State Taxation of Income From Foreign Affiliates
Multi-State Trends in Treatment of Subpart F Income, Sect. 78 Amounts, Combined Reporting and Other Tax Issues

WEDNESDAY, MAY 20, 2015, 1:00-2:50 pm Eastern

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State Taxation of Income From Foreign Affiliates

May 20, 2015

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Subpart F Income

Presented by:
Charles K. Kolstad
Subpart F Income

General Rule

- Income of a foreign corporation is not taxable to its U.S. shareholders until the income is distributed in the form of a dividend.
- If the foreign corporation is a resident of a country with which the U.S. has a specific type of income tax treaty, dividends received by an individual would be qualifying foreign dividends taxed at the federal long term capital gains rates under Section 1(h)(11) of the Internal Revenue Code of 1986, as amended ("Code").
Subpart F Income

- Subpart F Income
  - Subpart F of the Code provides for an anti-avoidance set of rules
  - If income of the foreign corporation consists of certain types of income, then that income is taxed to the U.S. shareholders on a current basis, whether or not actually distributed to the shareholder. See Section 951
Subpart F Income

- Only applies to Controlled Foreign Corporations ("CFC")
- A CFC is a foreign corporation in which U.S. shareholders own more than 50% of the voting stock or 50% of the value of all classes of stock. See Section 967
- A U.S. shareholder is a U.S. person who owns 10% or more of the vote or value of the stock of the CFC. See Section 951(b)
Subpart F Income

- Categories of Subpart F Income
  - Foreign Personal Holding Company Income (Section 954(c))
  - Foreign Base Company Sales Income (Section 954(d))
  - Foreign Base Company Service Income (Section 954(e))
  - Other Categories
Subpart F Income

- Foreign Personal Holding Company Income
  - Passive Income
    - Rents, royalties, dividends, interest, etc.
    - Gains from sales of assets giving rise to rents, royalties, etc.
    - Certain exceptions for unrelated party rents and royalties
    - Certain exceptions for related party interest and dividends from a controlled subsidiary
  - Personal Service Income
    - Named individual, greater than 25% shareholder
Subpart F Income

- Foreign Base Company Sales Income
  - Income from sales of products either purchased from or sold to related parties where either the manufacturing or the use occurs outside of the country in which the CFC is organized
  - Manufacturing branch rules
    - Anti-avoidance rule
    - Branch may be treated as a foreign corporation resulting in the income qualifying as FBCSI!
Subpart F Income

- Foreign Base Company Service Income
  - Income from services performed for or on behalf of a related party where the services are performed outside of the country in which the CFC is organized
Subpart F Income

- Federal Income Taxation of Subpart F Income
  - U.S. shareholders must include in income their respective share of the Subpart F income of a CFC
  - However, taxed at ordinary income tax rates in the hands of the U.S. shareholder
  - Does not qualify as a “qualifying foreign dividend”
    - Recent court cases
  - Corporate shareholder may claim foreign tax credits for the foreign taxes paid by the CFC (see Section 960)
Subpart F Income

- Taxation of Actual Dividends
  - Income inclusions of Subpart F Income creates “Previously Tax Income” (“PTI”)
  - Actual cash dividends are treated first as a reduction of PTI, and are only taxable to the extent that the distributions exceed the PTI account (See Section 959)
Subpart F Income

- Taxation of Actual Dividends
  - If a U.S. shareholder has a Subpart F income inclusion and receives cash dividends from the same CFC in the same year, the Subpart F income inclusion is first included in income, and then the cash dividends are treated as a reduction of PTI.
Subpart F Income

- **State Tax Treatment of Subpart F Income**
  - State’s incorporation of Subpart F of the Code varies from state to state
  - Most states do not incorporate the provisions of Subpart F Income of the Code in their state tax laws
  - Accordingly, in such cases, the Subpart F Income is NOT subject to state income tax, and only actual dividends are subject to state income tax
Subpart F Income

- State Tax Treatment of Subpart F Income
  - Foreign withholding taxes
    - Most states do NOT give a tax credit for any foreign withholding taxes imposed on dividends from CFCs
    - In addition, they do not allow for an indirect tax credit for the foreign corporate taxes paid by the CFC
WSB SALT
Combined Filings & Non US Companies

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MEET YOUR SPEAKER

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25 Years of Public & Private SALT Experience
“NEXUS” WHAT IS IT?

• When a business has a physical presence in a state, that presence creates a taxable connection called “nexus.” Once nexus is established, a state or city has a constitutional right to impose a tax on the business.

• Generally, the presence of employees, agents, or property (owned or rented) will create that taxable connection.

• A fixed place of business is NOT a requirement.

• There are also circumstances where nexus is created even when a physical presence does not exist.
• “PE” or “permanent establishment” means a fixed place of business of an enterprise through which the business is wholly or partially carried on.”
• Very different from the concept of “nexus.”
ECONOMIC NEXUS: “ECONOMIC ACTIVITY PURPOSEFULLY DIRECTED AT A STATE”

• Economic nexus: A state can impose a tax if an out-of-state taxpayer avails itself of the benefits of the economic market of a state regardless of physical presence.

• CA beginning January 1, 2011, sales > $500k ($529k in 2014)
• CT beginning January 1, 2010, sales > $500k
• CO beginning April 30, 2010, sales > $500k
• OH CAT sales > $500k
• MI sales > $350k with active solicitation
• WA beginning June 1, 2010, sales > $250k
• NYS beginning Jan 1, 2015, sales of $1 mil or more
Taxes imposed by states and localities in the US can be a source of confusion for foreign business.

The confusion arises because:

— (1) foreign businesses often do not have a PE in the US and as a result are not subject to Fed Income tax,

— (2) the foreign business’ home country may have a tax treaty with the US making exempting the business’ income from Fed income tax,

— (3) thousands of taxing state and local tax jurisdictions
COMBINED VS. CONSOLIDATED

• As of January 1, 2014, 29 states require or allow combined or consolidated filings.

• A consolidated state income tax return is “typically,” but not always, one return filed by an affiliated group that also files federal consolidated returns. There are variations

• A combined report is filed by a group of commonly owned corporations or businesses that constitute a unitary business because the basic operations of the entities are integrated and interrelated.

• Combined and consolidated filings can be required or elective, depending on the state.

• Each state has its own rules and reporting style.
WHAT STATES PERMIT OR REQUIRE COMBINED REPORTING?

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UNITARY BUSINESSES

• A unitary business can be required to include all of its unitary affiliates in a state income tax return even those affiliates that do not have nexus in a state.

• A unitary business is a vertically or horizontally integrated economic unit of affiliates that are treated as a single taxpayer.

• The United States Supreme Court has adopted its own test of what constitutes a unitary business, most notably, the Mobil test of "contributions to income resulting from functional integration, centralization of management, and economies of scale."
WATERS EDGE VS WORLDWIDE

• Worldwide
  — Worldwide combined reporting generally includes the entire unitary group, regardless of where the member was incorporated or what countries the member conducts business in.

• Water’s Edge
  — Water’s-edge combined reporting does not generally include group members incorporated in foreign countries or that conduct most business outside the US.
Who is included in the group? Depends on the state. For example...

- MI WE Group includes only US incorporated corps.
- CO: No 80/20s, even US incorporated 80/20s.
- ME & NM: If an affiliate is in a Federal consolidated group it is in the Water’s Edge group.
- MA: All US corps and any foreign corporation if the company’s average, payroll/prop/sales factors are 20% or more within the United States.
• When a corporation is part of a unitary group, some states require it to file its income tax return with all of its unitary affiliates, wherever those affiliates are located. This is “worldwide combined reporting.”

• Most states require common ownership of 50% or more before a corporation can be required to file combined.

• Multinational unitary businesses must file a combined report of their worldwide operations (worldwide combined report), in states where it is required.
• **Economic nexus** provisions do not apply to any company that is treated as a foreign corporation under the IRC and has no income effectively connected with a U.S. trade or business. Only a foreign corp’s effectively connected income will be considered as its gross income.
If a corporation is subject to a tax on its income in Massachusetts and it is engaged in a unitary business with one or more other corporations under common control, a combined report must be filed whether or not the other corporations are taxable in Massachusetts.

10 year election to file worldwide, otherwise the group must file water’s edge.

Treaty exempt items of income of non-U.S. corporations that are members of a water's edge combined group are excluded from the combined group's taxable income.
• Members of a MA combined group, whether or not taxable in MA, combine their income from the unitary business.

• A “taxable member” is a corporation included in a combined group which is taxable on its income in Massachusetts; all other corporations which are part of such a group are “non-taxable members”.

• If members of the group do not elect to file worldwide, they must file on a water’s edge basis, unlike CA.
Where the combined group has made and is subject to a valid worldwide election, any member incorporated in the United States, or federally treated as a U.S. corporation, calculates its taxable income to be included in the total income of the combined group using normal state adjusted FTI.

Worldwide filers include all income wherever derived, and is not limited to items of U.S. source income or effectively connected income within the meaning of the IRC.
MA WATERS EDGE COMBINED GROUP

• A MA water’s edge group includes US companies and...
  – Affiliates, regardless of the place incorporated or formed, if the average of its property, payroll, and sales factors within the United States is 20 per cent or more;
  – Any member that earns more than 20 per cent of its income, directly or indirectly, from intangible property or service-related activities the costs of which generally are deductible for federal income tax purposes.

• With Water’s edge filers, treaty exempt items of income of non-U.S. corporations that are members of a combined group are excluded from the group's taxable income; however, Non U.S. group members are included if the average of their property, payroll, and sales factors within the United States is 20% or more.
• Any member not incorporated in the United States and not federally treated as a U.S. corporation, the income to be included is determined from a P&L statement that must be prepared for each foreign branch or corp in the currency in which its books of account are regularly maintained, adjusted to conform it to GAAP accounting principles & further modified to take into account any book-tax adjustments necessary to reflect federal or Massachusetts tax law.
MA COMBINED WITH NO WORLDWIDE ELECTION

• Income derived from sources within the U.S. and that is not effectively connected, but has federal income tax collected on it through withholding should be included in the taxable net income of a combined group member that is not incorporated in the United States and not treated as a U.S. corporation under the IRC.

• Income that is neither U.S. source income nor effectively connected income is generally excluded from the determination of taxable net income of such member.
In the CA combined report, the entire amount of the unitary business income of all members of the unitary group (including unitary members with no property, payroll, or sales in California) is aggregated. The combined business income is then apportioned to California and to the unitary members subject to tax in California, by formula apportionment. Income apportioned to California is further apportioned to members of the unitary group subject to California tax.
CA WATER’S EDGE REPORTING

• Unlike MA, CA water's-edge filers elect out of worldwide combined reporting. The seven year election is made by filing Form 100WE.

• Many states limit the corporations includible in a combined reporting group to entities having a significant presence in the United States. Therefore, a common approach is to exclude a foreign corporation from its unitary group’s combined return if its property, payroll, and sales factors average in the U.S. is less than 20%.
CA WATER’S EDGE GROUPS INCLUDE...

- Domestic international sales corporations, as defined in IRC Section 992.
- Foreign sales corporations, as defined in IRC Section 922.
- Most corporations, if the average property, payroll, and sales factors within the U.S. is 20% or more.
- Most corporations incorporated in the U.S., except corps electing under IRC Sections 931 to 936.
- Export trade corporations.
- Controlled foreign corporations (CFC), as defined in IRC Section 957, that has subpart F income.
CALIFORNIA WE RETURNS

• Non-effectively connected income (NECI), which is income derived from the U.S. by a foreign corporation that is not engaged in a U.S. trade or business, is not included in CA Water’s-Edge returns.

• Effectively connected income (ECI) immunity provisions of the federal tax treaties do not apply for California purposes.

• A corporation that has both effectively connected income (income earned in the U.S.) and Subpart F income must include both sources of income in the WE income base.

• Water’s-edge taxpayers are generally allowed to exclude 75% of qualifying foreign dividends from income.
Any income satisfying the IRC definition of ECI, that is excluded from federal taxable income due to a tax treaty, is included for California purposes, even in a waters edge return.
NY COMBINED RETURNS

- New York does not follow the federal rules regarding taxation of non-U.S. companies, including rules established under treaties. For example, a foreign corporation that is not subject to federal tax because it lacks a “permanent establishment” (PE) may still be subject to tax in NY.

- A foreign corp that is treated as a domestic corp under the IRC must be included in the combined return if it is unitary and meets the > 50% ownership test.

- A foreign corporation with a PE that has effectively connected income and meets the unitary and ownership tests must be included in the combined return.
NY WATER'S-EDGE COMBINED REPORTING

• Prior to 1/1/15, NY did not have an election for “water's-edge combined reporting,” and did not allow non US corporations to be included in a combined return.

• As of 1/1/15 combination is required on a water's edge basis, except as provided in N.Y. Tax Law § 210-C(2)(c), for any taxpayer that:
  — owns or controls directly or indirectly > 50% of the voting power of the capital stock of one or more other corporations; or
  — is engaged in a unitary business with those corporations.

• Corporations not permitted to make a combined report include alien corporations that under the IRC are not treated as domestic corporations and have no ECI for the tax year.
A combined Colorado return will not include the income of any corporation that conducts business outside the United States (the 50 states and the District of Columbia) if 80% or more of the average of the corporation's property and payroll, as determined under the Multistate Compact apportionment rules, are assigned to locations outside the United States. [Colo. Rev. Stat. § 39-22-303(8);]
LOCAL TAXATION

- Compliance complexities multiply because US taxation geographies are further divided within states and some US cities have significant taxing powers.
- New York City, New York; Portland, Oregon; and Detroit, Michigan are examples of cities that impose their own income tax modeled after their respective state’s combined unitary reporting methodology.
- I have many times been approached by foreign accounting firms doing the compliance in NYS for their client after they realize they should have been filing in NYC.
- These types of problems are fixed through “VDAs.”
The Voluntary Disclosure Program

- Clean up unpaid taxes, unfiled returns, and other tax problems
- No penalty for past mistakes
- Covers all tax types

The New York State Tax Department’s Voluntary Disclosure Program has a simple goal: To help individuals and businesses with state tax debts meet their tax obligations.

A visit to our Web site starts the process – so don’t delay.

What is Voluntary Disclosure?
Our program makes it easy for most taxpayers who haven’t filed returns, or who have underreported their New York taxes, to come forward and resolve their tax problems.

The program covers all taxes administered by the Tax Department – including income, corporate, and sales tax.

Eligible taxpayers who “come clean” and agree to comply with the program must:
- report the taxes they owe,
- enter an agreement to pay what they owe, and
- agree to pay their taxes on time in the future.

In return, the Tax Department agrees to:
- waive tax penalties, and
- waive prosecution of cases that were criminal offenses.

How to Participate
It’s easy to apply online. All you need to do is:
- provide information about the taxes you owe,
- fill out a Voluntary Disclosure Agreement and return it to us with signed copies of the tax returns covered by the agreement, and
- pay the tax and interest due.

Eligibility
To be eligible, you must meet all of the following conditions:
- you’re not currently under audit by the New York State Tax Department,
- you haven’t received a bill for the tax debts you’re disclosing,
- you’re not under criminal investigation by a New York State agency or a political subdivision of the state, and
- you’re not disclosing participation in certain tax avoidance transactions (commonly known as a tax shelter).

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New York State Department of Taxation and Finance
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Apportionment
STATE APPORTIONMENT CALCULATIONS

- Traditional Formula: Payroll/Property/Sales apportionment calculation.
- Payroll Within/Payroll Everywhere (e.g. 100%)
- Property Within/Property Everywhere (e.g. 100%)
- Sales Within/Sales Everywhere (e.g. 50%)

\[100\% + 100\% + 50\% = 250\%\]

\[250\% / 3 = \text{Apportionment Factor of 83.33}\%\]
STATE APPORTIONMENT CALCULATIONS

• Many states still use some version of the Payroll/Property/Sales apportionment calculation.
• Equal sales weighting: AK, DE, HI, KS, MO, MT, NM, ND.
• Sales only: CA, CO, CT, GA, IA, IL, IN, ME, MI, NE, NJ NYS, OR, PA, RI, SC, TX, UT, WI.
• With other states, sales have added weight in the factor.
• **Worldwide**
  
  ― Worldwide combined reporting generally includes the factors of the entire unitary group, regardless of where the member was incorporated or what countries the member conducts business in.

• **Water’s Edge**
  
  ― Water’s-edge combined reporting does not generally include income/sales/payroll/property from group members incorporated in foreign countries or that conduct most business outside the US.
ELIMINATIONS

• For factor purposes, intercompany sales and other intercompany revenue items are eliminated in computing the numerator and denominator of the sales factor.

• Property or payroll (or appropriate portion thereof) that relate to such receipts are similarly excluded.

• MA: Where items of gross income are excluded from the federal gross income of a combined group member, the gross receipts to which such items of gross income are directly attributable are similarly excluded from the numerator and denominator of the member's sales factor.
WHERE’S THE PROFIT?

• If the US operations are more profitable, worldwide filing may be best.

• US apportionment may be higher in a water’s edge filing because the denominators will be smaller.

  — This requires analysis of the individual factors since some states are sales only and others still incorporate payroll and property into the calculation.

  • E.g. large international property and payroll will make a difference in a state like RI or AK, but it will have no impact in a CA filing for a media giant.

  — Not so for companies in mining or agriculture!
• A CA business is "unitary" if there is unity of ownership, unity of operation, and unity of use, or if the activities carried on within the state contribute to or are dependent upon the activities carried on without the state, or if there is a flow of value between the activities.

• CA requires waters edge filers include a certain proration of CFC income and apportionment factors. The amount included is calculated using a % of the CFC’s sub part f income to total earnings and profits.
• Domestic international sales corporations.
• Foreign sales corporation (IRC Sec 922).
• Any corp (other than a bank) if the average US property, payroll, and sales factors are 20% or more.
• Any corp incorporated in the U.S., except for those making an election under IRC Sec 931 to 936.
• Any export trade corporation as defined in IRC Section 971.
• The effectively connected income of any corp not described in items 1 through 5, even if excluded from FTI due to a treaty.
• CA does not honor US Fed tax treaties.
• Non US members’ financial/tax info must be “translated”
• Sales factor translation must be made using the simple average of the beginning and end-of-year exchange rate, unless there is substantial fluctuation.
• If there is substantial fluctuation, the exchange rate shall be either
  — (1) the simple average of the month-end rates, or
  — (2) the weighted average taking into account the volume of the transactions for the calendar month ending within that period.
For tax years beginning on or after January 1, 2011, the state uses the “Finnigan Rule.” For purposes of determining whether sales are in California and included in the numerator of the sales factor, all CA sales of the combined reporting group are included in the sales factor numerator for California, regardless of whether the member has nexus.
A Corp does not have to throw back foreign TPP sales to the California sales factor when it has more than $529,000 in TPP sales in a foreign (Non U.S.) jurisdiction because it would be taxable in such jurisdiction under CA rules.
• Sales of TPP shipped or delivered to a state end up in that state’s numerator, if a return is being filed there.

• If a member in a combined group makes sales to customers in a no nexus state where the combined group is filing the combined return, do the sales go into that state’s numerator?
  — In Joyce states, no.
  — In Finnigan states, yes.
JOYCE OR FINNIGAN? TPP RULE!

• What if a German advertising company that does not have CA nexus, but is part of a combined filing in CA provides advertising services for customers in CA?

• Are those sales put in the CA numerator under the Finnigan rule? No.

• Finnigan only applies to sales of TPP!
## FINNIGAN/JOYCE STATES

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<td>Joyce</td>
</tr>
<tr>
<td>NH</td>
<td>Joyce</td>
</tr>
<tr>
<td>NM</td>
<td>Joyce</td>
</tr>
<tr>
<td>NY</td>
<td>Finnigan</td>
</tr>
<tr>
<td>OR</td>
<td>Joyce</td>
</tr>
<tr>
<td>TX</td>
<td>Joyce</td>
</tr>
<tr>
<td>UT</td>
<td>Finnigan</td>
</tr>
<tr>
<td>VA</td>
<td>Joyce</td>
</tr>
<tr>
<td>VT</td>
<td>Joyce</td>
</tr>
<tr>
<td>WI</td>
<td>Finnigan</td>
</tr>
<tr>
<td>WV</td>
<td>Joyce</td>
</tr>
<tr>
<td>State</td>
<td>Throwback Rule</td>
</tr>
<tr>
<td>-------</td>
<td>----------------</td>
</tr>
<tr>
<td>AK</td>
<td>Yes</td>
</tr>
<tr>
<td>AL</td>
<td>Yes</td>
</tr>
<tr>
<td>AR</td>
<td>Yes Caution: Joyce rule followed</td>
</tr>
<tr>
<td>CA</td>
<td>Yes For taxable years beginning on or after 1/1/11, CA adopts the Finnigan rule; formerly, Joyce rule was used</td>
</tr>
<tr>
<td>CO</td>
<td>Yes Caution: &quot;Joyce Rule&quot; followed</td>
</tr>
<tr>
<td>DC</td>
<td>Yes</td>
</tr>
<tr>
<td>HI</td>
<td>Yes Caution: State applies Joyce rule</td>
</tr>
<tr>
<td>ID</td>
<td>Yes Caution: State applies Joyce rule</td>
</tr>
<tr>
<td>IL</td>
<td>Yes Caution: Applies Joyce rule</td>
</tr>
<tr>
<td>IN</td>
<td>Yes Caution: Indiana applies the Finnigan rule</td>
</tr>
<tr>
<td>KY</td>
<td>Yes for sales to U.S. gov't only</td>
</tr>
<tr>
<td>MA</td>
<td>Yes</td>
</tr>
<tr>
<td>ME</td>
<td>Yes Caution: Finnigan beginning on or after 1/1/10; Joyce for years beginning before 1/1/10</td>
</tr>
<tr>
<td>MO</td>
<td>Yes</td>
</tr>
<tr>
<td>MS</td>
<td>Yes</td>
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<tr>
<td>MT</td>
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<tr>
<td>ND</td>
<td>Yes</td>
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<tr>
<td>NH</td>
<td>Yes</td>
</tr>
<tr>
<td>NM</td>
<td>Yes</td>
</tr>
<tr>
<td>OK</td>
<td>Yes</td>
</tr>
<tr>
<td>OR</td>
<td>Yes</td>
</tr>
<tr>
<td>RI</td>
<td>Yes Caution: effective July 1, 2007</td>
</tr>
<tr>
<td>UT</td>
<td>Yes Caution: &quot;Finnigan Rule&quot; followed</td>
</tr>
<tr>
<td>WI</td>
<td>Yes Finnigan Rule, starting with tax year 2009</td>
</tr>
</tbody>
</table>
MA SALES FACTOR FINNIGAN ADJUSTMENT

• An adjustment is made to allocate among taxable members any Massachusetts-source sales of non-taxable members.

• Non-taxable Members of a combined group are not subject to tax on income.

• A non-taxable member that is not subject to income tax under said sections may nonetheless be subject to the nonincome measure of the corporate excise.

• When combined group has taxable and nontaxable member, the sales factor numerator(s) of the taxable members are increased as follows:
MA SALES FACTOR FINNIGAN ADJUSTMENT

- Total MA sales is determined for all non-taxable members;
- Each taxable member determines sales numerator without adjustments and the denominator which is the sum of the sales of all taxable members; and
- For each taxable member, the total Massachusetts receipts of the non-taxable members is multiplied by the fraction described in 830 CMR 63.32B2(7)(b)2., and the resulting product is added to the sales factor numerator, as otherwise determined, of the taxable member.
HOW ARE 20% US FACTORS DETERMINED

- MA water’s edge combined group members that were not incorporated or formed in the US have to demonstrate that their average property, payroll, and sales factors are at least 20% US.

- To do this, the apportionment calculation is to be done by the corporation on a stand-alone basis pursuant to its applicable apportionment formula.

- This calc consists of the 3-factor property, payroll, and sales formula irrespective of whether the corp would file using SSF, 3-factor, or double weighted sales factor formula

- The property, payroll and sales within the U.S. is to be determined by including property, payroll and sales in any of the U.S. states, D.C., any U.S. territory or possession, and any geographical area over which the U.S. has asserted jurisdiction.
• Since foreign corporations include only effectively-connected income in their federal taxable income, using a foreign taxpayer's worldwide apportionment factors to determine how much of its domestic business income should be apportioned to IL would not fairly represent that taxpayer's business activities within IL.

• A foreign taxpayer must use only the apport factors related to its domestic business income when apportioning its business income to IL.

• In other words, the apportionment factors associated with any excluded income are excluded from the apportionment formula. In apportioning its business income and in determining whether 80% or more of its business activity is conducted outside the U.S., however foreign sales corps must use all of apportionment factors.
ILLINOIS THROWBACK

• Sales made into foreign countries are “thrown back” to the Illinois taxpayers' sales factor numerators. Foreign countries must have enacted an income or business tax that taxes income earned from foreign sales.

• Nexus must also be established in the foreign country by employees engaged in activities that exceeded the mere solicitation of sales.
For sales of tangible personal property, only those sales where title passes inside the United States can be used in the sales factor, and for sales of tangible property other than tangible personal property, those sales must be apportioned in accordance with the provisions.

Foreign persons, other than certain disregarded entities, and foreign operating entities cannot be part of unitary/combined MI filings.

The corporate income tax base does not include net income from sales of tangible personal property where title passes outside the United States.

The corporate income tax base of a foreign person includes the sum of business income and the adjustments that are related to United States business activity.
MN CORPS APPORTIONMENT

- Effective for taxable years beginning after December 31, 2012, the income and apportionment factors of a foreign entity, other than an entity treated as a C corporation for federal income tax purposes, that are included in the federal taxable income, must be included in determining net income and the factors to be used in the apportionment of net income.

- A foreign entity that has nexus with Minnesota and is not included in a combined return must file a separate franchise tax return.
In CT for net income tax apportionment purposes, only property used in, payroll attributable to and receipts effectively connected with a foreign company's United States trade or business must be considered for purposes of calculating the company's apportionment fraction.
UNITARY APPORTIONMENT LESSONS

• One size does not fit all.
• Lack of uniformity among states.
• Different states include different members in a combined group.
• Federal treaties are inconsistently filed.
• Some states have tests potential group members must pass that are not necessarily consistent other rules, e.g. MA 20% test.
Section 78 Gross-up
Dividends Received Deduction
Section 78 Gross-up

- If a U.S. shareholder claims a foreign tax credit for its share of the foreign corporate taxes paid by the CFC under Section 960, then the amount equal to those foreign tax credits must be included in income (See Section 78)
  - This results in pre-tax income equal to what the U.S. shareholder’s income would have been had the foreign operations been conducted as a branch rather than as a corporation
Section 78 Gross-up

- If a state does not permit an indirect foreign tax credit for the foreign corporate taxes paid by the CFC, then the Section 78 gross-up should not be taxable for state income tax purposes
  - Accordingly, that amount should be subtracted in determining state taxable income
Dividends Received Deduction

- Many states provide for dividend received deductions for dividends paid by members of a controlled group where the dividends are paid out of unitary income
  - Most CFCs are not included in a unitary group, so that the dividends would be fully taxable
- If the state does not have a unitary filing requirement, then typically the dividend is fully subject to state tax