Multistate Tax Commission Uniformity Committee
Section 18 Apportionment Regulatory Working Group

NOTE:

This draft, if and when approved, would amend the Multistate Tax Commission's Model General Allocation and Apportionment Regulations by adding the provisions as set out here to the section pertaining to Section 18 of the Compact, Article IV (UDITPA).

This draft also includes two types of drafter's notes.

1. Notes within the text of the provisions and set off by brackets – [ ] – typically indicate where the state should provide a reference to state law or regulations including where the state has adopted other MTC model statutory or regulation provisions applicable or similar state-specific provisions. Bracketed text may also indicate where the state must chose between alternatives.
2. Other DRAFTER'S NOTES, indicated in caps at the beginning of a section or subsection, signal where drafters should consider their state's law in determining whether to adopt certain provisions.

DRAFT Proposed Model Regulation Establishing Formula for Apportioning Income of Taxpayers with No or Minimal "Receipts"

[REG. IV.18 Section #]

(a) This section applies to the determination of the receipts factor if the taxpayer's receipts, as defined by [reference to Compact Article IV.1.g or other similar state law], are less than 3.33% of the taxpayer's gross receipts, as defined by [reference to MTC Model Allocation and Apportionment Regulation IV.2.(a)(5) or similar state regulation].

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

(c) The following gross receipts are included in the receipts factor denominator and are assigned to the receipts factor numerator in this state as follows:

(1) DRAFTER'S NOTE: TREATMENT OF DIVIDEND INCOME VARIES WIDELY AMONG THE STATES. STATES SHOULD CHECK THEIR TAX BASE WHEN ADOPTING THIS EXAMPLE TO AVOID CONFUSION. Dividends paid by a related party, as defined in [reference to applicable 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 factors in this state for those years as determined pursuant to [reference to state law].

(B) If the dividends were paid from earnings that cannot reasonably 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 factors in this state for the current and preceding year as determined pursuant to [reference to state law].

EXAMPLE:

Taxpayer Bigbox Holding, Inc. (Holding) is a domestic corporation, domiciled in Delaware, with numerous foreign and domestic subsidiaries. Holding has no "receipts," as defined under this state's apportionment statutes. Holding is the corporate parent of Bigbox Retailing, Inc. (Retailing), a domestic corporation with its commercial domicile in

Maryland. During the tax year, Holding receives $100 million in dividends from Retailing and $100 million in dividends from Holding's foreign subsidiaries. Because the foreign-source dividends are excluded from this state's tax base pursuant to this state's laws, they are not "gross receipts" subject to apportionment and are not 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. Therefore, pursuant to subsection (c)(1)(B), Holding's receipts factor in this state is calculated by including the $100 million of apportionable dividends received from Retailing in the denominator, and $19 million in the receipts factor numerator in this state, based on the average of Retailing's apportionment factors in this state in the current year (20%) and prior year (18%).

(2) Gains (net of related losses, but not less than zero) 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, then the receipts from that gain are attributed to the receipts factor numerator of this state under subsections (d), (e), (f) or (g).

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* tangible 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%. Based on Target's apportionment factor, Nuclear would include $100 million in the denominator of its receipts factor and would assign $30 million to the receipts factor numerator in this state.

(ii) Same facts as (i) except Nuclear formed Target and then sold the 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 would 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 would include 30% of that gain in the receipts factor in 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 [reference to the MTC's Formula for the Apportionment and Allocation of the Net Income of Financial Institutions Model Statute as adopted July 29, 2015 or similar provisions of the state's financial institution receipts factor rules] are included in the receipts factor denominator and assigned to the receipts factor numerator in this state to the extent those receipts would be assigned to this state under [reference the MTC's Formula for the Apportionment and Allocation of the Net Income of Financial Institutions Model Statute as adopted July 29, 2015, including the rule of assignment to commercial domicile in section (p), or the state's financial institution receipts factor rules] as if the taxpayer were a financial institution. However, in the case of receipts associated with loans to a related party as defined by [reference to state law], which are not secured by real property, including interest, fees, and penalties, the receipts are included in this state's numerator in a proportion equal to the related party's apportionment factor in this state as determined by [reference to state law] in the year the receipts were generated.

EXAMPLES: DRAFTER'S NOTE: THESE EXAMPLES ASSUME THAT THE STATE HAS EITHER ADOPTED THE MTC MODEL FORMULA FOR THE APPORTIONMENT AND ALLOCATION OF THE NET INCOME OF FINANCIAL INSTITUTIONS OR DOES NOT HAVE SIMILAR RULES. IF THE STATE HAS ADOPTED SIMILAR RULES FOR FINANCIAL INSTITUTIONS, THIS EXAMPLE SHOULD REFERENCE THOSE RULES.

(i) Taxpayer Bigbox Holding, Inc. (Holding) is a domestic corporation, domiciled in Delaware, with numerous foreign and domestic subsidiaries. Holding has no "receipts," as defined under this state's apportionment statutes. Holding is the corporate parent of Bigbox Retailing, Inc. (Retailing), a domestic corporation with its commercial domicile in Maryland. During the tax year, Holding receives $100 million in dividends from Retailing and $100 million in dividends from Holding's foreign subsidiaries. Because the foreign-source dividends are excluded from this state's tax base pursuant to this state's laws, they are not "gross receipts" subject to apportionment and are not 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. Holding previously lent its excess capital to Retailing as an unsecured loan. In repayment of that loan, Holding received $40 million of interest income from Retailing in the tax year, in addition to the $100 million of dividend income that Holding received from Retailing. Pursuant to subsection (c)(3) of this regulation, Holdings' interest income would be included in the receipts factor denominator, and 20% of Holding's interest receipts ($8 million) would be included in the receipts factor numerator in this state because 20% of Retailing's apportionment factors were in this state in the year the interest income was generated. Assuming Holding had no other gross receipts, Holding's receipt factor numerator in this state is 19.28% ($27 million /$140 million).

(ii) Taxpayer Loan Participation Inc. (LPI) was formed to acquire and hold a participation in loans secured by real property originated by an unrelated financial institution. LPI has no employees or property and no other receipts except for payments of interest on the participation loan held. Even though LPI would not be considered a financial institution for purposes of this state's rules, its gross receipts are attributed to the receipts factor numerator in this state as if it were a financial institution.

(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 included in the denominator and assigned to the receipts factor numerator in this state to the extent those accounts receivable are attributed to borrowers located in this state; provided however, that if the taxpayer is not taxable as defined in [reference to Compact Article IV, section 3 or similar state law] in a state in which the borrowers are located, those gross receipts are excluded from the denominator of the taxpayer's receipts factor.

EXAMPLE: 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 purchases installment agreements originating from Iron Horse's borrowers in States A and B, and this state. Factoring is taxable in State A and this state, but not State B. Factoring re-sells the agreements as securitized instruments to institutional investors. Factoring's gross receipts from selling the securitized instruments originating from Iron Horse's borrowers in State A and this state would be included in the receipts factor denominator, and Factoring's receipts from selling securitized instruments originating from Iron Horse's borrowers in this state would be assigned to the receipts factor numerator 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[1] are assigned to the sales factor numerator in this state if the receipts would be assigned to this state under [reference to Section (n) or (p) 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 similar state financial institutions receipts factor rules]; all other receipts from investment activities are assigned to the receipts factor numerator in this state if the investments are managed in this state.

(d) DRAFTER'S NOTE: THIS PROVISION IS FOR STATES THAT USE A MULTI-FACTOR FORMULA. STATES WITHOUT A MULTI-FACTOR FORMULA SHOULD EXCLUDE THIS PROVISION. Gross

[1] Receipts from loan activities should be apportioned pursuant to Subsection 3(c) of this regulation.

receipts, other than those included and assigned under subsection (c), are included in the receipts factor denominator, and are assigned to the receipts factor numerator in this state in a proportion equal to [the taxpayer's other apportionment factor or average of those factors] determined pursuant to [reference to state law], if those factors are *non-de minimis.*

EXAMPLE: 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.

DRAFTER'S 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 BELOW WILL HAVE TO BE RENUMBERED.

(e) DRAFTER'S NOTE: THIS PROVISION IS FOR STATES THAT ALLOW STATE-LEVEL COMBINED OR CONSOLODATED FILING. STATES ADOPTING SUBSECTION (e) SHOULD CONSIDER WHETHER COMPUTATION OF THE RECEIPTS FACTOR USING THE COMBINED OR CONSOLIDATED FILING OPTIONS UNDER THEIR STATE'S LAW WILL FAIRLY REPRESENT THE SOURCE OF THE TAXPAYER'S RECEIPTS. Except gross receipts included and assigned under subsections (c) and (d), gross receipts of a taxpayer whose income and factors are included in a combined or state-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 [reference 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 and would include $250 million in the receipts factor numerator in this state.

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

(f) Except for those gross receipts included and assigned under other subsections of this regulation, gross receipts of a taxpayer electing to be included on 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: DRAFTER'S NOTE: STATES SHOULD CHOOSE ONE OF THE FOLLOWING ALTERNATIVES AS NOTED.

[Alternative 1 – States that have subsection (e)] - 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 not included on a combined or state-consolidated return filed in this state, 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 $1 billion in its receipts factor denominator and would assign 10% of that amount ($100 million) to the receipts factor numerator in this state.

[Alternative 2 – States that do not have subsection (e)] - 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 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 $1 billion in its receipts factor denominator and would assign 10% of that amount ($100 million) to the receipts factor numerator in this state.

(g) Nothing in this section shall prohibit the taxpayer from petitioning for or the [state tax agency or 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 [reference to Compact Article IV, Section 18 or similar state law], including the application of this rule in situations that do not meet the threshold of subsection (a). Such alternative method may be appropriate, for example, in situations otherwise addressed under subsection (c)(1) where dividends were paid from earnings that were generated by the activities of a related party of the dividend payor, in which case the dividends may be more appropriately assigned to the receipts factor numerator in this state using the related party's average apportionment factors in this state.