

DRAFT MODEL AS OF 4/18/17 WITH EXAMPLES

[REG. IV.18 Section #]

(a) This section applies to the determination of the receipts factor if:

(1) The taxpayer's receipts, as defined by [Compact Article IV.1.g], are less than 3.33% of the taxpayer's gross receipts, as defined by [Model Allocation and Apportionment Regulation IV.2.(a)(5)], or

(2) The [tax administrator] determines that application of this section is necessary to fairly represent the extent of the taxpayer's business activity in the state.

(b) To be included in the receipts factor under this section, gross receipts must give rise to apportionable income.

(c) Unless required to be excluded under subsection (g) of this section, the following gross receipts are included in the receipts factor denominator and are assigned to the receipts factor numerator in this state as provided below:

(1) Dividends paid by a related party, [as defined in Sec. 17 or other state law], are assigned to the receipts factor numerator in this state as follows:

(A) If paid from earnings that can be attributed to particular years, the dividends are assigned to the receipts factor numerator in this state in a proportion equal to the dividend payor's average apportionment factor in this state, determined pursuant to [ref. to state law], for those years.

(B) If it cannot reasonably be determined that the dividends were paid from earnings attributed to particular years, the dividends are assigned to the receipts factor numerator in this state in a proportion equal to the dividend payor's average apportionment factor in this state, determined pursuant to [ref. to state law], for the current and preceding year.

(C) If the dividends were paid from earnings that were generated by the activities of a related party of the dividend payor, the dividends are assigned to the receipts factor numerator in this state under paragraphs (A) or (B) of this subsection, as applicable, using the other related party's average apportionment factor in this state, determined pursuant to [ref. to state law].

EXAMPLES:

(i) Taxpayer Bigbox Holdings, Inc. (Holdings) is a Delaware corporation, domiciled in Delaware, with numerous foreign and domestic subsidiaries. Holdings has no "receipts," as defined under this state's apportionment statutes. Holdings is the corporate parent of Bigbox Retailing, Inc. (Retailing), a domestic corporation. During the tax year, Holdings receives \$100 million in dividends from Retailing and \$100 million in dividends from Holdings' foreign subsidiaries. Because the foreign-source dividends are excluded from this state's tax base, they are not "gross receipts" subject to apportionment and are not be included in the receipts factor. Retailing conducted operations in ten states, including this state. Retailing's apportionment factor in this state in the current year is 20% and was 18% in the prior year. The dividends received from Retailing cannot be reasonably attributed to that entity's earnings in any specific year. Assuming that Holdings would be subject to tax in all of the states where it would attribute its receipts under this regulation, then Holdings' receipts factor in this state is calculated by including \$100 million of dividends received from Retailing in the denominator and \$19 million in the numerator—an amount which is equal to the total dividends paid by Retailing times the average of Retailing's apportionment factors in this state in the current and prior years.

(ii) Same facts as (i) above, but this state determines that Holdings was not taxable in any other state to which its receipts from dividends would have been assigned had this regulation been adopted in those states. Under subsection (g) of this regulation, therefore, the \$81 million of dividends that would have been assigned to those states are eliminated from the receipts factor. The taxpayer's receipts factor in this state is 100% (\$19 million/\$19 million). (Although Holdings would have been taxable in Delaware, the state of its commercial domicile, under these facts no receipts would have been assigned to Delaware under this regulation.)

(iii) Taxpayer Parent, Inc. (Parent) is a C corporation taxable in this state. During the tax year Parent's gross receipts consisted entirely of dividends paid by its 90%-owned domestic subsidiary, Intermediate Holdings, Inc. (Holdings), a C corporation with a single employee in Florida. Holdings' gross receipts, in turn, consisted entirely of dividends received from its 100%-owned subsidiary, ABC Retailing, Inc. (Retailing), which operates retail stores in this state and nine other states. Retailing's dividends were paid from its net earnings generated in the preceding year, when Retailing had a 10% apportionment factor in this state. Under subsection (c)(1)(C) of this regulation, Holdings' apportionment factors would be disregarded in determining the portion of the dividends included in the numerator of Parent's receipts factor in this state. Instead, assuming Parent is subject to tax in all states where it would attribute its receipts under this regulation, Parent's receipts factor would include all of the dividends paid to it by Holdings in the denominator, and would attribute 10% of those receipts to the receipts factor numerator in this state, based on the apportionment factor of Retailing in this state in the preceding year.

(iv) Taxpayer CB Holdings, Inc. (Holdings) owns 90% of CB REIT, Inc. (REIT). REIT has an office and two employees in Nevada. REIT leases retail properties to a subsidiary of Holdings, Crazy Bob Auto Parts, Inc. (Parts). Parts has its commercial domicile outside this state. It has retail operations in this state and four other states. During the tax year, REIT paid 100% of its gross income, \$100 million, to Holdings as a taxable dividend. Holdings had no other receipts. Parts' apportionment factor in this state during the year was 20%. Under Subsection (c)(1)(C) of this regulation, assuming Holdings is subject to tax in all states where it would attribute its receipts under this regulation, Holdings would include \$100 million in its receipts factor denominator and would include 20% of those receipts, or \$20 million, in the numerator of the receipts factor in this state, using Parts' apportionment factor, because the dividends were generated by the activities of Parts.

(2) Gains (net of related losses, but not less than zero~~but not losses~~) from the disposition of stock (or other intangible property rights) representing at least a 20% ownership interest in a business entity, or from the disposition of assets of a business entity or segment of a business entity, are assigned to the receipts factor numerator in this state in a proportion equal to the apportionment factor in this state as determined pursuant to [ref. to state law] for that business entity as if filing on a separate corporate basis, for the year preceding the disposition. In any case where the apportionment factor of the

business entity cannot be reasonably determined, or where the apportion factor of the business entity in the year preceding the sale fails to represent the extent of the taxpayer's business activity in this state giving rise to the gains, then the receipts from that gain are attributed to the receipts factor numerator of this state under subsections (d), (e), (f) or (h).

EXAMPLES:

(i) Taxpayer, Nuclear Corp. (Nuclear), is a holding company with no "receipts" from transactions and activities in the ordinary course of business and only de minimis property and payroll. Nuclear forms Target Corp. (Target) and transfers its ownership interests in three power plants, located in three states, one of which is this state, to Target in exchange for the stock of Target. A year later, Nuclear sells the stock of Target to Risky Investments for \$500 million in cash, recognizing a gain of \$100 million. In the year preceding the sale, Target's apportionment factor in this state was 30%. Nuclear would include in the denominator of its receipts factor \$100 million and would assign to the receipts factor numerator in this state \$30 million, based on Target's apportionment factor in this state.

(ii) Same facts as (i) except Nuclear formed Target and then sold Target stock on the same day. Because Target did not exist in the year preceding the disposition, its apportionment factor in this state for that year cannot be determined. Nuclear's own apportionment factor in this state cannot be used to assign the receipts to the numerator in this state because Nuclear had no other receipts. Nuclear would therefore apply other subsections of this regulation to attribute receipts from the gain to the receipts factor numerator in this state. (Note that the receipts cannot be assigned under subsection (d) of this regulation because Nuclear's property and payroll factors are de minimis. Therefore, Nuclear would have to use subsection (e) or (f) to assign a portion of the \$100 million gain to its receipts factor numerator in this state.)

(iii) Same facts as (i) except Nuclear makes an IRC 338(h)(10) election, which this state conforms to, so the sale is treated as the sale by Target of its assets. The sale of Target's assets in this state (the power plant) generated a gain of \$150 million, and the sale of Target's remaining two power plants generated a loss of \$50 million. Target would include \$100 million of gain (the net amount) in the denominator of its receipts factor and assign 30% of that gain to this state based on Target's apportionment factors in this state in the year preceding the sale.

(3) Receipts from activities described in sections 3(d) through 3(j) of the MTC's Formula for the Apportionment and Allocation of the Net Income of Financial Institutions Model Statute (as adopted July 29, 2015) [or reference to state's financial institution receipts factor rules] are assigned to the receipts factor numerator in this state to the extent those receipts would be assigned to this state under the MTC's Formula for the Apportionment and Allocation of the Net Income of Financial Institutions Model Statute (as adopted July 29, 2015) [or this state's financial institution receipts factor rules] as if the taxpayer were a financial institution.

EXAMPLES:

(i) [NOTE: This example assumes that the state has either adopted the MTC Formula for the Apportionment and Allocation of the Net Income of Financial Institutions Model Statute or does not have similar rules. If the state has different rules for financial institutions, this example should reference those rules.] Assume the same facts as in Example (c)(1)(C)(iv) above, but in addition, Holdings lends its excess capital to Parts as an unsecured loan. As a result of that loan, Holdings has \$40 million of interest income from Parts, in addition to the \$100 million of dividend income that Holdings received from REIT. Holdings does not meet this state's definition of a financial institution, but pursuant to subsection (c)(3) of this regulation, Holdings' interest receipts would be assigned to Parts' commercial domicile outside of this state under the apportionment rules for financial institutions [reference] and would be included in the denominator of the receipts factor (assuming Holdings is subject to tax in the state where Parts has its commercial domicile). Holdings' receipt factor in this state is 14.28% (\$20 million / \$140million).

(ii) [NOTE: This example assumes that the state has either adopted the MTC Formula for the Apportionment and Allocation of the Net Income of Financial Institutions Model Statute or does not have similar rules. If the state has different rules for financial institutions, this example should reference those rules.] Taxpayer Loan Participation Services, Inc. (LPS) is a Delaware corporation formed by a related financial institution to hold securitized loan portfolios in trust for third-party investors. LPS has no employees or property and no other receipts except for payments from principal and interest on the loans held. Although LPS would not be considered a financial institution for purposes of this state's [or the MTC's special apportionment] rules, its gross receipts are attributed to the receipts factor numerator in this state as if it were a financial institution. So, for example, if LPS's loan portfolios represent

mortgages, its receipts would be attributable to the numerator of the receipts factor this state based on the location of the mortgaged real property.

(4) Gross receipts derived from accounts receivable previously sold to or otherwise transferred to the taxpayer, to the extent those gross receipts cannot be assigned under subsection (c)(3), are assigned to the receipts factor numerator in this state ~~if the receipts are collected from~~ to the extent those accounts receivable are attributed to borrowers located in this state.

EXAMPLE: (i) Taxpayer IH Factoring, Inc. (Factoring) is a Delaware corporation with all twenty of its employees in Delaware. Factoring exclusively purchases installment agreements (accounts receivable) from its parent corporation, Iron Horse Motorcycles, Inc. (Iron Horse). Factoring has information showing the addresses of the installment agreement customers. Factoring re-sells the agreements as securitized instruments to institutional investors. Factoring's receipts from selling the securitized instruments would be included in the receipts factor denominator (assuming it would have nexus in the states to which those receipts would be assigned under this regulation) and would assigned to the receipts factor numerator in this state in proportion to installment agreements made with borrowers in this state.

(5) The net amount, but not less than zero, of receipts not otherwise assigned under this subsection (c) arising from investment activities, including the holding, maturity, redemption, sale, exchange, or other disposition of marketable securities or cash are assigned to the sales factor numerator in this state if the receipts would be assigned to this state under Section (n) of the MTC's Formula for the Apportionment and Allocation of the Net Income of Financial Institutions Model Statute (as adopted July 29, 2015) [or this state's financial institutions receipts factor rules]; all other receipts from investment activities are assigned to the receipts factor numerator in this state if the investments~~receipts~~ are managed in this state.

(d) [USE IF THE STATE HAS A MULTI-FACTOR FORMULA] Gross receipts, other than those included and assigned under subsection (c) are included in the receipts factor denominator, unless eliminated under subsection (g), and are assigned to the receipts factor numerator in this state in a proportion equal to the [average] of the taxpayer's [other apportionment factors] determined pursuant to [ref. to state law], if those factors are non-de minimis.

EXAMPLE: (i) Taxpayer Windfall, Inc. (Windfall) is an indirect wholly-owned subsidiary of ABC Manufacturing Company (ABC). Windfall has 10% of its property and 20% of its payroll in this state. Windfall's only gross receipt is \$1 billion received in settlement of ABC's long-standing patent infringement suit against a business competitor. Because this settlement amount cannot be attributed to the receipts factor in this state under subsection (c) of this regulation, Windfall would include \$1 billion in its receipts factor denominator and [15%] of that amount in the receipts factor numerator in this state, under this state's apportionment formula.

NOTE – FROM THIS POINT – THE DRAFT'S NUMBERING ASSUMES THAT THE STATE INCLUDES SUBSECTION (d). IF NOT – THE FOLLOWING PROVISIONS AND CROSS-REFERENCES TO ANY SUBSECTIONS INCLUDING AND AFTER (d) WILL HAVE TO BE RENUMBERED.

(e) [\[USE IF THE STATE ALLOWS STATE-LEVEL COMBINED OR CONSOLIDATED FILING.\]](#) Except gross receipts included and assigned under subsections (c) and (d), or eliminated under subsection (g), gross receipts of a taxpayer whose income and factors are included in a combined or consolidated return in this state are included in the receipts factor denominator and are assigned to the receipts factor numerator in this state in a proportion equal to the receipts factor of the combined or consolidated group in this state determined pursuant to [state law].

EXAMPLE: Taxpayer Windfall, Inc. (Windfall) is an indirect wholly-owned subsidiary of ABC Manufacturing Company (ABC). Windfall's only gross receipt is \$1 billion received in settlement of ABC's long-standing patent infringement suit against a business competitor. Windfall is included on a combined return filed by ABC and Combined Subsidiaries. ABC and Combined Subsidiaries' receipts factor numerator in this state is 25%. Windfall would include \$1 billion in its receipts factor denominator (assuming that it would be subject to tax in every state to which a portion of that amount would be assigned under this regulation) and 25% of that amount would be assigned to the receipts factor numerator in this state.

[NOTE – FROM THIS POINT – THE DRAFT'S NUMBERING ASSUMES THAT THE STATE INCLUDES SUBSECTION \(d\) AND \(e\). IF NOT – THE FOLLOWING PROVISIONS AND CROSS-REFERENCES TO ANY SUBSECTIONS INCLUDING AND AFTER \(d\) WILL HAVE TO BE RENUMBERED.](#)

(f) Except gross receipts included and assigned under subsections (c), (d), and (e), or eliminated pursuant to subsection (g), gross receipts of a taxpayer that files as part of a federal consolidated return are included in the receipts factor denominator and are assigned to the receipts factor numerator in this state in a proportion equal to a percentage (but not greater than 100%), the numerator of which is the total of the consolidated group members' income apportioned to this state pursuant to [ref. to state law], and the denominator of which is the total federal consolidated income.

EXAMPLE: Same facts as in the example under subsection (e), except that Windfall is not part of a combined group, but is included on a consolidated federal return filed by ABC and Consolidated Subsidiaries. The total federal taxable income of that consolidated group is \$5 billion, and the total amount of income of all other members of the consolidated group apportioned to this state is \$500 million. Windfall would include in its receipts factor denominator \$1 billion (assuming that it would be subject to tax in every state to which a portion of that amount would be assigned under this regulation) and would assign 10% of that amount to the receipts factor numerator in this state.

(g) Notwithstanding any other provision of this section, if the application of these rules by a jurisdiction where the taxpayer is not taxable [as defined in Article IV, Section 3] would result in gross receipts being sourced to that jurisdiction, those gross receipts are eliminated from the receipts factor denominator.

(h) Nothing in this section shall prohibit the taxpayer from petitioning for or the [tax administrator] from applying an alternative method to calculate the taxpayer's receipts factor in order to fairly represent the extent of the taxpayer's business activity in this state as provided for in Article IV, Section 18.