of the taxpayer, and the liquid assets produce business income when sold, exchanged or otherwise disposed, the overall net gain from those transactions for each treasury function for the tax period is included in the sales factor.** For purposes of this subsection, each treasury function will be considered separately.

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

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

II. Treatment of hedging and receipts from securities under other states' rules.

The staff memo provided to the committee previously (see link above) includes a summary from Joe Huddleston (E&Y) of some of the other states' laws with respect to the inclusion in or exclusion from the sales factor of receipts from hedging and securities. Staff has now reviewed these provisions for the states provided and would note the following:

- In none of the states is it true that *gross* receipts from securities transactions are generally (that is, for any taxpayer) included in the receipts factor.
- Some states allow *net* receipts from securities transactions to be generally included for any taxpayer, but some do not.
- Of those states that do not allow net receipts from securities transactions to be included generally, one allows broker/dealers to include gross receipts, others do not allow broker/dealers to include receipts from securities transactions, and at least one state specifically requires apportionment for broker/dealers on the basis of commissions received.
- Most of the states do not allow the inclusion in the sales factor of *gross* receipts from hedging, some allow *net* receipts from hedging in certain circumstances.
- There are differences among the states in their definition of hedging.