



Financial Institutions Apportionment
Property Factor Issues for Discussion Purposes Only

Showing Work Group Recommendations and Discussion Issues
DRAFT 9-26-2012

1. Clarify “change of material fact”

a. Current Language: §4(i) *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 contact to a regular place of business there.

b. Problem to be Addressed: The term “change of material fact” in the loan assignment rule is undefined. A question has arisen as to whether the sale of a loan or pool of loans to another entity within the same controlled group of corporations as the seller constitutes a material change of fact. Both taxpayers and tax administrators would benefit from objective criteria to determine when there has been a material change of fact.

c. Issues and Options:

i. Should the model explicitly describe how sale of loans within the same controlled group will be treated?

YES. The Work Group recommends the following language:

(i)(1) The direct or indirect acquisition or transfer of a loan or a pool of loans to or from an entity that is within the same controlled group of corporations at the time of the acquisition or transfer is not a change of material fact. But, this prohibition does not, by itself, preclude other possible changes of fact from being considered in determining whether there has been a change of material fact.

ii. Should treatment of other transaction types also be explicitly described, such as:

A. The acquisition of the stock of an entity that owns loans.

YES – addressed as “direct or indirect” in (i)(1)

B. The acquisition of a loan or pool of loans from an entity that is not within the same controlled group of corporations.

YES. The Work Group recommends the following language:

(i)(2) The direct or indirect acquisition or transfer of a loan or a pool of loans to or from an entity that is not within the same controlled group of corporations at the time of the acquisition or transfer is a change of material fact.

- C. How does the “length of the original term of the loan” apply for credit card payments, renewals, etc.? [e.g., if a loan has no fixed term, then should the “term of the loan” be the term of the agreement between the financial institution and the borrower, or the expiration date of the card, etc.?)

No change is necessary.

- D. Is it clear that the “Thereafter” limitation applies to (re)assignments after a change of material fact as well as to (re)assignments after the original term of the loan? Or is it necessary to clarify in (i) or (i)(2) that (re)assignments after a change of material fact are also to be “based solely on the preponderance of the acquirer’s substantive contacts with the acquired loans [from FIST proposal for new (j)],” or to a state that “has a preponderance of substantive contact to a regular place of business there [from CA FTB proposal],” or something to that effect?

No change is necessary.

- E. Does the proposal properly handle securitizations where title transfers for book purposes but not for tax purposes (non-tax events)?

Yes. So no change is necessary. This is already covered since 4(b) provides that the property factor includes property the income or expenses of which are included in the computation of the apportionable income base for the tax year. If it is a non-tax event, then the income from the loans is included in the apportionable tax base and the loans are included in the property factor. Also, the value of loans and credit card receivables mentions charge-offs for federal income tax purposes – thus again indicating that you look to the tax treatment of the loans.

- iii. Should “controlled group” be defined?

Yes. Work Group members recommend different approaches for combined reporting and non-combined reporting states as follows:

Combined reporting states -

- “Controlled group of corporations” means “combined group” as defined in the state combined reporting statute.

Non-combined reporting states -

- If have an add-back statute
Reference definition of “related” or “affiliated” entity contained in the add-back statute.
- If no add-back statute
For purposes of this subsection, “controlled group of corporations” means “controlled group of corporations” as defined in 1563(a) of the Internal Revenue Code, except that “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 .

d. Proposed Language:

(i) **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 contact to a regular place of business there. For purposes of this section, “change of material fact” is a facts and circumstances test.

(1) The direct or indirect acquisition or transfer of a loan or a pool of loans to or from an entity that is within the same controlled group of corporations at the time of the acquisition or transfer is not a change of material fact. But, this prohibition does not, by itself, preclude other possible changes of fact from being considered in determining where there has been a change of material fact.

(2) The direct or indirect acquisition or transfer of a loan or a pool of loans to or from an entity that is not within the same controlled group of corporations at the time of the acquisition or transfer is a change of material fact.

(3) For purposes of this subsection, “controlled group of corporations” means [Insert one of the following as appropriate:

Combined reporting states -

- “‘combined group’ as defined in the [citation to state combined reporting statute].”

Non-combined reporting states -

- If have an add-back statute
“‘related’ [or ‘affiliated’] entity as that term is defined for purposes of [citation to state’s add-back statute].”
- If no add-back statute
“‘controlled group of corporations” as defined in 1563(a) of the Internal Revenue Code, except that “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.”]

2. Update and Clarify the SINAA loan assignment rule used in the property factor

- a. Do we want to retain a property factor?
- i. Yes. Shortly after this project was initiated, in 2008, the work group determined that it wanted to make narrow, “surgical” changes to address specific problems while maintaining the balance between money-center and market states that was struck under the original proposal. ***In April of 2009, the work group communicated to the Subcommittee its recommended overarching goal to “retain the equal-weighted, three factor model, rather than move to single sales factor model.”***
- ii. Should we review this decision? Options:
- A. Yes. [Identify preferable alternatives to the equal-weighted, three factor formula]
- B. No.
- b. If we retain the property factor, do we want to continue to assign loans in the property factor?
- i. Yes. In April of 2009 the workgroup listed an overarching goal for the sourcing of loans in the property factor:
“State and Industry Overarching Goal – the intent is not to recreate the 1994 apportionment outcome of sourcing property to particular states. Rather, the intent is to attempt to maintain the 1994 policy of sourcing property to location of loan activity.”
Including loans in the property factor is consistent with case law that found distortion where loans were not included in the property factor for a financial institution (*Crocker Equipment Leasing, Inc. v. Department of Revenue*, 838 P.2d 552 (OR 1992)).
- ii. Should we review this decision? Options:
- A. Yes. [Identify preferable alternatives for reflecting loans in the apportionment formula (or rationale for exclusion)]
- B. No.
- c. What should the loan assignment rule be?
- i. Current MTC model rule:
- A loan is in a state if it is properly assigned to a regular place of business of the taxpayer within this state. (4)(g)(1)(A). A “regular place of business” is defined as 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. (2)(q). A loan is properly assigned to the regular place of business with which it has a preponderance of substantive contacts. (4)(g)(1)(B). There are presumptions that come into play if the loan is assigned outside the state. To determine the state in which the preponderance of

substantive contacts relating to a loan have occurred, the facts and circumstances are 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. (4)(g)(3).”

- ii. Amendment Issues: In April of 2009, the work group communicated to the Subcommittee that its recommended overarching goal is not to recreate the 1994 apportionment outcome of sourcing property to particular states. Rather, the goal is to attempt to maintain the 1994 policy of sourcing property to location of loan activity.

A. What should the rule be?

- Which activities? (add and/or subtract from “SINAA”)?

Industry has recommended “INAA” See industry documents dated Nov. 24, 2010, Jan. 2011, Mar. 15, 2011, Apr. 26, 2011 and Jul. 11, 2011 setting forth the reasons for this recommendation and draft amended property factor language.

- How to measure the activities (e.g., employees, costs, etc.)?

Industry has recommended that the current measurement of activity be retained (attribute each activity to the state where the financial institution primarily performs that function) rather than creating a new costly system that will not change the result but will be difficult to implement and to audit. See industry documents dated Nov. 24, 2010, Jan. 2011, Mar. 15, 2011, Apr. 26, 2011 and Jul. 11, 2011 setting forth the reasons for this recommendation and draft amended property factor language.

- How to weight each of the SINAA factors (equal weight individual factors, self-weight by lumping dollar costs of each activity all into one big factor, etc.)?

Industry has recommended sourcing to the location where the greatest number of the SINAA functions are performed, consistent with how they have interpreted the current provision since it was adopted in 1994 and have reiterated on numerous working group calls as well as in industry documents dated Mar. 15, 2011, Apr. 26, 2011, Jun. 23, 2011 and Jul. 11, 2011, without receiving interpretations to the contrary.

Industry has also indicated that upon the filing of refund claims based on applying a cost of performance (COP) analysis in sourcing loans, the states that have adopted the MTC financial organization apportionment provisions have rejected applying COP in determining the preponderance of contacts based on SINAA.

- B. What should the rule apply to? (e.g., a loan, a group of loans, how to determine the group?)

The work group recommends that the rule should apply to groups of loans. Industry has proposed language which is under consideration:

To determine the preponderance of substantive contacts relating to loans, loans may be grouped by classes of similar instruments, by customer base, and/or another method (including a method combining instruments and customer bases) that reflects the taxpayer's books and records. For example, loans could be grouped as consumer loans, real property loans and commercial loans. Consumer loans could be further grouped such as into installment loans, credit card receivables, student loans, etc. The method of grouping should be consistent with the method of tracking loans within the taxpayer's own books and records used in the normal course of business that reasonably reflects the products/services sold as identified by the taxpayer. The taxpayer's loan groupings will be presumed to have been properly determined if the taxpayer applies the groupings consistently from year to year unless there has been a material change of fact with respect to that loan group. If a taxpayer cannot group loans, the preponderance of substantive contacts shall be determined on a loan by loan basis.

- C. What changes are then needed for the presumptions? (section 4(g)(1)(B)-(C))