Proposed Special Apportionment Regulation Latest Discussion Draft

(Updated 1/24/17):

Where 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),] the rules set forth herein shall be applied in calculating the taxpayer's receipts factor. These rules for calculating the receipts factor may also apply, in the discretion of the tax commissioner, in other circumstances in which the apportionment formula does not fairly represent the extent of the taxpayer's business activity in the state.

1) In the case of any taxpayer with gross receipts consisting of dividends from related parties, interest, investment income, or proceeds from the disposition of a business or business segment, those gross receipts, to the extent included in apportionable income, shall be assigned as follows:

    (a) Dividends paid by a related party [as defined in Sec. 17 or other state law], shall be included in the receipts factor denominator and shall be included in the receipts factor numerator of this state (i) where it can be reasonably determined that the dividends were paid from earnings generated by the dividend payor in particular years, by using the dividend payor's apportionment factors for those years; (ii) where the years in which the earnings were generated by the dividend payor cannot be reasonably determined, by using the average of the apportionment factor of the dividend payor for the current and preceding year; and (iii) where the dividend income was generated from earnings of one or more related parties to the dividend payor, by using the apportionment factors of those related parties in the years in which those earnings were generated;

    (b) Capital gains (but not capital losses) deriving from the disposition of the stock or other intangible property rights representing a [substantial? controlling?] ownership interest in a business entity shall be included in the receipts factor denominator and shall be included in the receipts factor numerator in [this state] to the same extent as the entity's average apportionment factors were assigned to this state in the year preceding the disposition. Capital gains (but not capital losses) deriving from the disposition of the assets of a business or business segment shall be included in the denominator and shall be included in the numerator in [this state] to the same extent as that business's apportionment factors were in this state in the year preceding the disposition.

    Comment [BJF1]: Placeholders; group didn't want this provision confused with investment activities

    (c) Receipts arising from those 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 this state's financial institution receipts factor rules] shall be included the receipts factor denominator and shall be included in the receipts factor numerator for this state to the extent those receipts would be assigned to this state under [this state's financial institution receipts factor rules] or [under the MTC's Formula for the Apportionment and Allocation of the Net Income of Financial Institutions Model Statute (as adopted July 29, 2015);

(d) Gross receipts derived from accounts receivable [having been] [or: previously] sold to or otherwise transferred to the taxpayer, to the extent they cannot be assigned under Subsection (c), shall be included in the denominator of the receipts factor and shall be included in the numerator of the receipts factor for this state to the extent those amounts are collected from borrowers in this state;

(e) The net amount [but not less than zero] of receipts not assigned under Sections (b-d) arising from investment activities, including the holding of or the maturity, redemption, sale, exchange or other disposition of [marketable securities or cash, shall be included in the denominator and shall be numerator of the receipts factor for this state to the extent the investment activities would be assigned to this state under [this state's financial institution receipts factor rules] or [under the MTC's Formula for the Apportionment and Allocation of the Net Income of Financial Institutions Model Statute (as adopted July 29, 2015), Section 3(n), if this state has not adopted a special apportionment rule or statute for financial institutions]; all other receipts from investment activities shall be assigned to the state in which such investments are managed.

2) If the taxpayer has gross receipts that are not included in the receipts factor pursuant to Section (1), and the state requires the use of multiple factor apportionment formulas, those gross receipts shall be included in the denominator of the receipts factor and included in the numerator of the receipts factor of this state by using the remaining apportionment factors and percentages applicable to that taxpayer where those factors are *non-deminimis*.

3) If the taxpayer has gross receipts that are not apportioned pursuant to Sections (1) and (2), those gross receipts shall be included in the denominator of the receipts factor and shall be included in the numerator of the receipts factor of this state in the same ratio as:

(a) the receipts factor of the remainder of the combined or consolidated group if the taxpayer's income and factors are included on a combined or consolidated report or return filed in this state; or

(b) the receipts factor applicable to the owner of a preponderance of beneficial interests in that taxpayer, if the taxpayer is filing as a separate entity in this state.

4) [NEW MATERIAL] Receipts which would be assigned to a jurisdiction in which the taxpayer is not taxable [as defined in Article IV, Section 3] shall be eliminated from the receipts factor.

Comment [BJF2]: Committee expressed concerns that some receipts are not "assigned" anywhere, since regulation only addresses assignment to "this state." But, this is almost identical to Section 17's throw-out provision.

(a) Receipts, other than receipts described in Section 16, are in this State if the taxpayer's market for the sales is in this state. The taxpayer's market for sales is in this state:

(c) If the taxpayer is not taxable in a state to which a receipt is assigned under subsection (a) or (b), or if the state of assignment cannot be determined under subsection (a) or reasonably approximated under subsection (b), such receipt shall be excluded from the denominator of the receipts factor.

5) To the extent application of the preceding subsections fails to result in an equitable apportionment of the taxpayer's gross receipts, the taxpayer may petition for, or the tax commissioner may require an alternative calculation of its receipts factor which reflects the extent of the taxpayer's business activity in this state.

Alternatives:

[references cost of performance]

5 (a) To the extent application of the preceding subsections fails to result in an equitable apportionment of the taxpayer's gross receipts, the taxpayer's receipts factor shall be calculated in a

manner which reflects the extent of the taxpayer's business presence in this state as determined by the percentage of income-producing activity in this state as measured by the costs of performance for that activity.

[*references income derived from state, not business presence*]

5 (b) To the extent application of the preceding subsections fails to result in an equitable apportionment of the taxpayer's gross receipts, the taxpayer's receipts factor shall be calculated in a manner which reflects the extent to which the taxpayer's income (or loss) was derived from this state in comparison to other states, provided that this method would not result in a substantial portion of the income (or loss) being apportioned to more than one taxing jurisdiction, or not apportioned to any taxing jurisdiction.

Examples:

1. Taxpayer CB Holdings, Inc. is a Nevada corporation with one employee and one office in Reno, Nevada. During the tax year it earned 100% of its gross income from dividends paid from CB REIT, Inc., which in turn in engaged exclusively in leasing stores to Crazy Bob Auto Parts, Inc. CB REIT, Inc. has one employee and one office, also in Reno, Nevada. All three corporations are related parties. 20% of CB REIT's leased stores are in this state. Although all of the taxpayer's dividend income is derived from CB REIT, under Section 1(a)(iii), 20% of the taxpayer's receipts are assigned to this state.

1a. Same facts, except that CB Holdings, Inc. maintains it is not subject to tax in the remaining four states in which CB REIT holds leases, because it lacks constitutional nexus in those states. Under Section 4, 100% of the taxpayer's receipts are assigned to this state.

2. Taxpayer Quick Sale Co. is a Delaware corporation formed exclusively to facilitate the disposition of three identical power plants in three separate states, which formerly belonged to Ten States Nuclear Corp. The sale is expected to generate a capital gain of $100 million on the plant located in this state and a capital loss of $25 million on each the two plants located elsewhere. In the year preceding the sale, 10% of Ten States Nuclear Corp's apportionment factors were in this state. One day after its formation, the taxpayer's stock is sold to Risky Investments for $500 million in cash. Because 10% of Ten State Nuclear Corp's apportionment factors in the year preceding the sale were in this state, ~~fail to reflect the location of Quick Sale Co.'s assets, 33%~~ 10% of Quick Sale's capital gain ($50 million) is assigned to this state.

2a. Same facts, but the sale is structured as a IRC Sec. 338(h)(10) election and is deemed to be a sale of assets, not stock, under this state's income tax conformity rules. Even though the plant located in this state accounted for the only capital disposition generating a gain, the taxpayer's receipts ($50 million) are assigned to [all ten] ~~three~~ states based on the taxpayer's apportionment factors in the year preceding the sale. ~~the location of the assets.~~

3. Taxpayer Loan Participation Services, Inc. is a Delaware corporation formed by a related financial institution for the exclusive purpose of holding securitized loan portfolios in trust for unrelated parties in multiple countries. The taxpayer has no employees or property. The securitized loan portfolios consist of mortgage loans; 10% of those mortgage interests can be traced to real property in this state. Even though Loan Participation Services, Inc. would not be considered a financial

Comment [BJF3]: Changed to reflect decision to assign capital gain based on location of taxpayer's apportionment factors, not the location of the assets/business segment being sold.

Comment [BJF4]: Changed to reflect group's decision that taxpayer's apportionment factors should be used, not location of assets.

institution under this state's laws, 10% of the portfolio's receipts derived from items including interest payments, late fees and origination fees are assignable to this state if this state has adopted the Multistate Tax Commission's model formula for the apportionment of financial institution income, or if the loan portfolio income would be assigned to this state under this state's apportionment formula for financial institutions.

4. Taxpayer IH Factoring, Inc. is a Delaware corporation with all twenty of its employees in Dover, Delaware. It exclusively purchases installment agreements (accounts receivable) from its parent corporation, Iron Horse Motorcycles, Inc., and re-sells those agreements (as securitized instruments) to institutional investors. IH Factoring would not be considered a financial institution under this state's laws. Iron Horse Motorcycles has a 10% apportionment factor in this state, but 25% of its dealers' purchase agreements sold to IH Factoring derive from motorcycle customers in your state. 25% of IH Factoring Inc.'s receipts are assigned to this state.

New Material:

Alternative Apportionment Example for 3(a), 3(b) and (5):

Taxpayer Windfall, Inc. is an indirectly wholly-owned subsidiary of ABC Manufacturing Company and its income is included on the water's edge unitary combined report filed by ABC Manufacturing Inc. and Combined Subsidiaries in this state; the numerator of the receipts factor for that group in this state is 3%. Windfall, Inc. has no property, payroll or receipts from transactions and activities undertaken in the regular course of its business. Windfall, Inc. receives $1 billion in settlement of ABC Manufacturing's long-standing patent infringement suit against a business competitor. Under Section 3(a) of this regulation, Windfall, Inc.'s receipts factor is 3%.

Same facts, except ABC Manufacturing Company and some of its subsidiaries file separate-entity returns in this state. Windfall, Inc. is 100% owned by Intermediary Corp., a Delaware corporation which limits its activities to that state. Intermediary Corp. in turn is owned 100% by ABC Manufacturing Company. Under Section 3(b) of this regulation, Windfall, Inc.'s has a receipts factor of $1 billion. While Windfall, Inc.'s numerator in this state would be zero under 3(b), because Intermediary Corp. does not have a receipts factor in this state, under (5) the tax commissioner may assign some portion of Windfall, Inc. receipts to this state in order to fairly represent the extent of the taxpayer's business activity in this state.