830 CMR 63.00: TAXATION OF CORPORATIONS

Section

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63.29.1: Credits for Insurance Companies

(1) Statement of Purpose; Outline of Topics; Effective Date.

(a) Statement of Purpose. The purpose of 830 CMR 63.29.1 is to explain the credits available to life insurance companies as provided in M.G.L. c. 63, § 29C and property and casualty insurance companies as provided in M.G.L. c. 63, §§ 29D and 29E. *See* St. 1998, c. 259.

(b) Outline of Topics. 830 CMR 63.29.1 is organized as:

1. Statement of Purpose; Outline of Topics; Effective Date
2. Definitions
3. Life Insurance Premiums Excise Credit
4. Net Investment Income Tax Rate Reduction
5. Property and Casualty Insurance Premiums Excise Credit
6. Gross Investment Income Tax Rate Reduction
7. Retaliatory Taxes Credit For Domestic Property and Casualty Insurance Companies
8. Corporate Restructuring

(c) Effective Date. The provisions of 830 CMR 63.29.1 shall take effect April 11, 2003.

(2) Definitions. For the purposes of 830 CMR 63.29.1, the following terms shall have the following meanings, unless the context requires otherwise:

Commissioner, the Commissioner of Revenue, or the Commissioner's duly authorized representative.

Department, the Department of Revenue.

Domestic Property and Casualty Insurance Company, a property and casualty insurance company organized or domiciled in Massachusetts.

Gross Investment Income Tax, the tax imposed under M.G.L. c. 63, § 22A.

Life Insurance Company, a corporation which satisfies the definition of either a domestic or foreign life insurance company in either M.G.L. c. 175, §§ 19F or 118, and which is subject to the provisions of M.G.L. c. 63.

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Life Insurance Premiums Excise, the excise imposed on life insurance companies under M.G.L. c. 63, §§ 20 and 22.

Massachusetts Life Insurance Company Community Investment Initiative ("Life Initiative"), an entity or its successor, created by life insurance companies, or the successor to such companies, pursuant to St. 1998, c. 259, § 2.

Massachusetts Property and Casualty Insurance Company Economic Development Initiative ("P&C Initiative"), an entity, or its successor, created by property and casualty insurance companies, or the successor to such companies, pursuant to St. 1998, c. 259, § 3.

Net Investment Income Tax, the tax imposed under M.G.L. c. 63, § 22B.

Property and Casualty Insurance Company, an insurance company which satisfies the definition of either a domestic or foreign insurance company in M.G.L. c. 175, § 1, except life insurance companies as defined in M.G.L. c. 175, § 118, and which is subject to the provisions of M.G.L. c. 63.

Property and Casualty Insurance Premiums Excise, the excise imposed on property and casualty insurance companies under M.G.L. c. 63, §§ 22 and 23.

Retaliatory Taxes, those taxes imposed or assessed by and paid to another jurisdiction by any domestic property and casualty insurance company due to the surtax imposed by St. 1969, c. 546, § 18. This term, however, shall not include penalties or interest for late payment of taxes.

Surtax, the tax imposed under St. 1969, c. 546, § 18.

(3) Life Insurance Premiums Excise Credit.

(a) General Rule. A life insurance company subject to the life insurance premiums excise will be allowed an annual credit against such excise if the company invests in the Life Initiative an amount equal to 1.5% of the company's total capital contribution to the Life Initiative in excess of their full proportionate share. For taxable years beginning on or after the fifth year in which a life insurance company contributes to the Life Initiative, the amount of the credit available to a life insurance company shall be equal to 1.5% of the company's total capital contribution to the Life Initiative. The credit is effective for tax years beginning after investments in the Life Initiative reaches $100,000,000 or the tax year 2004, whichever is later.

(b) Full Proportionate Share. A life insurance company's full proportionate share shall mean an investment in the Life Initiative equal to at least the product of:

1. $20,000,000;
2. multiplied by a fraction, the numerator of which shall be the life insurance company's total net investment income tax due and payable for the tax year ending on or before December 31, 1997, and the denominator of which shall be the total net investment income tax due and payable for all life insurance companies doing business in Massachusetts for the tax year ending on or before December 31, 1997.

The Department shall determine each life insurance company's full proportionate share. Such information shall be provided to each life insurance company within 30 days of receipt of written request by such company. Full proportionate share determination requests are to be sent to the Commissioner at the following address:

Massachusetts Department of Revenue
Bureau of Desk Audit, Banking and Insurance Unit
P.O. Box 7052
Boston, MA 02204

(c) Full Proportionate Share Determinations for New Life Insurance Companies. If a life insurance company was not subject to the net investment income tax in the tax year ending on or before December 31, 1997, such company's full proportionate share shall mean an investment in the Life Initiative equal to at least the product of:

1. $20,000,000;

63.29.1: continued

2. multiplied by a fraction, the numerator of which shall be the life insurance company's total net investment income tax due and payable for the taxable year two years prior to the current taxable year, and the denominator of which shall be the total net investment income tax due and payable for all life insurance companies doing business in Massachusetts for the tax year ending on or before December 31, 1997.

A newly formed life insurance company generally must be subject to the net investment income tax for at least two years before becoming eligible to participate in the Life Initiative. Only in the second year can such insurer calculate its full proportionate share.

The full proportionate share of a life insurance company formed after December 31, 1997, as a subsidiary of an existing life insurance company and capitalized from funds of the parent company will be zero, so long as the parent company is a contributing member of the Life Initiative.

The Department shall determine the full proportionate share of a life insurance company formed after December 31, 1997, as provided in 830 CMR 63.29.1(3)(b).

Example. The following example illustrates the provisions of 830 CMR 63.29.1(3)(c).

A newly formed life insurer (ABC) is established in 2001. In 2003, ABC becomes eligible to participate in the Life Initiative, since ABC is then able to calculate its full proportionate share, as follows:

$$\$20{,}000{,}000 \times \frac{\text{ABC's net investment income tax for tax year ending 12/31/2001}}{\text{Total net investment income tax for all life insurers for tax year ending 12/31/1997}}$$

Any amounts ABC contributes above this amount is eligible for the credit against the premiums excise in 2003 and thereafter.

(4) Net Investment Income Tax Rate Reduction. In general, a life insurance company not subject to tax under M.G.L. c. 63, § 22A is subject to an annual net investment income tax equal to 14% of its net investment income for the taxable year. M.G.L. c. 63, § 22B. Every such company which has contributed its full proportionate share to the Life Initiative for the current taxable year will be eligible for the following rate reductions:

(a) 12% for tax years beginning on or after the later of January 1, 1999 or the first year in which said company contributes its full proportionate share;

(b) 9.6% for tax years beginning on or after the second year in which said company contributes its full proportionate share;

(c) 7.2% for tax years beginning on or after the third year in which said company contributes its full proportionate share;

(d) 4.8% for tax years beginning on or after the fourth year in which said company contributes its full proportionate share;

(e) 2.4% for tax years beginning on or after the fifth year in which said company contributes its full proportionate share;

(f) No investment income tax shall be imposed for tax years beginning after the fifth year in which said company contributes its full proportionate share.

(5) Property and Casualty Insurance Premiums Excise Credit.

(a) General Rule. A property and casualty insurance company subject to the property and casualty insurance premiums excise will be allowed an annual credit against such excise if the company invests in the P&C Initiative an amount equal to 1.5% of the company's total capital contribution to the P&C Initiative in excess of its full proportionate share. For taxable years beginning on or after the fifth year in which a property and casualty insurance company contributes to the P&C Initiative, the amount of the credit available to a property and casualty insurance company shall be equal to 1.5% of the company's total capital contribution to the P&C Initiative. The credit is effective for tax years beginning after investments in the P&C Initiative reaches $100,000,000 or the tax year 2004, whichever is later.

(b) Full Proportionate Share. A property and casualty insurance company's full proportionate share shall mean an investment in the P&C Initiative equal to at least the product of:

1. $20,000,000;

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2. multiplied by a fraction, the numerator of which shall be the property and casualty insurance company's total gross investment income tax for the tax year ending on or before December 31, 1997, and the denominator of which shall be the total gross investment income tax for all property and casualty insurance companies doing business in Massachusetts for the tax year ending on or before December 31, 1997.

The Department shall determine each property and casualty insurance company's full proportionate share. Such information shall be provided to each property and casualty insurance company within 30 days of receipt of written request by such company. Full proportionate share determination requests are to be sent to the Commissioner at the following address:

Massachusetts Department of Revenue
Bureau of Desk Audit, Banking and Insurance Unit
P.O. Box 7052
Boston, MA 02204

(c) Full Proportionate Share Determinations for New Property and Casualty Insurance Companies. If a property and casualty insurance company was not subject to the gross investment income tax in the tax year ending on or before December 31, 1997, such company's full proportionate share shall mean an investment in the P&C Initiative equal to at least the product of:

1. $20,000,000;
2. multiplied by a fraction, the numerator of which shall be the property and casualty insurance company's total gross investment income tax due and payable for the taxable year two years prior to the current taxable year, and the denominator of which shall be the total gross investment income tax for all property and casualty insurance companies doing business in Massachusetts for the tax year ending on or before December 31, 1997.

A newly formed property and casualty insurance company generally must be subject to the gross investment income tax for at least two years before becoming eligible to participate in the P&C Initiative. Only in the second year can such insurer calculate its full proportionate share.

The full proportionate share of a property and casualty insurance company formed after December 31, 1997 as a subsidiary of an existing property and casualty insurance company and capitalized from funds of the parent company will be zero, so long as the parent company is a contributing member of the P&C Initiative.

The Department shall determine the full proportionate share of a property and casualty insurance company formed after December 31, 1997, as provided in 830 CMR 63.29.1(5)(b).

Example. The following example illustrates the provisions of 830 CMR 63.29.1(5)(c).

A newly formed property and casualty insurer (XYZ) is established in 2001. In 2003, XYZ becomes eligible to participate in the P&C Initiative, since XYZ is then able to calculate its full proportionate share, as follows:

$$\$20{,}000{,}000 \times \frac{\text{XYZ's gross investment income tax for tax year ending 12/31/2001}}{\text{Total gross investment income tax for all property and casualty insurers for tax year ending 12/31/1997}}$$

Any amounts XYZ contributes above this amount is eligible for the credit against the premiums excise in 2003 and thereafter.

(6) Gross Investment Income Tax Rate Reduction. In general, a property and casualty insurance company is subject to an annual gross investment income tax equal to 1% of its gross investment income for the taxable year. M.G.L. c. 63, § 22A. Every such company which has contributed its full proportionate share to the P&C Initiative for the current taxable year will be eligible for the following rate reductions:

(a) 0.8% for tax years beginning on or after the later of January 1, 1999 or the first year in which said company contributes its full proportionate share;

(b) 0.6% for tax years beginning on or after the second year in which said company contributes its full proportionate share;

(c) 0.4% for tax years beginning on or after the third year in which said company contributes its full proportionate share;

(d) 0.2% for tax years beginning on or after the fourth year in which said company contributes its full proportionate share;

(e) No gross investment income tax shall be imposed for tax years beginning on or after the fifth year in which said company contributes its full proportionate share.

63.29.1: continued

(7) Retaliatory Taxes Credit For Domestic Property and Casualty Insurance Companies.

(a) General Rule. A domestic property and casualty insurance company that pays retaliatory taxes will be allowed an annual credit against the property and casualty insurance premiums excise if such company contributes its full proportionate share to the P&C Initiative. Generally, the amount of the credit shall equal the retaliatory taxes payable to other jurisdictions for the preceding taxable year to the extent that such taxes are attributable to the surtax. Such credit is not refundable, and any company seeking the credit must furnish proof of payment of the retaliatory tax to the Commissioner, in the manner in which he may require.

(b) Allowable Credit. Retaliatory taxes credit amounts, in increasing percentages, are:

1. 20% for the tax year beginning on or after the later of January 1, 1999 or the first year in which said company contributes its full proportionate share;
2. 40% for the tax year beginning on or after the later of January 1, 2000 or the second year in which said company contributes its full proportionate share;
3. 60% for the tax year beginning on or after the later of January 1, 2001 or the third year in which said company contributes its full proportionate share;
4. 80% for the tax year beginning on or after the later of January 1, 2002 or the fourth year in which said company contributes its full proportionate share;
5. 100% for the tax year beginning on or after the later of January 1, 2003 or the fifth year in which said company contributes its full proportionate share.

(c) Limitations.

1. General Rule. If the total retaliatory taxes attributable to the surtax payable for the prior tax year for all domestic property and casualty insurance companies doing business in Massachusetts exceed $8,000,000, the amount of each domestic property and casualty insurance company's credit shall be limited to the lesser of the allowable credit or each company's credit share.
2. Credit Share. Credit share shall mean the product of the following:
   a. $8,000,000;
   b. multiplied by a fraction, the numerator of which shall be the domestic property and casualty insurance company's retaliatory taxes attributable to the surtax which would have been payable for the preceding taxable year, before application of the credit provided by 830 CMR 63.29.1(5)(a), and the denominator of which shall be the total retaliatory taxes attributable to the surtax which would have been payable for the preceding taxable year, before application of the credit provided by 830 CMR 63.29.1(5)(a) for all domestic property and casualty insurance companies doing business in Massachusetts that have submitted information to the Commissioner as required by 830 CMR 63.29.1(5)(d).

   The Commissioner shall report to each domestic property and casualty insurance company its credit share amount by February 15 of each taxable year.

(d) Reporting Requirements. A domestic property and casualty insurance company shall provide to the Commissioner, in such form as the Commissioner may require, the amount of its retaliatory taxes attributable to the surtax and payable for the preceding taxable year, before application of the credit provided by 830 CMR 63.29.1(5)(a), by December 31 of each taxable year.

(8) Corporate Restructuring. 830 CMR 63.29.1(8) applies to both life insurance companies and property and casualty insurance companies.

(a) Eligibility for Recalculation of Full Proportionate Share. An insurance company that existed on December 31, 1997 but which did not join the Life Initiative or the P&C Initiative, as applicable, prior to April 11, 2003 may seek a recalculation of its full proportionate share from the Department if it has undergone a significant corporate restructuring on or after January 1, 1998.

(b) Significant Corporate Restructuring Defined. For purposes of 830 CMR 63.29.1(8), the term significant corporate restructuring shall be defined as follows:

1. an acquisition, divestiture or reorganization by an insurance company, and
2. an increase or decrease in the reserves of said insurance company by 25% or more during the three year period preceding its application to the Department for recalculation of its full proportionate share.

(c) Full Proportionate Share Recalculation Formula. An insurance company that is eligible for recalculation of its full proportionate share due to significant corporate restructuring shall recalculate its full proportionate share as:

1. $20,000,000;

63.29.1: continued

2. multiplied by a fraction, the numerator of which shall be the amount of the insurance company's applicable Chapter 63 tax for the tax year ending on or before December 31 of the year immediately preceding the insurance company's application to the Department for recalculation, and the denominator of which shall be the aggregate Chapter 63 taxes for all similar insurance companies (*i.e.* either life or property and casualty insurers) doing business in Massachusetts for the tax year ending on or before December 31, 1997.

63.30.1: Liabilities in Determining the Net Worth of Intangible Property Corporations

(1) Introduction. M.G.L. c. 63, § 30 sets forth in paragraphs (8) and (9) the methods used in determining the Massachusetts net worth of domestic and foreign intangible property corporations, respectively. Under M.G.L. c. 63, § 30, intangible property corporations must subtract their "liabilities" from the book value of their total assets. 830 CMR 63.30.1 identifies the items that constitute liabilities in determining net worth for purposes of M.G.L. c. 63, § 30.

(2) General. "Liabilities" includes accounts payable, notes and bonds payable, accrued and unpaid taxes, and other similar accrued liabilities. Except as otherwise provided herein, it does not include surplus reserve accounts or appropriations from retained earnings, such as reserves for contingencies.

At a minimum, amounts must be regarded as liabilities according to generally accepted accounting principles to constitute liabilities under M.G.L. c. 63, § 30, but amounts so regarded are not necessarily liabilities under M.G.L. c. 63, § 30.

(3) Special Rules.

(a) Contingent Liabilities. When it is clear that a liability has been incurred on or before the last day of the taxable year, and the amount of the liability can be reasonably estimated at the time for filing the corporation's return, the reasonably estimated amount will be treated as a liability in determining net worth.

Example

Intangibles, Inc. is a calendar year taxpayer. In 1980, it sets aside reserves on its balance sheet for (1) approved public utility price increases to take effect in 1981; (2) projected 1982 office expansion; and (3) a fuel adjustment surcharge applicable to Intangibles' 1980 rent, but not payable until January 31, 1981; Intangibles has not yet been informed of the amount of the surcharge, but reasonably estimates it at $2,000.

Since the reserves for public utility increases and projected office expansion do not represent liabilities incurred on or before the last day of 1980, they may not be treated as liabilities on Intangibles' 1980 return. The reasonably-estimated amount of the fuel adjustment surcharge ($2,000) may be treated as a liability on Intangibles' 1980 return.

(b) Advance payments. When an intangible property corporation receives revenues that in whole or in part are not yet earned, because the corporation has not yet delivered all the goods or services to be provided in return for the revenues received, the unearned portion of the advance payments constitutes a liability.

Example 1

Fly-by-Night Travel Corporation, a calendar year taxpayer, is organizing a charter flight to the Bahamas in March of 1981. Fly-by-Night requires passengers to pay the full fare for the flight on or before November 15, 1980. In 1980, Fly-by-Night receives fares for the flight totaling $90,000.

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Fly-by-Night's 1980 accounting entries for the fares are debits totaling $90,000 to cash and credits totaling $90,000 to deferred charter income.

On its 1980 tax return, Fly-by-Night may treat the $90,000 in credits to deferred charter income as a liability in determining net worth.

Example 2

World Publishing Co., Inc. is a calendar year taxpayer that sells magazines by subscription. On December 31, 1980, it has outstanding 10,000 one-year, 12-issue subscriptions that run from July, 1980 through June, 1981. The subscriptions each cost $25 and each was paid for in full prior to July, 1980.

As of December 31, 1980, World has delivered six of the 12 issues to be provided under each subscription.

On July 1, 1980, World's accounting entries for the subscriptions are debits totaling $250,000 to cash and credits totaling $250,000 to deferred subscription income, a liability account. By December 31, 1980, $125,000 has been transferred from the deferred subscription income account to a revenue account.

On its 1980 tax return, World may treat the $125,000 remaining in its deferred subscription income account as a liability in determining net worth.

In the case of an uncompleted "long-term contract" as defined in U.S. Treasury Regulation Section 1.451-3(b)(1), the excess of

1. the contractual payments received by a corporation at the close of the taxable year; over
2. the portion of the gross contract price corresponding to the percentage of the entire contract which has been completed at the close of the taxable year constitutes a liability in determining net worth.

(c) Subject to the Commissioner's right to disallow amounts not reasonable and proper (*see* 830 CMR 63.30.1(4)(a)), a reserve or allowance for bad debts will reduce net worth, whether it is treated as an offset against assets or as a liability.

(d) Reasonable reserves established for the payment of employee annuities, pensions, or other retirement funds, or for the payment of deferred compensation, constitute liabilities in determining net worth.

(e) Reserves for deferred taxes. Reserves for deferred taxes constitute liabilities in determining net worth in the following circumstances.

1. Where, under federal or state law, the tax on income is deferred to a year subsequent to the year of receipt, and the receipts are reflected in the book value of the corporation's assets in determining its net worth, reserves for deferred federal and state income taxes arising therefrom constitute liabilities in determining net worth. For example, where, under Internal Revenue Code Section 453, an intangible property corporation reports income on an installment sale in a year or years subsequent to the year of the sale, but the gross receipts from the sale are reflected in the book value of the assets of the corporation in the year of the sale, deferred federal and state taxes arising therefrom may be treated as liabilities in determining net worth.
2. Where, under federal or state law, an intangible property corporation deducts an item from taxable income before the year in which the expense or loss giving rise to the deduction is reflected in the book value of the corporation's assets, deferred federal and state taxes arising therefrom may be treated as liabilities in determining net worth. For example, an intangible property corporation which, in accordance with IRC § 167, uses accelerated depreciation in computing net income for tax purposes, but uses the straight-line method in computing the book value of its assets, may treat deferred taxes arising therefrom as liabilities in determining its net worth.

(4) Valuation.

(a) General. The amount that a corporation identifies as a liability on its return must be reasonable and proper in light of the circumstances existing at the time the return is filed, and must be set in good faith. The Commissioner may disallow, in whole or in part, any such amount judged not reasonable and proper.

63.30.1: continued

(b) Deferred taxes.

1. Rates. Deferred taxes constituting liabilities generally must be calculated at federal and state tax rates applicable when the corporation's return is filed, but if at such time other rates have been established by law for the period during which the deferred income will be recognized for tax purposes, such other rates must be applied.

The applicable federal tax rate for purposes of calculating deferred taxes is the highest rate that applies to the corporation's taxable income. For example, a corporation with $80,000 of taxable income in 1980 must calculate deferred federal taxes by applying a rate of 40% to the amount of income deferred (with such further adjustments as may be required herein).

2. Estimating amount of deferred income that will be taxed. Generally, a taxpayer must calculate the amount of deferred taxes by applying the appropriate tax rate to the amount of income deferred, multiplied by a fraction the numerator of which is the corporation's estimated taxable income for the year during which the income will be recognized, and the denominator of which is the corporation's estimated gross income for that year. For this purpose, "gross income" means gross receipts from all sources less only returns and allowances. The corporation's estimates of taxable and gross income must be reasonable and proper under all the circumstances. This usual method of calculation is illustrated by the following example.

Example

In 1980, Intangibles, Inc. makes installment sales the total receipts from which are $500,000. The entire $500,000 is reflected in the book value of Intangibles' assets in 1980. However, of this amount, $400,000 will be reported as income for federal tax purposes in years subsequent to 1980.

Intangibles' federal taxable income for 1980 is $1,000,000.

The average ratio of taxable to gross income in Intangibles' taxable years 1975-1979 is .735. There is no reason to believe that its ratio of taxable to gross income will be substantially less than .735 in the years in which the $400,000 will be reported as income.

In 1980, Intangibles may treat $135,240 as a liability for deferred federal taxes in determining its net worth. This amount is obtained by applying the 46% federal tax rate for corporate income over $100,000 to the $400,000 of deferred income, multiplied by .735, the corporation's average ratio of taxable to gross income for the previous five years.

There are two instances in which the usual method of calculation need not be used.

First, where a taxpayer reasonably believes that his taxable income for the year in which deferred income will be recognized will be at least 90% of his gross income, the taxpayer may treat the entire amount of deferred income as subject to tax in calculating deferred taxes constituting liabilities.

Second, where a taxpayer demonstrates to the Commissioner that use of the usual method of calculation results in an understatement of the amount of deferred income that will in fact be taxed, it may use an alternative method that more accurately estimates the amount that will be taxed. The taxpayer bears the burden of proving that the usual method of calculation results in an understatement of deferred taxes and that his alternative method is more accurate. The Commissioner will calculate the reserve in accordance with the usual method and assess the tax accordingly if the taxpayer fails to meet this burden of proof.

(5) Record Retention. Every intangible property corporation must maintain records sufficient to establish that amounts identified as liabilities on its return are reasonable and proper, in accordance with the requirements of 830 CMR 62C.25.1 (Record Retention).

63.30.2: Net Operating Loss Deductions and Carryover

(1) Statement of Purpose, Outline of Topics.

(a) Purpose of 830 CMR 63.30.2. 830 CMR 63.30.2, explains how, and to what extent, a corporation may apply the deductions for net operating losses incurred in previous taxable years allowed by M.G.L. c. 63, § 30.5, *as amended by* St. 1992, c. 133, §§ 402 and 403, and St. 1988, c. 202, § 10, in determining net income for a taxable year. 830 CMR 63.30.2 applies only to the corporate excise imposed by M.G.L. c. 63.

(b) Outline of Topics. In order to facilitate the use of 830 CMR 63.30.2, 830 CMR 63.30.2(1)(b) lists the sections contained in 830 CMR 63.30.2.

1. Statement of Purpose, Outline of Topics.
2. Definitions.
3. Allowance of Net Operating Loss Deduction.
4. Computation of Net Operating Loss.
5. Start-up Corporation Net Operating Loss Deduction.
6. General Net Operating Loss Deduction.
7. Carryover of Net Operating Loss.
8. Examples.
9. S Corporations.
10. Combined Groups.
11. Mergers and Changes of Ownership.
12. Supporting Schedule Required.

(2) Definitions. For purposes of 830 CMR 63.30.2, the following terms shall have the following meanings, unless the context requires otherwise.

Code, the Internal Revenue Code, as amended and in effect for the taxable year.

Commissioner, the Commissioner of the Massachusetts Department of Revenue or the Commissioner's duly authorized representative.

Corporation, a business corporation organized under or subject to M.G.L. c. 156B, subject to the excise imposed by M.G.L. c. 63, § 32 or 32D(b), or a corporation, association, or organization established under laws other than those of Massachusetts, subject to the excise imposed by M.G.L. c. 63, § 39 or 32D(b).

Deduction or deductions, the deductions for net operating losses incurred in previous taxable years allowed by either M.G.L. c. 63, § 30.5(b) or M.G.L. c. 63, § 30.5(c).

Documentary evidence, original source documents that substantiate a claim for the deduction, including but not limited to articles of incorporation, stock certificates, and tax returns, but generally not including affidavits.

Federal net operating loss, net operating loss computed under Code § 172 for purposes of determining the federal net operating loss deduction.

Federal net operating loss deduction, the deduction for net operating loss incurred in previous taxable years allowed by Code § 172.

General net operating loss deduction, the deduction for net operating losses incurred in previous taxable years allowed by M.G.L. c. 63, § 30.5(b).

Net income for purposes of determining the general net operating loss deduction, net income determined under the provisions of M.G.L. c. 63, § 30.4, without regard to the net operating loss deduction allowed by M.G.L. c. 63, § 30.5.

Net income, net income determined under M.G.L. c. 63, § 30.4, for purposes of computing the income measure of the corporate excise.

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Net operating loss, the amount by which the sum of the deductions allowed under M.G.L. c. 63, § 30.4, not including the deductions for net operating loss allowed by M.G.L. c. 63, § 30.5, and the dividends received deduction allowed by M.G.L. c. 63, s. 38(a)(1), exceeds gross income determined under the provisions of M.G.L. c. 63, § 30.3, for a taxable year.

Start-up corporation net operating loss deduction, the deduction for net operating losses incurred in previous taxable years allowed by M.G.L. c. 63, § 30.5(c).

Taxable year, any fiscal or calendar year or period for which a corporation is required to file a federal income tax return.

Taxable net income, net income less the Massachusetts dividends received deduction allowed by M.G.L. c. 63, § 38(a)(1).

(3) Allowance of Net Operating Loss Deduction.

(a) General Rule. In calculating net income for a taxable year, corporations may claim one of the two following deductions for net operating losses incurred in previous taxable years:

1. Start-up corporation net operating loss deduction. During the first five taxable years of its existence, a corporation may deduct losses incurred in previous taxable years, to the extent allowed by M.G.L. c. 63, § 30.5(c), and 830 CMR 63.30.2; or

2. General net operating loss deduction. A corporation may deduct losses incurred in taxable years ending on or after December 31, 1989, to the extent allowed by M.G.L. c. 63, § 30.5(b), and 830 CMR 63.30.2.

(b) Only One Deduction Available for Each Taxable Year. A corporation may claim only one of the two net operating loss deductions in any taxable year. Where a corporation qualifies for both deductions in a taxable year, the choice between the two deductions is left to the corporation's discretion.

(c) Switching Between the Two Deductions Allowed. A corporation's choice between the two deductions under 830 CMR 63.30.2(3)(b), is effective only for the taxable year for which the deduction is claimed. A corporation may switch between the two deductions from one taxable year to another. Net operating loss incurred in a single taxable year may be split between the two net operating loss deductions claimed in two subsequent taxable years. However, where a corporation switches from the start-up corporation net operating loss deduction to the general net operating loss deduction, the corporation may not deduct or carry over any amounts that were treated as non-deductible losses under the start-up corporation net operating loss restrictions described at 830 CMR 63.30.2(5)(b)2, and (c), to the extent that those restrictions were imposed in a previous taxable year for which the corporation claimed the start-up corporation net operating loss deduction. *See* 830 CMR 63.30.2(7)(c)3.

(d) Deduction Available Only to Business Corporations. The deductions are available only in computing net income under M.G.L. c. 63, § 30.4, for purposes of computing a corporation's liability under the income measure of the corporate excise. The deductions are not available to any corporation whose liability under the corporate excise is not based on net income as defined under M.G.L. c. 63, § 30.4. Specifically, utility corporations subject to tax under M.G.L. c. 63, § 52A, and security corporations subject to tax under M.G.L. c. 63, § 38B, are among those corporations that may not claim the deductions.

(4) Computation of Net Operating Loss.

(a) General. A corporation incurs a net operating loss for a taxable year if net income as defined in M.G.L. c. 63, § 30.4, for the taxable year, determined without regard to the net operating loss deductions allowed under M.G.L. c. 63, § 30.5, and reduced by the dividends received deduction allowed under M.G.L. c. 63, § 38(a)(1), is less than zero.

(b) Computation of Net Operating Loss. The amount of net operating loss incurred in a taxable year is the amount by which the sum of the deductions allowed for the taxable year under M.G.L. c. 63, § 30.4, not including the deductions for net operating loss allowed by M.G.L. c. 63, § 30.5, and the dividends received deduction allowed under M.G.L. c. 63, § 38(a)(1), exceeds gross income as defined in M.G.L. c. 63, § 30.3, for the taxable year.

63.30.2: continued

(c) Required Adjustments. Where any provision of M.G.L. c. 63 requires net income to be adjusted, a corresponding adjustment must be made in computing net operating loss. For example, where M.G.L. c. 63, § 38H(b)(1), disallows a deduction under M.G.L. c. 63, § 30.4, with respect to expenditures for solar and wind power equipment deducted under M.G.L. c. 63, § 38H(a), the disallowed deduction may not be taken into account in determining net operating loss. Other provisions of M.G.L. c. 63 that require adjustments to net operating loss include M.G.L. c. 31E(c), and 38M(b).

(d) Other Massachusetts Deductions, Adjustments, and Credits Disregarded. Net operating loss is determined solely with reference to M.G.L. c. 63, § 30 and § 38(a)(1). Except as provided in 830 CMR 63.30.2(4)(c), any deductions, adjustments, and credits allowed by other provisions of M.G.L. c. 63 are disregarded in determining net operating loss. Specifically, the following items are disregarded:

1. Post-apportionment deductions. Net operating loss is computed without regard to the deductions from taxable net income apportioned to Massachusetts that are allowed by M.G.L. c. 63, §§ 38F and 38H.

2. Massachusetts credits. Net operating loss is computed without regard to any of the credits against the corporate excise allowed by M.G.L. c. 63.

(e) Net Operating Loss Computed Before Apportionment. Where a corporation does business both within and without Massachusetts, the corporation's net operating loss is computed before applying the apportionment provisions of M.G.L. c. 63, §§ 38 and 42.

(5) Start-up Corporation Net Operating Loss Deduction.

(a) General. Corporations that meet the eligibility requirements of 830 CMR 63.30.2(5)(b), may deduct net operating losses, as computed under 830 CMR 63.30.2(4), incurred in previous taxable years ending on or after December 31, 1975. The portion of the start-up corporation net operating loss deduction that is not used in a taxable year may be carried forward to succeeding taxable years, subject to the limitations described at 830 CMR 63.30.2(5)(c), and (7).

(b) Eligibility for the Deduction. To claim the start-up corporation net operating loss deduction for a taxable year, a corporation must meet all of the following requirements at all times during the taxable year:

1. First Five Years. The corporation must be in one of its first five consecutive taxable years of existence, measured from the earliest date of the corporation's establishment, organization, incorporation, or charter, whether the corporation was established, organized, incorporated, or chartered under the laws of Massachusetts or another jurisdiction; and

2. Ownership of Voting Stock. No other corporation, whether or not taxable in Massachusetts, may own 50% or more of the voting stock of the corporation.

(c) Restrictions on the Deduction. The following items of loss do not qualify for the start-up corporation net operating loss deduction:

1. Certain losses incurred by foreign corporations. Net operating losses incurred by a foreign corporation in previous taxable years during which the corporation was not subject to the Massachusetts corporate excise are not treated as net operating losses for purposes of determining the start-up corporation net operating loss deduction; and

2. Net operating losses carried back for federal net operating loss purposes. The start-up corporation net operating loss deduction is not available for any portion of the net operating loss incurred in a taxable year that is carried back to a previous taxable year for purposes of determining the federal net operating loss deduction.

(d) Computation of the Start-up Corporation Net Operating Loss Deduction. The amount of the start-up corporation net operating loss deduction for a taxable year is the sum of the net operating losses available for carryover from each of the corporation's four previous taxable years, as determined under 830 CMR 63.30.2(7)(c) and (d). The amount of net operating loss available for carryover from a previous taxable year is the net operating loss for the taxable year as determined under 830 CMR 63.30.2(4), not including losses incurred by foreign corporations in taxable years during which they are not subject to the corporate excise, reduced by the amount of the net operating loss previously deducted, as required by 830 CMR 63.30.2(7)(c)4, and further reduced by the amount of the net operating loss carried back to previous taxable years for federal net operating loss purposes, as required by 830 CMR 63.30.2(7)(c)2.

63.30.2: continued

1. Net operating losses previously deducted. The amount of net operating losses previously deducted is the amount of net operating loss incurred in a taxable year that already has been deducted under the provisions of M.G.L. c. 63, § 30.5, and 830 CMR 63.30.2, in taxable years beginning after the taxable year in which the loss occurred and before the taxable year for which the deduction is being computed. *See* 830 CMR 63.30.2(7)(c)4.

2. Net operating losses carried back for federal purposes. The amount of net operating loss carried back for federal net operating loss purposes is the amount of net operating loss incurred in a taxable year that was carried back to taxable years beginning before the year of the loss under Code § 172(b)(1)(A)(i), for purposes of computing the federal net operating loss deduction. *See* 830 CMR 63.30.2(7)(c)2.

(e) Evidence. Any corporation that claims the start-up corporation net operating loss deduction must upon request furnish to the Commissioner documentary evidence as defined at 830 CMR 63.30.2(2), to substantiate the claim.

(6) General Net Operating Loss Deduction.

(a) General. A corporation that does not claim the start-up corporation net operating loss deduction described at 830 CMR 63.30.2(5), may claim the general net operating loss deduction with respect to net operating losses, as computed under 830 CMR 63.30.2(4), incurred in previous taxable years ending on or after December 31, 1989. The amount of the general net operating loss deduction for a taxable year shall not exceed the limitations imposed by M.G.L. c. 63, § 30.5(b)(1) through (4), as set forth at 830 CMR 63.30.2(6)(b). The amount of net operating loss that is disallowed as a deduction in a taxable year because of those limitations may be carried over to succeeding taxable years under the carryover rules at 830 CMR 63.30.2(7).

(b) Limitation of the Deduction. The amount of the general net operating loss deduction may not exceed the following amounts for the following taxable years:

1. For taxable years ending on or after December 31, 1990 and before December 31, 1991, the amount of the deduction may not exceed 25% of the corporation's net income as computed under 830 CMR 63.30.2(6)(c);

2. For taxable years ending on or after December 31, 1991 and before December 31, 1992, the amount of the deduction may not exceed 50% of the corporation's net income as computed under 830 CMR 63.30.2(6)(c);

3. For taxable years ending on or after December 31, 1992 and before December 31, 1993, the amount of the deduction may not exceed 75% of the corporation's net income as computed under 830 CMR 63.30.2(6)(c); and

4. For taxable years ending on or after December 31, 1993, the amount of the deduction may not exceed 100% of the corporation's net income as computed under 830 CMR 63.30.2(6)(c).

The amount of net operating loss disallowed as a deduction for a taxable year because of the foregoing limitations may be carried forward to subsequent taxable years to the extent allowed under the carryover rules of 830 CMR 63.30.2(7).

(c) Net Income Defined for Purposes of Applying the Limitations on the General Net Operating Loss Deduction. For purposes of applying the limitations on the amount of the general net operating loss deduction set forth at 830 CMR 63.30.2(6)(b), net income for a taxable year is net income as defined in M.G.L. c. 63, § 30.4, determined without regard to the net operating loss deductions allowed under M.G.L. c. 63, § 30.5, and before applying the apportionment provisions of M.G.L. c. 63, §§ 38 and 42. Net income for purposes of applying the limitation is computed solely with reference to M.G.L. c. 63 § 30.4, and without regard to the dividends received deduction allowed under M.G.L. c. 63, § 38(a)(1), or the items described in 830 CMR 63.30.2(4)(d).

(d) Computation of the General Net Operating Loss Deduction. The amount of the general net operating loss deduction for a taxable year is the lesser of the sum of the net operating losses available for carryover from previous taxable years under the provisions of 830 CMR 63.30.2(7), or the maximum amount of the deduction determined under the limitation provisions of 830 CMR 63.30.2(6)(b).

63.30.2: continued

1. Net operating losses available for carryover. The amount of net operating loss available for carryover from a previous taxable year is the net operating loss for the taxable year as determined under 830 CMR 63.30.2(4), that may be carried over under the provisions of 830 CMR 63.30.2(7), reduced by the amount of the net operating loss for such taxable year that has been previously deducted.

2. Net operating losses previously deducted. The amount of net operating loss previously deducted is the amount of net operating loss incurred in a taxable year that already has been deducted under the provisions of M.G.L. c. 63, § 30.5, in taxable years beginning after the taxable year in which the loss occurred and before the taxable year for which the deduction is being computed. *See* 830 CMR 63.30.2(7)(c)4.

(7) Carryover of Net Operating Loss.

(a) General. A net operating loss incurred in a taxable year may be carried over to succeeding taxable years as follows.

1. Start-up corporation net operating loss. For purposes of determining the start-up corporation net operating loss deduction described at 830 CMR 63.30.2(5), a net operating loss may be carried forward to any succeeding taxable year that ends less than five calendar years after the date on which the corporation was organized.

2. General net operating loss. For purposes of determining the general net operating loss deduction described at 830 CMR 63.30.2(6), a net operating loss may be carried forward to the five succeeding taxable years following the year in which the loss was incurred.

(b) Ordering Rules. Net operating loss carryover shall be deducted after all current deductions allowed in determining current taxable net income, including the dividends received deduction allowed by M.G.L. c. 63, § 38(a)(1). Net operating loss must be carried over to the earliest succeeding taxable year in which it may be used. The portion of the net operating loss that is not used in the earliest succeeding taxable year may be carried over to a subsequent succeeding taxable year within the applicable carryover period set forth at 830 CMR 63.30.2(7)(a).

(c) Carryover. The amount of net operating loss incurred in a given taxable year that may be carried over to a succeeding taxable year is determined using the following steps.

1. Compute the net operating loss for the taxable year under the provisions of 830 CMR 63.30.2(4). For purposes of computing the start-up corporation net operating loss, losses incurred by a foreign corporation in a taxable year during which the corporation is not subject to the corporate excise are not treated as net operating losses and are not eligible for the start-up corporation net operating loss deduction. The net operating loss for the taxable year must be determined under the law applicable to the taxable year in which the loss was incurred without regard to the law applicable to the taxable year to which the net operating loss is being carried. The result is the corporation's tentative net operating loss carryover from the taxable year in which the loss was incurred.

2. In determining the carryover amount for start-up corporation net operating loss purposes only, subtract from the tentative net operating loss carryover, as determined under 830 CMR 63.30.3(7)(c)1., the amount of such net operating loss that was carried back to taxable years preceding the year of the loss for federal net operating loss purposes under Code § 172(b)(1)(A)(i). In determining the carryover amount for general net operating loss purposes, skip this step and go directly to step 3.

3. In determining the carryover amount for general net operating loss purposes only, subtract from the tentative net operating loss carryover, as determined under 830 CMR 63.30.3(7)(c)1, the following amounts:

a. The amount of such net operating loss that was carried back for federal purposes and was therefore treated as a non-deductible loss under the restrictions described at 830 CMR 63.30.2 (5)(c)2, (5)(d)2, and (7)(c)2., in any taxable year for which the corporation claimed the start-up corporation net operating loss deduction; and

63.30.2: continued

b. The amount of such net operating loss that was incurred in a taxable year during which the corporation was a foreign corporation not subject to the corporate excise and that was treated as a non-deductible loss under the restrictions described at 830 CMR 63.30.2(5)(c)1., in any taxable year for which the corporation claimed the start-up corporation net operating loss deduction; and

c. The amount of such net operating loss that was treated as a non-deductible loss because of the restrictions placed on the deduction by subsidiaries under 830 CMR 63.30.2(5)(b)2., in any taxable year during which the corporation claimed the start-up corporation net operating loss deduction.

In determining the carryover amount for start-up corporation net operating loss purposes, skip this step and go directly to step 4.

4. Subtract from the tentative net operating loss carryover, as determined under 830 CMR 63.30.3(7)(c)1., the amount of such net operating loss that was deducted under the provisions of M.G.L. c. 63, § 30.5, in taxable years beginning after the taxable year in which the loss was incurred. The result is the amount of the net operating loss incurred in the taxable year that is available for carryover.

(d) Amount of Net Operating Loss Available for Carryover. The amount of the net operating loss that is available for carryover to a taxable year is the sum of the net operating loss available for carryover from previous taxable years, determined under 830 CMR 63.30.2(7)(c)1.-4., that may be carried over under the applicable limitations set forth at 830 CMR 63.30.2(7)(a).

(e) Unused Net Operating Loss. Net operating loss incurred in a taxable year that is not deducted within the period set forth at 830 CMR 63.30.2(7)(a), is lost and may not be deducted for Massachusetts corporate excise purposes.

(f) Short Taxable Years. A taxable year that consists of less than 12 months is treated as a full taxable year for purposes of 830 CMR 63.30.2.

(g) Foreign Corporations Not Subject to Tax.

1. General. Taxable years during which a foreign corporation is not subject to the Massachusetts corporate excise are treated as taxable years for purposes of 830 CMR 63.30.2.

2. Imported Losses. For purposes of claiming the general net operating loss deduction only, foreign corporations may carry over and deduct net operating losses, calculated under the provisions of 830 CMR 63.30.2, that were incurred in taxable years during which the foreign corporation was not subject to the corporate excise. To claim the deduction with respect to such losses, the foreign corporation must complete a pro forma Massachusetts Schedule E showing the computation of Massachusetts net operating loss, Massachusetts net income and Massachusetts taxable net income for each such taxable year. Such pro forma schedules must be attached to the return for the taxable year for which the deduction is claimed.

3. Loss Carry Through. Net operating loss may be carried through taxable years during which the foreign corporation is not subject to the corporate excise. However, where the corporation has positive taxable net income determined without regard to the net operating loss deduction in any such taxable year, the amount of net operating loss that may be carried through that year must be reduced by the amount of such taxable net income. A corporation that claims the deduction with respect to any net operating loss carried through taxable years during which the corporation is not subject to the corporate excise must provide a supporting schedule that fully documents the amount of the deduction and the manner in which the deduction was computed. The corporation need not file a corporate excise return for taxable years during which it is not subject to the corporate excise in order to preserve the net operating loss carryover.

63.30.2: continued

(8) Examples. The following examples illustrate the provisions of 830 CMR 63.30.2(1)-(7). For purposes of these examples assume that all of the corporations are calendar year taxpayers that file separate returns. Further assume that none of the corporations claims a Massachusetts dividends received deduction. The corporations do not carry any net operating loss back to previous taxable years for federal tax purposes unless specified in the example.

Example 1: Alpha Centauri, Inc., a Massachusetts business corporation, is organized and begins doing business exclusively in Massachusetts in 1989. All of Alpha Centauri's stock is owned by individuals. In 1989 Alpha Centauri incurs a net operating loss of $100,000. In 1990 Alpha Centauri has net income of $50,000, determined without regard to the net operating loss deduction.

Because Alpha Centauri is in its first five taxable years of existence and no other corporation owns 50% or more of its voting stock, Alpha Centauri is eligible for the start-up corporation net operating loss deduction for 1990. Alternatively, as a business corporation, Alpha Centauri may claim the general net operating loss deduction. Alpha Centauri may deduct either of the following amounts in determining 1990 net income:

A start-up corporation net operating loss deduction of $50,000, resulting in net income of $0 for 1990 and $50,000 of net operating loss available for carryover; or

A general net operating loss deduction of $12,500, computed by multiplying net income of $50,000, determined without regard to the net operating loss deduction, by the percentage of net income allowable as a deduction for 1990 (25%). The general net operating loss deduction results in net income of $38,500 and $87,500 of net operating loss available for carryover.

Example 2: Assume that in Example 1 Alpha Centauri elects to take the start-up corporation net operating loss deduction. In 1991, Alpha Centauri has net income of $80,000, determined without regard to the net operating loss deduction. Alpha Centauri once again is eligible for both deductions, and may deduct either of the following amounts in determining 1991 net income:

A start-up corporation net operating loss deduction of $50,000 (the amount of net operating loss available for carryover from 1990), resulting in net income of $30,000, and no net operating loss available for carryover; or

A general net operating loss deduction of $40,000, computed by multiplying net income of $80,000, determined without regard to the net operating loss deduction, by the percentage of net income allowable as a deduction for 1991 (50%). The general net operating loss deduction results in net income of $40,000, and net operating loss available for carryover of $10,000, computed by subtracting the 1991 general net operating loss deduction of $40,000, from the $50,000 of net operating loss Alpha Centauri has available for carryover after claiming the start-up corporation net operating loss deduction in 1990.

Example 3: Betelgeuse, Inc. is a foreign corporation that has been in existence for ten years. In 1989 Betelgeuse does not do business in Massachusetts, but incurs a loss for the year. In 1990 Betelgeuse does business in Massachusetts and incurs a net operating loss of $40,000. In 1991, Betelgeuse does business in Massachusetts and has net income of $100,000, determined without regard to the net operating loss deduction. Betelgeuse's Massachusetts apportionment percentage is 10% for 1990 and 25% for 1991. Betelgeuse may claim the general net operating loss deduction for losses incurred in 1989 and 1990 when computing net income for 1991. The deduction is computed as follows:

To determine the amount of net operating loss available for carryover from 1989, Betelgeuse must compute Massachusetts net operating loss under the provisions of 830 CMR 63.30.2(4) in the same manner as if Betelgeuse were doing business in Massachusetts for that taxable year. Assume for the purposes of this example that Betelgeuse's net operating loss for 1989, determined in that manner, is $20,000. The amount of net operating loss available for carryover from 1990 is $40,000. The total amount of net operating loss available for deduction in 1991 is $60,000.

The maximum allowable amount of Betelgeuse's general net operating loss deduction for 1991 is $50,000, computed by multiplying net income of $100,000, determined without regard to the net operating loss deduction, by the percentage of net income allowable as a deduction for 1991 (50%).

63.30.2: continued

Betelgeuse's net operating loss deduction for the taxable year is $50,000, the lesser of the $60,000 of net operating loss available for deduction or the $50,000 maximum deduction. Betelgeuse has net income of $50,000, computed by subtracting the $50,000 net operating loss deduction from $100,000 of net income, determined without regard to the net operating loss deduction. Betelgeuse's apportioned net income for 1991 is $12,500, determined by multiplying net income of $50,000 by Betelgeuse's apportionment percentage of 25%. Betelgeuse has $10,000 of net operating loss available for carryover. The entire $10,000 is attributable to 1990 net operating loss.

Example 4: Assume the same facts as in Example 4 and that Betelgeuse discontinues doing business in Massachusetts from 1992 through 1994. Betelgeuse has positive taxable net income (determined without regard to the net operating loss deduction) of $500 in 1992, $300 in 1993, and $200 in 1994. In 1995, Betelgeuse resumes doing business in Massachusetts and has net income of $8,000, determined without regard to the net operating loss deduction. Betelgeuse's Massachusetts apportionment percentage for 1995 is 20%. Betelgeuse may claim the general net operating loss deduction for losses incurred in 1990 when computing 1995 net income.

The amount available for carryover from 1990 is $9,000, determined by subtracting from the $40,000 net operating loss incurred in that year, the $30,000 of that loss that was deducted in 1991, and offsetting the resulting amount by the $1,000 of positive taxable net income earned between 1992 and 1994.

The maximum allowable amount of Betelgeuse's general net operating loss deduction for 1995 is $8,000, computed by multiplying net income of $8,000, determined without regard to the net operating loss deduction, by the percentage of net income allowable as a deduction for the taxable year (100%).

Betelgeuse's net operating loss deduction for the taxable year is $8,000 resulting in net income of $0, determined by subtracting the $8,000 net operating loss deduction from $8,000 of net income, determined without regard to the net operating loss deduction.

Betelgeuse has $1,000 of net operating loss attributable to 1990. Because losses may be carried forward only five taxable years from the year in which they are incurred, including taxable years during which a corporation does not do business in Massachusetts, the $1,000 of net operating loss is not available for carryover to subsequent taxable years.

Example 5: Cassiopeia Corporation is a Massachusetts business corporation that organizes and begins doing business in Massachusetts in 1988. In 1988, Cassiopeia has positive net income. In 1989, Cassiopeia incurs a net operating loss of $40,000. Cassiopeia carries $10,000 of the loss *back* to 1988 to reduce its 1988 income for federal tax purposes. The carry back of net operating loss is not permitted for Massachusetts purposes. Thus, for Massachusetts purposes Cassiopeia's 1988 net income is unaffected by its 1989 net operating loss. Cassiopeia has $40,000 of 1989 net operating loss available for carryover for Massachusetts purposes.

In 1990 Cassiopeia has net income of $20,000, determined without regard to the net operating loss deduction. In order to maximize the amount its 1990 deduction, Cassiopeia chooses the start-up corporation net operating loss deduction for 1990. The amount of net operating loss available to Cassiopeia for purposes of the start-up corporation deduction is $30,000, determined by subtracting from the $40,000 of loss available for carryover from 1989, the $10,000 of loss that was carried back to 1988 for federal tax purposes. (Had Cassiopeia elected to carry the 1989 net operating loss *forward* for federal tax purposes, the full amount of 1989 loss would have been available for carryover for Massachusetts purposes.) The amount of the start-up corporation net operating loss deduction is $20,000, resulting in net income of $0 and $10,000 of 1989 net operating loss available for carryover.

Had Cassiopeia chosen the general net operating loss deduction for 1990, the amount of the deduction would have been $5,000, computed by multiplying net income of $20,000, determined without regard to the net operating loss deduction, by the percentage of net income allowable as a deduction (25%). Neither the 1990 general net operating loss deduction nor the amount of loss available for carryover from 1989 would be affected by the $10,000 of 1989 loss carried back for federal purposes. The general net operating loss would have resulted in net income of $15,000, and $35,000 of 1989 net operating loss available for carryover.

63.30.2: continued

Example 6: Assume the same facts as in Example 5, and that Neutron Star, LTD, a Massachusetts corporation, acquires 50% of Cassiopeia's voting stock in 1991. Because another corporation owns 50% or more of Cassiopeia's voting stock, Cassiopeia is not eligible for the start-up corporation net operating loss deduction for 1991.

In 1991, Cassiopeia has net income of $12,000, determined without regard to the net operating loss deduction. Cassiopeia may claim a general net operating loss deduction of $6,000, determined by adding the amounts of net operating loss available for carryover from previous taxable years and applying the applicable limitation to the deduction as follows:

The amount of net operating loss available for carryover from 1989 is $10,000 determined by subtracting from the $40,000 net operating loss incurred in that year, the $20,000 of that loss that was deducted in 1990, and the 10,000 of that loss that was carried back for federal tax purposes. Even though Cassiopeia is claiming the general net operating loss deduction for 1991, the $10,000 treated as non-deductible in 1989 is eliminated from the pool of loss available for carryover under the restrictions described at 830 CMR 63.30.2(5)(c).

The maximum allowable deduction is $6,000, computed by multiplying Cassiopeia's net income of $12,000, determined without regard to the net operating loss deduction, by the percentage of net income allowable as a deduction for 1990 (50%). Cassiopeia's 1991 net operating loss deduction is $6,000, resulting in net income of $6,000 and $4,000 of 1989 net operating loss available for carryover.

Example 7: Dog Star, Inc. is a foreign corporation that begins doing business in Massachusetts in 1992. To compute its net operating loss available for carryover to 1992, Dog Star must determine its net operating loss, net income, and taxable net income for taxable years 1989 through 1991 as though it were doing business in Massachusetts. Dog Star applies the provisions of M.G.L. c. 63, and 830 CMR 63.30.2, to those taxable years and determines that in 1989 and 1990 it incurred net operating losses of $15,000, and $10,000, respectively. In 1991 it had positive taxable net income of $12,000, determined without regard to the net operating loss deduction. Dog Star's total net operating loss available for carryover to 1992 is $13,000, determined by adding the 1990 net operating loss of $15,000 and the 1990 net operating loss of $10,000, and subtracting 1991 taxable net income of $12,000. Of the total net operating loss available for carryover to 1992, $3,000 is attributable to 1989, and $10,000 is attributable to 1990. Because the losses available for carryover to 1992 were incurred in taxable years during which Dog Star was not subject to the corporate excise, Dog Star may deduct those losses only if it chooses the general net operating loss deduction.

(9) S Corporations.

(a) General. A Massachusetts S corporation that is subject to the income measure of the corporate excise due to total receipts of $6,000,000 or more may claim a net operating loss deduction for net operating losses incurred in taxable years ending on or after December 31, 1989, as provided below. The deduction is available only in computing net income for purposes of determining the income measure of the corporate excise under M.G.L. c. 63, § 32D(b), and only to the extent that it would be allowed to a C corporation under the provisions M.G.L. c. 63, § 30.5, and 830 CMR 63.30.2. A Massachusetts S corporation may not deduct any net operating losses incurred in taxable years ending before December 31, 1989.

(b) Generation of Net Operating Loss. An S corporation can incur a net operating loss only in a taxable year during which it is subject to the income measure of the corporate excise due to total receipts of six million dollars or more. Losses incurred in taxable years during which the S corporation had total receipts of less than $6,000,000 are not net operating losses for purposes of M.G.L. c. 63, § 30.5, and 830 CMR 63.30.2.

(c) Carryover of S Corporation Losses. Subject to the carryover provisions of 830 CMR 63.30.2(7), an S corporation may carry a net operating loss through succeeding taxable years during which the S corporation has total receipts of less than $6,000,000, and may deduct the loss in succeeding taxable years during which the corporation has total receipts of $6,000,000 or more. For purposes of applying the carryover provisions of 830 CMR 63.30.2(7), taxable years during which the S corporation has total receipts of less than $6,000,000 and short taxable years are treated as full taxable years.

63.30.2: continued

(d) Deduction Restricted. A Massachusetts S corporation that receives income taxed to the S corporation for federal purposes may not deduct net operating losses from that income for purposes of computing its tax liability under M.G.L. c. 63, § 32D(a).

(10) Combined Groups. The net operating loss deduction and carryover amounts are computed separately, under the provisions of 830 CMR 63.30.2, for each corporation that is a member of a combined group, as defined at 830 CMR 63.32B.1(2). The combined group itself, therefore, has no net operating loss deduction or carryover. Net operating loss carried over by a member of the group may be used to reduce the combined net income of the group only under the circumstances and in the manner described in the net operating loss carryover provisions of the combined returns of income regulation at 830 CMR 63.32B.1(9). A member of a combined group that uses its net operating loss to reduce the combined net income of the group for a taxable year must reduce its net operating loss available for carryover in the manner required by 830 CMR 63.30.2(7)(c). The amount of the required reduction shall be the amount of the member's apportioned loss that was used to reduce the combined income of the group, divided by the member's apportionment percentage for the taxable year.

(11) Mergers and Changes of Ownership.

(a) Mergers. In the event of a merger of two or more corporations, the surviving corporation retains any net operating loss that it separately incurred before the merger, subject to the limitations of 830 CMR 63.30.2(11)(b). All of the net operating loss of a corporation absorbed in the merger is lost. The surviving corporation may not deduct or carry over the net operating loss of a corporation it absorbs. In the event of a consolidation of two or more previously existing corporations into a new corporation, the new corporation starts with no net operating loss. All of the net operating loss of the previously existing corporations is lost. The new corporation may not deduct or carry over any net operating loss incurred by any of the previously existing corporations before the consolidation.

(b) Changes in Ownership. Where a corporation undergoes an ownership change, as defined in Code § 382(g), the amount of the corporation's net income that may be offset by pre-change net operating loss in any taxable year shall not exceed the limitation imposed by Code § 382, provided that the limitation shall be adjusted for differences between Massachusetts taxable net income and federal taxable income determined without regard to the federal net operating loss deduction. The adjustment shall be made for each taxable year by multiplying the Code § 382 limitation by Massachusetts taxable net income, determined without regard to the net operating loss deduction, and dividing the resulting amount by federal taxable income, determined without regard to the federal net operating loss deduction. Any amount of net operating loss that cannot be deducted because of the limitation may be carried over as provided in 830 CMR 63.30.2(7).

(12) Supporting Schedule Required. To claim a net operating loss deduction for a taxable year a corporation must file with its tax return a Massachusetts Schedule E-2. The Commissioner may require corporations to attach to Schedule E-2 such additional information and schedules as the Commissioner determines are necessary for the administration of the deduction. The Commissioner will prescribe the form and content of any additional information and schedules in the instructions to Schedule E-2 and in other public written statements.

63.30.3: Entity Classification under St. 2008, c. 173

(1) Statement of Purpose; Outline of Topics; Effective Date.

(a) Statement of Purpose. St. 2008, c. 173 has changed the way unincorporated businesses are classified and treated for purposes of the Massachusetts corporate excise and personal income taxes, resulting in general conformity with federal entity classification and filing rules, effective with the first taxable year beginning on or after January 1, 2009. By St. 2008, c. 173, Massachusetts adopts the federal “check-the-box” rules, which permit unincorporated businesses generally to elect how they will be classified.

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Under the federal check-the-box rules, unincorporated businesses with two or more members are allowed to elect to be taxed either as corporations or as partnerships. Also, unincorporated associations with a single member may elect to be taxed as corporations or they may elect to be disregarded as an entity separate from their owner, thus being treated as a branch or division of their owner for tax purposes. Pursuant to St. 2008, c. 173, an entity's federal check-the-box election or default federal classification will also apply for Massachusetts personal income tax and corporate excise purposes; no separate Massachusetts election is required or permitted.

The check-the-box rules have applied in Massachusetts to limited liability companies (LLCs) since 1997. Thus, the statutory change pursuant to St. 2008, c. 173 will apply particularly to partnerships and to corporate trusts. Formerly, partnership status for purposes of M.G.L. c. 62, § 17 (and related personal income tax and corporate excise provisions) has been generally determined by evaluating various legal and factual characteristics of the entity. "Corporate trusts" – that is, business trusts, or certain other entities (such as partnerships) with transferable shares, as defined in M.G.L. c. 62, § 1(j) have been subject to the rules at M.G.L. c. 62, § 8. Because federal law has no separate tax classification for corporate trusts, the recent legislation repeals the specific Massachusetts rules that applied to the taxation of corporate trusts.

All federal S corporations are now subject to the entity level tax that applies to S corporations in Massachusetts under M.G.L. c. 63, § 32D, notwithstanding the entity's legal form of organization. Formerly, a qualified federal Subchapter S corporation subsidiary (QSUB) was subject to an entity level tax separate from its parent. St. 2008, c. 173 changes this, and a QSUB is now evaluated together with its parent in determining the parent S corporation's Massachusetts tax liability.

830 CMR 63.30.3 addresses the statutory changes and the effect they will have on an entity's status and returns, both in the transitional year and in future years. It explains the tax consequences of the classification changes, which generally would result in a deemed incorporation, reorganization or liquidation depending on the circumstances. Under St. 2008, c. 173's transition rule authority effective as of July 3, 2008, 830 CMR 63.30.3 also describes consequences of transactions, distributions, and other events occurring on or after July 3, 2008, and prescribes methods by which tax-free earnings and profits of corporate trusts are taxed to entities or successors or to their direct or indirect owners, partners, or beneficiaries. Finally, 830 CMR 63.30.3 states the rules for changes to the estimated payment obligations of an affected entity and its shareholders or members.

This guidance does not address every issue related to Massachusetts' conformity with federal entity classification; special adjustments or tax consequences not specifically considered in this document may be required in particular cases in order to achieve Massachusetts tax treatment and consequences consistent with the legislative changes effected by St. 2008, c. 173 and 830 CMR 63.30.3.

(b) Outline of Topics. 830 CMR 63.30.3 is organized as follows:

1. Statement of Purpose; Outline of Topics; Effective Date
2. Definitions
3. Entity Classification under St. 2008, c. 173
4. Tax consequences of reclassification under new statute
5. Changes in estimated tax payment responsibilities

(c) Effective Date. Except to the extent otherwise indicated in 830 CMR 63.30.3(2)(c):

1. entity classification rules, as established in 830 CMR 63.30.3, apply to taxable years beginning on or after January 1, 2009; and

2. transition rules contained in 830 CMR 63.30.3(2)(c), including without limitation rules governing the consequences of certain transactions, distributions, and other events occurring on or after July 3, 2008 and the methods for taxing tax-free earnings and profits of corporate trusts, apply as provided in 830 CMR 63.30.3(2)(c) on and after July 3, 2008. 830 CMR 63.30.3 supersedes all prior public written statements to the extent it is or may be inconsistent with any such prior statement or portion thereof.

(2) Definitions. For the purposes of 830 CMR 63.30.3, the following terms shall have the following meanings, unless the context requires otherwise:

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Business Corporation, any corporation, or any 'other entity' as defined in M.G.L. c. 156D, § 1.40, whether the corporation or other entity may be formed, organized, or operated in or under the laws of the Commonwealth or any other jurisdiction, and whether organized for business or for non-profit purposes, that is classified for the taxable year as a corporation for federal income tax purposes.

Corporate Trust, an entity that was taxable under the former M.G.L. c. 62, § 8, repealed by St. 2008, c. 173 (effective for taxable years beginning on or after January 1, 2009), and defined as any partnership, association or trust, the beneficial interest of which is represented by transferable shares. This category often includes entities generally described as business trusts.

Disregarded Entity, an entity that is disregarded as a separate entity from its owner for federal income tax purposes. Such an entity shall similarly be disregarded for purposes of 830 CMR 63.30.3, and without limitation, all income, assets, and activities of the entity shall be considered to be those of the owner.

Member, may include, without limitation, a partner in an entity that is organized as a partnership, including a limited partner in a limited partnership; a member of an LLC; a shareholder in a corporation or a corporate trust; or any other type of owner of an interest in an incorporated or unincorporated association the income of which is subject to taxation in Massachusetts.

Partnership, an entity that is classified for the taxable year as a partnership for federal income tax purposes, except as otherwise provided in 830 CMR 63.30.3.

Tax-free Earnings and Profits, earnings and profits that were considered tax-free earnings and profits under M.G.L. c. 62, § 8, as in effect on December 31, 2008, including such amounts that have accrued or may accrue under certain specific circumstances as described in 830 CMR 62.8.2(4)(b).

(3) Entity Classification under St. 2008, c. 173. Under St. 2008, c. 173, taxpayers who make, or have made, the entity classification election under the check-the-box rules using federal Form 8832 will apply that classification to their Massachusetts filing status. Taxpayers who do not make or have not made a federal election will have a default federal classification that will apply in Massachusetts. The detailed rules for federal entity classification, applicable to M.G.L. c. 62 and c. 63, are found at 26 CFR 301.7701-1 through 301.7701-3.

Generally, under the federal default rules that apply in the absence of an affirmative election on Form 8832, an entity that is eligible to choose its entity classification and does not do so is treated, in the case of a domestic (that is, U.S.) eligible entity; as a partnership if it has two or more members; or as disregarded as an entity separate from its owner if it has a single owner. A foreign (non-U.S.) eligible entity is treated as a partnership if it has two or more members and at least one member does not have limited liability, a corporation if all members (whether one or more) have limited liability, or disregarded as an entity separate from its owner if it has a single owner that does not have limited liability. *See* 26 CFR 301.7701-3(b).

St. 2008, c. 173 revises various Massachusetts definitions of a business entity. For purposes of M.G.L. c. 63, the introductory clause to the corporate excise provisions at M.G.L. c. 63, § 30, is revised to state that ". . . the terms "business corporation," "disregarded entity," and "partnership," defined in M.G.L. c. 63, § 30 paragraphs 1, 2 and 16, shall, unless otherwise provided, also have the following meanings and effect for all purposes of 830 CMR 63.30.3." 830 CMR 63.30.3(3) clarifies that the use of these terms is consistent throughout the corporate excise provisions in M.G.L. c. 63, including in the context of financial institutions, under M.G.L. c. 63, §§ 1 through 7, insurance companies, under M.G.L. c. 63, §§ 20 through 29E, and utility corporations, under M.G.L. c. 63, § 52A.

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(a) Corporations, Generally. Pursuant to St. 2008, c. 173, entities that are treated federally as corporations must generally file in Massachusetts either as business corporations taxable under M.G.L. c. 63, § 39, or under other more specific sections of M.G.L. c. 63 based upon the classification of the entity. For example, business corporations that are financial institutions are taxable under M.G.L. c. 63, §§ 1 through 7. Business corporations that are federal S corporations are subject to tax as S corporations under M.G.L. c. 63, § 2B or 32D (and are also subject to the corporate excise non-income measure and minimum tax under M.G.L. c. 63, § 39). Business corporations that are insurance companies are taxable under M.G.L. c. 63, §§ 20 through 29E, and business corporations qualifying as utility corporations are taxable under M.G.L. c. 63, § 52A.

Consistent with the definition of "business corporation," St. 2008, c. 173 similarly defines "corporation" for purposes of the definition of "financial institutions" that are subject to the financial institutions excise, M.G.L. c. 63, §§ 1 through 7, by adding the following sentence:

"The term 'corporation' as used in this definition shall mean any corporation, or any 'other entity' as defined in M.G.L. c. 156D, § 1.40, whether the corporation or other entity may be formed, organized, or operated in or under the laws of the commonwealth or any other jurisdiction, that is classified for the taxable year as a corporation for federal income tax purposes."

Under federal entity classification rules, entities that are formed in any state as a corporation, and certain foreign entities that are treated as "per se" corporations, must file as a corporate taxpayer, and are not allowed to elect their classification under the check-the-box rules. *See* Treas. Reg. §§ 301.7701-2, 301.7701-3(a). In addition to classification under the check-the-box rules, certain specialized federal classifications also apply in Massachusetts. For example, certain publicly traded partnerships are treated for federal purposes as corporations, IRC § 7704, generally including all publicly traded partnerships unless 90% or more of the gross income of the entity consists of certain qualifying income (generally, investment-type income). *See* IRC § 7704, Treas. Reg. §§ 1.7704-1, 1.7704-3. Another example of special federal treatment is the case of a partnership that if considered as a corporation could qualify as a Regulated Investment Company under IRC § 851; such an entity is exempt from the corporate filing requirement if it meets certain conditions. IRC § 7704(c)(3). In addition, following federal tax treatment, a real estate investment trust (REIT) may own a "qualified REIT subsidiary". Such subsidiary is not treated as a separate corporation for federal purposes and will also not be treated as a separate corporation for Massachusetts purposes; and following federal treatment, the REIT will treat all of the subsidiary's assets, liabilities and items of income, deduction, and credit as its own. *See* IRC § 856(1).

St. 2008, c. 173 provides the following rules for calculating basis that apply to all taxpayers subject to taxation under M.G.L. c. 63. St. 2008, c. 173, § 46, adding M.G.L. c. 63, § 31M. M.G.L. c. 63, § 31M reads in its entirety:

Section 31M. In determining gross income under 830 CMR 63.30.3, if the federal gross income includes any item of gain or has been reduced by any item of loss, with respect to property, then the federal gross income shall be increased by the excess of the federal adjusted basis of the property over the Massachusetts adjusted basis of the property, and shall be decreased by the excess of the Massachusetts adjusted basis of the property over the federal adjusted basis of the property, so that the gain or loss realized for Massachusetts purposes takes into account all applicable differences in the Massachusetts and federal tax rules over the life of an asset that should, in principle, give rise to differences in basis. The Massachusetts adjusted basis of property shall be the federal adjusted basis, except that any federal adjustment resulting from provisions of the Code that were not applicable in determining Massachusetts gross income at the time the federal adjustments were made shall be disregarded; and adjustments shall be made for any item that was applicable in determining Massachusetts gross income but that was not so applicable in determining federal gross income and for which a federal adjustment would be allowed under the Code if the item had been applicable in determining federal gross income. Without limitation of the foregoing, the federal basis of shares in a business corporation that was formerly treated as a corporate trust or of shares in a successor of that entity shall be reduced in computing Massachusetts adjusted basis to take into account any tax-free earnings and profits accumulated by the former corporate trust.

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Among other things, the last sentence of these basis adjustment provisions provides a method of ensuring that in the case of an entity that is treated under the new rules as a corporation but that was previously taxed as a corporate trust under M.G.L. c. 62, § 8, any accumulated tax-free earnings and profits of such corporate trust are recognized and taxable no later than when the shares of the successor corporation are sold or otherwise transferred. This basis adjustment is discussed further in 830 CMR 63.30.3(4)(a) and (b), in connection with various transactions or deemed transactions involving corporate trusts (or their successor entities) and the shareholders or other members thereof.

(b) S Corporations and QSUBs. Prior to adoption of St. 2008, c. 173, an entity could be treated as an S corporation for federal tax purposes, but be treated as a partnership, corporate trust, or financial institution for Massachusetts tax purposes. Pursuant to St. 2008, c. 173, a federal S corporation will in every case also be an S corporation for Massachusetts purposes, taxable under M.G.L. c. 63, § 2B or 32D, notwithstanding its form of organization, and its shareholders will be taxable in accordance with M.G.L. c. 62, § 17A. No separate Massachusetts election is necessary or allowed. St. 2008, c. 173 creates a new taxing structure for financial institutions that are S corporations, M.G.L. c. 63, § 2B. *See* St. 2008, c. 173, § 32.

Massachusetts formerly subjected QSUBs to separate entity-level tax, both for income and non-income measure purposes. However, under St. 2008, c. 173, an S corporation must take into account its QSUB's income, loss, deductions, and credits in determining its net income as may be subject to tax under M.G.L. c. 63, §§ 2B or 32D. In determining the non-income measure of the corporate excise under M.G.L. c. 63, § 39, the S corporation parent will take into account the QSUB's property for purposes of measuring its tax liability. There is no longer a separate income or non-income measure for the QSUB, and the QSUB is no longer considered a separate entity for any corporate excise purpose. Accordingly, the S corporation, rather than a QSUB, will in every case also be responsible for the minimum tax under M.G.L. c. 63, § 39, where applicable.

(c) Partnerships. St. 2008, c. 173 adds a definition to the general definitions section of the personal income tax law at M.G.L. c. 62, § 1, which makes partnership status in Massachusetts conform to the entity's federal status:

(p) "Partnership", an entity that is classified for the taxable year as a partnership for federal income tax purposes, except as otherwise provided in 830MR 63.30.3. *See* St. 2008, c. 173, § 11.

M.G.L. c. 63, § 30.16 adds a similar definition of partnership to the corporate excise provisions, at M.G.L. c. 63, § 30. *See* St. 2008, c. 173, § 42.

Prior to adoption of St. 2008, c. 173, the term "partnership" was not defined in M.G.L. c. 62 (or for purposes of applying the provisions of M.G.L. c. 63). By the new definition, an entity will be treated as a partnership for purposes of the Massachusetts personal income tax and corporate excise provisions if it elects partnership treatment for federal tax purposes, or meets the default category for partnership treatment under federal rules, notwithstanding its organization in Massachusetts as a partnership, corporate trust, limited liability company, or any other unincorporated form of association.

(d) Corporate Trusts. St. 2008, c. 173 eliminates the separate taxation rules for corporate trusts. *See* St. 2008, c. 173, § 16 (removing a reference to corporate trusts in the tax rates described at M.G.L. c. 62, § 4); St. 2008, c. 173, § 19 (repealing M.G.L. c. 62, § 8, the taxation provisions applicable to corporate trusts); St. 2008, c. 173, § 22 (repealing M.G.L. c. 62, § 19, which stated that corporate trusts were not taxable as partnerships); St. 2008, c. 173, §§ 23, 25 (repealing filing requirements for corporate trusts). However, St. 2008, c. 173 preserves certain attributes of corporate trusts to be used in calculating the future tax liabilities of their owners or successors. For example, St. 2008, c. 173 preserves the accounting for tax-free earnings and profits that were accumulated by corporate trusts under prior law. St. 2008, c. 173 authorizes the Commissioner to adopt rules to prescribe methods by which such earnings and profits shall be taxed to the entities or their successors or to their direct or indirect owners, partners, or beneficiaries. *See* St. 2008, c. 173, § 96, by § 102 made effective on enactment, which states that "[f]or the purposes of modifying the tax treatment of corporate trusts to create general conformity with federal classification rules and insuring that any tax-free earnings and profits accumulated by an entity formerly treated as a corporate trust shall be subject to tax under M.G.L. c . 62 or M.G.L. c. 63, the

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commissioner of revenue may adopt reasonable rules, by regulation or otherwise, to determine the methods by which previously untaxed amounts shall be taxed to the entity, its successor, or its direct or indirect owners, partners or beneficiaries". *See* also St. 2008, c. 173, § 46, adding M.G.L. c. 63, § 31M (last sentence providing for basis adjustment in shares of business corporation that was treated as corporate trust under prior law). The rules for the accounting and taxation of such tax-free earnings and profits are described in 830 CMR 63.30.3(3)(d) and in various portions of 830 CMR 63.30.3(4).

1. Taxation of and required accounting for tax-free earnings and profits of corporate trusts. In particular, St. 2008, c. 173 provides that any tax-free earnings and profits accumulated by an entity formerly treated as a corporate trust that was in existence and treated as a corporate trust on or after July 3, 2008 shall be subject to tax under M.G.L. c. 62 or 63. St. 2008, c. 173, § 96. *See* St. 2008, c. 173, § 96 (by § 102 made effective on enactment). To assist in achieving this legislative directive, the Commissioner will require all such former corporate trusts or their successors to file an accounting of all tax-free earnings and profits that have been earned, accumulated, or distributed by the corporate trust. 830 CMR 63.30.3(3)(d)1. applies to any entity subject to treatment as a corporate trust under M.G.L. c. 62, § 8 at any time on or after July 3, 2008, including any successor to such a corporate trust in the case of entities that reorganized (or whose businesses were otherwise transferred directly or indirectly to a successor) on or after July 3, 2008. The Department will issue guidance as to the form, method, and due date for furnishing this accounting. Corporate trusts that are publicly traded and that qualify for one or more taxable years as regulated investment companies (RICs) or as real estate investment trusts (REITs) under the Code are only required to perform this accounting for such taxable years to the extent they have undistributed earnings and profits in such taxable years. RICs or REITs that have annually distributed all earnings and profits to shareholders and that therefore have no accumulated tax-free earnings and profits are exempt from filing the accounting statement, provided that such entities file with the Commissioner a statement identifying themselves and attesting to their qualification for this exemption.

The accounting shall be broken down by year, showing the tax-free earnings and profits attributable to each year, the Massachusetts apportionment percentage of the trust for that year (to be used by non-residents in calculating their tax liabilities), and noting for each entry under what regulatory category (namely, 830 CMR 62.8.2(4)(b)1., 2., 3., or 4.) the earnings are derived. The accounting must show for each year the beginning balance of tax-free earnings and profits, any accruals to and any distributions from such tax-free earnings and profits during the year, and the ending balance for the year. The former corporate trust or successor thereto must report to its members their proportionate share of tax-free earnings and profits, broken down by taxable year. With respect to members that were residents of Massachusetts for all or a part of any tax year in which such tax-free earnings and profits were accrued, the report must show any income taxes paid by the corporate trust to other states with respect to such earnings and profits. With respect to members that were non-residents for all or a part of any tax year in which tax-free earnings and profits were accrued in the categories described in 830 CMR 62.8.2(4)(b)1., 2. or 4., the report must include the apportionment percentage of the corporate trust for that year. Non-residents are not taxable on tax-free earnings and profits that accrued in the category described in 830 CMR 62.8.2(4)(b)(3).)

2. a. <u>Distributions Out of Tax-free Earnings and Profits Taxed as Dividend Income</u>. All distributions made on or after July 3, 2008 by any entity (including C corporations, S corporations, partnerships, disregarded entities, or any other form of entity), or a successor thereto, that at any time on or after July 3, 2008 was in existence as a corporate trust, shall be deemed to be dividends, taxable as dividend income, to the extent there are remaining tax-free earnings and profits that have not been subject to Massachusetts taxation, and any distributions shall be deemed to have been paid first out of any tax-free earning and profits of the paying entity. Such distributions shall be recognized as income by the recipient in the taxable year of the recipient in which they are distributed by such corporate trust. Such treatment as dividend income shall not be required to the extent that such tax-free earnings and profits have already been required to be taxed as dividend income pursuant to other rules described in 830 CMR 63.30.3.

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The entity paying such dividends must notify the recipient that the dividends are deemed to represent taxable dividend income derived from tax-free earnings and profits. Massachusetts resident taxpayers are allowed a credit for income taxes paid to other jurisdictions on dividends received out of tax-free earnings and profits of such a corporate trust. *See* M.G.L. c. 62, § 6(a), as amended by St. 2008, c. 173, § 17.

Non-resident members must report such taxable dividends as Massachusetts source income to the extent of any tax-free earnings and profits apportioned to Massachusetts that accrued in the categories described in 830 CMR 62.8.2(4)(b)1., 2. or 4. In determining a non-resident's share of tax-free earnings and profits apportioned to Massachusetts, the member shall apply the apportionment percentage of the former corporate trust attributable to any year the member was a non-resident in which such tax-free earnings and profits were accrued under 830 CMR 62.8.2(4)(b)1., 2. or 4. Non-residents who were residents during any year the former corporate trust accumulated tax-free earnings and profits must report as Massachusetts source income all distributions out of all such tax-free earnings and profits without apportionment, but are entitled to the credit for taxes paid to another jurisdiction in the manner of a resident for that year. Note that all tax-free earnings that are taxable to non-residents remain taxable indefinitely, wherever and for however long the non-resident continues to receive such distributions/dividends.

b. Special rule for publicly traded RICs and REITS. Deemed or actual distributions from publicly traded RICs and REITs are not treated as Massachusetts source income to non-residents for purposes of 830 CMR 63.30.3(3)2. to the extent that the actual or deemed distributions are attributable to periods when the distributing entity was a publicly traded RIC or REIT.

3. Deemed Distributions of Tax-free Earnings and Profits Upon Reclassification, Reorganization, or Disposition of Corporate Trust. To ensure that all tax-free earnings and profits are properly subject to Massachusetts taxation under St. 2008, c. 173, the reclassification of a corporate trust by operation of St. 2008, c. 173, or a change in classification of the corporate trust (or a successor) occurring as a result of any form of reclassification, reorganization, or disposition, by any transaction or deemed transaction occurring on or after July 3, 2008, to a different type of status for Massachusetts tax purposes (partnership, corporation, or disregarded entity), shall result in a deemed distribution to all members of any tax-free earnings and profits of such corporate trust or any successor thereto, taxable to the members as dividend income. *See* 830 CMR 63.30.3(3)(d)4., regarding an exception to such treatment in the case of corporate successors. All members (resident and non-resident) must recognize such income as dividend income on their first return due:

a. after the close of the corporate trust's last taxable year ending on or after December 31, 2008, or

b. where a corporate trust was the subject of a reclassification, reorganization, or disposition on or after July 3, 2008 and before a change in classification that would occur by operation of St. 2008, c. 173, after such reclassification, reorganization, or disposition.

Thus, in the case of a corporate trust filing a calendar year return and with shareholders also filing calendar year returns, deemed distributions due to untaxed earnings and profits of the corporate trust occur on December 31, 2008 and are recognized by shareholders on their calendar 2008 return. The rules described in 830 CMR 63.30.2(3)(d)2 .regarding a potential credit for resident shareholders for income taxes paid to other jurisdictions and regarding the potential application of apportionment rules for non-resident shareholders shall apply to these deemed distributions of taxable dividend income as well.

4. a. Exception for corporate successors to corporate trusts. A statutory exception to the immediate recognition of dividend income on account of tax-free earnings and profits exists where a corporate trust is reclassified by operation of St. 2008, c. 173 as a corporation for Massachusetts tax purposes or reorganizes such that it is taxable in Massachusetts as a corporation. In such a case, the corporate trust or its successor

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must report to its shareholders their proportionate share of tax-free earnings and profits remaining after accounting for any taxation of tax-free earnings and profits that occurred on or after July 3, 2008. Shareholders of the successor corporation must reduce their Massachusetts basis in their corporate shares to the extent of their proportionate share of any such remaining tax-free earnings and profits. M.G.L. c. 63, § 31M. The preceding rule applies also to non-residents to the extent they would be taxable in the event of distributions of such tax-free earnings and profits under the rules described in 830 CMR 63.30.3(3)(d)2. To the extent a shareholder's proportionate share of tax-free earnings and profits exceeds the Massachusetts basis in the shares of the successor corporation, that shareholder must recognize the income as dividend income on that shareholder's first return due after the close of the corporate trust's last taxable year ending on or after December 31, 2008, or where a corporate trust reorganized into an entity taxable in Massachusetts as a corporation on or after July 3, 2008 and before a change in classification that would occur by operation of St. 2008, c. 173, after such reorganization. To the extent the shareholder pays Massachusetts tax on any tax-free earnings and profits on account of which it had reduced its basis in shares as provided in 830 CMR 63.30.3(3)(d)4.a., the shareholder may reverse such basis reduction and adjust its basis in shares upwards to reflect the dollar amount of such tax-free earnings and profits that were taxed. All tax-free earnings and profits that are required to be reflected in an adjustment to shareholder basis remain taxable as dividend income upon a subsequent distribution, *see* 830 CMR 63.30.3(3)(d)2., or disposition of shares by the shareholder, *see* 830 CMR 63.30.3(3)(d)6., and shall be subject to the rules described in 830 CMR 63.30.3(3)(d)2. regarding a potential credit for resident shareholders for income taxes paid to other jurisdictions and regarding the potential application of apportionment rules for non-resident shareholders.

b. Special Rule for Certain Corporate Successors to Corporate Trusts Qualifying as Regulated Investment Companies or Real Estate Investment Trusts. Corporate trusts that are publicly traded and that qualify as of July 3, 2008 as regulated investment companies (RICs) or as real estate investment trusts (REITs) under the Code and that are succeeded by a corporate taxpayer under St. 2008, c. 173 are allowed the following special treatment with respect to dispositions of shares of such corporate trust or corporate successor occurring on or after July 3, 2008 and before the first taxable year beginning on or after January 1, 2009. In such cases, a shareholder is not required to reduce Massachusetts basis in such shares under the general rule at 830 CMR 63.30.3(3)(d)4.a., on account of tax-free earnings and profits, provided and to the extent that such tax-free earnings and profits are currently distributed by the RIC or REIT for its taxable year in which derived. All undistributed earnings and profits of the REIT or RIC are subject to treatment under the general rules at 830 CMR 63.30.3(3)(d).

5. Shareholder Election to be Taxed on Deemed Distribution of Proportionate Share of Tax-free Earnings and Profits in *Lieu* of Reducing Basis in Shares. In *lieu* of making the basis reduction in shares described in 830 CMR 63.30.3(3)(d)4., a shareholder may elect to pay Massachusetts tax on a deemed distribution of all of the proportionate tax-free earnings and profits attributable to such shareholder in accordance with the rules described in 830 CMR 63.30.3(3)(d)3.

6. Disposition of Shares of a Corporate Trust or of a Corporate Successor to Corporate Trust on or after July 3, 2008. A member of a corporate trust (or of a corporate successor thereto in a situation where a shareholder of such successor is required to reduce Massachusetts tax basis in the shareholder's shares of the corporate successor to account for tax-free earnings and profits of a former corporate trust, as described in 830 CMR 63.30.3(3)(d)4.) is required to recognize taxable dividend income, to the extent of any tax-free earnings and profits, upon the disposition in any manner (direct or indirect, whether otherwise taxable or tax-free) on or after July 3, 2008 of any shares or other interest in such corporate trust or corporate successor. Such dispositions would include, without limitation, dispositions by gift or deemed dispositions in a liquidation of the corporate trust or corporate successor (whether shares are transferred, relinquished, or canceled). Where the disposition is of shares of a corporate successor to the corporate

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trust, such recognition of dividend income shall be limited to the extent of any basis reduction required to be made on account of such earnings and profits. 830 CMR 63.30.3(3)(d)2. regarding a potential credit for resident shareholders for income taxes paid to other jurisdictions and regarding the potential application of apportionment rules for non-resident shareholders shall apply to taxable dividend income required to be recognized under 830 CMR 63.30.3(3)d)6. Dispositions that are subject to tax as described in 830 CMR 63.30.3(3)d)6. shall include all direct or indirect dispositions on or after July 3, 2008, including, without limitation, by sale, exchange, liquidation, gift, bequest, or other transfer. Indirect dispositions by a member shall be deemed to occur, without limitation, when a corporate trust or a corporate successor issues or transfers shares or other ownership interests that have the effect of reducing the ownership interest of such member. *See* 830 CMR 63.30.3(3)(d)4.b. for special rule for certain dispositions of shares of certain corporate trusts or corporate successors qualifying as RICs or REITs.

It is the intent of 830 CMR 63.30.3 and of 830 CMR 63.30.3(3)(d) in particular, to effectuate the purpose of St. 2008, c. 173 to ensure that all tax-free earnings and profits are subject to Massachusetts taxation to the extent permitted by law. Nothing in this document should be construed to provide a limitation on the taxation of tax-free earnings and profits, or to provide a means of postponing or avoiding the taxation of tax-free earnings and profits.

Example (3)(d). HoldCo is a calendar-year entity organized in Massachusetts as a Massachusetts business trust with transferable shares. As of July 3, 2008, HoldCo is treated for Massachusetts taxation purposes as a corporate trust subject to taxation under M.G.L. c. 62, § 8. HoldCo has assets worth $100M. It has 100,000 outstanding shares, held by five shareholders. HoldCo is treated for federal purposes as an S corporation. On September 1, 2008, the shareholders of HoldCo agree to cause HoldCo to issue non-voting shares, representing 50% of the ownership interest of HoldCo, and to cause such shares to be contributed to HoldCo Foundation, a tax-exempt charitable foundation.

HoldCo has $5M of tax-free earnings and profits, based on the properly-completed accounting of tax-free earnings and profits that HoldCo is required to submit to DOR. As discussed above, any direct or indirect transfer of an interest in a corporate trust will trigger the taxable recognition of tax-free earnings and profits as dividend income to the shareholders. Thus, the shareholders must collectively recognize 50% of the total tax-free earnings and profits as taxable dividend income (the 50% figure representing the percentage of the value of the business that was transferred to the charitable foundation) on their first tax return due after the close of HoldCo's 2008 taxable year. Any resident shareholders may claim a credit for income taxes paid to other jurisdictions on the tax-free earnings and profits taxed to them as dividend income. Any shareholder that is a non-resident for taxable year 2008 must recognize taxable dividend income under the rules described in 830 CMR 63.30.3(3)(d)2. that apply in the event of distributions of such tax-free earnings and profits.

HoldCo becomes a corporation for Massachusetts tax purposes by operation of St. 2008, c. 173 as of the close of 2008, and the shareholders must use the remaining tax-free earnings and profits attributable to them to reduce their Massachusetts tax basis in shares of the successor corporation; any tax-free earnings and profits in excess of basis must be recognized immediately as taxable dividend income. Any non-residents must adjust their Massachusetts basis in shares to account for the remaining tax-free earnings and profits for which they are subject to Massachusetts tax under the rules described in 830 CMR 63.30.3(3)(d)2., 4.

(e) LLCs. Massachusetts previously adopted the federal entity classification rules as to LLCs in 1997. However, St. 2008, c. 173 repeals the specific statutory provisions that subjected only LLCs to the federal check-the-box rules, since these provisions are no longer necessary in light of the general applicability of the federal classification rules. *See* St. 2008, c. 173, § 20 (repealing references in the partnership taxation provisions at M.G.L. c. 62, § 17 that included LLCs and made the statute applicable to LLCs that were federally treated as partnerships, and that also stated that a disregarded LLC was to be disregarded as an entity separate from its member). The removal of the LLC-specific references has no effect on the taxation of LLCs, and LLCs will continue to be subject to the check-the-box rules as fully adopted in Massachusetts by St. 2008, c. 176.

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(f) Disregarded Entities. Pursuant to St. 2008, c. 173, Massachusetts conforms to the federal principle that an entity with a single member that is disregarded under federal law as a separate taxable entity is treated as a branch or division of its owner. In the absence of an affirmative election to be a disregarded entity, this is also the default position for an unincorporated association with a single member that makes no election under Treas. Reg. 301-7701-3, except in the case of a foreign (non-U.S.) entity with a single member that has limited liability. *See* Treas. Reg. 301.7701-3(b).

To effectuate this change, St. 2008, c. 173 adds the following definition to the personal income tax provisions and the corporate excise provisions:

Disregarded Entity, an entity that is disregarded as a separate entity from its owner for federal income tax purposes. Such an entity shall be similarly disregarded for purposes of 830 CMR 63.30.3; and, without limitation, all income, assets, and activities of the entity shall be considered to be those of the owner. M.G.L. c. 62, § 1(q), and M.G.L. c. 63, § 30.2.

In the case of a disregarded entity, the owner includes all the income, losses and attributes of the disregarded entity in its own tax calculations. For personal income tax and corporate excise purposes, the disregarded entity has no separate identity, although in most other respects the entity continues to be regarded as a separate legal entity, with its own obligations and privileges.

With respect to the treatment of a qualified REIT subsidiary, *see* 830 CMR 63.30.3(3)(a).

(4) Tax Consequences of Reclassification under New Statute.

(a) General Principles and Transitional Rules. The new check-the-box conformity rules require specific changes in the way that many affected taxpayers will calculate their tax liabilities. Borrowing from the federal rules at 26 CFR 301.7701-3(g), and subject to certain modifications as noted in 830 CMR 63.30.3(4) describes general principles and transitional rules that govern the Massachusetts tax effects to an affected entity or its successors, and to the entity's or successor's partners, shareholders, or other owners, that result from a change in entity classification.

St. 2008, c. 173, § 96 effective on July 3, 2008 grants broad authority to the Commissioner to "determine reasonable transition rules for entities, including but not limited to corporate trusts and qualified subchapter S subsidiaries, and the successors, direct or indirect owners, partners or beneficiaries of those entities, whose tax classification shall be altered by St. 2008, c. 173. These transition rules may include provisions for nonrecognition of gain or loss in the event of a conversion of an entity's Massachusetts tax status resulting from St. 2008, c. 173, with corresponding adjustments to basis or other tax attributes if and as determined by the commissioner to be appropriate." In addition, M.G.L. c. 63, § 31M, added by St. 2008, c. 173 and quoted in 830 CMR 63.30.3(3)(a), provides for a basis adjustment to shares in a corporation that was formerly subject to tax as a corporate trust to account for tax-free earnings and profits.

Except as otherwise indicated, the Massachusetts tax consequences described in 830 CMR 63.30.3 applies both in the case of reclassifications of entities that occur by operation of St. 2008, c. 173 and in the case of reclassifications that follow from transactions or deemed transactions initiated by entities or successors, or their members, on or after July 3, 2008 and prior to the time at which a change in classification would otherwise occur by operation of St. 2008, c. 173. Such consequences would include, among other things, the recognition of gain to an entity that has been treated as a corporation for Massachusetts tax purposes and is deemed to liquidate, whether by reason of its change of classification pursuant to St. 2008, c. 173 or, for example, in a transaction or transactions that result in a conversion into a different form of entity or in the termination of status as a corporation for Massachusetts tax purposes. To the extent rules or principles are not otherwise described in 830 CMR 63.30.3, the Massachusetts tax consequences of reclassifications pursuant to St. 2008, c. 173 and of transactions and deemed transactions that result in a change in the entity classification will generally be determined by applying federal rules and principles, including those related to income recognition and basis adjustments, as adjusted so as to be consistent with the rules and principles described in 830 CMR 63.30.3 and as otherwise needed to take account of Massachusetts statutory and other modifications.

Entities and their successors and members that are the subject of, or involved in, an entity reclassification in Massachusetts, whether pursuant to St. 2008, c. 173 or as a result of a transaction or deemed transaction occurring on or after July 3, 2008 and prior to the time at which a change in classification would otherwise occur by operation of St. 2008, c. 173, may

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need to determine the tax basis in their assets or their shares or other ownership interests, and make certain other calculations and adjustments, in a manner that differs from their federal tax reporting in determining their Massachusetts income tax and corporate excise liabilities. As noted, entities that were formerly taxable in Massachusetts as corporations and, as a result of St. 2008, c. 173, will be taxable under a different classification will be deemed to liquidate, which will generally require recognition of gain or loss to the corporation for Massachusetts tax purposes. Such gain or loss must be reported on the closing return of the liquidating corporation. In some cases, there could be other tax consequences to the liquidating entity, such as recapture of a previously-taken benefit for which the taxpayer is ineligible under its new classification. For example, an entity that was classified as a manufacturing corporation and was eligible to receive the Investment Tax Credit under M.G.L. c. 63, § 31A, will be ineligible to receive that credit if its new classification is as a partnership. Thus, the liquidating entity will be subject to the recapture provisions described in M.G.L. c. 63, § 31A; any recapture must be reported on the closing return of the liquidating corporation.

The specific transition rules described in 830 CMR 63.30.3(4)(a)1. through 7. applies to entities whose Massachusetts entity classification changes pursuant to St. 2008, c. 173 as of the commencement of an entity's first taxable beginning on or after January 1, 2009. 830 CMR 63.30.3 will also apply to entities that change their form or classification on or after July 3, 2008 and prior to the time at which a change in classification would otherwise occur by operation of St. 2008, c. 173, and in that context they should be applied in a manner that treats the change in entity classification, and the resulting consequences, as taking effect at the pertinent time of reclassification (rather than necessarily as of the first taxable year beginning on or after January 1, 2009 as in the statutory reclassifications described in 830 CMR 63.30.3(4)(a)1 through 7. Note, however, the special rules regarding accounting for and reporting of tax-free earnings and profits of former corporate trusts, as described in 830 CMR 63.30.3(3)(d)1. The rules regarding tax-free earnings and profits of former corporate trusts apply to any such entity that was or would have been treated as a corporate trust at any time on or after July 3, 2008, to successors of such corporate trusts regardless of the form of organization of the successor, and to the owners or members of such corporate trusts or their successor entities, and regardless of whether the trust terminates by an affirmative action of the entity or by operation of St. 2008, c. 173.

1. Change from a Partnership to a Corporation. An entity that formerly was treated as a Massachusetts partnership under M.G.L. c. 62, § 17 and now will be treated as a corporation under M.G.L. c. 63 is deemed to contribute all of its assets and liabilities to the corporation in exchange for stock in the corporation. Immediately thereafter, the partnership is deemed to liquidate by distributing the stock of the corporation to its partners. The deemed contribution of assets and liabilities to a corporation will be treated for Massachusetts tax purposes in accordance with the federal rules that would apply to such a transaction if it were also occurring federally – for example, in determining the extent of any recognition of gain or loss upon the contribution and the resulting basis in the assets of the corporation. *See, e.g.,* IRC § 351, 357, 362. Similarly, the deemed liquidation of the partnership will be treated in accordance with the federal rules that would apply to such a transaction if it were also occurring federally – for example, in determining the extent of any recognition of gain or loss upon the deemed distribution of stock of the corporation to the partners in the deemed liquidation of the partnership, and the resulting basis of the partners in the stock of the corporation. *See, e.g.,* IRC § 731, 732.

2. Change from a Corporate Trust to a Corporation.

a. General Transition Rules. An entity that formerly was treated as a corporate trust under M.G.L. c. 62, § 8 as of July, 3, 2008, but that will be treated as a M.G.L. c. 63 corporate taxpayer for tax years beginning on or after January 1, 2009, will be generally treated as having been party to a tax-free reorganization for Massachusetts tax purposes. The corporate trust will not generally be considered to recognize gain or loss due to the reclassification of the corporate trust as a corporation, and the basis in assets of the former corporate trust will carry over to the successor corporation. The shareholders of the former corporate trust will have a Massachusetts tax basis in the shares of the successor corporation equal to the basis they previously had in the shares of the corporate trust, reduced as follows: shareholders of such entities that

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have any tax-free earnings and profits must reduce the Massachusetts tax basis in the shares of the successor corporation by the dollar amount of tax-free earnings and profits attributable to the shares to the extent those earnings and profits have not been previously taxed to the entity or its shareholders. With respect to non-resident individual shareholders, the basis reduction for such tax-free earnings and profits shall be made after proper apportionment to Massachusetts under rules described in 830 CMR 63.30.3(3)(d)2., 4. *See generally* St. 2008, c. 173, §§ 46 (as codified at M.G.L. c. 63, § 31M), 96, 102. As noted in 830 CMR 63.30.3(3)(d)5., a shareholder may elect to be taxed on such tax-free earnings and profits in *lieu* of making such basis reduction. The holding period for shareholders in the shares of the corporation will be a continuation of their existing holding period in the shares of the corporate trust, and will not recommence with the conversion. At the time of any distribution to shareholders or of any shareholder's direct or indirect disposition of the shares of the successor corporation, whether, for example, by sale or redemption of individual shares, by liquidation of the entire corporation, or by any tax-free disposition (including by gift), such shareholder must recognize taxable dividend income for Massachusetts tax purposes, to the extent of any of such basis reduction reflecting the tax-free earnings and profits, whether or not there is federal income recognition. The dividend income is Massachusetts source income to the non-resident shareholders as described in 830 CMR 63.30.3(3)(d)2.

The shareholders of an entity that formerly was treated as a corporate trust under M.G.L. c. 62, § 8, but which has been a corporation for federal tax purposes will often have a Massachusetts basis in their shares that differs, possibly significantly, from their federal basis. This may be particularly the case where the corporate trust was an S corporation for federal tax purposes. Where the required reduction in basis to reflect tax-free earnings and profits would exceed the available Massachusetts tax basis, the excess must be taken into account as dividend income under the rules described in 830 CMR 63.30.3(3)(d).

Distributions from S Corporation Successor to Corporate Trust. Distributions to shareholders of an S corporation that is a successor to a corporate trust shall be deemed to be paid first from previously undistributed tax-free earnings and profits of the corporate trust, to the extent that they have not yet been taxed to the shareholders, and thus shall be treated as taxable dividend income to the shareholders. Any further distributions shall be deemed to be first from any accumulated S corporation income attributable to an S corporation that was a predecessor to a QSUB owned by the corporate trust, where such S corporation income had been previously taxed under M.G.L. c. 62 to the predecessor S corporation shareholders, and then from previously undistributed earnings and profits of the corporate trust, until all such earnings and profits of the corporate trust are exhausted. *See* DOR Directive 04-2 (February 13, 2004). The rules in Directive 04-2 are modified by 830 CMR 63.30.3. 830 CMR 63.30.3 requires that any distributions be treated as first paid out of any tax-free earnings and profits of the corporate trust that has not yet been taxed to the shareholders, and provides that such distributions shall be taxed to the shareholders as taxable dividend income.

Distributions of previously undistributed earnings and profits of the corporate trust will not reduce the shareholders' Massachusetts tax basis in their S corporation shares. Distributions other than those out of earnings and profits of the corporate trust will be governed by existing S corporation rules.

For special rules that apply to QSUBs of former corporate trust parents, *see* 830 CMR 63.30.3(4)(a)7.

Treatment of Capital Loss Carryover Attributable to the Corporate Trust. To the extent an entity taxable as a corporate trust under the former M.G.L. c. 62, § 8, but taxable as a federal S corporation, has any ongoing capital loss carryforward, such amounts are not carried forward to its successor entity. However, a shareholder in such former corporate trust at the time of its conversion into an S corporation for Massachusetts tax purposes may take a proportionate share of such capital loss carryforward for Massachusetts tax purposes for the tax year beginning on or after January 1, 2009, provided that the shareholder held such proportionate interest in the corporate trust's shares on July 3, 2008.

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b. Estates that Include an Interest in a Former Corporate Trust. Respecting the statutory intent to ensure Massachusetts state-level taxation of tax-free earnings and profits of a former corporate trust, the following rule applies to estates or other persons ("holders having an IRC § 1014 basis") that own an interest in a corporate trust or its successor where the shares or other interests in the corporate trust or successor were or are subject to inclusion in the estate of a decedent shareholder or other owner or beneficiary of the corporate trust or successor. The basis in such shares, derived after application of IRC § 1014, must be reduced in the hands of the estate or other holder having an IRC § 1014 basis by the amount of tax-free earnings and profits of the former corporate trust attributable to that holder's interest, to the extent such tax-free earnings and profits have not been subject to Massachusetts tax in the hands of the trust or its shareholders or other owners or beneficiaries. To the extent of any such basis reduction on account of such tax-free earnings and profits, gain is to be recognized by the estate or other holder having an IRC § 1014 basis upon sale, transfer, or distribution of shares by such holder, including by gift or distribution to heirs and without regard to whether any disposition would otherwise be taxable or tax-free for Massachusetts tax purposes. These rules apply to all items counted as part of the estate, even if those items are not in the control of the estate or its fiduciary.

3. Change from a Corporation to a Partnership. An entity that was formerly treated as a Massachusetts corporation under M.G.L. c. 63 but for tax years beginning on or after January 1, 2009 will be treated as a partnership under M.G.L. c. 62, § 17 and M.G.L. c. 63, § 30, is deemed to distribute all of its assets and liabilities to its shareholders in liquidation of the corporation, and immediately thereafter, the shareholders are deemed to contribute all of the distributed assets and liabilities to a newly formed partnership. Generally, this liquidation will result in recognition of gain or loss for Massachusetts tax purposes at the corporate level, which must be reported by the corporation on its final Massachusetts return. *See* generally IRC § 336. Note that any gain must be reported even though this deemed liquidation will not result in the recognition of any federal gross income. In the event that a part of such deemed liquidation could qualify as a tax-free liquidation under the provisions of IRC § 332 and 26 CFR 301.7701-3(g)(2) if a federal election were being made under 26 CFR 301.7701-3 that resulted in the classification as a partnership of an entity previously treated as a corporation for federal income tax purposes, such provisions may apply in this context for Massachusetts tax purposes as well.

As to the shareholders of the corporation that will be now treated as a partnership, ordinarily the application of federal rules to the deemed liquidation of the corporation in these circumstances would also require the recognition of gain or loss to shareholders, and a resulting change in the basis of the former corporation's assets that the shareholders are deemed to contribute to the partnership. However, to provide as much consistency in asset basis as possible between Massachusetts and federal law, the Department has determined that in these circumstances the shareholders will not recognize gain or loss upon the deemed liquidation of the corporation, and the shareholders will take a Massachusetts tax basis in the assets received upon the deemed liquidation equal to the corporation's Massachusetts tax basis in such assets immediately prior to its deemed liquidation. The shareholders will then be deemed to transfer those assets to the partnership under the federal rules applicable to such a transaction, *see, e.g.*, IRC §§ 721-723, with the partnership generally taking the same basis in the assets that the transferor shareholders had and with the shareholders now having a basis in their interests in the successor partnership consistent with their basis in the assets deemed to be transferred. The holding period for partners in their partnership interests will be a continuation of the existing holding period in their shares of the former corporation, and will not recommence with the conversion. The holding period for the partnership in the assets of the former corporation will be deemed to include the corporation's former holding period in its assets.

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4. Change from a Corporate Trust to a Partnership. An entity that was formerly treated as a corporate trust under M.G.L. c. 62, § 8, but for tax years beginning on or after January 1, 2009 will be treated as a partnership under M.G.L. c. 62, § 17 and M.G.L. c. 63, § 30, will be generally treated as having been party to a tax-free reorganization for Massachusetts tax purposes. The corporate trust will not generally be considered to recognize gain or loss due to the reclassification of the corporate trust as a partnership; however, all tax-free earnings and profits of the former corporate trust must be recognized as taxable dividend income to the partners on their first return after the conversion. With respect to the treatment of tax-free earnings and profits, to both resident individual partners and non-resident individual partners, see in 830 CMR 63.30.3(3)(d). The basis in assets of the former corporate trust will carry over to the successor partnership. The holding period for the partnership in the assets of the former corporate trust will be deemed to include the corporate trust's holding period in its assets. The shareholders of the former corporate trust will have a Massachusetts tax basis in their interests in the successor partnership equal to the basis they previously had in the shares of the corporate trust.

Distributions to partners shall be deemed to be paid first from previously undistributed earnings and profits of the corporate trust (both tax-free earnings and profits that were taxed to the partners upon the conversion to the partnership, and earnings and profits that were taxed to the corporate trust), until all such earnings and profits are exhausted; such distributions will not reduce the partners' Massachusetts tax basis in their partnership interests. After exhaustion of earnings and profits attributable to the former corporate trust, subsequent distributions of the successor partnership will be governed by ordinary partnership rules.

5. Change from a Corporation to a Disregarded Entity. An entity that was formerly treated as a Massachusetts corporation under M.G.L. c. 63 but for tax years beginning on or after January 1, 2009 will be treated as a disregarded entity under M.G.L. c. 62, § 1 and M.G.L. c. 63, § 30, is deemed to distribute all of its assets and liabilities to its shareholder in liquidation of the corporation. Generally, this liquidation will result in recognition of gain or loss for Massachusetts tax purposes at the corporate level, which must be reported by the corporation on its final Massachusetts return. *See generally* IRC § 336. Note that any gain must be reported even though this deemed liquidation will not result in the recognition of any federal gross income. In the event that such deemed liquidation could qualify as a tax-free liquidation under the provisions of IRC § 332 and 26 CFR 301.7701-3(g)(2) if a federal election were being made under 26 CFR 301.7701-3 that resulted in "disregarded entity" classification of an entity previously treated as a corporation for federal income tax purposes, such provisions may apply in this context for Massachusetts tax purposes as well.

As to the corporation's shareholder, ordinarily the application of federal rules to the deemed liquidation of the corporation in these circumstances would also require the recognition of gain or loss to the shareholder, and a resulting change in the basis of the former corporation's assets in the hands of such shareholder. However, to provide as much consistency in asset basis as possible between Massachusetts and federal law, the Department has determined that in these circumstances the shareholder will not recognize gain or loss upon the deemed liquidation of the corporation, and the shareholder/owner will take a Massachusetts tax basis in the assets received upon the deemed liquidation equal to the corporation's Massachusetts tax basis in such assets immediately prior to its deemed liquidation. The holding period for the shareholder in the assets will be deemed to include the corporation's former holding period in its assets.

6. Change from a Corporate Trust to a Disregarded Entity. An entity that was formerly treated as a corporate trust under M.G.L. c. 62, § 8, but for tax years beginning on or after January 1, 2009 will be treated as a disregarded entity under M.G.L. c. 62, § 1 and M.G.L. c. 63, § 30, will be treated as having been liquidated for Massachusetts purposes. Under these transition rules, the corporate trust will not generally be considered to recognize gain or loss on the deemed liquidation due to the reclassification of the corporate trust as a disregarded entity; however, all tax-free earnings and profits of the former corporate trust must be recognized as taxable dividend income to the shareholder

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or other owner on such owner's first return after the conversion. With respect to the treatment of tax-free earnings and profits, to an individual resident or non-resident owner, *see* 830 CMR 63.30.3(3)(d). The basis in assets of the former corporate trust will carry over to the shareholder/owner. The holding period for the shareholder in the assets will be deemed to include the corporate trust's former holding period in its assets.

7. Transition Rules with Respect to QSUBs. Formerly, a QSUB was subject to an entity-level tax separate from its parent. St. 2008. c. 173 changes this, and a QSUB's income, assets, and other attributes are now taken into account by the QSUB's S corporation parent, together with the parent's income, assets, and other attributes, in determining the parent S corporation's Massachusetts tax liability. The Department will not consider this change in tax status of the QSUB to a fully disregarded entity to be a liquidation or other potentially taxable event. Thus, neither the QSUB nor its parent will recognize gain or loss as a consequence of the change in taxation of the QSUB. The basis in assets of the QSUB will carry over to the S corporation parent. The holding period for the S corporation parent in the assets will be deemed to include the QSUB's former holding period in its assets. For related provisions in St. 2008, c. 173, *see* M.G.L. c. 63, § 32D. *See also* M.G.L. c. 63, § 2B, as inserted by St. 2008, c. 173, § 32. Any net operating loss or credit amounts that would have been carried forward by the QSUB will be considered as having been generated by and as available to the S corporation parent for purposes of M.G.L. c. 63, § 2B or 32D, to the extent the parent would be eligible for such carry forward or credit amount.

(b) Permanent rules applying to all M.G.L. c. 63 taxpayers; changes to the dividends received deduction for dividends received from corporate successor to corporate trust on or after July 3, 2008.

Before the enactment of St. 2008, c. 173, corporations were not allowed to take into account the dividends on shares of a corporate trust in calculating their dividends received deduction under M.G.L. c. 63, § 38(a)(1). With the elimination of separate tax provisions for corporate trusts, this clause becomes obsolete. However, St. 2008, c. 173 addresses the issue of dividends received by business corporations with respect to their ownership of shares of corporations that formerly were treated as corporate trusts under M.G.L. c. 62, § 8. The legislation provides that such dividends are not eligible for the dividends received deduction if the dividends represent tax-free earnings and profits, as defined in M.G.L. c. 62, § 8, as in effect on December 31, 2008. St. 2008, c. 173, § 57, repealing M.G.L. c. 63, § 38(a)(1)(i). *See also* St. 2008, c. 173, §§ 96, 102 (providing for transition rules effective July 3, 2008 to ensure the taxation of tax-free earnings and profits of corporate trusts under M.G.L. c. 62 and M.G.L. c. 63).

All dividends received by a corporation on or after July 3, 2008 from a corporate successor to an entity that was in existence as a corporate trust at any time on or after July 3, 2008 shall first be deemed to have been paid out of tax-free earning and profits of the paying entity, to the extent there are remaining tax-free earnings and profits that have not been subject to Massachusetts taxation, and to that extent shall be fully taxable as dividend income without regard to the dividends received deduction. A corporation that was previously a corporate trust, or a successor thereto, that is paying such dividends must notify the recipient of the extent to which the dividends are deemed to represent such tax-free earnings and profits. To the extent of such taxable dividends out of tax-free earnings and profits of a predecessor corporate trust, in a case where the recipient corporation's basis in the shares of the former corporate trust had been reduced (pursuant to M.G.L. c. 63, § 31M, added by St. 2008, c. 173, § 46) on account of the tax-free earnings and profits that are being distributed, the recipient corporation may readjust its basis in the shares of the payor upwards in the amount of tax-free earnings and profits distributed and taken into income.

The Department will issue regulations regarding the combined reporting obligations of certain corporations, as set forth in St. 2008, c. 173. *See* St. 2008, c. 173, § 48, adopting M.G.L. c. 63, § 32B. 830 CMR 63.30.3 will, among other things, set forth the rules for the elimination of certain dividends among members of the combined reporting group, as a general matter, and for an exception to such elimination in the case of dividends from a former corporate trust.

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(c) Permanent Rules Applying to all M.G.L. c. 62 Taxpayers.

1. Taxation of Dividends Received from Corporate Trust or Successor. Before adoption of St. 2008, c. 173, in determining Massachusetts gross income pursuant to M.G.L. c. 62, taxpayers deducted from their federal gross income "dividends received from a corporate trust subject to taxation under [M.G.L. c. 62] to the extent that such dividends are exempt from taxation under [M.G.L. c. 62, § 8]." M.G.L. c. 62, § 2(a)(2)(D). This deduction has been revised in light of the repeal of M.G.L. c. 62, § 8, and as of taxable years beginning on or after January 1, 2009, the deduction from federal gross income will apply to "dividends received from a corporate trust subject to taxation under M.G.L. c. 62, § 8, as in effect on December 31, 2008, to the extent that they are derived from earnings and profits previously taxed to the trust under M.G.L. c. 62, § 8, but only to the extent that the trust properly filed returns and paid all taxes due." M.G.L. c. 62, § 2(a)(2)(D). *See also* St. 2008, c. 173, § 12, repealing M.G.L. c. 62, § 2(a)(1)(E), which formerly added to federal gross income to be used in calculating tax liability "[a]mounts excluded under Subchapter S of the [Internal Revenue] Code with respect to a federal S corporation which is subject to taxation under [M.G.L. c. 62] as a corporate trust."; St. 2008, c. 173, § 13, repealing M.G.L. c. 62, § 2(a)(2)(B), which formerly deducted from federal gross income in calculating tax liability "[a]mounts included under Subchapter S of the [Internal Revenue] Code with respect to a federal S corporation which is subject to taxation under [M.G.L. c. 62] as a corporate trust."; St. 2008, c. 173, § 15, repealing M.G.L. c. 62, § 2(d)(1)(J), which formerly allowed as a deduction from Part B gross income "[a]ny deduction allowed by Subchapter S of the [Internal Revenue] Code with respect to a federal S corporation which is subject to taxation under [M.G.L. c. 62] as a corporate trust."

All dividends received on or after July 3, 2008 from an entity (whether classified as a corporation or otherwise) that was subject to treatment as a corporate trust at any time on or after July 3, 2008, or a successor thereto, are taxable to a recipient who is taxable under M.G.L. c. 62 unless they are derived from earnings and profits previously taxed to the corporate trust under M.G.L. c. 62, § 8 and the corporate trust properly filed returns and paid all taxes due. *See* St. 2008, c. 173, § 96. With respect to dividends paid out of tax-free earnings and profits accumulated by a corporate trust, Massachusetts resident taxpayers will be allowed a credit for income taxes paid to other jurisdictions on such dividends and non-residents are taxable as described and to the extent provided in 830 CMR 63.30.3(3)(d)2. *See* M.G.L. c. 62, § 6(a).

2. Shareholders of an S Corporation that was Formerly Taxed as a Corporate Trust. Before adoption of St. 2008, c. 173, shareholders of a federal S corporation that was treated for Massachusetts purposes as a corporate trust taxable under M.G.L. c. 62, § 8 were not subject to tax on their distributive share of income. M.G.L. c. 62, § 17A. St. 2008, c. 173 repeals these provisions. Shareholders of S corporations are now subject to tax on their total distributive share of income, under M.G.L. c. 62, § 17A. In addition, all distributions from an S corporation to its shareholders are taxable as dividend income to the shareholders to the extent they are paid out of tax-free earnings and profits derived from a former corporate trust or successor. *See* 830 CMR 63.30.3(3)(d). Further rules applicable to the ordering and treatment of distributions from an S corporation that was formerly treated as a corporate trust are set out in 830 CMR 63.30.3(4)(a)2.a.

With respect to the treatment of capital losses attributable to corporate trusts that become S corporations after July 3, 2008, *see* 830 CMR 63.30.3(4)(a)2.a., last paragraph.

(5) Changes in Estimated Tax Payment Responsibilities.

(a) General Rules. A taxpayer whose filing status changes pursuant to St. 2008, c. 173 or 830 CMR 63.30.3 from a M.G.L. c. 62 filer to a M.G.L. c. 63 filer, or vice versa, and where applicable its owners or members, are required to adjust their estimated tax payments accordingly. For tax years beginning prior to January 1, 2009, the effective date of the legislative changes, taxpayers subject to tax under M.G.L. c. 62 must continue to make payments of estimated tax if required to do so under M.G.L. c. 62B, §§ 13, 14 for that tax year. If the same entity, or successio, is classified as a corporation for tax years beginning on or after January 1, 2009, the entity shall be subject to the estimated tax payment rules set

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forth at M.G.L. c. 63B, as modified by certain transition rules set forth in 830 CMR 63.30.3(5)(b)1. through 3. For tax years beginning prior to January 1, 2009, taxpayers subject to tax under M.G.L. c. 63 must continue to make payments of estimated tax if required to do so under M.G.L. c. 63B for that tax year. If the same entity, or successor, is classified as a partnership or as a disregarded entity to the extent owned by M.G.L. c. 62 taxpayers, for tax years beginning on or after January 1, 2009 the partners or other owners shall be subject to the estimated tax payment rules at M.G.L. c. 62B, §§ 13, 14, as modified by certain transition rules set forth in 830 CMR 63.30.3(5)(b)1. through 3. Taxpayers are required to register with the Department under their proper classification at the beginning of their first taxable year on or after January 1, 2009.

The corporate estimated tax payment rules are found at 830 CMR 63B.2.2. Note that as a general rule, these tax payments are not of equal amount, and are front-weighted. This contrasts with the estimated tax filing rules under M.G.L. c. 62B, § 13 through 15, applicable to individuals, where the general rule requires four equal payments of the estimated tax due.

(b) Specific Rules. One of the statutory methods for determining estimated tax payments, for both corporate excise and personal income tax purposes, is to base the payments on the prior year's tax due. *See* M.G.L. c. 62B, § 14(c), M.G.L. c. 63B, § 3(c). To account for differences in taxpayer classification, the following transition rules apply for estimated payments in the year of the change. Nothing in 830 CMR 63.30.3 is intended to abridge the requirements imposed under 830 CMR 63B.2.2; in particular, rules applying to large corporations, as noted in 830 CMR 63B.2.2(8) apply to all entities affected by St. 2008, c. 173.

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1. Shareholders in a Successor to a Corporate Trust. A shareholder in an entity that was formerly taxed at the entity level under M.G.L. c. 62, § 8, may now be taxable as a partner in a partnership or as an owner of a disregarded entity for tax years beginning January 1, 2009. In making estimated tax payments on account of their earnings from the partnership or disregarded entity, in cases where their "required annual payment" is based on the prior year formula set forth at M.G.L. c. 62B, § 14(c)(ii), resident shareholders must take into account their proportionate share of the former corporate trust's tax due for the prior tax year. Further, in such cases, non-resident shareholders must base their estimated tax payments for the first year of the change in filing status on the personal income tax rate as applied to their proportionate share of the former corporate trust's Massachusetts source income for the prior tax year.

2. S Corporations and Their Shareholders. Pursuant to St. 2008, c. 173, a federal S corporation is a Massachusetts S corporation, irrespective of its treatment under prior law. In some cases, the income of S corporation shareholders previously would not have included S corporation distributive share income for Massachusetts income tax purposes because the S corporation was previously taxed in Massachusetts only at the entity-level (*e.g.*, as a corporate trust under M.G.L. c. 62, § 8, or as financial institution under M.G.L. c. 63, §§ 1 through 7), but the shareholders' estimated tax payments may nonetheless be based on the tax due from the preceding taxable year. In these cases, the shareholders must calculate their estimated taxes as they relate to the S corporation's income based on what the personal income tax for the preceding taxable year would have been with respect to the shareholder's distributive share of the entity's income, loss, deduction and credit if the entity been treated as an S corporation for Massachusetts tax purposes. Further, non-resident shareholders must use the apportionment percentage of the former corporate trust or financial institution for the preceding taxable year in calculating their estimated payments, to the extent required under M.G.L. c. 62B, § 14(c)(ii). The S corporation must provide its shareholders with all information necessary for shareholders to comply with these requirements.

Pursuant to St. 2008, c. 173, S corporations and their QSUBs are no longer subject to separate taxation, and are evaluated together for income and non-income measure purposes. *See* M.G.L. c. 63, § 32D, as amended by St. 2008, c. 173, §§ 49 through 53. To ensure proper calculation of estimated tax payments required under M.G.L. c. 63B, to the extent the estimated payment of the entity is based on the prior year's tax due, according to the rules at 830 CMR 63B.2.2, the amount must be based on the sum of the tax due for the S corporation and its QSUBs for the preceding taxable year, as that term is defined at 830 CMR 63B.2.2(2). In many cases, estimated tax payments after the first of four required estimates must be based on the entity's actual circumstances during the current taxable year, according to 830 CMR 63B.2.2(8)(b)1.

In addition to the preceding general rule, an S corporation that was formerly subject to taxation as either a corporate trust, under M.G.L. c. 62, § 8, or as a financial institution, under M.G.L. c. 63, §§ 1 through 7, must recalculate its tax due for the preceding taxable year as though the entity had been subject to taxation under M.G.L. c. 63, § 32D or 2B including the income of its QSUBs, to the extent the first payment due is based on the income tax liability of the preceding taxable year.

3. C Corporations. In some cases an entity the income of which formerly was subject to taxation under M.G.L. c. 62 is now subject to taxation under M.G.L. c. 63 and therefore under the new statutory scheme must determine its estimated tax payment due under 830 CMR 63B.2.2. In these cases, to the extent the required annual payment is properly based on the tax due in the preceding taxable year, under 830 CMR 63B.2.2(8)(b), the entity must calculate its tax liability for the entity for the preceding year as if the entity had been subject to tax under M.G.L. c. 63. In many cases, payments after the first of four required estimates must be based on the entity's actual circumstances during the taxable year, according to the rule set forth at 830 CMR 63B.2.2(8)(b)1.

63.31.1: Add Back of Interest or Intangible Expense

(1) Purpose, General Rule, and Outline.

(a) Purpose. The purpose of 830 CMR 63.31.1 is to explain the add back of related member interest or intangible expense, as provided in M.G.L. c. 63, §§ 31I, 31J and 31K, including the add back of related member interest expense that derives from dividend notes or similar obligations, as referenced in M.G.L. c. 63, § 30.4. 830 CMR 63.31.1 extends to the computation of "net income" under M.G.L. c. 63 generally, and therefore applies to foreign and domestic corporations, financial institutions and utility corporations.

(b) General Rule. Generally, a taxpayer must add back to net income related member interest and intangible expense. The add back rule applies, *inter alia*, to losses incurred in connection with factoring or discounting transactions; interest expense paid, accrued or incurred in connection with a dividend note or similar obligation; and certain acquisition interest expense that is paid, accrued or incurred to a person or entity that is not a related member. This general rule is subject to certain exceptions.

(c) Exceptions to the General Rule. Notwithstanding the provisions of 830 CMR 63.31.1(1)(b), a taxpayer is permitted to establish by clear and convincing evidence that a particular add back would be unreasonable, as further defined by 830 CMR 63.31.1. Also, a taxpayer is permitted to claim other specific exceptions to the general rule stated in 830 CMR 63.31.1(1)(b), as further explained by 830 CMR 63.30.3. A taxpayer that seeks to claim that the add back of a particular interest or intangible expense would be unreasonable or that otherwise claims an exception to the general rule stated in 830 CMR 63.31.1(1)(b) must do so on a schedule completed as required by the Commissioner and filed as part of its tax return.

(d) Outline. 830 CMR 63.31.1, is organized as follows:

1. Purpose, General Rule, Exceptions to the General Rule, and Outline
2. Definitions
3. Add Back of Related Member Interest or Intangible Expense
4. Exceptions to Add Back of Related Member Interest or Intangible Expense
5. Add Back Exception when Related Member Resides in a Nation that is Party to a U.S. Bilateral Income Tax Treaty
6. Filing Schedule; Claiming an Add Back Exception
7. Requests for More Information; Procedure for Evaluating an Exception Claim
8. No Limitations as to Other Agreements, Compromises or Adjustments
9. Interaction with Determination as to Existence of Net Operating Loss
10. Interaction with Taxation of a Related Member

(2) Definitions. For the purposes of 830 CMR 63.31.1 the following terms have the following meanings unless the context requires otherwise:

Acquisition Interest Expense, interest paid, accrued or incurred by a taxpayer with respect to debt to a person or entity that is not a related member where the debt was incurred to acquire the taxpayer's assets or stock in a transaction that is referenced in Code § 368.

Aggregate Effective Rate of Tax, the sum of the effective rates of tax imposed on a related member by a state or U.S. possession or foreign nation or any combination thereof.

Clear and Convincing Evidence, evidence that is so clear, direct and weighty that it will permit the Commissioner to come to a clear conviction without hesitancy of the validity of the taxpayer’s claim. This evidentiary standard requires a strong showing of proof that instills a degree of belief greater than is required under the preponderance of evidence standard.

Code, the federal Internal Revenue Code as amended and in effect for the taxable year.

Economic Substance, a transaction has economic substance when it involves material economic risk and has material practical economic consequences other than the creation of a tax benefit.

Embedded Royalty, portion of a cost or expense paid, accrued or incurred by a taxpayer for property received from or services rendered by a related member that relates to intangible property owned by such related member or to an intangible expense paid, accrued or incurred by said related member in a direct or indirect transaction with one or more other related members.

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Effective Rate of Tax, as to any state or U.S. possession or foreign nation, the maximum statutory rate of tax imposed by the jurisdiction on a related member's net income multiplied by the apportionment percentage, if any, applicable to the related member under the laws of the jurisdiction. For purposes of 830 CMR 63.31.1(2): Effective Rate of Tax, the effective rate of tax as to any jurisdiction is zero where the related member's net income tax liability in the jurisdiction is computed on a combined or consolidated return that includes both the taxpayer and the related member and where the transactions giving rise to the interest or intangible expense between the taxpayer and the related member are substantially eliminated or substantially offset each other. When determining the effective rate of tax imposed upon a related member, it is not generally relevant whether and to what extent the related member's actual tax to be paid to one or more jurisdictions is reduced by deductions, losses, credits, etc. However, when computing the effective rate of tax for a jurisdiction in which a related member's net income is eliminated or offset by a credit or similar adjustment that is dependent upon the related member either maintaining or managing intangible property or collecting investment income in that jurisdiction, the maximum statutory rate of tax imposed by said jurisdiction shall be decreased to reflect the statutory rate of tax that applies to the related member as effectively reduced by such credit or similar adjustment.

Intangible Expense, includes, without limitation:

(a) expenses, losses and costs for, related to, or in connection directly or indirectly with the direct or indirect acquisition, use, licensing, maintenance, or management, or ownership, or the sale, exchange, or any other disposition, of intangible property to the extent such amounts are allowed as deductions or costs in determining taxable income before operating loss deductions and special deductions for the taxable year under the Code;

(b) losses related to, or incurred in connection directly or indirectly with, factoring transactions or discounting transactions;

(c) royalties, fees, technical charges, and other costs or expenses paid or incurred for or related to the acquisition, use, licensing, maintenance, or ownership of patents, copyrights, trademarks and trade names, know-how, and other intangible property;

(d) other similar expenses and costs; and

(e) amounts directly or indirectly allowed as deductions under Code § 163 for purposes of determining taxable income under the Code to the extent such expenses and costs are directly or indirectly for, related to, or in connection with the direct or indirect acquisition, use, licensing, maintenance, management, ownership, sale, exchange or disposition of intangible property.

Intangible Property, patents, patent applications, trade names, trademarks, service marks, copyrights, mask works, know-how, trade secrets, and similar types of intangible assets.

Interest Expense, amounts directly or indirectly allowed as deductions under Code § 163 for purposes of determining taxable income under the Code, including acquisition interest expense, other than amounts that are included in the definition of "intangible expense." The term interest expense includes an expense paid, accrued or asserted in connection with a dividend of a note or similar obligation that states the requirement that such interest is to be paid by the corporation that dividends such obligation to its shareholder(s).

Related Member, a person that, with respect to the taxpayer during all or any portion of the taxable year, is:

(a) a related entity;

(b) a component member as defined in subsection (b) of Code § 1563;

(c) a person to or from whom there is attribution of stock ownership in accordance with subsection (e) of Code § 1563; or

(d) a person that, notwithstanding its form of organization, bears the same relationship to the taxpayer as a person described in 830 CMR 63.31.1(2): Related Member(a) through (c).

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Related Entity:

(a) a stockholder who is an individual, or a member of the stockholder's family set forth in Code § 318, if the stockholder and the members of the stockholder's family own, directly, indirectly, beneficially or constructively, in the aggregate, at least 50% of the value of the taxpayer's outstanding stock;

(b) a stockholder, or a stockholder's partnership, limited liability company, estate, trust or corporation, if the stockholder and the stockholder's partnerships, limited liability companies, estates, trusts and corporations own directly, indirectly, beneficially or constructively, in the aggregate, at least 50% of the value of the taxpayer's outstanding stock; or

(c) a corporation, or a party related to the corporation in a manner that would require an attribution of stock from the corporation to the party or from the party to the corporation under the attribution rules of the Code if the taxpayer owns, directly, indirectly, beneficially or constructively, at least 50% of the value of the corporation's outstanding stock. The attribution rules of the Code shall apply for purposes of determining whether the ownership requirements of this definition have been met.

Statutory Rate of Tax, the rate of tax that applies to the taxpayer under M.G.L. c. 63 without any consideration as to the taxpayer's apportionment percentage, if any.

Valid Business Purpose, a good-faith business purpose, other than tax avoidance, that was, either alone or in combination with one or more other good-faith business purposes, the primary motivation for entering into a transaction. To qualify as a valid business purpose within the meaning of this regulation, the purpose or purposes must be commensurate with the value of the tax benefit claimed. For purposes of 830 CMR 63.31.1(2): Valid Business Purpose, an intention to reduce taxes in any state or other jurisdiction or under the Code is not a valid business purpose.

(3) Add Back of Related Member Interest or Intangible Expense.

(a) Intangible Expense Add Back. For purposes of computing net income under M.G.L. c. 63, a taxpayer shall add back otherwise deductible intangible expense directly or indirectly paid, accrued or incurred to, or in connection directly or indirectly with one or more direct or indirect transactions with, one or more related members. This provision applies, *inter alia*, in the instance of an embedded royalty and also as to a loss related to or incurred directly or indirectly with a factoring or discounting transaction entered into with a related member.

(b) Interest Expense Add Back. For purposes of computing net income under M.G.L. c. 63, a taxpayer shall add back otherwise deductible interest expense directly or indirectly paid, accrued or incurred to one or more related members including related member interest expense that derives from a dividend note or a similar obligation. In addition, a taxpayer shall add back otherwise deductible acquisition interest expense.

(4) Exceptions to Add Back of Related Member Interest or Intangible Expense.

(a) Full Exceptions. The add back required by 830 CMR 63.31.1(3)(a) or (b) shall not be required in the following instances.

1. Exception Because Add Back Would be Unreasonable. The taxpayer establishes by clear and convincing evidence that the add back would be unreasonable.

a. Add back unreasonable where it would result in significant actual double taxation. The add back adjustment will be considered unreasonable where the taxpayer establishes by clear and convincing evidence that the interest or intangible expense was paid, accrued or incurred to a related member that is taxed on the corresponding income by a state, U.S. possession or foreign jurisdiction or any combination thereof at an aggregate effective rate of tax that is within three percentage points of the taxpayer's statutory rate of tax. A taxpayer that seeks to claim this exception must file the applicable schedule with its tax return setting forth the information required by the Commissioner. For purposes of verifying the taxpayer's claim, the Commissioner requires that the taxpayer retain and produce upon request the relevant copy or copies of the tax returns of the related member(s) in question. The Commissioner may contest an exception that is claimed on this basis when, irrespective as to the taxpayer's claim and the numeric computation reflected therein, the underlying transaction lacks either a valid business purpose or economic substance or a principal purpose of the transaction was the avoidance of taxes. This exception does not apply in the instance of an acquisition interest expense.

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Example 1. Orange Corp. is a corporation that is engaged in business in Massachusetts and is taxed at a statutory rate of tax of 9.5% under M.G.L. c. 63, § 39. Purple Corp. is a related member corporation that loans funds to Orange Corp. Purple Corp. apportions one-quarter of its income to each of the following four states and is taxed on the interest income at the maximum statutory rate noted: State A (7.5%), State B (8.25%), State C (8%), and State D (7%). Purple Corp. has no property, payroll or sales or any other activity in any other state or jurisdiction. Also, there is no basis to question whether the underlying transaction is supported by a valid business purpose or economic substance or whether a principal purpose of the transaction was the avoidance of taxes. Given these facts, Purple Corp.'s effective rate of tax in the four states referenced is 7.69% (the number obtained by multiplying for each state that state's statutory rate of tax by each state's respective apportionment percentage of 25%, then adding the four numbers together). Because Purple Corp. is actually taxed on the interest income in question at an aggregate effective rate of tax that is within 3% of the statutory rate of tax applied to Orange Corp., the Commissioner will recognize a full exception to the statutory add back for the interest paid by Orange Corp. to Purple Corp. in connection with the loan.

Example 2. Same facts as in Example 1, except that Orange Corp. files a combined report in State C that includes Orange Corp. and Purple Corp. where the transactions between Orange Corp. and Purple Corp. eliminate or offset. Because Purple Corp.'s effective rate of tax in State C is now zero for purposes of 830 CMR 63.31.1, Purple Corp.'s aggregate effective rate of tax in the four states referenced is now 5.6875%. Since Purple Corp. is not actually taxed on the interest income at an aggregate effective rate of tax that is within 3% of the statutory rate of tax applied to Orange Corp., the Commissioner will not recognize a full exception to the statutory add back for Orange Corp. based upon the tax applied to Purple Corp. However, a partial add back exception will be available under 830 CMR 63.31.1(4)(b)1.

Example 3. Indigo Corp. is a corporation that is engaged in business in Massachusetts and is taxed at a statutory rate of tax of 9.5% under M.G.L. c. 63, § 39. Violet Corp. is a related member corporation that owns and manages intangible property and that licenses the use of such intangible property to Indigo Corp. Violet Corp. is subject to tax only in State A. Violet Corp. has no property, payroll or sales or any other activity in any other state or jurisdiction. The maximum statutory rate of tax to be applied to Violet Corp.'s net income in State A is 8.7%. However, State A confers a credit upon corporations that own or manage intangible property in that state that, in and of itself, results in Violet Corp. not owing any net income tax to that state. Because the effective rate of tax of Violet Corp. in State A is reduced to zero as a result of that state's credit for the management of intangible property, the Commissioner will not recognize a full exception to the statutory add back for Indigo Corp. under 830 CMR 63.31.1(4)(a)1.a.

b. Add back unreasonable where taxpayer proves by clear and convincing evidence that underlying transaction was primarily motivated by valid business purpose and supported by economic substance. The add back will also be considered unreasonable where the taxpayer establishes by clear and convincing evidence that it incurred the interest or intangible expense as a result of a transaction that was primarily entered into for a valid business purpose and that is supported by economic substance. However, a taxpayer will not carry its burden of demonstrating by clear and convincing evidence that a disallowance is unreasonable unless the taxpayer demonstrates that reduction of tax was not a principal purpose for the transaction. In cases that pertain to an interest expense this exception includes a requirement that the taxpayer establishes by clear and convincing evidence that the purported underlying debt is *bona fide* debt. The taxpayer must also establish by clear and convincing evidence that its interest or intangible expense reflects fair value or fair consideration. *See* M.G.L. c. 63, §§ 33 and 39A.

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In general, a taxpayer seeking to claim this exception must file a schedule with its tax return setting forth the information that is required by the Commissioner. The taxpayer must also prepare with its tax return and make available to the Commissioner upon his request, either with its tax return or otherwise as requested by the Commissioner, a supporting statement that includes the information referenced in 830 CMR 63.31.1(4)(2)(a)i. through vii. identifying any referenced documents where appropriate. Further, the taxpayer must include as part of its supporting statement any additional information and references to any additional documents that would be necessary or helpful for the Commissioner to evaluate the taxpayer's add back exception claim. Unless all relevant evidence is incorporated into the taxpayer's supporting statement and attachments, if any, the taxpayer's supporting statement must clearly identify the other evidence on which the taxpayer relies.

i. Specific Statement as to the Valid Business Purpose for the Transaction that Gave Rise to the Expense. The taxpayer's business purpose or purposes for its transaction should be stated as specifically as possible and not stated in the abstract. Also, the taxpayer's business purpose or purposes should be related to discrete business activity that is conducted by the taxpayer or activity that the taxpayer is planning to conduct. General statements as to business purpose are insufficient to satisfy the clear and convincing evidence standard. In addition to its statement of business purpose, the taxpayer should identify each of the elements of the transaction that it relies upon to support a finding of economic substance. In the case of an intangible expense, the Commissioner will be skeptical of an asserted business purpose or an element of the transaction asserted to demonstrate economic substance where such purpose or element is generic to the intangible holding company structure and not specifically related to the operation of the taxpayer's business.

ii. Description of the Transaction. The taxpayer's statement should provide a detailed description of the transaction that generated the claimed deduction. For example, if the deduction is claimed pursuant to a written contract, the taxpayer should briefly describe the transaction governed by the contract and should provide the date of the contract, the relevant terms, and a statement as to whether the transacting parties are in compliance with said terms. In the specific instance of a dividend note or similar obligation, the taxpayer should briefly describe the transaction and state the material terms of the note, including the date, term, and the principal and interest payment schedule. In the specific case of a discounting or factoring loss, the taxpayer should briefly describe the methodology by which the transfer price, and thus the loss, was determined. If the taxpayer entered into the transaction on the advice of a tax advisor, or if the terms of the engagement with a tax advisor measured the fee paid to the advisor directly or indirectly by reference to the actual or anticipated tax savings derived from the transaction, the taxpayer should note this fact. In these latter circumstances, the Commissioner is more likely to reject the exception claim. The taxpayer should also reference any other affirmative evidence that would tend to prove that tax avoidance was not a principal purpose for the transaction.

iii. Basis for the Payment Amounts. The taxpayer must state the basis for its determination that the amount of the claimed expense is substantially identical to what would be expended in an arm's length transaction under substantially similar circumstances. In making this statement the taxpayer may make reference to appropriate rules concerning arm's length charges set forth in Code § 482, including the rules that relate to the imposition of an arm's length rate of interest. If for purposes of showing that the amount of its claimed expense was fair, the taxpayer is relying upon an appraisal or a study, the taxpayer should identify this appraisal or study and its preparer, and state the date on which it was issued and the general conclusions thereof. Where a taxpayer cannot show by clear and convincing evidence that the amount of its asserted deduction was fair, the Commissioner in his discretion may adjust the expense so that it will reflect fair value or fair consideration, or, alternatively, deny the taxpayer's exception claim in its entirety.

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iv. Statement that there was no "Circular Flow of Funds." The taxpayer's statement should indicate whether the claimed expense was actually paid and, if so, whether the cash was substantially returned to the taxpayer in whole or in part, including through the form of a loan or loans. In cases in which the cash was returned to the taxpayer either in whole or in part, the taxpayer should state when the cash was returned to the taxpayer and in what manner, including the terms of the loans or loans, if any. The Commissioner will generally reject an exception claim when it is based upon a purported expense with respect to which no actual transfer of funds was made or with respect to which funds were substantially returned to the taxpayer, either directly or indirectly, within a short period of time.

v. Statement as to the Acquisition of Intangibles. In the case of an intangible expense, the taxpayer's statement should explain how the related member obtained the intangibles in question. In general, the Commissioner will be more likely to accept an asserted add back exception for an intangible expense when the intangibles were either developed by the related member that receives the payment or were purchased by the related member in a *bona fide* arm's length sales transaction.

vi. Statement of Capitalization for Purposes of Loan Payments. In the case of interest expense, the taxpayer's statement should briefly explain what the taxpayer's capital structure was at the time that it incurred the purported debt in question. In many instances a copy of the taxpayer's separate-company balance sheet on its Massachusetts tax return for the year the debt was incurred will suffice for this purpose. The Commissioner generally will also review the taxpayer's balance sheet for the year of the potential add back as part of his analysis of the adequacy of the taxpayer's capitalization. The taxpayer's statement may include such other information as the taxpayer believes may be helpful in assessing its capital structure.

vii. Statement as to Whether the Loan is "Acquisition Debt." In the case of interest expense, the taxpayer's statement should also indicate whether the interest expense constitutes acquisition interest expense within the meaning of this regulation. In general, an exception to the add back for an interest expense will not be regarded as appropriate in such cases.

Examples. The following examples are intended to illustrate the application of 830 CMR 63.31.1(4)(a)1.b. In each of these examples, it should be assumed, unless otherwise stated, that no other exception applies. Also, it should be assumed that in each case the taxpayer that requests the add back exception has filed a completed schedule referencing the claimed exception and required information as part of its tax return and has provided the Commissioner upon his request with a supporting statement that was prepared contemporaneously with the taxpayer's tax return. Further, it should be assumed that there are no additional material facts or circumstances that would alter the determination as stated in each example. In each case in which an example refers to a taxpayer's proof that its transaction was not "entered into for tax avoidance purposes," the example refers to proof as to whether the transaction was entered into for a valid business purpose and is supported by economic substance, as well as proof that the reduction of tax was not a principal purpose for the transaction.

Example 1. Pre-existing licensing contract between unrelated parties that become related parties but continue to stand in relation to each other as if unrelated; sufficient proof presented that add back exception is justified. Abel Corp. is engaged in manufacturing operations in Massachusetts and has been licensing technology from Baker Corp., an unrelated out-of-state corporation. Baker Corp. acquires a controlling interest in Abel Corp., but Abel Corp. continues to use Baker Corp's technology pursuant to the pre-existing licensing contract. Although Baker Corp. has acquired a controlling interest in Abel Corp., the two corporations continue to stand in relationship to one another as if they are unrelated. Consequently, Abel Corp. can establish that not only was the licensing transaction not entered into for tax avoidance purposes, but that the intangible expense continues to reflect an arm's length charge. The Commissioner will recognize an exception to the statutory add back for the royalties paid by Abel Corp. to Baker Corp. pursuant to the pre-existing licensing contract.

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Example 2. Overstated intangible expense justifies denial of entire add back exception or arm's length adjustment. An out-of-state corporation, Carter Corp., licenses intangibles that it owns and has developed to unrelated out-of-state entities that manufacture and sell goods to which the intangibles relate. The unrelated entities pay a royalty fee to Carter Corp. that comprises payment for manufacturing-related intangibles and also for an exclusive right to sell the manufactured product within a defined region. Carter Corp. previously formed Delta Inc., a wholly owned corporation that is to operate stores in Massachusetts. Carter Corp. previously caused Delta Inc. to enter into a contract with it pursuant to which Delta Inc. has the exclusive right to sell products that are manufactured by another subsidiary of Carter Corp. within a certain territory. The terms of this licensing contract require Delta Inc. to pay Carter Corp. a royalty fee in connection with its in-state retail sales. Although Delta Inc., unlike Carter Corp.'s unrelated licensees, merely sells products that it purchases from Carter Corp., the percentage royalty that Delta Inc. seeks to deduct is similar to that paid by Carter Corp's unrelated licensees. It is assumed for purposes of this example that Delta Inc. can show that the transaction was not entered into for tax avoidance purposes. However, note that despite this assumption the royalty paid by Delta Inc. is apparently in excess of fair value. Therefore, in the absence of other facts to support the amount of Delta Inc.'s asserted royalty deduction, the Commissioner will either deny the claimed add back exception or adjust the royalty to correspond to an arm's length rate.

Example 3. Pre-existing loan between unrelated parties that become related parties; purported debt shown to be true debt. Exit Corp., a Massachusetts utility corporation that is subject to tax under M.G.L. c. 63, § 52A, has an outstanding loan in place with Fire Co., which is an unrelated corporation doing business outside the state. Fire Co. later acquires Exit Corp. and Exit Corp. continues to make interest payments to Fire Co. in accordance with the pre-existing loan agreement. Because the debt was *bona fide* when incurred and the parties continue to abide by the terms of the pre-existing loan agreement, the Commissioner will recognize an exception to the statutory add back for the interest paid by Exit Corp. to Fire Co.

Example 4. Related member's management operates in arm's length manner; purported debt shown to be true debt. Groom Corp. is engaged in manufacturing operations in Massachusetts and is acquired by Hire Corp., which is an out-of-state corporation that is in a service business. Although Hire Corp. formally controls Groom Corp. by reason of its acquisition, Hire Corp. permits the separate management of Groom Corp. to continue to independently run the operations of that entity. The management of Groom Corp. determines that Groom Corp. needs to take on debt to fund expansion of the manufacturing business. Although Groom Corp. could borrow funds from an unrelated party, its management decides to borrow these funds from Hire Corp. Groom Corp. and Hire Corp. then enter into a formal loan agreement and Groom Corp. subsequently uses the borrowed funds for bona fide business purposes as planned. Further, Groom Corp. makes regular payments on the loan in accordance with the loan terms. Assuming that the terms of the loan, including the stated interest rate, closely resemble what would be used in an arm's length transaction under substantially similar circumstances, the Commissioner will recognize an exception to the statutory add back.

Example 5. Dividend note; insufficient proof that transaction was not entered into for tax avoidance purposes. Idle Corp., an out-of-state corporation, enters into an agreement with an unrelated corporation, Sell Corp., to acquire Jewel Co., a Massachusetts utility corporation that is a wholly owned subsidiary of Sell Corp. Subsequent to the acquisition of Jewel Co., Jewel Co. declares a dividend of a note to Idle Corp. that substantially replicates the terms of Idle Corp.'s loan agreement with the unrelated lender. Jewel Co. seeks to claim significant tax savings in Massachusetts by reason of the use of the note. The dividend is declared in connection with Idle Corp.'s acquisition of Jewel Co., but, nonetheless, a principal purpose for use of the dividend note was to create tax deductions on the part of Jewel Co. Because this is so, the Commissioner will not recognize an add back exception for interest deductions that are asserted by Jewel Co. in connection with the dividend of the note.

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Example 6. Use of Net Operating Losses (NOLs) in context of purported debt creates inference that transaction was entered into for tax avoidance purposes. An individual, Mr. Knoll, owns and operates Luther Corp., a profitable Massachusetts corporation. Mr. Knoll acquires Mother Inc., a second Massachusetts corporation engaged in a similar line of business, which Mr. Knoll will also manage. Mother Inc. is profitable during the tax year in question, but because it has substantial net operating losses from prior years, it will have not any Massachusetts tax liability for the tax year. In fact, there is a real risk that most of Mother Inc.'s net operating loss carry forwards will expire unused for Massachusetts purposes. Mr. Knoll causes Mother Inc. to loan monies to Luther Corp. to use in Luther Corp.'s general operations and also causes Luther Corp. to make regular payments on the loan. Most of the funds that are lent to Luther Corp. are not actually used in its general operations during the tax year at issue. These facts suggest that the loan transaction between Luther Corp. and Mother Inc. may have been entered into for tax avoidance purposes, *i.e.*, generating interest income to Mother Inc. to absorb otherwise expiring NOLs. The Commissioner will not recognize an exception to the statutory add back for the interest deductions that are asserted by Luther Corp. if a principal purpose for the loan transaction was tax avoidance.

Example 7. Purported debt shown to be true debt; sufficient proof presented that transaction was not entered into for tax avoidance purposes. Niles Co. is a technology start-up corporation doing business in Massachusetts that is owned by two individuals, one of whom resides in Massachusetts and one of whom does not. Niles Co.'s rate of tax under the Massachusetts statute is 9.5%. The rate at which the Massachusetts resident is taxed is 5.3% and the rate at which the non-resident is taxed is 4.75%. To help fund the expansion of the business the two individuals loan monies to the corporation and execute notes reflecting arm's length interest and terms that would pass muster under Code § 482 (irrespective of whether Code § 482 applies to the transaction). There are no factors that suggest that the loan should be recharacterized as a contribution to capital. Further, Niles Co. uses the loan funds in its business, and makes regular payments on the loan in accordance with the loan terms. Because Niles Co. can make the requisite showing that the transaction was not entered into for tax avoidance purposes, the Commissioner will recognize a full exception to the statutory add back. Note that a full exception based on the notion of substantial actual double taxation would not be appropriate on these facts because neither of the two related individual shareholders is taxed at a rate of tax within 3% of Niles Co.'s statutory in-state rate. *See* 830 CMR 63.31.1(4)(a)1.a. However, if a full exception were not appropriate, the Commissioner would recognize a partial exception to the statutory add back based upon the fact that each of the two individuals was actually taxed on the interest income in question. *See* 830 CMR 63.31.1(4)(b)1.

Example 8. Use of affiliated insurance company in context of purported debt creates inference that transaction was entered into for tax avoidance purposes. A parent corporation, Parent, owns a controlling interest in two subsidiaries, Result Corp. and Sister Inc., which conduct business operations solely in Massachusetts. Result Corp. conducts general business operations, whereas Sister Inc. is an insurance company within the meaning of M.G.L. c. 63, § 20, *et seq*. Parent capitalizes Sister Inc. with more money than it needs to conduct its insurance operations and then causes Sister Inc. to lend the excess cash to Result Corp. Interest payments made by Result Corp. to Sister Inc. are not taxable to Sister Inc. because insurance companies are only taxable on their insurance premiums. Result Corp. seeks to claim significant tax savings in Massachusetts by reason of this transaction. Assuming that a principal purpose for the loan transaction was tax avoidance, the Commissioner will not recognize an exception to the statutory add back for the interest deductions that are asserted by Result Corp.

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Example 9. Dividend note; international tax restructuring suggests transaction was entered into for tax avoidance purposes. Total Co., a multinational corporation that is organized and has a headquarters in Freedonia, has significant operations in the U.S. and a U.S. commercial domicile in Massachusetts. Total Co. establishes a wholly-owned subsidiary, a U.S. holding company, Usher Corp., which is organized as a Delaware limited liability company and treated as a branch of its Freedonian parent for Freedonian tax purposes. Usher Corp. is an "eligible entity" that checks the box to be treated as a corporation for purposes of U.S. tax law, and is treated as a corporation for Massachusetts purposes as well. Also, Usher Corp. declares a dividend to its parent, Total Co., in the form of a note in the amount of $100 million, and then claims a deduction for the interest expense attributable to the note on its U.S. and Massachusetts tax returns. These facts suggest that that the interest expense is the result of a transaction that was entered into for tax avoidance purposes, and in fact Usher Corp. seeks to claim significant tax savings in Massachusetts by reason of the transaction. Assuming that a principal purpose for the transaction was tax avoidance, Usher Corp. must add back the interest expense on its Massachusetts tax return. Note that the failure to meet the requisite evidentiary burden on these facts would also prevent Usher Corp. from asserting the treaty exception set forth in 830 CMR 63.31.1(5), even assuming that Total Co. was a resident of a nation which has in force a comprehensive income tax treaty with the United States. The conclusions in this example are without regard to the ultimate impact of particular federal tax rules that may affect the treatment of the interest under the Code, because the add back analysis turns on whether there was a tax avoidance purpose for the restructuring.

Example 10. Purported debt shown to be true debt; sufficient proof presented that transaction was not entered into for tax avoidance purposes. Ms. Victor, who is a resident of Massachusetts, is the president and sole owner of Wire Inc., a C corporation that owns several video stores and is only doing business in this state. To help fund expansion of the business, Ms. Victor makes a loan of $100,000 to Wire Corp. on arms-length terms, and Wire Inc. executes a ten-year note reflecting these terms. Funding the business expansion appears to be the sole purpose for the loan and the transaction does not appear to have been entered into for tax avoidance purposes. There are no other circumstances suggesting that the loan should be re-characterized as a capital contribution, and also the required payments generally are made timely. The Commissioner will not add back the interest expense incurred by Wire Inc. because disallowing the deduction would be unreasonable in these circumstances, notwithstanding the fact that there is more than a 3% difference between Wire Inc.'s 9.5% Massachusetts rate and Ms. Victor's 5.3% Massachusetts tax rate. *See* 830 CMR 63.31.1(4)(a)1.a. In the seventh year of the loan, Ms. Victor turns over day-to-day management of Wire Corp. to her son and retires to Florida, where she establishes her exclusive tax domicile. Even though Florida imposes no personal income tax, the Commissioner will not add back the interest expense incurred by Wire Inc. for the years after Ms. Victor moves to Florida.

Example 11. Debt transaction structured for tax avoidance purposes. Same facts as example 10, except that Ms. Victor owns the corporation, Wire Inc., through her 100% interest in a corporation, Wave Co., that has been set up in a jurisdiction that imposes no corporate-level income tax. Rather than make the loan to Wire Inc. directly, Ms. Victor advances the funds to Wave Co. as a capital contribution, and Wave Co. then makes the loan to Wire Inc. Ms. Victor structures the transaction in this manner so that the interest on the loan will not be subject to state income tax. Although there is a valid business purpose for a loan between Ms. Victor and Wire Inc., there is no valid business purpose for the loan between Wave Co. and Wire Inc. Consequently, the Commissioner will not recognize an exception to the statutory add back on these facts.

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Example 12. Use of structure to avoid tax by paying intangible expense to a related member based in a combination state indicates the transaction was entered into for tax avoidance purposes. Yoga Corp. operates retail stores in Massachusetts and other states in which it sells products that bear the company's trademarks. Yoga Corp. is taxable in each of the states in which it operates a retail store. Yoga Corp. is headquartered in a state that taxes the net income of Yoga Corp. and all of its "unitary" affiliates on a combined basis. Yoga Corp. saves money on its state taxes vis-à-vis Massachusetts and other "separate company tax reporting" states by separately incorporating a wholly owned subsidiary, Zero Inc., to serve as an intangibles holding company in the unitary state in which it is headquartered. To achieve the tax savings, Yoga Corp. transfers its trademarks to Zero Inc. and then begins paying a royalty for the use of these trademarks, based upon a percentage of sales made in Massachusetts and the other states. Yoga Corp. deducts royalty payments paid to Zero Inc. and thereby decreases its taxable income in separate company tax reporting states like Massachusetts. Zero Inc. is established with limited property and payroll, such that Zero Inc. is only taxable in the unitary state in which it is based, in which state it will file with its parent, Yoga Corp., on a combined basis. The royalty payments made between Yoga Corp. and Zero Inc. will "wash" in the unitary state and therefore do not have any tax consequences in that state. These facts suggest that the transaction between Yoga Corp. and Zero Corp. is entered into for tax avoidance purposes, and in fact Yoga Corp. seeks to claim significant tax savings in Massachusetts by reason of the transaction. Assuming that a principal purpose for the transaction was tax avoidance, the Commissioner will deny an add back exception. This is so despite the fact that Yoga Corp. may be able to claim that there are business benefits and efficiencies that result from the Zero Corp. restructuring.

Example 13. Use of structure to avoid tax by paying intangible expense to a related member based in a combination state indicates that transaction was entered into for tax avoidance purposes. Same facts as in Example 12, except that Yoga Corp. instead transfers its trademarks to a wholly owned subsidiary, Zorro Corp., that was previously incorporated in the unitary state in which Yoga Corp. is headquartered. Zorro Corp. is engaged in business activities that do not directly relate to the trademarks and was previously established in such a way that it has no nexus with other states. Although this structure does not rely upon a more traditional "intangibles holding company" whose activities are limited to the intangible property that it receives, the structure is intended to yield the same state tax benefit. Yoga Corp. deducts its royalty payments to Zorro Corp., whereas the royalty payments made between Yoga Corp. and Zorro Corp. "wash" and therefore have no tax consequences in the unitary state in which Zorro Corp. is taxed. These facts suggest that the transaction between Yoga Corp. and Zorro Corp. is entered into for tax avoidance purposes, and in fact Yoga Corp. seeks to claim significant tax savings in Massachusetts by reason of the transaction. Assuming that a principal purpose for the transaction was tax avoidance, the Commissioner will deny an add back exception. This is so despite the fact that Yoga Corp. may be able to claim that there are business benefits and efficiencies that result from the Zorro Corp. restructuring, and also may be able to claim that Zorro Corp. possesses business "substance" by reason of its pre-existing and ongoing business activities.

Example 14. Purported debt shown to be true debt; sufficient proof presented that transaction was not entered into for tax avoidance purposes. Calco is a California-based business that was formed in 1995. It owns a number of franchised fast-food restaurants, each of which is operated through a separate, direct subsidiary of Calco Inc., the corporate parent. Calco Inc. performs Calco's headquarters function and operates solely in California. The Calco group derives its income exclusively from sales at the fast-food restaurants. The group pays license fees for each of the restaurants to a large, unrelated multinational company that owns the intangibles associated with the restaurant chain. Calco has been expanding its operations steadily since its formation by acquiring more and

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more restaurants. Until 2001, all of its restaurants were located in California. Calco's practice in acquiring the restaurants has always been to set up a new subsidiary, determine the funds that is needed for the acquisition and operation of the restaurant, and capitalize the new subsidiary with such funds by using 60% equity and 40% debt. The loans between Calco Inc. and each of its subsidiaries reflect arm's length terms and these loans are not entered into for tax avoidance purposes. (Calco Inc. and its subsidiaries, until 2001, filed state tax returns only in California, and filed on a unitary basis in that state.)

In 2001, Calco acquires a restaurant in Massachusetts, which it will operate through a new subsidiary, Masscorp. Calco Inc. capitalizes Masscorp. the same way it has always capitalized its California subsidiaries. Calco executives realize at the time that Masscorp. is funded that this capital structure will potentially give rise to a tax benefit, because the interest expense may be deductible in Massachusetts and the interest income will be eliminated in the California unitary return. However, the loan with Masscorp. is not entered into for tax purposes because the same structure would have been used in the absence of a tax benefit. There are no other circumstances suggesting that the loan should be recharacterized as a capital contribution. Further, Masscorp. uses the loan funds in its business and makes regular payments on the loan in accordance with the loan terms. The Commissioner will not add back Masscorp.'s interest expense because disallowing the deduction would be unreasonable in these circumstances. (Note that notwithstanding this example, the Commissioner will determine what is an appropriate debt-equity ratio for all Massachusetts tax purposes on a case-by-case basis, taking into account all relevant facts and circumstances.)

Example 15. Factoring transaction creates inference of tax avoidance intent; insufficient proof that the transaction was not entered into for tax avoidance purposes. Shark Corp. is a corporation that is engaged in certain lending and service transactions. Shark Corp.'s business activities result in it having large amounts of different types of receivables, including loan receivables, accounts receivables and certain trade receivables. For business reasons, Shark Corp. wants to "securitize" its receivables and sell these security interests to investors. For purposes of effecting the securitization, Shark Corp. sets up a "special purpose subsidiary", Porpoise Corp., to which it sells the receivables at a discount. Since the price paid by Porpoise Corp. is less than the face amount of the outstanding receivables, Shark Corp. recognizes a loss from the affiliate transaction. In addition, Porpoise Corp. is set up in a state in which it will only pay a minimal corporate level income tax. These facts suggest that the factoring transaction between Shark Corp. and Porpoise Corp. was tax motivated. Shark Corp. claims that it is entitled to an exception for the loss that results from its factoring transaction because the securitization transactions have a business purpose. Also, Shark Corp. claims that the use of Porpoise Corp. permits a greater return to be received on the sale of the securitized receivables since the underlying receivables may no longer be subject to a potential bankruptcy on the part of Shark Corp. (a potential bankruptcy which is not imminent at the time of the transaction). However, the additional return that is claimed to result from the use of the bankruptcy remote entity would be significantly less than the effect of the asserted tax loss to be realized by Shark Corp. from the discounting transaction. By reason of the latter loss, Shark Corp. seeks to claim significant tax savings in Massachusetts Assuming that a principal purpose for the transaction was tax avoidance, the Commissioner will deny the claimed add back exception. Note that even if a principal purpose for the transaction was not tax avoidance the prospect of a claimed additional return that would be, if realized, significantly less than the asserted tax loss does not provide a valid business purpose, as among other things, this purpose is not commensurate with the value of the tax benefit claimed.

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Example 16. Restructuring to separate trademarks from the operating affiliate; insufficient proof that the transaction was not entered into for tax avoidance purposes. Pie Corp. is a multistate corporation with in-state stores that is engaged in the manufacture and sale of paint. Pie Corp. separates its trademarks and other similar intangible property (collectively "trademarks") from its operating business by transferring the trademarks in a Code § 351 transaction into a newly-formed subsidiary, Crust Corp., and Pie Corp. begins to license back these trademarks in return for royalties that Pie Corp. pays to Crust Corp. Crust Corp. is an out-of-state corporation that is subject to tax only in a jurisdiction that does not impose a corporate-level income tax. Crust Corp. rents office space and has two employees who enter into trademark license contracts with unrelated parties, collect and invest royalties paid by Pie Corp. and the unrelated parties, and also enter into contracts for marketing and quality control with respect to the trademarks. Pie Corp. assists Crust Corp. with respect to its unrelated-party licensing, investment of royalty receipts and the marketing and quality control contracts. All of Crust Corp's expenses are paid directly or indirectly by Pie Corp. or out of the royalties and investment returns received by Crust Corp. From time to time, Crust Corp. pays the licensing receipts and the investment returns to Pie Corp., either in the form of dividends, loans or payments that are made through one or more of the corporations' other affiliated entities.

These facts suggest that the licensing transaction between Pie Corp and Crust Corp. was tax-motivated, and in fact Pie Corp. seeks to claim significant tax savings in Massachusetts by reason of the transaction. Assuming that a principal purpose for the transaction was tax avoidance, the Commissioner will deny an add back exception on these facts. This is so despite the fact that Pie Corp. may be able to claim that because it is no longer the legal owner of the trademarks it has to license these trademarks from Crust Corp. to use in selling the branded products and that the arrangement helps the affiliated group to centrally manage its trademarks and to better evaluate the value of the marks. Note that it is not relevant whether there is economic substance that supports the taxpayer's transaction because, even assuming that there is, the taxpayer must also prove by clear and convincing evidence that the transaction is supported by a valid business purpose and that a principal purpose of the transaction was not tax avoidance.

Example 17. Payments made pursuant to a cash management system; purported debt not shown to be true debt. Sweep Co. is the out-of-state parent corporation of numerous subsidiaries engaged in various sales and service activities. On a daily basis all of the receipts of the subsidiaries are paid to Sweep Co. Sweep Co. invests these receipts on behalf of the affiliated enterprise and uses these funds to pay expenses for the subsidiaries and to provide funding to these subsidiaries on as needed basis. Various economies of scale result from this centralized cash management system. The books of the affiliated enterprise reference the advances to the various subsidiaries pursuant to the cash management account as being "loans." However, there are no notes that document specific advances to the subsidiaries as being loans. Also, there is no expectation that the various subsidiaries will in fact pay back the funds that are advanced to them with designated interest by a time-certain. Although the subsidiaries do cause their receipts to be paid to Sweep Co. on a daily basis, this would happen irrespective as to whether an individual subsidiary had received a prior advance. Finance Co., a lending corporation with in-state offices, is one of Sweep Co.'s subsidiaries. Finance Co. seeks an add back exception for certain payments that it makes to Sweep Co. that it claims constitute interest on *bona fide* debt. However, payments made pursuant to the cash management system do not constitute payments on bona fide debt. Therefore, an add back exception is not appropriate on these facts.

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Example 18. Use of structure to avoid tax by paying intangible expense as an embedded royalty indicates the transaction was entered into for tax avoidance purposes. Box Corp., Bag Corp. and Paper Corp. are wholly owned subsidiaries of Parent Corp., a parent corporation that owns multiple affiliates all of which are collectively involved in the manufacture and sale of clothing. Box Corp. has retail operations in Massachusetts. Bag Corp., Paper Corp. and Parent Corp. are not subject to Massachusetts tax. Previously, Box Corp. paid an intangible expense to Paper Corp., a corporation that was not subject to tax in any state and that was the record owner of the trademarks and other intangible property that was used by the various corporations in Parent Corp.'s affiliated group. Subsequently, Paper Corp. transfers record ownership of the affiliated group's intangible property to Parent Corp. Parent Corp. then licenses the use of this intangible property to Bag Corp., which manufactures clothing using the intangible property and sells the clothing with an "embedded royalty" to Box Corp. Box Corp. seeks to deduct or otherwise reduce its income on account of the embedded royalty paid to Bag Corp., similar to the deduction that it previously asserted for the intangible expense paid to Paper Corp. These facts suggest that the transactions that generate the embedded royalty were entered into for tax avoidance purposes, and in fact Box Corp. seeks to claim significant tax savings in Massachusetts by reason of the transaction. Assuming that a principal purpose for the transaction was tax avoidance, the Commissioner will deny an add back exception. This is so despite the fact that Box Corp. may be able to claim that there are business benefits and efficiencies that result from the restructuring, and also may be able to claim that Bag. Corp. possesses business "substance." (Note that this same analysis would apply whether or not the embedded royalty transaction was a variation on a prior intangible expense transaction, as is the situation in this example.)

2. Exception Because Add Back Applies to an Intangible "Conduit" Expense. In the case of an intangible expense (and not an interest expense), the taxpayer establishes by a preponderance of the evidence that, although a portion of the expense was paid, accrued or incurred to a related member, the related member during the same taxable year directly or indirectly paid, accrued or incurred such portion to a person that was not a related member and the transaction did not have tax avoidance as a principal purpose. This exception may be a full or partial exception depending upon the extent to which the requirement is met. In general, a taxpayer seeking to claim this exception must file a schedule with its tax return setting forth the information that is required by the Commissioner. The taxpayer must also prepare with its tax return and make available to the Commissioner upon his request, either with its tax return or otherwise, as requested by the Commissioner, a supporting statement that includes the following information, identifying any referenced documents where appropriate:

a. whether intangibles payments were made, first, between the taxpayer and a related member and second between the related member and an unrelated party;

b. whether the two sets of payments were identical in kind and amount and in all other respects (with an explanation as to any differences);

c. whether the payments were made in either case pursuant to one or more written agreements; and

d. how the taxpayer actually used the intangible property in question.

Further, the taxpayer should provide as part of its supporting statement any additional information and references to any additional documents that would be necessary or helpful for the Commissioner to evaluate the taxpayer's add back exception claim. Unless all relevant evidence is incorporated into the taxpayer's statement and attachments, if any, the taxpayer's statement should clearly identify the other evidence on which the taxpayer relies.

3. Exception Because Add Back Applies in Specific Case of a Foreign Treaty. The taxpayer establishes by clear and convincing evidence that it is entitled to the exception provided in 830 CMR 63.31.1(5).

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4. Exception Because Add Back Applies in Case of Overriding Agreement as to Alternative Apportionment. The taxpayer and the Commissioner agree in writing to the application or use of an alternative method of apportionment under M.G.L. c. 63, § 42. In these cases, the fact that the Commissioner grants relief under M.G.L. c. 63, § 42 will not, by itself, entitle the taxpayer to an exception to the add back provisions, M.G.L. c. 63, §§ 31I and 31J. Rather, the Commissioner will determine on a case by case basis whether such an exception is appropriate, taking into account the nature of the M.G.L. c. 63, § 42 relief granted and the purpose underlying both M.G.L. c. 63, § 42 and the add back provisions.

(b) Partial Exceptions. The add back required by 830 CMR 63.31.1(3)(a) or (b) shall not be required in part in the following instances.

1. The taxpayer establishes by clear and convincing evidence that a portion of the add back would be unreasonable. A portion of the add back will be considered unreasonable to the extent that the taxpayer establishes by clear and convincing evidence that the interest or intangible expense was paid, accrued or incurred to a related member that is taxed on the corresponding income by a state, U.S. possession or foreign jurisdiction. A taxpayer that seeks to claim this exception must file a schedule that sets forth the information required by the Commissioner. For purposes of verifying the taxpayer's claim, the Commissioner requires that the taxpayer retain and produce upon request the relevant copy or copies of the tax returns of the related member(s) in question. The Commissioner may contest an exception that is claimed on this basis when, irrespective as to the taxpayer's claim and the numeric computation reflected therein, the underlying transaction lacks either a valid business purpose or economic substance. This exception does not apply in the instance of acquisition interest.

2. In cases involving an intangible expense in which a partial exception would be warranted under 830 CMR 63.31.1(4)(a)2.

(5) Add Back Exception when Related Member Resides in a Nation that is Party to a U.S. Bilateral Income Tax Treaty. The add back required by 830 CMR 63.31.1(3)(a) or (b) shall not be required when the taxpayer establishes by clear and convincing evidence that each of the following requirements are met:

(a) the interest or intangible expense is paid, accrued or incurred to a related member that is not a controlled foreign corporation within the meaning of Code § 957;

(b) the related member is a resident of a nation which has in force a comprehensive income tax treaty with the United States;

(c) the expense is deductible under the Code;

(d) the transaction giving rise to the expense is supported by a valid business purpose and economic substance; and

(e) all of the terms of the transaction would have been agreed to in an arm's length negotiation between independent parties.

In general, a taxpayer seeking to claim this exception must file a schedule with its tax return setting forth the information that is required by the Commissioner. The taxpayer must also prepare with its tax return and make available to the Commissioner upon his request, either with its tax return or otherwise, a supporting statement that states that the above-referenced requirements have been met, and also provides additional detail concerning the requirements set forth in 830 CMR 63.31.1(5)(d) and (e). The latter detail must include the information required pursuant to 830 CMR 63.31.1(4)(a)1.b, in the manner set forth in 830 CMR 63.31.1(4)(a)1.b. *See* also 830 CMR 63.31.1(4)(a)1.b.: Example 9.

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(6) Filing Schedule; Claiming an Add Back Exception. A taxpayer that seeks to claim an exception to the interest or intangible expense add back must do so on a schedule completed as required by the Commissioner and filed as part of its tax return. A taxpayer that completes and submits a schedule as required may take a claimed deduction on its tax return despite the fact that the underlying transaction may be subject to a statutory add back. The taxpayer retains the burden of proving that the application of the add back is unreasonable or that another exception applies. A taxpayer must state the basis for its claimed exception on the schedule and provide the additional information required by the Commissioner. In some cases, the schedule that is filed by a taxpayer must be further substantiated by a contemporaneous supporting statement that sets forth certain specific information, as more fully explained by this regulation. The supporting statement must be made available to the Commissioner upon his request, either with the taxpayer's tax return or otherwise.

(7) Requests for More Information; Procedure for Evaluating an Exception Claim. When a taxpayer claims an exception to an add back provision on its tax return without specifying the claimed exception on the schedule required by the Commissioner and providing the other information required by said schedule, the Commissioner will notify the taxpayer that it has filed an incorrect or insufficient return. *See* M.G.L. c. 62C, § 28. When a taxpayer claims an exception to an add back provision using the schedule, the Commissioner may request additional information or evidence in addition to that provided if he determines that this additional submission would be necessary or helpful to evaluate the taxpayer's asserted add back claim. This additional information or evidence may include, but is not limited to, that set forth on a taxpayer's supporting statement in instances where a supporting statement is required under 830 CMR 63.31.1 and where the Commissioner does not request that the supporting statement be submitted with the taxpayer's tax return. If the taxpayer fails to respond to the Commissioner's request to provide additional information or evidence, the Commissioner will notify the taxpayer that it has filed an incorrect or insufficient return.

In cases in which the Commissioner does not accept a taxpayer's add back claim, either as filed or subsequent to the submission of additional requested information or evidence, the Commissioner will assess additional tax. In these cases, the Commissioner will send a Notice of Intention to Assess to the taxpayer and afford the taxpayer an opportunity for a hearing, as provided under M.G.L. c. 62C, § 26(b).

Failure to request additional information or evidence at the time that a taxpayer files a schedule as part of its tax return shall not be construed to mean that the Commissioner has approved the taxpayer's add back exception claim. A failure to make such a request at such time shall not mean that the Commissioner is foreclosed from requesting additional supporting information or evidence from the taxpayer at a later date.

(8) No Limitations as to Other Agreements, Compromises or Adjustments. Nothing in 830 CMR 63.31.1 shall be construed to limit or negate the Commissioner's authority to enter into agreements and compromises otherwise allowed by law. Also, nothing in 830 CMR 63.31.1 shall be construed to limit or negate the Commissioner's authority to make adjustments under M.G.L. c. 63, §§ 33 and 39A or to make adjustments otherwise allowed by law.

(9) Interaction with Determination as to Existence of Net Operating Loss. For purposes of computing a net operating loss pursuant to M.G.L. c. 63, § 30.5, the interest or intangible expense add back shall be included as part of the computation that is required under M.G.L. c. 63, §§ 30.3, 30.4.

Example. In year one, a taxpayer that is based entirely in Massachusetts has a $100,000 net loss as computed under M.G.L. c. 63, §§ 30.3 and 30.4, prior to the determination as to any interest or intangible expense add back. However, the taxpayer is required to add back an interest expense of $300,000. Consequently, the net income of the taxpayer for year one on which tax is due is $200,000. In year two, the taxpayer does not have a net operating loss carryforward, irrespective of the fact that it would have had a loss carryforward absent the application of the interest expense add back.

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(10) Interaction with Taxation of a Related Member. Nothing in 830 CMR 63.31.1 shall be construed to impact the taxation of a related member to which a taxpayer pays, accrues or incurs an interest or intangible expense, including the analysis whether the related member is subject to Massachusetts tax. In some cases, the in-state ownership and use of intangible property may subject a foreign corporation to Massachusetts tax. *See* Directive 96-2. Where a taxpayer pays, accrues or incurs an interest or intangible expense to a related member that is taxed on the corresponding income, either by Massachusetts or some other state, US possession or foreign nation, the taxpayer may be entitled to a full or partial add back exception as explained in 830 CMR 63.31.1(4)(a)1.a and (b)1.

63.31N.1: Massachusetts Property Basis Adjustments

(1) Statement of Purpose; Outline of Topics.

(a) Purpose. 830 CMR 63.31N.1 implements the rules set forth in M.G.L. c. 63, § 31N, which requires certain adjustments to the basis of a corporation's property, including stock owned by the corporation, for purposes of determining gross income, deductions and other tax items of an entity taxable under M.G.L. c. 63. 830 CMR 63.31N.1 also provides some examples of when these adjustments may be necessary. 830 CMR 63.31N.1 does not purport to describe all of the situations where adjustments to the basis of a corporation's property will be necessary pursuant to M.G.L. c. 63, § 31N for purposes of determining the corporation's Massachusetts corporate excise. Adjustments to the Massachusetts basis of a corporation's property may be required in circumstances not described in 830 CMR 63.31N.1.

(b) Outline. 830 CMR 63.31N.1 is organized as follows.

1. Statement of Purpose; Outline of Topics
2. Definitions
3. General Rules
4. Special Rule for Former Corporate Trusts
5. Intercompany Transactions; Basis Adjustments Attributable Thereto
6. Combined Reporting; Basis in Subsidiaries; Earnings and Profits
7. Application of the Sham Transaction Rule and Related Doctrines
8. Effective Date

(2) Definitions. For purposes of 830 CMR 63.31N.1, the following terms have the following meanings.

Code, the federal Internal Revenue Code, as amended and in effect for the taxable year.

Combined Group, a group of corporations that is required to file a Massachusetts combined report for a taxable year beginning on or after January 1, 2009, including a combined group that results from a Massachusetts affiliated group election. A combined report is required to be filed pursuant to M.G.L. c. 63, § 32B, as enacted by St. 2008, c. 173. *See* 830 CMR 63.32B.2. A combined group does not refer to a combined group allowed to file a combined return within the meaning of former M.G.L. 63, § 32B (*i.e.*, prior to M.G.L. 63, § 32B's repeal by St. 2008, c. 173, § 48). *See* 830 CMR 63.32B.1.

Consolidated Federal Income Tax Return, a return of income filed with the federal government pursuant to Code § 1501 by an affiliated group as determined under Code § 1504.

Corporate Trust, an entity defined in M.G.L. c. 62, § 1(j), and subject to the provisions of M.G.L. c. 62, § 8 prior to the enactment of St. 2008, c. 173, pursuant to which Massachusetts adopted the federal "check the box" conformity rules and repealed the Massachusetts personal income tax rules that applied to the taxation of corporate trusts.

Corporation, a business corporation within the meaning of M.G.L. c. 63, § 30, whether or not organized in Massachusetts. For taxable years beginning prior to January 1, 2009, a "corporation" refers to a foreign or domestic business corporation, a utility corporation, a financial institution, an insurance company, or other entity taxable under M.G.L. c. 63, depending upon the context, as determined under the pertinent provisions of M.G.L. c. 63, in effect for such years.

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Federal Consolidated Group, an affiliated group as defined in Code §1504 that is required to file a consolidated federal income tax return. The corporations that are includible corporations for purposes of a consolidated federal income tax return generally include only corporations that are formed under the laws of the U.S. or a U.S. state, and generally do not include, for example, non-profit corporations that are exempt from federal income tax, S corporations, real estate investment trusts (REITs) as referenced under Code §§ 856 through 859, and regulated investment companies (RICs) as referenced under Code §§ 851 through 855.

Massachusetts Affiliated Group Election, an election by the taxable member or members of a combined group to treat the combined group as consisting of such member or members and all additional corporations included within the Massachusetts affiliated group of such member or members as determined under M.G.L. c. 63, § 32B and 830 CMR 63.32B.2.

(3) General Rules.

(a) Determination of Federal Gross Income as Determined for Massachusetts Purposes. In determining a corporation's gross income under M.G.L. c. 63, if the corporation's federal gross income as determined for Massachusetts purposes includes any item of gain or has been reduced by an item of loss, with respect to property, then such federal gross income shall be increased by the amount by which the federal adjusted basis of the property exceeds the Massachusetts adjusted basis of the property, and shall be decreased by the amount by which the Massachusetts adjusted basis of the property exceeds the federal adjusted basis of the property, such that the gain or loss realized for Massachusetts purposes takes into account all applicable differences in the Massachusetts and federal tax rules over the life of an asset that should in principle give rise to differences in basis.

(b) Relationship between Massachusetts and Federal Adjusted Basis of Property. Except as otherwise provided by Massachusetts law, the Massachusetts adjusted basis of property shall be the federal adjusted basis of such property; provided, however, that:

1. any federal adjustment attributable to provisions of the Code that were not applicable in determining Massachusetts net or gross income at the time that such federal adjustment was made shall be disregarded in determining Massachusetts basis; provided, however, that federal basis adjustments attributable to federal tax credits claimed by a taxpayer or to federal grants, subsidies, or similar payments made to a taxpayer shall not be so disregarded under this clause unless otherwise prescribed by Massachusetts law; and

2. adjustments shall be made for any item that was applicable in determining Massachusetts net or gross income but that was not so applicable in determining federal net or gross income at the time of such Massachusetts determination, and for which a federal adjustment would be allowed under the Code if the item had been applicable in determining federal net or gross income. For example, Massachusetts does not allow bonus depreciation under Code § 168(k). Therefore, when a corporation that is subject to the income measure of the Massachusetts corporate excise takes a bonus depreciation deduction with respect to an item of property for federal income tax purposes, such depreciation deduction must be disregarded for Massachusetts purposes, and the corporation's Massachusetts basis in the property is not reduced on account of the federal adjustment. On the other hand, there may be basis adjustments that apply for Massachusetts purposes that do not apply federally.

(c) Examples. The following examples illustrate the provisions of 830 CMR 63.31N.1(3)(b).

1. Example 1. On January 1, 2009, X, a calendar-year corporation engaged in business in Massachusetts purchases qualified ten-year MACRS property for $100,000 and places it in service. X's initial basis in the property is $100,000 both for federal and Massachusetts purposes. On its 2009 federal tax return, X claims depreciation equal to 50% of the basis of the property, or $50,000, pursuant to Code § 168(k). Therefore, X's basis in the property is reduced to $50,000 for federal tax purposes. In addition, X takes a regular federal MACRS depreciation deduction for 2009, applying the 200% Declining Balance method, in the amount of $5,000 ($50,000 x .20 = $10,000, divided by 2 to account for the ½ year convention). Therefore, for federal tax purposes, X's basis in the property is $45,000. On its 2009 Massachusetts tax return, X must calculate the federal depreciation deduction for the property as if it did not elect to utilize the federal bonus

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depreciation allowance, as Massachusetts does not allow bonus depreciation. In the absence of the federal bonus depreciation, the property's first-year federal MACRS depreciation would be $10,000 ($100,000 x .20 = $20,000, divided by 2 to account for the ½ year convention). Thus, the Massachusetts 2009 depreciation deduction for the property is $10,000, and X's basis in the property is reduced to $90,000 for Massachusetts tax purposes. On November 30, 2010, X sells the property to an unrelated party for $75,000. X has a $30,000 gain for federal tax purposes and a $15,000 loss for Massachusetts tax purposes.

2. Example 2. On January 1, 2011, X, a calendar-year corporation engaged in business in Massachusetts purchases property that includes an abandoned building in an economic opportunity area of Massachusetts, as determined by the economic assistance coordinating council established by M.G.L. c. 23A, § 3B. X has an initial cost basis in the property for both Massachusetts and federal purposes in the amount of $500,000. X spends $300,000 to renovate the building in 2011, and thereby increases its basis in the property for both federal and Massachusetts purposes to $800,000. X also deducts 10% of its costs in renovating the building pursuant to M.G.L. c. 63, § 38O, thereby further reducing its basis in the property for Massachusetts purposes to $770,000. No similar deduction applies for federal income tax purposes, and so X's basis in the property for federal purposes remains $800,000. Subsequently, in December of 2011, X sells the renovated property to an unrelated party for $1,000,000, recognizing a $230,000 gain in Massachusetts and a $200,000 gain federally.

(d) Rule of Convenience; Election to Adopt Massachusetts Adjusted Basis Where Non-taxable Corporation Becomes Taxable Corporation. In general, when a corporation (other than a corporation that is or becomes a member of a combined group) first becomes subject to the income measure of the corporate excise, the initial Massachusetts basis of its various assets will be the basis of such assets as determined for federal income tax purposes, rather than the Massachusetts adjusted basis that the property would have had if it had been acquired and held during a time when the corporation was subject to the corporate excise under M.G.L. c. 63 with regard to its income. Notwithstanding the foregoing, a corporation that was not previously subject to the corporate excise under M.G.L. c. 63 with regard to its income may elect to determine and adopt the Massachusetts adjusted basis as to all of its assets acquired prior to becoming a Massachusetts taxpayer by taking this position on the corporation's initial Massachusetts corporate excise return as filed with the state, provided that the corporation possesses and maintains adequate records to demonstrate the appropriate Massachusetts adjusted basis for all such assets. The election must be made during the period of limitations for abatement under M.G.L. c. 62C, § 37, without taking into account the provisions of M.G.L. c. 62C, § 30, for the tax year during which the corporation first becomes subject to the corporate excise under M.G.L. c. 63 with regard to its income. If the corporation's return is not timely filed and/or the election is not made within such filing period then the corporation is precluded from electing to adopt a Massachusetts adjusted basis for its assets. Once made, this election is irrevocable. Further, 830 CMR 63.31N.1(3)d) does not apply in the instance of a corporation that is a member of a combined group, because in the latter such cases an election to adjust the basis of the corporation's assets must be made pursuant to the rules that apply to such groups. *See* 830 CMR 63.31N.1(3)(f)2.

(e) Examples. The following examples illustrate the provisions of 830 CMR 63.31N.1(3)(d). Assume for purposes of these examples that Corporation X reports its income on a calendar year basis for both federal and Massachusetts tax purposes. Assume also that Corporation X is not a member of a combined group during its 2009 or 2010 taxable years.

Example 1. Corporation X is a corporation that is not subject to the corporate excise under M.G.L. c. 63 with regard to its income during its 2008 tax year. X purchases a business asset that is ten-year property on January 1, 2008 for $10,000. For tax year 2008, X takes a 50% bonus depreciation deduction of $5,000 as to the purchased asset for federal income tax purposes pursuant to Code § 168(k). In addition, X takes a regular MACRS depreciation deduction in the amount of $500 ($5,000 x .20 = $1,000, divided by 2 to account for the ½ year convention). Therefore, for federal tax purposes, X's basis in the asset as of January 1, 2009, is $4,500 ($10,000 - $5,000 - $500). On January 1, 2009, X expands its activities into Massachusetts such that it becomes subject to the income measure of the corporate excise for its 2009 tax year. At this time, the

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default Massachusetts basis of X's various assets will be the basis of such assets as determined for federal income tax purposes. However, X may elect to determine and adopt a Massachusetts adjusted basis for all of its assets, provided that it possesses and maintains adequate records to demonstrate the appropriate Massachusetts adjusted basis for all such assets. Assuming that X makes this election, its Massachusetts basis in the purchased asset as of January 1, 2009 will be $10,000 - $1,000 ($10,000 x. 20, divided by 2 to account for the ½ year convention), or $9,000. This basis number is the same as what the asset's federal basis would have been had the taxpayer not taken federal bonus depreciation in 2008. On January 2, 2009, X sells the asset for $8,000. X will recognize a $3,500 federal taxable gain and a $1,000 Massachusetts taxable loss.

Example 2. Assume the same facts as in Example 1. Assume further that X does not sell the purchased asset on January 2, 2009. Rather, X holds the asset until the end of its 2009 tax year. For federal tax purposes, X's depreciation deduction for the 2009 tax year will be $900 ($4,500 x .20), resulting in a federal tax basis of $3,600. For Massachusetts tax purposes, X's depreciation deduction for the 2009 tax year will be $1,800 ($9,000 x .20), resulting in a Massachusetts tax basis of $7,200. Assume that X subsequently sells the asset on January 2, 2010 for $8,000. For purposes of its 2010 tax year, X will recognize a $4,400 federal taxable gain and an $800 Massachusetts taxable gain.

Example 3. Assume the same facts as Example 1, except that upon becoming subject to the Massachusetts corporate excise in 2009, X does not make the election to determine and adopt a Massachusetts adjusted basis as to its assets. Therefore, as of January 1, 2009, X's Massachusetts adjusted basis in the purchased asset will be $4,500, the same as X's federal basis in this asset. If X sells the asset on January 2, 2009 for $8,000, it will have a $3,500 taxable gain for both federal and Massachusetts tax purposes.

(f) Massachusetts Basis of Property Held by Members of a Combined Group.

1. In General. For purposes of determining a combined group's taxable income pursuant to 830 CMR 63.32B.2(6)(c)2., each member of the combined group shall determine its separate income by taking into account the Massachusetts adjusted basis of each asset held by such member; provided, however, that in the case of a combined group subject to a worldwide election, any member not incorporated in the United States and not treated as a U.S. corporation under the Code shall determine its separate income in accordance with 830 CMR 63.32B.2(6)(c)2.b(i)B and shall not be subject to the requirement in 830 CMR 63.31N.1(3)(f)1.

2. Non-Massachusetts Taxpayer's Massachusetts Basis in its Assets at the Time it is First Included in a Combined Group; Election to Adopt Massachusetts Adjusted Basis for All Assets of All Members of a Combined Group. In general, when a corporation that was not previously a Massachusetts taxpayer enters or otherwise is first included in a combined group, the Massachusetts basis of its various assets at that time will be the basis of such assets as determined for federal income tax purposes, rather than the Massachusetts adjusted basis that the property would have had if it had been acquired and held during a time when the corporation was subject to Massachusetts tax. Notwithstanding the foregoing, the principal reporting corporation of a combined group may elect to determine and adopt the Massachusetts adjusted basis for all previously-acquired assets of every member of the group that was not previously a Massachusetts taxpayer, including any non-taxpayer corporation that subsequently enters or otherwise is included in the group, provided that such corporations possess and maintain adequate records to demonstrate the appropriate Massachusetts adjusted basis for all such assets. The election must be made by a combined group during the period of limitations for abatement under M.G.L. c. 62C, § 37, without taking into account the provisions of M.G.L. c. 62C, § 30, for the tax year that first includes a previously non-taxable member. If the group's combined return is not timely filed and/or the election is not made within such filing period then the group members are precluded from electing to adopt a Massachusetts adjusted basis for their assets. The election is irrevocable and is to be made in such form and in such manner as prescribed by the Commissioner. *See* 830 CMR 63.32B.2(6)(d).

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(4) Special Rules for Former Corporate Trusts. Notwithstanding the general rules set forth in 830 CMR 63.31N.1(3), the federal basis of shares in a business corporation that was formerly treated as a corporate trust or of shares in a successor of that entity shall be reduced in computing Massachusetts adjusted basis to take into account any tax-free earnings and profits accumulated by the former corporate trust, as adjusted in accordance with 830 CMR 63.30.3.

(5) Intercompany Transactions; Basis Adjustments Attributable Thereto.

(a) General Tax Consequences of Intercompany Transactions.

1. Effect of an Intercompany Transaction with Respect to Property on the Determination of the Property's Basis. Where a corporation that is a member of an affiliated group engages in a transaction with respect to property with another member of an affiliated group, the gain or loss that derives from that transaction, if any, may require an adjustment to the property's basis in the hands of its owner. In determining the required basis adjustment in the context of intercompany transactions, Massachusetts law generally looks to federal income tax law, as explained further in the succeeding subsections.

2. Application of Federal Law in Determining Massachusetts Gain or Loss in the Context of an Intercompany Transaction. In determining whether and when gain or loss is recognized for Massachusetts corporate excise purposes in the case of a transaction between members of a combined group, the federal rules and principles applicable to transactions between members of a federal consolidated group generally shall apply, except where a divergence between Massachusetts law and such federal rules and principles requires a different result. In contrast, in determining whether and when gain or loss is recognized for Massachusetts corporate excise purposes in the case of a transaction between two affiliated corporations that are not members of a combined group, the federal rules and principles applicable to transactions between members of a federal consolidated group generally shall not apply, even if such corporations are members of a federal consolidated group.

(b) Rules Applicable to Transactions Between Corporations That Are Not Members of a Combined Group. In determining whether gain or loss is recognized for Massachusetts corporate excise purposes in connection with a transaction between corporations that are not members of a combined group, and, by extension, the effect that such a transaction will have on basis for Massachusetts purposes, Massachusetts law generally incorporates the analogous federal rules that would apply in the absence of a federal consolidated group. The Massachusetts rules that apply to transactions between affiliated corporations that are not members of a combined group may include those set forth under M.G.L. c. 63, § 39A and M.G.L. c. 62C, § 3A, and the incorporated federal rules may include those set forth under Code §§ 163 and 267, among others. In the case of the disposition of property between corporations that are not members of a combined group, the Massachusetts basis of the property disposed of generally shall be adjusted in the hands of the acquiring corporation when gain or loss is taken into account, consistent with the applicable Massachusetts and federal rules. Special rules that apply in the instance of a combined group are set forth at 830 CMR 63.31N.1(5)(c).

(c) Rules Applicable to Transactions Between Members of a Combined Group.

1. In General. Whether gain or loss is recognized for Massachusetts corporate excise purposes in connection with a transaction between corporations that are members of a combined group, and, by extension, the effect that such a transaction will have on basis for Massachusetts purposes, generally depends upon the state application of the federal rules that apply in the instance of a federal consolidated group, even if such corporations are not members of a federal consolidated group. Where two affiliated corporations are members of a combined group, any item of income, expense, gain or loss that results from a transaction between such corporations in respect of the group's unitary business (*e.g.*, the disposition of property between such corporations where such property is used in the group's unitary business) will not be taken into account at such time. Rather, any item of income, expense, gain or loss that results from a transaction between the members of a combined group in respect of the group's unitary business is generally taken into account by applying the federal rules and principles applicable to transactions

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between members of a federal consolidated group as set forth in Treas. Reg. § 1.1502-13, except where a divergence between Massachusetts law and such federal rules requires a different result, or where no analogous situation exists for purposes of the federal rules. *See* 830 CMR 63.32B.2(6)(c)9. Similar treatment applies when any item of income, expense, gain or loss results from a transaction between members of a combined group in any case in which the group has made and is subject to a Massachusetts affiliated group election without regard to any unitary business determination. *See* 830 CMR 63.32B.2(10). An item of income, expense, gain or loss described in 830 CMR 63.31N.1(5)(c) is not initially taken into account, but rather accounted for later, consistent with the federal rules as referenced in this subsection. Examples of events upon which the deferred item of income, expense, gain or loss, is taken into account are provided in 830 CMR 63.31N.1(5)(c)2. In the case of the disposition of property between corporations that are members of a combined group, the Massachusetts basis of the property disposed of generally shall be adjusted when gain or loss is taken into account, consistent with the applicable Massachusetts and federal rules. An item of income, expense, gain or loss not described in 830 CMR 63.31N.1(5)(c) shall be accounted for consistent with the rules set forth in 830 CMR 63.31N.1(5)(b).

2. Subsequent Events that Trigger Recognition of a Previously Deferred Item of Income, Expense, Gain or Loss. An item of income, expense, gain or loss, that is not initially taken into account under the rules set forth in 830 CMR 63.31N.1(5)(c)1. shall be subsequently taken into account in a manner similar to, and utilizing the principles referenced in, Treas. Reg. § 1.1502-13. For example, in the case of a sale of property between two members of a combined group, the item of income or gain that was not taken into account upon the initial sale shall be taken into account upon, and apportioned as income earned immediately before, certain recognition events, including but not limited to:

a. the object of the intercompany transaction is sold or otherwise disposed of by the buying member (that is, the combined group member that purchased the object of the intercompany transaction from the selling member) to a person or entity that is not a member of the combined group;

b. where the combined group is based upon the existence of a unitary business (*i.e.*, no Massachusetts affiliated group election has been made), the object of the intercompany transaction is:

i. sold by the buying member to an entity that is a member of the combined group for use outside the unitary business in which the buying member and selling member are engaged; or

ii. converted by the buying member to a use outside the unitary business in which the buying member and selling member are engaged; or

c. the buying member and selling member are no longer members of the same combined group (including where a combined group ceases to be determined pursuant to a pre-existing Massachusetts affiliated group or worldwide election and the buying member and selling member are no longer in a combined group for that reason).

See 830 CMR 63.32B.2(6)(c)5. The rules that explain the apportionment consequences of an intercompany transaction in the context of a combined group are set forth at 830 CMR 63.32B.2(7).

3. Examples. The following examples illustrate the application for Massachusetts corporate excise purposes of some of the general principles set forth in Treas. Reg. § 1.1502-13 as applied in the context of 830 CMR 63.31N.1(5)(c). Assume for purposes of these examples that for tax years 2009-2013 Corporations C and D are affiliated corporations and that for tax years 2010-2013 Corporations C and D are engaged in a unitary business and constitute a combined group that is required to file a combined report. Further, both C and D are taxed on a calendar year basis and are on the accrual method of accounting.

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a. Example 1. During tax year 2010, C sells a non-depreciable asset with a basis of $80,000 to D for $100,000. For Massachusetts tax purposes, because C and D file as members of a combined group, the gain from the sale of the asset is not taken into account at this time, and D has a cost basis in the asset of $100,000. In January 2011, D sells the asset previously purchased from C to an unrelated party, X, for $130,000. For Massachusetts tax purposes, C recognizes gain of $20,000 (which is deferred gain that was not taken into account on the prior 2010 sale to D) and D recognizes gain of $30,000. In contrast, if C and D had not been members of a combined group in 2010, C would have recognized gain of $20,000 upon the sale to D in 2010, and D would still have recognized $30,000 of gain upon the sale to X in 2011.

b. Example 2. On January 1, 2009, C buys a depreciable asset with a ten-year useful life for $100,000 and begins to depreciate it under the straight-line method of recovery. C claims $10,000 of depreciation for each of 2009 and 2010, leaving C with an $80,000 basis in the asset on January 1, 2011. On that date, C sells the asset to D for $130,000. For Massachusetts tax purposes, because C and D file as members of a combined group, the gain from the sale of the asset is not taken into account at this time, and D takes a cost basis in the asset of $130,000.

Subsequent to the sale, for purposes of calculating D's depreciation deductions, D steps into C's shoes to the extent D's basis does not exceed C's adjusted basis at the time of the sale (*i.e.*, $80,000). Any basis on the part of D in excess of C's adjusted basis at the time of sale (*i.e.*, $130,000 - $80,000, or $50,000) is treated as new ten-year recovery property for which D elects the straight-line method of recovery. Therefore, for 2011 D has $15,000 of depreciation: $10,000 of depreciation with respect to $80,000 of its basis (the portion of its $130,000 basis not exceeding C's adjusted basis at the time of sale), and $5,000 of depreciation with respect to the $50,000 of its basis that exceeded C's adjusted basis at the time of sale. C's $50,000 gain that was not taken into account in connection with the sale to D is taken into account to reflect the difference for each combined reporting year between D's depreciation ($15,000) and the depreciation D would have been entitled to had C and D been divisions of the same corporation ($10,000). Thus, C is to take into account $5,000 of gain in each remaining year in the original ten-year recovery period, which is offset by the additional $5,000 of depreciation taken each year by D. Consequently, C takes into account $5,000 of gain for each of the tax years 2011 and 2012.

On January 1, 2013, D sells the asset previously purchased from C to an unrelated party, X, for $110,000. As explained above, D has $15,000 of depreciation with respect to the asset in each of 2011 and 2012, leaving D with a basis of $100,000 at the time of the sale. For Massachusetts tax purposes, C recognizes $40,000 of gain upon D's sale of the asset to X (which is the balance of C's gain that was not taken into account on the prior 2011 sale to D). D recognizes gain of $10,000 (*i.e.*, the difference between the sale price of $110,000 and its adjusted basis in the property of $100,000).

(d) Intercompany Transactions Where the Composition of the Massachusetts Combined Group Differs from that of the Federal Consolidated Group.

1. In General. Although the Massachusetts rules for accounting for an item of income that results from a transaction between members of a combined group are similar to the federal rules that apply to intercompany transactions in the context of a federal consolidated group, the composition of such groups can differ. For example, the common ownership requirement used to determine a Massachusetts combined group, *i.e.*, more than 50% voting control, is different than the 80% control "vote and value" standard that applies for purposes of determining a federal consolidated group. Also, in contrast to the federal rules, the Massachusetts ownership standard is met when the voting control standard is satisfied through either direct or indirect ownership and a common owner may be either corporate or non-corporate. Further, there are certain types of corporations that are not included in a federal consolidated group that may be included in a Massachusetts combined group, for example, corporations that are not incorporated under the laws of the United States or a U.S. state, S corporations, REITs, RICs and certain insurance companies. Conversely, there are certain corporations that are not included in a Massachusetts combined group that may be included in a federal

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consolidated group, for example, a corporation that is incorporated under the laws of the United States or a U.S. state but that is not engaged in a unitary business with the corporations that are included in the combined group (provided that the combined group has not made a Massachusetts affiliated group election). Consequently, because there can be differences between the composition of a Massachusetts combined group and that of a federal consolidated group, there may be differences as to the treatment of an intercompany transaction that takes place between the members of such groups. Such differences in treatment are illustrated in the examples in 830 CMR 63.31N.1(5)(d)2. In any instance in which a member of a Massachusetts combined group enters into a transaction with a corporation that is not a member of the combined group, any item of income, expense, gain or loss that results from such transaction shall be determined consistent with the general rules set forth in 830 CMR 63.31N.1(5)(a).

2. a. Examples. The examples in this section illustrate the provisions of 830 CMR 63.31N.1(5). Assume for purposes of these examples that Corporation P owns 100% of Corporations A, B, C and D and that these five corporations file a consolidated federal income tax return for the 2010 and 2011 tax years. All of the corporations are taxed on a calendar year basis and are on the accrual method of accounting. Assume that Corporations P, C and D, (but not A and B) are engaged in a unitary business during tax years 2010 and 2011, and therefore constitute a combined group (the PCD combined group) that is required to file a combined report under M.G.L. c. 63, § 32B as applicable for such years.

b. Example 1. During tax year 2010, C sells a non-depreciable asset used in the PCD unitary business with a basis of $80,000 to D for $100,000. For both federal and Massachusetts tax purposes, the gain from the sale between C and D is not taken into account at this time, and D has a cost basis in the asset of $100,000. In January 2011, D sells the asset purchased from C in tax year 2010 to an unrelated party, X, for $130,000. For federal and Massachusetts tax purposes, C recognizes $20,000 of gain upon D's sale in 2011 (which is deferred gain that was not taken into account in connection with the prior 2010 sale to D) and D recognizes gain of $30,000. For Massachusetts tax purposes the gain of C and D is included in the taxable income of the PCD combined group for tax year 2011.

c. Example 2. During tax year 2010 C sells a non-depreciable asset used in the PCD unitary business with a basis of $120,000 to B for $100,000. For federal tax purposes, the loss from the asset sale between C and B is not taken into account at this time, and B has a cost basis in the asset of $100,000. For Massachusetts tax purposes, C realizes a $20,000 loss on the transaction because B is not a member of the combined group. Whether such gain or loss is recognized depends on the application of the relevant state and federal rules as provided in 830 CMR 63.31N.1(5)(a). Consequently, under the Code § 267 rules as applied in Massachusetts, the loss must be deferred until there is a later triggering event, such as B's later sale of the asset to an unrelated party. For Massachusetts tax purposes, B has a basis in the asset of $100,000. In January 2011, B sells the asset purchased from C to an unrelated party for $130,000. For both federal and Massachusetts tax purposes, B recognizes a gain of $30,000 on the sale and C recognizes a $20,000 loss (which for Massachusetts tax purposes is the loss that was previously deferred under the Code § 267 rules as applied in Massachusetts in connection with C's prior asset sale to B). For Massachusetts tax purposes, the loss of C is included in the taxable income computation of the PCD combined group for tax year 2011.

(6) Combined Reporting; Basis in Subsidiaries; Earnings and Profits.

(a) General; Purpose. 830 CMR 63.31N.1(6) applies the provisions of M.G.L. c. 63, § 31N and M.G.L. c. 63, § 32B to determine, in the context of a combined group, the basis of stock owned by a shareholder corporation in a subsidiary and the impact of a subsidiary's earnings and profits on the earnings and profits of the shareholder corporation. In addition to providing general guidance on the mechanics of the adjustments to basis and earnings and profits that may be required in the context of a combined group, a significant purpose of this section, 830 CMR 63.31N.1(6) is to promote the clear reflection of a combined group's income by preventing a subsidiary's items of income, gain, deduction

63.31N.1: continued

and loss from giving rise to duplicative gain or loss with respect to the subsidiary's stock. In the case of a shareholder corporation and its subsidiary that are not members of a combined group, the determination of Massachusetts basis in the shareholder's stock in the subsidiary, and of the earnings and profits of the subsidiary and the shareholder, shall generally follow the analogous federal rules that would apply in the absence of a federal consolidated group, except where a divergence between Massachusetts law and such federal rules requires a different result.

(b) Basis in Subsidiaries. Combined reporting is required of certain corporations engaged in a unitary business where more than 50% of the voting control of such corporations is directly or indirectly owned by one or more common owners. *See* 830 CMR 63.32B.2(2) and (4)(a). Where a member of a combined group holds shares directly or indirectly in another member of the combined group, such shareholder corporation's basis in the subsidiary's stock shall be adjusted for Massachusetts purposes to reflect certain distributions from the subsidiary and the subsidiary's items of income, gain, deduction and loss taken into account for the period that the subsidiary is a member of the combined group by applying the federal rules and principles set forth in Treas. Reg. § 1.1502-32, except where a divergence between Massachusetts law and such federal rules requires a different result, or where no analogous situation exists for purposes of the federal rules. In determining such adjustments, the following general rules, *inter alia*, shall apply:

1. An adjustment to a shareholder corporation's Massachusetts basis in a subsidiary's stock shall not be made for the subsidiary's distributions or items of income, gain, deduction, or loss taken into account for the subsidiary's taxable years beginning prior to January 1, 2009, except as required in connection with the election described in 830 CMR 63.31N.1(3)(f);

2. An adjustment to a shareholder corporation's Massachusetts basis in a subsidiary's stock shall not be made for the subsidiary's items of income, gain, deduction, or loss to the extent those items were not included in the combined group's taxable income (except in the case of tax exempt income that would have been included in the combined group's taxable income had it not been exempt from tax);

3. An adjustment to reduce the Massachusetts basis of a shareholder corporation's basis in a subsidiary's stock shall be made for the subsidiary's distributions to the extent those distributions are from earnings and profits attributable to items that were included in the combined group's taxable income (for purposes of determining the amount of the basis reduction under this subsection, the LIFO and *pro rata* rules set forth in 830 CMR 63.32B.2(6)(c)(4) shall apply);

4. Negative adjustments may exceed the shareholder corporation's Massachusetts basis in the subsidiary's stock, resulting in the shareholder corporation having an "excess loss account" in the subsidiary's stock, the consequences of which shall be determined in a manner similar to, and by applying the rules and principles referenced in, Treas. Reg. §§ 1.1502-19 and -32(a)(3)(ii);

5. Basis adjustments shall be attributed to a subsidiary that holds stock in a lower tier subsidiary from such lower tier subsidiary using the same general rules set forth above, with the adjustments applied in the order of the tiers, from the lowest to the highest;

6. A basis adjustment is not to be made under this section or any other applicable rule of law in a manner that has the effect of duplicating a Massachusetts adjustment; and

7. The adjustments to basis required by this subsection shall be allocated among the shares of a subsidiary's stock in a manner similar to, and by applying the rules and principles referenced in, Treas. Reg. § 1.1502-32(c).

No such adjustments shall be made pursuant to this section 830 CMR 63.31N.1(6)(b) in the case of a shareholder corporation and its subsidiary when such entities are not members of a Massachusetts combined group, irrespective as to whether such entities are members of a federal consolidated group.

(c) Examples. The following examples illustrate the provisions of 830 CMR 63.31.N.1(6).

Example 1. Corporations X and Y are members of a combined group that file a combined report for the 2010 tax year on a calendar year basis. Y is a wholly owned subsidiary of X. At the beginning of the group's 2010 tax year, X's basis in the stock of Y is $1,000,000. During the group's 2010 tax year, Y has $100,000 of net income, all of which is included in the combined group's taxable income for 2010. During 2010, Y also pays a dividend of $80,000 to X, all of which is attributable to earnings and profits of the

combined group. Assume that the entire dividend from Y to X is eliminated from the XY group's taxable income in 2010 pursuant to 830 CMR 63.32B.2(6)(c)(4). Consistent with the rules set forth in 830 CMR 63.31.N.1(6)(b), Y's $100,000 of net income results in a positive adjustment of $100,000 to X's basis in the stock of Y, and Y's $80,000 distribution to X results in a negative basis adjustment of $80,000 to X's basis in the stock of Y. Therefore, X's basis in the stock of Y as of the beginning of the group's 2011 tax year is $1,020,000 (*i.e.*, $1,000,000 + $100,000 - $80,000).

Example 2. Corporations X, Y and Z are members of a combined group that file a combined report for the 2010 tax year on a calendar year basis. X owns all the stock of Y, and Y owns all the stock of Z. At the beginning of the group's 2010 tax year, X has an unadjusted basis of $500,000 in Y's stock, which includes Y's unadjusted basis of $200,000 in Z stock. In the group's 2010 taxable year, Y has a total of $80,000 of net income, all of which is included in the XYZ group's taxable income, and Z has a total of $150,000 of net income. Z's net income includes $20,000 that was attributable to income earned outside the United States that is not included in the XYZ group's taxable income for 2010 pursuant to 830 CMR 63.32B.2(6)(c)(2). Neither Y nor Z makes any distributions in 2010. Consistent with the rules set forth in 830 CMR 63.31N.1(6)(b), Y's basis in the stock of Z is increased by $130,000 to reflect the $130,000 of Z's income that is included in the XYZ group's 2010 taxable income. Also, X's basis in the stock of Y is increased by the $130,000 adjustment to Y's basis in Z, and by Y's $80,000 of net income. No adjustment is made for the $20,000 of Z's net income that is not attributable to the XYZ group. Therefore, at the end of the group's 2010 tax year, Y's basis in the stock of Z is $330,000 (*i.e.*, $200,000 + $130,000) and X's basis in Y's stock is $710,000 (*i.e.*, $500,000 + $80,000+ $130,000).

(d) Earnings and Profits. Where a shareholder corporation and its subsidiary corporation are members of a combined group, the shareholder corporation's earnings and profits shall be adjusted to reflect the undistributed earnings and profits of the subsidiary by applying the federal rules and principles set forth in Treas. Reg. § 1.1502-33, except where a divergence between Massachusetts law and such federal rules requires a different result, or where no analogous situation exists for purposes of the federal rules. In determining such adjustments, the following general rules, *inter alia*, shall apply:

1. Intercompany transactions as between members of the combined group are not reflected in earnings and profits before they are taken into account pursuant to 830 CMR 63.31N.1(5)(b); and

2. In any instance in which the combined group consists of tiers, the adjustments are applied in the order of the tiers, from the lowest to the highest.

No such adjustments shall be made pursuant to 830 CMR 63.31N.1(6)(d) in the case of a shareholder corporation and its subsidiary when such entities are not members of a Massachusetts combined group, irrespective as to whether such entities are members of a federal consolidated group.

(e) Example. The following example illustrates the provisions of 830 CMR 63.31N.1(6)(d). Corporations X, Y and Z are members of a combined group that file a combined report for the 2010 tax year on a calendar year basis. X owns all the stock of Y and Y owns all the stock of Z. During the XYZ group's 2010 tax year, X has earnings of $300,000 and Y has earnings of $500,000. Assume these amounts are attributable entirely to items included in the XYZ group's taxable income for its 2010 taxable year. Z has $400,000 of earnings for the 2010 tax year. However, $50,000 of this amount is attributable to income earned outside the United States that is not included in the XYZ group's taxable income for 2010 pursuant to 830 CMR 63.32B.2(6)(c)(2). Assume neither Y nor Z made any distributions in 2010. At the end of 2010, Y's total current year earnings and profits are $850,000 (*i.e.*, $500,000 + the $350,000 of Z's earnings attributable to income included in the XYZ group's taxable income), and X's current year earnings and profits are $1,150,000 (*i.e.*, $300,000 + $850,000 attributed from Y).

(f) Effective Date. *See* 830 CMR 63.31N.1(8)(b) for specific rules regarding the effective date of 830 CMR 63.31N.1(6).

(7) Application of the Sham Transaction Rule and Related Doctrines. All transactions and other activities that increase or decrease basis, or otherwise affect basis, in a corporation's property, including stock owned by such corporation, are potentially subject to additional adjustment as permitted under Massachusetts law, including pursuant to the sham transaction doctrine and other related tax doctrines as referenced in M.G.L. c. 62C, § 3A.

63.31N.1: continued

(8) Effective Date.

(a) General. Except as specifically provided in 830 CMR 63.31N.1(8)(b) or to the extent that a provision reflects prior law, the provisions in 830 CMR 63.31N.1, generally shall apply to tax years beginning on or after January 1, 2009.

(b) Application of 830 CMR 63.31N.1(6). Notwithstanding the general rule set forth in 830 CMR 63.31N.1(8)(a), the provisions of 830 CMR 63.31N.1(6) generally shall apply to tax years beginning on or after January 1, 2014. However, for tax years beginning on or after January 1, 2009, the Commissioner may apply the provisions of 830 CMR 63.31N.1(6) or make other appropriate adjustments in order to properly reflect gain and to avoid the duplication of gain or loss.

(PAGES 213 THROUGH 218 ARE RESERVED FOR FUTURE USE.)

63.32B.2: Combined Reporting

(1) Purpose; General Rule; Relationship to Other Rules; Outline

(a) Purpose. The purpose of 830 CMR 63.32B.2 is to provide rules for the combined reporting of income as required by M.G.L. c. 63, § 32B. The M.G.L. c. 63, § 32B reporting requirement recognizes that a unitary business can be conducted not only through separate divisions of a single corporation but also through corporations related by common ownership such that in either instance, in the case of a multi-state business, it is appropriate and constitutionally permissible to apportion the resulting income of the unitary business even if that income arises from activities conducted outside the state. A combined report is a computational schedule that is generally required to be filed when a corporation that is subject to tax under M.G.L. c. 63 is engaged in a unitary business with one or more other corporations that are required to be included in a combined report under M.G.L. c. 63, § 32B. In such cases, in the case of a multi-state business, the combined report is required to calculate the corporation's taxable net income derived from the unitary business as its share, attributable to the commonwealth, of the apportionable income or loss of the combined group engaged in the unitary business.

(b) General Rule. In general, a corporation is required to file a combined report when it is subject to tax under M.G.L. c. 63 and is engaged in a unitary business with one or more other corporations that are required to be included in a combined report pursuant to M.G.L. c. 63, § 32B. In such cases, if any member of the group has income from the activities of the group's unitary business that is taxable in another state, the taxable member shall calculate its taxable net income derived from such unitary business as its apportioned share of the income or loss of the combined group engaged in the unitary business, determined in accordance with such combined report. The combined report shall be filed with the taxpayer's tax return, as further explained in 830 CMR 63.32B.2, and shall include the income and apportionment information of all corporations that are members of the combined group and such other information as required by the Commissioner. The composition of the combined group and the computation of the taxable member's income and its apportionment formula are explained by 830 CMR 63.32B.2. A combined report is also required in cases where a taxpayer corporation is engaged in a unitary business with one or more corporations and no member of the combined group has income from the activities of the group's unitary business that is taxable in another state. In some cases a taxpayer may make an election to treat as its combined group all corporations that are members of its Massachusetts affiliated group, as defined in 830 CMR 63.32B.2(2), on such terms and in keeping with such requirements as are further explained by 830 CMR 63.32B.2. The requirement to file a combined report is *not* dependent upon an evidentiary showing that there is a distortion of income between corporations that are related by common ownership or that there is a lack of arm's length pricing in transactions between such corporations.

63.32B.2: continued

(c) Relationship to Other Rules.

1. Application of Combined Reporting. The corporations that are included in a combined group, including the taxable member or members of such group, generally retain their separate identities under M.G.L. c. 63 for purposes of determining the income measure of the corporate excise to be applied to the taxable members' share of the combined group's taxable income. Consequently, in determining the corporate excise income tax on such taxable income, the rules of M.G.L. c. 63 generally apply to determine the computation of such income and the apportionment formulas, as applicable, of the taxable members of the group, subject to modifications pursuant to M.G.L. c. 63, § 32B or 830 CMR 63.32B.2, as well as the rate of tax to be applied to the taxable members' apportioned income derived from the group.

2. Continued General Application of M.G.L. c. 63. The combined reporting requirement does not disregard the separate identity of an individual taxable member of a combined group for purposes of M.G.L. c. 63 generally. Therefore, a taxable member may have tax attributes or tax consequences apart from those determined through the means of a combined report. For example, in any case where no affiliated group election is made, a taxable member of a combined group may have, in addition to its apportionable share of the combined group's unitary business income, allocable or apportionable income from activities that were conducted by the taxpayer and not as part of the combined group's unitary business. In these cases, the taxpayer corporation shall be subject to tax on such other income under the general rules as set forth in M.G.L. c. 63.

3. Application of Non-income Measure. The combined reporting rules provide a method for determining the share of taxable net income derived by a taxable member of a combined group from the group's unitary business activities (or Massachusetts affiliated group activities in the instance of an affiliated group election). These rules do not dispense with the requirement that certain corporations are required to pay the minimum corporate excise or the non-income measure of the corporate excise as determined under M.G.L. c. 63, § 39. A member of a combined group that is subject to the non-income measure must separately calculate that measure under the rules that apply thereto. In some instances payment of the non-income measure is required even when a corporation is not subject to tax on its income either through the means of a combined report or otherwise. For example, a corporation that would otherwise be subject to the income measure but for the application of Public Law 86-272 is nonetheless required to pay either the greater of the minimum excise or the non-income measure.

4. Revocation of Election under Prior M.G.L. c. 63, § 32B. Pursuant to the enactment of M.G.L. c. 63, § 32B by St. 2008, c. 173, the prior version of M.G.L. c. 63, § 32B has been repealed. Therefore, any taxpayer election that was made pursuant to prior M.G.L. c. 63, § 32B and 830 CMR 63.32B.1, is revoked for tax years beginning on or after January 1, 2009 and any such prior election shall have no further effect except as set forth in 830 CMR 63.32B.2.

(d) Outline. 830 CMR 63.32B.2 is organized as follows:

1. Purpose; General Rule; Relationship to Other Rules; Outline
2. Definitions
3. Unitary Presumptions and Inferences
4. Corporations to Be Included in a Combined Report
5. Water's Edge or Worldwide Parameters of a Combined Report
6. Determination of Taxable Income of Taxable Member of a Combined Group
7. Apportionment of Income Computation; Tax Computation Where No Apportionment
8. Net Operating Loss Carry Forwards
9. Credits
10. Affiliated Group Election
11. Principal Reporting Corporation; Liability
12. Tax Returns; Taxable Year; Fiscalization; Partial Years
13. No Limit on Other Authority
14. Effective Date

63.32B.2: continued

(2) Definitions.

Affiliated Group, a Massachusetts affiliated group as defined by 830 CMR 63.32B.2(2), unless the context requires differently.

Affiliated Group Election, an election by a taxable member on behalf of itself and its affiliates to treat as its combined group all corporations that are members of its Massachusetts affiliated group, on such terms and in keeping with such requirements as are further explained by 830 CMR 63.32B.2 and such forms or other notices as are issued by the Department. *See* 830 CMR 63.32B.2(10).

Affiliated Group Income, the aggregate taxable net income or loss of the group members of a Massachusetts affiliated group for a taxable year in which an affiliated group election is in effect, which is to be apportioned to (or attributed under 830 CMR 63.32B.2(7)(k)) the members of the group pursuant to the affiliated group election made by such group, whether in the absence of the application of the affiliated group election some or all of any such apportioned income would have been allocable to a particular state.

Code, the federal Internal Revenue Code as amended and in effect for the taxable year.

Combined Group, a group of two or more corporations related by common ownership including one or more corporations that are subject to tax on their income under M.G.L. c. 63, § 2, 2B, 32D, 39 or 52A that are required to be included in a combined report pursuant to M.G.L. c. 63, § 32B, as enacted by St. 2008, c. 173, because the corporations are engaged in a unitary business. A combined group specifically includes or excludes certain types of corporations as described at 830 CMR 63.32B.2(4). The combined group shall consist of the one or more taxable members of the group, irrespective of their place of incorporation or formation, and the additional non-taxable members of such group as determined under 830 CMR 63.32B.2(5). In the case of an affiliated group election, the term "combined group" refers to the Massachusetts affiliated group to which the election applies.

Combined Group's Taxable Income, the aggregate taxable net income or loss, subject to apportionment and derived from a unitary business or the aggregate taxable income or loss of a Massachusetts affiliated group in the case of an affiliated group election, in either case as reported on a combined report of every taxable member and non-taxable member of the combined group.

Combined Report, a schedule or schedules, as required by M.G.L. c. 63, § 32B, as enacted by St. 2008, c. 173, and 830 CMR 63.32B.2 or such other rules as the Commissioner may establish, which are to be attached to a taxpayer's tax return and that report the income and apportionment information of all corporations that are members of the taxpayer's combined group, as well as any supporting information, as required by the Commissioner.

Commissioner, the Commissioner of the Massachusetts Department of Revenue or the Commissioner's duly authorized representative.

Commonly Owned or Common Ownership, where more than 50% of the voting control of one or more corporations or other entities, as applicable in the context, is directly or indirectly owned by one or more common owners, whether corporate or non-corporate, subject to the following specific rules and examples.

(a) Direct and Indirect Voting Control, and Tiered Ownership. If the same person (and/or any related persons) holds directly or indirectly more than 50% of the voting control of a corporation (a parent corporation), that person shall be considered to hold indirectly any stock or other interest in ownership or control in a lower-tier corporation (a subsidiary corporation) that is directly or indirectly held by the parent corporation. Thus, by way of illustration, a parent corporation and any one or more corporations (whether or not in a direct chain) connected through direct or indirect stock ownership, where more than 50% of the voting control of each subsidiary corporation is directly or indirectly owned by a corporation (and/or any related persons), are treated as commonly owned or under common ownership, and subject to inclusion in a combined group.

63.32B.2: continued

Example 1. Corporation A, a widely-held publicly-traded corporation, owns 51% of the stock of Corporation B; B owns 51% of Corporation C; and C owns 60% of Corporation D. Corporations A, B, C, and D are all treated as commonly owned or under common ownership, and subject to inclusion in a combined group.

Example 2. Same facts as in Example 1, except Corporation C owns 40% of Corporation D, with another 20% of D being owned by an individual who owns 100% of Corporation A. All of Corporations A, B, C, and D are, again, treated as commonly owned or under common ownership, and subject to inclusion in a combined group. D is treated as commonly owned through the aggregation of C's 40% ownership in D and the related individual's 20% ownership in D.

(b) Related Versus Unrelated Owners.

1. Two or more corporations, where stock representing more than 50% of the voting control of each corporation is owned directly or indirectly by the same person (and/or any related persons), whether corporate or non-corporate, are treated as commonly owned or under common ownership, and subject to inclusion in a combined group. A common owner or owners need not be members of the combined group.

Example 3. Individual (W) owns 51% of Corporation A, 60% of Corporation B, and 100% of Corporation C. Corporations A, B, and C are all treated as commonly owned or under common ownership, and subject to inclusion in a combined group. The same conclusion would be reached if W owned 35% of B and W's husband, a related person, owned 25% of B, so that together W and her husband owned 60% of B.

Example 4. Foreign corporation (F) owns 100% of the stock of Corporation A (organized in the U.S.) and of Corporation B (also organized in the U.S.). A and B each directly or indirectly own various corporate subsidiaries in separate chains leading up to A and B, where the voting control of each subsidiary is more than 50%-owned by a higher-tier corporation in the chain. A and B and all of their respective direct and indirect subsidiaries are treated as commonly owned or under common ownership, and subject to inclusion in a single combined group. Assuming that no worldwide election is made and that F is not a foreign corporation that would be included in a "water's edge" combined group under 830 CMR 63.32B.2(5)(b)1.b. or c., F itself would not be subject to inclusion in such combined group.

2. Two or more corporations shall not be treated as commonly owned or under common ownership, and subject to inclusion in a combined group, solely because such corporations have one or more *unrelated* owners in common, where aggregation of the ownership of such unrelated owners would be necessary in order to represent more than 50% of the voting control of any of such corporations.

Example 5. Individual I-1 owns stock representing 40% of the voting control of Corporation A and stock representing 20% of the voting control of Corporation B. Individual I-2 owns 30% of A and 45% of B. I-1 and I-2 are not related persons, and A and B are not otherwise related persons. A and B are not treated as commonly owned or under common ownership, and thus are not subject to inclusion in a combined group.

(c) Two or more corporations that are "stapled entities" are treated as commonly owned or under common ownership, and subject to inclusion in a combined group. Stapled entities are entities where, by reason of their form of ownership, or restrictions on transfer of ownership, or other terms or conditions (whether existing by operation of law, by written contract, or otherwise), in the case of a transfer of one or more ownership interests, more than 50% of the voting control of each entity is required to be transferred.

(d) A group of corporations under common ownership may be engaged in one or more unitary businesses.

Example 6. Assume the same facts as in Example 4. Both A and B and all of their direct and indirect subsidiaries are engaged in unitary business X. In addition, A and all of its subsidiaries are engaged in unitary business Y, but B and its subsidiaries are not engaged in unitary business Y. Assuming that an affiliated group election is not made, A and B and all of their respective direct and indirect subsidiaries would be included in a combined group with respect to unitary business X, and A and all of its direct and indirect subsidiaries would be included in a combined group with respect to unitary business Y.

63.32B.2: continued

(e) Related Parties; Constructive Ownership. In determining whether a person is a related person or is considered to hold stock or other ownership or control interests in an entity that is directly held by another person, the constructive ownership rules described in Code § 318 shall generally apply, to the extent not inconsistent with the rules or requirements described in this definition or elsewhere in 830 CMR 63.32B.2, except that:

1. in applying Code § 318(a)(2), if a partnership, estate, trust, or corporation owns, directly or indirectly, more than 50% of the voting control of a corporation, it shall be considered to own all of the stock or other ownership or control interests in such corporation; and

2. if a person has an option to acquire stock or other ownership interests in an entity, such stock or other ownership interests shall be treated as owned by such person only to such extent as determined by the Commissioner as necessary to prevent tax avoidance.

(f) In determining common ownership, the Commissioner may take into account any plan or arrangement, whether existing by operation of law, by contract, or otherwise, for bestowing or shifting ownership or voting control, in addition to the terms of any actual stock ownership or control.

(g) 830 CMR 63.32B2(2)Commonly Owned(a) through (f) shall be subject to the rules addressing partners and partnership interests that are described in 830 CMR 63.32B.2(2)Unitary Business or the rules set forth elsewhere in 830 CMR 63.32B.2.

Consolidated Return, a return of income filed with the federal government pursuant to Code § 1501 by an affiliated group as determined under Code § 1504.

Corporation, a business corporation within the meaning of M.G.L. c. 63, § 30, whether or not organized in Massachusetts. For taxable years beginning prior to January 1, 2009, a "corporation" refers to either a foreign or domestic business corporation, utility corporation, financial institution, or insurance company, depending upon the context, as determined under the pertinent provisions of M.G.L. c. 63 in effect for such years.

Credit, any tax credit that a corporation may apply against its excise under the pertinent provisions of M.G.L. c. 63.

Disregarded Entity, a disregarded entity within the meaning of M.G.L. c. 63, § 30.

Federal Consolidated Group, an affiliated group as defined in Code § 1504 that has filed a consolidated return of income under Code § 1501.

Massachusetts Affiliated Group, an affiliated group as defined in Code § 1504 that participates in the filing of a federal consolidated return except that the Massachusetts affiliated group shall also include all corporations that are under common ownership that are includable in a combined group under 830 CMR 63.32B.2(4)(b) and (5)(b) irrespective as to whether such corporations are engaged in one or more unitary businesses and irrespective whether such corporations are included in more than one consolidated return filed by more than one federal consolidated group. *See also* 830 CMR 63.32B.2(10)(a) through (c). For example, in cases where the common ownership standard is met, a Massachusetts affiliated group shall include all corporations incorporated in the United States or formed under the laws of the United States, any state, the District of Columbia or any territory or possession of the United States that are commonly owned, directly or indirectly, by any member of such affiliated group. Also, a Massachusetts affiliated group shall include any other commonly owned corporation, regardless of the place of its incorporation or formation that has property, payroll, and sales factors within the United States that average 20% or more. Further, a Massachusetts affiliated group shall include any other commonly owned corporation, regardless of place of incorporation or formation, that earns more than 20% 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, whether currently or over a period of time, against the business income of other members of the group, but in this case only to the extent of that income and the apportionment factors that relate to that income.

Net Operating Loss, a net operating loss within the meaning of M.G.L. c. 63, § 30.5.

63.32B.2: continued

Non-taxable Member, a member of a combined group that is not subject to tax on its income under M.G.L. c. 63, § 2, 2B, 32D, 39 or 52A. A non-taxable member that is not subject to income tax under M.G.L. c. 63, § 2, 2B, 32D, 39 or 52A may nonetheless be subject to the non-income measure of the corporate excise as determined under M.G.L. c. 63, § 39.

Partnership, a partnership within the meaning of M.G.L. c. 63, § 30.

Principal Reporting Corporation, the taxable member of a combined group that reports the income of the combined group and otherwise acts as the agent of the members of the group, as further described at 830 CMR 63.32B.2(11).

Taxable Member, a member of a combined group that is subject to tax on its income under M.G.L. c. 63, § 2, 2B, 32D, 39 or 52A, other than a corporation described in M.G.L. c. 63, § 38Y.

Unitary Business, a group of two or more corporations related by common ownership that are sufficiently interdependent, integrated or interrelated through their activities so as to provide mutual benefit and produce a significant sharing or exchange of value among them or a significant flow of value between the separate parts. This sharing, exchange or flow of value to a corporation located in this state provides the constitutional basis to apportion the resulting income of the unitary business even if that income arises from activities conducted outside the state. The term unitary business shall be construed to the broadest extent permitted under the Constitution of the United States. Any business conducted by a partnership shall be treated as the business of the partners, whether the partnership interest is directly held or indirectly held through a series of partnerships, to the extent of the partner's distributive share of the partnership's income, regardless of the magnitude of the partner's ownership interest or its distributive share of partnership income. Moreover, a business conducted directly or indirectly by one corporation is unitary with that portion of a business conducted by another, commonly-owned corporation through its direct or indirect interest in a partnership if the activities conducted by the former corporation and the partnership are unitary regardless of the magnitude of the partner's ownership interest or its distributive or any other share of partnership income. A group of corporations related by common ownership may be engaged in more than one unitary business.

Example. The following example provides an illustration of the partnership rules included in the definition of a "unitary business." X, Y, Z and U are corporations with the following relationships. X owns 55% of Y and Z. U is unrelated to X, Y and Z. Y and U own, respectively, 30% and 70% of partnership P. X, Y and Z are each engaged in discrete businesses that are not unitary with one another. Z is engaged 100% in the manufacture of widgets. P is engaged 100% in the distribution of Z's widgets, a business that is unitary with the business of Z. P's widget business is treated as the business of Y to the extent of Y's distributive share of P's income, 30%. Therefore, Z is engaged in a unitary business with Y to this extent.

Worldwide Election, an election by a taxable member of a combined group on behalf of all of the members of such group engaged in a unitary business to treat as its combined group for purposes of 830 CMR 63.32B.2 all members that are engaged in such unitary business, wherever located, on such terms and in keeping with such requirements as are further explained by 830 CMR 63.32B.2 and such forms or other notices as are issued by the Department. *See* 830 CMR 63.32B.2(5).

(3) Unitary Presumptions and Inferences.

(a) General. Without limiting the scope of a unitary business, 830 CMR 63.32B.2(3)(b) through (f) set forth certain presumptions and inferences concerning whether and when two or more corporations under common ownership will be deemed to be engaged in a unitary business. 830 CMR 63.32B.2(3)(b) through (f) do not purport to set forth all of the *indicia* of a unitary business, as that determination is to be made pursuant to U.S. constitutional principles.

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(b) Likely Unitary Situations. Without limiting the scope of a unitary business as determined in other situations, business activities conducted by corporations under common ownership that are in the same general line of business, such as a multistate grocery chain, will generally constitute a unitary business. Business activities conducted by corporations under common ownership that comprise different steps in a vertically structured business will almost always constitute a unitary business. For example, a business engaged in the exploration, development, extraction, and processing of a natural resource and the subsequent sale of a product based upon the extracted natural resource, is engaged in a single unitary business.

(c) Newly-acquired and Newly-formed Entities. In the tax year in which the common ownership standard is first met by reason of one of the transactions described in 830 CMR 63.32B.2(3)(c)1. and 2., the rebuttable presumptions stated in 830 CMR 63.32B.2(3)(c)1. and 2. shall apply. These presumptions may be rebutted by the taxpayer or the Commissioner by the presentation of clear and cogent evidence showing that the corporations in question either are, or are not, engaged in a unitary business, as the case may be.

1. Where a voting interest is directly or indirectly acquired by or in a taxpayer, or by or in a member of a taxpayer's combined group, that results in achieving for the first time common ownership, it shall be presumed that the acquiring and acquired corporations are not engaged in a unitary business for purposes of the tax reporting period of the combined reporting group that includes the acquisition. This presumption against unity shall not apply where the combined group and the acquired corporation were previously engaged in a relationship described in 830 CMR 63.32B.2(3)(b) apart from meeting the common ownership standard.

2. Where a taxpayer, or one or more members of the taxpayer's combined group, forms a new corporation it shall be presumed that the formed corporation(s) is engaged in a unitary business with the forming corporation(s) from the date of its formation.

(d) Passive Holding Companies. A passive parent holding company that directly or indirectly controls one or more operating company subsidiaries engaged in a unitary business shall be deemed to be engaged in a unitary business and includable in a combined report with the subsidiary or subsidiaries. An intermediate passive holding company shall be deemed to be engaged in a unitary business with the parent and subsidiary or subsidiaries and includable in a combined report with them.

(e) Sharing of Intellectual Property; Intercompany Financing. Transfers or sharing of technical information or intellectual property, such as patents, copyrights, trademarks and service marks, trade secrets, processes or formulas, know-how, research, or development, provide evidence of a unitary relationship when the information or property transferred or shared is significant to the businesses' operations. Similarly, a unitary relationship is indicated when there is significant common or intercompany financing, including the guarantee by, or the pledging of the credit of, one or more business entities for the benefit of another business entity or entities, if the financing activity serves an operational purpose.

(f) Relevance of Market-based or "Arm's Length" Pricing to Intercompany Transactions. One *indicia* of a unitary business conducted between corporations related by common ownership is sales, exchanges, or transfers of products, services and/or intangibles between such corporations. When such evidence exists this evidence is not negated by the use of market-based or "arm's length" pricing as to the transactions by the corporations in question.

(4) Corporations to Be Included in a Combined Report.

(a) General. In general, where a corporation subject to tax under M.G.L. c. 63, § 2, 2B, 32D, 39 or 52A, is engaged in a unitary business with one or more other corporations that are related by common ownership, the taxpayer corporation must determine its tax liability based upon the income and apportionment information of all corporations included in the combined group through the means of a combined report. In some cases, the taxable member or members of a combined group may make an election to treat their Massachusetts affiliated group as the combined group and to file a combined report on that basis. *See* 830 CMR 63.32B.2(10). Irrespective as to whether an affiliated group election is made, not every type of corporation is required to be included in a combined group and therefore to have its tax attributes included in a combined report. The rules for included and excluded corporations are set forth in 830 CMR 63.32B.2(4)(b) and (c).

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(b) Included Corporations. Corporations that are required to be included in a combined group and therefore required to be included in a combined report filed by a taxable member of a combined group shall include all entities of the kind that are subject to tax or would be subject to tax if doing business in the commonwealth, under M.G.L. c. 63, § 2, 2B, 32D, 39 or 52A, and entities described in M.G.L. c. 63, §§ 20 through 29E, including so-called "captive" insurance companies, if such entities do not qualify for treatment as a life insurance company as defined in Code § 816 or an insurance company subject to tax imposed by Code § 831. Each such corporation is included in a combined group and the resulting combined report filing, as stated, irrespective of whether the corporation is actually subject to tax under M.G.L. c. 63, § 2, 2B, 32D, 39 or 52A. Consequently, for example, an S corporation is subject to tax under M.G.L. c. 63, § 32D and included in a combined group irrespective as to whether in any given year it actually has a tax liability under M.G.L. c. 63, § 32D. Also, the corporations to be included in a combined group include a real estate investment trust (REIT) as referenced under Code §§ 856 through 859, and a regulated investment company (RIC) as referenced under Code §§ 851 through 855. However, a corporation is only required to be included in a combined group with one or more other corporations if, *inter alia*, it is related with such corporations by common ownership. Therefore, for example, in many cases the ownership of a REIT or a RIC may not meet this standard.

(c) Excluded Corporations. Corporations that are not included in a combined group and therefore not included in a combined report filed thereby, irrespective as to whether they are engaged in a unitary business with a taxable member of such group, include an entity described in M.G.L. c. 63, § 38Y or an entity classified and taxed under M.G.L. c. 63, § 38B. Also, such excluded corporations include an entity described in M.G.L. c. 63, §§ 20 through 29E, except as provided in 830 CMR 63.32B.2(4)(b) or as otherwise provided in M.G.L. c. 63.

(5) Water's Edge or Worldwide Parameters of Combined Report.

(a) General Rule. A corporation, regardless of its place of incorporation or formation, is required to file a combined report when it is subject to tax under M.G.L. c. 63, § 2, 2B, 32D, 39 or 52A and is engaged in a unitary business with one or more corporations that are required to be included in the combined report. In such cases, the taxable member or members of the combined group engaged in a unitary business may elect to determine their apportioned share of the aggregate taxable net income or loss derived from the unitary business pursuant to a worldwide election under which each taxable member shall take into account the income and apportionment factors of all the members, wherever located, includible in the combined group. However, if the taxable members of a combined group do not make this election, each taxable member shall determine its apportioned share of such income on a water's edge basis as determined under 830 CMR 63.32B.2(5)(b). The mechanics for making a worldwide election are set forth in 830 CMR 63.32B.2(5)(c).

(b) Water's Edge Determination.

1. If the taxable members of a combined group do not make a worldwide election, each member shall determine its share of the aggregate taxable net income or loss of the combined group on a water's edge basis under which each member shall take into account the income and apportionment information of the taxable members of the group and of those non-taxable members of the group that are described in any one or more of 830 CMR 63.32B.2(5)(b)1.a. through c.:

a. any member incorporated in the United States or formed under the laws of the United States, any state, the District of Columbia or any territory or possession of the United States;

b. any member, regardless of the place of incorporation or formation, if the average of its property, payroll, and sales factors within the United States is 20% or more;

c. any member that earns more than 20% 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, whether currently or over a period of time, against the business income of other members of the group, but only to the extent of that income and the apportionment factors related thereto.

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Example. W is a corporation incorporated under the laws of a foreign country that is doing business in Massachusetts and is subject to tax under M.G.L. c. 63, § 39. W is engaged in a unitary business with corporations X, Y and Z, none of which is subject to Massachusetts tax. X is a corporation incorporated under the laws of a U.S. state, Y is a corporation incorporated under the laws of a U.S. possession and Z is a corporation that is incorporated under the laws of a foreign country. Z does not have a U.S. domestic apportionment formula of 20% or more as determined under 830 CMR 63.32B.2(5)(b)1.b. and is not subject to the provisions of 830 CMR 63.32B.2(5)(b)1.c. Further, each of the corporations, X, Y and Z, are includible within a combined group within the meaning of 830 CMR 63.32B.2(4)(b). W may make an election to determine its apportioned share of the combined group's taxable income on a worldwide basis, in which case it shall take into account the additional income and apportionment information of X, Y and Z. If W does not make a worldwide election, it shall determine its apportioned share of the combined group's taxable income taking in account the additional income and apportionment information of only X and Y, and not Z. For purposes of the analysis it is not relevant whether W has a U.S. domestic apportionment formula of 20% or more as would be determined under 830 CMR 63.32B.2(5)(b)1.b., or whether W could be subject to the provisions of 830 CMR 63.32B.2(5)(b)1.c., as W is a taxable member of the combined group and said provisions apply to determine the water's edge inclusion of non-taxable members of the combined group.

2. For purposes of 830 CMR 63.32B.2(5)(b)1.b. (*i.e.*, the determination of whether a member has average property, payroll and sales factors within the United States of 20% or more), the apportionment calculation is to be done by the corporation in question on a stand-alone basis pursuant to its applicable apportionment formula prescribed in M.G.L. c. 63, without recourse to the rules set forth in M.G.L. c. 63, § 32B or 830 CMR 63.32B.2(7). For purposes of this computation transactions with commonly owned corporations are taken into consideration, but subject to the rules set forth in M.G.L. c. 63, § 39A and M.G.L. c. 62C, § 3A. However, in any case in which such calculation is pursuant to M.G.L. c. 63, § 38, the calculation is to consist of a three-factor formula consisting of property, payroll and sales without any increased weighting of sales, irrespective as to whether the corporation would file a return under M.G.L. c. 63 generally applying a single sales factor formula or a three factor formula with a double weighted sales factor. Further, the property, payroll and sales within the United States is to be determined by including property, payroll and sales in any of the U.S. states, the District of Columbia, any territory or possession of the United States and any geographic area over which the United States has asserted jurisdiction or claimed exclusive rights with respect to the exploration of natural resources. In any case where the apportionment calculation is pursuant to M.G.L. c. 63, § 38, the rules under M.G.L. c. 63, § 38 shall generally apply, including the rules concerning the elimination of a *de minimis* factor pursuant to M.G.L. c. 63, § 38(g) and the regulatory rules, if any, as relevant to the corporation, promulgated pursuant to M.G.L. c. 63, § 38(j). In any case where the apportionment calculation is pursuant to M.G.L. c. 63, § 2A, the rules thereunder shall generally apply, including the rules relating to missing factors pursuant to M.G.L. c. 63, § 2A(b). In any case in which 830 CMR 63.32B.2(5)(b)1.b. and c. both apply to an individual corporation, such corporation shall be considered to be included in the water's edge combined group pursuant to 830 CMR 63.32B.2(5)(b)1.b. *See* 830 CMR 63.32B.2(5)(b)5.

3. Subject to further regulatory amendment, in applying 830 CMR 63.32B.2(5)(b)1.c., the Commissioner will take the position that said 830 CMR 63.32B.2(5)(b)1.c. is implicated where a member earns more than 20% of its gross income, directly or indirectly, from intangible property or service-related activities as further set forth in such provision. In determining whether this 20% income threshold is exceeded, items of gross income in the numerator and denominator shall not be limited to items of federal gross income. However, when 830 CMR 63.32B.2(5)(b)1.c. is implicated because the 20% income threshold is exceeded, the income of the member to be included in the combined group's taxable income under 830 CMR 63.32B.2(5)(b)1.c. shall be limited to items of federal gross income, as described in 830 CMR 63.32B.2(6)(c)2.a., as reduced by the deduction of expenses of the member that are reasonably related and not disproportionate to such items of federal gross income, as determined pursuant to such guidance as may

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be issued by the Commissioner. However, in no event shall income to be included in the combined group's taxable income under 830 CMR 63.32B.2(5)(b)1.c. be reduced below zero. Further, the property and payroll of the member deriving the income to be included in the determination of the combined group's taxable income are included in the computation of the combined group's apportionment formula to the extent that such property and payroll relate to such included income, whereas the intra-group sales that produced such income are eliminated for purposes of computing the combined group's apportionment formula. For purposes of 830 CMR 63.32B.2(5)(b)1.c., examples of income from intangible property or service-related activities shall include, without limitation, royalty income from the license of trademarks, patents, or other intellectual property, interest and other income from lending money, and income from management services. In any case where:

(i) the provisions of 830 CMR 63.32B.2(5)(b)1.c would apply but for the fact that the threshold 20% income standard is not satisfied; or

(ii) the provisions of 830 CMR 63.32B.2(5)(b)1.c. do apply but certain items counted in satisfying the 20% income threshold are not included in the determination of the combined group's taxable income because they do not constitute federal gross income, the payment of items not included in determining the combined group's taxable income may be subject to the add back requirements of M.G.L. c. 63, §§ 31I, J and K. *See* also 830 CMR 63.32B.2(6)(c)2.a(ii).

4. The following example illustrates the application of 830 CMR 63.32B.2(5)(b)1.c. and 830 CMR 63.32B.2(5)(b)3.

Corporations L, M and N are corporations that are related by common ownership. M and N are corporations that are formed under the laws of a U.S. jurisdiction as referenced in 830 CMR 63.32B.2(5)(b)1.a. M is subject to Massachusetts tax, whereas N is not subject to Massachusetts tax. L is formed under the laws of a non-U.S. jurisdiction (*i.e.*, L is not incorporated or otherwise formed under U.S. laws as referenced in 830 CMR 63.32B.2(5)(b)1.a.). Also, the average of L's property, payroll and sales factors within the U.S. is not 20% or more within the meaning of 830 CMR 63.32B.2(5)(b)1.b.

L is engaged in lending activity and lends to M and N. L's lending activities fund M and N's business activities and the three corporations are engaged in a unitary business (L's lending activities forge its unitary link with M and N, see 830 CMR 63.32B.2(3)(e)). The combined group is required to file a combined report in Massachusetts and does not make a worldwide election.

During the tax year in question, M and N deduct on their federal consolidated return a total of $1,000,000 in interest expense paid to L. L's total gross income for the year, including the $1,000,000 interest payments received from M and N, is $2,000,000. The $1,000,000 of interest from M and N is included in L's federal gross income. L has $100,000 in costs deductible under U.S. accounting principles, which are reasonably related and not disproportionate to the $1,000,000 of gross income items received from M and N.

Because L receives more than 20% of its gross income from its loans to M and N, L is deemed by the Commissioner to be included in a "water's edge" combined group with M and N to the extent of this gross income, $1,000,000, and to the extent of L's expenses that are reasonably related and not disproportionate to this gross income, $100,000. In determining the combined group's taxable income, the activities of L are considered but only to the extent that they generated said income. The intra-group interest payments by M and N to L are eliminated in the determination of the combined group's taxable income. Thus, the combined group's taxable income as calculated for the taxable year in question is not reduced for a separate deduction to M or N for such interest payments or increased for the separate income of L from the receipt of such payments. However, the combined group's taxable income is reduced by a deduction for L's $100,000 of qualifying expenses related to its interest payments received from M and N. The property and payroll of L, to the extent that they relate to L's $1,000,000 of interest payments from M and N are included in the computation of the group's apportionment formula (*i.e.*, for purposes of computing the apportionment percentage for M, the Massachusetts taxpayer that is included in the combined group). However, the interest payments received by L from M and N, which constitute the intra-group sales, are eliminated for purposes of computing the group's apportionment formula. It should be

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noted that this elimination is on account of the intra-group elimination of the payments between M and N on the one hand and L on the other, wholly apart from the fact that interest is generally excluded (except in cases in which a financial institution is included in the combined group) from the sales factor in any event. *See* 830 CMR 63.32B.2(7)(h).

5. Where a corporation would be included in a combined group both by reason of 830 CMR 63.32B.2(5)(b)1.c. and 830 CMR 63.32B.2(5)(b)1.a. or b., the corporation shall be deemed to be included in the combined group under 830 CMR 63.32B.2(5)(b)1.a or b., as applicable, such that the rules that apply to a corporation that is included in a combined group pursuant to 830 CMR 63.32B.2(5)(b)1.c. shall not apply. Thus, for example, in any case in which 830 CMR 63.32B.2(5)(b)1.b. and c. both apply to an individual corporation, such corporation shall be considered to be included in the water's edge combined group pursuant to 830 CMR 63.32B.2(5)(b)1.b., and the rules set forth in 830 CMR 63.32B.2(5)(b)1.c. and 830 CMR 63.32B.2(5)(b)3 and 4 shall not apply. Further, the provisions of 830 CMR 63.32B.2(5)(b)1.a through c., only apply to determine the inclusion of non-taxable members of a combined group, and therefore the rules that apply to corporations that are included in the combined group pursuant to these sections do not apply to taxable members of the combined group. Thus, for example, a taxable member of a combined group that earns more than 20% of its gross income, directly or indirectly, from intangible property or service-related activities as generally described in 830 CMR 63.32B.2(5)(b)1.c. shall determine its income, expenses, and apportionment factors to be included in determining the combined group's taxable income pursuant to 830 CMR 63.32B.2(6) and (7) and not pursuant to the rules set forth in 830 CMR 63.32B.2(5)(b)1.c. and 830 CMR 63.32B.2(5)(b)3 and 4.

6. The provisions of 830 CMR 63.32B.2(5)(b) also apply for purposes of determining the inclusion of corporations in a Massachusetts affiliated group. *See* 830 CMR 63.32B.2(11).

(c) Worldwide Election.

1. Mechanics for Making the Election. A worldwide election shall be made by the principal reporting corporation of the combined group. The election shall be made on an original, timely filed return or as otherwise required in writing by the Commissioner. A return shall be considered timely if it is filed on or before the earliest due date or extended due date for the filing of the principal reporting corporation's return under M.G.L. c. 63. No return filed after this date, whether filed with an application for abatement or otherwise, shall constitute a valid worldwide election. The election, to be valid, must indicate in the manner required by the Commissioner that every corporation that is a member of the combined group has agreed to be bound by such election, including an agreement by each member of the group that such election shall apply to any member that subsequently enters the group and an agreement that each member continues to be bound by the election in the event that such member is subsequently the subject of a reverse acquisition as described in U.S. Treas. Reg. § 1.1502-75(d)(3).

2. Effect of Election in Subsequent Tax Years. A worldwide election shall be binding for and applicable to the taxable year for which it is made and for the next nine taxable years. Any corporation entering the unitary combined group after the year of the election shall be deemed to have consented to the application of the election and to have waived any objection thereto. Reverse acquisition rules based on the federal rules set forth in U.S. Treas. Reg. 1.1502-75(d)(3) shall be applied in determining whether a corporation is bound by a worldwide election.

3. Revocation, Renewal of Election. A worldwide election, once made, cannot be revoked until after it has been effective for ten taxable years. When an election is made it may be renewed after ten taxable years for another ten taxable years. The revocation or renewal of an election shall be made on an original, timely filed return by the combined group's principal reporting corporation or as otherwise required in writing by the Commissioner. A revocation or a renewal shall be effective for the first taxable year after the completion of the ten taxable years for which the prior election was in place. Any revocation or renewal, to be valid, must indicate in the manner required by the Commissioner that every corporation that is a member of the combined group has agreed to be bound by such revocation or renewal. If a prior worldwide election is neither affirmatively revoked nor renewed after ten taxable years pursuant to the terms of 830 CMR 63.32B.2(5)(c), the election shall terminate for the subsequent taxable year, but a new worldwide election may be made for any ten-year period thereafter by election on the terms set forth in 830 CMR 63.32B.2(5)(c).

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4. Change in Reporting Method. If either the water's edge or worldwide method was used to account for the combined group members' income and apportionment data in the preceding tax year and the other method is to be used for the combined group's combined report for the current tax year, adjustments to the income and apportionment data of the group members shall be made to prevent income and apportionment data from being omitted or duplicated, *etc*.

5. Interaction with Affiliated Group Election. A taxpayer may not make a worldwide election and an affiliated group election for the same taxable year and may not make a worldwide election for any year in which an affiliated group election is in effect. *See* 830 CMR 63.32B.2(10).

6. Agreement to Provide Documents**.** An election under 830 CMR 63.32B.2(5)(c) shall constitute consent to the production of documents or other information that the Commissioner reasonably requires -- for example, for purposes of verifying the appropriate members of the combined group, that the requirements of the worldwide election have been met, that the tax computation and tax reporting are proper, *etc*. The documents shall be provided in language and form acceptable to the Commissioner.

(6) Determination of Taxable Income of Taxable Member of a Combined Group.

(a) General Rule. A corporation subject to tax under M.G.L. c. 63, § 2, 2B, 32D, 39 or 52A and included in a combined group with one or more other corporations shall file with its tax return a combined report that includes the income of all corporations that are members of the combined group and such other information as required by the Commissioner. An explanation of the components of the income of a taxable member of a combined group (for example, addressing the situation where the member may have income apart from that derived from the combined group) and the rules for determining a combined group's taxable income are set forth in 830 CMR 63.32B.2(6). If one or more members of a combined group have income from the activities of the group's unitary business that is taxable in another state (or, in the case of an affiliated group election, one or more members of the group are taxable on their income from business activity in another state), each taxable member of the combined group shall determine its net income derived from the activities of the combined group by applying its apportionment percentage as determined under 830 CMR 63.32B.2(7) to the combined group's taxable income as determined under 830 CMR 63.32B.2(6)(c).

(b) Components of Income of a Taxable Member of a Combined Group.

1. Unitary Group Members. A taxable member's share of the unitary business income apportionable to this state of each combined group of which it is a member shall be determined by reference to a combined report filed with respect to the unitary business. The use of the combined report does not disregard the separate identities of the taxable members of the combined group. Each taxable member of a combined group engaged in a unitary business is responsible for an income-based excise that is to be determined based upon its taxable income or loss apportioned or allocated to this state, which shall include, as relevant, the taxpayer's:

a. share of any unitary business income apportionable to this state for each of the combined groups of which it is a member;

b. share of any income apportionable to this state of a distinct business activity conducted within and without the state by the taxable member and not as a part of the unitary business referenced in 830 CMR 63.32B.2(6)(b)1.a.;

c. income from a business conducted by the taxable member entirely within the state and not as a part of the unitary business referenced in 830 CMR 63.32B.2(6)(b)1.a.;

d. income or loss allocable to this State; and

e. net operating loss carry forward(s), including any NOL carry forward(s) of another taxable member of the combined group that the taxpayer is permitted to share, to be offset against the taxpayer's taxable net income on a post-apportioned basis as explained in 830 CMR 63.32B.2(8).

Depending upon the circumstances of any individual taxpayer, without limitation as to other possible adjustments, other items of income or adjustments to the taxpayer's apportioned net income may also apply.

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2. Massachusetts Affiliated Group Members. In the case of an affiliated group election, each taxable member of the combined group is subject to an income-based excise. If one or more members of the affiliated group have apportionable income, the income-based excise of each taxable member of the group is to be determined based upon the member's taxable income or loss apportioned to this state, which shall be its apportioned share of the combined group's affiliated group income prior to any post-apportionment adjustments, including the application of any NOL carry forwards. *See* 830 CMR 63.32B.2(8).

3. Relationship to Non-income Measure. The combined reporting rules provide a method for determining the apportioned taxable net income derived by a taxable member of a combined group from the group's unitary business activities, or from the Massachusetts affiliated group's activities in the instance of an affiliated group election. However, a member of a combined group that is subject to M.G.L. c. 63, § 39, whether or not taxable on its income under M.G.L. c. 63, shall also be separately responsible for the minimum excise or a non-income-based excise as determined under M.G.L. c. 63, § 39. The non-income measure continues to be computed as it was prior to the adoption of M.G.L. c. 63, § 32B and so, for example, a corporation subject to this measure may be required to compute a stand-alone apportionment percentage for purposes of this calculation.

(c) Rules to Determine a Combined Group's Taxable Income. The combined group's taxable income shall be determined by applying 830 CMR 63.32B.2(6)(c)1. through 10.

1. In the case of a combined group taxable with respect to its unitary business, from the total income of the combined group, subtract any income, and add any expense or loss, other than the unitary business income, expense or loss of the combined group. In the case a combined group that has made an affiliated group election, no subtractions or additions are necessary or permitted.

2. Except as otherwise provided, the total income of the combined group is the sum of the incomes, separately determined, of each member of the combined group. The separate income of each member of the combined group shall be determined as follows:

a. Combined Group not Subject to a Worldwide Election.

(i) In any case where the combined group is not reporting under a valid worldwide election, for any member, irrespective as to its place of incorporation, the income to be included in the total income of the combined group shall be the taxable net income for the corporation as determined under M.G.L. c. 63, subject to any further adjustments as required by 830 CMR 63.32B.2. In general, the taxable net income of a corporation as determined under M.G.L. c. 63, is gross income as defined under the Code, with certain Massachusetts adjustments, less the deductions (with certain Massachusetts adjustments) but not the credits that are allowable under the Code. *See, e.g.*, M.G.L. c. 63, § 30.4, 38(a) (which determine Massachusetts net income and then taxable net income for general business corporations by beginning with federal "gross income" as described in M.G.L. c. 63, § 30.3). The definition of federal gross income that is used as the starting point in determining taxable net income under M.G.L. c. 63 generally (a) includes without limitation in the case of a corporation incorporated in the United States or treated as a U.S corporation under the Code, all gross income of the corporation, wherever derived, and (b) includes in the case of a corporation that is not incorporated in the United States and not treated as a U.S. corporation under the Code, only (1) gross income that is effectively connected with the conduct of a trade or business within the U.S. (effectively connected income) and (2) gross income that is derived from sources within the U.S. and that is not effectively connected income, which would include among other things items of non-effectively connected income on which the U.S. federal income tax may be collected through withholding imposed on the payers of such items. *See* Code § 882(b); *see* also Code §§ 881(a), 882(a). Therefore, any income that is effectively connected income as well as any non-effectively connected income that is U.S. source income are generally included in the determination of 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 Code, whereas income that is neither U.S. source income nor effectively connected income is

63.32B.2 continued

generally excluded from the determination of taxable net income of such member. The U.S. source income and the effectively connected income of a member to be included in the total income of the combined group shall not be reduced on account of any U.S. bilateral income tax treaty, except to the extent, if any, that such treaty results in the exclusion of an item from such member's federal gross income as determined under the Code and thereby decreases the member's taxable net income as determined under M.G.L. c. 63. Where a combined group member's federal gross income taken into account in determining taxable net income is limited under the Code (or pursuant to Massachusetts adjustments), any deductions in determining taxable net income are also limited to those permitted to be taken under the Code (and any such Massachusetts adjustments) with respect to those items of gross income taken into account. *See* also 830 CMR 63.32B.2(6)(c)10. Notwithstanding the provisions of 830 CMR 63.32B.2(6)(c)2.a., in any case in which a corporation is included in a combined group solely because of the applicability of 830 CMR 63.32B.2(5)(b)1.c., the income and any related expenses of such member to be included in determining the combined group's taxable income is determined pursuant to said 830 CMR 63.32B.2(5)(b)1.c. and 830 CMR 63.32B.2(5)(b)3. and 4.

(ii) In any case in which a combined group member pays, accrues or incurs an expense to a combined group member that is not incorporated in the United States and not treated as a U.S. corporation under the Code and that expense results in income to the non-U.S. corporation that is not federal gross income (in which case an intra-group elimination does not apply), that expense shall be subject to the provisions of M.G.L. c. 63, §§ 31I, 31J and 31K, if those provisions otherwise apply. This provision applies irrespective as to whether the non-U.S. corporation is included in the combined group by reason of the application of 830 CMR 63.32B.2(5)(b)1.a through c. or alternatively because the non-U.S. corporation is a taxable member of the combined group. *See* also 830 CMR 63.32B.2(13).

b. Combined Group Subject to a Worldwide Election.

(i) In any case where the combined group has made, and is subject to, a valid worldwide election, (A) for any member incorporated in the United States, or treated as a U.S. corporation under the Code, the income to be included in the total income of the combined group shall be the taxable net income for the corporation as determined under M.G.L. c. 63, subject to any further adjustments as required by 830 CMR 63.32B.2, and (B) for any member not incorporated in the United States and not treated as a U.S. corporation under the Code, the income to be included in the total income of the combined group shall be determined from a profit and loss statement that shall be prepared for each foreign branch or corporation in the currency in which its books of account are regularly maintained, adjusted to conform it to the accounting principles generally accepted in the United States for the preparation of such statements and further modified to take into account any book-tax adjustments necessary to reflect federal or Massachusetts tax law. The income in cases described in 830 CMR 63.32B.2(6)(c)2.(b)(i)(B) shall, except as otherwise provided in 830 CMR 63.32B.2, 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 Code. The profit and loss statement of each member of the combined group referenced in 830 CMR 63.32B.2(6)(c)2.b.(i)(B), and the apportionment factors related thereto, whether United States or foreign, shall be translated into or from the currency in which the parent company maintains its books and records on any reasonable basis consistently applied on a year-to-year and entity-by-entity basis. Unrealized foreign currency gains and losses shall not be taken into account. Income apportioned to this state shall be expressed in United States dollars.

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(ii) In any case where the combined group has made, and is subject to, a valid worldwide election, any member not incorporated in the United States and not treated as a U.S. corporation under the Code, may, in *lieu* of the procedures set forth in 830 CMR 63.32B.2(6)(c)2.b.(i), and subject to the determination of the Commissioner that the income to be reported reasonably approximates income as determined under M.G.L. c. 63, determine its income on the basis of any other reasonable method consistently applied on a year-to-year and entity-by-entity basis.

(iii) Where the combined group has made, and is subject to, a valid worldwide election, the income to be included in the combined group's taxable income to be apportioned to the combined group members is limited to the income that derives from the combined group's unitary business.

3. If the unitary business includes income from a partnership, the income to be included in the total income of the combined group shall be the combined group member's direct and indirect distributive share of the partnership's unitary business income. Where an affiliated group election has been made and the income of the combined group includes income from a partnership, the income to be included in the total income of the combined group shall be the combined group member's direct and indirect distributive share of the partnership's aggregate income.

4. Dividends as between members of a combined group shall be treated as follows:

a. Dividends paid by one combined group member to another combined group member shall, to the extent those dividends are paid out of the earnings and profits of the unitary business included in the combined report, from the current or an earlier year, be eliminated from the income of the recipient. Where a member has such earnings and profits from the unitary business and also has earnings and profits that are not from the unitary business (*e.g.*, from non-business activities) or that were otherwise not included in such a combined report (*e.g.*, earnings from tax years beginning prior to January 1, 2009) and this member pays out dividends, the dividends will be deemed to be paid out of earnings and profits on a last in first out (LIFO) basis as between taxable years and on a *pro rata* basis with respect to an individual taxable year. Any dividends that are not eliminated under 830 CMR 63.32B.2(6)(c)4.a. may be eligible for a dividends received deduction under 830 CMR 63.32B.2(6)(c)4.b. Dividends received by a utility corporation from a non-utility corporation and dividends received by a financial institution from a non-financial institution are eliminated under 830 CMR 63.32B.2(6)(c)4.a. if the requirements for elimination under 830 CMR 63.32B.2(6)(c)4.a. are otherwise met.

b. To the extent that a member of a combined group receives a dividend from another member of a combined group and an intercompany elimination does not apply under 830 CMR 63.32B.2(6)(c)4.a., the recipient corporation may be entitled to a dividends received deduction. In these cases, if the dividend is paid out of the earnings and profits of the unitary business, the dividend is included in the combined group's income and the dividends received deduction shall be applied against the combined group's income. Alternatively, if the dividend is not paid out of the earnings and profits of the unitary business and is paid to a taxpayer member of the group, *e.g.*, as in the case of allocable income, the income is included in such recipient member's income and the dividends received deduction is applied against the separate income of such member. In general, the dividends received deduction is 95% if the dividend payer otherwise qualifies under the statute. *See* M.G.L. c. 63, §§ 1 and 38(a)(1). Where the payer is an 80%-owned utility corporation and pays a dividend to another utility corporation the dividends received deduction is 100%. *See* M.G.L. c. 63, § 52A(b). There is no dividends received deduction that applies where a corporation that is not an 80%-owned utility corporation pays a dividend to a utility corporation. *See* M.G.L. c. 63, §52A(b). No dividends received deduction is available with respect to and to the extent that a dividend is eliminated under 830 CMR 63.32B.2(6)(c)4.a. Also, no dividends received deduction is allowed for a distribu-tion from a REIT or any other distribution for which no dividends received deduction is allowed to the recipient under the applicable provisions of M.G.L. c. 63.

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c. The provisions in 830 CMR 63.32B.2(6)(c)4.a. similarly apply to a combined group where an affiliated group election has been made. However, in such cases the references in 830 CMR 63.32B.2(6)(c)4.a. to the earnings and profits of a unitary business included in a combined report are instead to the earnings and profits derived from all activities of the Massachusetts affiliated group, business activities or otherwise, as included in a combined report.

d. The LIFO and *pro rata* rules stated in 830 CMR 63.32B.2(6)(c)4.a. do not apply where the member that pays the dividends has tax-free earnings and profits from its prior activities as a Massachusetts corporate trust (MCT) or from a predecessor or other entity that was a MCT. In such cases, any dividends paid by such member are first paid out of the tax-free MCT earnings and profits. Further, there is no dividends received deduction that applies under 830 CMR 63.32B.2(6)(c)4.b. where a combined group member has tax-free MCT earnings and profits as referenced in 830 CMR 63.32.2(6)(c)4.d. and pays a dividend with respect to these tax-free MCT earnings and profits.

e. The following examples illustrate the rules in 830 CMR 63.32B.2(6):

Example 1. X, Y and Z are general business corporations that are members of a combined group engaged in a unitary business in tax year 2009. X is not a taxpayer in Massachusetts, whereas both Y and Z are Massachusetts taxpayers. X owns 100% of the stock of Y, and Y owns 100% of the stock of Z. For tax year 2009, X has $100,000 of income prior to the inclusion of any inter-company dividends, whereas Y and Z each have $50,000 of income prior to the inclusion of any inter-company dividends. Consequently, the combined group's taxable income to be apportioned to the Massachusetts taxpayers, Y and Z, prior to the inclusion of any dividends, is $200,000. None of the corporations have earnings and profits from sources other than the unitary business.

On December 31, 2009, Z issues a dividend of $125,000 to Y and Y issues a dividend of $225,000 to X. Under the LIFO rule Y eliminates $50,000 of the dividend paid by Z because $50,000 of the $125,000 dividend relates to the 2009 earnings of the XYZ unitary business that are included in the combined report. Thus Y has to account for the remaining $75,000 of the dividend paid by Z, as that portion of the dividend relates to earnings from the unitary business that are not included in the 2009 combined report (*i.e.*, from tax years prior to 2009). Because all of the latter $75,000 distribution is out of non-excludible earnings and profits of the unitary business, it is includible in the XYZ combined group's taxable income and the dividends received deduction of $71,250 (*i.e.*, 95%) is taken at that level.

X eliminates $175,000 of its $225,000 dividend from Y under the LIFO rule. The amount eliminated is $175,000 because:

(i) $50,000 relates to Y's 2009 earnings of $50,000 from the XYZ unitary business included in the 2009 combined report;

(ii) $50,000 relates to Z's 2009 earnings of $50,000 from the XYZ unitary business included in the 2009 combined report; and

(iii) $75,000 relates to the dividend paid by Z to Y out of pre-2009 earnings of the XYZ unitary business that are included in the 2009 combined report.

The remaining $50,000 of the dividend paid by Y to X relates to earnings from the XYZ unitary business that are not included in the 2009 combined report (and that were not included in a prior combined report). X has to account for the remaining $50,000 of the dividend paid by Y and, since the $50,000 relates to non-excludible earnings from the XYZ unitary business, this income is included in the XYZ combined group's taxable income and the dividends received deduction of $47,500 (*i.e.*, 95%) is taken at that level.

The total taxable income of the combined group, including both the dividends and the deductions, is $206,250.

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Example 2. X, Y and Z are general business corporations that are members of a combined group engaged in a unitary business in tax year 2009. X is not a taxpayer in Massachusetts, whereas both Y and Z are Massachusetts taxpayers. X owns 100% of the stock of Y, and Y owns 100% of the stock of Z. For tax year 2010, X has $100,000 of income prior to the inclusion of any inter-company dividends, whereas Y and Z each have $50,000 of income prior to the inclusion of any inter-company dividends. Consequently, the combined group's taxable income to be apportioned to the Massachusetts taxpayers, Y and Z, prior the inclusion of any dividends, is $200,000.

On December 21, 2010, Z receives a dividend from Corporation U of $200,000. On the same day, Z pays a dividend of $200,000 to Y. Z owns 25% of the stock of U. The business of U is unrelated to the unitary business of the XYZ group and the remaining 75% of U is owned by unrelated parties; therefore, U is not part of the XYZ unitary business. Further, the facts demonstrate that the dividend income received by Z from U is allocable to Massachusetts.

The $200,000 dividend received by Z from U in tax year 2010 is not included in the XYZ group's 2010 unitary business income. Rather, Z must separately account for this $200,000 as allocable income. Z is entitled to a 95% dividends received deduction of $190,000 that it applies to the dividend income. In computing its taxable income for the year, Z will add the $10,000 net amount from the allocable dividend to its apportioned share of the XYZ group's unitary business income.

Z has $250,000 of current year earnings, $50,000 of which (20% of the total) is included in the XYZ combined report for the 2010 tax year. Applying the *pro rata* dividend rule, 20% of the $200,000 dividend paid by Z to Y, $40,000, is deemed to be paid out of the XYZ group's unitary business income included in the 2009 combined report. Therefore, Y eliminates this $40,000. However, Y must account for the remaining $160,000 in dividend income received from Z. Further, this $160,000 dividend from Z to Y retains its character to Y as income allocable to Massachusetts (and not, for example, as income derived from the XYZ unitary business). Therefore, if Y is domiciled in Massachusetts this income is allocated to Massachusetts (whereas if Y is not domiciled in Massachusetts, the $160,000 is not taxable in Massachusetts). Assuming that the $160,000 in dividend income is taxable to Y, Y is entitled to a 95% dividends received deduction of $152,000 with respect to this income. In this instance, in computing its income Y would add the $8,000 net amount to its apportioned share of the XYZ group's unitary business income.

5. Income from an intercompany transaction between members of the same combined group that relates to the unitary business of the group, or income from intercompany transactions in the case of an affiliated group election without regard to any unitary determination, shall be deferred in a manner similar to that provided in U.S. Treas. Reg. § 1.1502-13. Upon the occurrence of any of the following events, deferred income resulting from an intercompany transaction between members of a combined group shall be restored to the income of the seller and shall be apportioned as income earned immediately before the event, as unitary business income where no affiliated group election has been made and as affiliated group income where an affiliated group election is in effect at the time of the intercompany transaction:

a. the object of a deferred intercompany transaction is re-sold or otherwise disposed of by the buyer to an entity that is not a member of the combined group;

b. where the combined group is based upon the existence of a unitary business (*i.e.*, no affiliated group election has been made), the object of a deferred intercompany transaction is:

(i) re-sold by the buyer to an entity that is a member of the combined group for use outside the unitary business in which the buyer and seller are engaged; or

(ii) converted by the buyer to a use outside the unitary business in which the buyer and seller are engaged; or

c. the buyer and seller are no longer members of the same combined group (including where a combined group ceases to be determined pursuant to a pre-existing affiliated group or worldwide election and the buyer and seller are no longer in a combined group for that reason).

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6. A charitable expense incurred by a member of a combined group shall, to the extent allowable as a deduction pursuant to Code § 170, be deducted, first from the unitary business income of the combined group with any Code § 170 income limitation applied to such group income, or, where an affiliated group election has been made, from the income of the affiliated group with said income limitation applied to such income. If the total contributions of all combined group members exceed the amount which may be deducted from the group's income, those contributions shall be allowed on a *pro rata* basis per the contributions made by each member. Any group member that has a charitable expense which may not be deducted from the group's income under 830 CMR 63.32B.2(6)(c)6. and which, where an affiliated group election has not been made, also has net income from other sources, shall deduct that expense from such other income before any allocation or apportionment and subject to a separately calculated Code § 170 limitation applied as to such other income. Any member that has a charitable deduction that is disallowed under the 830 CMR 63.32B.2(6)(c)6. shall carry forward the amount disallowed. A charitable deduction disallowed under the 830 CMR 63.32B.2(6)(c)6. but allowed as a carry forward deduction in a subsequent year, shall be treated as originally incurred in the subsequent year by the same member, and the rules of 830 CMR 63.32B.2(6)(c)6. shall apply in the subsequent year in determining the allowable deduction in that year. The carry forward shall be limited to the period provided under the Code. If a member that incurs a charitable expense subsequently leaves the combined group and enters a new combined group the same rules shall apply to the use of the charitable expense in such new group.

Example. C and D are corporations engaged in a unitary business during tax year 2009. During the 2009 tax year, C makes a charitable contribution of $5,000 and D makes a charitable contribution of $7,500. The total unitary business income of the CD combined group, before any charitable expense deduction, is $50,000. The 10% Code § 170 income limitation to be applied to a charitable expense deduction is applied to the combined group's taxable income, resulting in a dollar limitation of $5,000 (*i.e.*, 10% x $50,000). The amount of expense allowed as a deduction, $5,000, is allocated between C & D. Thus, $2,000 of the contribution made by C and $3,000 of the contribution made by D are deducted from group income, which is reduced to $45,000. In addition to its share of the unitary business income, C has separate allocable income of $20,000. Irrespective as to whether this separate allocable income is taxable in Massachusetts, C shall deduct $2,000 of its charitable contribution (*i.e.*, 10%) from this separate income. C's disallowed charitable contribution deduction available for carry forward to the next tax year is $1,000. D has separate apportionable income of $10,000 and shall apply $1,000 of its charitable expense (*i.e.*, 10%) against this apportionable income on a pre-apportioned basis. D's disallowed charitable contribution deduction available for carry forward to the next tax year is $3,500.

7. Any expense of one member of the unitary group which is directly or indirectly attributable to the allocable income of another member of the unitary group shall be allocated to that other member as corresponding allocable expense, as appropriate. 830 CMR 63.32B.2(6)(c)7. does not apply in the context of an affiliated group election.

8. Capital gains or losses and Code § 1231 gains or losses from the sale or exchange of property shall be removed from the combined group's taxable income and shall be apportioned and allocated as follows under 830 CMR 63.32B.2(6)(c)8.a. through e. The combined group's taxable income that remains shall be apportioned to the taxable members of the group without regard to such capital and Code § 1231 gains or losses. However, the removal of such gains and losses from the combined group's taxable income shall not by itself have an effect upon the apportionment factors of the group or any of its members (*e.g.*, where a member has a capital gain resulting from the sale of property used in the combined group's unitary business, that gain shall be reflected in the apportionment computation of the group and the member, except as otherwise provided in M.G.L. c. 63, § 38 or in 830 CMR 63.32B.2).

a. Before any netting of capital gains and losses and Code § 1231 gains and losses, the gains and losses are segregated by type (*i.e.* capital or Code § 1231) and then classified as apportionable or allocable, as the case may be.

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b. Each taxable member's apportionable capital gains and losses and Code § 1231 gains and losses derived from the sale or exchange of property used in the combined group's unitary business (or the activities of the combined group in the case of an affiliated group election) are then aggregated and apportioned to the member using the apportionment factor applicable to such member as determined under 830 CMR 63.32B.2(7), to arrive at the member's Massachusetts gains and losses for the respective classes of income or loss.

c. The apportioned capital and Code § 1231 gains and losses referenced in 830 CMR 63.32B.2(6)(c)8.b. and, in the case where no affiliated group election has been made, any capital or Code § 1231 gains and losses that:

(i) are to be allocated to Massachusetts;

(ii) are to be apportioned to Massachusetts based upon the apportionment factors of the taxpayer member only (*i.e.*, because the gains or losses derive from the separate non-unitary business activity of the member); or

(iii) are derived from the sale or exchange of property used in the unitary business of another combined group and have been separately apportioned under these rules as applied to that group, are then netted by each taxable member using the rules of Code §§ 1231 and 1222, without regard to any of the member's gains or losses that are to be allocated to another state.

d. Any resulting Massachusetts net capital gain or ordinary income (and any ordinary loss, in a case where the netting of Code § 1231 gains and losses produces a resulting ordinary loss) of a taxable member produced by the application of 830 CMR 63.32B.2(6)(c)8.a. through c. shall then be added to (or, in the case of a resulting ordinary loss after netting of Code § 1231 gains and losses, subtracted from) the taxable income of that member. *See* 830 CMR 63.32B.2(6)(b)1. Any resulting Massachusetts capital loss shall not be offset against the member's taxable income and shall not be carried forward to subsequent years.

e. In the instance where there is a fiscalized member of the combined group, the gains and losses to be aggregated and apportioned under 830 CMR 63.32B.2(6)8.b. must first be assigned to the combined group's taxable year. See 830 CMR 63.32B.2(12)(b) and (c). After the aggregation and apportionment under 830 CMR 63.32B.2(6)(c)8.b., the resulting Massachusetts gains and losses are then adjusted to align such gains and losses to the tax year of the taxable member to which it relates.

9. Apart from the specific rules otherwise set forth in 830 CMR 63.32B.2(6)(c), the Commissioner will generally apply the principles set forth in U.S. Treas. Reg. § 1.1502-13 as to intercompany transactions, including as to deferrals and eliminations, to the extent consistent with state combined group membership and reporting principles in general and state law as set forth in M.G.L. c. 63, § 32B and M.G.L. c. 63.

10. Apart from the specific rules otherwise set forth in 830 CMR 63.32B.2(6)(c), any expense incurred by a member of a combined group that is limited under federal law shall generally be likewise limited under Massachusetts law to the extent consistent with state combined group membership and reporting principles in general and state law as set forth in M.G.L. c. 63, § 32B and M.G.L. c. 63.

The rules set forth in 830 CMR 63.32B.2(6)(c) generally apply to determine the combined group's taxable income that is to be apportioned or, where there is no member of the combined group that has apportionable income, attributed to the taxable members of the combined group. After the apportioned or attributed Massachusetts income of the taxable members of the combined group has been determined there may be additional Massachusetts adjustments to such members' income that apply, including the application of any net operating loss carry forwards. *See* 830 CMR 63.32B.2(8).

(d) Federal Basis of Non-Massachusetts Taxpayer Included in a Combined Group; Election to Use Massachusetts Basis for All Assets of All Combined Group Members. In general, when a corporation that was not previously a Massachusetts taxpayer enters or otherwise is first included in a combined group the basis of the various assets of such member will be the basis of such assets for federal income tax purposes. However, the principal reporting corporation of a combined group may elect to determine and apply a Massachusetts-adjusted basis for all assets of every member of the combined group that was not previously a Massachusetts taxpayer, including any non-taxpayer corporation that subsequently enters or otherwise is included in the combined group, provided that the corporation must possess and

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maintain adequate records to demonstrate the appropriate Massachusetts-adjusted basis for all such assets. The election must be made by a combined group during the period of limitations for abatement under M.G.L. c. 62C, § 37, without taking into account the provisions of M.G.L. c. 62C, § 30, for the tax year that first includes a previously non-taxable member. The election is irrevocable and is to be made in such form and in such manner as prescribed by the Commissioner. If a taxpayer is unable to reasonably document basis adjustments pursuant to this election for any member of the group, the election will be treated as void with respect to all group members and taxable periods that are within the statute of limitations for assessment.

(7) Apportionment of Income Computation; Tax Computation Where No Apportionment.

(a) General.

1. A corporation subject to tax under M.G.L. c. 63, § 2, 2B, 32D, 39 or 52A and included in a combined group with one or more other corporations shall file with its tax return a combined report that includes the income of all corporations that are members of the combined group and such other information as required by the Commissioner. *See* 830 CMR 63.32B.2(6). Further, if one or more members of the combined group have income from the activities of the group's unitary business that is taxable in another state or, in the case of an affiliated group election one or members of the group is taxable on its income from business activity in another state, each taxable member must also include the apportionment information of all group members as required by the Commissioner. *See* M.G.L. c. 63, § 38(b). For the rules that govern when the combined group does not include any member that is taxable in another state as described in 830 CMR 63.32B.2(7)(a)1., *see* 830 CMR 63.32B.2(7)(k).

2. A taxable member of a combined group that is required to apportion its income shall determine its net income derived from the activities of the combined group by applying its apportionment percentage as determined under 830 CMR 63.32B.2(7) to the combined group's taxable income as determined under 830 CMR 63.32B.2(6)(c). Subject to the rules set forth in 830 CMR 63.32B.2(7), each member of a combined group shall separately determine its apportionment information pursuant to the apportionment provisions of M.G.L. c. 63 that apply to such member, provided however, that if an affiliated group election is not in effect, both the numerator and denominator of the apportionment factors for this purpose shall exclude any property or payroll utilized in, or sales that derive from, activity other than the unitary business. In any case in which property or payroll is utilized both in the unitary business and in activity other than that of the unitary business, the computation shall include the appropriate portion thereof. The apportionment method used by each such member depends on the classification of the individual member, *e.g.*, whether the individual member is a general business corporation, a manufacturing corporation, financial institution, utility corporation, mutual fund service corporation, *etc*. The apportionment provisions in 830 CMR 63.32B.2(7) shall only be applied to determine the apportionment of the unitary business income (or in the case of an affiliated group election, the affiliated group income) derived by a taxable member of a combined group from such group. Therefore, for example, these apportionment provisions do not apply to determine the non-income measure of a combined group member subject to tax under M.G.L. c. 63, § 39, which is to be separately determined by such member under M.G.L. c. 63, § 39.

(b) Determination of Factor Numerators; Sales Factor "Finnigan" Adjustment. The numerator of the apportionment factor or factors that apply to each taxable member of a combined group shall include the property, payroll, and sales/receipts, as applicable, of such member as sourced to Massachusetts under the rules provided under M.G.L. c. 63, § 2A, 38 or 42, as applicable, subject to any adjustments provided for in 830 CMR 63.32B.2(7). Where a combined group includes one or more taxable members and one or more non-taxable members, the sales/receipts factor numerator(s) of the taxable member or members are increased in the following manner:

1. The total amount of sales or receipts sourced to Massachusetts under M.G.L. c. 63, § 2A, 38 or 42, is determined for all non-taxable members;

2. Each taxable member determines a fraction, the numerator of which is the sales/receipts factor numerator of such member, determined without any adjustments under 830 CMR 63.32B.2(7)(b), and the denominator of which is the sum of the sales/receipts factor numerators of all taxable members, as determined without any adjustments under 830 CMR 63.32B.2(7)(b); and

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3. For each taxable member, the total Massachusetts receipts of the non-taxable members is multiplied by the fraction described in 830 CMR 63.32B.2(7)(b)2., and the resulting product is added to the sales factor numerator, as otherwise determined, of the taxable member.

(c) Application of M.G.L. c. 63, § 38(f) "Throwback". For purposes of determining whether sales are to be sourced to Massachusetts and included in the numerator of the sales factor of a taxable member of a combined group under M.G.L. c. 63, § 38(f) (*i.e.*, as "throw back" sales), such taxable member is considered taxable in any state in which any member of its combined group is subject to tax with respect to the income derived from the group's unitary business (or, in the case of an affiliated group election, in any state in which any member of the combined group is taxable). 830 CMR 63.32B.2(7)(c) applies only if at least one member of the combined group is entitled to apportion its income under M.G.L. c. 63 for the tax year in question.

(d) Determination of Factor Denominators. The denominator of the apportionment factor or factors that shall apply to each taxable member of a combined group shall include the property, payroll, and sales/receipts, regardless of location, of the combined group as a whole. The factors of the combined group as a whole are determined by adding together the denominators of all members of the combined group, as individually determined under the rules provided in M.G.L. c. 63, § 2A, 38 or 42, subject to any adjustments provided in 830 CMR 63.32B.2(7). The denominators of the members of the combined group shall be individually determined under said rules that apply to such member, or under such rules that would apply to such member in the case of a non-taxable member assuming that such non-taxable member were subject to Massachusetts income tax. The denominators of the property and payroll factors of the combined group as a whole shall include the property and payroll factor denominators, determined under M.G.L. c. 63, § 38, of a combined group member that either is to apply the single sales factor apportionment rules set forth under M.G.L. c. 63, § 38 or that would be required to apply these rules if such member were subject to Massachusetts income tax.

(e) Inclusion of Partnership Factors. Where a taxable member of a combined group receives unitary business income through a direct or indirect ownership interest in a partnership or disregarded entity the property, payroll, and sales/receipts factors of such taxable member shall include its *pro rata* share of the factors relating to such income as attributed to the taxable member through such ownership interest. *See* 830 CMR 63.38.1(12). In the case of an affiliated group election, a taxable member of a combined group shall include in its property, payroll and sales/receipts factors its *pro rata* share of the property, payroll and sales/receipts factors relating to all income that is attributed to the taxable member through its direct or indirect ownership interest in a partnership or disregarded entity.

(f) Exclusion of Factors Related to Items Excluded from Federal Gross Income. 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. Also, any property or payroll (or appropriate portion thereof) that relate to such receipts are similarly excluded from the property or payroll factors of the combined group member. Thus, for example, in any case in which a combined group is not reporting under a valid worldwide election, for any member not incorporated in the United States and not treated as a U.S. corporation under the Code, the income to be included in the total income of the combined group shall be the taxable net income as determined under M.G.L. c. 63. *See* 830 CMR 63.32B.2(6)(c)2.a.(i)(b). In these cases, where receipts to which any items of gross income are directly attributable are not included in the determination of such taxable net income, these receipts are similarly excluded from the numerator and denominator of the member's sales factor. Also, any property or payroll (or appropriate portion thereof) that relate to such receipts are similarly excluded from the property or payroll factors of the combined group member. Notwithstanding the provisions of 830 CMR 63.32B.2(7)(f), in any case in which a corporation is included in a combined group solely because of the applicability of 830 CMR 63.32B.2(5)(b)1.c., the income and factors of the corporation to be included in determining the combined group's taxable income are determined pursuant to 830 CMR 63.32B.2(5)(b)1.c. and 830 CMR 63.32B.2(5)(b)3. and 4.

63.32B.2: continued

(g) Intercompany Transactions. In determining the numerator and denominator of the apportionment factors of the members of a combined group, transactions between combined group members that relate to the unitary business are generally disregarded. Also, intercompany transactions between a combined group member and a partnership whose income is included in the unitary business of the combined group are also generally disregarded where the transactions relate to the unitary business to the extent of the group member's distributive share interest in partnership income consistent with the rules set forth in 830 CMR 63.38.1(12). Where a taxable member of a combined group has made an affiliated group election, all transactions between the members of the Massachusetts affiliated group are generally disregarded. With respect to intercompany transactions, the specific rules set forth in 830 CMR 63.32B.2(7)(g)1. through 4. also apply.

1. Intercompany sales are disregarded for purpose of the sales/receipts factors.

2. A sale by a member of a combined group to a purchaser that is not a member of the combined group is attributed to the group member that books the sale, subject to the adjustments to be made under 830 CMR 63.32B.2(7)(b). However, 830 CMR 63.32B.2(7)(g)2.a. through e. shall apply to avoid distortion of applicable apportionment formulas in the case of intra-group sales.

a. Where a group member making a sale to a purchaser that is not a member of the combined group previously acquired the property or services sold from another combined group member, the activities of both the member producing the property or services and the member making the sale to the non-member must be considered jointly for purposes of determining the appropriate apportionment formula of the member making the sale. For example, where a combined group member (A) manufactures property and sells all of the manufactured property, directly or indirectly, to member (B), which, in turn, resells the property to a purchaser that is not a member of the combined group, both the activities of A and the activities of B must be considered jointly to determine whether B must use the single sales factor apportionment formula applicable to manufacturers or the three-factor apportionment formula applicable to non-manufacturers. In this example, both A and B are considered to be engaged in manufacturing and the joint property, payroll, and receipts of A and B will be considered to determine whether the manufacturing activity attributed to B is substantial. For purposes of this determination, B's receipts from the sales of property manufactured by A are considered to be manufacturing receipts. If the activities of A and B considered jointly involve substantial manufacturing, as provided under M.G.L. c. 63, § 38, then B must use a single sales factor apportionment formula.

b. To the extent that A sells its manufactured property both to B and to other buyers, the property, payroll, and receipts of B shall be combined with the pro-rated property and payroll of A for purposes of determining whether B is engaged in substantial manufacturing. B's receipts from sales of property manufactured by A shall be considered to be manufacturing receipts of B. The property and payroll of A shall be pro-rated in the same ratio that A's sales to B bear to A's total sales.

Example 1. A unitary group is comprised of members A and B. Both A and B have nexus in Massachusetts. A manufactures widgets, all of which it then sells to B. B sells the widgets to unrelated parties. A has $1,000 of property, $150 of payroll and $300 of sales (*i.e.*, the sales made to B). All of A's property, payroll, and receipts are attributable to manufacturing. B has $50 of property, $150 of payroll, and $500 of sales (*i.e.*, of property purchased from A). For purposes of apportionment, A is a manufacturing corporation using a single sales factor apportionment formula. However, as all of A's sales are to another group member, A has no applicable sales factor and none of the group's income is apportioned to A. A's activities and its property, payroll, and sales are considered together with those of B for purposes of determining whether B is a manufacturing corporation. Therefore, B is considered to be engaged in manufacturing and $1,000/1,050 of its property, $150/300 of its payroll, and $500/500 of its sales (excluding the intercompany sales) are attributable to manufacturing. Applying the provisions of M.G.L. c. 63, § 38(l), B's deemed manufacturing activity is substantial. B must apportion the group's combined income to Massachusetts using a single sales factor apportionment formula. B's denominator is $500 and its numerator is the portion of the $500 attributable to Massachusetts sales.

63.32B.2: continued

Example 2. Same facts as in example one except that A has $1,000 of sales, $300 of which are to B and $700 are to unrelated parties. B has $2,000 of sales, $500 of which relate to goods purchased from A and $1,500 relate to goods purchased from unrelated vendors that are then resold. A uses a single sales factor apportionment formula. Its sales factor denominator is $2700 (excluding $300 of intercompany sales) and its numerator is the portion of its $700 in direct sales that are attributable to Massachusetts customers. B is also deemed to be engaged in substantial manufacturing because A's manufacturing activity is attributed to B and 25% (*i.e.*, $500/2,000) of its sales are manufacturing sales, which satisfies the "substantial manufacturing" threshold. B therefore also uses a single sales factor apportionment. B's denominator is $2,700 and its numerator is the portion of its $2,000 in sales that are attributable to Massachusetts sales.

Example 3. Same facts as example two except that only B has nexus in Massachusetts. B continues to use a single sales factor apportionment formula. B's denominator remains $2,700. B's numerator is the sum of its numerator in example 2 and A's numerator in example 2.

63.32B.2: continued

c. The provisions of 830 CMR 63.32B.2(7)(g)2.a. and b. shall apply to sales of tangible personal property to a purchaser that is not a member of the combined group either where the member of the group making the third party sale first acquires title to the property from another member of the combined group or where one combined group member acts as the sales agent or representative for the other member with regard to the third party sale without taking title to the property.

d. In any case where a corporation is deemed to be engaged in substantial manufacturing within the meaning of M.G.L. c. 63, § 38 pursuant to 830 CMR 63.32B.2(7)(g)2.a. and b., and such manufacturing activity occurs in Massachusetts, such corporation will similarly be deemed entitled to claim the M.G.L. c. 63, § 31A credit for the limited purpose of being able to share a M.G.L. c. 63, § 31A credit that has been generated by such other group member. Such sharing shall be pursuant to, and subject to the requirements and limitations set forth in, 830 CMR 63.32B.2(9).

e. In the case of sales "other than sales of tangible personal property", *see* M.G.L. c. 63, § 38(f), between combined group members prior to a sale of such services, intangible property, *etc*., to a purchaser that is not a combined group member, the activities of the combined group members participating in the transaction shall be considered jointly for purposes of defining the nature of the income-producing activity and associated costs of performance when sourcing the sale under M.G.L. c. 63, § 38(f). In general, such sales between group members should not alter the sourcing of the receipt for apportionment purposes.

3. Intercompany leases of employees are disregarded for purposes of the payroll factor. Wages paid to an employee shall be attributed in the payroll factor of the group member for whom the employee is providing actual services. In the case of an employee performing services for more than one combined group member, the group shall reasonably allocate the wages of the employee among the members for whom actual services are provided.

4. Payments to a non-group member for the lease of property shall be attributed to the group member making actual use of the leased property, to the extent of such actual use. If tangible property owned by one group member is leased to another group member, the property shall be included both in the property factor of the owner at the original cost to the group member that originally acquired the property and in the property factor of the lessee, to the extent of actual use of the property by the lessee, in an amount equal to eight times the net annual rent, provided that the original cost amount used by the owner in the numerator or denominator of its property factor shall be reduced (but not below zero) by the dollar amounts included in the numerator or denominator, respectively, of lessee members within the combined group. Except as provided in 830 CMR 63.32B.2(7)(g)4., leases between group members are disregarded for purposes of the property factor. For purposes of 830 CMR 63.32B.2(7)(g)4. actual use of property shall not include sublease of the property to another party. The intra-group rental of property shall be at fair market value for purposes of determining the property factors of the lessor and the lessee.

Example. A combined group includes corporation A, which owns a building with an original cost of $10 million, and corporation B, which leases use of the building from corporation A and actually uses the one floor of the building that it leases at a fair market annual rent of $250,000. The property is located in Massachusetts. The numerator and denominator of B's property factor shall include $2 million (*i.e*., 8 x $250,000) attributable to the intercompany lease. The numerator and denominator of A's property factor shall include $8 million, which equals the original cost of the building of $10 million, reduced by the amount included in the numerator and denominator of B's property factor.

(h) Combined Group That Includes Financial Institutions and Non-financial Institutions. The calculation of apportionment factors for individual financial institutions under M.G.L. c. 63, § 2A, and for individual non-financial business corporations under M.G.L. c. 63, § 38, vary in certain respects. In particular, a financial institution includes various interest and other amounts in its receipts factor under M.G.L. c. 63, § 2A, that would generally be excluded from the sales factor of a non-financial business corporation under M.G.L. c. 63, § 38. Similarly, the property factor of a financial institution includes intangible property,

63.32B.2: continued

whereas the property factor of a non-financial business corporation is limited to tangible property. In order to provide more consistent methodology in the determination of apportionment factors where a combined group of corporations consists of at least one member that is a financial institution as defined in M.G.L. c. 63, § 1, and at least one member that is not a financial institution, the adjustments in 830 CMR 63.32B.2(7)(h)1. through 4. shall be made to the numerators and denominators of the apportionment factors of the group members.

1. Any member of the combined group that is a financial institution shall adjust the numerator and denominator of its property factor so that the value of intangible property included in the factor is reduced by 80% of the amount otherwise determined under M.G.L. c. 63, § 2A.

2. Any member of the combined group that is not a financial institution shall adjust the numerator and denominator of its sales factor so that any interest or other receipts of the member described in M.G.L. c. 63, § 2A(d)(i) through (d)(xi) and otherwise excluded from the sales factor determined under M.G.L. c. 63, § 38, are added to the sales factor denominator of the member and are added to the sales factor numerator of the member to the extent such receipts are sourced to Massachusetts under M.G.L. c. 63, § 2A(d)(i) through (d)(xi).

3. In the case of a sale or deemed sale of a business, receipts from the sale of the business "good will" or similar intangible value, including without limitation "going concern value" and "workforce in place," shall not be included in the sales factor numerators or denominators of any member.

4. The denominator of the combined group's property, payroll, and sales/receipts factors shall be the sum of the denominators of each individual member's respective factors, as separately determined and adjusted under 830 CMR 63.32B.2(7)(h). The denominators of the combined group's factors shall be used by any taxable member, whether or not such member is individually classified as a financial institution, in determining its individual Massachusetts apportionment percentage.

(i) Mutual Fund Service Corporations.

1. A mutual fund service corporation is any corporation doing business in the commonwealth which derives more than 50% of its gross income as determined on a separate company basis from the provision, directly or indirectly, of management, distribution or administrative services to or on behalf of a regulated investment company and from trustees, sponsors, and participants of employee benefits plans which have accounts in a regulated investment company. It must separate its gross income into two categories, mutual fund sales and non-mutual fund sales.

2. The receipts from mutual fund sales are assigned to the numerator of the sales factor in accordance with 830 CMR 63.38.7. For purposes of apportioning the income of the combined group, the mutual fund service corporation is treated as two separate members, *i.e.*, one with a mutual fund sales business and one with a non-mutual fund sales business. It must calculate two apportionment percentages using two sets of apportionment factors, one for its mutual fund sales business and one for its non-mutual fund sales business. The mutual fund business will determine its share of the combined group's income apportioned to Massachusetts using a single sales factor calculated in accordance with 830 CMR 63.38.7. The non-mutual fund business will determine its share of the combined group's income apportioned to Massachusetts using a three factor apportionment with a double weighted sales factor. The total of these amounts will be the corporation's income apportioned to Massachusetts. The Massachusetts property values and payroll expenses of the mutual fund service corporation that are directly traceable to its non-mutual fund sales business are included in the property and payroll factor numerators, respectively, used to determine the apportionment percentage of the mutual fund service corporation's non-mutual fund sales business. The Massachusetts property values and payroll expenses of the mutual fund service corporation that are not directly traceable to either its mutual fund sales business or its non-mutual fund sales business are allocated between its mutual fund sales business and non-mutual fund sales business in the same ratio that each type of sales bears to the total Massachusetts sales of the mutual fund service corporation. Sales of a non-nexus member are assigned to the mutual fund sales business and the non-mutual fund sales business of the mutual fund

service corporation according to the provisions of 830 CMR 63.32B.2(7)(b). In determining whether a member of a combined group is a mutual fund service corporation, the Commissioner reserves the right to disregard or reassign transactions among combined group members as necessary to avoid the distortion of the applicable apportionment method.

(j) Interaction with Alternative Apportionment Rules. Where the apportionment methods provided under M.G.L. c. 63, §§ 2A and 38 generally, are not reasonably adapted to approximate the net income from business carried on in Massachusetts, an alternative apportionment method may apply to the extent provided in M.G.L. 63, § 2A(g), 38(j) or 42. In general, such alternative apportionment rules affect inclusion or exclusion of particular items in the apportionment factor numerator(s) of an individual corporation and therefore do not alter the apportionment rules provided by 830 CMR 63.32B.2(7). Such alternative apportionment rules, may, however, modify the provisions of 830 CMR 63.32B.2(7) to the extent specified in alterative apportionment regulations promulgated under M.G.L. 63, § 38(j), or to the extent specified in agreements relating to individual taxpayers under M.G.L. c. 63, §§ 2A(g) and 42. Such modification might be necessary, for example, in the case of alternative apportionment methods adding or deleting particular types of property, payroll, or receipts from the factors described in M.G.L. 63, §§ 2A and 38, or in the case of alternative apportionment methods invoking unique apportionment factors unrelated to property, payroll, or receipts. In such cases, the alternative modifications may affect the factors of the group as a whole or the factors of one or more members, to the extent specified in such alternative apportionment regulations or agreements.

(k) Tax Computation Where No Apportionment. Where a combined group does not have any member that has income from the activities of the group's unitary business that is taxable in another state (or, in the case of an affiliated group election, any member that is taxable on its income from business activity in another state), all of the combined group's taxable income is taxable in Massachusetts. Each member of the group must determine its share of the combined group's taxable income by multiplying such income by a fraction which is the average of the taxable member's respective shares of the unitary business:

1. owned or rented property and
2. payroll (or, in the case of an affiliated group election, the taxable member's respective share of all property and payroll), as determined under the provisions of M.G.L. c. 63 but with inter-company transactions eliminated.

If a member of the combined group is a financial institution taxable under M.G.L. c. 63, § 2, then its property for purposes of this attribution of the combined group's taxable income is calculated under the provisions of M.G.L. c. 63, § 2A, however, the property value determined under M.G.L. c. 63, § 2A for certain intangible property is reduced by 80%. *See* 830 CMR 63.32B.2(7)(h)1. The 80% reduction is not to be made when the combined group consists solely of a combined group of financial institutions. All other group members are to determine their property and payroll for purposes of this attribution of the combined group's taxable income under M.G.L. c. 63, § 38. The income separately attributed to each combined group member, when totaled, must equal 100% of the combined group's taxable income.

(l) Examples.

Example 1. *Combined nexus and non-nexus general business corporations, where the non-nexus general business corporation has no Massachusetts sales.* X, Y and Z are corporations engaged in a unitary business during tax year 2009. For taxable year 2009, X and Y are general business corporations subject to three factor apportionment with a double weighted sales factor under M.G.L. c. 63, § 38 and taxable under M.G.L. c. 63, § 39; whereas Z is a non-taxpayer corporation that would be subject to apportionment as a general business corporation under M.G.L. c. 63, § 38 and would be taxable under M.G.L. c. 63, § 39 if it were subject to tax in Massachusetts. The combined group's taxable income as determined under 830 CMR 63.32B.2(6)(c) is $100,000. The apportionment information and factor and tax determinations of the three corporations are as follows:

63.32B.2: continued

a. Apportionment Information.

	X (nexus) Bus. corp.	Y (nexus) Bus. corp.	Z (no nexus) Bus. corp.	Combined
MA property	$5,000,000	$1,000,000		
Everywhere property	$17,000,000	$1,000,000	$2,000,000	$20,000,000
MA payroll	$1,000,000	$5,000,000		
Everywhere payroll	$2,000,000	$5,000,000	$1,000,000	$8,000,000
MA sales	$5,000,000	$1,000,000		
Everywhere sales	$10,000,000	$3,000,000	$2,000,000	$15,000,000

b. Apportionment Factor Computation.

	Member X	Member Y	Member Z
Property numerator	$5,000,000	$1,000,000	n/a
Property denominator	$20,000,000	$20,000,000	n/a
Property factor	25.00%	5.00%	n/a
Payroll numerator	$1,000,000	$5,000,000	n/a
Payroll denominator	$8,000,000	$8,000,000	n/a
Payroll factor	12.50%	62.50%	
Sales numerator	$5,000,000	$1,000,000	n/a
Sales denominator	$15,000,000	$15,000,000	n/a
Sales factor	33.33%	6.67%	n/a
Apportionment %	26.04%*	20.21%*	n/a

*Three factor, double weighted sales.

c. Tax Determination.

	Member X	Member Y	Member Z	Total
Apportionment %	26.04%	20.21%	n/a	
Combined group TI	$100,000	$100,000	n/a	
Apportioned income	$26,040	$20,210	n/a	
Tax rate	9.50%	9.50%	n/a	
Tax	$2,474	$1,920	n/a	$4,394

Example 2. *Combined nexus and non-nexus general business corporations, where the non-nexus general business corporation has Massachusetts sales.* The facts are the same as in 830 CMR 63.32B.2(7)(l)1. *Example 1.*, except that Z has $1,000,000 in Massachusetts sales. Therefore, because Z is a non-nexus corporation, an additional step is required for purposes of computing the apportionment formulas of X and Y, wherein the Massachusetts sales of Z are re-attributed to X and Y. *See* 830 CMR 63.32B.2(7)(b).

a. Apportionment Information.

	X (nexus) Bus. corp.	Y (nexus) Bus. corp.	Z (no nexus) Bus. corp.	Combined
MA property	$5,000,000	$1,000,000		
Everywhere property	$17,000,000	$1,000,000	$2,000,000	$20,000,000

63.32B.2: continued

	X (nexus) Bus. corp.	Y (nexus) Bus. corp.	Z (no nexus) Bus. corp.	Combined
MA payroll	$1,000,000	$5,000,000		
Everywhere payroll	$2,000,000	$5,000,000	$1,000,000	$8,000,000
MA sales	$5,000,000	$1,000,000	$1,000,000	
Everywhere sales	$10,000,000	$3,000,000	$2,000,000	$15,000,000

b. Apportionment Factor Computation.

(i) Assign Z's Massachusetts Sales to X and Y.

	Member X	Member Y	Member Z
Nexus member MA sales	$5,000,000	$1,000,000	n/a
Total nexus members' MA sales	$6,000,000	$6,000,000	n/a
Nexus member sales %	83.33%	16.67%	n/a
Non-nexus member sales	n/a	n/a	$1,000,000
Assigned non-nexus member sales	$833,333	$166,667	n/a
Sales factor numerator	$5,833,333	$1,166,667	n/a

(ii) Determine Apportionment Factors.

	Member X	Member Y	Member Z
Property numerator	$5,000,000	$1,000,000	n/a
Property denominator	$20,000,000	$20,000,000	n/a
Property factor	25.00%	5.00%	n/a
Payroll numerator	$1,000,000	$5,000,000	n/a
Payroll denominator	$8,000,000	$8,000,000	n/a
Payroll factor	12.50%	62.50%	
Sales numerator	$5,833,333	$1,166,667	n/a
Sales denominator	$15,000,000	$15,000,000	n/a
Sales factor	38.89%	7.78%	n/a
Apportionment %	28.82%*	20.76%*	n/a

*Three factor, double weighted sales.

c. Tax Determination .

	Member X	Member Y	Member Z	Total
Apportionment %	28.82%	20.76%	n/a	
Combined group TI	$100,000	$100,000	n/a	
Apportioned income	$28,820	$20,760	n/a	
Tax rate	9.50%	9.50%	n/a	
Tax	$2,738	$1,972	n/a	$4,710

Example 3. *Combined nexus and non-nexus general business and manufacturing corporations, where the non-nexus general business corporation has Massachusetts sales*. The facts are the same as in 830 CMR 63.32B.2(7)(b) *Example 2*., except that X is not a general business corporation but rather a manufacturing corporation subject to single sales factor apportionment under M.G.L. c. 63, § 38. Assume for purposes of the example that X does not sell any of its manufactured property to Y or Z such that the provisions of 830 CMR 63.32B.2(7)(g)2. are implicated.

63.32B.2: continued

a. Apportionment Information.

	X (nexus) Manuf. corp.	Y (nexus) Bus. corp.	Z (no nexus) Bus. corp.	Combined
MA property	$5,000,000	$1,000,000		
Everywhere property	$17,000,000	$1,000,000	$2,000,000	$20,000,000
MA payroll	$1,000,000	$5,000,000		
Everywhere payroll	$2,000,000	$5,000,000	$1,000,000	$8,000,000
MA sales	$5,000,000	$1,000,000	$1,000,000	
Everywhere sales	$10,000,000	$3,000,000	$2,000,000	$15,000,000

b. Apportionment Factor Computation.

(i) Assign Z's Massachusetts Sales to X and Y.

	Member X	Member Y	Member Z
Nexus member's MA sales	$5,000,000	$1,000,000	n/a
Total nexus member MA sales	$6,000,000	$6,000,000	n/a
Nexus member sales %	83.33%	16.67%	n/a
Non-nexus member sales	n/a	n/a	$1,000,000
Assigned non-nexus member sales	$833,333	$166,667	n/a
Sales factor numerator	$5,833,333	$1,166,667	n/a

(ii) Determine Apportionment Factor.

	Member X	Member Y	Member Z
Property numerator	n/a	$1,000,000	n/a
Property denominator	n/a	$20,000,000	n/a
Property factor	n/a	5.00%	n/a
Payroll numerator	n/a	$5,000,000	n/a
Payroll denominator	n/a	$8,000,000	n/a
Payroll factor	n/a	62.50%	
Sales numerator	$5,833,333	$1,166,667	n/a
Sales denominator	$15,000,000	$15,000,000	n/a
Sales factor	38.89%	7.78%	n/a
Apportionment %	38.89%*	20.76%**	n/a

* Single factor, sales.
**Three factor, double weighted sales.

c. Tax Determination.

	Member X	Member Y	Member Z	Total
Apportionment %	38.89%	20.76%	n/a	
Combined group TI	$100,000	$100,000	n/a	
Apportioned income	$38,890	$20,760	n/a	
Tax rate	9.50%	9.50%	n/a	
Tax	$3,695	$1,972	n/a	$5,667

63.32B.2: continued

Example 4. *Combined nexus and non-nexus manufacturing and general business corporations, where a non-nexus general business corporation has Massachusetts sales and the nexus manufacturing corporation has throwback sales.* X, Y, and Z are corporations engaged in a unitary business during tax year 2010. The activities of the group are such that one or more members are taxable in the six New England states plus New York and New Jersey. X and Y have activities that make them taxable in Massachusetts. Z does not have any activities that make it taxable in Massachusetts and as such Z does not have Massachusetts nexus. X is a manufacturing corporation and has its sales office in Massachusetts. X makes sales into the six New England states, New York, New Jersey, Delaware, Maryland, Florida, and Canada. The sales by X destined to Massachusetts total $5,000,000. The sales by X destined to Florida, Maryland, and Delaware total $500,000. The combined group's taxable income as determined under 830 CMR 63.32B.2(6)(c) is $250,000. The apportionment information and factor and tax determinations of the three corporations are as follows:

a. Apportionment Information.

	X (nexus) Manuf. corp.	Y (nexus) Bus. corp.	Z (no nexus) Bus. corp.	Combined
MA property	$5,000,000	$1,000,000		
Everywhere property	$17,000,000	$1,000,000	$2,000,000	$20,000,000
MA payroll	$1,000,000	$5,000,000		
Everywhere payroll	$2,000,000	$5,000,000	$1,000,000	$8,000,000
MA destination sales	$5,000,000	$1,000,000	$1,000,000	
MA throwback sales*	$500,000			
MA sales	$5,500,000	$1,000,000	$1,000,000	
Everywhere sales	$10,000,000	$3,000,000	$2,000,000	$15,000,000

*Because no member of the group was taxable in Maryland, Florida or Delaware, sales made into those states are thrown back to Massachusetts and included in the numerator of the sales factor if those sales were not made by employees, agents or others connected with a sales office located outside Massachusetts. *See* 830 CMR 63.38.1(9)(c)2.

b. Apportionment Factor Computation.

(i) Assign Z's Massachusetts Sales to X and Y.

	Member X	Member Y	Member Z
Nexus member MA sales	$5,500,000	$1,000,000	n/a
Total nexus members' MA sales	$6,500,000	$6,500,000	n/a
Nexus member sales %	84.62%	15.38%	n/a
Non-nexus member sales	n/a	n/a	$1,000,000
Assigned non-nexus member sales	$846,200	$153,800	n/a
Sales factor numerator	$6,346,200	$1,153,800	n/a

(ii) Determine Apportionment Factors.

	Member X	Member Y	Member Z
Property numerator	$5,000,000	$1,000,000	n/a
Property denominator	$20,000,000	$20,000,000	n/a
Property factor	25%	5.00%	n/a
Payroll numerator	$1,000,000	$5,000,000	n/a
Payroll denominator	$8,000,000	$8,000,000	n/a
Payroll factor	12.5%	62.50%	

63.32B.2: continued

	Member X	Member Y	Member Z
Sales numerator	$6,346,200	$1,153,800	n/a
Sales denominator	$15,000,000	$15,000,000	n/a
Sales factor	42.31%	7.69%	n/a
Apportionment %	42.31%*	20.72%**	n/a

*Single factor, sales.
**Three factor, double weighted sales.

c. Tax Determination.

	Member X	Member Y	Member Z	Total
Apportionment %	42.31%	20.72%	n/a	
Combined group TI	$250,000	$250,000	n/a	
Apportioned income	$105,775	$51,800	n/a	
Tax rate	9.50%	9.50%	n/a	
Tax	$10,049	$4,921	n/a	$14,970

Example 5. *Combined nexus and non-nexus general business and financial corporations, where the non-nexus general business corporation has no Massachusetts sales*. X, Y and Z are corporations engaged in a unitary business during tax year 2009. For taxable year 2009 the corporations reflect the following facts: X is a financial institution subject to three factor apportionment under M.G.L. c. 63, § 2A and taxable under M.G.L. c. 63, § 2; Y is a general business corporation subject to three factor double weighted sales factor apportionment under M.G.L. c. 63, § 38 and taxable under M.G.L. c. 63, § 39; Z is a non-nexus taxpayer corporation that would be subject to apportionment as a general business corporation under M.G.L. c. 63, § 38 and would be taxable under M.G.L. c. 63, § 39 if it were subject to tax in Massachusetts. For taxable year 2009, X, a financial institution, has $105,000,000 in everywhere property as determined under M.G.L. c. 63, § 2A, which includes $100,000,000 in intangible property (*e.g.*, loans and credit card receivables). Because X is to be combined with one or more general business corporations, it must reduce the value of its intangible property by 80% for purposes of determining the group property factor. *See* 830 CMR 63.32B.2(7)(h). Because Y and Z are to be combined with a financial institution, they must each adjust their sales factor denominator and Y is also to adjust its sales factor numerator for purposes of determining the group sales factor by including sales that would be included in their sales factor computations if they were subject to M.G.L. c. 63, § 2A(d)(i) through (d)(xi). *See* 830 CMR 63.32B.2(7)(h). The combined group's taxable income as determined under 830 CMR 63.32B.2(6)(c) is $100,000. The apportionment information and factor and tax determinations of the three corporations are as follows:

a. Apportionment Information.

	X (nexus) Fin. Inst.	Y (nexus) Bus. corp.	Z (no nexus) Bus. corp.	Combined
MA property	$20,000,000	$2,000,000		
MA property adjusted	$4,000,000*	$2,000,000		
Everywhere property	$105,000,000	$2,000,000	$3,000,000	
Everywhere property adjus'd	$25,000,000*	$2,000,000	$3,000,000	$30,000,000
MA payroll	$1,000,000	$5,000,000		
Everywhere payroll	$2,000,000	$5,000,000	$1,000,000	$8,000,000
MA sales	$5,000,000	$1,000,000		
MA sales adjusted	$5,000,000	$1,500,000**		$6,500,000
Everywhere sales	$10,000,000	$3,000,000	$2,000,000	$15,000,000
Everywhere sales adjusted	$10,000,000	$4,000,000**	$3,000,000**	$17,000,000

63.32B.2: continued

*X's Massachusetts property and everywhere property is adjusted to reduce its intangible assets by 80%; since X has $5,000,000 in tangible assets located outside the state, in addition to $100,000,000 in total intangible assets, its everywhere property is reduced from $105,000,000 to $25,000,000.
**Y and Z's Massachusetts and everywhere sales are adjusted to include sales that would be included in Y and Z's sales factor computations if it were subject to the financial institution apportionment rules set forth at M.G.L. c. 63, § 2A(d)(i) through (d)(xi).

b. Apportionment Factor Computation.

	Member X	Member Y	Member Z
Property numerator	$4,000,000	$2,000,000	n/a
Property denominator	$30,000,000	$30,000,000	n/a
Property factor	13.33%	6.67%	n/a
Payroll numerator	$1,000,000	$5,000,000	n/a
Payroll denominator	$8,000,000	$8,000,000	n/a
Payroll factor	12.50%	62.50%	
Sales numerator	$5,000,000	$1,500,000	n/a
Sales denominator	$17,000,000	$17,000,000	n/a
Sales factor	29.41%	8.82%	n/a
Apportionment %	18.41%*	21.70%**	n/a

*Three factor, equal weighting
**Three factor, double weighted sales

c. Tax Determination.

	Member X	Member Y	Member Z	Total
Apportionment %	18.41%	21.70%	n/a	
Combined group TI	$100,000	$100,000	n/a	
Apportioned income	$18,410	$21,700	n/a	
Tax rate	10.50%	9.50%	n/a	
Tax	$1,933	$2,062	n/a	$3,995

Example 6. *Combined S and C corporations with resident and non-resident shareholders.* S1, S2 and C are corporations engaged in a unitary business during tax year 2009 with business activities both within and without Massachusetts. All three corporations have the same two 50% individual shareholders, one of whom, R, is a resident and one of whom, NR, is a non-resident. The gross receipts for the unitary group for tax year 2009, net of intercompany eliminations, exceeds $6 million. S1 is a manufacturing corporation within the meaning of M.G.L. c. 63, § 38, whereas both S2 and C are general business corporations. Both R and NR have federal distributive share income from S1 and S2 and also dividend income from C. S1, S2 and C have only unitary business activity from their joint activities and, for example, none of the corporations have any allocable income. The combined group has net income of $4,000,000. The corporations have to separately determine their income for federal income tax purposes, and as discussed in 830 CMR 63.32B.2(7)(l): Example 6 S1 and S2 have to separately determine their income to determine each shareholder's distributive share. The separately determined net income for Massachusetts and federal purposes for S1 and S2, respectively, is $1,000,000, and for C is $2,000,000 (*i.e.*, assume no Massachusetts and federal differences for purposes of the example). The apportionment information for the corporations is as follows:

63.32B.2: continued

	S1 (nexus) Manuf. Corp	S2 (nexus) Bus. corp.	C (nexus) Bus. corp.	Combined
MA property	$20,000,000	$12,000,000	$4,000,000	
Everywhere property	$60,000,000	$24,000,000	$20,000,000	$104,000,000
MA payroll	$1,000,000	$5,000,000	$100,000	
Everywhere payroll	$2,000,000	$5,000,000	$2,000,000	$9,000,000
MA sales	$15,000,000	$6,000,000	$1,000,000	
Everywhere sales	$30,000,000	$10,000,000	$20,000,000	$60,000,000

M.G.L. c. 63 Analysis. To determine their apportioned M.G.L. c. 63 income, the three corporations perform the same analysis as would apply in a case involving only C corporations (*see, e.g.*, 830 CMR 63.32B.2(7)(l) *Example 5.*). Since S1 is a manufacturing corporation it applies a single sales factor apportionment percentage. Since both S2 and C are general business corporations, they apply a three factor apportionment percentage that includes a double weighted sales factor. Upon determining their apportioned M.G.L. c. 63 income, S1 and S2 apply the tax rate as determined under M.G.L. c. 63, § 32D, whereas C applies the tax rate as determined under M.G.L. c. 63, § 39.

	S1 (nexus) Manuf. Corp	S2 (nexus) Bus. corp.	C (nexus) Bus. corp.
Property numerator	$20,000,000	$12,000,000	$ 4,000,000
Property denominator	$104,000,000	$104,000,000	$104,000,000
Property factor	n/a	11.54%	3.85%
Payroll numerator	$1,000,000	$5,000,000	$100,000
Payroll denominator	$9,000,000	$9,000,000	$9,000,000
Payroll factor	n/a	55.56%	1.11%
Sales numerator	$15,000,000	$6,000,000	$1,000,000
Sales denominator	$60,000,000	$60,000,000	$60,000,000
Sales factor	25%	10%	1.67%
Apportionment %	25%	21.77%*	2.07%*
MA apportioned income	$1,000,000	$870,940	$82,906

*Three factor, double weighted sales.

M.G.L. c. 62 Analysis. R is taxable on federal distributive share income from S1 and S2 without any adjustment, although R may claim a credit against this distributive share income for other state income tax paid on such distributive share by R or S1 or S2. R is taxable on its dividends from C with no credit applicable. NR has federal distributive share income from S1 and S2 and is taxable on its apportioned share of this income. *See* M.G.L. c. 62, § 5A(b) (the Commissioner may adopt regulatory rules as to non-resident taxation). In the case of S1, the apportionment is done using single sales factor apportionment, whereas in the case of S2, the apportionment is done using three factor apportionment with a double weighted sales factor. NR is to file a Massachusetts non-resident return that documents its apportioned S1 and S2 income as Massachusetts source income. If either S1 or S2 had any allocable income, NR's distributive share of this allocable income would not be apportioned but rather would be either 100% taxable or non-taxable in Massachusetts depending upon whether the income is allocable to Massachusetts. Under M.G.L. c. 62, S1 and S2 must compute their net income in the same manner as they did prior to the enactment of M.G.L. c. 63, § 32B. In addition, because

63.32B.2: continued

S1 and S2 have nonresident shareholders both S1 and S2 must compute their own separate apportionment percentages to determine the nonresident's distributive share of Massachusetts source income from S1 and S2. S1 and S2 compute their apportionment percentages as follows:

	S1 (nexus) Manuf. Corp	S2 (nexus) Bus. corp.	
Property numerator	$20,000,000	$12,000,000	
Property denominator	$60,000,000	$24,000,000	
Property factor	n/a		50%
Payroll numerator	$1,000,000	$5,000,000	
Payroll denominator	$2,000,000	$5,000,000	
Payroll factor	n/a	100%	
Sales numerator	$15,000,000	$6,000,000	
Sales denominator	$30,000,000	$10,000,000	
Sales factor	50%	60%	
Apportionment %	50%	67.50%*	
Separate MA net income	$1,000,000	$1,000,000	
MA apportioned income	$500,000	$675,000	

*Three factor, double weighted sales

As a Massachusetts resident, R would report R's distributive share of the total unapportioned net income of S1 and S2 on R's personal income tax return. Since R is a 50% shareholder in both corporations, R reports $1,000,000, *i.e.*, $500,000 from each entity. As a nonresident, NR would report NR's distributive share of the Massachusetts source income of S1 and S2 on NR's Massachusetts non-resident income tax return. Since NR is a 50% shareholder in both corporations, NR reports $587,000, *i.e.*, $250,000 from S1 and $337,500 from S2.

Example 7. *Combined mutual fund service corporation and nexus and non-nexus general business corporation where the non-nexus general business corporation has Massachusetts sales.* X, Y and Z are corporations engaged in a unitary business during tax year 2009. For taxable year 2009, X is a mutual fund service corporation subject to single sales factor apportionment under M.G.L. c. 63, § 38. As a mutual fund service corporation, X must separate its gross income into two categories, mutual fund sales and non-mutual fund sales (*i.e.*, other sales). Therefore, for purposes of the combined group, X is treated as two separate members. X derives 80% of its gross income from mutual fund sales, and 20% of its gross income from other sales. Y is a general business corporation subject to three factor apportionment with a double weighted sales factor under M.G.L. c. 63, § 38 and taxable under M.G.L. c. 63, § 39. Z is a non-taxpayer corporation that would be subject to apportionment as a general business corporation under M.G.L. c. 63, § 38 and would be taxable under M.G.L. c. 63, § 39 if it were subject to tax in Massachusetts. Z has $1,000,000 in Massachusetts sales. Therefore, because Z is a non-nexus corporation, an additional step is required for purposes of computing the apportionment formulas of X and Y, wherein the Massachusetts sales of Z are re-attributed to X and Y. *See* 830 CMR 63.32B.2(7)(b). The combined group's taxable income as determined under 830 CMR 63.32B.2(6)(c) is $100,000. Further, assume for purposes of the example that X does not provide mutual fund services to Y or Z such that the provisions of 830 CMR 63.32B.2(7)(g) are implicated. The apportionment information and factor and tax determinations of the three corporations are as follows:

63.32B.2: continued

a. Apportionment Information.

	X (nexus) (mut. fund)	X (nexus) (other sales)	Y (nexus) Bus. corp.	Z (no nexus) Bus. corp.	Combined
MA property	$3,000,000	$2,000,000	$1,000,000		
Everywhere property	$15,000,000	$2,000,000	$1,000,000	$2,000,000	$20,000,000
MA payroll	$850,000	$150,000	$5,000,000		
Everywhere payroll	$1,600,000	$400,000	$5,000,000	$1,000,000	$8,000,000
MA sales	$4,000,000	$1,000,000	$1,000,000	$1,000,000	
Everywhere sales	$8,000,000	$2,000,000	$3,000,000	$2,000,000	$15,000,000

b. Apportionment Factor Computation.

(i) Assign Z's Massachusetts Sales to X and Y.

	Member X (mut. fund)	Member X (other sales)	Member Y	Member Z
Nexus member MA sales	$4,000,000	$1,000,000	$1,000,000	n/a
Total nexus member MA sales	$6,000,000	$6,000,000	$6,000,000	n/a
Nexus member sales %	66.66%	16.67%	16.67%	n/a
Non nexus member sales	n/a	n/a	n/a	$1,000,000
Assigned non nexus member sales	$666,666	$166,667	$166,667	n/a
Sales factor numerator	$4,666,666	$1,166,667	$1,166,667	n/a

(ii) Determine Apportionment Factor.

	Member X (mut. fund)	Member X (other sales)	Member Y	Member Z
Property numerator	n/a	$2,000,000	$1,000,000	n/a
Property denominator	n/a	$20,000,000	$20,000,000	n/a
Property factor	n/a	10.00%	5.00%	n/a
Payroll numerator	n/a	$150,000	$5,000,000	n/a
Payroll denominator	n/a	$8,000,000	$8,000,000	n/a
Payroll factor	n/a	1.88%	62.50%	n/a
Sales numerator	$4,666,666	$1,166,667	$1,166,667	n/a
Sales denominator	$15,000,000	$15,000,000	$15,000,000	n/a
Sales factor	31.11%	7.78%	7.78%	n/a
Apportionment %	31.11%*	6.86%**	20.77%**	n/a

* Single factor, sales
**Three factor, double weighted sales

c. Tax Determination.

	Member X (mut. fund)	Member X (other sales)	Member Y	Member Z	Total
Apportionment %	31.11%	6.86%		20.77%	n/a
Combined group TI	$100,000	$100,000	$100,000	n/a	
Apportioned income	$31,110	$6,860		$20,770	n/a
Tax rate	9.50%	9.50%	9.50%	n/a	
Tax	$2,955	$652	$1,973	n/a	$5,580

63.32B.2: continued

Example 8. *Combined corporations where no corporation is entitled to apportion*. X, Y and Z are corporations engaged in a unitary business in tax year 2009. None of the corporations can apportion their income because none of the corporations have income from business activities that are taxable in another state. Consequently, the combined group cannot apportion its income. Therefore, 100% of the combined group's taxable income is taxable in Massachusetts. The combined group's taxable income in tax year 2009 as determined under 830 CMR 63.32B.2(6)(c) is $1,000. To determine the amount of this income that is attributed to each combined group member the following information is relevant. X is an S corporation and a manufacturing corporation with sales of $1,000, average property of $2,000 and a payroll of $500. Y is a financial institution with receipts of $2,000, average property of $11,000 ($10,000 of which is intangible property within the meaning of M.G.L. c. 63, § 2A) and a payroll of $1,000. Z is a general business corporation with sales of $1,000, average property of $1,000 and a payroll of $500. The computation of the respective income of the combined group members for tax year 2009, which must add up to $1,000, is as follows:

	X S corp.	Y Fin. Inst.	Z Bus. corp.	Combined
MA property	$2,000	$3,000*	$1,000	$6,000*
Everywhere property	$6,000	$6,000	$6,000	
Property factor	33.33%	50%	16.67%	
MA payroll	$500	$1,000	$500	$2,000
Everywhere payroll	$2,000	$2,000	$2,000	
Payroll factor	25%	50%	25%	
Total factor percentage	58.33%	100%	41.67%	200%
Average factor	29.167%	50%	20.833%	100%
Income computation	$291.67	$500	$208.33	$1,000

* The property factor for Y includes 20% of Y's $10,000 of intangible property (*i.e.*, $2,000) plus $1,000 of other property.

(8) Net Operating Loss Carry Forwards.

(a) General. For taxable years beginning on or after January 1, 2009, if the computation of a combined group's taxable income results in a taxable net loss, a taxable member of such group may carry forward its apportioned share of the loss to offset against its post apportioned taxable income derived from the combined group in a future year to the extent the carry forward and offset is consistent with the requirements and limitations set forth in M.G.L. c. 63, § 30.5 and M.G.L. c. 63 generally. A taxpayer shall determine its Massachusetts apportioned share of a combined group's taxable income prior to the deduction of any net operating loss (NOL) carry forwards for a taxable year. Further, any taxpayer that has more than one NOL carry forward derived from losses incurred in more than one tax year shall apply such carry forwards in the order that the underlying loss was incurred, with the oldest carry forward to be deducted first. Neither a financial institution taxable under M.G.L. c. 63, § 2 nor a utility corporation taxable under M.G.L. c. 63, § 52A is permitted to carry forward a net operating loss.

(b) Sharing of NOL Carry Forwards.

1. A taxable member of a combined group that has a NOL carry forward that derived from a loss incurred from the activities of the combined group in a taxable year beginning on or after January 1, 2009, may share the NOL carry forward with the other taxable members of the group as provided in 830 CMR 63.32B.2(8). The taxable member that has a NOL carry forward must first deduct the carry forward against its post apportioned Massachusetts taxable net income derived from the combined group, if any. Then, to the extent the taxpayer has excess NOL carry forward, it may share that excess with the other taxable members of the combined group that were members of the combined group during the year in which the underlying loss was incurred in the manner described in 830 CMR 63.32B.2(8)(b)2. provided, however, that the excess NOL carry forward may

63.32B.2: continued

not be shared with either a financial institution taxable under M.G.L. c. 63, § 2 or a utility corporation taxable under M.G.L. c. 63, § 52A. A taxable member of the combined group that was not a member of a combined group during the taxable year in which the activities of the group resulted in a net operating loss is not subsequently entitled to share in the use of the NOL carry forward.

2. The other taxable members of a combined group may use the taxable member's NOL carry forward as referenced in 830 CMR 63.32B.2(8)(b)1. to offset against their apportioned Massachusetts taxable net income derived from the combined group to the extent that they have such net income. In such cases, the other taxable members of the combined group must first deduct any NOL carry forwards that they individually possess, derived from losses that they previously incurred, before applying any excess NOL carry forward of any other combined group member. The NOL carry forwards of a taxable member of a combined group, including any carry forwards that a member seeks to share with the other taxable members of its combined group, shall be applied in the order that the underlying loss was incurred, with the oldest carry forward to be deducted first. Where a taxable member has an excess NOL that can be shared with more than one taxpayer group member such excess NOL must be allocated among those other members eligible to share in such NOL in a manner that is proportionate to the respective amounts of apportioned income from the combined group that each such eligible group member has for the taxable year in which such excess NOL is to be shared after applying each such group member's own NOLs. In all cases, the use of the NOL carry forwards by the other taxable members of the combined group must be consistent with the requirements and limitations that govern the use of NOL carry forwards under M.G.L. c. 63, § 30.5. and M.G.L. c. 63 generally, including the requirement that the oldest NOLs must be utilized first. Any amount of a NOL carry forward that is subsequently deducted by any taxable member of a combined group shall reduce the amount of the NOL that may subsequently be carried forward by the taxpayer that originally incurred the loss.

(c) Ownership of NOL Carry Forward; Situation Where Carry Forward Owner Leaves Combined Group. NOLs shall be carried forward from year to year separately by the individual taxpayer that originally incurred the underlying loss and therefore remain the tax attribute of that member, although such carry forwards may be shared in some cases with the other taxable members of a combined group as noted in 830 CMR 63.32B.2(8). Consequently, in any case in which a taxable member of a combined group ceases to be a member of the combined group, for whatever reason, any NOL carry forward owned by such taxpayer is no longer available for use by the other taxable members of the combined group with which the taxpayer was previously affiliated. In such cases, if the taxpayer becomes a member of a new combined group, the taxpayer may not share the NOL carry forward with the taxable members of its new combined group unless one of the taxable members of the new combined group was also a member of the taxpayer's combined group during the year the loss was incurred and all the other requirements referenced in 830 CMR 63.32B.2(8) are met. Where a taxpayer that has a NOL carry forward becomes a member of a new combined group, the change of ownership rules set forth in Code § 382 as applied under Massachusetts law may apply, though any amount of NOL carry forward that cannot be applied because of these limitations may be carried forward consistent with the rules and limitations of 830 CMR 63.32B.2(8)(c). *See* 830 CMR 63.30.2(11). In the event that a member of a combined group has a NOL carry forward and subsequently takes part in a merger or consolidation, the NOL carry forward will be lost if, for example, the member liquidates or terminates as a result of the merger or consolidation. *See* 830 CMR 63.30.2(11). In the case of a S Corporation owning a QSub that was then treated with the QSub as a single corporation by reason of St. 2008, c. 173, for tax years beginning on or after January 1, 2009, the NOL carry forward of the S corporation and/or the QSub shall be treated as the NOL carry forward of the single corporation. *See* 830 CMR 63.30.3.

(d) Pre-2009 NOL Carry Forwards. Where a taxable member of a combined group has a NOL carry forward that derives from a loss incurred in a taxable year beginning prior to January 1, 2009, the carry forward shall remain available to be deducted by the taxpayer that incurred the loss in a subsequent tax year as permitted under Massachusetts law as in effect during the year that the loss was incurred, subject to the limitation set forth in 830 CMR 63.32B.2(8)(f). Consequently, such NOL carry forwards as allowed under M.G.L. c. 63, § 30.5(b) may only be deducted by the taxpayer that incurred the loss and cannot be shared

63.32B.2: continued

by the taxpayer with the other taxable members of its combined group. Further, as neither a financial institution taxable under M.G.L. c. 63, § 2 nor a utility corporation taxable under M.G.L. c. 63, § 52A was entitled to a NOL carry forward under the law in effect prior to January 1, 2009, such taxpayers cannot carry forward a NOL derived from a loss that was incurred for a taxable year beginning prior to January 1, 2009. For taxable years beginning prior to January 1, 2009 a taxpayer's NOL carry forward was to be "grossed up" to reflect a pre-apportionment calculation, by dividing the amount of any unused loss by the taxpayer's apportionment percentage from the year in which the loss was incurred. However, to apply such a carry forward to apportioned income that derives from the activity of a combined group for a taxable year beginning on or after January 1, 2009, the taxable member of the group must first convert the NOL carry forward to a post-apportionment calculation. Therefore, in the case of a NOL carry forward that derives from a loss incurred in the taxpayer's 2008 taxable year, the taxable member of a combined group shall carry forward the loss to its 2009 taxable year on a 2008 post-apportioned basis. Also, in the case of a NOL carry forward that derives from a loss incurred in the taxpayer's 2007 taxable year or an earlier taxable year, any remaining carry forward from such year shall be multiplied by the taxpayer's apportionment percentage from that year for purposes of being carried forward by the taxpayer to its 2009 tax year, or thereafter.

(e) Carry Forwards from Prior to Inclusion in a Combined Group. Where a taxpayer corporation that was not previously a member of a combined group enters a pre-existing combined group or becomes part of a new combined group with one or more other corporations, the corporation may continue to deduct any NOL carry forwards that it has from prior taxable years against its apportioned income as derived from the combined group, subject to the limitation set forth in 830 CMR 63.32B.2(8)(f). However, in such cases a taxpayer's pre-combination NOL carry forward was to be "grossed up" to reflect a pre-apportionment calculation, by dividing the amount of any unused loss by the taxpayer's apportionment percentage from the year in which the loss was incurred. To apply such a carry forward to apportioned income that derives from the activity of a combined group for a taxable year beginning on or after January 1, 2009, the taxable member of the group must first convert the NOL carry forward to a post-apportionment calculation. To do so, the taxpayer must multiply the remaining NOL carry over from any individual pre-combination year by the taxpayer's apportionment percentage from that year.

(f) Limitation on Use of Pre-combination NOL.

1. Where a taxable member of a combined group is carrying forward a NOL from a year or years beginning prior to January 1, 2009, or from a year or years in which the corporation was not a member of a combined group, the use of the corporation's pre-apportionment NOL from such year(s) is limited to the amount of the current year combined group taxable income that would be apportioned to the member as determined by using:

a. the dollar amounts of the member's Massachusetts apportionment factor numerators in the year(s) in which the loss was incurred (determined, in the case of the sales factor, by excluding all "throwback sales" other than destination sales "thrown back" in the year of the loss from jurisdictions in which no member of the combined group is subject to tax in the year the NOL deduction is taken) and

b. the current year group denominators.

In the case of NOL carry forward from two or more such years, the Massachusetts apportionment factor numerators shall be averaged for all such loss years, weighting the factors for each loss year in accordance with the amount of the loss carried forward to the current year calculated on a post-apportionment basis, and the resulting average Massachusetts property, payroll, and sales factor numerators shall be divided by the current year group denominators to determine an apportionment percentage. The apportionment percentage thus determined shall be multiplied by the current year combined group taxable income. The product is the maximum current year income of the member that may be offset in the taxable year by its pre-combination NOL carry forward, subject to any other applicable loss carry forward limitation. The Commissioner may disregard material transactions among affiliated entities on or after November 1, 2008, to the extent that such transactions would affect the limitation under 830 CMR 63.32B.2(8)(f).

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2. For purposes of the application of the limitation set forth in 830 CMR 63.32B.2(8)(f)1., the dollar amounts of a member's Massachusetts apportionment factor numerators in years when losses were incurred may, at the election of the combined group, be increased in proportion to any over-all growth in Massachusetts property and payroll for all combined group members between the year of the loss and the tax year, commencing on or after January 1, 2009, for which a pre-2009 loss carry forward is claimed. Under this method, the dollar amount of all Massachusetts property and payroll for all combined group members, including all predecessor entities in existence in the year that the loss was incurred, regardless of prior year ownership of any predecessor entities, are totaled for each apportionment factor and are compared to the total dollar amounts of Massachusetts property and payroll in the year in which the carry forward is claimed. The dollar amounts of Massachusetts property, payroll, and sales for an individual corporation described in 830 CMR 63.32B.2(8)(f)1. in a particular loss year are then increased or decreased in proportion to the combined group's Massachusetts increase or decrease for each apportionment factor. A taxpayer electing this methodology must recalculate the dollar amount of Massachusetts property and payroll for each factor using this methodology and must apply the methodology for purposes of calculating NOL carry forward limitations under 830 CMR 63.32B.2(8)(f)1. to all group members with pre-2009 loss carry forwards. In the case of NOL carry forward from two or more loss years, the limitation in 830 CMR 63.32B.2(8)(f)1. must be calculated by adjusting the prior numerators to reflect the change in Massachusetts activity separately for each loss year, before applying the weighted average methodology otherwise described in 830 CMR 63.32B.2(8)(f)1.

3. In no event may the NOL deduction from the taxpayer's apportioned share of the combined group's taxable income exceed the amount of income actually apportioned to the taxpayer using current year apportionment factor numerators.

(g) Relationship to Allocable Losses and Loss Carry Forwards, and to Other Apportionable Losses and Carry Forwards. The determination of an allocable loss, *see* M.G.L. c. 63, § 38(b), is determined separately from the determination of the combined group's taxable income or loss, as to an individual taxpayer on a separate company basis. A taxpayer that has an allocable loss or an allocable loss carry forward may offset the loss first against its allocable income and then against its post-apportioned income derived from a combined group. An allocable loss or allocable loss carry forward is a separate company loss that can only be used by the taxpayer that incurred the loss and cannot be shared. Therefore, a taxpayer that has an allocable loss to carry forward must carry forward that allocable loss separately from a post-apportioned NOL carry forward derived from the activities of a combined group. Similarly, if a combined group member has an apportioned loss from business activities other than from the activities of a combined group, this loss and any loss carry forward resulting therefrom is a separate company loss and may only be used by the taxpayer that incurred the loss and cannot be shared. In general, a taxpayer must apply its oldest carry forward losses first irrespective as to whether they are derived from a separate company loss (allocated or apportioned) or from the apportioned loss derived from the activities of a combined group. However, with respect to any tax year from which the taxpayer has both a separate company loss carry forward and an apportioned loss carry forward derived from the activities of a combined group it must apply the separate company loss carry forwards first against separate company income and vice versa.

(h) Examples. (In these examples, it is assumed under the particular facts unless otherwise stated that the dollar amounts of the Massachusetts apportionment factor numerators of the corporations remain constant for the years discussed, so that the limitation in 830 CMR 63.32B.2(8)(f) does not restrict the use of the NOL carry forwards).

Example 1. X and Y are commonly owned taxpayer corporations during the three year period 2007-2009. X is a general business corporation taxable under M.G.L. c. 63, § 39, whereas Y is a financial institution taxable under M.G.L. c. 63, § 2. For taxable year 2007, X has a 20% apportionment and an apportioned loss of $10,000, which "grosses up" to a pre-apportionment NOL of $50,000 ($10,000 divided by .20) to carry forward. Y also has a loss for tax year 2007, but because it is a financial institution it cannot carry forward this loss. In taxable year 2008, X again has an apportionment percentage of 20%, but has no taxable income, whereas Y has apportioned taxable income of $20,000. Although X has a NOL carry forward of $50,000 from 2007 in taxable year 2008 that NOL carry forward cannot be shared with Y. In tax year 2009, the two corporations are

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engaged in a unitary business. In conducting their 2009 unitary business, the XY combined group has combined income of $100,000, and X and Y have respective apportionment percentages of 20% and 10%. Therefore, X and Y's respective share of the 2009 combined group's taxable income is $20,000 and $10,000. X has a pre-apportioned NOL carry forward of $50,000 from 2007 that must be converted into a post apportionment computation for purposes of X using this NOL as a deduction against its 2009 income. To accomplish this conversion, X multiplies its $50,000 2007 carry forward by its 2007 apportionment percentage of 20%, resulting in a carry forward of $10,000. Consequently X has a $10,000 2007 NOL carry forward that can be applied against its $20,000 of income for the 2009 tax year. X has no remaining carry forward from 2007 that can be brought forward into 2010.

Example 2. X, Y and Z are commonly owned taxpayer corporations taxable under M.G.L. c. 63, § 39 during the three year period 2008-2010. For taxable year 2008, X, Y and Z file as a combined group under the predecessor version of M.G.L. c. 63, § 32B, which has been repealed for taxable years beginning after January 1, 2009. X has an apportioned loss of $100,000 for 2008 and Y and Z have apportioned income, respectively, of $25,000 and $50,000. Consequently, in 2008 $75,000 of X's loss is used to offset the apportioned income of Y and Z and $25,000 remains to be carried forward. In tax year 2009, the three corporations are engaged in a unitary business. In conducting their 2009 unitary business, the XYZ combined group has a combined loss of $80,000, and X, Y and Z have respective apportionment percentages of 25%, 20% and 10%. Consequently, X, Y and Z have an apportioned share of the combined group's loss for 2009 that is, respectively, $20,000, $16,000 and $8,000. In 2010 the XYZ combined group remains unchanged and has combined taxable income of $300,000, and X, Y and Z have respective apportionment percentages of 33.4%, 5% and 10%. Therefore, X, Y and Z's respective share of the 2010 group's income is, respectively, $100,000, $15,000 and $30,000. The Massachusetts income and loss attributes for the XYZ group for tax years, 2009-2010, is computed as follows:

Tax year 2009.

Entity	Combined Income	App%	MA Income	2009 NOL to carry forward	2008 NOL carry forward
X	($80,000)	25%	($20,000)	($20,000)	($25,000)
Y	($80,000)	20%	($16,000)	($16,000)	n/a
Z	($80,000)	10%	($ 8,000)	($8,000)	n/a

Tax year 2010.

Entity	Combined Income	App%	MA Income	NOL carry forward used	Taxable Income
X	$300,000	33.34%	$100,000	$45,714*	$54,286
Y	$300,000	5%	$15,000	$15,000**	$0
Z	$300,000	10%	$30,000	$8,286***	$21,714

* X applies its entire NOL carry forward from 2008, $25,000. X also applies its entire NOL carry forward from 2009, $20,000. X also uses $714 of Y's NOL carry forward from 2009, which is determined based upon its percentage of the income of X and Z after each corporation applies its own NOLs ($55,000/$77,000 multiplied by Y's $1,000 excess NOL).

** Y applies $15,000 of its NOL carry forward from 2009; it has $1,000 of NOL carry forward from 2009 that remains to share with X and Z.

*** Z applies its entire NOL carry forward from 2009, $8,000, plus Z applies $286 of Y's excess NOL carry forward from 2009, which is determined based upon its percentage of the income of X and Z after each corporation applies its own NOLs ($22,000/$77,000 multiplied by $1,000).

Example 3. X, Y and Z are commonly owned taxpayer corporations taxable under M.G.L. c. 63, § 39 during the three year period 2008-2010. For taxable year 2008, X, Y and Z file as a combined group under the predecessor version of M.G.L. c. 63, § 32B. X has an apportioned loss of $150,000 for 2008 and Y and Z have apportioned income, respectively, of $10,000 and $5,000. Consequently, in 2008 $15,000 of X's loss is used

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to offset the apportioned income of Y and Z and $135,000 remains to be carried forward. In tax 2009, the three corporations are engaged in a unitary business. In conducting their 2009 unitary business, the XYZ combined group has a combined loss of $20,000, and X, Y and Z have respective apportionment percentages of 10%, 50% and 10%. Consequently, X, Y and Z have an apportioned share of the combined group's loss for 2009 that is, respectively, $2,000, $10,000 and $2,000. In 2010 the XYZ combined group remains unchanged and has combined taxable income of $100,000, and X, Y and Z have respective apportionment percentages of 10%, 50% and 10%. Therefore, X, Y and Z's respective share of the group's 2010 income is, respectively, $10,000, $50,000 and $10,000. The Massachusetts income and loss attributes for the XYZ group for tax years, 2008-2010, is computed as follows:

Tax year 2009.

Entity	Combined Income	App%	MA Income	2009 NOL to carry forward	2008 NOL carry forward
X	($20,000)	10%	($2,000)	($2,000)	($135,000)
Y	($20,000)	50%	($10,000)	($10,000)	n/a
Z	($20,000)	10%	($2,000)	($2,000)	n/a

Tax year 2010 .

Entity	Combined Income	App%	MA Income	NOL carry forward used	Taxable Income
X	$100,000	10%	$10,000	$10,000*	$0
Y	$100,000	50%	$50,000	$11,667**	$38,333
Z	$100,000	10%	$10,000	$2,333***	$7,667

* X has $135,000 of carry forward from 2008 to apply. It applies $10,000 of its 2008 carry forward to eliminate its 2010 taxable income, leaving it with $125,000 to carry forward for its use in subsequent years. None of X's 2008 carry forward can be shared with Y or Z. X also has $2,000 of NOL carry forward from 2009 remaining, which can be shared with Y and Z.
** Y applies its $10,000 NOL carry forward from 2009; Y also uses $1,667 of X's NOL carry forward from 2009 (which unlike X's 2008 NOL carry forward can be shared), which is determined based upon its percentage of the income of Y and Z after each corporation applies its own NOLs ($40,000/$48,000 or 5/6).
*** Z applies its entire NOL carry forward from 2009, $2,000; Z also uses $333 of X's NOL carry forward from 2009, which is determined based upon its percentage of the income of Y and Z after each corporation applies its own NOLs ($8,000/$48,000 or 1/6).

Example 4. Y and Z are corporations taxable under M.G.L. c. 63, § 39 that are engaged in a unitary business during the three year period 2009-2011. For taxable year 2009, the YZ combined group's taxable income is $100,000 and the apportionment percentage of Y and Z is 10%, and 5% respectively. Z also has an allocable loss of $20,000 that derives from an activity that is unrelated to the combined group's unitary business. The apportioned taxable income of Y and Z derived from the combined group prior to the deduction of any losses is $10,000 and $5,000, respectively. Z applies its allocable loss, $20,000, against its apportioned share of the combined group's taxable income, $5,000 and has a remaining loss of $15,000 to carry forward. Z's $15,000 loss carry forward is an allocable loss, and therefore cannot be shared with Y in the 2009 tax year or any future tax year.

For taxable year 2010, the YZ combined group has a net loss of $50,000 and the apportionment percentage of Y and Z is 10% and 6%, respectively. Therefore, Y and Z generate NOL carry forwards of $5,000 and $3,000, respectively. Because these carry forwards are derived from the operation of the combined group's unitary business, Y and Z may share these NOLs with each other in future years. Z also has allocable income from 2010 of $5,000. Z's allocable loss from 2009, $15,000, is deducted from its allocable income from 2010, $5,000, up to the limit specified in M.G.L. c. 63, § 30.5 (*i.e.*, in this case, reducing Z's taxable income to zero). Z retains the remainder of its 2009 allocable NOL derived from 2009, *i.e.*, $10,000, which Z can carry forward and use against its own income (but which cannot be shared with Y) in future years.

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For taxable year 2011, the YZ combined group has net income of $200,000 and the apportionment percentage of Y and Z is 10% and 4%, respectively. Therefore, Y and Z's apportioned share of the combined group's taxable income is $20,000 and $8,000, respectively. Neither Y nor Z has any allocable income or loss in 2011. Y applies its NOL carry forward previously derived from the activities of the YZ combined group, $5,000, against its $20,000 in 2011 apportioned income from such group, and thereby reduces this income to $15,000. Z must first apply its NOL carry forward previously derived from the activities of the YZ combined group, $3,000, to reduce its $8,000 in 2011 apportioned income from such group, and thereby reduces this income to $5,000. Subsequently, Z may apply $5,000 of its allocable NOL against its remaining 2011 apportioned income from the YZ group, thereby reducing this income to zero. Z retains the remainder of its 2009 allocable NOL, *i.e.*, $5,000, which Z can carry forward and use against its own income (but which cannot be shared with Y) in future years.

Example 5. Y is a manufacturing corporation taxable in Massachusetts that applies single sales factor apportionment for the tax years 2007-2009. Y has an available NOL from tax year 2007 of $40,000 calculated on a pre-apportionment basis. In 2007 Y had Massachusetts destination sales of $45,000 and sales subject to throwback of $55,000, for a total numerator of $100,000. Also, in 2007 Y had a sales factor denominator of $200,000 and therefore a resulting apportionment percentage of 50%. In 2008, Y is a Massachusetts taxpayer that has no taxable income or loss. In 2009 Y is a member of a combined group engaged in a unitary business with corporation Z. The YZ combined group's 2009 taxable income is $100,000 and Y has a 2009 apportionment percentage, calculated under 830 CMR 63.32B.2(7), of 8%. Therefore, Y's 2009 apportioned share of the combined group's taxable income is $8,000. The denominator of the YZ combined group's 2009 sales factor is $1,000,000. Also, the group is taxable in every state so none of Y's 2007 sales would be considered sales shipped to non-nexus states for throwback purposes if made by Y in 2009.

To calculate the amount of its 2007 NOL that is available to be used in tax year 2009, Y multiplies its pre-apportionment 2007 NOL by its 2007 apportionment percentage (40,000 x 50%), which results in Y having a post-apportionment NOL available from 2007 of $20,000. To calculate the limit on the amount of its 2007 NOL that Y may use in the 2009 tax year, Y must re-determine its 2007 sales factor numerator, excluding sales thrown back to Y in 2007 to the extent those sales were shipped to purchasers in states in which the YZ combined group is taxable in the 2009 tax year. Y's 2007 numerator as re-determined for this purpose is $45,000. Therefore, the limit on the amount of Y's 2007 NOL which may be used by Y in tax year 2009 is Y's revised 2007 numerator divided by the YZ combined group's 2009 denominator times the YZ combined group's taxable income (*i.e.*, 45,000/1,000,000 x $100,000 = 4.5% of $100,000 or $4,500.). Consequently, Y may use $4,500 of its 2007 post apportionment NOL against its 2009 apportioned share of the YZ combined group's taxable income and, upon so doing, has $3,500 of taxable net income. Y then has $15,500 of post-apportioned NOL from 2007 remaining to carry forward to future years.

Example 6. Same facts as in 830 CMR 63.32B.2(8)(h) *Example 5*. except that Y also has an NOL carry forward from the 2008 tax year determined on a pre-apportioned basis of $30,000. In 2008 Y had destination sales of $60,000, throwback sales of $20,000 and a sales factor denominator of $240,000. Y's apportionment percentage for 2008 was 33.33%.

To determine the limit on the amount of its pre-combination NOL carry forward that it may use in tax year 2009, Y must first determine how much of its NOL carry forward is available from each of the two tax years 2007 and 2008 on a post-apportionment basis. Y's post-apportionment NOL from 2007 is $20,000, and using its applicable 2008 apportionment factor, Y determines that its post apportionment NOL from 2008 is $10,000. Also, Y's re-determined numerator for 2007 is $45,000 (*See* example 5) and its re-determined numerator for 2008 (excluding throwback to states in which the group has nexus in the current year) is $60,000. Y must use the weighted average of these numerators (⅔ of the 2007 numerator plus ⅓ of the 2008 numerator) to calculate its limitation under 830 CMR 63.32B.2(8)(f). The weighted average is $50,000. The YZ combined group's 2009 denominator is $1,000,000 and the YZ combined group's 2009

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taxable income is $100,000 so the limit on the amount of pre-combination NOL which Y may use in tax year 2009 is $5,000 (*i.e.*, 50,000/1,000,000 x $100,000 = 5% of $100,000 or $5,000.). Y uses $5,000 of its 2007 NOL and has $15,000 of its 2007 NOL (on a post-apportionment basis) available to carry forward to the following year. Y uses none of its 2008 NOL and has $10,000 of 2008 post apportionment NOL to carry forward to the following year. Y's taxable net income after the NOL deduction is $3,000.

Example 7. Same facts as in 830 CMR 63.32B.2(8)(h) *Example 6*. except that Y and Z have increased their total Massachusetts property and payroll from tax year 2007 to tax year 2009 and, because this is so, the YZ combined group elects to apply the provisions of 830 CMR 63.32B.2(8)(f)2. to determine the limit on pre-combination NOL carry forwards that may be used by the group members (assume for purposes of the example, however, that Z has no pre-combination NOL carry forwards). The increase in the Massachusetts property and payroll of Y and Z from 2007 to 2009 was 50%. The increase in the Massachusetts property and payroll of Y and Z from 2008 to 2009 was 25%. Y's re-determined 2007 numerator is $45,000 (*See* 830 CMR 63.32B.2(8)(h) *Example 5*.), increased by 50% to reflect the increase in the Massachusetts property and payroll of Y and Z from 2007 to 2009 for a revised figure of $67,500. Y's re-determined 2008 numerator is $60,000 (*See* 830 CMR 63.32B.2(8)(h) *Example 6*.), increased by 25% to reflect the increase in the Massachusetts property and payroll of Y and Z from 2008 to 2009 for a revised figure of $75,000. Applying the weighted average rule (⅔ for 2007, ⅓ for 2008 based on the amount of NOL available), Y's average numerator for the pre-combination loss years is $70,000 and therefore the limit on its pre-combination losses that may be used is $7,000. Y will use $7,000 of the 2007 NOL carry forward and has $13,000 remaining to carry forward to the following year. Y uses none of the 2008 NOL carry forward and has $10,000 available to carry forward to the following year.

(9) Credits.

(a) General; Possible Sharing of Credits Within a Combined Group. In general, a tax credit generated by a taxpayer belongs to that taxpayer and can be applied against the excise of that taxpayer and in some cases against the excise of the affiliates of the taxpayer, subject to the rules that govern the use of the credit. Further, pursuant to M.G.L. c. 63, § 32B, for tax years beginning on or after January 1, 2009, a credit that may be validly claimed by a taxable member of a combined group and that is attributable to the combined group's unitary business may be shared with the other taxable members of the combined group to the extent such sharing of the credit is consistent with the statutory requirement for claiming the credit, taking into account the nature of the business and activities of each of the taxable members that seek to share the credit. Thus, for example, in the case of an investment tax credit (ITC) that is generated by a taxable member of a combined group pursuant to M.G.L. c. 63, § 31A for a taxable year beginning on or after January 1, 2009, such credit may be applied against the excise due from one or more other taxable members of the combined group if the qualified property is used in the combined group's unitary business and such other taxable members could have validly claimed a credit under M.G.L. c. 63, § 31A, *e.g.*, as a manufacturing corporation. For purposes of the preceding sentence, a taxable member seeking to share the M.G.L. c. 63, § 31A credit shall be deemed to meet the standard that it could have validly claimed a credit under M.G.L. c. 63, § 31A for the taxable year if it is deemed to be engaged in manufacture for such year pursuant to 830 CMR 63.32B.2(7)(g)2.d. Also, in the case of a research credit that is generated by a taxable member of a combined group pursuant to M.G.L. c. 63, § 38M, for a taxable year beginning on or after January 1, 2009, such credit may be applied against the excise due from one or more other taxable group members if the credit derives from the unitary business of such group and the other taxable group members are corporations taxable under M.G.L. c. 63, § 39 or § 32D. In the case of a group of corporations for which an affiliated group election has been made, a credit that is validly claimed by a taxpayer in the combined group may be shared with the other taxable members of such group irrespective as to whether the combined group members sharing the credit are all engaged in a unitary business to the extent such sharing of the credit is consistent with the statutory requirement for claiming the credit, as discussed in 830 CMR 63.32B.2(9)(a).

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(b) Application of Current Year Credits. In any case where a taxpayer's credit can be shared among the taxable members of the taxpayer's combined group, the credit must first be applied against the excise of the taxpayer that generated the credit consistent with the requirements and limitations that apply to such credit. If the taxpayer has more credit than it may use against its own excise, such excess credit may be applied against the excise of the other taxable members that are eligible to share the credit, again consistent with the requirements and limitations that apply to such credit, provided however that each of such other taxable members must first use its own credits, including any credits carried forward from prior years. In general, the credit conferred under M.G.L. c. 63, §§ 31A and 38N are each subject to a 50% annual limitation and the credit conferred under M.G.L. c. 63, § 38M is subject to a 75% annual limitation (*i.e.*, the credit may not reduce the taxpayer's excise for the year by more than 50% or 75%, respectively, as the case may be), although the first $25,000 of the M.G.L. c.63, § 38M credit is not subject to any percentage limitation. A credit may be applied against a taxpayer's income or non-income measure determined under M.G.L. c. 63, § 39. However, under no circumstance may a general business corporation subject to tax under M.G.L. c. 63, § 39 reduce its excise to less than the minimum corporate excise as determined under M.G.L. c. 63, § 39.

Example 1. X, Y and Z are taxpayer corporations engaged in a unitary business in tax year 2009. These corporations have an income measure excise as determined under M.G.L. c. 63, § 39, before the application of any credits, of $10,000, $20,000 and $10,000, respectively. X is a manufacturing corporation within the meaning of M.G.L. c. 63, § 31A. Y is a research and development corporation within the meaning of M.G.L. c. 63, § 31A that would be entitled to ITC if it made a qualified acquisition thereunder. Z is a corporation that is not referenced within the meaning of M.G.L. c. 63, § 31A that would not be able to claim the ITC under M.G.L. c. 63, § 31A even it acquired property as referenced therein. In tax year 2009, X purchases equipment to be used in the XYZ unitary business that generates $15,000 of ITC. Also, during tax year 2009, Y engages in activity as part of the unitary business that entitles it to $45,000 of research credit under M.G.L. c. 63, § 38M. The credits for the group are determined as follows:

Tax year 2009.

Entity	Excise	Credit generated	Own credit used	Shared from X	Shared from Y	Excise post credits	Carry forward credit
X	$10,000	$15,000	$5,000	n/a	$4,544	$456	$8,581
Y	$20,000	$45,000	$18,125	$1,419	n/a	$456	$13,269
Z	$10,000	n/a	n/a	n/a	$9,062	$938	$0

X must use its ITC first, which results in it claiming $5,000 of ITC. X is then able to share any excess research credit of Y. X's research credit limitation is $9,062. (X's tax was $10,000 and the group's overall tax was $40,000 and so X contributed to 25% of the group's tax. Accordingly 25% of the $25,000 research credit limitation is applied to X. Thus 25% multiplied by the $25,000 credit limitation or $6,250 plus 75% of the remaining tax of $3,750 or $2,812 equals X's available research credit of $9,062.) However, the research credit is further limited to $4,544 so that the tax due by X is at least $456. Y must use its research credit first against its own excise. Y's available research credit for 2009 is $18,125 (50% of the $25,000 group limitation plus 75% of the remaining tax.). In addition, since Y, like X, is a corporation that is entitled to claim an ITC under M.G.L. c. 63, § 31A, Y may share in X's ITC. The ITC is limited to 50% of Y's excise, and in this case is further limited so that Y's excise does not fall below $456. Therefore, Y can use $1,419 of X's ITC. Z may share Y's research credit. Z's share of Y's research credit is 25% of the group's $25,000 limitation plus 75% of any remaining excise.

(c) Carry Forward of Credits: Post-2009 and Pre-2009 Credits.

1. General: Post-2009 Credits. In general, a taxpayer that does not use the full amount of a credit generated in a taxable year may carry forward the amount of credit not used consistent with the statutory requirements for applying the credit. Where a taxpayer generates a credit for a taxable year beginning on or after January 1, 2009, the taxpayer

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may carry forward the portion of such credit that is not taken by the taxpayer and the other taxable members of the taxpayer's combined group. Any such credit that is carried forward by the taxable member may only be shared with a member of the taxpayer's current combined group that in addition:

a. was a member of the taxpayer's combined group during the year (*i.e.*, a tax year beginning on or after January 1, 2009) that the credit was generated; or

b. is a successor in whole or part to one or more combined group members from such prior post-2008 tax year such that there is 100% continuity of ownership as between the successor corporation and one or more corporations that were in the combined group during such prior year.

The requirements for sharing the carry forward of a credit that is generated for a taxable year beginning on or after January 1, 2009 are the same as those for sharing such a credit in the year that the credit was generated. That is, if the credit is attributable to the combined group's unitary business, the credit carry forward may be shared with the other taxable members of the combined group to the extent such sharing is consistent with the statutory requirement for claiming the credit, as discussed in 830 CMR 63.32B.2(9)(a) through (c). As in the case of the application of a credit for the tax year in which the credit was generated, a credit carry forward must first be applied against the excise of the taxpayer that generated the credit, and then any excess credit may be applied against the excise of the other taxable members of the combined group that may share the credit, in each case consistent with the requirements and limitations that apply to the credit.

Example 2. Same facts as in 830 CMR 63.32B.2(9)(b) *Example 1*. One year later, in tax year 2010, it remains the case that X, Y and Z are engaged in a unitary business. Also, it remains the case that X is a manufacturing corporation within the meaning of M.G.L. c. 63, § 31A; Y is a research and development corporation within the meaning of M.G.L. c. 63, § 31A; and Z is a corporation that is not referenced within the meaning of M.G.L. c. 63, § 31A and that would not be able to claim the ITC under M.G.L. c. 63, § 31A even if it acquired property as referenced therein. X has an excise of $2,000, Y has an excise of $4,000 and Z has an excise of $10,000. X also has $8,581 of ITC credit carry forward that may be shared with Y but not Z (the credit carry forward cannot be shared with Z because Z was not able to claim an ITC in tax year 2009). Y has a research credit carry forward of $13,269 that can be shared with both X and Z since the credit derived from the unitary business conducted by Y with both X and Z in 2009, and also in 2010 both X and Z are members of Y's combined group and are both corporations taxable under M.G.L. c. 63, § 39. None of the corporations have any additional credits for 2010. The credits for the group are calculated as follows:

Tax year 2010.

Entity	Excise	Carry Forward	Own credit used	Shared from X	Shared from Y	Excise post credits	Carry forward credit
X	$2,000	$8,581	$1,000	n/a	$544	$456	$7,581
Y	$4,000	$13,269	$3,544	n/a	n/a	$456	-
Z	$10,000	n/a	n/a	n/a	$9,181	$819	-

X must use its ITC carry forward against its own excise first, which results in it claiming $1,000 of ITC. X is then able to share any excess research credit of Y. There is no research credit limitation because the entire group's excise is less than $25,000. Y must use its research credit first against its own excise. Y may claim $3,544 of research credit and reduce its excise to $456. X may use $544 of Y's research credit to reduce its excise to $456. Z may also share Y's research credit. Z is able to claim the remaining $9,181 of Y's research credit. Z's excise is reduced to $819.

Example 3. Same facts as in 830 CMR 63.32B.2(9)(c)1. *Example 2*., except that Y separates part of its operations into a new taxpayer corporation, N, which it forms as a wholly owned subsidiary on January 1 of 2011, and N becomes part of the XYZ

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combined group as of that date. N and Y are both research and development corporations within the meaning of M.G.L. c. 63, § 31A that would be able to claim ITC thereunder. X has an excise of $2,000, Y has an excise of $4,000, Z has an excise of $10,000, and N has an excise of $4,000. The credits for the group are determined as follows:

Tax year 2011.

Entity	Excise	Credit generated	Own credit used	Shared from X	Shared from Y	Excise post credits	Carry forward credit
X	$2,000	$7,581	$1,000	n/a	n/a	$1,000	$2,581
Y	$4,000	n/a	n/a	$2,000	n/a	$2,000	-
Z	$10,000	n/a	n/a	n/a	n/a	$10,000	-
N	$4,000	n/a	n/a	$2,000	n/a	$2,000	-

X may share its ITC credit carry forward with Y and N, both of which are entitled to reduce their excise by 50% consistent with the rules for claiming an ITC. Y can share X's ITC because it is entitled to claim an ITC during tax year 2011 and also was a member of Z's combined group during 2009, the tax year that the ITC was generated. N can share X's ITC because it is entitled to claim an ITC during tax year 2011 and also, though it was not a member of the XYZ combined group in the tax year that the ITC was generated, N is a successor in part to Y, which was a combined group member during 2009, and also there is 100% continuity of ownership as between Y and N.

Example 4. Same facts as in 830 CMR 63.32B.2(9)(c)1. *Example 2*. (with X possessing an ITC carry forward from the unitary business activities of the XYZ combined group from tax year 2009), except that Z acquires 100% of the voting shares of a new taxpayer corporation, V, on January 1 of 2011. V is not engaged in a unitary business with X, Y or Z during 2011. However, the principal reporting corporation of the XYZ unitary group makes an affiliated group election for 2011. V is a manufacturing corporation within the meaning of M.G.L. c. 63, § 31A that would be entitled to claim ITC if it made a qualified acquisition thereunder. V has an income measure excise for tax year, 2011, of $4,000. X may not share any of its remaining ITC carry forward from tax year 2009 with V as V was not a part of the XYZ combined group in the tax year that the credit was generated.

2. Pre-2009 Credits. In the case of a credit that was generated by a taxpayer for a taxable year beginning prior to January 1, 2009, a credit carry forward may be applied in a subsequent tax year consistent with the statutory rules that applied to such credits in the year the credit was generated. Consequently, in tax years beginning on or after January 1, 2009, such a credit carry forward may be shared by the taxpayer that generated the credit with one or more taxable members of its combined group only if such sharing is consistent with the statutory rules that applied to the credit in the year that the credit was generated and, if those rules required the filing of a combined return of income under the predecessor version of M.G.L. c. 63, § 32B for the credit to be shared, only if the taxpayer that generated the credit and the other members seeking to share the credit jointly filed such a return for the last tax year beginning prior to January 1, 2009. Thus, for example, in the case of a carry forward of a research credit generated by a taxable member of a combined group pursuant to M.G.L. c. 63, § 38M for a taxable year beginning prior to January 1, 2009, such carry forward may be applied against the excise due from one or more other members of the combined group if the credit relates to the group's unitary business and the other taxable members seeking to share the credit and the taxable member that generated the credit filed a combined return of income under the predecessor version of M.G.L. c. 63, § 32B in the last tax year beginning prior to January 1, 2009. In contrast, since a credit generated pursuant to M.G.L. c. 63, § 31A could not be shared by corporations in tax years beginning prior to January 1, 2009, a credit carry forward of a M.G.L. c. 63, § 31A credit cannot be shared by combined group members in taxable years beginning on or after January 1, 2009.

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Example 5. X, Y and Z are commonly owned taxpayer corporations taxable under M.G.L. c. 63, § 39 during the two year period 2008-2009. For taxable year 2008, X, Y and Z file as a combined group under the predecessor version of M.G.L. c. 63, § 32B, which has been repealed for taxable years beginning on or after January 1, 2009. X is a manufacturing corporation within the meaning of M.G.L. c. 63, § 31A and has an ITC carry forward from 2008 of $10,000. Y is a research and development corporation within the meaning of M.G.L. c. 63, § 31A and has a research credit carry forward from 2008 of $20,000. Z is a corporation that is not referenced within the meaning of M.G.L. c. 63, § 31A and would not be able to claim the ITC under M.G.L. c. 63, § 31A even if it acquired property as referenced therein. In 2009, the three corporations are engaged in a unitary business within the meaning of current M.G.L. c. 63, § 32B, and have an income measure excise as determined under M.G.L. c. 63, § 39, before the application of any credits, of $10,000, $20,000 and $10,000, respectively. The credits for the group are determined as follows.

Tax year 2009.

Entity	Excise	'08 Credit carried forward	Own credit used	Shared from X	Shared from Y	Excise post credits	Carry forward credit
X	$10,000	$10,000	$5,000	n/a	$1,875	$3,125	$5,000
Y	$20,000	$20,000	$18,125	n/a	n/a	$1,875	-
Z	$10,000	n/a	n/a	n/a	n/a	$10,000	-

X must use its ITC first and can offset 50% of its excise with its ITC. Therefore X uses $5,000 of its ITC. Y must use its research credit first against its own excise. Y's research credit limitation is $18,125 so it must use this amount first. (Y's research limitation is $12,500 plus $5,625. Since Y's liability is 50% of the group's liability Y is allocated 50% of the $25,000 credit limitation or $12,500 plus 75% of the excise remaining in excess of the $12,500 limitation or 75% of $7,500). Y's research credit can be shared with X since both X and Y, as combined group members under former M.G.L. c. 63, § 32B, were able to share the credit during the tax year that it was generated, 2008, and also in 2009 both X and Z are members of Y's combined group and are both corporations taxable under M.G.L. c. 63, § 39. Therefore, X can share in Y's remaining research credit of $1,875. However, X may not share any of its remaining ITC generated in 2008 with either Y or Z, as during tax year 2008 the M.G.L. c. 63, § 31A credit could only be used by the corporation that generated it. Z does not take any credit in this example, but had X not used any of Y's research credit Z could have claimed it. Alternatively, X and Z could have each taken a portion of Y's excess research credit. X has a carryover ITC of $5,000.

(d) Ownership of a Credit: Situation Where Credit Owner Leaves Combined Group. Although a credit and a credit carry forward may sometimes be shared among the taxable members of a combined group as discussed in 830 CMR 63.32B.2(9)(a) through (c), the credit nonetheless remains the property of the taxpayer that initially generated the credit. Consequently, in any case in which a taxable member of a combined group ceases to be a member of the combined group, for whatever reason, any credit carry forward owned by such taxpayer is no longer available for use by the other taxable members of the combined group with which the taxpayer was previously affiliated. In such cases, if the taxpayer becomes a member of a new combined group, the taxpayer may not share the credit with the taxable members of its new combined group unless one of the taxable members of the new combined group was also a member of the taxpayer's combined group during the year that the credit was generated and all the other requirements set forth in 830 CMR 63.32B.2(9) are met. Where a taxpayer that has a credit carry forward becomes a member of a new combined group, the change of ownership rules set forth in Code § 383 as applied under Massachusetts law may apply, though any amount of credit carry forward that cannot be applied because of these limitations may be carried forward consistent with the rules and limitations discussed in 830 CMR 63.32B.2(9)(c). In the event that a member of a combined group has a credit carry forward and subsequently takes part in a merger or consolidation the credit carry forward will be lost if, for example, the member liquidates or terminates as a result of the merger or consolidation. In the case of a S Corporation owning a QSub that was then treated with the QSub as a single corporation by reason of St. 2008, c. 173, for tax years beginning

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on or after January 1, 2009, the credit carry forward of the S corporation and/or the QSub shall be treated as the credit carry forward of the single corporation. *See* 830 CMR 63.30.3.

Example 6. X, Y and Z are taxpayer corporations engaged in a unitary business in tax year 2009. X is a manufacturing corporation within the meaning of M.G.L. c. 63, § 31A. Y is a research and development corporation within the meaning of M.G.L. c. 63, § 31A that would be entitled to ITC if it made a qualified acquisition thereunder. Z is a corporation that is referenced within the meaning of M.G.L. c.63, § 31A that would have been able to claim the ITC under M.G.L. c. 63, § 31A if it acquired property as referenced therein. X has an ITC carry forward from tax year 2009 that it can carry forward to 2010. In tax year 2010 all of the stock of X is sold to taxpayer corporation N. X is engaged in a unitary business with corporation N in tax year 2010 (although it is presumed under 830 CMR 63.32B.2(3)(b) that X is not engaged in a unitary business with N, assume that the presumption is rebutted). X has $5,000 of ITC carry forward, which derived from a credit that it generated in 2009. N, like X, is a manufacturing corporation within the meaning of M.G.L. c. 63, § 31A that would be entitled to claim a credit thereunder. In 2010, X and N have an income measure excise as determined under M.G.L. c. 63, § 39, before the application of any credits, of $5,000 and $5,000, respectively. N does not generate any credit in 2010 and has no credit carry forward. X may apply $2,500 of its ITC credit carry forward against its $5,000 2010 excise and reduce that excise to $2,500 (*i.e.*, by 50%). X may not share its remaining $2,500 of ITC carry forward with N, as it was not engaged in a unitary business with N at the time that it generated the ITC. Also, as X is no longer a member of a unitary group with Y and Z and departed that unitary group with its ITC credit carry forward, neither Y nor Z can use the credit carry forward that belongs to X in tax year 2010.

Tax year 2010.

Entity	Excise	Carry forward	Own credit used	Shared from X	Excise post credits	Carry forward credit
X	$5,000	$5,000	$2,500	n/a	$2,500	$2,500
N	$5,000	n/a	n/a	n/a	$5,000	-

Example 7. X, Y and Z are taxpayer corporations engaged in a unitary business in tax year 2009. X is a manufacturing corporation within the meaning of M.G.L. c. 63, § 31A. Y is not a corporation that would be entitled to ITC if it made a qualified acquisition thereunder. X has an ITC carry forward from tax year 2009 that it can carry forward to 2010. In tax year 2010 all of the stock of X and Y is sold to taxpayer corporation N, which is a member of a combined group with corporation O. X and Y are engaged in a unitary business with corporations N and O in tax year 2010 (although it is presumed under 830 CMR 63.32B.2(3)(b) that X and Y are not engaged in a unitary business with N and O for the tax period after the acquisition, assume that this presumption is rebutted). N and O were engaged in a unitary business in tax year 2009. N has an ITC carry forward in 2010 of $10,000 that derives from a credit that N generated in 2009, during which year O was also entitled to claim an ITC.

In 2010, N and O are manufacturing corporations and Y becomes a research and development corporation, all of whom are entitled to generate an ITC under M.G.L. c.63, § 31A. In 2010, X, Y, N and O have an income measure excise as determined under M.G.L. c. 63, § 39, before the application of any credits, of $5,000, $10,000, $5,000 and $10,000, respectively. X may apply $2,500 of its ITC credit carry forward against its $5,000 excise and reduce that excise to $2,500 (*i.e.*, by 50%). X may also share its remaining $2,500 of ITC carry forward with Y, as it was engaged in a unitary business with Y in 2009 when it generated this credit and Y is a corporation that is entitled to claim an ITC in tax year 2010. N may apply $2,500 of its ITC credit carry forward against its $5,000 excise and reduce that excise to $2,500 (*i.e.*, by 50%). N may also share $5,000 of its remaining $7,500 of ITC with O, as N was engaged in a unitary business with O in 2009 when it generated this credit and O is a corporation that is entitled to claim an ITC in tax year 2010. Y may apply the $2,500 ITC carry forward that

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it receives from X to reduce its excise to $7,500. O may apply the $5,000 carry forward that it receives from N to reduce its excise to $5,000. N has $2,500 of ITC to carry forward to 2011.

Tax year 2010.

Entity	Excise	Carry Forward	Own credit used	Shared from X	Shared from N	Excise post credits	Carry forward credit
X	$5,000	$5,00	$2,500	n/a	n/a	$2,500	-
Y	$10,000	n/a	n/a	$2,500	n/a	$7,500	-
N	$5,000	$10,000	$2,500	n/a	n/a	$2,500	$2,500
O	$10,000	n/a	n/a	n/a	$5,000	$5,000	-

(e) Investment Tax Credit and Economic Opportunity Area Credit Recapture; Recapture in General. Where a taxpayer generates a credit pursuant to M.G.L. c. 63, § 31A or § 38N for a taxable year beginning on or after January 1, 2009, and then subsequently disposes of the property, or where the property otherwise ceases to be in qualified use within the meaning of M.G.L. c. 63, § 31A or § 38N, recapture of the credit shall be determined pursuant to M.G.L. c. 63, § 31A based upon the total credit previously taken by the taxpayer and its combined group members. This rule applies even if the taxpayer first leaves the combined group, then in a subsequent year disposes of the qualified property or otherwise causes recapture, and therefore in such subsequent tax year is no longer included in a combined group with the corporations whose use of the credit must be considered for purposes of recapture. Where a taxpayer generates a credit pursuant to M.G.L. c. 63, § 31A or § 38N for a taxable year beginning on or after January 1, 2009, there shall be no recapture if the taxpayer subsequently transfers the qualified property to another taxable member of its combined group with which the credit could be shared under the rules in 830 CMR 63.32B.2(9). However, in this case, if the transferee leaves the combined group or subsequently transfers the property outside the combined group or to a member of the combined group with which the credit cannot be shared under the rules in 830 CMR 63.32B.2(9) there shall be recapture of the credit on the part of the taxpayer that generated the credit determined pursuant to M.G.L. c. 63, § 31A based upon the total credit previously taken by the combined group members. In any other case where a Massachusetts credit that is subject to recapture can be shared among combined group members, the recapture shall be evaluated in a similar manner.

Example 8. X, Y and Z are taxpayer corporations engaged in a unitary business in tax year 2009. X is a manufacturing corporation within the meaning of M.G.L. c. 63, § 31A. Y and Z are a research and development corporation and manufacturing corporation, respectively, within the meaning of M.G.L. c. 63, § 31A that would be entitled to ITC if they made a qualified acquisition thereunder. Midway through tax year 2009, on July 1st, X purchases one piece of equipment with a five year life to be used in the XYZ unitary business that generates $15,000 of ITC. During tax year 2010, X transfers the qualified equipment that generated the ITC to Z. No recapture is required on this transfer of the equipment from X to Z as Z is a manufacturing corporation within the meaning of M.G.L. c. 63, § 31A that would be entitled to ITC if it made a qualified acquisition, *etc.*, thereunder. In tax years 2009 and 2010, corporations X, Y and Z each use annually $2,500 of the ITC belonging to X consistent with the requirements for claiming ITC, such that all of the $15,000 of ITC has been claimed. On June 30, 2011, Z sells the equipment that generated the ITC to an unrelated corporation. X is required to recapture 3/5 of the ITC previously taken by X, Y and Z, or $9,000.

Example 9. X, Y and Z are taxpayer corporations engaged in a unitary business in tax year 2009. X is a manufacturing corporation within the meaning of M.G.L. c. 63, § 31A. Y and Z are a research and development corporation and manufacturing corporation, respectively, within the meaning of M.G.L. c. 63, § 31A that would be entitled to ITC if they made a qualified acquisition thereunder. Midway through tax year 2009, on July 1st, X purchases one piece of equipment with a five year life to be used in the XYZ unitary business that generates $15,000 of ITC. In tax year 2009, corporations X, Y and Z use $7,500 of the ITC generated by X, leaving X with a $7,500 credit carry forward.

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On January 1, 2010, all of the shares of X are acquired by an unrelated corporation, N, and therefore X is no longer engaged in a unitary business with X and Y. Corporation X is not permitted to share its ITC carry forward with the acquiring corporation N, but nonetheless uses the remaining $7,500 of this carry forward itself in 2010. On June 30, 2011, X sells the equipment that generated the ITC to N. X is required to recapture 3/5 of the ITC previously taken by X, Y and Z, or $9,000.

(10) Affiliated Group Election.

(a) General. A corporation, whether foreign or domestic, is required to file a combined report when it is subject to tax under M.G.L. c. 63, § 2, 2B, 32D, 39 or 52A and engaged in a unitary business with one or more corporations that are required to be included in the combined report. In such cases, the one or more taxable members of the combined group may elect for a tax year to treat as their combined group all corporations that are members of their Massachusetts affiliated group as defined by 830 CMR 63.32B.2. The election does not require the Commissioner's consent. If the taxable members of a combined group make an affiliated group election, all of the corporations that are members of their Massachusetts affiliated group shall be treated as the members of a single Massachusetts combined group hereunder irrespective as to, for example, whether:

1. these corporations are included in more than one federal consolidated return filed by more than one federal consolidated group or
2. these corporations are engaged in one or more unitary businesses.

Upon making the election, the Massachusetts affiliated group shall calculate the combined group's taxable income and the respective taxable income of the taxable members of the group in accordance with 830 CMR 63.32B.2(6) and (7), provided that, if any group member is taxable on its income from business activity in another state in a particular tax year during the period of the election, all income of all group members for such year shall be treated as apportionable income, irrespective as to whether, for example, such income would be allocable to a particular state in the absence of the election. An affiliated group election can only be made if the Massachusetts affiliated group to which the election is to apply in the first year of application includes one or more federal affiliated groups filing a consolidated federal income tax return.

(b) Water's Edge Aspect: Relationship to Worldwide Election. An affiliated group election determines the apportionable net income of a taxable member of a combined group derived from the activities of the group on a water's edge basis. Therefore, a taxable member of a combined group may not make an affiliated group election and a worldwide election for the same taxable year and may not make an affiliated group election for any tax year in which a worldwide election is in effect.

(c) Relationship to Federal Consolidated Election. The membership of a combined group as determined pursuant to an affiliated group election is not limited to those corporations that are members of one or more affiliated groups under Code § 1504 that are filing a federal consolidated return. The affiliated group election shall include any corporation participating in the filing of a federal consolidated return, but the Massachusetts affiliated group is broader in several respects. For example, a Massachusetts affiliated group shall include a corporation that meets either of the two following standards even though such corporations would not be included in a federal consolidated return:

1. any corporation regardless of the place incorporated or formed, if the average of the corporation's property, payroll, and sales factors within the United States is 20% or more, or
2. any corporation that earns more than 20% 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, whether currently or over a period of time, against the business income of other members of the group, but only to the extent of that income and the apportionment factors related thereto. *See* 830 CMR 63.32B.2(5)(b) (explaining the application of these provisions).

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Also, the Massachusetts affiliated group shall be determined by including all corporations that are related by common ownership applying the common ownership test described in 830 CMR 63.32B.2(10)(c) (*i.e.*, direct or indirect ownership of more than 50% of voting control), rather than applying the standard applicable for federal consolidated return purposes that looks to 80% control of certain stock by vote and value. Further, control of members of the Massachusetts affiliated group may be direct or indirect, and a common owner or owners may be corporate or non-corporate. For example, two or more federal consolidated groups would be combined in one Massachusetts affiliated group filing if both consolidated groups were commonly owned by a non-US corporation.

(d) Mechanics for Making the Election. An affiliated group election shall be made by a taxable member of a combined group, provided, however, that where the election is to apply to one or more combined groups that filed a combined return in Massachusetts for the previous tax year, the election shall be made by a corporation that served as the principal reporting corporation of a combined group for such prior tax year. The election shall be made on an original, timely filed return or as otherwise required in writing by the Commissioner. A return shall be considered timely if it is filed by the taxpayer on or before the earliest due date or extended due date for the filing of the taxpayer's return under M.G.L. c. 63. No return filed after this date, whether filed with an application for abatement or otherwise, shall constitute a valid affiliated group election. The election, to be valid, must indicate in the manner required by the Commissioner that every corporation that is a member of the Massachusetts affiliated group has agreed to be bound by such election, including an agreement by each member of the group that such election shall apply to any member that subsequently enters the group and an agreement that each member continues to be bound by the election in the event that such member is subsequently the subject of a reverse acquisition as described in U.S. Treas. Reg. § 1.1502-75(d)(3).

(e) Effect of Election in Subsequent Tax Years. An affiliated group election shall be binding for and applicable to the taxable year for which it is made and for the next nine taxable years. The election shall continue in place irrespective as whether a federal consolidated group to which the combined group belongs discontinues the filing of a federal consolidated return. Any corporation that enters a Massachusetts affiliated group during the time that the affiliated group election is in effect shall be included in the Massachusetts combined group beginning with the first group's tax reporting period after the corporation enters the group, and shall be considered to have consented to the application of the election and to have waived any objection to its inclusion in the combined group. Reverse acquisition rules based on the federal rules set forth in U.S. Treas. Reg. § 1.1502-75(d)(3) shall be applied in determining whether a corporation is bound by an affiliated group election.

(f) Revocation, Renewal of Election. An affiliated group election, once made, cannot be revoked until after it has been effective for ten taxable years. When an election is made it may be renewed after ten taxable years for another ten taxable years, provided however that in the case of a revocation a new election shall not be permitted in any of the three taxable years immediately following the revocation. The revocation or renewal of an election shall be made on an original, timely filed return by the principal reporting corporation of the Massachusetts affiliated group or as otherwise required in writing by the Commissioner. A revocation or a renewal shall be effective for the first taxable year after the completion of the ten taxable years for which the prior election was in place. Any revocation or renewal, to be valid, must indicate in the manner required by the Commissioner that every corporation that is a member of the Massachusetts affiliated group has agreed to be bound by such revocation or renewal. If a prior affiliated group election is neither affirmatively revoked nor renewed after ten taxable years pursuant to the terms of 830 CMR 63.32B.2(10), the election shall terminate for the subsequent taxable year and no affiliated group election shall apply for that year and the subsequent two taxable years. In such cases, the Massachusetts affiliated group may make a new election for a ten taxable year period commencing with the fourth taxable year after the termination on the terms set forth in 830 CMR 63.32B.2(10).

(g) Change in Reporting Method. If either the unitary business standard or the Massachusetts affiliated group standard was used to account for the combined group members' income and apportionment data in the preceding tax year and the other standard is to be used for the combined group's combined report for the current tax year, adjustments to the income and apportionment data of the group members shall be made to prevent income and apportionment data from being omitted or duplicated, *etc*.

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(h) Interaction with M.G.L. c. 62C, § 3A. The purpose of the affiliated group election is to simplify the filing of returns for commonly owned corporations that are or may be involved in two or more separate unitary businesses by avoiding the fact-intensive analysis associated with determining the scope of each unitary business. The election may in application result in an increase or decrease in Massachusetts tax liability from year to year, but it is made binding for a ten year period to ensure that elections are made for purposes of simplification rather than for tax reduction. Although an affiliated group election does not require the consent of the Commissioner, in light of this legislative purpose, the Commissioner may disregard the tax effects of such an election pursuant to M.G.L. c. 62C, § 3A, where it appears, from facts available at the time of the election, that the election will not have meaningful continuing application. For example, and without limitation, the Commissioner would disregard the tax effects of an affiliated group election made in anticipation of the sale of substantially all of a business conducted in Massachusetts where a material part of the anticipated gain from the disposition would be allocated to Massachusetts in the absence of the election and where the sale results in the winding up of the seller's business in Massachusetts, such that the continued application of the affiliated group election would be anticipated to have no meaningful continuing impact in Massachusetts. Conversely, the Commissioner would not seek to disregard an otherwise proper election that results in a reduction of Massachusetts tax liability, whether or not such reduction is foreseeable at the time of the election, provided that at the time of the election the taxpayer anticipates continuing material business operations in Massachusetts subject to and affected by the filing requirements of the election.

(i) Agreement to Provide Documents. An election under 830 CMR 63.32B.2(10) shall constitute consent to the production of documents or other information that the Commissioner reasonably requires, for example, for purposes of verifying the appropriate members of the group, that the requirements of the affiliated group election have been met, that the tax computations and tax reporting are proper, and for purposes of determining the revenue implications of the affiliated group election.

(11) Principal Reporting Corporation, Liability.

(a) Principal Reporting Corporation. In the event that there are two or more taxable members of a combined group, the principal reporting corporation shall report the income of the combined group in the form and manner prescribed by the Commissioner. Except as otherwise approved in writing by the Commissioner, the principal reporting corporation shall be the taxable member of the combined group that is either the combined group's common parent corporation, or where there is no such common parent corporation or this parent corporation is not a taxable member of the combined group, the taxable member of the combined group that the group reasonably expects will have the largest amount of Massachusetts taxable net income on a recurring basis. The principal reporting corporation agrees to act as the agent on behalf of the taxable members of the combined group for all tax matters relating to the combined group, including: assessments; requesting extensions of time to file returns; making, renewing or revoking an election such as an affiliated group election or worldwide election; filing a refund claim; accepting of refunds or notices; executing waivers; and providing access to tax and other relevant records of the non-taxable members of the combined group as reasonably requested by the Commissioner. In the case of a request for an extension of time to file returns, such request shall be treated as such a request for both the combined group's income measure and each individual group member's non-income measure return.

(b) Liability. Every member of a combined group, including a Massachusetts affiliated group treated as a combined group hereunder, shall be jointly and severally liable for any tax due from any member of the combined group subject to tax under M.G.L. c. 63, including any interest, additions to tax, and penalties, to the extent permitted under the Constitution of the United States. An assessment against any member of a combined group for the excise attributable to the group's income in a particular taxable year, including any interest, additions to tax, or penalties, shall be deemed to constitute an assessment against all members of the combined group for that year. If, for example, the Commissioner determines, through an inspection of returns or otherwise, that the proper amount of excise attributable to the group's income has not been assessed, she may assess such additional excise against any member of the group, regardless of whether or not that member filed a

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return as a member of the combined group. The latter assessment may be made under any applicable provisions of M.G.L. c. 62C at any time within the time allowed under M.G.L. c. 62C as determined for that member.

(12) Tax Returns; Taxable Year; Fiscalization; Mid-year Entry or Departure.

(a) Tax Returns. Tax returns filed by taxable members of a combined group and by members of a combined group that are subject to the minimum excise or non-income measure of the corporate excise shall be filed consistent with the provisions set forth in M.G.L. c. 63 and M.G.L. c. 62C and the relevant rules set forth in 830 CMR 63.32B.2, provided, however, that the Commissioner may provide additional administrative rules and guidance and all such tax filings shall be made in the manner as prescribed by the Commissioner.

(b) Taxable Year.

1. General. The combined group's taxable year is determined as follows:

a. if two or more members of the group file a federal consolidated return the group's taxable year is the taxable year of the federal consolidated group (or the federal consolidated group with the most total assets, in the case where the members of the combined group file more than one federal consolidated return); and

b. in all other cases, the group's taxable year shall be the taxable year of the principal reporting corporation.

2. 52 to 53 Week Tax Years. Where a corporation files federal income tax returns on the basis of an annual period which varies from 52 to 53 weeks, its taxable year shall be treated as beginning with the first day of the calendar month beginning nearest to the first day of such taxable year or ending with the last day of the calendar month ending nearest to the last day of such taxable year. *See* M.G.L. c. 63, § 30(12).

(c) Fiscalization.

1. General. If the taxable year of one or more members of a combined group does not begin or end on the same dates as the taxable year of the combined group, those members' accounting periods must be adjusted in order for the appropriate share of the combined group's unitary business income or affiliated group income, as the case may be, to be properly attributed to those members' taxable years.

2. Calculating Members' Share of Combined Group Income for Combined Group's Tax Year. In general, any member that has a taxable year different from that of the combined group should determine its income and apportionment data for the taxable year of the combined group by using the interim closing method described in 830 CMR 63.32B.2(12)(c)2.a. This method requires an interim closing of the books for members whose taxable year differs from that of the combined group. However, a *pro rata* method of converting income to the combined group's taxable year will be accepted in certain instances, provided that the *pro rata* method does not produce a material misstatement of income apportioned to Massachusetts. Further, the Commissioner reserves the right to require use of the interim closing method in certain instances. Unless otherwise permitted or required by the Commissioner, the treatment of both the income and the apportionment data of any particular member must be determined based on the same method. If one method was used to account for a member's income and apportionment data in the preceding taxable year and another method will be used in the combined report for the current taxable year, adjustments to income and apportionment data of the member shall be made to prevent income and apportionment data from being omitted or duplicated.

a. Interim Closing Method. Under the interim closing method, the unitary business or affiliated group income or loss attributable to a member of a combined group is determined by first calculating the income or loss from the books and records of the member for the two periods that together encompass the combined group's single taxable year. For example, if the combined group has a taxable year ending on December 31, 2009, and another member has a taxable year ended March 31, 2010, the other member determines its income from its books and records for the partial accounting periods beginning January 1, 2009 and ending March 31, 2009, and from April 1, 2009 and ending December 31, 2009. The apportionment data shall also be determined by reference to the member's books and records for the appropriate partial

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taxable year provided, however, in the case of the property factor, the average property owned is required to be determined using monthly averaging as described in 830 CMR 63.38.1(7)(e)3. Interim income and apportionment data from the respective partial tax years is then combined with the income and apportionment data of the taxable year of the combined group, along with the income and apportionment data of other members of the combined group for the same period, and the members' share of the combined group's taxable income for the combined group's tax year is computed.

b. *Pro Rata* Method.

(i) Under the *pro rata* method, the income and apportionment data of the member as adjusted to reflect the determination of income under Massachusetts law is assigned to the respective portion of the combined group's taxable year based on the ratio of months in common with the tax year of the combined group. For example, if the combined group's taxable year ends on December 31, 2010, a member whose income year ends on March 31 will include 3/12^{ths} of its adjusted separate income and its apportionment data for its taxable year ended March 31, 2010 in the December 31, 2010 taxable year of the combined group. That member will then also include 9/12^{ths} of its adjusted separate income and its apportionment data for its taxable year ended March 31, 2011 in the December 31, 2010 taxable year of the combined group. However, the property factor is required to be determined using monthly averaging as described in 830 CMR 63.38.1(7)(e)3.

(ii) The income and apportionment data from the member's recomputed taxable years is then combined with the income and apportionment data of the taxable year of the combined group, along with the income and apportionment data of other members of the combined group for the same period, similarly recomputed if necessary. The combined group's taxable income is then apportioned to each of the taxable members of the combined group.

(iii) In the event that the *pro rata* method requires the determination of income and apportionment data of a corporation whose taxable year has not yet closed, and the information cannot be obtained in time for the other members to file an accurate return, the income and apportionment data for that period shall be estimated based on available information. If the use of actual income and apportionment data results in a material misstatement of income apportioned to Massachusetts by the combined group, the taxable members must file an amended return to reflect the change.

(iv) For the purpose of determining whether a re-determination of income made with respect to the *pro rata* method results in a material misstatement of income apportioned to Massachusetts by the combined group, it is presumed that there is such material misstatement where the aggregate tax liability of the combined group members that filed returns based on a *pro rata* estimate is found to have understated the aggregate correct liability for such members by the greater of $10,000 or 10% or, where the change in the apportioned group income for any one taxable member of the group increases or decreases by more than $100,000.

3. Attributing Combined Group Income from Combined Group's Tax Year to Member's Tax Years. After determining the combined group's taxable income apportioned to Massachusetts of a taxable member that is not filing its return with respect to that same taxable year, that income is then proportionately assigned to the applicable portion of that member's taxable year, based on the number of months falling within the common taxable period of the combined group.

4. Determination of and Sharing of Credits Between Members with Different Fiscal Years. Where members of a combined group are eligible to share credits under 830 CMR 63.32B.2(9) and the members have different tax years, no credit may be shared until the member generating the credit has filed its return for the tax year from which the credit derives. Where members engaged in a unitary business are required to determine credits on an aggregated basis (*e.g.*, as in the case of the credit provided for in M.G.L. c. 63, § 38M), the credits are determined for the tax year of the combined group and, subject to any statutory restrictions generally applicable with respect to the credit, such credits may be claimed by a taxable member on its first return filed for a period on or after the close of the combined group's taxable year.

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(d) Partial Years. Where a member enters the combined group after the start of the combined group's taxable year, only the income, apportionment data, and other tax attributes of the group member after it qualifies for inclusion are used to calculate and apportion the combined group's taxable income. Where a member leaves the combined group after the start of the combined group's taxable year, through a change of control or otherwise, only its tax attributes before it ceases to qualify for inclusion are used to calculate and apportion the combined group's taxable income. Whenever the income, apportionment data, and other tax attributes of one or more members of the combined group are includible for only part of the taxable year for which the combined group's taxable income is being determined and apportioned, the value of the member's owned or rented property will be reduced to reflect the ratio of the number of months for which the member's tax attributes are included in the combined group's taxable income determination and the total number of months in the combined group's taxable year.

(13) No Limitation on Other Authority. Nothing in 830 CMR 63.32B.2 shall be construed to limit or negate the Commissioner's authority to make adjustments as otherwise permitted under Massachusetts law, including under M.G.L. c. 63, § 31I, 31J or 31K; M.G.L. c. 63, § 39A; and M.G.L. c. 62C, § 3A. In general, the provisions of M.G.L. c. 63, § 39A and M.G.L. c. 62C, § 3A apply with respect to transactions governed by 830 CMR 63.32B.2. The provisions of M.G.L. c. 63, §§ 31I, 31J and 31K shall not apply to transactions between corporations that are members of the same combined group to the extent such transactions are deferred or eliminated under 830 CMR 63.32B.2; in any case in which an affiliated group election has not been made, these provisions do apply as to transactions between corporations that, although under common ownership, are each a member of a separate combined group or as to transactions between corporations that are otherwise filing on a combined basis when the transaction does not relate to the unitary business.

(14) Effective Date. 830 CMR 63.32B.2 shall apply to taxable years beginning on or after January 1, 2009.

63.38.1: Apportionment of Income

(1) Purpose, General Rule, Sham Transactions, and Outline.

(a) Purpose. The purpose of 830 CMR 63.38.1 is to explain the allocation and apportionment of income of business corporations, as provided in M.G.L. c. 63, § 38. 830 CMR 63.38.1 also governs the calculation of an apportionment percentage by other taxable entities when such entities are permitted or required to use the income apportionment method set out in M.G.L. c. 63, § 38. For example, 830 CMR 63.38.1 applies to manufacturing corporations; to S corporations and their shareholders, as described under M.G.L. c. 63, § 32D and M.G.L. c. 62, § 17A; and to nonresident individuals when permitted or required by 830 CMR 62.5A.1. However, except as expressly stated, 830 CMR 63.38.1 does not apply to income derived from mutual fund sales received by mutual fund service corporations within the meaning of M.G.L. c. 63, § 38(m). *See* 830 CMR 63.38.7. 830 CMR 63.38.1 also applies to corporations that are subject to combined reporting within the meaning of M.G.L. c. 63, § 32B, provided, however, that additional apportionment rules that apply in that context are set forth in 830 CMR 63.32B.2. Also, 830 CMR 63.38.1 applies to determine the apportionment percentage to be used to calculate, on a separate company basis, a corporation's non-income measure excise.

(b) General Rule. All of a taxpayer's taxable net income is allocated to Massachusetts if the taxpayer does not have income from business activity which is taxable in another state. If a taxpayer has income from business activity which is taxable both in Massachusetts and in another state, then the part of its net income derived from business carried on in Massachusetts is determined by multiplying all of its taxable net income by the three factor apportionment percentage as provided in M.G.L. c. 63, § 38(c) through (g) and 830 CMR 63.38.1. If a taxpayer with a Massachusetts commercial domicile has income from business activity which is taxable both in Massachusetts and in another state but also has an income stream that is prohibited from being taxed in another non-domiciliary state by reason of the U.S. Constitution, that income stream shall be allocated in full to Massachusetts.

(c) Exceptions to the General Rule. Notwithstanding the general rule set forth in 830 CMR 63.38.1(1)(b), the following taxpayers shall determine the part of their net income derived from business carried on in Massachusetts in the following manner:

1. Section 38 Manufacturers. If a section 38 manufacturer has income from business activity which is taxable both in Massachusetts and in another state, then the part of its net income derived from business carried on in Massachusetts is determined by multiplying all of its taxable net income, other than taxable net income derived from mutual fund sales received by a mutual fund service corporation, by the apportionment percentage provided in M.G.L. c. 63, § 38(l) and 830 CMR 63.38.1(10).

2. Mutual Fund Service Corporations. Regardless of whether it has income from business activity which is taxable both in Massachusetts and in another jurisdiction, a mutual fund service corporation shall apportion its taxable net income derived from mutual fund sales as provided in M.G.L. c. 63, § 38(m). Where a mutual fund service corporation has both taxable net income derived from mutual fund sales and other taxable net income, then the mutual fund service corporation shall allocate or apportion such other taxable net income as provided in 830 CMR 63.38.1 provided that the mutual fund service corporation shall determine such other taxable net income by taking into account only those deductions that are attributable to income from sources other than mutual fund sales.

(d) Sham Transactions. All transactions that determine a taxpayer's ability to apportion or determine the composition of a taxpayer's apportionment percentage are subject to the sham transaction doctrine and the related tax doctrines as set forth in M.G.L. c. 62C, § 3A.

(e) Outline. 830 CMR 63.38.1, is organized as follows:

1. Purpose, General Rule, Sham Transactions, and Outline
2. Definitions
3. Income Subject to Apportionment
4. Related Business Activities
5. Taxpayer and Taxpayer's Income Taxable in Another State
6. Consistent Accounting Method
7. Property Factor
8. Payroll Factor
9. Sales Factor

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10. Section 38 Manufacturers
11. One or More Factors Inapplicable
12. Corporate Partners
13. Alternative Apportionment Methods
14. Effective Date

(2) Definitions. For the purposes of 830 CMR 63.38.1 the following terms have the following meanings unless the context requires otherwise:

Agent, any person whose actions would be imputed to a taxpayer under the standards of 830 CMR 63.39.1 for purposes of determining whether the taxpayer is doing business in Massachusetts (or another state). In general, any taxpayer employee or other representative acting under the direction and control of the taxpayer is an agent, provided that *bona fide* independent contractors retained by a taxpayer are not agents of the taxpayer.

Allocable Item of Income, in the instance of a taxpayer with income from business activity taxable in more than one state, income from a transaction or activity that, consistent with the U.S. Constitution, can only be taxed in the state of the taxpayer's commercial domicile, because the item of income was not derived from a unitary business or from transactions that serve an operational function.

Base of Operations, the taxpayer's place of business from which an employee customarily begins work or to which the employee customarily returns at some other time to receive instructions, direction, and supervision from the taxpayer or communications from customers or other persons, to replenish stock or other materials, to repair equipment, or to perform any other function necessary to the exercise of the employee's trade or profession.

Business Activity, all of a taxpayer's transactions and activities, regardless of classification or labels, occurring in the course of a taxpayer's trade or business, including, but not limited to "incidents" as described in M.G.L. c. 63, § 39(1) through (3). Business activities of an agent conducted on behalf of a principal are deemed to be the business activities of the principal.

Capital Asset, an asset as defined in 26 U.S. Code § 1221, as modified by M.G.L. c. 62, § 1(m) and 830 CMR 63.38.1(2). For purposes of 830 CMR 63.38.1, Capital Asset includes property used in a trade or business within the meaning of U.S. Code § 1231(b) without regard to the holding period requirement in U.S. Code § 1231(b), and property held in connection with a trade or business entered into for profit within the meaning of U.S. Code § 1231(a)(3)(A)(ii)(II) without regard to the holding period requirement in U.S. Code § 1231(a)(3)(A)(ii)(II).

Code, the Federal Internal Revenue Code in effect for the taxable year.

Commissioner, the Commissioner of Revenue or the Commissioner's duly authorized representative.

Corporate Partner, any corporation that is a partner in a partnership.

Corporation, a business corporation as defined in M.G.L. c. 63, § 30.1.

Documentary Evidence, journals, books of account, invoices, expense reports, or other records that are maintained by the taxpayer in the regular course of its business. Generally, an affidavit or other document prepared in anticipation of, or in connection with, a tax audit, examination, or litigation is not documentary evidence.

Domicile (or commercial domicile), the principal place from which the business activities of a taxpayer are directed or managed, or, in the case of a shareholder of a RIC, the domicile as described in 830 CMR 63.38.7(4)(c). If it is not possible to determine the principal place from which the business activities of a taxpayer are directed or managed, the state of the taxpayer's incorporation shall be considered to be its state of domicile.

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Employee, in general, any officer of a corporation, or any person who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee. Generally, a person will be presumed to be an employee if such person is included by the taxpayer as an employee for purposes of the payroll taxes imposed by the Federal Insurance Contributions Act. However, for purposes of 830 CMR 63.38.1, a leased employee is an employee of the client (lessee) organization, and not an employee of the employee leasing company.

Employee Leasing Company, a business that contracts with a client company to supply workers to perform services for the client company; provided that, Employee Leasing Company does not include private employment agencies that provide workers to employers on a temporary help basis or entities such as driver-leasing companies which lease employees to another business to perform a specific service. *See* 430 CMR 5.07 through 5.13.

Income, taxable net income as defined in M.G.L. c. 63, § 38(a). Income encompasses both positive income and losses.

Independent Contractor, any person who performs services for a taxpayer but who is not an employee of the taxpayer, and who is not otherwise subject to the supervision or control of the taxpayer in the performance of the services. In general, a person is treated as an independent contractor with respect to a taxpayer if that person's actions would not be imputed to the taxpayer under the standards of 830 CMR 63.39.1 for purposes of determining whether the taxpayer is doing business in Massachusetts (or another state).

Leased Employee, a person who performs services for a client company pursuant to a contract between the client company and an employee leasing company.

Manufacture, Manufacturing or Manufacturing Activity, the process of transforming raw or finished physical materials by hand or machinery, and through human skill and knowledge, into a new product possessing a new name, nature and adapted to a new use. In determining whether a process constitutes manufacture, manufacturing or manufacturing activity, the Commissioner will examine the facts and circumstances of each case in the manner set forth in the Manufacturing Corporation Regulation, 830 CMR 58.2.1(6)(b) and (c).

Mobile Property, motor vehicles, construction equipment, or other tangible personal property that an owner or lessee regularly moves from place to place in the course of its business. Property normally used in a fixed location is not mobile property merely because it happens to be moved into or out of Massachusetts or another state during the taxable year.

Mutual Fund Sales, mutual fund sales within the meaning of M.G.L. c. 63, § 38 and § 38(m)(1).

Mutual Fund Service Corporation, a mutual fund service corporation within the meaning of M.G.L. c. 63, § 38(m)(1).

Partnership and Partner, as a general rule, Partnership and Partner have the same meaning as in 26 U.S. Code § 7701, provided that Partnership and Partner shall also apply to other entities and their members treated as partnerships and partners for purposes of M.G.L. c. 62, § 17. Partnership does not include any trust or estate subject to taxation under M.G.L. c. 62 or any entity taxed as a corporation under M.G.L. c. 63.

Person, a natural or legal person, including, but not limited to, an individual, corporation, corporate trust, limited liability company, partnership, or S corporation.

Presumption, a conclusion of law or fact that is assumed to apply to a taxpayer unless the Commissioner or the taxpayer affirmatively rebuts the presumption by presenting contrary evidence of the actual facts and circumstances applicable to the taxpayer.

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Receipts, consideration or value of any kind received from a taxpayer's business activity, including but not limited to cash, cash equivalents, payments in kind, and boot, that the taxpayer obtains from selling or providing property or services to another party. In the case of a sale, exchange or other disposition of a capital asset, including a transaction with respect to a capital asset that is deemed to be a sale or exchange under 26 U.S. Code, Receipts as used in 830 CMR 63.38.1 refers to the amount of the gain from the transaction. Receipts are subject to the Commissioner's adjustments under M.G.L. c. 63, § 39A.

Regulated Investment Company (RIC), a regulated investment company within the meaning of M.G.L. c. 63, § 38(m)(1).

Section 38 Manufacturer, a corporation that is engaged in manufacturing during the taxable year, and whose manufacturing activities during the taxable year are substantial within the meaning of 830 CMR 63.38.1(10)(b)2. and 3., regardless of whether the corporation is a manufacturing corporation under M.G.L. c. 63, § 42B, and regardless of whether the corporation is classified as a manufacturing corporation under M.G.L c. 58, § 2 and 830 CMR 58.2.1: Manufacturing Corporations. As used in 830 CMR 63.38.1, Section 38 Manufacturer refers to a corporation that is a manufacturing corporation within the meaning of M.G.L. c. 63, § 38(l)1.

Security, any interest or instrument commonly treated as a "security," as well as other instruments which are customarily sold in a public or secondary market or on a recognized exchange, including, but not limited to, transferable shares of beneficial interest in any corporation or other entity, bonds, debentures, notes, and other evidences of indebtedness, accounts receivable and notes receivable, cash and cash equivalents including foreign currencies, and futures contracts. A partnership interest will be treated as a security for purposes of 830 CMR 63.38.1 only in the case of a limited partnership whose activity is not attributed to its corporate limited partners under the provisions of 830 CMR 63.39.1(8) (Corporate Nexus). Security shall not be applied to the determination of security corporation classification under M.G.L. c. 63, § 38B.

State, any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or a political subdivision of any of the foregoing. M.G.L. c. 63, § 30.13.

State of the Purchaser, the state to which tangible personal property sold by a taxpayer is ultimately shipped or delivered. In the case of a third party recipient who receives the tangible personal property by direct shipment from the taxpayer at the direction of the purchaser, the “state of the purchaser" is the state of the third party recipient.

Tax or Taxes, with regard to Massachusetts, any tax or excise, including the corporate excise imposed under M.G.L. c. 63, § 39 or the personal income tax imposed under M.G.L. c. 62, § 4 as it applies under M.G.L. c. 62, § 5A for nonresidents, M.G.L. c. 62, § 17 for partners of partnerships, and M.G.L. c. 62, § 17A for shareholders of S corporations.

Taxable Net Income, the part of the net income of a taxpayer derived from the taxpayer's business activities carried on in Massachusetts and which is adjusted as required by the applicable provisions of M.G.L. c. 63, § 38(a) or M.G.L. c. 62, §§ 5A, 17, or 17A, or by regulation, in order to determine the base amount of income to be multiplied by the apportionment percentage.

Taxpayer, any person as defined in 830 CMR 63.38.1(2) who is entitled or required to allocate or apportion income under M.G.L. c. 63, § 38 and 830 CMR 63.38.1. In the case of a combined group within the meaning of M.G.L. c. 63 § 32B and 830 CMR 63.32B.2, any member of the group who is entitled or required to allocate or apportion income under M.G.L. c. 63, § 38 and 830 CMR 63.38.1 is a taxpayer.

Three Factor Apportionment Percentage, a fraction, the numerator of which consists of the property factor, payroll factor, and sales factor, and the denominator of which is the total number of factors utilized in the numerator. In the case of a taxpayer subject to tax under M.G.L. c. 63, § 38(c), or M.G.L. c. 62, §§ 5A, 17 or 17A, the numerator of the fraction is the property factor plus the payroll factor plus twice the sales factor, and the denominator of the fraction is four. The factors are computed in accordance with the provisions of 830 CMR 63.38.1.

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Unrelated Business Activities, (or Unrelated Activities), two or more of a taxpayer's business activities that are not related business activities as defined in 830 CMR 63.38.1(4).

(3) Income Subject to Apportionment.

(a) General Rule. A taxpayer with income from business activity which is taxable both within and outside of Massachusetts must apportion its taxable net income to Massachusetts by multiplying its taxable net income, determined under M.G.L. c. 63, § 38(a), by the apportionment percentage determined under M.G.L. c. 63, § 38 and 830 CMR 63.38.1. For Massachusetts tax purposes, a taxpayer's income subject to apportionment is its entire income derived from its related business activities within and outside of Massachusetts not including any allocable items of income that either are or are not subject to the tax jurisdiction of Massachusetts.

(b) Corporations subject to Combined Reporting. Corporations subject to combined reporting are subject to the apportionment rules in 830 CMR 63.31.1 and the apportionment provisions of 830 CMR 63.32B.2.

(c) Treatment of an Allocable Item of Income. An allocable item of income is allocated to Massachusetts and therefore not subject to apportionment if the taxpayer's commercial domicile is in the Commonwealth. Consequently, in such cases, any property or payroll utilized in, or sales that derive from, activity or transactions that generate an allocable item of income are excluded from the taxpayer's apportionment factors, in the case of property or payroll, to the extent that the property or payroll generated the item of income and, in the case of sales, to the extent that the sales derived from the item of income. An allocable item of income is not allocated to Massachusetts if the taxpayer's commercial domicile is outside the Commonwealth.

(d) Treatment of Income Derived from Unrelated Activities. If a taxpayer has one or more items of income derived from unrelated business activities, as determined under 830 CMR 63.38.1(4), the items of income will be excluded from the taxpayers taxable net income and will not be apportioned to Massachusetts if Massachusetts does not have jurisdiction to tax the items of income under the constitution of the United States. A taxpayer must disclose on its return the nature and amount of any item of income that is derived from unrelated business activities and is excluded from (or is excludable from) taxable net income. The taxpayer must also disclose and exclude expenses allocable in whole or part to such unrelated business activities. M.G.L. c. 63, § 30.4. Any property or payroll utilized in, or sales that derive from, unrelated business activity are excluded from the taxpayer's apportionment factors if the income from the unrelated activity is not subject to tax in Massachusetts, in the case of property or payroll, to the extent that the property or payroll generated the item of income and, in the case of sales, to the extent that the sales derived from the item of income.

Example 1. Famous Corporation is a corporation doing business in Massachusetts but domiciled in another state. Famous acquires a minority interest in the shares of Unknown Corporation as a long-term investment. The operations of Famous and Unknown are not related business activities. Any gain or loss on the sale of the Unknown stock is excluded from Famous' taxable net income and is not apportioned to Massachusetts. Famous must disclose the nature and amount of the excluded gain or loss on its Massachusetts return.

Example 2. Local Corporation is a corporation doing business and domiciled in Massachusetts. Local acquires a minority interest in the shares of Distant Corporation as a long-term investment. The operations of Local and Distant are not related business activities. Any gain or loss on the sale of Distant stock is included in Local's taxable net income and is allocated to Massachusetts.

(4) Related Business Activities.

(a) Definition.

1. General Rule. Related business activities are activities where there is a sharing or exchange of value between the segments of a single entity or multiple entities such that the activities are mutually beneficial, interdependent, integrated, or such that they otherwise contribute to one another. In general, any two segments or activities of a single corporation (or other taxpayer) are related business activities unless the two segments or activities are not unitary under U.S. constitutional principles. In addition, some activities are related business activities notwithstanding the absence of a unitary relationship, *e.g.*, the short term investment of capital in a non-unitary business segment or activity.

63.38.1: continued

2. Income from Cash, Cash Equivalents, and Short-term Securities. Interest or other income from cash deposits, cash equivalents, and short-term securities is considered related business income if such capital serves or performs an operational function. Without limitation, examples of operational functions include: the use or holding of funds as working capital or reserves; the use or holding of funds to maintain a favorable credit rating (*e.g.* by maintaining a strong current or quick asset ratio); the use or holding of funds to self-insure against business risks; and the interim investment of funds pending their future use in the taxpayer's business.

(b) Determination of Related Business Activities. The determination of whether business activities are related will turn on the facts and circumstances of each case. The presence of related business activities between two business entities may be demonstrated by the vertical or horizontal integration of the two entities, or by other indicia of related business activity including, but not limited to: sales, exchanges, or transfers between the entities; common marketing; transfer or pooling of technical information; common purchasing; other common operations or systems; or centralized management. In determining the presence of related business activities, a taxpayer's business activities, both within and outside of Massachusetts, its organizational structure, and the underlying economic realities applicable to its business, must be considered as a whole.

(c) Burden of Proof. Except as provided in 830 CMR 63.38.1(4)(d) (relating to corporate limited partners), all income of a single taxpayer (whether derived directly or through agents, partnerships, or other entities whose activities are attributed to the taxpayer) is presumed to be income from related business activities until the contrary is established. Either the taxpayer or the Commissioner may assert that an item of a taxpayer's income is derived from unrelated business activities. The party making such an assertion must prove by clear and cogent evidence that, in the aggregate, the related business factors at 830 CMR 63.38.1(4)(b), do not reasonably warrant a finding that the business activities are related. To demonstrate that income from cash, cash equivalents, or short-term securities is derived from unrelated business activities, a taxpayer must prove by clear and cogent evidence that the underlying assets and their acquisition, maintenance, and management were, in fact, unrelated to the taxpayer's business activities in the Commonwealth.

(d) Presumption of Unrelated Business Activity of Corporate Limited Partners. In cases where a corporate limited partner owns, either directly or indirectly (including all interests of any party whose direct or indirect stock ownership would be attributed to the corporate limited partner under the provisions of 26 U.S. Code § 318), less than 50% of either the capital or profit interests of a partnership and the business activity of the limited partnership is attributed to the corporate limited partner under 830 CMR 63.39.1(8), the business activity of the limited partnership is presumed to be unrelated to the corporation's other business activities unless the Commissioner or the taxpayer rebuts this presumption. If the business activities of the partnership and the corporate limited partner are unrelated, then the corporate limited partner must separately account for its income from the holding or disposition of its limited partnership interest and its other business income and must separately apportion to Massachusetts income from each unrelated activity (to the extent that Massachusetts has jurisdiction to tax income from each such activity), using only the apportionment factors applicable to that activity. The separate accounting shall apply both to the determination of income subject to apportionment under M.G.L. c. 63, § 2A, 38 or 42, and to the determination of the non-income measure under M.G.L. c. 63, § 39(a)(1).

Either the Commissioner or a taxpayer may rebut the presumption of unrelated business activity by demonstrating that the corporate limited partner and the partnership are engaged in a unitary business. If a corporate limited partner has engaged in a unitary business with the partnership in one or more taxable years, the corporate limited partner may not separately account in any such taxable year for the income it derives from the partnership. Instead, the corporate limited partner shall apportion to Massachusetts all income derived from business activity carried on within the commonwealth, including income derived from its partnership interest, in accordance with the rules of M.G.L. c. 63, § 2A, 38 or 42 using the corporate limited partner's own property, payroll, and sales plus its *pro rata* portion of the partnership's property, payroll, and sales to determine an apportionment percentage.

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Example 1. Corporation A, which is domiciled outside of Massachusetts, owns a minority limited partnership interest in Partnership A. Partnership A conducts business in Massachusetts. Apart from this partnership holding, Corporation A does not conduct business in Massachusetts. Neither Corporation A nor the Commissioner rebuts the presumption that the business activities of Corporation A and Partnership A are unrelated. Corporation A must separately apportion to Massachusetts income from the holding or disposition of its interest in Partnership A, using the apportionment factors derived from the partnership's activity. Income from Corporation A's other activities is not subject to Massachusetts tax jurisdiction and is excluded from the Corporation's taxable net income.

Example 2. Corporation B, which is domiciled outside of Massachusetts, conducts business in Massachusetts and, in addition, owns a minority limited partnership interest in Partnership B. Partnership B does not conduct business in Massachusetts. Neither Corporation B nor the Commissioner rebuts the presumption that the business activities of Corporation B and Partnership B are unrelated. Income from Corporation B's holding or disposition of its interest in Partnership B is not subject to Massachusetts tax jurisdiction and is excluded from the Corporation's taxable net income. Corporation B must apportion the balance of its income to Massachusetts using the apportionment factors derived from its other activities.

Example 3. Corporation C is domiciled in Massachusetts and holds a minority limited partnership interest in Partnership C. Partnership C may or may not be engaged in business in Massachusetts. Neither Corporation C nor the Commissioner rebuts the presumption that the activities of Corporation C and Partnership C are unrelated. Corporation C must separately apportion to Massachusetts income derived from its interest in Partnership C, using the apportionment factors derived from the partnership's activity. Corporation C must apportion the balance of its income to Massachusetts using the apportionment factors derived from its other activities. The taxable net income of Corporation C is the sum of these separately apportioned amounts.

(e) Evidentiary Matters. In determining whether two business activities conducted by a taxpayer are related, the Commissioner will apply the following evidentiary rules.

1. Production of Evidence. Failure by the taxpayer to produce evidence that is in the control of either the taxpayer or an entity controlled by the taxpayer gives rise to an inference that the evidence is unfavorable.

2. Reporting Consistency. A taxpayer must assert claims of unrelated business activity consistently from year to year on its Massachusetts returns. A taxpayer must also consistently treat items of income as constitutionally apportionable or non-apportionable on returns filed in various states where the taxpayer is subject to tax unless such consistency is precluded by differences in the statutory allocation and apportionment rules of the various states in which the taxpayer is subject to tax. The provisions of 830 CMR 63.38.1(4)(b) notwithstanding, if a taxpayer claims on a return filed with Massachusetts or another state in any taxable year that income from a particular activity is apportionable income, such claims may be considered as evidence that the income is from a related business activity and is subject to apportionment in Massachusetts in the current taxable year.

3. Disallowance of Expenses. In each taxable year in which expenses are allocable to two or more business activities, the taxpayer must disclose and distinguish expenses allocable in whole or part to each business activity. If the business activity to which an expense is allocable is not subject to tax in Massachusetts, the expense must be excluded. M.G.L. c. 63, § 30.4. The Commissioner may consider a taxpayer's failure, in any taxable year, to disclose and distinguish the expenses associated with specific business activities as evidence that those activities are not, in fact, unrelated to the taxpayer's business activities in Massachusetts.

(5) Taxpayer or Taxpayer's Income Taxable in Another State. A taxpayer is required to apportion its income when it is has income from business activity that is taxable both in Massachusetts and at least one other state. For purposes of 830 CMR 63.38.1(5), taxable has the meaning set forth in 830 CMR 63.38.1(5)(b. This standard is not satisfied as to such other state merely because the taxpayer is incorporated in such state or files a return in that state that relates to a capital stock tax or a franchise tax for the privilege of doing business.

63.38.1: continued

For purposes of determining a taxpayer's apportionment percentage under 830 CMR 63.38.1(9)(c)2., pertaining to throwback sales, a taxpayer is taxable in another state if it meets either test set forth in 830 CMR 63.38.1(5)(a) or (b) for all or part of the taxable year.

The provisions in 830 CMR 63.38.1(5) also applies to corporate partners as set forth in 830 CMR 63.38.1(12).

(a) Subject to Tax. A taxpayer is considered taxable in another state if the taxpayer is "subject to" a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax imposed by that state. Whether or not a taxpayer is subject to any such tax depends upon the nature and substance of the tax and not upon its form or title.

1. Evidence That Corporation is Subject to Tax. Any taxpayer that claims it is subject to one of the taxes described in M.G.L. c. 63, § 38(b)(1) and 830 CMR 63.38.1(5)(a) in another state must furnish to the Commissioner upon request documentary evidence to support the claim. The documentary evidence should include proof that the taxpayer has filed the requisite tax return and has paid the tax due. A taxpayer that does not establish that it has filed a return and paid the tax due in a particular state is presumed not to be subject to tax in that state.

2. Voluntary Filing Insufficient. A voluntary filing in another state not required by the law of such other state does not cause the taxpayer to be subject to tax in that state.

3. Abatements. A taxpayer that has filed a return in another state and paid tax to that state nevertheless is presumed not to be subject to tax in that state if the taxpayer has filed an abatement application or similar claim in that state alleging that it is not subject to tax in such state.

(b) Jurisdiction to Tax. A taxpayer is considered taxable in another state if that other state has jurisdiction to subject the taxpayer to a net income tax, regardless of whether, in fact, the state does or does not impose such a tax on the taxpayer.

1. Standard Used. Another state has jurisdiction to subject the taxpayer to a tax with respect to a business activity if, under the Constitution and laws of the United States, the taxpayer's business activity could be taxed in Massachusetts under the same facts and circumstances that exist in the other state. A state does not have such jurisdiction where, inter alia, the state is prohibited from imposing the tax by reason of the provisions of P.L. 86-272, 15 U.S.C. §§ 381 through 384.

2. Evidence of Jurisdiction to Tax. The Commissioner will presume that any activities of a corporation in another state are protected from the other state's tax jurisdiction by federal law, including P.L. 86-272, if the corporation does not file returns in that jurisdiction. Any taxpayer that claims to be subject to the tax jurisdiction of another state must furnish evidence to the Commissioner upon request to substantiate the claim. Documentary evidence contemporaneous with the events in question will be given greater weight than affidavits or other evidence not contemporaneous with those events in determining whether the taxpayer's activities subject it to another state's jurisdiction.

In addition to documentary evidence, the Commissioner will generally recognize that another state has jurisdiction to subject a particular taxpayer to a net income tax if the state has issued a written opinion to the taxpayer to that effect, provided that:

a. the opinion is issued by a competent governmental authority in the other state;

b. the opinion identifies the particular taxpayer and tax period to which it applies; and

c. the opinion is based on an evaluation of the activities of the taxpayer viewed as a separate entity, rather than upon activities that may be conducted by unitary affiliates of the taxpayer in the other state.

The following examples illustrate the application of 830 CMR 63.38.1(5)(a) and (b).

63.38.1: continued

Example 1. In Year 1, a corporation that is incorporated in Massachusetts ("Corporation") and has business activities in Massachusetts is also engaged in the solicitation of sales of tangible personal property in Nevada, which does not impose a corporate income tax. In addition, if Nevada imposed a corporate income tax, the imposition of that tax would be proscribed by the provisions of the Federal law, Public Law 86-272. Although Corporation is engaged in business activity in both Massachusetts and one other state, it does not have income from business activity in a state other than Massachusetts that is taxable in such state. Therefore, all of Corporation's income from its business activities is allocated to Massachusetts. (Note that if Corporation were entitled to apportion its income by reason of its activities in an additional state, it would not be taxable in Nevada for purposes of determining its throwback sales under 830 CMR 63.38.1(9)(c)2. *See* 830 CMR 63.38.1(5)(a) and (b).)

Example 2. Same facts as in Example 1, except that in Year 2, Corporation undergoes an F reorganization under the Code and, as a result of this reorganization, is re-incorporated in Delaware. Merely as a result of this re-incorporation, Corporation is required to file a franchise tax return for the privilege of doing business in Delaware. Although Corporation is required to make a franchise tax filing in Delaware, Corporation is not engaged in business activity in that state. It continues to be the case that Corporation does not have income from business activity in a state other than Massachusetts that is taxable in such state. Therefore, all of Corporation's income from its business activities is allocated to Massachusetts. (Note that if Corporation were entitled to apportion its income by reason of its activities in an additional state, it would not be taxable in Nevada but would be taxable in Delaware for purposes of determining its throwback sales under 830 CMR 63.38.1(9)(c)2. *See* 830 CMR 63.38.1(5)(a) and (b).)

Example 3. Same facts as in Example 2, except that in Year 3, apart from its Massachusetts business activities, Corporation is also engaged in the solicitation of sales of tangible personal property in both Nevada and Pennsylvania. Although Pennsylvania imposes an income tax on corporations, Corporation is protected from the imposition of this tax by the application of the Federal law, Public Law 86-272. Pennsylvania also imposes a capital stock tax, which that state does impose upon Corporation. Although Corporation is subject to the Pennsylvania capital stock tax, this tax is not a tax on the Corporation's income from business activity in Pennsylvania. It continues to be the case that Corporation does not have income from business activity in a state other than Massachusetts that is taxable in such state. Therefore, all of Corporation's income from its business activities is allocated to Massachusetts. (Note that if Corporation were entitled to apportion its income by reason of its activities in an additional state, it would not be taxable in Nevada but would be taxable in Delaware and Pennsylvania for purposes of determining its throwback sales under 830 CMR 63.38.1(9)(c)2. *See* 830 CMR 63.38.1(5)(a) and (b).)

Example 4. Same facts as in Example 3, except that in Year 4, apart from its Massachusetts business activities and its sales solicitation activities in Nevada and Pennsylvania, Corporation also opens a sales office in Nevada. Nevada does not impose a corporate income tax. However, if Nevada imposed a corporate income tax, Corporation would no longer be protected from the imposition of this tax by the application of the Federal law, Public Law 86-272. Therefore, Corporation has income from business activity that is taxable in one state other than Massachusetts, and is required to apportion its income. For purposes of determining Corporation's throwback sales under 830 CMR 63.38.1(9)(c)2., Corporation is taxable in Nevada and also Pennsylvania and Delaware. *See* 830 CMR 63.38.1(5)(a) and (b).

3. "States" Outside the United States.

a. In the case of any foreign country or any other "state" as defined in M.G.L. c. 63, § 30.13 and 830 CMR 63.38.1(2), other than a state of the United States or political subdivision of a state of the United States, the determination of whether such state has jurisdiction to subject the taxpayer to a net income tax is made as though the federal jurisdictional standards of the United States applied in that state. If jurisdiction to tax is otherwise present, a foreign state is not considered to lack jurisdiction by reason of the provisions of a treaty between the foreign state and the United States or by reason of the provisions of P.L. 86-272, 15 U.S.C. §§ 381 through 384.

63.38.1: continued

b. For purposes of determining whether a taxpayer must allocate its income to Massachusetts under M.G.L. c. 63, § 38(b), or apportion its income to Massachusetts under M.G.L. c. 63, § 38(c), a taxpayer is not subject to tax in a foreign state merely by virtue of the taxpayer's sales of tangible personal property to purchasers in the foreign state. However, if a taxpayer engaged in making such sales is otherwise entitled to apportion its income under M.G.L. c. 63, § 38(c), and must therefore calculate a sales factor under M.G.L. c. 63, § 38(f), then solely for purposes of calculating its sales factor, such taxpayer will be deemed to be taxable in a foreign state whenever it ships or delivers the tangible personal property sold to a purchaser in that foreign state. *See* 830 CMR 63.38.1(9)(c)2.b.ii. The deemed taxability applies only where a taxpayer is engaged in making sales of tangible personal property in a foreign state and, for example, does not apply where a taxpayer is engaged only in selling services or licensing intangible property in a foreign state. In the latter cases, 830 CMR 63.38.1(5)(b)3.a applies.

(c) Separate Company Determination; Combined Reporting. Except as otherwise provided herein, an individual corporation is subject to tax in another state or subject to the tax jurisdiction of another state for purposes of 830 CMR 63.38.1(5)(a) or (b) only on the basis of the separate activities of that individual corporation, including without limitation activities attributed to that corporation through partnerships engaged in related business activities with the corporate partner, as described in 830 CMR 63.39.1 (Corporate Nexus). In the instance of a taxpayer that is a taxable member of a combined group within the meaning of M.G.L. c. 63 § 32B and 830 CMR 63.32B.2, such taxable member is considered taxable in any state in which any member of its combined group is subject to tax with respect to income derived from the group's unitary business (or, in the case of an affiliated group election, in any state in which a member of the combined group is taxable). *See* 830 CMR 63.32B.2(7)(c). The rule in the preceding sentence applies only if at least one member of the combined group is entitled to apportion its income under M.G.L. c. 63 for the taxable year in question. *Id*.

(6) Consistent Accounting Method.

(a) To the extent not inconsistent with the provisions of M.G.L. c. 63, § 38, or 830 CMR 63.38.1, amounts included in the factors of the apportionment percentage must be determined by the same accounting method as the taxpayer uses in determining its federal taxable income for the same taxable period. If a taxpayer changes its accounting methods for Massachusetts tax purposes but does not simultaneously change its federal accounting methods, the taxpayer shall take into account adjustments necessary to prevent amounts from being duplicated or omitted from the taxpayer's taxable net income and apportionment factors, utilizing the rules and principles of 26 U.S. Code § 481(a) ("Adjustments required in method of accounting").

(b) A taxpayer's taxable year for Massachusetts tax purposes is any fiscal or calendar year or period for which the taxpayer is required to file a federal return. A taxpayer that engages in business in Massachusetts for all or part of its taxable year must file a Massachusetts return for the full federal year or period, and the apportionment factors must reflect the full year or period. In the case of a "short" federal tax year for which a separate federal return is required, the taxpayer must file a Massachusetts return for the same short year, and the apportionment factors on the return shall reflect the taxpayer's activity during only the short year. The non-income measure of excise is prorated for short taxable years under M.G.L. c. 63, § 39, but the excise attributable to income earned during a short taxable year is not prorated.

(7) Property Factor. The property factor is a fraction the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in Massachusetts during the taxable year and the denominator of which is the average value of all of its real and tangible personal property owned or rented and used during the taxable year.

63.38.1: continued

(a) Real and Tangible Personal Property. Real and Tangible Personal Property includes land, buildings, machinery, stock of goods, equipment, and other real and tangible personal property, but does not include coin and currency unless held as a stock of goods for resale. Leaseholds and leasehold improvements, whether located within or without Massachusetts, are included within the meaning of "real and tangible personal property", regardless of whether the taxpayer is entitled to remove the improvements or the improvements revert to the lessor upon expiration of the lease. In general, any real or tangible property whose cost is not capitalized, but is directly expensed, for federal income tax purposes is excluded from the numerator and denominator of the property factor, provided that this exclusion shall not apply to otherwise depreciable property whose cost is expensed pursuant to an election under the Code, such as the election to expense under 26 U.S. Code § 179.

(b) Property Used During the Taxable Year. Real or tangible personal property owned or leased by a taxpayer during the taxable year is included in the property factor if it is used directly or indirectly during the taxable year for the production of business income. Real or tangible personal property of a type that is depreciable under 26 U.S. Code § 167 is considered to be used by the taxpayer for the production of business income when it has been placed in service within the meaning of Treas. Reg. § 1.167(a) through 10(b), provided that the property has not been retired within the meaning of Treas. Reg. § 1.167(a) through 8. Property or equipment under construction shall be included in the property factor of a construction contractor to the extent that the work completed exceeds progress payments received by the contractor. Real or tangible personal property of a type that is not depreciable under 26 U.S. Code § 167 is presumed to be used directly or indirectly for the production of business income unless the taxpayer or the Commissioner rebuts this presumption under the facts of a particular case.

(c) Property in Transit. Property in transit between locations of the taxpayer to which it belongs shall be considered to be at its destination for purposes of the property factor. Property in transit between a buyer and seller which is included by a taxpayer in the denominator of its property factor in accordance with its regular accounting practices shall be included in the numerator according to the state of destination. If goods in transit to a buyer are included in the property factor of a seller, such state of destination for property factor purposes shall be the state in which the seller's possession and control of the property is transferred to the buyer. (830 CMR 63.38.1(9)(c)1.a.i through iv. shall not apply to the property factor).

(d) Mobile Property. If a taxpayer owns or rents mobile property, as defined in 830 CMR 63.38.1(2), and such property is used both within and outside of Massachusetts during the taxable year, the numerator of the taxpayer's property factor shall include the value of the property multiplied by a percentage which represents the use of the property in Massachusetts relative to its use everywhere during the taxable year. Except as otherwise required by special apportionment regulations promulgated under the authority of M.G.L. c. 63, § 38(j), a taxpayer may elect to use any reasonable method for determining the percentage of use of its mobile property in Massachusetts. The election is made by filing a return that employs the chosen method for the first tax year, ending on or after August 11, 1995 (the date on which the first version of 830 CMR 63.38.1 was promulgated), in which the taxpayer owns or rents mobile property and apportions income to Massachusetts. The taxpayer must attach a statement to its return describing the method chosen and must use the same method consistently from year to year. The taxpayer must maintain records adequate to substantiate its calculations. Once a taxpayer elects a particular method, it may supplement its election prospectively with respect to new types of mobile property that it may acquire in future years, but the Commissioner generally will not allow a change in any method, once elected, either upon application for abatement or upon filing of returns for future years, unless the former method does not reasonably reflect the taxpayer's use of mobile property in Massachusetts. In the case of a lease or rental of mobile property, the rules of assignment set forth in 830 CMR 63.38.1(7)(d) apply to both the lessor and the lessee of the property.

The Commissioner will presume that the methods stated in 830 CMR 63.38.1(7)(d)1. through 4. reasonably approximate the use of mobile property in Massachusetts.

1. A taxpayer may determine the use of mobile property in Massachusetts based upon the proportion of time during the taxable year that the property is owned or rented by a taxpayer and in actual use in Massachusetts relative to the total time during the taxable year that the property is owned or rented by the taxpayer and in actual use in jurisdictions where the taxpayer is subject to tax.

63.38.1: continued

2. A taxpayer may attribute the use of on-road vehicles owned or rented by the taxpayer to Massachusetts by a fraction, the numerator of which is the miles such vehicles were driven in Massachusetts during the taxable year, and the denominator of which is the number of miles that the vehicles were driven during the taxable year in jurisdictions where the taxpayer is subject to tax. A taxpayer may maintain mileage records on a per-vehicle basis or, if a taxpayer owns or rents a fleet of vehicles that is located both within and outside of Massachusetts, on a fleet basis, provided that all vehicles in a fleet must be of a substantially similar type and value.

3. A taxpayer may attribute the use of an automobile assigned to a traveling employee to the state in which the automobile is registered, provided that the taxpayer uses this method for all of its automobiles assigned to traveling employees.

4. A taxpayer may attribute the entire use of an item of mobile property owned or rented by the taxpayer to the state in which the property is located for 80% or more of the taxable year, provided that any taxpayer electing this method must use it with respect to all items of mobile property that it owns or rents during the taxable year and that are located in any one state for at least 80% of the taxable year.

(e) Valuation of Property Owned. Property owned by the taxpayer is valued at its original cost. Without limitation, property owned by a taxpayer includes property leased to another, provided that the transaction is treated as a lease, rather than as a conditional sale, for federal income tax purposes.

1. Original Cost. As a general rule, Original Cost means the basis of the property for federal income tax purposes (prior to any federal adjustments) at the time of acquisition by the taxpayer and adjusted by subsequent capital additions or improvements thereto and partial disposition thereof, as, for example, by reason of sale, exchange, or abandonment, but not adjusted for subsequent depreciation. However, 830 CMR 63.38.1(7)(e)1.a. through d. shall apply.

a. If the original cost of property is not ascertainable, the property is included in the factor at its fair market value on the date of acquisition by the taxpayer.

b. Generally, if a taxpayer acquires assets in a transaction in which the transferor does not recognize gain or loss under 26 U.S. Code, such as a reorganization, liquidation, gift, or contribution to capital, and if under 26 U.S. Code the acquiring taxpayer carries over the transferor's basis (or adjusted basis), then the original cost to the acquiring taxpayer is the same as the original cost to the transferor.

c. If a taxpayer acquires assets in a transaction in which, under 26 U.S. Code, there is a step-up in basis, (*e.g.* 26 U.S. Code § 338 election), then the original cost to the acquiring taxpayer for purposes of valuation of property is the stepped-up basis.

d. The original cost of property acquired by a taxpayer in a like-kind exchange is the original cost of the property transferred by the taxpayer, plus any gain that 26 U.S. Code requires the taxpayer to recognize on account of the exchange.

2. Inventory or Stock of Goods. Inventory or stock of goods is included in the property factor in accordance with the valuation method used for federal income tax purposes. Consigned inventory owned by the taxpayer is included in the property factor.

3. Averaging Property Values. As a general rule, the average value of property owned by a taxpayer is determined by averaging the values at the beginning and end of the taxable year. However, the Commissioner may require averaging by monthly values if such method is required to reflect properly the average value of the taxpayer's property for the tax period. Averaging by monthly values will generally be applied if substantial changes or fluctuations in the values of the property occur during the taxable year or where property is acquired after the beginning of the taxable year or disposed of before the end of the taxable year. When a corporation makes a final disposition of its assets or liquidates, thus terminating its taxable year (and the last month of such year), the value of its items of property for such end of year (and month) shall be the value of such items at the commencement of business on such day of final disposition or liquidation.

(f) Valuation of Rented Property. Property rented by the taxpayer is valued at eight times its net annual rent, provided that such rate reflects the fair rental value of the property as of the date of the rental agreement.

63.38.1: continued

1. Items Included in Rent. Rent is the actual sum in money or other consideration payable directly or indirectly by the taxpayer or for its benefit for the use of property, regardless of how such amounts may be designated. Rents include amounts that are calculated as a percentage of sales or profits, and amounts payable as additional rent or in lieu of rent, such as interest, taxes, insurance, repairs, or any other items which are required to be paid by the terms of the rental agreement. Rent does not include travel expenses such as hotel or motel accommodations, or amounts paid to a lessor as *bona fide* service charges, such as payments for separately metered utilities, janitorial services, or other *bona fide* services provided to a lessee that the lessee might, in regular commercial practice, obtain from a party other than the lessor. If a payment includes rent and *bona fide* service charges, and the amounts are not segregated, the amount of the rental shall be determined on the basis of the relative fair market values of the property and the services provided.

The following examples illustrate the application of 830 CMR 63.38.1(7)(f)1.:

Example 1. Pursuant to the terms of a lease of real property, a taxpayer pays the lessor $12,000 a year rent, which includes a $1,200 fee for janitorial services. Additionally, the taxpayer pays taxes in the amount of $2,000 and interest in the amount of $1,000. The annual rent is $13,800.

Example 2. A taxpayer stores part of its inventory in a public warehouse. Under the terms of the contract, the total charge for the year is $1,000, of which $700 was for the exclusive use of a designated storage space and $300 for inventory insurance, handling and shipping charges, and C.O.D. collections. The annual rent is $700.

2. Annual Rent. As a general rule, the annual rental is the amount paid as rent for property for a 12-month period. Where property is rented for less than a 12-month period, the amount paid for the actual rental period shall be considered to be the annual rent for the tax period. However, in the case of a short taxable year, the rent paid for the short tax period shall be annualized.

3. Net Annual Rent. Net annual rent is the annual rental paid by the taxpayer, less the aggregate annual subrentals paid by subtenants of the taxpayer. The net annual rent may not be less than an amount which bears the same relation to the annual rent paid by the taxpayer as the property used by the taxpayer bears to the total property.

The following example illustrates the application of 830 CMR 63.38.1(7)(f)3.:

A corporation rents a ten-story building at an annual rent of $1,000,000. It occupies two stories and sublets eight stories for $1,000,000 a year. The net annual rent of the corporation must not be less than two-tenths of the corporation's annual rent for the entire year, or $200,000.

4. Property Used at No Charge or Nominal Rent. If property owned by others is used by the taxpayer at no charge or rented by the taxpayer for a nominal amount, the net annual rent for such property shall be the fair market rental value for such property, as determined on the basis of rentals of substantially similar properties in the same market in transactions negotiated at arm's length. However, all rentals of property from federal or state governmental entities shall be deemed to be at fair value.

(g) Property Reporting Consistency. A taxpayer must use the same rules for valuing property or for including or excluding types of property in both the numerator and the denominator of the property factor. If a taxpayer changes its method of valuing property, or of excluding or including property in the property factor, from the method used in its return in the prior year, the taxpayer must disclose in the return for the current year the presence of such change, the nature and extent of the change, and the reason for the change. The Commissioner may disregard changes in the current year or in future tax years if they have not been adequately disclosed.

(8) Payroll Factor. The payroll factor is a fraction the numerator of which is the total amount paid for compensation in Massachusetts during the taxable year by the taxpayer and the denominator of which is the total amount paid for compensation everywhere during the taxable year.

(a) Effect of Method of Accounting.

1. General Rule. The total amount paid for compensation is computed on the cash basis, as reported for unemployment compensation purposes.

63.38.1: continued

2. Alternative Accrual Method Election. Notwithstanding 830 CMR 63.38.1(8)(a)1., a taxpayer that uses the accrual method of accounting in computing its taxable net income may elect for purposes of 830 CMR 63.38.1(8) to use the accrual method in determining the total amount of compensation paid in Massachusetts during the taxable year.

a. Election. In order to elect the accrual method, a taxpayer must properly complete and file its return reporting the total compensation accrued during the taxable year along with an electing statement that "pursuant to 830 CMR 63.38.1(8)(a)2.a., the taxpayer is electing the accrual method of accounting for purposes of computing the payroll factor." An election by the taxpayer is binding for all subsequent taxable years except as provided at 830 CMR 63.38.1(8)(a)2.b.

b. Revocation of Election. A taxpayer may not revoke an election under 830 CMR 63.38.1(8)(a)2. to use the accrual method of accounting for determining the payroll factor except with the prior written approval of the Commissioner. The Commissioner may grant such approval for any taxable year upon the written request of the taxpayer for a letter ruling, under 830 CMR 62C.3.2, if the request is submitted to the Commissioner on or before the due date, including extensions, for the filing of the taxpayer's return, as determined under M.G.L. chs. 62, 62C, or 63, as applicable. Permission to change accounting methods under 830 CMR 63.38.1(8) will be granted only for a valid business purpose other than a reduction in tax.

(b) Compensation Paid in Massachusetts. Compensation is paid in Massachusetts if any one of the following tests is met:

1. The employee's service is performed entirely within Massachusetts;

2. The employee's service is performed both within and without Massachusetts, but the service performed outside Massachusetts is incidental to the employee's service within Massachusetts. Service is incidental if it is temporary or transitory in nature, or it is rendered in connection with an isolated transaction;

3. Some of the employee's service is performed in Massachusetts; and

a. the employee's base of operations is in Massachusetts; or

b. there is no base of operations in any state, but the place from which the employee's service is directed or controlled is in Massachusetts; or

c. the base of operations or the place from which the employee's service is directed or controlled is not in any state in which some part of the service is performed, but the employee's primary residence is in Massachusetts.

(c) Items Included. Compensation included in the payroll factor includes wages, salaries, commissions, and any other form of remuneration paid to employees for personal services rendered. Amounts will generally be considered to be paid if they are treated as wages under M.G.L. c. 151A, § 1. However, in the event of any ambiguity in the treatment of a particular item under M.G.L. c. 151A, § 1, the amount shall be treated as paid to an employee if the amount constitutes income to the employee under 26 U.S. Code during the taxable year or if the amount would constitute income to the employee during the taxable year if the employee were subject to 26 U.S. Code.

Inclusion of items in the payroll factor depends upon the particular facts and circumstances. In determining whether compensation is includible in the payroll factor, the following guidelines will be employed:

1. Compensation is includible in the payroll factor if the compensation is paid for personal services rendered by the employee to the taxpayer during the taxable year. Compensation is not limited to payments described by the taxpayer as salary, wages, commissions, or bonuses. For example, compensation would generally include employee travel or other allowances in excess of expenses, or the value of board, housing, or the personal use of an automobile, provided that 26 U.S. Code includes these benefits in the gross income of the recipient.

2. Employer contributions under a qualified cash or deferred arrangement as defined in 26 U.S. Code § 401(k) and employer contributions to nonqualified deferred compensation plans are generally included in the payroll factor. *See* M.G.L. c. 151A, § 1(s)(B).

63.38.1: continued

(d) Items Excluded. For purposes of the payroll factor, compensation excludes payments that are not made by a taxpayer to its employees for personal services rendered, including any amount specifically excluded from the definition of "wages" under M.G.L. c. 151A, § 1(s)(A). The following items are excluded without limitation (subject to the amendment of M.G.L. c. 151A):

1. Payments to or on behalf of employees (including amounts paid for insurance or annuities) for sickness or accident disability, hospitalization, or death, as provided by M.G.L. c. 151A, § 1(s)(A).

2. Payments to or from qualified trusts under 26 U.S. Code § 401(a) (other than employer contributions under qualified cash or deferred arrangements as defined in 26 U.S. Code § 401(k)), payments to or from qualified annuity plans or contracts under 26 U.S. Code § 403, and payments to or from simplified employee pensions under 26 U.S. Code § 408(k).

3. Employer's payments of employee's FICA taxes.

4. Tips paid in any medium other than cash, and cash tips which are less than $20 a month and not reported to the employer pursuant to 26 U.S. Code § 6053(a).

5. Non-cash payments to employees for services not in the course of the taxpayer's trade or business.

6. Payments made to independent contractors, retirees, or other persons not properly classified as employees.

(e) Treatment of Leased and Temporary Employees.

1. Leased Employees. Compensation paid for personal services rendered by leased employees is includible in the payroll factor of the taxpayer if the taxpayer is the recipient of the services of the leased employee. Compensation for personal services rendered by leased employees to client companies is excluded from the payroll factor of employee leasing companies.

2. Temporary Employees. Compensation paid for personal services rendered to client companies by employees of temporary help agencies is included in the payroll factor of the temporary agency and is generally excluded from the payroll factor of the client company. However, the Commissioner may require the inclusion of compensation paid to temporary employees that perform services under the direction and control of a client company in the payroll factor of that client company in any taxable year in which all compensation paid to temporary employees performing such services in Massachusetts for the client company exceeds 50% of the client company's Massachusetts payroll, as calculated without the inclusion of compensation paid to officers or shareholders of the client company. For purposes of 830 CMR 63.38.1(8)(e)2., if compensation paid to temporary employees is included in the payroll factor of a client company, such compensation shall be 85% of the payments during the taxable year by the client company to the temporary help agency or agencies providing the temporary employees. Any adjustment to the payroll factor of a client company shall not affect the payroll factor of the temporary help agency or agencies providing the temporary employees.

(f) Affiliated Corporations. In order to prevent distortions in the payroll factor, the Commissioner may require compensation paid to an employee of a corporation that is a member of an affiliated group, as defined in 26 U.S. Code, § 1504, to be included in the payroll factor of the group member for which the employee performed an amount of services greater than the amount of services the employee performed for any other group member, regardless of which group member actually paid the compensation.

(g) Payroll Consistency. A taxpayer must use the same rules for determining compensation paid in both the numerator and the denominator of the payroll factor. If a taxpayer changes its method of determining compensation paid, including, but not limited to, its method of accounting of such compensation, from the method used in its return for the prior year, the taxpayer must disclose in the return for the current year the presence of the change, the nature and extent of the change, and the reason for the change. The Commissioner may disregard changes in the current year or in future tax years if they have not been adequately disclosed.

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(9) Sales Factor. The sales factor is a fraction whose numerator is total sales of the taxpayer in Massachusetts during the taxable year and whose denominator is total sales of the taxpayer everywhere during the taxable year. In general, a taxpayer's total sales are its gross receipts. However, certain items, as more particularly referenced in 830 CMR 63.38.1(9)(a), are specifically excluded from this computation. Also, in the case of the sale, exchange or other disposition of a capital asset used in a taxpayer's trade or business the sales to be included are measured by the gain from the transaction and not the gross receipts. In the case of a transaction that is deemed to be a sale or exchange under the provisions of 26 U.S. Code, the sales are the deemed receipts or gain from the transaction under 26 U.S. Code, as the case may be, depending upon whether the deemed transaction is a deemed sale or exchange of a capital asset.

(a) Items Excluded From Sales. Sales do not include the following items:

1. Interest.
2. Dividends.
3. Gross receipts from the maturity, redemption, sale, exchange, or other disposition of securities as defined at 830 CMR 63.38.1(2).
4. Gross receipts from the sale of business "good will" or similar intangible value, including, without limitation, "going concern value" or "workforce in place"(*i.e.*, in the case of a sale or deemed sale of a business).
5. Gross receipts that result in an allocable item of income, irrespective as to whether that allocable item of income is allocated to Massachusetts.

(b) Items Included in Sales. Sales include (but are not limited to) the following items:

1. Manufacturing and Selling, Purchasing and Reselling, Goods or Products. Sales include gross sales, less returns and allowances, of goods or products (or other property of a kind which would properly be included in inventory if on hand at the close of the taxable year) which a taxpayer manufactures and sells or purchases and resells. Sales also include all service charges, carrying charges, and other non-interest charges incidental to sales. Federal excises and state excises are included as part of sales if the taxes are passed on to the buyer or included as part of the selling price of the product.
2. Cost-plus Contracts. In the case of a cost-plus-fee contract, such as certain contracts for the operation of government-owned plants, sales include the entire reimbursed cost, plus the fee. Receipts or gain attributable to the sale of tangible personal property designed or constructed and sold under a cost-plus-fee or similar arrangement are treated as receipts from the sale of tangible personal property, and may not be treated as receipts from personal services.
3. Providing Services. Sales include gross receipts from the performance of services including commissions, fees, management charges, and similar items. (*See* 830 CMR 63.38.1(9)(b)8. regarding proper amount of service fees in certain intercompany transactions.)
4. Lease or Rental of Real or Tangible Personal Property. Sales include the gross receipts from renting, leasing, or licensing the use of real or tangible personal property except in cases in which the lease, rental, or license of the asset in question is treated, for purposes of M.G.L. c. 63, as a sale, exchange, or other disposition of a capital asset used in a taxpayer's trade or business, in which case sales include only the gain from the disposition of the property in question.
5. Sale, Licensing, or Assignment of Intangible Property other than Securities. Sales generally include gross receipts from the sale, licensing, or assignment of intangible property other than securities or business "good will" or similar intangible value, *see* 830 CMR 63.38.1(9)(a), except in cases in which the sale, licensing or assignment of the property in question is treated, for purposes of M.G.L. c. 63, as a sale, exchange, or other disposition of a capital asset used in a taxpayer's trade or business, in which case the sales include the gain (and not the gross receipts) from the disposition of the property in question. For detailed rules pertaining to the sales factor rules that pertain to the license and sale of intangible property *see* 830 CMR 63.38.1(9)(d)5. and 6.
6. Capitalized Leases. Property subject to a capitalized lease for federal income tax purposes is treated as subject to a capitalized lease for purposes of the corporate excise, and sales include income or gain derived from a capitalized lease transaction to the extent that the income or gain from such transaction is included in the federal gross income of the taxpayer.

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7. Sale, Exchange, or Other Disposition of Fixed Assets. In the case of the sale, exchange or other disposition of a fixed asset used in a taxpayer's trade or business, such as property, plant or equipment, sales are measured by the gain from such transaction. Gain from the disposition of a fixed asset shall include (but is not limited to) deemed gain from a transaction that is treated under 26 U.S. Code as a sale of a taxpayer's assets and that results in the taxpayer's recognition of income for Massachusetts purposes. For example, gain from the deemed sale of assets (other than securities) by a target corporation under 26 U.S. Code § 338 is included in a target's sales factor. Similarly, the gain that results from a payment of a dividend (other than securities) by a subsidiary corporation to its parent that is deemed to be a sale of assets by the subsidiary under 26 U.S. Code § 311(b) is included in the subsidiary's sales factor.

8. Intercompany Sales. Sales between affiliated corporations, to the extent otherwise includible in the sales factor under M.G.L. c. 63, § 38(f) and 830 CMR 63.38.1(9)(a) and (b), are generally included in the sales factor of the selling corporation except as described in 830 CMR 63.38.1(9)(b)8. In the case of intercompany transactions included in the sales factor under 830 CMR 63.38.1(9)(b)8., the amount of gross receipts included in the sales factor shall reflect the fair market value of the property or services provided in an arms-length transaction, subject to adjustments or rules adopted by the Commissioner pursuant to M.G.L. c. 63, § 39A.

a. Where Corporations Are Members of the Same Combined Group. In general, transactions between affiliates that are members of the same combined group within the meaning of M.G.L. c. 63, § 32B and 830 CMR 63.32B.2 are not included in the sales factor for purposes of the income measure. *See* 830 CMR 63.32B.2(7)(g). However, when computing the non-income measure, a taxpayer shall include in its sales factor any sales to affiliates that are members of the same combined group. *See* 830 CMR 63.32B.2(6)(b)3.

b. Where Corporations Are Not Members of the Same Combined Group. When a taxpayer makes sales to an affiliate and the two corporations are not members of the same combined group within the meaning of M.G.L. c. 63, § 32B and 830 CMR 63.32B.2, the taxpayer's sales include the gross receipts from such sales transactions, irrespective of whether the two corporations are members of the same federal consolidated group.

c. Exclusion of Dividends. A payment from a subsidiary corporation to its parent will be excluded from the numerator and denominator of the parent's sales factor if, in substance, the payment represents a dividend, even if the payment would otherwise be included in the parent's sales factor under 830 CMR 63.38.1(9)(b)8.b.

(c) When Sales of Tangible Personal Property are in Massachusetts. There are two rules for determining whether a sale of tangible personal property is in Massachusetts. Under the primary (destination) rule, a sale is in Massachusetts if the property is delivered or shipped to a purchaser, including the United States government, who takes possession within Massachusetts, regardless of the F.O.B. point or other conditions of sale. Under the secondary (throwback) rule, a sale is in Massachusetts if the selling taxpayer is not taxable in the state where the property sold is delivered to the purchaser, and the property is not sold by an agent of the taxpayer who is chiefly situated at, connected with, or sent out from the taxpayer's owned or rented business premises outside of Massachusetts.

1. Destination Sales. Sales are in Massachusetts if the property is delivered or shipped to a purchaser in Massachusetts regardless of the F.O.B. point or other condition of sale. Tangible property is deemed to have been shipped or delivered to a purchaser within Massachusetts if:

a. the property is delivered directly by the vendor to the possession and control of the purchaser or its agent within Massachusetts unless the vendor can substantiate that no use is made of the property in Massachusetts other than immediate transshipment; or

b. the property is delivered to the possession and control of the purchaser by the vendor or by a carrier outside of Massachusetts, if the property is immediately transshipped to Massachusetts;

c. the property is diverted to a purchaser in Massachusetts while *en route* to a third-party consignee in another state; or

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d. the third-party recipient of the tangible personal property is located in Massachusetts, even if the property is ordered from outside the state.

The following example illustrates the application of 830 CMR 63.38.1(9)(c)1.:

Example. Office Objects, Inc. ("Objects") manufactures office furniture in Massachusetts. Objects will either ship furniture from its Massachusetts manufacturing facility to its customers by common carrier, or it will allow customers to pick up their purchase at its Massachusetts facility. Empty Environment, Inc., ("Empty"), a Rhode Island corporation, purchases some office furniture from Objects. If Objects hires a common carrier to ship the furniture to Rhode Island, the sale is not a Massachusetts sale under the destination rule of 830 CMR 63.38.1(9)(c)1. because Objects did not transfer possession and control of the furniture to Empty in Massachusetts. If Empty uses its own truck and driver or hires its own carrier to pick up the furniture from Object's Massachusetts facility and transport it to Rhode Island, the sale will not be a Massachusetts sale under the destination rule if the taxpayer substantiates that no use is made of the property in Massachusetts other than the immediate transshipment.

2. Throwback Sales. Where tangible personal property is delivered or shipped to a purchaser outside of Massachusetts, sales are in Massachusetts if the taxpayer is not taxable in the state where the property is delivered to the purchaser and the property is not sold by an agent of the taxpayer who is chiefly situated at, connected with, or sent out from the taxpayer's owned or rented business premises outside of Massachusetts.

a. Burden of Proof. If tangible personal property is delivered or shipped to a purchaser outside of Massachusetts, the taxpayer has the burden of proving either that the taxpayer is taxable in the state of the purchaser or that the tangible personal property was sold by an agent of the taxpayer who is chiefly situated at, connected with, or sent out from the taxpayer's owned or rented business premises outside of Massachusetts.

b. Taxable in the State of the Purchaser. For purposes of the sales factor, the following special rules apply in determining whether a taxpayer is considered taxable in the state of the purchaser.

i. Taxable in Another State. A taxpayer is taxable in the state of the purchaser if it meets either test set out in 830 CMR 63.38.1(5). *See* 830 CMR 63.38.1(5), Examples 1 through 4.

ii. Foreign Sales. A taxpayer is taxable in the state of the purchaser if tangible personal property is delivered or shipped to a purchaser in a foreign country.

c. Property Not Sold by Agent Who Is Chiefly Situated at, Connected with or Sent out from Taxpayer's Owned or Rented Business Premises Outside of Massachusetts. Where the taxpayer is not taxable in the state of the purchaser, sales that are not the direct result of the efforts of an agent of the taxpayer who is chiefly situated at, connected with, or sent out from the taxpayer's owned or rented business premises outside of Massachusetts are sales in Massachusetts. For purposes of the sales factor, the following rules apply in determining whether tangible personal property is considered sold by an agent chiefly situated at, connected with or sent out from the taxpayer's owned or rented business premises outside of Massachusetts.

i. Independent Contractors. Independent contractors as defined at 830 CMR 63.38.1(2), control their own activities and, in general, are chiefly associated with their own offices. They are not agents chiefly situated at, connected with or sent out from a taxpayer's owned or rented business premises. In most cases, sales of a taxpayer's goods by independent contractors are therefore included in the numerator of the taxpayer's sales factor. However, if substantially all of a taxpayer's contacts with an independent contractor are conducted and controlled by an agent or employee of the taxpayer who is chiefly situated at, connected with or sent out from the taxpayer's owned or rented business premises outside of Massachusetts, then sales made by the independent contractor will be regarded as made by that agent or employee.

63.38.1: continued

ii. Determining Who "Sold" Property. The person who actually negotiates and effects an order is the person who sells the property. The person who sells the property is generally not the person who performs mere clerical approval acceptance, or processing, including a routine credit check of the purchaser. The taxpayer has the burden of proving who sold the property.

Reorders of property originating from the efforts of a person who negotiated and effected the original order are treated the same as the original order unless this treatment is not reasonable in light of material changes in the taxpayer's business operations after the time the original order was placed.

A taxpayer's catalog sales, made when a customer, who has received mail-order solicitations from the taxpayer, telephones or sends a written order to a Massachusetts location of the taxpayer, are not sales made by an agent from premises outside Massachusetts.

iii. Determining Location of Taxpayer's Owned or Rented Business Premises. The determination of the particular business premises owned or rented by a taxpayer that an agent is chiefly situated at, or that an agent is chiefly connected with, or that an agent is chiefly sent out from, is a factual determination. In making the determination, the following guidelines will be employed:

Business Premises. For purposes of the sales factor, the taxpayer's owned or rented premises for the transaction of business ("business premises") is the taxpayer's owned or rented sales office that the selling agent customarily uses to receive instructions, directions, or supervision from the taxpayer, or communications from customers; to replenish stock or other materials; to repair equipment; or to perform any other function necessary to the selling of the taxpayer's tangible personal property. Facilities used exclusively as warehouses or manufacturing facilities are not sales offices. The presence of company employees receiving orders and shipping tangible personal property will not, by itself, change a facility from a warehouse to a sales office.

Chiefly Situated at. In the case of an agent who spends 50% or more of his or her time at a taxpayer's owned or rented business premises, the agent is chiefly situated at that business location.

Chiefly Sent out from. In the case of an agent who spends more than 50% of his or her working hours away from a fixed business premises, the agent is chiefly sent out from that business premises where the agent customarily returns for various paperwork, correspondence and administrative matters, such as participation in office meetings and conferences, meetings with supervisors or managers, and preparation of sales materials, contracts and the like.

Chiefly Connected With. In the case of an agent who does not fall within the rules described above in - Chiefly Situated at or - Chiefly Sent out From, the agent is chiefly connected with the business premises that exercises supervision and control over the agent's activities.

The following example illustrates the application of 830 CMR 63.38.1(9)(c)2.c.iii.

Taxpayer A has its executive office, sales office, and factory in New York. Taxpayer A also rents a branch sales office in Massachusetts and a warehouse in Rhode Island. Taxpayer A has four sales representatives in the New England region.

Saleswoman Barbara Resides in Massachusetts. She works daily at the branch sales office in Massachusetts where she meets with customers, receives telephone orders, approves and transmits approved orders to the warehouse personnel in Rhode Island for shipment. Barbara is "situated at" the Massachusetts branch sales office, and all sales made by Barbara are attributed to Massachusetts.

Salesman Bob operates out of his New Hampshire residence and solicits orders throughout New Hampshire and Maine. Bob regularly visits, reports to, and sends orders for approval to Saleswoman Barbara at the branch office in Massachusetts. Based on the facts, Bob is "sent out from" the taxpayer's rented branch sales office in Massachusetts. Assuming Taxpayer A is not taxable in New Hampshire and Maine, all sales of tangible personal property made by Bob to purchasers in New Hampshire and Maine are attributed to Massachusetts.

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Salesman John operates out of his Vermont residence and solicits orders in Vermont. John was hired by, makes weekly reports to, and receives instructions from, the Vice President of Sales who operates out of the New York office. Although John routes his orders through the Massachusetts branch office where they are approved, he has no other contacts with that office. Based on the facts, John is "connected with" the taxpayer's owned New York office. Whether or not Taxpayer A is taxable in Vermont, none of the John's sales of tangible personal property to purchasers in Vermont are attributed to Massachusetts.

Salesman Tom resides in Rhode Island and solicits orders in Connecticut. Although Tom regularly visits the warehouse in Rhode Island, he reports to, and sends orders for approval to Saleswoman Barbara at the branch office in Massachusetts. Based on the facts, Tom is "connected with" the taxpayer's rented branch sales office in Massachusetts. Assuming that Taxpayer A is not taxable in Connecticut, all sales of tangible personal property made by Tom to purchasers in Connecticut are attributed to Massachusetts.

3. Resale to Foreign Government. Sales of tangible personal property to the United States or any of its agencies or instrumentalities for resale to a foreign government or an agency or instrumentality of a foreign government are not sales in Massachusetts.

(d) When Sales Other than Sales of Tangible Personal Property Are in Massachusetts.

1. General Rules.

a. Market-based Sourcing. Sales, other than sales of tangible personal property, are in Massachusetts within the meaning of 830 CMR 63.38.1 if and to the extent that the corporation's market for the sales is in Massachusetts as more fully set forth in M.G.L. c, 63, § 38(f) and 830 CMR 63.38.1(9)(d). In general, the provisions of 830 CMR 63.38.1(9)(d)4. through 7. establish uniform rules for:

i. determining whether and to what extent the market for a sale other than the sale of tangible personal property is in Massachusetts;

ii. reasonably approximating the state or states of assignment where such state or states cannot be determined; and

iii. excluding the sale where the state or states of assignment cannot be determined or reasonably approximated.

b. Outline of topics. The provisions in 830 CMR 63.38.1(9)(d) are organized as follows.

i. General Rules.

a. Market-based Sourcing
b. Outline of Topics
c. Definitions
d. General Principles of Application; Contemporaneous Records
e. Rules of Reasonable Approximation
f. Rules with respect to Exclusion of Sales from the Sales Factor
g. Changes in Methodology; Commissioner Review
h. Industry-specific Alternative Apportionment Rules
i. Application to Services Provided Directly or Indirectly to a RIC
j. Further Guidance

ii. Sale, Rental, Lease or License of Real Property.

iii. Rental, Lease or License of Tangible Personal Property.

iv. Sale of a Service.

a. General Rule
b. In-person Services
c. Services Delivered to the Customer or on Behalf of the Customer, or Delivered Electronically Through the Customer
d. Professional Services

v. License or Lease of Intangible Property

a. General Rules
b. License of a Marketing Intangible
c. License of a Production Intangible
d. License of a Mixed Intangible
e. License of Intangible Property where Substance of the Transaction Resembles a Sale of Goods or Services

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f. Examples

vi. Sale of Intangible Property.

a. Assignment of Sales

b. Examples

vii. Special Rules.

a. Software Transactions

b. Sales or Licenses of Digital Goods and Services

c. Enforcement of Legal Rights

c. Definitions. For the purposes of 830 CMR 63.38.1(9)(d) the following terms have the following meanings.

Billing Address means the location indicated in the books and records of the taxpayer as the primary mailing address relating to a customer's account as of the time of the transaction as kept in good faith in the normal course of business and not for tax avoidance purposes.

Business Customer means a customer that is a business operating in any form, including an individual that operates a business through the form of a sole proprietorship. Sales to a non-profit organization, to a trust, to the U.S. Government, to any foreign, state or local government, or to any agency or instrumentality of such government shall be treated as sales to a business customer and shall be assigned consistent with the rules that apply to such sales.

Individual Customer means any customer that is not a business customer.

Intangible Property, generally includes, without limitation, copyrights; patents; trademarks; trade names; brand names; franchises; licenses; trade secrets; trade dress; information; know-how; methods; programs; procedures; systems; formulae; processes; technical data; designs; licenses; literary, musical, or artistic compositions; information; ideas; contract rights including broadcast rights; agreements not to compete; goodwill and going concern value; securities (*see* 830 CMR 63.38.1(2) (definition of "security")); and, except as otherwise provided in 830 CMR 63.38.1, computer software. In the case of a sale of intangible property, such sale may or may not be includable in the numerator and denominator of the taxpayer's sales factor, depending upon the application of 830 CMR 63.38.1(9)(d)6.

Place of Order, means the physical location from which a customer places an order for a sale other than a sale of tangible personal property from a taxpayer, resulting in a contract with the taxpayer.

State Where a Contract of Sale is Principally Managed by the Customer, means the primary location at which an employee or other representative of a customer serves as the primary contact person for the taxpayer with respect to the implementation and day-to-day execution of a contract entered into by the taxpayer with the customer.

d. General Principles of Application; Contemporaneous Records. In order to satisfy the requirements of 830 CMR 63.38.1(9)(d), a taxpayer's assignment of sales of other than tangible personal property must be consistent with the following principles:

i. A taxpayer's application of 830 CMR 63.38.1(9)(d) shall be based on objective criteria and shall consider all sources of information reasonably available to the taxpayer at the time of its tax filing including, without limitation, the taxpayer's books and records kept in the normal course of business. A taxpayer's method of assigning its sales shall be determined in good faith, applied in good faith, and applied consistently with respect to similar transactions and year to year. A taxpayer shall retain contemporaneous records that explain the determination and application of its method of assigning its sales, including its underlying assumptions, and shall provide such records to the Commissioner upon request.

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ii. The provisions of 830 CMR 63.38.1(9)(d)4. through 7. provide for various assignment rules that apply sequentially in a hierarchy. For each sale to which a hierarchical rule applies, a taxpayer must make a reasonable effort to apply the primary rule applicable to the sale before seeking to apply the next rule in the hierarchy (and must continue to do so with each succeeding rule in the hierarchy, where applicable). For example, in some cases, the applicable rule first requires a taxpayer to determine the state or states of assignment, and where the taxpayer cannot do so, the rule then requires the taxpayer to reasonably approximate such state or states. In such cases, the taxpayer must in good faith and with reasonable effort attempt to determine the state or states of assignment (*i.e.*, apply the primary rule in the hierarchy) before it may reasonably approximate such state or states.

iii. A taxpayer's method of assigning its sales, including the use of a method of approximation, where applicable, must reflect an attempt to obtain the most accurate assignment of sales consistent with the regulatory standards set forth in 830 CMR 63.38.1(9)(d), rather than an attempt to lower the taxpayer's tax liability. A method of assignment that is reasonable for one taxpayer may not necessarily be reasonable for another taxpayer, depending upon the applicable facts.

e. Rules of Reasonable Approximation.

i. In General. In general, the provisions of 830 CMR 63.38.1(9)(d)4. through 7. establish uniform rules for determining whether and to what extent the market for a sale other than the sale of tangible personal property is in Massachusetts. The provisions of 830 CMR 63.38.1(9)(d)4. through 7. also set forth rules of reasonable approximation, which apply where the state or states of assignment cannot be determined. In some instances, the reasonable approximation must be made in accordance with specific rules of approximation prescribed by 830 CMR 63.38.1. *See, e.g., 830* CMR 63.38.1(9)(d)4.d. (pertaining to professional services). In other cases, the applicable rule in 830 CMR 63.38.1(9)(d) permits a taxpayer to reasonably approximate the state or states of assignment, using a method that reflects an effort to approximate the results that would be obtained under the applicable rules or standards set forth in 830 CMR 63.38.1(9)(d).

ii. Approximation Based Upon Known Sales. In any instance where, applying the applicable rules in 830 CMR 63.38.1(9)(d)4., pertaining to sales of services, a taxpayer can ascertain the state or states of assignment of a substantial portion of its sales of substantially similar services ("assigned sales"), but not all of such sales, and the taxpayer reasonably believes, based on all available information, that the geographic distribution of some or all of the remainder of such sales generally tracks that of the assigned sales, it shall include those sales which it believes tracks the geographic distribution of the assigned sales in its sales factor in the same proportion as its assigned sales. 830 CMR 63.38.1(9)(a)1.e.ii. also applies in the context of licenses and sales of intangible property where the substance of the transaction resembles a sale of goods or services. *See* 830 CMR 63.38.1(9)(d)5.e. and 6.a.v.

f. Rules With respect to Exclusion of Sales from the Sales Factor.

i. In any case in which a taxpayer cannot ascertain the state or states to which a sale is to be assigned pursuant to the applicable rules set forth in 830 CMR 63.38.1(9)(d) (including through the use of a method of reasonable approximation, where relevant) using a reasonable amount of effort undertaken in good faith, the sale shall be excluded from the numerator and the denominator of the taxpayer's sales factor.

63.38.1: continued

ii. In any case in which a taxpayer can ascertain the state or states to which a sale is to be assigned pursuant to the applicable rules set forth in 830 CMR 63.38.1(9)(d), but the taxpayer is not taxable in one or more such states, the sales that would otherwise be assigned to such states where the taxpayer is not taxable shall be excluded from the numerator and denominator of the taxpayer's sales factor. The rules to determine whether a taxpayer is taxable in a state are set forth at 830 CMR 63.38.1(5).

g. Changes in Methodology; Commissioner Review.

i. General Rules Applicable to Original Returns. In any case in which a taxpayer files an original return for a taxable year in which it properly assigns its sales using a method of assignment, including a method of reasonable approximation, in accordance with 830 CMR 63.38.1(9)(d), the application of such method of assignment shall be deemed to be a correct determination by the taxpayer of the state or states of assignment to which the method is properly applied. In such cases, neither the Commissioner nor the taxpayer (through the form of an audit adjustment, amended return, abatement application or otherwise) may modify the taxpayer's methodology as applied for assigning such sales for such taxable year. However, the Commissioner and the taxpayer may each subsequently, through the applicable administrative process, correct either factual errors or calculation errors with respect to the taxpayer's application of its filing methodology.

ii. Commissioner Authority to Adjust a Taxpayer's Return. The Commissioner's ability to review and adjust a taxpayer's assignment of sales on a return to more accurately assign such sales consistent with the rules or standards of 830 CMR 63.38.1(9)(d), includes, but is not limited to, each of the following potential actions.

(A) In any case in which a taxpayer fails to properly assign a sale in accordance with the rules set forth in 830 CMR 63.38.1(9)(d), including the failure to properly apply a hierarchy of rules consistent with the principles of 830 CMR 63.38.1(9)(d)1.d.ii., the Commissioner may adjust the assignment of such sales in accordance with the applicable rules in 830 CMR 63.38.1(9)(d).

(B) In any case in which a taxpayer uses a method of approximation to assign its sales and the Commissioner determines that the method of approximation employed by the taxpayer is not reasonable, the Commissioner may substitute a method of approximation that the Commissioner determines is appropriate or may exclude the sales from the taxpayer's numerator and denominator, as appropriate.

(C) In any case in which the Commissioner determines that a taxpayer's method of approximation is reasonable, but has not been applied in a consistent manner with respect to similar transactions or year to year, the Commissioner may require that the taxpayer apply its method of approximation in a consistent manner.

(D) In any case in which a taxpayer excludes sales from the numerator and denominator of its sales factor on the theory that the assignment of such sales cannot be reasonably approximated, the Commissioner may determine that the exclusion of such sales is not appropriate, and may instead substitute a method of approximation that the Commissioner determines is appropriate.

(E) In any case in which a taxpayer fails to retain contemporaneous records that explain the determination and application of its method of assigning its sales, including its underlying assumptions, or fails to provide such records to the Commissioner upon request, the Commissioner may treat the taxpayer's assignment of sales as unsubstantiated, and may adjust the assignment of such sales in a manner consistent with the applicable rules in 830 CMR 63.38.1(9)(d).

(F) In any case in which the Commissioner concludes that a taxpayer's customer's billing address was selected for tax avoidance purposes, the Commissioner may adjust the assignment of sales to such customer in a manner consistent with the applicable rules in 830 CMR 63.38.1(9)(d).

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iii. Taxpayer Authority to Change a Method of Assignment on a Prospective Basis. In filing its original return for a tax year, a taxpayer may change its method of assigning its sales under 830 CMR 63.38.1(9)(d) from the method it used in the preceding year, including changing its method of approximation from that used on previous returns. However, the taxpayer may only make such change for purposes of improving the accuracy of assigning its sales consistent with the 830 CMR 63.38.1(9)(d), including, for example, to address the circumstance where there is a change in the information that is available to the taxpayer as relevant for purposes of complying with such rules. Further, a taxpayer that seeks to change its method of assigning its sales must disclose, in the original return filed for the year of the change, the fact that it is has made the change, and must retain and provide to the Commissioner upon request documents that explain the nature and extent of the change, and the reason for the change. If a taxpayer fails to adequately disclose such change or retain and provide such records upon request, the Commissioner may disregard the taxpayer's change and substitute an assignment method that the Commissioner determines is appropriate.

iv. Commissioner Authority to Change a Method of Assignment on a Prospective Basis. The Commissioner may direct a taxpayer to change its method of assigning its sales in tax returns that have not yet been filed, including changing the taxpayer's method of approximation, if upon reviewing the taxpayer's filing methodology applied for a prior tax year, the Commissioner determines that such change is appropriate to reflect a more accurate assignment of the taxpayer's sales within the meaning of 830 CMR 63.38.1(9)(d), and determines that such change can be reasonably adopted by the taxpayer. The Commissioner will provide the taxpayer with a written explanation as to the reason for making such change. In any case in which a taxpayer fails to comply with the Commissioner's direction on subsequently filed returns, the Commissioner may deem the taxpayer's method of assigning its sales on such returns to be unreasonable, and may substitute an assignment method that the Commissioner determines is appropriate.

h. Industry-specific Alternative Apportionment Rules. Prior to the enactment of St. 2013, c. 46, § 37, the Commissioner promulgated six industry-specific alternative apportionment regulations to address industries where the application of the provisions of M.G.L. c. 63, § 38 were not reasonably adapted to approximate the net income derived from business carried on within Massachusetts. *See* M.G.L. c. 63, § 38(j). Following the enactment of St. 2013, c. 46, § 37, the Commissioner reviewed those six industry-specific alternative apportionment regulations, and determined for each industry that the provisions of M.G.L. c. 63, § 38 as a whole continue not to be reasonably adapted to approximate the net income derived from business carried on within Massachusetts. However, in the case of three of the industries, the Commissioner determined that industry-specific alternative sales factor rules were no longer needed in light of St. 2013, c. 46, § 37. In the case of the other three industries, the Commissioner determined that the industry-specific alternative sales factor rules remain necessary.

i. Industry-specific Sales Factor Provisions that Remain in Effect. Prior to the enactment of St. 2013, c. 46, § 37 the Commissioner promulgated industry-specific alternative apportionment regulations for pipeline companies, corporations engaged in the electricity industry, and corporations engaged in the telecommunications industry. *See* 830 CMR 63.38.8 (pipeline companies); 830 CMR 63.38.10 (electricity industry) and 830 CMR 63.38.11 (telecommunications industry). These industry-specific regulations remain fully in effect and are not superseded in whole or in part by 830 CMR 63.38.1(9)(d), as these regulations continue to address circumstances where the provisions of M.G.L. c. 63, § 38, including M.G.L. c. 63, § 38(f), are not reasonably adapted to approximate the net income derived from business carried on within Massachusetts. However, a special rule pertaining to taxpayers that provide telecommunications services that are also engaged in the sale or license of digital goods and services shall apply notwithstanding the rules set forth in 830 CMR 63.38.11. *See* 830 CMR 63.38.1(9)(d)7.b.ii.

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ii. Industry-specific Sales Factor now Determined under 830 CMR 63.38.1.(9)(d). Prior to the enactment of St. 2013, c. 46, § 37 the Commissioner promulgated industry-specific alternative apportionment regulations for motor carriers, airlines, and courier and package delivery services. *See* 830 CMR 63.38.2 (airlines); 830 CMR 63.38.3 (motor carriers); 830 CMR 63.38.4 (courier and package delivery services). In each of these cases, the sales factor is now determined pursuant to 830 CMR 63.38.1(9)(d). The industry-specific property and payroll factor rules for those industries remain fully in effect.

i. Application to Services Provided Directly or Indirectly to a RIC. Nothing in 830 CMR 63.38.1(9)(d) shall be construed to supersede or affect the application of 830 CMR 63.38.7 that apply to mutual fund service corporations. *See* M.G.L. c. 63, § 38(m). However, rules with respect to mutual fund sales, as defined at 830 CMR 63.38.1(2), as made by a taxpayer that is not a mutual fund service corporation, are set forth at 830 CMR 63.38.1(9)(d)4.d.iii.(D).

j. Further Guidance. The Commissioner may issue further public written statements with respect to the rules set forth in 830 CMR 63.38.1(9)(d). Such further guidance may, among other things, include guidance with respect to:

i. what constitutes a reasonable method of approximation within the meaning of such rules; and

ii. the circumstances in which a filing change with respect to a taxpayer's method of reasonable approximation will be deemed appropriate.

2. Sale, Rental, Lease or License of Real Property. In the case of a sale, rental, lease or license of real property, the sale is in Massachusetts if and to the extent that the property is in Massachusetts.

3. Rental, Lease or License of Tangible Personal Property. In the case of a rental, lease or license of tangible personal property, the sale is in Massachusetts if and to the extent that the property is in Massachusetts. If property is mobile property that is located both within and without Massachusetts during the period of the lease or other contract, the receipts assigned to Massachusetts shall be the receipts from the contract period multiplied by the fraction used by the taxpayer for property factor purposes under 830 CMR 63.38.1(7)(d) (as adjusted when necessary to reflect differences between usage during the contract period and usage during the taxable year).

4. Sale of a Service.

a. General Rule. The sale of a service is in Massachusetts if and to the extent that the service is delivered at a location in Massachusetts. In general, the term "delivered" shall be construed to refer to the location of the taxpayer's market for the service provided and is not to be construed by reference to the location of the property or payroll of the taxpayer as otherwise determined for corporate apportionment purposes pursuant to 830 CMR 63.38.1(7) and (8). The rules to determine the location of the delivery of a service in the context of several specific types of service transactions are set forth at 830 CMR 63.38.1(9)(d)4.b. through d.

b. In-person Services.

i. In General. Except as otherwise provided in 830 CMR 63.38.1(9)(d)4.b., in-person services are services that are physically provided in person by the taxpayer, where the customer or the customer's real or tangible property upon which the services are performed is in the same location as the service provider at the time the services are performed. 830 CMR 63.38.1(9)(d)4.b. includes situations where the services are provided on behalf of the taxpayer by a third-party contractor. Examples of in-person services include, without limitation, warranty and repair services; cleaning services; plumbing services; carpentry; construction contractor services; pest control; landscape services; medical and dental services, including medical testing and x-rays and mental health care and treatment; child care; hair cutting and salon services; live entertainment and athletic performances; and in-person training or lessons. In-person services include services within the description above that are performed at:

(A) a location that is owned or operated by the service provider; or

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(B) a location of the customer, including the location of the customer's real or tangible personal property.

Various professional services, including legal, accounting, financial and consulting services, and other such services as described in 830 CMR 63.38.1(9)(d)4.d., although they may involve some amount of in-person contact, are not treated as in-person services within the meaning of 830 CMR 63.38.1(9)(d)4.b.

ii. Assignment of Sales. Except as otherwise provided in 830 CMR 63.38.1(9)(d)4.b., where the service provided by the taxpayer is an in-person service, the delivery of the service is at the location where the service is received. Therefore, the sale is in Massachusetts if and to the extent the customer receives the in-person service in Massachusetts. In assigning its sales of in-person services, a taxpayer shall first attempt to determine the location where a service is received, as follows:

(A) Where the service is performed with respect to the body of an individual customer in Massachusetts (*e.g.* hair cutting or x-ray services) or in the physical presence of the customer in Massachusetts (*e.g.* live entertainment or athletic performances), the service is received in Massachusetts.

(B) Where the service is performed with respect to the customer's real estate in Massachusetts or where the service is performed with respect to the customer's tangible personal property at the customer's residence or in the customer's possession in Massachusetts, the service is received in Massachusetts.

(C) Where the service is performed with respect to the customer's tangible personal property and the tangible personal property is to be shipped or delivered to the customer, whether the service is performed in Massachusetts or outside Massachusetts, the service is received in Massachusetts if such property is shipped or delivered to the customer in Massachusetts.

In any instance in which the state or states where a service is actually received cannot be determined, but the taxpayer has sufficient information regarding the place of receipt from which it can reasonably approximate the state or states where the service is received, the taxpayer shall reasonably approximate such state or states. In any instance where the state to which the sale is to be assigned can be determined or reasonably approximated, but the taxpayer is not taxable in such state, the sale that would otherwise be assigned to such state shall be excluded from the numerator and denominator of the taxpayer's sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

iii. Transportation and Delivery Services.

(A) In General. Transportation and delivery services, involving the physical transportation of people or tangible personal property from one destination to another, are in-person services within the meaning of 830 CMR 63.38.1(9)(d)4.b. Special rules of assignment apply to receipts from the provision of transportation and delivery services. The assignment of receipts from such services depends upon whether such services are provided by air or by other means as provided in 830 CMR 63.38.1(9)(d)4.b.iii.(B) and (C). Receipts from a taxpayer's sale of transportation and delivery services are assigned pursuant to this section whether the transportation and delivery services are provided directly by the taxpayer or indirectly by another entity under common ownership with the taxpayer as defined in 830 CMR 63.32B.2. If a taxpayer provides transportation and delivery services exclusively by air, the rule in 830 CMR 63.38.1(9)(d)4.b.iii(B) applies to receipts from such services. If a taxpayer provides transportation and delivery services both by air and by means other than air, the rule in 830 CMR 63.38.1(9)(d)4.b.iii(C) applies to receipts from such services. If a taxpayer that provides transportation and delivery services also derives receipts from activities other than transportation and delivery services, such other receipts are apportioned according to the applicable rules under 830 CMR 63.38.1(9).

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(B) Transportation and Delivery Services Provided Exclusively by Air. Transportation and delivery services provided exclusively by air are assigned to the state or states of the aircraft departures associated with such services. Therefore, the receipts assigned to Massachusetts shall be determined by multiplying the taxpayer's total receipts from such services by the percentage of the aircraft departures occurring in Massachusetts relative to the aircraft departures that take place everywhere. In any case where the services are provided by multiple aircraft types, the calculation shall be weighted by the values of the aircraft types as provided in 830 CMR 63.38.2(3)(a). 830 CMR 63.38.1(9)(d)4.b.iii.(B) supersedes the rules set forth in 830 CMR 63.38.2 to the extent of any inconsistency.

(C) Transportation and Delivery Services Provided by Means other than Exclusively by Air.

1. Except as otherwise provided by 830 CMR 63.38.1(9)(d)4.b.iii(C), transportation and delivery services (other than exclusively by air) are assigned to the state or states of the departures and arrivals (in the case of the transportation of people), or pickups and deliveries (in the case of the transportation of tangible personal property), associated with such services. Therefore, the receipts assigned to Massachusetts shall be determined by multiplying the taxpayer's total receipts from such services by the percentage of the total departures (or pickups) and arrivals (or deliveries) that take place in Massachusetts relative to the departures (or pickups) and arrivals (or deliveries) that take place everywhere. Transportation and delivery services to which 830 CMR 63.38.1(9)(d)4.b.iii(C) applies include, without limitation, such services as provided by cars, buses, trains, and trucks, and with respect to a taxpayer that provides transportation and delivery services by both air and means other than air, all of such transportation services. 830 CMR 63.38.1(9)(d)4.b.iii.C. supersedes the rules set forth in 830 CMR 63.38.3 (motor carriers) and 830 CMR 63.38.4 (courier and package delivery services) to the extent of any inconsistency. 830 CMR 63.38.1(9)(d)4.b.iii(C), does not apply to transportation and delivery services as provided through the means of pipelines, which are governed by the industry-specific alternative apportionment rules in 830 CMR 63.38.8.

2. For purposes of 830 CMR 63.38.1(9)(d)4.b.iii(C):

i. The location of a "pickup" shall be the location at which an item of tangible personal property is transferred from the customer or the customer's designee for transportation and subsequent delivery; and

ii. The location of a "delivery" shall be the location at which an item of tangible personal property that has been transported is transferred to the customer or the customer's designee.

iv. Examples. Assume in each of these examples that the taxpayer that provides the service is taxable in Massachusetts and is to apportion its income pursuant to M.G.L. c. 63, § 38. Also, assume, where relevant, unless otherwise stated, that the taxpayer is taxable in each state other than Massachusetts to which its sale or sales would be assigned, so that there is no requirement in such examples that such sale or sales be eliminated from the numerator and denominator of the taxpayer's sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii. Note that for purposes of the examples it is irrelevant whether the services are performed by an employee of the taxpayer or by an independent contractor acting on the taxpayer's behalf.

Example 1. Salon Corp. has retail locations in Massachusetts and in other states where it provides hair cutting services to individual and business customers, the latter of whom are paid for through the means of a company account. The sales of services provided at Salon Corp.'s Massachusetts locations are in Massachusetts. The sales of services provided at Salon Corp.'s locations outside Massachusetts, even when provided to Massachusetts residents, are not Massachusetts sales.

Example 2. Landscape Corp. provides landscaping and gardening services in Massachusetts and in neighboring states. Landscape Corp. provides landscaping services at the Massachusetts vacation home of an individual who is a resident of another state and who is located outside Massachusetts at the time the services are performed. The sale of services provided at the Massachusetts location is in Massachusetts.

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Example 3. Same facts as in Example 2, except that Landscape Corp. provides the landscaping services to Retail Corp., a corporation with retail locations in several states, and the services are with respect to such locations of Retail Corp. that are in Massachusetts and in other states. The sale of services provided to Retail Corp. is in Massachusetts to the extent the services are provided in Massachusetts.

Example 4. Camera Corp. provides camera repair services at a Massachusetts retail location to walk-in individual and business customers. In some cases, Camera Corp. actually repairs a camera that is brought to its Massachusetts location at a facility that is in another state. In such cases, the repaired camera is then returned to the customer at Camera Corp.'s Massachusetts location. The sale of such services is in Massachusetts.

Example 5. Same facts as in Example 4, except that a customer located in Massachusetts mails the camera directly to the out-of-state facility owned by Camera Corp. to be fixed, and receives the repaired camera back in Massachusetts by mail. The sale of the service is in Massachusetts.

Example 6. Teaching Corp. provides seminars in Massachusetts to individual and business customers. The seminars and the materials used in connection with the seminars are prepared outside the state, the teachers who teach the seminars include teachers that are resident outside the state, and the students who attend the seminars include students that are resident outside the state. Because the seminars are taught in Massachusetts the sales of the services are in Massachusetts.

Example 7. Bus Corp. sells bus tickets to individual and business customers at bus depots located in Massachusetts and in other states, and also through phone and Internet sales. The bus tickets are for travel to locations in Massachusetts and to locations in other states. During the taxable year, Bus Corp. sells 150,000 bus tickets. Each ticket has a departure location and an arrival location, for a total of 300,000 departure and arrival locations. Of these bus tickets, 25,000 have a departure location in Massachusetts and 20,000 have an arrival location in Massachusetts. The sale of such transportation services shall be assigned by multiplying Bus Corp.'s total revenues from such services by the percentage of Bus Corp.'s total departures and arrivals that take place in Massachusetts relative to Bus Corp.'s total number of departures and arrivals. Therefore, Bus Corp. must determine the amount of its ticket sales that are to be assigned to Massachusetts by multiplying its total such sales by a fraction equal to 45,000 divided by 300,000, or .15. For purposes of the analysis it is irrelevant where and how the bus tickets are sold or whether the customer is an individual or business customer.

c. Services Delivered to the Customer or on Behalf of the Customer, or Delivered Electronically Through the Customer.

i. In General. Where the service provided by the taxpayer is not an in-person service within the meaning of 830 CMR 63.38.1(9)(d)4.b. or a professional service within the meaning of 830 CMR 63.38.1(9)(d)4.d., and the service is delivered to or on behalf of the customer, or delivered electronically through the customer, the sale is in Massachusetts if and to the extent that the service is delivered in Massachusetts. For purposes of 830 CMR 63.38.1(9)(d)4.c., a service that is delivered "to" a customer is a service in which the customer and not a third party is the recipient of the service. A service that is delivered "on behalf of" a customer is one in which a customer contracts for a service but one or more third parties, rather than the customer, is the recipient of the service, such as fulfillment services (*see* 830 CMR 63.38.1(9)(d)4.c.ii.(A)) or the direct or indirect delivery of advertising to the customer's intended audience (*see* 830 CMR 63.38.1(9)(d)4.c.ii.(C)). A service that is delivered electronically "through" a customer is a service that is delivered electronically to a customer for purposes of resale and subsequent electronic delivery in substantially identical form to an end user or other third-party recipient. Except in the instance of a service that is delivered through a customer (where the service must be delivered electronically), a service is included within the meaning of 830 CMR 63.38.1(9)(d)4.c., irrespective of the method of delivery, *e.g.*, whether such service is delivered by a physical means or through an electronic transmission.

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ii. Assignment of Sales. The assignment of a sale to a state or states in the instance of a service that is delivered to the customer or on behalf of the customer, or delivered electronically through the customer, depends upon the method of delivery of the service and the nature of the customer. Separate rules of assignment apply to services delivered by physical means and services delivered by electronic transmission. (For purposes of 830 CMR 63.38.1(9)(d)4.c., a service delivered by an electronic transmission shall not be considered a delivery by a physical means). In any instance where, applying the rules set forth in 830 CMR 63.38.1(9)(d)4.c., the rule of assignment depends on whether the customer is an individual or a business customer, and the taxpayer acting in good faith cannot reasonably determine whether the customer is an individual or business customer, the taxpayer shall treat the customer as a business customer. In any instance where the state to which the sale is to be assigned can be determined or reasonably approximated, but the taxpayer is not taxable in such state, the sale that would otherwise be assigned to such state shall be excluded from the numerator and denominator of the taxpayer's sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

(A) Delivery to or on Behalf of a Customer by Physical Means, Whether to an Individual or Business Customer. Services delivered to a customer or on behalf of a customer through a physical means include, for example, product delivery services where property is delivered to the customer or to a third party on behalf of the customer; the delivery of brochures, fliers or other direct mail services; the delivery of advertising or advertising-related services to the customer's intended audience in the form of a physical medium; and the sale of custom software (*e.g.*, where software is developed for a specific customer in a case where the transaction is properly treated as a service transaction for purposes of M.G.L. c. 63) where the taxpayer installs the custom software at the customer's site. 830 CMR 63.38.1(9)(d)4.c.ii.(i) applies whether the taxpayer's customer is an individual customer or a business customer.

1. Rule of Determination. In assigning the sale of a service delivered to a customer or on behalf of a customer through a physical means, a taxpayer must first attempt to determine the state or states where such services are delivered. Where the taxpayer is able to determine the state or states where the service is delivered, it shall assign the sale to such state or states.

2. Rule of Reasonable Approximation. Where the taxpayer cannot determine the state or states where the service is actually delivered, but has sufficient information regarding the place of delivery from which it can reasonably approximate the state or states where the service is delivered, it shall reasonably approximate such state or states.

3. Examples. Assume in each of these examples that the taxpayer that provides the service is taxable in Massachusetts and is to apportion its income pursuant to M.G.L. c. 63, § 38. Also, assume, where relevant, unless otherwise stated, that the taxpayer is taxable in each state other than Massachusetts to which its sale or sales would be assigned, so that there is no requirement in such examples that such sale or sales must be eliminated from the numerator and denominator of the taxpayer's sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

Example 1. Direct Mail Corp., a corporation based outside Massachusetts, provides direct mail services to its customer, Business Corp. Business Corp. transacts with Direct Mail Corp. to deliver printed fliers to a list of customers that is provided to it by Business Corp. Some of Business Corp.'s customers are in Massachusetts and some of those customers are in other states. Direct Mail Corp. will use the postal service to deliver the printed fliers to Business Corp'.s customers. The sale of Direct Mail Corp.'s services to Business Corp. is assigned to Massachusetts to the extent that the services are delivered on behalf of Business Corp. to Massachusetts customers (*i.e.*, to the extent that the fliers are delivered on behalf of Business Corp. to Business Corp.'s intended audience in Massachusetts).

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Example 2. Ad Corp. is a corporation based outside Massachusetts that provides advertising and advertising-related services in Massachusetts and in neighboring states. Ad Corp. enters into a contract at a location outside Massachusetts with an individual customer who is not a Massachusetts resident to design advertisements for billboards to be displayed in Massachusetts, and to design fliers to be mailed to Massachusetts residents. All of the design work is performed outside Massachusetts. The sale of the design services is in Massachusetts because the service is physically delivered on behalf of the customer to the customer's intended audience in Massachusetts.

Example 3. Same facts as Example 2, except that the contract is with a business customer that is based outside Massachusetts. The sale of the design services is in Massachusetts because the services are physically delivered on behalf of the customer to the customer's intended audience in Massachusetts.

Example 4. Fulfillment Corp., a corporation based outside Massachusetts, provides product delivery fulfillment services in Massachusetts and in neighboring states to Sales Corp., a corporation located outside Massachusetts that sells tangible personal property through a mail order catalog and over the Internet to customers. In some cases when a customer purchases tangible personal property from Sales Corp. to be delivered in Massachusetts, Fulfillment Corp. will, pursuant to its contract with Sales Corp., deliver that property from its fulfillment warehouse located outside Massachusetts. The sale of the fulfillment services of Fulfillment Corp. to Sales Corp. is assigned to Massachusetts to the extent that Fulfillment Corp'.s deliveries on behalf of Sales Corp. are to recipients in Massachusetts.

Example 5. Software Corp., a software development corporation, enters into a contract with a business customer, Buyer Corp., which is physically located in Massachusetts, to develop custom software to be used in Buyer Corp.'s business. Software Corp. develops the custom software outside Massachusetts, and then physically installs the software on Buyer Corp.'s computer hardware located in Massachusetts. The development and sale of the custom software is properly characterized as a service transaction, and the sale is assigned to Massachusetts because the software is physically delivered to the customer in Massachusetts.

Example 6. Same facts as Example 5, except that Buyer Corp. has offices in Massachusetts and several other states, but is commercially domiciled outside Massachusetts and orders the software from a location outside Massachusetts. The receipts from the development and sale of the custom software service are assigned to Massachusetts because the software is physically delivered to the customer in Massachusetts.

(B) Delivery to a Customer by Electronic Transmission. Services delivered by electronic transmission include, without limitation, services that are transmitted through the means of wire, lines, cable, fiber optics, electronic signals, satellite transmission, audio or radio waves, or other similar means, whether or not the service provider owns, leases or otherwise controls the transmission equipment. In the case of the delivery of a service by electronic transmission to a customer, the following rules apply.

1. Services Delivered by Electronic Transmission to an Individual Customer.

a. Rule of Determination. In the case of the delivery of a service to an individual customer by electronic transmission, the service is delivered in Massachusetts if and to the extent that the taxpayer's customer receives the service in Massachusetts. If the taxpayer can determine the state or states where the service is received, it shall assign the sale to such state or states.

b. Rules of Reasonable Approximation. If the taxpayer cannot determine the state or states where the customer actually receives the service, but has sufficient information regarding the place of receipt from which it can reasonably approximate the state or states where the service is received, it shall reasonably approximate such state or states. Where a taxpayer does not have sufficient information from which it can determine or reasonably approximate the state or states in which the service is received, it shall reasonably approximate such state or states using the customer's billing address.

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2. Services Delivered By Electronic Transmission to a Business Customer.

a. Rule of Determination. In the case of the delivery of a service to a business customer by electronic transmission, the service is delivered in Massachusetts if and to the extent that the taxpayer's customer receives the service in Massachusetts. If the taxpayer can determine the state or states where the service is received, it shall assign the sale to such state or states. For purposes of 830 CMR 63.38.1(9)(d)4.c.ii.(B)2., it is intended that the state or states where the service is received reflect the location at which the service is directly used by the employees or designees of the customer.

b. Rule of Reasonable Approximation. If the taxpayer cannot determine the state or states where the customer actually receives the service, but has sufficient information regarding the place of receipt from which it can reasonably approximate the state or states where the service is received, it shall reasonably approximate such state or states.

c. Secondary Rule of Reasonable Approximation. In the case of the delivery of a service to a business customer by electronic transmission where a taxpayer does not have sufficient information from which it can determine or reasonably approximate the state or states in which the service is received, such state or states shall be reasonably approximated as set forth in 830 CMR 63.38.7(a). In such cases, unless the taxpayer can apply the safe harbor set forth in 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.d. the taxpayer shall reasonably approximate the state or states in which the service is received as follows: first, by assigning the sale to the state where the contract of sale is principally managed by the customer; second, if the state where the customer principally manages the contract is not reasonably determinable, by assigning the sale to the customer's place of order; and third, if the customer's place of order is not reasonably determinable, by assigning the sale using the customer's billing address; provided, however, that in any instance in which the taxpayer derives more than 5% of its sales of services from a customer, the taxpayer is required to identify the state in which the contract of sale is principally managed by that customer.

d. Safe Harbor. In the case of the delivery of a service to a business customer by electronic transmission a taxpayer may not be able to determine, or reasonably approximate under 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.b., the state or states in which the service is received. In these cases, the taxpayer may, in *lieu* of the rule stated at 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.c., apply the safe harbor stated in 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.d. Under this safe harbor, a taxpayer may assign its sales to a particular customer based upon the customer's billing address in any taxable year in which the taxpayer (1) engages in substantially similar service transactions with more than 250 customers, whether business or individual, and (2) does not derive more than 5% of its sales of services from such customer. This safe harbor applies only for purposes of 830 CMR 63.38.1(9)(d)4.c.ii.(B)2., to services delivered by electronic transmission to a business customer, and not otherwise.

3. Examples. Assume in each of these examples that the taxpayer that provides the service is taxable in Massachusetts and is to apportion its income pursuant to M.G.L. c. 63, § 38. Also, assume, where relevant, unless otherwise stated, that the taxpayer is taxable in each state other than Massachusetts to which its sale or sales would be assigned, so that there is no requirement in such examples that such sale or sales must be eliminated from the numerator and denominator of the taxpayer's sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii. Further, assume where relevant, unless otherwise stated, that the safe harbor set forth at 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.d., does not apply.

Example 1. Support Corp., a corporation that is based outside Massachusetts, provides software support and diagnostic services to individual and business customers that have previously purchased certain software from third-party vendors. These individual and business customers are located in Massachusetts and other states. Support Corp. supplies its services on a case by case basis when directly contacted by its customer. Support Corp. generally provides these services through the Internet but sometimes provides these services by phone. In all cases, Support Corp. verifies the customer's account information before providing any service. Using the information that Support Corp. verifies before performing a service, Support Corp. can determine where its services are received, and therefore must assign its sales to these locations. The sales made to Support Corp.'s individual and business customers are in Massachusetts to the extent that Support Corp.'s services are received in Massachusetts. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(B)1. and 2.

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Example 2. Online Corp., a corporation based outside Massachusetts, provides web-based services through the means of the Internet to individual customers who are resident in Massachusetts and in other states. These customers access Online Corp.'s web services primarily in their states of residence, and sometimes, while traveling, in other states. For a substantial portion of its sales, either Online Corp. can determine the state or states where such services are received, or, where it cannot determine such state or states, it has sufficient information regarding the place of receipt to reasonably approximate such state or states. However, Online Corp. cannot determine or reasonably approximate the state or states of receipt for all of such sales. Assuming that Online Corp. reasonably believes, based on all available information, that the geographic distribution of the sales for which it cannot determine or reasonably approximate the location of the receipt of its services generally tracks those for which it does have this information, Online Corp. must assign to Massachusetts the sales for which it does not know the customers' location in the same proportion as those sales for which it has this information. *See* 830 CMR 63.38.1(9)(d)1.e.ii.

Example 3. Same facts as in Example 2, except that Online Corp. reasonably believes that the geographic distribution of the sales for which it cannot determine or reasonably approximate the location of the receipt of its web-based services do not generally track the sales for which it does have this information. Online Corp. must assign the sales of its services for which it lacks information as provided to its individual customers using the customers' billing addresses. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(B)1.b.

Example 4. Same facts as in Example 3, except that Online Corp. is not taxable in one state to which some of its sales would be otherwise assigned. The sales that would be otherwise assigned to that state are to be excluded from the numerator and denominator of Online Corp.'s sales factor. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(B); 830 CMR 63.38.1(9)(d)1.f.ii.

Example 5. Net Corp., a corporation based outside Massachusetts, provides web-based services to a business customer, Business Corp., a company with offices in Massachusetts and two neighboring states. Particular employees of Business Corp. access the services from computers in each Business Corp. office. Assume that Net Corp. determines that Business Corp. employees in Massachusetts were responsible for 75% of Business Corp.'s use of Net Corp.'s services, and Business Corp. employees in other states were responsible for 25% of Business Corp.'s use of Net Corp.'s services. In such case, 75% of the sale is received in Massachusetts, and therefore 75% of the sale is in Massachusetts. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.a. Assume alternatively that Net Corp. lacks sufficient information regarding the location or locations where Business Corp.'s employees used the services to determine or reasonably approximate such location or locations. Under these circumstances, if Net Corp. derives 5% or less of its sales from Business Corp., Net Corp. must assign the sale under 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.c. to the state where Business Corp. principally managed the contract, or if that state is not reasonably determinable, to the state where Business Corp. placed the order for the services, or if that state is not reasonably determinable, to the state of Business Corp.'s billing address. If Net Corp. derives more than 5% of its sales of services from Business Corp., Net Corp. is required to identify the state in which its contract of sale is principally managed by Business Corp. and must assign the receipts to that state.

Example 6. Net Corp., a corporation based outside Massachusetts, provides web-based services through the means of the Internet to more than 250 individual and business customers in Massachusetts and in other states. Assume that for each customer Net Corp. cannot determine the state or states where its web services are actually received, and lacks sufficient information regarding the place of receipt to reasonably approximate such state or states. Also assume that Net Corp. does not derive more than 5% of its sales of services from any single customer. Net Corp. may apply the safe harbor stated in 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.d., and may assign its sales using each customer's billing address. If Net Corp. is not taxable in one or more states to which some of its sales would be otherwise assigned, it must exclude those sales from the numerator and denominator of its sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

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(C) Services Delivered Electronically Through or on Behalf of an Individual or Business Customer. A service delivered electronically "on behalf of" the customer is one in which a customer contracts for a service to be delivered electronically but one or more third parties, rather than the customer, is the recipient of the service, such as the direct or indirect delivery of advertising on behalf of a customer to the customer's intended audience. A service delivered electronically "through" a customer to third-party recipients is a service that is delivered electronically to a customer for purposes of resale and subsequent electronic delivery in substantially identical form to end users or other third-party recipients.

1. Rule of Determination. In the case of the delivery of a service by electronic transmission, where the service is delivered electronically to end users or other third-party recipients through or on behalf of the customer, the service is delivered in Massachusetts if and to the extent that the end users or other third-party recipients are in Massachusetts. For example, in the case of the direct or indirect delivery of advertising on behalf of a customer to the customer's intended audience by electronic means, the service is delivered in Massachusetts to the extent that the audience for such advertising is in Massachusetts. In the case of the delivery of a service to a customer that acts as an intermediary in reselling the service in substantially identical form to third-party recipients, the service is delivered in Massachusetts to the extent that the end users or other third-party recipients receive such services in Massachusetts. 830 CMR 63.38.1(9)(d)4.c.ii.(C) apply whether the taxpayer's customer is an individual customer or a business customer and whether the end users or other third-party recipients to which the services are delivered through or on behalf of the customer are individuals or businesses.

2. Rule of Reasonable Approximation. If the taxpayer cannot determine the state or states where the services are actually delivered to the end users or other third-party recipients either through or on behalf of the customer, but has sufficient information regarding the place of delivery from which it can reasonably approximate the state or states where the services are delivered, it shall reasonably approximate such state or states.

3. Select Secondary Rules of Reasonable Approximation.

i. Where a taxpayer's service is the direct or indirect electronic delivery of advertising on behalf of its customer to the customer's intended audience, if the taxpayer lacks sufficient information regarding the location of the audience from which it can determine or reasonably approximate such location, the taxpayer shall reasonably approximate the audience in a state for such advertising using the following secondary rules of reasonable approximation. Where a taxpayer is delivering advertising directly or indirectly to a known list of subscribers, the taxpayer shall reasonably approximate the audience for advertising in a state using a percentage that reflects the ratio of the state's subscribers in the specific geographic area in which the advertising is delivered relative to the total subscribers in such area. For a taxpayer with less information about its audience, the taxpayer shall reasonably approximate the audience in a state using the percentage that reflects the ratio of the state's population in the specific geographic area in which the advertising is delivered relative to the total population in such area.

ii. Where a taxpayer's service is the delivery of a service to a customer that then acts as the taxpayer's intermediary in reselling such service to end users or other third-party recipients, if the taxpayer lacks sufficient information regarding the location of the end users or other third-party recipients from which it can determine or reasonably approximate such location, the taxpayer shall reasonably approximate the extent to which the service is received in a state by using the percentage that reflects the ratio of the state's population in the specific geographic area in which the taxpayer's intermediary resells such services, relative to the total population in such area.

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4. Examples. Assume in each of these examples that the taxpayer that provides the service is taxable in Massachusetts and is to apportion its income pursuant to M.G.L. c. 63, § 38. Also, assume, where relevant, unless otherwise stated, that the taxpayer is taxable in each state other than Massachusetts to which its sale or sales would be assigned, so that there is no requirement in such examples that such sale or sales must be eliminated from the numerator and denominator of the taxpayer's sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

Example 1. Cable TV Corp., a corporation that is based outside of Massachusetts, has two revenue streams. First, Cable TV Corp. sells advertising time to business customers pursuant to which the business customers' advertisements will run as commercials during Cable TV Corp.'s televised programming. Some of these business customers, though not all of them, have a physical presence in Massachusetts. Second, Cable TV Corp. sells monthly subscriptions to individual customers in Massachusetts and in other states. Cable TV Corp.'s sale of advertising time to its business customers is assigned to Massachusetts to the extent that the audience for Cable TV Corp.'s televised programming during which the advertisements run is in Massachusetts. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(C)1. If Cable TV Corp. is unable to determine the actual location of its audience for the programming, and lacks sufficient information regarding audience location to reasonably approximate such location, Cable TV Corp. must approximate its Massachusetts audience using the percentage that reflects the ratio of its Massachusetts subscribers in the geographic area in which Cable TV Corp.'s televised programming featuring such advertisements is delivered relative to its total number of subscribers in such area. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(C)3.i. To the extent that Cable TV Corp.'s sales of monthly subscriptions represent the sale of a service, such sales are properly assigned to Massachusetts in any case in which the programming is received by a customer in Massachusetts. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(B)1. In any case in which Cable TV Corp. cannot determine the actual location where the programming is received, and lacks sufficient information regarding the location of receipt to reasonably approximate such location, such sales of Cable TV Corp.'s monthly subscriptions are assigned to Massachusetts where its customer's billing address is in Massachusetts. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(B)1.b. Note that whether and to the extent that the monthly subscription fee represents a fee for a service or for a license of intangible property does not affect the analysis or result as to the state or states to which the sales are properly assigned. *See* 830 CMR 63.38.1(9)(d)5.e.

Example 2. Network Corp., a corporation that is based outside of Massachusetts, sells advertising time to business customers pursuant to which the customers' advertisements will run as commercials during Network Corp.'s televised programming as distributed by unrelated cable television and satellite television transmission companies. Network Corp.'s sale of advertising time to its business customers is assigned to Massachusetts to the extent that the audience for Network Corp.'s televised programming during which the advertisements will run is in Massachusetts. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(C)1. If Network Corp. cannot determine the actual location of the audience for its programming during which the advertisements will run, and lacks sufficient information regarding audience location to reasonably approximate such location, Network Corp. must approximate the amount of the sales that constitutes Massachusetts sales by multiplying the amount of such sales by a percentage that reflects the ratio of the Massachusetts population in the specific geographic area in which the televised programming containing the advertising is run relative to the total population in such area. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(C)3.i. In any case in which Network Corp.'s sales would be assigned to a state in which Network Corp. is not taxable, such sales shall be excluded from the numerator and denominator of Network Corp.'s sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

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Example 3. Web Corp., a corporation that is based outside Massachusetts, provides Internet content to viewers in Massachusetts and other states. Web Corp. sells advertising space to business customers pursuant to which the customers' advertisements will appear in connection with Web Corp.'s Internet content. Web Corp. receives a fee for running the advertisements that is determined by reference to the number of times the advertisement is viewed or clicked upon by the viewers of its website. Web Corp.'s sale of advertising space to its business customers is assigned to Massachusetts to the extent that the viewers of the Internet content are in Massachusetts, as measured by viewings or clicks. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(C)1. If Web Corp. is unable to determine the actual location of its viewers, and lacks sufficient information regarding the location of its viewers to reasonably approximate such location, Web Corp. must approximate the amount of its Massachusetts sales by multiplying the amount of such sales by a percentage that reflects the Massachusetts population in the specific geographic area in which the content containing the advertising is delivered relative to the total population in such area. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(C)3.i. In any case in which Web Corp.'s sales would be assigned to a state in which Web Corp. is not taxable, such sales shall be excluded from the numerator and denominator of Web Corp.'s sales factor. *See* 830 CMR 63.38.1(9)(d).1.f.ii.

Example 4. Retail Corp., a corporation that is based outside of Massachusetts, sells tangible property through its retail stores located in Massachusetts and other states, and through a mail order catalog. Answer Co., a corporation that operates call centers in multiple states, contracts with Retail Corp. to answer telephone calls from individuals placing orders for products found in Retail Corp.'s catalogs. In this case, the phone answering services of Answer Co. are being delivered to Retail Corp.'s customers and prospective customers. Therefore, Answer Co. is delivering a service electronically to Retail Corp.'s customers or prospective customers on behalf of Retail Corp., and must assign the proceeds from this service to the state or states from which the phone calls are placed by such customers or prospective customers. If Answer Co. cannot determine the actual locations from which phone calls are placed, and lacks sufficient information regarding the locations to reasonably approximate such locations, Answer Co. must approximate the amount of its Massachusetts sales by multiplying the amount of its fee from Retail Corp. by a percentage that reflects the Massachusetts population in the specific geographic area from which the calls are placed relative to the total population in such area. *See* 830 CMR 63.38.1(9)(d)4.c.i; 830 CMR 63.38.1(9)(d)4.c.ii(C). Answer Co.'s sales shall also be excluded from the numerator and denominator of its sales factor in any case in which such sales would be assigned to a state in which Answer Co. is not taxable. *See* 830 CMR 63.38.1(9)(d).1.f.ii.

Example 5. Web Corp., a corporation that is based outside of Massachusetts, sells tangible property to customers via its Internet website. Design Co. designed and maintains Web Corp.'s website, including making changes to the site based on customer feedback received through the site. Design Co.'s services are delivered to Web Corp., the proceeds from which are assigned pursuant to 830 CMR 63.38.1(9)(d)4.c.ii(B). The fact that Web Corp.'s customers and prospective customers incidentally benefit from Design Co.'s services, and may even interact with Design Co. in the course of providing feedback, does not transform the service into one delivered "on behalf of" Web Corp. to Web Corp.'s customers and prospective customers.

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Example 6. Wholesale Corp., a corporation that is based outside Massachusetts, develops an Internet-based information database outside Massachusetts and enters into a contract with Retail Corp. whereby Retail Corp. will market and sell access to this database to end users. Depending on the facts, the provision of database access may be either the sale of a service or the license of intangible property or may have elements of both. Assume that on the particular facts applicable in this example Wholesale Corp. is selling database access in transactions properly characterized as involving the performance of a service. When an end user purchases access to Wholesale Corp.'s database from Retail Corp., Retail Corp. in turn compensates Wholesale Corp. in connection with that transaction. In this case, Wholesale Corp.'s services are being delivered through Retail Corp to the end user. Wholesale Corp. must assign its sales to Retail Corp. to the state or states in which the end users receive access to Wholesale Corp.'s database. If Wholesale Corp. cannot determine the state or states where the end users actually receive access to Wholesale Corp.'s database, and lacks sufficient information regarding the location from which the end users access the database to reasonably approximate such location, Wholesale Corp. must approximate the extent to which its services are received by end users in Massachusetts by using a percentage that reflects the ratio of the Massachusetts population in the specific geographic area in which Retail Corp. regularly markets and sells Wholesale Corp.'s database relative to the total population in such area. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(C)3.ii. Note that it does not matter for purposes of the analysis whether Wholesale Corp's sale of database access constitutes a service or a license of intangible property, or some combination of both. *See* 830 CMR 63.38.1(9)(d)5.e. In any case in which Wholesale Corp.'s sales would be assigned to a state in which Wholesale Corp. is not taxable, such sales shall be excluded from the numerator and denominator of Wholesale Corp.'s sales factor. *See* 830 CMR 63.38.1(9)(d).1.f.ii.

d. Professional Services.

i. In General. Except as otherwise provided in 830 CMR 63.38.1(9)(d)4.d.ii, professional services are services that require specialized knowledge and in some cases require a professional certification, license or degree. Professional services include, without limitation, management services, bank and financial services, financial custodial services, investment and brokerage services, fiduciary services, tax preparation, payroll and accounting services, lending and credit card services, legal services, consulting services, video production services, graphic and other design services, engineering services, and architectural services.

ii. Overlap with Other Categories of Services.

(A) Certain services that fall within the definition of "professional services" set forth in 830 CMR 63.38.1(9)(d)4.d.i. are nevertheless treated as "in-person services" within the meaning of 830 CMR 63.38.1(9)(d)4.b., and are assigned under 830 CMR 63.38.1(9)(d)4.b. Specifically, professional services that are physically provided in person by the taxpayer such as carpentry, certain medical and dental services or child care services, where the customer or the customer's real or tangible property upon which the services are provided is in the same location as the service provider at the time the services are performed, are "in-person services" and are assigned as such, notwithstanding that they may also be considered to be "professional services". However, professional services where the service is of an intellectual or intangible nature, such as legal, accounting, financial and consulting services, are assigned as professional services under 830 CMR 63.38.1(9)(d)4.d.iii., notwithstanding the fact that such services may involve some amount of in-person contact.

(B) Professional services may in some cases include the transmission of one or more documents or other communications by mail or by electronic means. However, in such cases, despite this transmission, the assignment rules that apply are those set forth in 830 CMR 63.38.1(9)(d)4.d.iii., and not those set forth in 830 CMR 63.38.1(9)(d)4.c., pertaining to services delivered to a customer or through or on behalf of a customer.

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iii. Assignment of Sales. In the case of a professional service, it is generally possible to characterize the location of delivery in multiple ways by emphasizing different elements of the service provided, no one of which will consistently represent the market for the services. Therefore, for purposes of consistent application of the market sourcing rule stated in M.G.L. c. 63, § 38(f), the Commissioner has concluded that the location of delivery in the case of professional services is not susceptible to a general rule of determination, and must be reasonably approximated. The assignment of a sale of a professional service depends in many cases upon whether the customer is an individual or business customer. In any instance in which the taxpayer, acting in good faith, cannot reasonably determine whether the customer is an individual or business customer, the taxpayer shall treat the customer as a business customer. For purposes of assigning the sale of a professional service, a taxpayer's customer is the person who contracts for such service, irrespective of whether another person pays for or also benefits from the taxpayer's services. Except as provided in 830 CMR 63.38.1(9)(d)4.d.iii.(D) (mutual fund sales), in any instance in which the taxpayer is not taxable in the state to which a sale shall be assigned, the sale shall be excluded from the numerator and denominator of the taxpayer's sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

(A) General Rule. Sales of professional services other than those services described in 830 CMR 63.38.1(9)(d)4.d.iii.(B) (architectural and engineering services), 830 CMR 63.38.1(9)(d)4.d.iii.(C) (services provided by a financial institution) and 830 CMR 63.38.1(9)(d)4.d.iii.(D) (certain services provided to RICs)), are assigned in accordance with 830 CMR 63.38.1(9)(d)4.d.iii.(A).

1. Professional Services Delivered to Individual Customers. Except as otherwise provided in 830 CMR 63.38.1(9)(d)4.d., in any instance in which the service provided is a professional service and the taxpayer's customer is an individual customer, the state or states in which the service is delivered shall be reasonably approximated as set forth in 830 CMR 63.38.1(9)(d)4.d.iii.(A)1. In particular, the taxpayer shall assign the sale to the customer's state of primary residence, or, if the taxpayer cannot reasonably identify the customer's state of primary residence, to the state of the customer's billing address; provided, however, in any instance in which the taxpayer derives more than 5% of its sales of services from an individual customer, the taxpayer is required to identify the customer's state of primary residence and must assign the receipts from the service or services provided to that customer to that state.

2. Professional Services Delivered to Business Customers. Except as otherwise provided in 830 CMR 63.38.1(9)(d)4.d., in any instance in which the service provided is a professional service and the taxpayer's customer is a business customer, the state or states in which the service is delivered shall be reasonably approximated as set forth in 830 CMR 63.38.1(9)(d)4.d.iii.(A)2. In particular, unless the taxpayer may use the safe harbor set forth at 830 CMR 63.38.1(9)(d)4.d.iii.(A)3., the taxpayer shall assign the sale as follows: first, by assigning the receipts to the state where the contract of sale is principally managed by the customer; second, if such place of customer management is not reasonably determinable, to the customer's place of order; and third, if such customer place of order is not reasonably determinable, to the customer's billing address; provided, however, in any instance in which the taxpayer derives more than 5% of its sales of services from a customer, the taxpayer is required to identify the state in which the contract of sale is principally managed by the customer.

3. Safe Harbor; Large Volume of Transactions. Notwithstanding 830 CMR 63.38.1(9)(d)4.d.iii.(A)1. and 2., a taxpayer may assign its sales to a particular customer based on the customer's billing address in any taxable year in which the taxpayer (1) engages in substantially similar service transactions with more than 250 customers, whether individual or business, and (2) does not derive more than 5% of its sales of services from such customer. This safe harbor applies only for purposes of 830 CMR 63.38.1(9)(d)4.d.iii.(A), and not otherwise.

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(B) Architectural and Engineering Services with Respect to Real or Tangible Personal Property. Architectural and engineering services with respect to real or tangible personal property are professional services within the meaning of 830 CMR 63.38.1(9)(d)4.d. However, unlike in the case of the general rule that applies to professional services, (1) the sale of such an architectural service is assigned to a state or states if and to the extent that the services are with respect to real estate improvements located, or expected to be located, in such state or states; and (2) the sale of such an engineering service is assigned to a state or states if and to the extent that the services are with respect to tangible or real property located in such state or states, including real estate improvements located in, or expected to be located in, such state or states. 830 CMR 63.38.1(9)(d)4.d. applies whether or not the customer is an individual or business customer. In any instance in which architectural or engineering services are not described in 830 CMR 63.38.1(9)(d)4.d.iii.(B), the sale of such services shall be assigned under the general rule for professional services. *See* 830 CMR 63.38.1(9)(d)4.d.iii.(A).

(C) Services Provided by a Financial Institution. The apportionment rules that apply to financial institutions are set forth at M.G.L. c. 63, § 2A. M.G.L. c. 63, § 2A includes specific rules to determine a financial institution's sales factor. *See* M.G.L. c. 63, § 2A(d). However, M.G.L. c. 63, § 2A also provides that receipts from sales, other than sales of tangible personal property, including service transactions, that are not otherwise apportioned under M.G.L. c. 63, § 2A(d), are to be assigned pursuant to M.G.L. c. 63, § 38(f). *See* M.G.L. c. 63, § 2A(d)(xi). In any instance in which a financial institution performs services that are to be assigned pursuant to M.G.L. c. 63, § 38(f), including, for example, financial custodial services, those services shall be considered professional services within the meaning of 830 CMR 63.38.1(9)(d)4.d., and shall be assigned according to the general rule for professional service transactions as set forth at 830 CMR 63.38.1(9)(d)4.d.iii.(A).

(D) Mutual Fund Sales. Mutual fund sales within the meaning of 830 CMR 63.38.1, generally are sales of professional services for purposes of 830 CMR 63.38.1(9)(d)4.d. *See* 830 CMR 63.38.1(2) (definition of mutual fund sales). However, the rules to assign mutual fund sales made by a mutual fund service corporation are those set forth in 830 CMR 63.38.7, and not those set forth in 830 CMR 63.38.1. Also, in the case of mutual fund sales made by a taxpayer that is not a mutual fund service corporation, such mutual fund sales shall be assigned by applying the sourcing methodology described in 830 CMR 63.38.7(4)(c)4. to such sales. In these cases, consistent with the rules of M.G.L. c. 63, § 38(f) and 830 CMR 63.38.7, the mutual fund sales made by the taxpayer directly or indirectly to the RIC are included in the numerator and denominator of the taxpayer's sales factor irrespective as to whether the taxpayer is taxable in one or more of the states in which the RIC's shareholders are domiciled.

iv. Examples. Unless otherwise stated, assume in each of these examples, where relevant: (a) that the taxpayer that provides the service is taxable in Massachusetts and is to apportion its income pursuant to M.G.L. c. 63, § 38; (b) that the taxpayer is taxable in each state other than Massachusetts to which its sale or sales would be assigned, so that there is no requirement in such examples that such sale or sales must be excluded from the numerator and denominator of the taxpayer's sales factor, *see* 830 CMR 63.38.1(9)(d)1.f.ii.; (c) that the safe harbor set forth at 830 CMR 63.38.1(9)(d)4.ii.(A).3 does not apply; and (d) that the taxpayer's service at issue is not provided directly or indirectly to a RIC, *see* 830 CMR 63.38.1(9)(d)4.d.iii.(D).

Example 1. Broker Corp. provides securities brokerage services to individual customers who are resident in Massachusetts and in other states. Assume that Broker Corp. knows the state of primary residence for many of its customers, and where it does not know this state of primary residence, it knows the customer's billing address. Also assume that Broker Corp. does not derive more than 5% of its sales of services from any one individual customer. Where Broker Corp. knows its customer's state of primary residence, it shall assign the sale to that state. Where Broker Corp. does not know its customer's state of primary residence, but rather knows the customer's billing address, it shall assign the sale to that state. *See* 830 CMR 63.38.1(9)(d)4.d.iii.(A)1.

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Example 2. Same facts as in Example 1, except that Broker Corp. has several individual customers from whom it derives, in each instance, more than 5% of its sales of services. Sales to customers from whom Broker Corp. derives 5% or less of its sales of services shall be assigned as described in example 1. For each customer from whom it derives more than 5% of its sales of services, Broker Corp. is required to determine the customer's state of primary residence and must assign the receipts from the services provided to that customer to that state. In any case in which a 5% customer's state of primary residence is Massachusetts, a sale made to that customer must be assigned to Massachusetts; in any case in which a 5% customer's state of primary residence is not Massachusetts a sale made to that customer is not assigned to Massachusetts. Where a sale is assigned to a state other than Massachusetts, if the state of assignment (*i.e.*, the state of primary residence of the individual customer) is a state in which Broker Corp. is not taxable, receipts from the sales shall be excluded from the numerator and denominator of Broker Corp.'s sales factor. *See* 830 CMR 63.38.1(9)(d)4.d.iii.(A); 830 CMR 63.38.1(9)(d)1.f.ii.

Example 3. Architecture Corp. provides building design services as to buildings located, or expected to be located, in Massachusetts to individual customers who are resident in Massachusetts and other states, and to business customers that are based in Massachusetts and other states. Architecture Corp.'s sales are assigned to Massachusetts because the locations of the buildings to which its design services relate are in Massachusetts, or are expected to be in Massachusetts. For purposes of assigning these sales, it is not relevant where, in the case of an individual customer, the customer primarily resides or is billed for such services, and it is not relevant where, in the case of a business customer, the customer principally manages the contract, placed the order for the services or is billed for such services. Further, such sales are assigned to Massachusetts even if Architecture Corp.'s designs are either physically delivered to its customer in paper form in a state other than Massachusetts or are electronically delivered to its customer in a state other than Massachusetts. *See* 830 CMR 63.38.1(9)(d)4.d.iii.(B).

Example 4. Law Corp. provides legal services to individual clients who are resident in Massachusetts and in other states. In some cases, Law Corp. may prepare one or more legal documents for its client as a result of these services and/or the legal work may be related to litigation or a legal matter that is ongoing in a state other than where the client is resident. Assume that Law Corp. knows the state of primary residence for many of its clients, and where it does not know this state of primary residence, it knows the client's billing address. Also assume that Law Corp. does not derive more than 5% of its sales of services from any one individual client. Where Law Corp. knows its client's state of primary residence, it shall assign the sale to that state. Where Law Corp. does not know its client's state of primary residence, but rather knows the client's billing address, it shall assign the sale to that state. For purposes of the analysis it is irrelevant whether the legal documents relating to the service are mailed or otherwise delivered to a location in another state, or the litigation or other legal matter that is the underlying predicate for the services is in another state. *See* 830 CMR 63.38.1(9)(d)4.d.ii.(B) and iii.(A)1.

Example 5. Same facts as in Example 4, except that Law Corp. provides legal services to several individual clients who it knows have a primary residence in a state where Law Corp. is not taxable. Receipts from these services shall be excluded from the numerator and denominator of Law Corp.'s sales factor even if the billing address of one or more of these clients is in a state in which Law Corp. is taxable, including Massachusetts. *See* 830 CMR 63.38.1(9)(d)4.d.iii.(A)1.; 830 CMR 63.38.1(9)(d)1.f.ii.

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Example 6. Law Corp. provides legal services to several multistate business clients. In each case, Law Corp. knows the state in which the agreement for legal services that governs the client relationship is principally managed by the client. In one case, the agreement is principally managed in Massachusetts; in the other cases, the agreement is principally managed in a state other than Massachusetts. Where the agreement for legal services is principally managed by the client in Massachusetts the sale of the services shall be assigned to Massachusetts; in the other cases, the sale is not assigned to Massachusetts. In the case of the sale that is assigned to Massachusetts, the sale shall be so assigned even if (1) the legal documents relating to the service are mailed or otherwise delivered to a location in another state, or (2) the litigation or other legal matter that is the underlying predicate for the services is in another state. *See* 830 CMR 63.38.1(9)(d)4.d.ii.(B) and iii.(A)2.

Example 7. Same facts as in example 6, except that Law Corp. is not taxable in one of the states other than Massachusetts in which Law Corp.'s agreement for legal services that governs the client relationship is principally managed by the business client. Receipts from these latter services shall be excluded from the numerator and denominator of Law Corp.'s sales factor. *See* 830 CMR 63.38.1(9)(d)4.d.iii. and iii.(A)2.; 830 CMR 63.38.1(9)(d)1.f.ii.

Example 8. Consulting Corp., a company that provides consulting services to law firms and other customers, is hired by Law Corp. in connection with legal representation that Law Corp. provides to Client Co. Specifically, Consulting Corp. is hired to provide expert testimony at a trial being conducted by Law Corp. on behalf of Client Co. Client Co. pays for Consulting Corp.'s services directly. Assuming that Consulting Corp. knows that its agreement with Law Co. is principally managed by Law Corp. in Massachusetts, the sale of Consulting Corp.'s services shall be assigned to Massachusetts. It is not relevant for purposes of the analysis that Client Co. is the ultimate beneficiary of Consulting Corp.'s services, or that Client Co. pays for Consulting Corp.'s services directly. *See* 830 CMR 63.38.1(9)(d)4.d.iii.(A)2.

Example 9. Bank Corp. provides financial custodial services to 100 individual customers who are resident in Massachusetts and in other states, including the safekeeping of some of its customers' financial assets. Assume for purposes of this example that Bank Corp. knows the state of primary residence for many of its customers, and where it does not know this state of primary residence, it knows the customer's billing address. Also assume that Bank Corp. does not derive more than 5% of its sales of all of its services from any single customer. Note that because Bank Corp. does not have more than 250 customers, it may not apply the safe harbor for professional services stated in 830 CMR 63.38.1(9)(d)4.d.iii.(A)3. Where Bank Corp. knows its customer's state of primary residence, it must assign the sale to that state. Where Bank Corp. does not know its customer's state of primary residence, but rather knows the customer's billing address, it must assign the sale to that state. Bank Corp.'s sales are assigned to Massachusetts if the customer's state of primary residence (or billing address, in cases where it does not know the customer's state of primary residence) is in Massachusetts, even if Bank Corp.'s financial custodial work, including the safekeeping of the customer's financial assets, takes place in a state other than Massachusetts. *See* 830 CMR 63.38.1(9)(d)4.d.iii.(A)1. and (C).

Example 10. Same facts as Example 9, except that Bank Corp. has more than 250 customers, individual or business. Bank Corp. may apply the safe harbor for professional services stated in 830 CMR 63.38.1(9)(d)4.d.iii.(A)3., and may assign its sales to a state or states using each customer's billing address. If Bank Corp is not taxable in one or more states to which some of its sales would be assigned, it must exclude the sales that would be assigned to those states from the numerator and denominator of its sales factor. *See* 830 CMR 63.38.1(9)(d)4.d.iii., iii.(C); 830 CMR 63.38.1(9)(d)1.f.ii.

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Example 11. Same facts as Example 10, except that Bank Corp. derives more than 5% of its sales from a single individual customer. As to the sales made to this customer, Bank Corp. is required to determine the individual customer's state of primary residence and must assign the receipts from the service or services provided to that customer to that state. *See* 830 CMR 63.38.1(9)(d)4.d.iii.(A)1., iii.(C). Sales to all other customers are assigned as described in Example 10.

Example 12. Advisor Corp., a corporation that provides investment advisory services, provides such advisory services to Investment Co. Investment Co. is a multistate business client of Advisor Corp. that uses Advisor Corp.'s services in connection with investment accounts that it manages for individual clients, who are the ultimate beneficiaries of Advisor Corp.'s services. Assume that Investment Co.'s individual clients are persons that are resident in numerous states, which may or may not include Massachusetts. Assuming that Advisor Corp. knows that its agreement with Investment Co. is principally managed by Investment Co. in Massachusetts, the sale of Advisor Corp.'s services shall be assigned to Massachusetts. It is not relevant for purposes of the analysis that the ultimate beneficiaries of Advisor Corp.'s services may be Investment Co.'s clients, who are residents of numerous states. *See* 830 CMR 63.38.1(9)(d)4.d.iii.(A)2.

Example 13. Same facts as Example 12, except that in addition to providing investment advisory services to Investment Co., Advisor Corp. also provides its advisory services to Mutual Fund Co., a regulated investment company with shareholders that are resident in numerous states, including Massachusetts. Advisor Corp. is not a mutual fund service corporation; however Advisor Corp.'s services provided to Mutual Fund Co. constitute mutual fund sales within the meaning of 830 CMR 63.38.1. *See* 830 CMR 63.38.1(2). Advisor Corp.'s mutual fund sales to Mutual Fund Co. shall be assigned to Massachusetts to the extent that Mutual Fund Co.'s shareholders of record are domiciled in Massachusetts. *See* 830 CMR 63.38.1(9)(d)4.d.iii.(D). However, unlike in the rule set forth generally in 830 CMR 63.38.1(9)(d), there shall be no exclusion of such sales from the numerator and denominator of Advisor Corp.'s sales factor in any case in which such shareholders of record are domiciled in a state in which Advisor Corp. is not taxable. *See id.* In contrast to its mutual fund sales made to Mutual Fund Co., Advisor Corp.'s advisory services provided to Investment Co. are assigned as stated in Example 12, and its sales to Investment Co. shall be excluded from the numerator and denominator of Advisor Corp.'s sales factor if such sales would be assigned to a state in which Advisor Corp. is not taxable. *See* 830 CMR 63.38.1(9)(d)4.d.iii. and iii.(A)2.

Example 14. Advisor Corp. provides investment advisory services to Investment Fund LP, a partnership that invests in securities and other assets. Assuming that Advisor Corp. knows that its agreement with Investment Fund LP is principally managed by Investment Fund LP in Massachusetts, the sale of Advisor Corp.'s services shall be assigned to Massachusetts. *See* 830 CMR 63.38.1(9)(d)4.d.iii.(A)2. Note that, unlike in the case of mutual fund sales (*see* 830 CMR 63.38.1(9)(d)4.d.iii.(D)), it is not relevant for purposes of the analysis that the partners in Investment Fund LP are residents of numerous states.

Example 15. Design Corp. is a corporation based outside Massachusetts that provides graphic design and similar services in Massachusetts and in neighboring states. Design Corp. enters into a contract at a location outside Massachusetts with an individual customer to design fliers for the customer. Assume that Design Corp. does not know the individual customer's state of primary residence and does not derive more than 5% of its sales of services from the individual customer. All of the design work is performed outside Massachusetts. The sale is in Massachusetts if the customer's billing address is in Massachusetts. *See* 830 CMR 63.38.1(9)(d)4.d.iii.(A)1.

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5. License or Lease of Intangible Property.

a. General Rules.

i. The receipts from the license of intangible property are in Massachusetts if and to the extent the intangible is used in Massachusetts. In general, the term "use" shall be construed to refer to the location of the taxpayer's market for the use of the intangible property that is being licensed and is not to be construed to refer to the location of the property or payroll of the taxpayer as otherwise determined for corporate apportionment purposes pursuant to 830 CMR 63.38.1(7) and (8). 830 CMR 63.38.1(7) and (8) determines the location of the use of intangible property in the context of several specific types of licensing transactions are set forth at 830 CMR 63.38.1(9)(d)5.b. through e. For purposes of the rules set forth in 830 CMR 63.38.1(9)(d)5., a lease of intangible property is to be treated the same as a license of intangible property.

ii. In general, a license of intangible property that conveys all substantial rights in such property is treated as a sale of intangible property for tax purposes. *See* 830 CMR 63.38.1(9)(d)6. Note, however, that for purposes of 830 CMR 63.38.1(9)(d)5. and 6., a sale or exchange of intangible property is treated as a license of such property where the receipts from the sale or exchange derive from payments that are contingent on the productivity, use or disposition of the property

iii. Intangible property licensed as part of the sale or lease of tangible property is treated under 830 CMR 63.38.1(9) as the sale or lease of tangible property.

iv. In any instance in which the taxpayer is not taxable in the state to which the receipts from the license of intangible property are assigned, the receipts shall be excluded from the numerator and denominator of the taxpayer's sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

v. To the extent that the transfer of either a security, as defined in 830 CMR 63.38.1(2), or business "goodwill" or similar intangible value, including, without limitation, "going concern value" or "workforce in place," may be characterized as a license or lease of intangible property, receipts from such transaction shall be excluded from the numerator and the denominator of the taxpayer's sales factor.

b. License of a Marketing Intangible. Where a license is granted for the right to use intangible property in connection with the sale, lease, license, or other marketing of goods, services, or other items (*i.e.*, a marketing intangible), the royalties or other licensing fees paid by the licensee for such right are assigned to Massachusetts to the extent that the fees are attributable to the sale or other provision of goods, services, or other items purchased or otherwise acquired by customers in Massachusetts. Examples of a license of a marketing intangible include, without limitation, the license of a service mark, trademark, or trade name; certain copyrights; the license of a film, television or multimedia production or event for commercial distribution; and a franchise agreement. In each of these instances the license of the marketing intangible is intended to promote consumer sales. In the case of the license of a marketing intangible, where a taxpayer has actual evidence of the amount or proportion of its receipts that is attributable to Massachusetts, it shall assign such amount or proportion to Massachusetts. In the absence of actual evidence of the amount or proportion of the licensee's receipts that are derived from Massachusetts customers, the portion of the licensing fee to be assigned to Massachusetts shall be reasonably approximated by multiplying the total fee by a percentage that reflects the ratio of the Massachusetts population in the specific geographic area in which the licensee makes material use of the intangible property to regularly market its goods, services or other items relative to the total population in such area. Where the license of a marketing intangible is for the right to use the intangible property in connection with sales or other transfers at wholesale rather than directly to retail customers, the portion of the licensing fee to be assigned to Massachusetts shall be reasonably approximated by multiplying the total fee by a percentage that reflects the ratio of the Massachusetts population in the specific geographic area in which the licensee's goods, services, or other items are ultimately marketed using the intangible property relative to the total population of such area.

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c. License of a Production Intangible. Where a license is granted for the right to use intangible property other than in connection with the sale, lease, license, or other marketing of goods, services, or other items, and the license is to be used in a production capacity (a "production intangible"), the licensing fees paid by the licensee for such right are assigned to Massachusetts to the extent that the use for which the fees are paid takes place in Massachusetts. Examples of a license of a production intangible include, without limitation, the license of a patent, a copyright, or trade secrets to be used in a manufacturing process, where the value of the intangible lies predominately in its use in such process. In the case of a license of a production intangible, it shall be presumed that the use of the intangible property takes place in the state of the licensee's commercial domicile (where the licensee is a business) or the licensee's state of primary residence (where the licensee is an individual) unless the taxpayer or the Commissioner can reasonably establish the location(s) of actual use. Where the Commissioner can reasonably establish that the actual use of intangible property pursuant to a license of a production intangible takes place in part in Massachusetts, it shall be presumed that the entire use is in Massachusetts except to the extent that the taxpayer can demonstrate that the actual location of a portion of the use takes place outside Massachusetts.

d. License of a Mixed Intangible. Where a license of intangible property includes both a license of a marketing intangible and a license of a production intangible (a "mixed intangible") and the fees to be paid in each instance are separately and reasonably stated in the licensing contract, the Commissioner will accept such separate statement for purposes of 830 CMR 63.38.1 if it is reasonable. Where a license of intangible property includes both a license of a marketing intangible and a license of a production intangible and the fees to be paid in each instance are not separately and reasonably stated in the contract, it shall be presumed that the licensing fees are paid entirely for the license of the marketing intangible except to the extent that the taxpayer or the Commissioner can reasonably establish otherwise.

e. License of Intangible Property where Substance of Transaction Resembles a Sale of Goods or Services.

i. In General. In some cases, the license of intangible property will resemble the sale of an electronically-delivered good or service rather than the license of a marketing intangible or a production intangible. In such cases, the receipts from the licensing transaction shall be assigned by applying 830 CMR 63.38.1(9)(d)4.c.ii.(B) and (C), as if the transaction were a service delivered to an individual or business customer or delivered electronically through an individual or business customer, as applicable. Examples of transactions to be assigned under 830 CMR 63.38.1(9)(d)5.e. include, without limitation, the license of database access, the license of access to information, the license of digital goods (*see* 830 CMR 63.38.1(9)(d)7.b.), and the license of certain software (*e.g.*, where the transaction is not the license of pre-written software that is treated as the sale of tangible personal property, *see* 830 CMR 63.38.1(9)(d)7.a.).

ii. Sublicenses. Pursuant to 830 CMR 63.38.1(9)(d)5.e.i., 830 CMR 63.38.1(9)(d)4.c.ii.(C) may apply where a taxpayer licenses intangible property to a customer that in turn sublicenses the intangible property to end users as if the transaction were a service delivered electronically through a customer to end users. In particular, 830 CMR 63.38.1(9)(d)4.c.ii.(C) that apply to services delivered electronically to a customer for purposes of resale and subsequent electronic delivery in substantially identical form to end users or other recipients may also apply with respect to licenses of intangible property for purposes of sublicense to end users, provided that for this purposes. the intangible property sublicensed to an end user shall not fail to be substantially identical to the property that was licensed to the sublicensor merely because the sublicense transfers a reduced bundle of rights with respect to such property (*e.g.*, because the sublicensee's rights are limited to its own use of the property and do not include the ability to grant a further sublicense), or because such property is bundled with additional services or items of property.

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f. Examples. Assume in each of these examples that the taxpayer that licenses the intangible property is taxable in Massachusetts and is to apportion its income pursuant to M.G.L. c. 63, § 38. Also, assume, where relevant, unless otherwise stated, that the taxpayer is taxable in each state other than Massachusetts to which its sale or sales would be assigned, so that there is no requirement in such examples that such sale or sales must be eliminated from the numerator and denominator of the taxpayer's sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

Example 1. Crayon Corp. and Dealer Co. enter into a license contract under which Dealer Co. as licensee is permitted to use trademarks that are owned by Crayon Corp. in connection with Dealer Co.'s sale of certain products to retail customers. Under the contract, Dealer Co. is required to pay Crayon Corp. a licensing fee that is a fixed percentage of the total volume of monthly sales made by Dealer Co. of products using the Crayon Corp. trademarks. Under the contract, Dealer Co. is permitted to sell the products at multiple store locations, including store locations that are both within and without Massachusetts. Further, the licensing fees that are paid by Dealer Co. are broken out on a per-store basis. The licensing fees paid to Crayon Corp. by Dealer Co. represent fees from the license of a marketing intangible. The portion of the fees to be assigned to Massachusetts shall be determined by multiplying the fees by a percentage that reflects the ratio of Dealer Co.'s receipts that are derived from its Massachusetts stores relative to Dealer Co.'s total receipts. *See* 830 CMR 63.38.1(9)(d)5.b.

Example 2. Program Corp., a corporation that is based outside Massachusetts, licenses programming that it owns to licensees, such as cable networks, that in turn will offer the programming to their customers on television or other media outlets in Massachusetts and in all other U.S. states. Each of these licensing contracts constitutes the license of a marketing intangible. For each licensee, assuming that Program Corp. lacks evidence of the actual number of viewers of the programming in Massachusetts, the component of the licensing fee paid to Program Corp. by the licensee that constitutes Program Corp.'s Massachusetts sales is determined by multiplying the amount of the licensing fee by a percentage that reflects the ratio of the Massachusetts audience of the licensee for the programming relative to the licensee's total U.S. audience for the programming. *See* 830 CMR 63.38.1(9)(d)5.b. If Program Corp. is not taxable in any state in which the licensee's audience is located, the sales that would be assigned to such state shall be excluded from the numerator and denominator of Program Corp.'s sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii. Note that the analysis and result as to the state or states to which sales are properly assigned would be the same to the extent that the substance of Program Corp.'s licensing transactions may be determined to resemble a sale of goods or services, instead of the license of a marketing intangible. *See* 830 CMR 63.38.1(9)(d)5.e.

Example 3. Moniker Corp. enters into a license contract with Wholesale Co. Pursuant to the contract Wholesale Co. is granted the right to use trademarks owned by Moniker Corp. to brand sports equipment that is to be manufactured by Wholesale Co. or an unrelated entity, and to sell the manufactured equipment to unrelated companies that will ultimately market the equipment to consumers in a specific geographic region, including a foreign country. The license agreement confers a license of a marketing intangible, even though the trademarks in question will be affixed to property to be manufactured. In addition, the license of the marketing intangible is for the right to use the intangible property in connection with sales to be made at wholesale rather than directly to retail customers. The component of the licensing fee that constitutes the Massachusetts sales of Moniker Corp. is determined by multiplying the amount of the fee by a percentage that reflects the ratio of the Massachusetts population in the specific geographic region relative to the total population in such region. *See* 830 CMR 63.38.1(9)(d)5.b. If Moniker Corp. is not taxable in any state (including a foreign country, *see* 830 CMR 63.38.1(2)) in which Wholesale Co.'s ultimate consumers are located, the sales that would be assigned to such state shall be excluded from the numerator and denominator of Moniker Corp.'s sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

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Example 4. Formula, Inc and Appliance Co. enter into a license contract under which Appliance Co. is permitted to use a patent owned by Formula, Inc. to manufacture appliances. The license contract specifies that Appliance Co. is to pay Formula, Inc. a royalty that is a fixed percentage of the gross receipts from the products that are later sold. The contract does not specify any other fees. The appliances are both manufactured and sold in Massachusetts and several other states. Assume the licensing fees are paid for the license of a production intangible, even though the royalty is to be paid based upon the sales of a manufactured product (*i.e.*, the license is not one that includes a marketing intangible). Because the Commissioner can reasonably establish that the actual use of the intangible property takes place in part in Massachusetts, the royalty is assigned based to the location of such use rather than to location of the licensee's commercial domicile, in accordance with 830 CMR 63.38.1(9)(d)5.c. It is presumed that the entire use is in Massachusetts except to the extent that the taxpayer can demonstrate that the actual location of some or all of the use takes place outside Massachusetts. Assuming that Formula, Inc. can demonstrate the percentage of manufacturing that takes place in Massachusetts using the patent relative to such manufacturing in other states, that percentage of the total licensing fee paid to Formula, Inc. under the contract will constitute Formula, Inc.'s Massachusetts sales. *See* 830 CMR 63.38.1(9)(d)5.c.

Example 5. Axel Corp. enters into a license agreement with Biker Co. in which Biker Co. is granted the right to produce motor scooters using patented technology owned by Axel Corp., and also to sell such scooters by marketing the fact that the scooters were manufactured using the special technology. The contract is a license of both a marketing and production intangible, *i.e.*, a mixed intangible. The scooters are manufactured outside Massachusetts. Assume that Axel Corp. lacks actual information regarding the proportion of Biker Co.'s receipts that are derived from Massachusetts customers. Also assume that Biker Co. is granted the right to sell the scooters in a U.S. geographic region in which the Massachusetts population constitutes 25% of the total population during the period in question. The licensing contract requires an upfront licensing fee to be paid by Biker Co. to Axel Corp. and does not specify what percentage of the fee derives from Biker Co.'s right to use Axel Corp.'s patented technology. Because the fees for the license of the marketing and production intangible are not separately and reasonably stated in the contract, it is presumed that the licensing fees are paid entirely for the license of a marketing intangible, unless either the taxpayer or Commissioner reasonably establishes otherwise. Assuming that neither party establishes otherwise, 25% of the licensing fee constitutes Massachusetts sales. *See* 830 CMR 63.38.1(9)(d)5.b. and d.

Example 6. Same facts as Example 5, except that the license contract specifies separate fees to be paid for the right to produce the motor scooters and for the right to sell the scooters by marketing the fact that the scooters were manufactured using the special technology. The licensing contract constitutes both the license of a marketing intangible and the license of a production intangible. Assuming that the separately stated fees are reasonable, the Commissioner will: (1) assign no part of the licensing fee paid for the production intangible to Massachusetts, and (2) assign 25% of the licensing fee paid for the marketing intangible to Massachusetts. *See* 830 CMR 63.38.1(9)(d)5.d.

Example 7. Better Burger Corp., which is based outside Massachusetts, enters into franchise contracts with franchisees who agree to operate Better Burger restaurants as franchisees in various states. Several of the Better Burger Corp. franchises are in Massachusetts. In each case, the franchise contract between the individual and Better Burger provides that the franchisee is to pay Better Burger Corp. an upfront fee for the receipt of the franchise and monthly franchise fees, which cover, among other things, the right to use the Better Burger name and service marks, food processes and cooking know-how, as well as fees for management services. The upfront fees for the receipt of the Massachusetts franchises constitute fees paid for the licensing of a marketing intangible. These fees constitute Massachusetts sales because the franchises are for the right to

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make Massachusetts sales. The monthly franchise fees paid by Massachusetts franchisees constitute fees paid for (1) the license of marketing intangibles (the Better Burger name and service marks), (2) the license of production intangibles (food processes and know-how) and (3) personal services (management fees). The fees paid for the license of the marketing intangibles and the production intangibles constitute Massachusetts sales because in each case the use of the intangibles is to take place in Massachusetts. *See* 830 CMR 63.38.1(9)(d)5.b. and c. The fees paid for the personal services are to be assigned pursuant to 830 CMR 63.38.1(9)(d)4.

Example 8. Online Corp., a corporation based outside Massachusetts, licenses an information database through the means of the Internet to individual customers that are resident in Massachusetts and in other states. These customers access Online Corp.'s information database primarily in their states of residence, and sometimes, while traveling, in other states. The license is a license of intangible property that resembles a sale of goods or services and shall be assigned in accordance with 830 CMR 63.38.1(9)(d)5.e. If Online Corp. can determine or reasonably approximate the state or states where its database is accessed, then it must do so. Assuming that Online Corp. cannot determine or reasonably approximate the location where its database is accessed, Online Corp. must assign the sales made to the individual customers using the customers' billing addresses to the extent known. Assume for purposes of this example that Online Corp. knows the billing address for each of its customers. In this case, Online Corp.'s sales made to its individual customers are in Massachusetts in any case in which the customer's billing address is in Massachusetts. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(B)1.

Example 9. Net Corp., a corporation based outside Massachusetts, licenses an information database through the means of the Internet to a business customer, Business Corp., a company with offices in Massachusetts and two neighboring states. The license is a license of intangible property that resembles a sale of goods or services and shall be assigned in accordance with 830 CMR 63.38.1(9)(d)5.e. Assume that Net Corp. cannot determine where its database is accessed but reasonably approximates that 75% of Business Corp.'s database access took place in Massachusetts, and 25% of Business Corp.'s database access took place in other states. In such case, 75% of the receipts from database access is in Massachusetts. Assume alternatively that Net Corp. lacks sufficient information regarding the location where its database is accessed to reasonably approximate such location. Under these circumstances, if Net Corp. derives 5% or less of its receipts from database access from Business Corp., Net Corp. must assign the sale under 830 CMR 63.38.1(9)(d)4.c.ii.(B)2. to the state where Business Corp. principally managed the contract, or if that state is not reasonably determinable to the state where Business Corp. placed the order for the services, or if that state is not reasonably determinable to the state of Business Corp.'s billing address. If Net Corp. derives more than 5% of its receipts from database access from Business Corp., Net Corp. is required to identify the state in which its contract of sale is principally managed by Business Corp. and must assign the receipts to that state. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.

Example 10. Net Corp., a corporation based outside Massachusetts, licenses an information database through the means of the Internet to more than 250 individual and business customers in Massachusetts and in other states. The license is a license of intangible property that resembles a sale of goods or services and shall be assigned in accordance with 830 CMR 63.38.1(9)(d)5.e. Assume that Net Corp. cannot determine or reasonably approximate the location where its information database is accessed. Also assume that Net Corp. does not derive more than 5% of its sales of database access from any single customer. Net Corp. may apply the safe harbor stated in 830 CMR 63.38.1(9)(d)4.c.ii.(B)2.d., and may assign its sales to a state or states using each customer's billing address. If Net Corp. is not taxable in one or more states to which some of its sales would be otherwise assigned, it must exclude those sales from the numerator and denominator of its sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

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Example 11. Web Corp., a corporation based outside of Massachusetts, licenses an Internet-based information database to business customers who then sublicense the database to individual end users that are resident in Massachusetts and in other states. These end users access Web Corp.'s information database primarily in their states of residence, and sometimes, while traveling, in other states. Web Corp.'s license of the database to its customers includes the right to sublicense the database to end users, while the sublicenses provide that the rights to access and use the database are limited to the end users' own use and prohibit the individual end users from further sublicensing the database. Web Corp. receives a fee from each customer based upon the number of sublicenses issued to end users. The license is a license of intangible property that resembles a sale of goods or services and shall be assigned by applying the rules set forth in 830 CMR 63.38.1(9)(d)4.c.ii.(C). *See* 830 CMR 63.38.1(9)(d)5.e. If Web Corp. can determine or reasonably approximate the state or states where its database is accessed by end users, then it must do so. Assuming that Web Corp. lacks sufficient information from which it can determine or reasonably approximate the location where its database is accessed by end users, Web Corp. must approximate the extent to which its database is accessed in Massachusetts using a percentage that represents the ratio of the Massachusetts population in the specific geographic area in which Web Corp.'s customer sublicenses the database access relative to the total population in such area. *See* 830 CMR 63.38.1(9)(d)4.c.ii.(C)3.ii.

6. Sale of Intangible Property.

a. Assignment of Sales. The assignment of a sale to a state or states in the instance of a sale or exchange of intangible property depends upon the nature of the intangible property sold. For purposes of 830 CMR 63.38.1(9)(d)6., a sale or exchange of intangible property includes a license of such property where the transaction is treated for tax purposes as a sale of all substantial rights in the property and the receipts from transaction are not contingent on the productivity, use or disposition of the property. For the rules that apply where the consideration for the transfer of rights is contingent on the productivity, use or disposition of the property, *see* 830 CMR 63.38.1(9)(d)5.a. and 6.a.iv.

i. Contract Right or Government License that Authorizes Business Activity in Specific Geographic Area. In the case of a sale or exchange of intangible property where the property sold or exchanged is a contract right, government license or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area, the sale is assigned to a state if and to the extent that the intangible property is used or otherwise associated with the state. Where the intangible property is used in, or otherwise associated with, only Massachusetts the taxpayer shall assign the sale to Massachusetts. Where the intangible property is used in or is otherwise associated with Massachusetts and one or more other states, the taxpayer shall assign the sale to Massachusetts to the extent that the intangible property is used in, or associated with, Massachusetts, through the means of a reasonable approximation.

ii. Agreement Not to Compete. An agreement or covenant not to compete in a specified geographic area requires the contract party to refrain from conducting certain business activity in that specified area. In the case of an agreement or covenant not to compete the receipts are to be assigned to a state based upon the percentage that reflects the state's population in the U.S. geographic area specified in the contract relative to the total population in such area.

iii. Taxpayer Not Taxable in State of Assignment. In any instance in which, pursuant to 830 CMR 63.38.1(9)(d)6.a.i. and ii., the state to which the sale is to be assigned can be determined or reasonably approximated, but where the taxpayer is not taxable in such state, the sale that would otherwise be assigned to such state shall be excluded from the numerator and denominator of the taxpayer's sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

63.38.1: continued

iv. Sale that Resembles a License (Receipts are Contingent on Productivity, Use or Disposition of the Intangible Property). In the case of a sale or exchange of intangible property where the receipts from the sale or exchange are contingent on the productivity, use or disposition of the property, the receipts from the sale shall be assigned by applying 830 CMR 63.38.1(9)(d)5. (pertaining to the license or lease of intangible property).

v. Sale that Resembles a Sale of Goods and Services. In the case of a sale or exchange of intangible property where the substance of the transaction resembles a sale of goods or services and where the receipts from the sale or exchange do not derive from payments contingent on the productivity, use or disposition of the property, the receipts from the sale shall be assigned by applying 830 CMR 63.38.1(9)(d)5.e. (relating to licenses of intangible property that resemble sales of goods and services). Examples of such transactions include those that are analogous to the license transactions cited as examples in 830 CMR 63.38.1(9)(d)5.e.

vi. Excluded Sales. The sale of a security as defined at 830 CMR 63.38.1(2) and the sale of business "goodwill" or similar intangible value, including, without limitation, "going concern value" and "workforce in place," shall be excluded from the numerator and denominator of a taxpayer's sales factor. *See* M.G.L. c. 63, § 38(f). Also, except as otherwise provided in 830 CMR 63.38.1(9)(d), the sale of intangible property that is not referenced in 830 CMR 63.38.1(9)(d)6.a.i., ii., iv., or v., shall be excluded from the numerator and the denominator of the taxpayer's sales factor. The sale of intangible property that is not referenced in 830 CMR 63.38.1(9)(d)6.a.i., ii., iv., or v., and that therefore is excluded from the numerator and denominator of the taxpayer's sales factor includes, without limitation, the sale of a partnership interest that is not otherwise a security within the meaning of 830 CMR 63.38.1(2).

b. Examples. Assume in each of these examples that the taxpayer that provides the service is taxable in Massachusetts and is to apportion its income pursuant to M.G.L. c. 63, § 38. Also, assume, where relevant, unless otherwise stated, that the taxpayer is taxable in each state other than Massachusetts to which some of its sales would be assigned, so that there is no requirement in such examples that such sales to other states must be excluded from the taxpayer's numerator and denominator. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

Example 1. Airline Corp., a corporation based outside Massachusetts, sells its rights to use several gates at an airport located in Massachusetts to Buyer Corp., a corporation that is based outside Massachusetts. The contract of sale is negotiated and signed outside of Massachusetts. The sale is in Massachusetts because the intangible property sold is a contract right that authorizes the holder to conduct a business activity solely in Massachusetts. *See* 830 CMR 63.38.1(9)(d)6.a.i.

Example 2. Wireless Corp., a corporation based outside Massachusetts, sells a license issued by the Federal Communications Commission (FCC) to operate wireless telecommunications services in a designated area in Massachusetts to Buyer Corp., a corporation that is based outside Massachusetts. The contract of sale is negotiated and signed outside of Massachusetts. The sale is in Massachusetts because the intangible property sold is a government license that authorizes the holder to conduct business activity solely in Massachusetts. *See id.*

Example 3. Same facts as in Example 2 except that Wireless Corp. sells to Buyer Corp. an FCC license to operate wireless telecommunications services in a designated area in Massachusetts and an adjacent state. Wireless Corp. must attempt to reasonably approximate the extent to which the intangible property is used in or associated with Massachusetts. For purposes of making this reasonable approximation, Wireless Corp. may rely upon credible data that identifies the percentage of persons that use wireless telecommunications in the two states covered by the license. *See id.*

63.38.1: continued

Example 4. Same facts as in Example 3 except that Wireless Corp. is not taxable in the adjacent state in which the FCC license authorizes it to operate wireless telecommunications services. The receipts paid to Wireless Corp. that would be assigned to the adjacent state must be excluded from the numerator and denominator of Wireless Corp's sales factor. *See* 830 CMR 63.38.1(9)(d)6.a.i.; 830 CMR 63.38.1(9)(d)1.f.ii.

Example 5. Sports League Corp., a corporation that is based outside Massachusetts, sells the rights to broadcast the sporting events played by the teams in its league in all 50 U.S. states to Network Corp. Although the games played by Sports League Corp. will be broadcast in all 50 states, the games are of greater interest in the northeast region of the country, including Massachusetts. Because the intangible property sold is a contract right that authorizes the holder to conduct a business activity in a specified geographic area, Sports League Corp. must attempt to reasonably approximate the extent to which the intangible property is used in or associated with Massachusetts. For purposes of making this reasonable approximation, Sports League Corp. may rely upon audience measurement information that identifies the percentage of the audience for its sporting events in Massachusetts and the other states. *See* 830 CMR 63.38.1(9)(d)6.a.i.

Example 6. Same facts as in Example 5, except that Sports League Corp. is not taxable in one state. The receipts paid to Sports League Corp. that would be assigned to that state must be excluded from the numerator and denominator of Sports League Corp.'s sales factor. *See* 830 CMR 63.38.1(9)(d)6.a.i.; 830 CMR 63.38.1(9)(d)1.f.ii.

Example 7. Business Corp., a corporation based outside Massachusetts engaged in business activities in Massachusetts and other states, enters into a covenant not to compete with Competition Corp., a corporation that is based outside Massachusetts, in exchange for a fee. The agreement requires Business Corp. to refrain from engaging in certain business activity in Massachusetts and other states. The component of the fee that constitutes a Massachusetts sale is determined by multiplying the amount of the fee by a fraction represented by the percentage of the Massachusetts population over the total population in the specified geographic region. *See* 830 CMR 63.38.1(9)(d)6.a.ii. In any case in which a portion of the fee would be assigned to a state in which Business Corp. is not taxable, such portion shall be excluded from the numerator and denominator of Business Corp.'s sales factor. *See* 830 CMR 63.38.1(9)(d)1.f.ii.

Example 8. Business Corp., a corporation that is commercially domiciled in Massachusetts, sells all of its assets including its business goodwill, to a business customer that is based in Massachusetts. The sale of the goodwill shall be excluded from the numerator and denominator of Business Corp.'s sales factor. *See* 830 CMR 63.38.1(9)(d)6.a.vi.

Example 9. Inventor Corp., a corporation that is based outside Massachusetts, sells patented technology that it has developed to Buyer Corp., a business customer that is based in Massachusetts. Assume that the sale is not one in which the receipts derive from payments that are contingent on the productivity, use or disposition of the property. *See* 830 CMR 63.38.1(9)(d)6.a.iv. Inventor Corp. understands that Buyer Corp. is likely to use the patented technology in Massachusetts, but the patented technology can be used anywhere (*i.e.*, the rights sold are not rights that authorize the holder to conduct a business activity in a specific geographic area). The sale of the patented technology shall be excluded from the numerator and denominator of Inventor Corp.'s sales factor. *See* 830 CMR 63.38.1(9)(d)6.a.vi.

63.38.1: continued

7. Special Rules.

a. Software Transactions. A license or sale of pre-written software for purposes other than commercial reproduction (or other exploitation of the intellectual property rights), when transferred on a tangible medium, is treated as the sale of tangible personal property, rather than as either the license or sale of intangible property or the performance of a service. In such cases, the receipts are in Massachusetts as determined under the rules for the sale of tangible personal property set forth at 830 CMR 63.38.1(9)(c). In all other cases, the receipts from a license or sale of software are to be assigned to Massachusetts as determined otherwise under 830 CMR 63.38.1 (*e.g.*, depending on the facts, as the development and sale of custom software, *see* 830 CMR 63.38.1(9)(d)4.c., as a license of a marketing intangible, *see* 830 CMR 63.38.1(9)(d)5.b., as a license of a production intangible, *see* 830 CMR 63.38.1(9)(d)5.c., as a license of intangible property where the substance of the transaction resembles a sale of goods or services, *see* 830 CMR 63.38.1(9)(d)5.e., or as a sale of intangible property, *see* 830 CMR 63.38.1(9)(d)6).

b. Sales or Licenses of Digital Goods or Services.

i. In General. In the case of a sale or license of digital goods or services, including, among other things, the sale of various video, audio and software products or similar transactions, the receipts from the sale or license shall be assigned by applying 830 CMR 63.38.1(9)(d)4.c.ii.(B) or (C), as if the transaction were a service delivered to an individual or business customer or delivered through or on behalf of an individual or business customer. For purposes of the analysis, it is not relevant what the terms of the contractual relationship are or whether the sale or license might be characterized, depending upon the particular facts, as, for example, the sale or license of intangible property or the performance of a service. *See* 830 CMR 63.38.1(9)(d)5.e. and (6)a.v.

ii Telecommunications Companies. In the case of a taxpayer that provides telecommunications or ancillary services and that is thereby subject to the provisions of 830 CMR 63.38.11, the sale or license of digital goods or services not otherwise assigned for apportionment purposes pursuant to 830 CMR 63.38.11 shall be assigned pursuant to 830 CMR 63.38.1(9)(d)7.b.ii., by applying 830 CMR 63.38.1(9)(d)4.c.ii.(B) or (C) as if the transaction were a service delivered to an individual or business customer or delivered through or on behalf of an individual or business customer. *See* 830 CMR 63.38.11(3). However, in applying such rules, if the taxpayer cannot determine the state or states where a customer receives the purchased product it may reasonably approximate this location using the customer's place of "primary use" of the purchased product, applying the definition of "primary use" set forth in 830 CMR 63.38.11.

c. Enforcement of Legal Rights. Receipts attributable to the protection or enforcement of legal rights of a taxpayer through litigation, arbitration, or settlement of legal disputes or claims, including the filing and pursuit of claims under insurance contracts, shall be excluded from the numerator and denominator of the taxpayer's sales factor. For purposes of 830 CR 63.38.1, in the case of a settlement agreement, it shall not be relevant how the parties to the agreement characterize the payment made under the agreement.

(e) Exclusion of Factors Related to Items Excluded from Federal Gross Income. Where items of gross income are excluded from the federal gross income of a taxpayer, the gross receipts to which such items of gross income are directly attributable are similarly excluded from the numerator and denominator of the taxpayer's sales factor. Also, any property or payroll (or appropriate portion thereof) that relate to such receipts are similarly excluded from the property or payroll factors of the taxpayer. *See also* 830 CMR 63.32B.2(7)(f).

(f) Sales Factor Consistency. A taxpayer must use the same rules for excluding or including gross receipts in both the numerator and the denominator of the sales factor. If the taxpayer changes its method of excluding or including gross receipts in the sales factor from the method used in its return in the prior year, the taxpayer must disclose in the return for the current year the fact of such change, the nature and extent of the change, and the reason for the change. The Commissioner may disregard changes in the current year or in future tax years if they have not been adequately disclosed. *See also* 830 CMR 63.38.1(9)(d)1.g.

63.38.1: continued

(10) Section 38 Manufacturers.

(a) General. A section 38 manufacturer that has income from business activity which is taxable both in Massachusetts and in another state shall determine the part of its net income derived from business carried on in Massachusetts by applying an apportionment percentage that shall be a fraction that is equal to the corporation's sales factor, determined under 830 CMR 63.38.1(9).

(b) Section 38 Manufacturer Defined.

1. General. A corporation is a section 38 manufacturer for any taxable year if (i) it is engaged in manufacturing during the taxable year and (ii) its manufacturing activity during the taxable year is substantial. A corporation that is so engaged in manufacturing and whose manufacturing activities are substantial is a section 38 manufacturer for the taxable year regardless of whether, or to what extent, it conducts its manufacturing activities in Massachusetts. The principles set forth in 830 CMR 58.2.1(6)(b): *Manufacturing* apply for purposes of determining whether a process constitutes manufacturing.

2. Substantial Manufacturing. A corporation's manufacturing activity is substantial for any taxable year if the corporation meets any of the following tests:

a. The corporation derives 25% or more of its receipts for the taxable year from the sale of manufactured goods that the corporation manufactures;

b. The corporation pays 25% or more of its payroll for the taxable year to employees working in manufacturing operations and derives 15% or more of its receipts for the taxable year from the sale of manufactured goods that the corporation manufactures;

c. The corporation uses 25% or more of its tangible property in manufacturing during the taxable year and derives 15% or more of its receipts for the taxable year from the sale of manufactured goods that the corporation manufactures;

d. The corporation uses 35% or more of its tangible property in manufacturing during the taxable year.

3. Coordination with 830 CMR 58.2.1: *Manufacturing Corporations*. For purposes of 830 CMR 63.38.1(10)b.2., the following shall apply.

a. For any taxable year, the percentage of receipts derived from a corporation's sale of manufactured goods that it manufactures shall be equal to the gross receipts fraction determined for that taxable year under 830 CMR 58.2.1(6)(e)1.: *Gross Receipts Fraction*, except that gross receipts attributable to business activities (including manufacturing activities) performed outside Massachusetts shall be taken into account in the fraction;

b. For any taxable year, the percentage of payroll paid to employees working in manufacturing operations shall be equal to the employees fraction determined for that taxable year under 830 CMR 58.2.1(6)(e)3.: *Employees Fraction*, except that payroll attributable to business activities (including manufacturing activities) performed outside Massachusetts shall be taken into account in the fraction; and

c. For any taxable year, the percentage of tangible property used in manufacturing operations shall be equal to the tangible property fraction determined for that taxable year under 830 CMR 58.2.1(6)(e)2.: *Tangible Property Fraction*, except that tangible property used in business activities (including manufacturing activities) performed outside Massachusetts shall be taken into account in the fraction.

(11) One or More Factors Inapplicable.

(a) Three Factor Apportionment. Where a taxpayer is required to determine the part of its net income derived from business carried on in Massachusetts using an apportionment percentage that employs three factors, the following shall apply:

1. Two Factors Applicable. In cases where only two of the three apportionment factors (property, payroll, sales) are applicable, the taxable net income of the taxpayer is apportioned by a fraction, the numerator of which is the remaining two factors with their respective weights and the denominator of which is the number of times that such factors are used in the numerator.

2. One Factor Applicable. In cases where only one of the three apportionment factors (property, payroll, sales) is applicable, the taxable net income of the taxpayer is apportioned solely by that factor with its respective weight, and the denominator is the number of times the factor is used in the numerator.

63.38.1: continued

3. No Factors Applicable. In cases where none of the three apportionment factors (property, payroll, sales) is applicable, the taxable net income of the taxpayer is presumed to be 100% apportioned to Massachusetts unless the taxpayer demonstrates that such apportionment will not reasonably approximate its income derived from business carried on within Massachusetts. Where none of the three apportionment factors is applicable to a taxpayer's activities, the taxpayer is encouraged to apply for alternative apportionment under M.G.L. c. 63, § 42.

4. Determination of Applicability. For purposes of determining whether a factor is applicable, the following shall apply:

a. A factor is not inapplicable merely because the numerator of the factor is zero. However, a factor is inapplicable if both its numerator and denominator are zero.

b. A factor is inapplicable and, consequently, is not used to calculate a taxpayer's apportionment percentage if the denominator of the factor is less than 3.33% of the taxpayer's taxable net income, or if the factor is otherwise determined to be insignificant in producing income.

(b) Single Factor Apportionment. Where (i) a taxpayer is required to determine the part of its net income derived from business carried on in Massachusetts using its sales factor only and (ii) the sales factor is inapplicable, then the taxable net income of the taxpayer is presumed to be 100% apportioned to Massachusetts unless the taxpayer demonstrates that such apportionment will not reasonably approximate its income derived from business carried on within Massachusetts. Under these circumstances, the taxpayer is encouraged to apply for alternative apportionment under M.G.L. c. 63, § 42. In the instance of a Section 38 manufacturer the sales factor is inapplicable if the denominator of the factor is less than 3.33% of the taxpayer's taxable net income, or if the factor is otherwise determined to be insignificant in producing income.

(12) Corporate Partners. A corporation with an interest in a partnership must include its distributive share of the partnership income, loss, or deduction in calculating its income, in accordance with 26 U.S. Code and M.G.L. c. 63. The character of any item included in the distributive share is determined as if it were realized or incurred directly by the corporation. Except as otherwise provided, the trade or business of the partnership is treated as the trade or business of the corporation. For purposes of determining whether the corporation is a mutual fund service corporation or a Section 38 manufacturer, the corporation's *pro rata* share (as defined in 830 CMR 63.38.1(12)(f)) of all of the partnership's items, factors and activities shall be taken into account to the extent relevant to the determination, whether or not the corporation and the partnership are engaged in related business activities. If the partnership and corporate partner are engaged in related business activities, the corporation's *pro rata* share (as defined in 830 CMR 63.38.1(12)(f)) of partnership property, payroll, and sales are included in the partner's apportionment factors, subject to the special rules provided in 830 CMR 63.38.1(12)(d). (Except as otherwise expressly stated, the partnership rules provided in 830 CMR 63.38.1(12) presume that a partnership and corporate partner are engaged in related business activities.)

(a) Taxable in Massachusetts.

1. A corporation that is not otherwise subject to Massachusetts tax jurisdiction is nevertheless taxable in Massachusetts if it is a general partner in a partnership whose activities, if conducted directly by the corporation, would subject the corporation to the excise under M.G.L. c. 63, § 39. *See* 830 CMR 63.39.1(8).

2. In general, a corporation that is not otherwise subject to Massachusetts tax jurisdiction is taxable in Massachusetts if it is a limited partner in a partnership whose activities, if conducted directly by the corporation, would subject the corporation to the excise under M.G.L. c. 63, § 39. However, as provided in 830 CMR 63.38.1(4)(d), the business activities of the partnership and the corporate limited partner are, in certain circumstances, presumed to be unrelated, so that unless the presumption is rebutted, such partner is taxable in Massachusetts only with respect to the partnership activity. Moreover, under the circumstances described in 830 CMR 63.39.1(8)(b) through (d) (relating to certain partnerships dealing in securities, publicly traded partnerships, and certain de minimis limited partnership holdings), the activities of the partnership are not attributed to the corporation, and the corporation is not taxable in Massachusetts merely by virtue of holding such a limited partnership interest.

63.38.1: continued

(b) Taxable in Another State. A corporation is taxable in another state within the meaning of 830 CMR 63.38.1(5) if the corporation is a general partner in a partnership with business activities in that state that cause either the partnership or its partners to be taxable in that state described in 830 CMR 63.38.1(5). A corporation that is a limited partner in a partnership with business activity in another state is taxable in another state within the meaning of 830 CMR 63.38.1(5) if and to the extent that the corporation would be taxed in Massachusetts under the same facts and circumstances that exist in the other state. A corporation holding a limited partnership interest in a partnership that does business in another state is taxable in the other state for purposes of apportioning its partnership income, but not for purposes of apportioning income from its other business activities, unless the corporate partner and the partnership are engaged in related business activities, or unless the corporate partner is separately taxable in the other state on the basis of its other (unrelated) business activities.

(c) Income Measure of the Excise. When computing its net income for the taxable year, a corporation must include its distributive share of partnership items for any partnership year ending with or within its taxable year. The following examples illustrate the application of 830 CMR 63.38.1(12)(c):

1. Corporation C holds a 20% profits interest in Partnership P. C's income for the year was $1,000,000 and P's income for the same year was $800,000. The income of C is $1,160,000 ($1,000,000 plus 20% of $800,000).

2. Corporation C holds a 90% profits interest in Partnership P. C incurred a loss of $500,000 for the year but P's income was $1,000,000. The income of C is $400,000 (90% of $1,000,000 = $900,000 less the loss of $500,000).

(d) Special Apportionment Rules. In general, if a corporate partner is taxable in another state, it must apportion its taxable net income using the apportionment percentage in M.G.L. c. 63, § 38. However, the following shall apply:

1. Property Factor. In determining the denominator of its property factor, a corporate partner must include its *pro rata* share of the total value of the partnership's real and tangible personal property, owned or rented, used during the partnership's taxable year. In determining the numerator of its property factor, a corporate partner must include its pro rata share of the value of such property located in Massachusetts.

a. In order to avoid duplication, however, certain adjustments must be made to the value of any property leased or rented by the corporation to the partnership or vice versa.

i. Where a corporation rents property to the partnership, it must include the original cost of the property in its property factor. No portion of the value of this property as rental property of the partnership is included.

ii. Where the partnership rents property to the corporation, the corporation includes in its property factor the sum of:

A. the original cost of the property multiplied by the corporation's percentage of interest in the partnership; plus

B. eight times the net annual rental rate of the property, multiplied by the difference between 100% and the corporation's percentage of interest in the partnership.

b. The following examples illustrate the application of 830 CMR 63.38.1(12)(d)1.:

i. Corporation C has a 20% profits interest in Partnership P. C owns a building (original cost $100,000) which it rents to P at a fair market rate of $12,000 per year. C must include the $100,000 original cost of the building in its property factor. No portion of the value of the property as rental property of the partnership is included in C's property factor.

ii. The facts are the same as in the previous example except that P owns the building and rents it to C. C will include $20,000 (20% of $100,000) in its property factor because of its interest in P. C will also include $76,800 ([$12,000 x 8] x 80%) in its property factor to account for the rented building used in its operations. Thus, the building's value in C's property factor is $96,800 ($20,000, plus $76,800).

63.38.1: continued

2. Payroll Factor. In determining the denominator of its payroll factor, a corporate partner must include its *pro rata* share of the total compensation paid by the partnership during the partnership's taxable year. In determining the numerator of its payroll factor, a corporate partner must include its *pro rata* share of such compensation paid in Massachusetts during the taxable year. The following example illustrates the application of 830 CMR 63.38.1(12)(d)2.:

Corporation C has a 20% profits interest in Partnership P. C's own payroll is $1,000,000, half of which is attributable to Massachusetts employees, and P's payroll is $800,000, one quarter of which is attributable to Massachusetts employees. The denominator of C's payroll factor is $1,160,000 ($1,000,000, plus 20% of $800,000, or $160,000). The numerator of C's payroll factor is $540,000 (50% of $1,000,000 plus 25% of $160,000).

3. Sales Factor. In determining the denominator of its sales factor, a corporate partner must include its *pro rata* share of the partnership's total sales during the partnership's taxable year. In determining the numerator of its sales factor, a corporate partner must include its *pro rata* share of such sales in Massachusetts.

a. In order to avoid duplication, however, the following sales must be eliminated from both the numerator and denominator of the sales factor:

i. sales by the corporation to the partnership in an amount equal to the total of such sales multiplied by the corporation's profits interest in the partnership; and

ii. sales by the partnership to the corporation in an amount not to exceed the total of all sales made by the partnership multiplied by the corporation's profits interest in the partnership.

b. The following examples illustrate the application of 830 CMR 63.38.1(12)(d)3.

i. Corporation C's profits interest in Partnership P is 20%. C's sales were $20,000,000 for the year, $5,000,000 of which were made to P. P made sales of $10,000,000 during the same year, none of which were to C or the other partners.

The denominator of C's sales factor is $21,000,000 determined as follows:

Sales by Corporation C ……		20,000,000
Add: Corporation C's interest (20%) in Partnership P's sales ……	2,000,000	
Less: Corporation C's interest (20%) in Corporation C's sales to Partnership P ……	1,000,000	1,000,000
Denominator of sales factor ……		21,000,000

ii. The following facts apply to examples A. through C. below. Corporation C's profits interest in Partnership P is 20%, and Corporation D's profits interest is 80%.

A. The sales made by C, D, and P are as follows:

Corporation C ……		20,000,000
Corporation D ……		60,000,000
Partnership P:		
To Corporation C ……	2,000,000	
To Corporation D ……	8,000,000	
		10,000,000

The denominator of Corporation C's sales factor is $20,000,000 determined as follows:

Sales by Corporation C ……	20,000,000	
Add: Corporation C's interest (20%) in Partnership P's sales ……	2,000,000	
Less: Partnership P's sales to Corporation C ……	2,000,000	-0-

63.38.1: continued

The denominator of Corporation D's sales factor is $60,000,000 determined as follows:

Sales by Corporation D …….....……		60,000,000
Add: Corporation D's interest (80%) in Partnership P's sales …….....	8,000,000	
Less: Partnership P's sales to Corporation D ….....	8,000,000	-0-
		60,000,000

B. The sales made by Corporation C, Corporation D, and Partnership P are as follows:

Corporation C ..…….….		20,000,000
Corporation D ……		60,000,000
Partnership P:		
To Corporation C ……	1,000,000	
To Corporation D ……	9,000,000	
		10,000,000

The denominator of Corporation C's sales factor is $21,000,000 determined as follows:

Sales by Corporation C …….....		20,000,000
Add: Corporation C's interest (20%) in Partnership P's sales ….....…….....	2,000,000	
Less: Partnership P's sales to Corporation C ….....	1,000,000	1,000,000
Denominator of Corporation C's sales factor …….....		21,000,000

The denominator of Corporation D's sales factor is $60,000,000 determined as follows:

Sales by Corporation D …….....….....		60,000,000
Add: Corporation D's interest (80%) in Partnership P's sales ……..	8,000,000	
Less: Intercompany sales between Partnership P and Corporation D …….....	8,000,000 [1]	-0-
Denominator of Corporation D's sales factor..... ……		60,000,000

C. The sales made by Corporation C, Corporation D, and Partnership P are as follows:

Corporation C …….....		20,000,000
Corporation D …….....		80,000,000
Partnership P:		
To Corporation C ……	3,000,000	
To Corporation D ……	6,000,000	
To Corporation X ……	1,000,000	10,000,000

[1] Not to exceed taxpayer's interest in Partnership P's sales.

63.38.1: continued

The denominator of Corporation C's sales factor is $20,200,000 determined as follows:

Sales by Corporation C …….....		20,000,000
Add: Corporation C's interest in Partnership P's sales to nonpartner X Corporation (20% x $1,000,000) …….....		200,000
Corporation C's interest in Partnership P's sales to Partners (20% x $9,000,000) …….....	1,800,000	
Less: Intercompany sales from Partnership P to Corporation C …….....	1,800,000 [2]	-0-
Denominator of Corporation C's sales factor …….....		20,200,000

The denominator of Corporation D's sales factor is $82,000,000 determined as follows:

Sales by Corporation D …….....		80,000,000
Add: Corporation D's interest in Partnership P's sales to nonpartner X Corporation (80% x $1,000,000) …….....		800,000
Corporation D's interest in Partnership P's sales to Partners (80% x $9,000,000).....	7,200,000	
Less: Intercompany sales from Partnership P to Corporation D …	6,000,000	82,000,000

(e) For purposes of the non-income measure of the excise, the classification and valuation of a general or limited partnership interest shall be determined by the books and records of the corporation, as maintained under generally accepted accounting principles (GAAP), as provided as follows:

1. Where (i) a corporation's ownership interest in a general or limited partnership (as determined under GAAP) is less than 20% and (ii) the corporation and the partnership are not required to be included in the same consolidated or combined financial statement under GAAP, the corporation shall use the cost method of accounting for its investment in the partnership.
2. Where (i) a corporation's ownership interest in a general or limited partnership (as determined under GAAP) is 20% or more and (ii) the corporation and the partnership are not required to be included in the same consolidated or combined financial statement under GAAP, the corporation shall use the equity method of accounting for its investment in the partnership.
3. Where (i) a corporation owns any interest in a general or limited partnership and (ii) the corporation and the partnership are required to be included in the same consolidated or combined financial statement under GAAP, the corporation may account for its investment in the partnership either (i) by using the equity method or (ii) by consolidating or combining its assets and activities with those of the partnership in the manner required by GAAP; provided that the corporation must use the same method to report its interest in partnerships consistently from taxable year to taxable year.

[2] Not to exceed taxpayer's interest in Partnership P's sales.

63.38.1: continued

(f) *Pro Rata* Share. For purposes of 830 CMR 63.38.1(12), a partner's *pro rata* share of a partnership's items, factors and activities shall be its percentage interest in partnership profit or loss for the taxable year, as stated on the partner's Schedule K-1, provided however, that if, under the partnership agreement, a partner's share of gain or loss from the sale of particular partnership assets is specially allocated in a manner different from its profit or loss ratio stated on Schedule K-1, and such special allocation has "substantial economic effect" as defined in Treas. Reg. § 1.704-1(b)(2), gross receipts from sales of such assets shall be assigned to its sales factor in the same proportion as the partner's interest in gain or loss from the sale. In the event of a termination or other change in a partner's interest during the taxable year, the partner's *pro rata* share of payroll and sales must be modified to reflect partnership payroll and sales during the actual period that the partner held its interest.

(13) Alternative Apportionment Methods.

(a) If a taxpayer claims that the allocation or apportionment provisions of 830 CMR 63.38.1 are not reasonably adapted to approximate the net income derived from business carried on in Massachusetts, a taxpayer may apply to the Commissioner to have such income determined by an alternative apportionment method pursuant to the provisions of M.G.L. c. 63, § 42 and 830 CMR 63.42.1.

(b) The provisions of 830 CMR 63.38.1(13)(a), notwithstanding, if the Commissioner determines that the apportionment provisions of 830 CMR 63.38.1 are not reasonably adapted to approximate the net income derived from business carried on in Massachusetts by certain industries, the Commissioner may, by regulation, adopt alternative apportionment provisions for such industries. To the extent the Commissioner adopts alternative apportionment regulations for certain industries, the rules contained in the alternative apportionment regulations will supersede the provisions of 830 CMR 63.38.1 to the extent provided.

(14) Effective Dates. The provisions in 830 CMR 63.38.1 generally shall apply to tax years beginning on or after January 2, 2015, except to the extent that a provision (i) is subject to a specific effective date provided in 830 CMR 63.38.1, (ii) is subject to a specific effective date created by legislation (including the rules enacted pursuant to St. 2013, c. 46, § 37, pertaining to the sales factor apportionment of sales of other than tangible personal property, which are effective for taxable years beginning on or after January 1, 2014, *see* 830 CMR 63.38.1(9)(d)), or (iii) reflects a position appearing in a prior public written statement or other Department of Revenue publication, including electronic publication. All rules that antedate 830 CMR 63.38.1, whether appearing in a prior public written statement or other Department of Revenue publication, continue in force and effect except to the extent any such rules are revised or altered by 830 CMR 63.38.1. 830 CMR 63.38.1 notwithstanding, for periods prior to January 2, 2015, the Commissioner reserves the right to assert a position reflected in this regulation that is not inconsistent with a prior public written statement, and that otherwise is consonant with the law in effect at that time.

63.38.2: Apportionment of Income of Airlines

(1) General. If an airline has income derived from business carried on both within and outside Massachusetts, the Commissioner shall determine the amount of the airline's income derived from business carried on within Massachusetts pursuant to M.G.L. c. 63, § 38, and applicable regulations, in particular 830 CMR 63.38.1, except to the extent that 830 CMR 63.38.1 and the applicable regulations are modified pursuant to 830 CMR 63.38.2. 830 CMR 63.38.2, has been issued pursuant to the commissioner's authority under M.G.L. c. 63, § 38(j).

830 CMR 63.38.2 states rules for determining the property factor and the payroll factor of the apportionment formula that applies to airlines, because the apportionment provisions of M.G.L. c. 63, § 38 are not reasonably adapted under the Apportionment of Income regulation, 830 CMR 63.38.1, to approximate the net income derived from business carried on within Massachusetts by an airline with respect to the property and payroll factors. The rules for determining the sales factor for an airline under the Apportionment of Income regulation, 830 CMR 63.38.1(9), particularly at 830 CMR 63.38.1(9)(d)4.b.iii., however, are reasonably adapted to approximate such income with respect to the sales factor, and are thus not restated in 830 CMR 63.38.2. *See* also, 830 CMR 63.38.1(9)(d)1.h. ("Industry-specific Alternative Apportionment Rules").

63.38.2: continued

Once the property and payroll factors of the apportionment formula for an airline are determined under the provisions of 830 CMR 63.38.2, a taxpayer will use those factors in calculating its apportionment percentage under M.G.L. c. 63, § 38, and the applicable regulations.

A taxpayer may have characteristics of an airline, a courier and package delivery service, as defined in 830 CMR 63.38.4, and/or a motor carrier, as defined in 830 CMR 63.38.3, as in the example of a taxpayer that accepts and delivers a package using both air and ground transportation. In such cases, the Apportionment of Income of Courier and Package Delivery Services regulation, 830 CMR 63.38.4, applies.

(2) Definitions.

Aircraft Ready for Flight, aircraft in the possession of the airline that are available for service on its routes.

Airline, any business entity that, for compensation, transports passengers or freight by air.

Departure, a take-off by an aircraft with passengers or freight.

Flight Personnel, the air crew aboard an aircraft assisting in the operations of the aircraft or the welfare of passengers while in the air.

Nonflight Personnel, all employees other than flight personnel.

(3) Determining Property and Payroll Factors for Airline Corporations.

(a) Property Factor. An airline's property factor is a fraction, the numerator and denominator of which are determined according to 830 CMR 63.38.2(3)(a)1. through 5.

1. The denominator of the property factor is the average value of all of the airline's real and tangible personal property owned, rented, or leased, and used during the taxable year. All property values are determined according to the rules of M.G.L. c. 63, § 38, and 830 CMR 63.38.1.

2. The numerator of the property factor shall be the sum of the following two amounts:

a. the average value of the real and tangible personal property of the airline, other than aircraft ready for flight, situated in Massachusetts; and

b. the average value of the aircraft ready for flight owned or rented and used by the airline in Massachusetts.

3. The average value of the aircraft ready for flight owned or rented and used by the airline in Massachusetts shall be computed separately for each type of aircraft operated by the airline. For each type of aircraft, the value shall consist of the total average value of that type of aircraft ready for flight owned by the airline, multiplied by the percentage of departures of the airline, of that aircraft type, taking place within Massachusetts.

4. Property in the possession of an airline under the terms of a lease, which is treated as a lease for federal income tax purposes by operation of provisions contained or previously contained in 26 U.S. Code § 168 (the Internal Revenue Code), shall be treated as owned, not rented, by the airline.

5. Example 1. During the taxable year, Wingit Airways owned real and tangible personal property, other than aircraft ready for flight, with an average value of $20,000,000. Of this property, a portion with an average value of $10,000,000 was located in Massachusetts. Wingit also owned ten Boeing 727-200s and five Lockheed L1011-500s. The total average value of the 727-200s ready for flight was $90,000,000 and the total average value of the L1011-500s ready for flight was $150,000,000. Wingit's 727-200s made 2,000 departures during the taxable year, of which 1,000 occurred in Massachusetts, and Wingit's L1011-500s made 1200 departures during the taxable year, of which 800 occurred in Massachusetts. The numerator of Wingit's property factor consists of $10,000,000 (the average value of the airline's real and tangible personal property other than aircraft ready for flight located in Massachusetts) plus $45,000,000 (the total average value of Wingit's 727-200s ready for flight, multiplied by the proportion of the airline's departures of that aircraft type occurring in Massachusetts, namely 50%) plus $100,000,000 (the total average value of Wingit's

63.38.2: continued

L1011-500s ready for flight, multiplied by the proportion of the airline's departures of that aircraft type occurring in Massachusetts, namely 66.67%). The denominator of the property factor is $260,000,000, the total value of Wingit's real and tangible personal property, including aircraft ready for flight. Thus, Wingit's property factor equals:

$$\frac{\$10,000,000 + \$45,000,000 + \$100,000,000}{\$260,000,000},$$

or .5962.

(b) Payroll Factor. An airline's payroll factor is a fraction, the numerator and denominator of which are determined according to 830 CMR 63.38.2(3)(b)1. through 4.

1. The denominator of the payroll factor is the total compensation paid by the airline during the taxable year.
2. The numerator of the payroll factor is the sum of the following two amounts:
   a. the compensation paid in Massachusetts to nonflight personnel during the taxable year; and
   b. the compensation paid in Massachusetts to flight personnel during the taxable year.
3. The compensation paid in Massachusetts to flight personnel shall be computed by multiplying the airline's total payroll for flight personnel by the percentage of the airline's aircraft departures occurring in Massachusetts weighted, in a manner similar to that described in 830 CMR 63.38.2(3)(a), by the values of the aircraft types operated by the airline.
4. Example 2. Wingit Airways, the airline described in Example 1, had a total payroll for nonflight personnel during the taxable year of $25,000,000, of which $10,000,000 was paid to nonflight personnel based in Massachusetts. The airline had a total payroll for flight personnel of $20,000,000. Based on the aircraft values and departure figures set forth in Example 1, 60.44% of Wingit's payroll for flight personnel, or $12,088,000, was paid in Massachusetts. Specifically:

90,000,000 [total value of 727-200s]
240,000,000 [total value of aircraft ready for flight]

x 50% percentage of 727-200s departing from Massachusetts] = .1875

plus

150,000,000 [total value of L1011-500s]
240,000,000 [total value of aircraft ready for flight]

X 66.67% [percentage of L1011-500s departing from Massachusetts] = .4167

Equals .6042

Thus, Wingit's payroll factor equals:

$10,000,000	[nonflight in MA]	+	$12,084,000	[flight in MA]
$25,000,000	[total nonflight personnel]	+	$20,000,000	[total flight]

or .4908.

(4) Determining the Sales Factor for Airlines. The sales factor of an airline shall be determined according to the rules generally applicable to corporations under the Apportionment of Income regulation. *See* generally 830 CMR 63.38.1(9). *See* also 830 CMR 63.38.1(9)(d)4.b.iii. ("Transportation and Delivery Services"), 830 CMR 63.38.1(9)(d)1.h. ("Industry-specific Alternative Apportionment Rules").

63.38.2: continued

(5) Effective Date. 830 CMR 63.38.2, is effective for taxable years beginning on or after January 1, 2014.

63.38.3: Apportionment of Income of Motor Carriers

(1) General. If a motor carrier has income derived from business carried on both within and outside Massachusetts, the Commissioner shall determine the amount of the motor carrier's income derived from business carried on within Massachusetts pursuant to M.G.L. c. 63, § 38, and applicable regulations, in particular 830 CMR 63.38.1, except to the extent that 830 CMR 63.38.1 and the applicable regulations are modified pursuant to 830 CMR 63.38.2. 830 CMR 63.38.3, has been issued pursuant to the commissioner's authority under M.G.L. c. 63, § 38(j).

830 CMR 63.38.3 states rules for determining the property factor and the payroll factor of the apportionment formula that applies to motor carriers, because the apportionment provisions of M.G.L. c. 63, § 38 are not reasonably adapted under the Apportionment of Income regulation, 830 CMR 63.38.1, to approximate the net income derived from business carried on within Massachusetts by a motor carrier with respect to the property and payroll factors. The rules for determining the sales factor for a motor carrier under the Apportionment of Income regulation, 830 CMR 63.38.1(9), particularly at 830 CMR 63.38.1(9)(d)4.b.iii., however, are reasonably adapted to approximate such income with respect to the sales factor, and are thus not restated in 830 CMR 63.38.3. *See* also 830 CMR 63.38.1(9)(d)1.h., "Industry-specific Alternative Apportionment Rules."

Once the property and payroll factors of the apportionment formula for a motor carrier are determined under the provisions of 830 CMR 63.38.3, a taxpayer will use those factors in calculating its apportionment percentage under M.G.L. c. 63, § 38, and the applicable regulations.

A taxpayer may have characteristics of a motor carrier, a courier and package delivery service, as defined in 830 CMR 63.38.4, and/or an airline, as defined in 830 CMR 63.38.2, as in the example of a taxpayer that accepts and delivers a package using both air and ground transportation. In such cases, the Apportionment of Income of Courier and Package Delivery Services regulation, 830 CMR 63.38.4, applies.

(2) Definitions.

Mobile Property, all motor vehicles, including trailers, engaged directly in the movement of property or passengers, other than vehicles eighty percent or more of whose mileage is traveled in one state. Mobile property may be owned, rented, or leased by the motor carrier.

Motor Carrier, any business entity, including an individual owner/operator, which engages in the carriage of passengers or freight, for compensation, on the public roads or highways. A vendor that uses its own vehicles to transport goods that it has sold is not, on that account alone, a motor carrier.

Operating Personnel, personnel who operate or travel in mobile property as the predominant activity of their employment.

(3) Determining Property and Payroll Factors for Motor Carriers.

(a) Property Factor. A motor carrier's property factor is a fraction, the numerator and denominator of which are determined according to the following rules.

1. The denominator of the property factor is the average value of all of the motor carrier's real and tangible personal property owned, rented, or leased, and used during the taxable year. All property values are determined according to M.G.L. c. 63, § 38, and 830 CMR 63.38.1.

2. The numerator of the property factor is the sum of the following two amounts:

a. the value of the real and tangible personal property of the motor carrier, other than mobile property, situated in Massachusetts; and

b. the value of the mobile property owned, rented, or leased and used by the motor carrier in Massachusetts.

3. The value of the mobile property owned, rented, or leased, and used by the motor carrier in Massachusetts is the total value of the motor carrier's mobile property, multiplied by the percentage of miles traveled by the motor carrier's mobile property in Massachusetts.

63.38.3: continued

4. Example 1. During the taxable year, Kiepahn Trucking owned real and tangible personal property, other than mobile property, with an average value of $10,000,000. Of this property, a portion with an average value of $5,000,000 was located in Massachusetts. Kiepahn also owned mobile property worth $7,000,000. 30% of Kiepahn's mileage was traveled in Massachusetts. The numerator of Kiepahn's property factor is $5,000,000 (the value of its real and tangible personal property other than mobile property located in Massachusetts) plus $2,100,000 (30% of the value of its mobile property). The denominator of Kiepahn's property factor is $17,000,000 (the total value of Kiepahn's real and tangible personal property, including mobile property). Thus, Kiepahn's property factor equals:

$$\frac{\$5{,}000{,}000 + \$2{,}100{,}000}{\$17{,}000{,}000}$$

or .4176.

(b) Payroll Factor. A motor carrier's payroll factor is a fraction, the numerator and denominator of which are determined according to the following rules.

1. The denominator of the payroll factor is the total compensation paid by the motor carrier during the taxable year.
2. The numerator of the payroll factor is the sum of the following two amounts:
   a. the compensation paid in Massachusetts to personnel other than operating personnel; and
   b. the compensation paid in Massachusetts to operating personnel.
3. The compensation paid in Massachusetts to operating personnel shall be computed by multiplying the motor carrier's total payroll for operating personnel by the percentage of miles traveled by the motor carrier's mobile property in Massachusetts.
4. Example 2. During the taxable year, Kiepahn Trucking, the motor carrier described in Example 1, had a total payroll for personnel other than operating personnel of $3,000,000, of which $1,000,000 was paid in Massachusetts. Kiepahn had a total payroll for operating personnel of $4,000,000. 30% of Kiepahn's miles were traveled in Massachusetts. The numerator of Kiepahn's payroll factor is $1,000,000 (the Massachusetts payroll for persons other than operating personnel) plus $1,200,000 (30% of Kiepahn's payroll for operating personnel). The denominator of Kiepahn's payroll factor is its total payroll of $7,000,000. Thus, Kiepahn's payroll factor equals:

$$\frac{\$1{,}000{,}000 + \$1{,}200{,}000}{\$7{,}000{,}000},$$

or .3143.

(4) Determining the Sales Factor for Motor Carriers. The sales factor of a motor carrier is determined according to the rules generally applicable to corporations under the Apportionment of Income regulation. *See* generally 830 CMR 63.38.1(9). *See* also 830 CMR 63.38.1(9)(d)4.b.iii. ("Transportation and Delivery Services"), 830 CMR 63.38.1(9)(d)1.h. ("Industry-specific Alternative Apportionment Rules").

(5) Effective Date. 830 CMR 63.38.3, is effective for taxable years beginning on or after January 1, 2014.

63.38.4: Apportionment of Income of Courier and Package Delivery Services

(1) General. If a courier or package delivery service has income derived from business carried on both within and outside Massachusetts, the Commissioner shall determine the amount of its income derived from business carried on within Massachusetts pursuant to M.G.L. c. 63, § 38, and applicable regulations, in particular 830 CMR 63.38.1, except to the extent 830 CMR 63.38.1 and the applicable regulations are modified pursuant to 830 CMR 63.38.4. 830 CMR 63.38.4, has been issued pursuant to the commissioner's authority under M.G.L. c. 63, § 38(j).

63.38.4: continued

830 CMR 63.38.4 states rules for determining the property factor and the payroll factor of the apportionment formula that applies to courier and package delivery services, because the apportionment provisions of M.G.L. c. 63, § 38 are not reasonably adapted under the Apportionment of Income regulation, 830 CMR 63.38.1, to approximate the net income derived from business carried on within Massachusetts by a courier or package delivery service with respect to the property and payroll factors. The rules for determining the sales factor for a courier or package delivery services under the Apportionment of Income regulation, 830 CMR 63.38.1(9), particularly at 830 CMR 63.38.1(9)(d)4.b.iii., however, are reasonably adapted to approximate such net income with respect to the sales factor, and thus are not restated in 830 CMR 63.38.4. *See* also, 830 CMR 63.38.1(9)(d)1.h., "Industry-specific Alternative Apportionment Rules."

Once the property and payroll factors of the apportionment formula for a courier or package delivery service are determined under the provisions of 830 CMR 63.38.4, a taxpayer will use those factors in calculating its apportionment percentage under M.G.L. c. 63, § 38, and the applicable regulations.

A taxpayer may have characteristics of a courier and package delivery service, an airline, as defined in 830 CMR 63.38.2, and/or a motor carrier, as defined in 830 CMR 63.38.3, as in the example of a taxpayer that accepts and delivers packages using both air and ground transportation. In such cases this regulation, Apportionment of Income of Courier and Package Delivery Services regulation, 830 CMR 63.38.4, applies.

(2) Definitions.

Aircraft Ready for Flight, aircraft in possession of the company that are available for service on its routes.

Courier or Package Delivery Service, any company that transmits packages or written communications primarily to residences and business addresses. A company that receives written communications, and transmits facsimiles to recipients by electronic or other means, shall also be a courier or package delivery service for purposes of 830 CMR 63.38.4. A vendor that transports goods that it has sold to its customers' residences or business addresses is not on that account alone, a courier or package delivery service.

Flight Personnel, the air crew aboard an aircraft assisting in the operations of the aircraft.

Nonflight Mobile Personnel, personnel who operate or travel in nonflight mobile property as the predominant activity of their employment.

Nonflight Mobile Property, all motor vehicles, including trailers, engaged directly in the movement of property, other than aircraft and other than vehicles eighty percent or more of whose mileage is traveled in one state. Mobile property may be owned, rented, or leased by the courier or package delivery service.

(3) Determining Property and Payroll Factors for Courier or Package Delivery Services.

(a) Property Factor. A courier or package delivery service's property factor is a fraction, the numerator and denominator of which are determined according to 830 CMR 63.38.4(3)(a)1. through 6.

1. The denominator of the property factor is the average value of all of the company's real and tangible personal property owned or rented and used during the taxable year. All property values are determined according to the rules of M.G.L. c. 63, § 38, and 830 CMR 63.38.1.

2. The numerator of the property factor shall be the sum of the following three amounts:

a. the average value of the real and tangible personal property used by the company, other than aircraft ready for flight and nonflight mobile property, situated in Massachusetts;

b. the average value of the aircraft ready for flight owned or rented and used by the company in Massachusetts; and

63.38.4: continued

c. the average value of the nonflight mobile property owned or rented and used by the company in Massachusetts.

3. The average value of the aircraft ready for flight owned or rented and used by the company in Massachusetts shall be computed separately for each type of aircraft operated by the company. For each type of aircraft, the average value shall consist of the total average value of that type of aircraft ready for flight owned by the company, multiplied by the percentage of departures of the company, of that aircraft type, taking place within Massachusetts. For further guidance on this method of valuation, *see* "Apportionment of Income of Airlines", 830 CMR 63.38.2(3)(a).

4. The average value of the nonflight mobile property owned or rented and used by the company in Massachusetts shall be the total value of the company's nonflight mobile property, multiplied by the percentage of miles traveled by the company's nonflight mobile property in Massachusetts.

5. Property in the possession of the company under the terms of a lease, which is treated as a lease for federal income tax purposes by operation of provisions contained or previously contained in 26 U.S. Code § 168 (the Internal Revenue Code) shall be treated as owned, not rented, by the company.

63.38.4: continued

6. Example. Taxpayer is a corporation that operates a package delivery service. Taxpayer transmits packages using aircraft and trucks. Taxpayer owns property, as follows: real and tangible personal property other that aircraft ready for flight and other than nonflight mobile property, with an average value of $10,000,000. The average value of this property situated in Massachusetts is $6,000,000. Taxpayer also owns and/or rents aircraft ready for flight with an average value of $30,000,000. The value of the aircraft ready for flight is multiplied by the percentage of departures of the company taking place in Massachusetts, in this case 15%, with the result of $4,500,000 attributable to Massachusetts. Taxpayer also owns or rents nonflight mobile property, namely delivery trucks, with an average value of 8,000,000. The percentage of miles traveled by the company's trucks in Massachusetts is 20%, with the result of $1,600,000 attributable to Massachusetts. Taxpayer's property factor is calculated as follows:

$$\frac{(\$6{,}000{,}000 + \$4{,}500{,}000 + \$1{,}600{,}000) = 12{,}100{,}000}{(\$10{,}000{,}000 + \$30{,}000{,}000 + \$8{,}000{,}000) = 48{,}000{,}000}$$

= .252 property factor

(b) Payroll Factor. A courier or package delivery service's payroll factor is a fraction, the numerator and denominator of which are determined according to 830 CMR 63.38.4(3)(b)1. through 4.

1. The denominator of the payroll factor is the total compensation paid by the company during the taxable year.
2. The numerator of the payroll factor shall be the sum of the following three amounts:
   a. the compensation paid in Massachusetts to personnel other than flight personnel and nonflight mobile personnel during the taxable year;
   b. the compensation paid in Massachusetts to flight personnel during the taxable year; and
   c. the compensation paid in Massachusetts to nonflight mobile personnel during the taxable year.
3. The compensation paid in Massachusetts to flight personnel shall be computed by multiplying the company's total payroll for flight personnel by the percentage of the company's departures occurring in Massachusetts weighted, in a manner similar to that described in 830 CMR 63.38.4(3)(a), by the values of the aircraft types operated by the company.
4. The compensation paid in Massachusetts to nonflight mobile personnel shall be computed by multiplying the company's total payroll for nonflight mobile personnel by the percentage of miles traveled by the company's nonflight mobile property in Massachusetts.

(4) Determining the Sales Factor for Courier or Package Delivery Services. The sales factor of a courier or package delivery service shall be determined according to the rules generally applicable to corporations under the Apportionment of Income regulation. *See* generally 830 CMR 63.38.1(9). *See* also 830 CMR 63.38.1(9)(d)4.b.iii. ("Transportation and Delivery Services"), 830 CMR 63.38.1(9)(d)1.h. ("Industry-specific Alternative Apportionment Rules").

(5) Corporation Serving as a Courier or Package Delivery Services, a Motor Carrier, and/or an Airline. A single company may be a courier or package delivery service, a motor carrier (as that term is defined in 830 CMR 63.38.3), and/or an airline (as that term is defined in 830 CMR 63.38.2) and if so its income from its activities as a courier or package delivery service shall be apportioned as provided in 830 CMR 63.38.4, its income from its activities as a motor carrier shall be apportioned as provided in 830 CMR 63.38.3, and its income from its activities as an airline shall be apportioned as provided in 830 CMR 63.38.2. To the extent that a corporation's services as a courier or package delivery service overlap with its services as a motor carrier or an airline such that the income cannot be separated by function, the provisions of the courier and package delivery service, 830 CMR 63.38.4, apply.

(6) Effective Date. 830 CMR 63.38.4, is effective for taxable years beginning on or after January 1, 2014.

63.38.7: Apportionment of Income of Mutual Fund Service Corporations

(1) Statement of Purpose; Outline of Topics; Effective Date

(a) Statement of Purpose. The purpose of 830 CMR 63.38.7 is to explain the allocation and apportionment of income from mutual fund sales of mutual fund service corporations, as provided in M.G.L. c. 63, § 38(m).

(b) Outline of Topics. 830 CMR 63.38.7, is organized as follows:

1. Statement of Purpose; Outline of Topics; Effective Date
2. Definitions
3. General
4. Apportionment of Income from Mutual Fund Sales
5. Job Growth Requirements
6. Reporting Requirements

(c) Effective Date. The provisions of 830 CMR 63.38.7 shall take effect upon promulgation.

(2) Definitions. For the purposes of 830 CMR 63.38.7, the following terms shall have the following meanings, unless the context requires otherwise:

Affiliate, the meaning as set forth in 15 U.S.C. § 80a-2(a)(3)(c), as may be amended from time to time.

Affiliated Regulated Investment Company (or Affiliated RIC), a regulated investment company that is a shareholder in another regulated investment company; and in common with such other regulated investment company, obtains management or distribution services, as described in 830 CMR 63.38.7(3)(d), from the same provider of such services or a related provider.

Commissioner, the Commissioner of Revenue, or the Commissioner's duly authorized representative.

Corporate Trust, any partnership, association or trust, organized by the execution and delivery of a declaration of trust, the beneficial interest of which is divided into transferable units or shares.

Limited Liability Company, an unincorporated organization formed under M.G.L. c. 156C, and having two or more members or a limited liability company formed under the laws of any other state or foreign country. *See* M.G.L. c. 156C, § 2.

Mutual Fund Sales, taxable net income derived within the taxable year, directly or indirectly, from the rendering of management, distribution, or administration services to a regulated investment company, including net income received directly or indirectly from trustees, sponsors, and participants of employee benefit plans which have accounts in a regulated investment company. *See* 830 CMR 63.38.7(3)(d).

Mutual Fund Service Corporation, any domestic or foreign corporation, corporate trust, or limited liability company doing business in Massachusetts, which derives more than 50% of its gross income from providing, directly or indirectly, management, distribution or administration services to or on behalf of a regulated investment company, and from trustees, sponsors and participants of employee benefit plans which have accounts in a regulated investment company.

Qualified Employee in Massachusetts, an individual who (i) is employed by a mutual fund service corporation; (ii) works on a full-time basis with a normal work week of 30 or more hours; (iii) at the start of his or her employment does not have a predetermined or specified termination date; (iv) is eligible to receive employee benefits, including, but not limited to, paid holidays, vacation and unemployment benefits; and (v) is subject to Massachusetts income tax withholding. Three or fewer individuals who between them fulfill the requirement of (ii) and who each meet the requirements of (i), (iii), (iv), and (v) shall be counted as one qualified employee.

63.38.7: continued

Qualified Employee Worldwide, an individual who meets the criteria in 830 CMR 63.38.7(2): Qualified Employee in Massachusetts(i) through (iv). Three or fewer individuals who between them fulfill the requirement of 830 CMR 63.38.7(2): Qualified Employee in Massachusetts(ii) and who each meet the requirements of 830 CMR 63.38.7(2): Qualified Employee in Massachusetts(i), (iii), (iv) and (v) shall be counted as one qualified employee.

Regulated Investment Company (RIC), the meaning as set forth in Section 851 of the Internal Revenue Code, as amended and in effect for the taxable year.

Taxable Net Income, gross income less deductions under M.G.L. c. 63, § 30, adjusted as provided in M.G.L. c. 63, § 38(a).

(3) General.

(a) Application of Regulation. 830 CMR 63.38.7 applies only to taxable net income that is (i) derived from mutual fund sales and (ii) received by mutual fund service corporations. Any taxable net income received by mutual fund service corporations that is not derived from mutual fund sales must be apportioned according to the provisions of M.G.L. c. 63, § 38(c). *See* 830 CMR 63.38.1.

(b) Use of a Weighted Average Apportionment Percentage to Calculate the Non-income Measure of the Excise. Based on the above apportionment rules, a mutual fund service corporation that has taxable net income from mutual fund sales as well as taxable net income from non-mutual fund sales in the same tax year will have two income apportionment percentages for that year. If a mutual fund service corporation is subject to the non-income measure of the corporate excise under M.G.L. c. 63, §§ 32, 39, the mutual fund service corporation must use a weighted average of the two apportionment percentages to calculate the non-income measure of its excise due for that tax year. To determine the weighted average percentage, a mutual fund service corporation must calculate the ratio of its taxable net income from mutual fund sales to its taxable net income from non-mutual fund sales.

Example 1: ABC Company has $900,000 of taxable net income from mutual fund sales and its apportionment percentage for this income is 25%. ABC Company also has $100,000 of taxable net income from non-mutual fund sales and its apportionment percentage for this income is 75%. ABC Company's taxable net income from mutual fund sales represents 90% of its total taxable net income and its taxable net income from non-mutual fund sales represents 10% of its total taxable net income.

To determine ABC Company's weighted average apportionment percentage, calculate as follows:

1. multiply the mutual fund apportionment percentage by its weight 25% x 90% = 22.5%
2. multiply the other income apportionment percentage by its weight 75% x 10% = 7.5%
3. add these two percentages to arrive at the weighted average apportionment percentage 22.5% +7.5% = 30%

ABC Company would then use this percentage (30%) to calculate the non-income measure of its excise due for that tax year.

The above calculation shall be used when a mutual fund service corporation has taxable net income from mutual fund sales and taxable net income from non-mutual fund sales. When a mutual fund service corporation has a loss from its mutual fund sales business, a loss from its non-mutual fund sales business, or both, the corporation must determine its weighted average apportionment percentage based on the ratio of its gross receipts from its mutual fund sales business to its gross receipts from its non-mutual fund sales business. For purposes of 830 CMR 63.38.7(3)(b), the term "gross receipts" shall mean gross income as defined under M.G.L. c. 63, § 30.

63.38.7: continued

Example 2: XYZ Company has a $70,000 loss from its mutual fund sales business and its apportionment percentage for this income is 25%. XYZ Company also has a $50,000 loss from its non-mutual fund sales business and its apportionment percentage for this income is 75%. Because XYZ Company has a loss from both its mutual fund sales and non-mutual fund sales businesses, its weighted apportionment percentage must be determined by reference to its respective gross receipts from its mutual fund sales and non-mutual fund sales businesses. XYZ Company has $2,200,000 in gross receipts from its mutual fund sales business and $300,000 in gross receipts from its non-mutual fund sales business. Therefore, XYZ Company has gross receipts from its mutual fund sales business that represent 88% of its total gross receipts and gross receipts from its non-mutual fund business that represent 12% of its total gross receipts.

To determine XYZ Company's weighted average apportionment percentage, calculate as follows:

1. multiply the mutual fund apportionment percentage by its weight 25% x 88% = 22%
2. multiply the non-mutual fund apportionment percentage by its weight 75% x 12% = 9%
3. add these two percentages to arrive at the weighted average apportionment percentage 22% + 9% = 31%

XYZ Company would then use this percentage (31%) to calculate the non-income measure of its excise due for that tax year.

Example 3: Fund Corporation has a $25,000 loss from its mutual fund sales business and its apportionment percentage for this income is 30%. Fund Corporation also has $75,000 of taxable net income from its non-mutual fund sales business and its apportionment percentage for this income is 70%. Because Fund Corporation has a loss from its mutual fund sales business, its weighted apportionment percentage must be determined by reference to its respective gross receipts from its mutual fund sales and non-mutual fund sales businesses. Fund Corporation has $2,700,000 in gross receipts from its mutual fund sales business and $300,000 in gross receipts from its non-mutual fund sales business. Therefore, Fund Corporation has gross receipts from its mutual fund sales business that represent 90% of its total gross receipts and gross receipts from its non-mutual fund business that represent 10% of its total gross receipts.

To determine Fund Corporation's weighted average apportionment percentage, calculate as follows:

1. multiply the mutual fund apportionment percentage by its weight 30% x 90% = 27%
2. multiply the non-mutual fund apportionment percentage by its weight 70% x 10% = 7%
3. add these two percentages to arrive at the weighted average apportionment percentage 27% + 7% = 34%

Fund Corporation would then use this percentage (34%) to calculate the non-income measure of its excise due for that tax year.

(c) Taxable Net Income From Mutual Fund Sales. To determine taxable net income from mutual fund sales, a mutual fund service corporation must take the following steps.

1. The mutual fund service corporation must separate its gross income into two categories: (i) mutual fund sales and (ii) non-mutual fund sales.
2. The mutual fund service corporation must also separate its allowable deductions into categories: (i) deductions directly traceable to mutual fund sales, (ii) deductions directly traceable to non-mutual fund sales, and (iii) other allowable deductions. The category of other allowable deductions consists of deductions not directly traceable to either type of sale. Taxable net income from mutual fund sales equals gross income derived from mutual fund sales less: (i) any deductions directly traceable to its mutual fund sales and (ii) a portion of other allowable deductions. To determine the portion of other allowable deductions to be subtracted from gross income derived from mutual fund sales, a mutual fund service corporation must multiply the total amount of other allowable deductions by a fraction, the numerator of which is the mutual fund service corporation's gross income derived from mutual fund sales for the taxable year and the denominator of which is the mutual fund service corporation's total gross income for the taxable year.

63.38.7: continued

(d) Mutual Fund Sales. Mutual fund sales include all amounts derived, directly or indirectly, from the performance of the following services:

1. Management services. The term management services includes, but is not limited to, the rendering of investment advice or investment research to or on behalf of a RIC, making determinations as to when sales and purchases of securities are to be made on behalf of the RIC, or the selling or purchasing of securities constituting assets of a RIC. Such activities must be performed:

a. pursuant to a contract with the RIC entered into pursuant to 15 U.S.C. section a-15(a);

b. for a person that has entered into a such a contract with the RIC; or

c. for a person that is affiliated with a person that has entered into such a contract with the RIC.

2. Distribution services. The term distribution services includes, but is not limited to, advertising, servicing, marketing or selling shares of a RIC, including the receipt of contingent deferred sales charges and fees received pursuant to 17 CFR § 270.12b-1.

a. In the case of an open end company, advertising, servicing or marketing shares must be performed by a person who is either engaged in or affiliated with a person that is engaged in the services of selling shares of a RIC. The service of selling shares of a RIC must be performed pursuant to a contract entered into pursuant to 15 U.S.C. section a-15(b).

b. In the case of a closed end company, advertising, servicing or marketing shares must be performed by a person who was either engaged in or affiliated with a person that was engaged in the services of selling shares of a RIC.

3. Administration services. The term administration services includes, but is not limited to, clerical, fund or shareholder accounting, participant record keeping, transfer agency, bookkeeping, data processing, custodial, internal auditing, legal and tax services performed for a RIC. The provider of administration services must also provide or be affiliated with a person that provides management or distribution services to any RIC.

(e) Direct and Indirect Services.

1. Direct services. Amounts are derived directly from the performance of management, distribution or administration services when they are received as compensation for providing such services to a RIC or to a RIC's officers, directors or trustees acting on behalf of the RIC. For example, the fee received by a person hired by a RIC's trustees to manage the RIC's assets is derived directly from the performance of management services.

2. Indirect services. Amounts are derived indirectly from the performance of management, distribution or administration services when they are received as compensation for providing such services to a person who is directly responsible for providing management, distribution or administration services to a RIC pursuant to a contract between such person and the RIC or the RIC's officers, directors, or trustees acting on behalf of the RIC . For example, the fee received by a brokerage firm hired by a person that is under contract to provide management services to a RIC is derived indirectly from the performance of management services.

(4) Apportionment of Income from Mutual Fund Sales.

(a) Qualifying Mutual Fund Service Corporations. A mutual fund service corporation that meets the job growth criteria under 830 CMR 63.38.7(5), must apportion its taxable net income from mutual fund sales to Massachusetts by multiplying its total taxable net income from mutual fund sales for the taxable year by the mutual fund service corporation's sales factor, determined under 830 CMR 63.38.7(4)(c).

(b) Non-qualifying Mutual Fund Service Corporations.

1. A mutual fund service corporation that (i) has gross income derived from mutual fund sales to one or more RICs with shareholders domiciled outside Massachusetts and (ii) does not meet the job growth criteria under 830 CMR 63.38.7(5), must multiply its total taxable net income from mutual fund sales for the taxable year by a fraction, the numerator of which is the sum of its property and payroll factors, determined under 830 CMR 63.38.1, and twice times its sales factor, determined under 830 CMR 63.38.7(4)(c), and the denominator of which is four.

63.38.7: continued

2. A mutual fund service corporation that does not have gross income derived from mutual fund sales to one or more RICs with shareholders domiciled outside Massachusetts and does not meet the job growth criteria under 830 CMR 63.38.7(5), below, must allocate all of its taxable net income from mutual fund sales to Massachusetts.

(c) Sales Factor. A mutual fund service corporation determines its sales factor as follows:

1. Mutual fund sales are determined separately for each separate RIC from which the mutual fund service corporation receives fees for mutual fund services.

2. Mutual fund sales for each RIC are then multiplied by a fraction, the numerator of which is the average number of shares owned by the RIC's shareholders domiciled in Massachusetts at the beginning and end of the RIC's taxable year that ends with or within the mutual fund service corporation's taxable year, and the denominator of which is the average number of shares owned by all of the RIC's shareholders for the same period. Notwithstanding the above, a mutual fund service corporation may use the year end of the RIC's fund advisor for this calculation so long as the mutual fund service corporation consistently uses this method from year to year. For purposes of this provision, a RIC's fund advisor is the person that is directly and primarily responsible for providing investment advice to the RIC under a contract entered into pursuant to 15 U.S.C. § a-15(a).

3. The resulting amounts for each RIC are then added together. The sum is the amount of mutual fund sales assigned to Massachusetts.

4. The sales factor is a fraction, the numerator of which is the amount of mutual fund sales assigned to Massachusetts and the denominator of which is the mutual fund service corporation's total amount of mutual fund sales.

For purposes of this calculation, mutual fund sales by a mutual fund service corporation are assigned to Massachusetts based on the domicile of the RIC's shareholders of record. The domicile of a shareholder of record is generally the shareholder's mailing address on the records of the RIC. Notwithstanding 830 CMR 63.38.7(4)(c):

i. if a shareholder of record is an affiliated RIC, then for shares held by such affiliated RIC, the mailing addresses of the shareholders of record of the affiliated RIC shall be presumed to be the domicile of the shareholder of record, determined proportionately with respect to the shares of the affiliated RIC held by each such shareholder of the affiliated RIC.

Example: ABC is a mutual fund service corporation. ABC provides management services to a number of RICs (the ABC Funds) that are marketed to the public as being part of an identifiable mutual fund group sponsored by ABC or related entities. The ABC Funds invest cash in IFunds, another RIC within the ABC group of funds. IFunds specializes in investing in various short-term money-market and similar instruments. ABC, or a related service provider, provides management services to IFunds. The management fee income received by ABC, or such related provider, that is attributable to management services rendered to IFunds and that is characterized as mutual fund sales income shall be assigned to Massachusetts based on the domicile of IFunds' shareholders of record. Where any such shareholder of record is an ABC Fund that is an affiliated RIC, then to the extent of the IFund shares owned by such ABC Fund, the shareholders of record of such shares shall be presumed to be the shareholders of such ABC Fund, in proportion to their holdings in such ABC Fund. Thus, if an ABC Fund, qualifying as an affiliated RIC, held 100,000 shares in IFunds, and if 10% of the shares of such ABC Fund were held by shareholders having Massachusetts mailing addresses, then 10,000 shares of IFunds held by such ABC Fund would be assigned to Massachusetts.

ii. if a shareholder of record is a company which holds the shares of the RIC as depositor for the benefit of a separate account, then for all shares held in such separate account, the mailing address of such company shall be presumed to be the domicile of the shareholder of record. However, if either the RIC or mutual fund service corporation has actual knowledge that the company's mailing address is different than the company's principal place of business, then the presumption does not apply and the address of the company's principal place of business shall be considered the domicile of the shareholder of record.

63.38.7: continued

Notwithstanding any other provisions of 830 CMR 63.38.7, the provisions of 830 CMR 63.38.7(4)(c) shall apply to taxable years beginning on or after January 1, 2006.

(d) The following example illustrates the provisions of 830 CMR 63.38.7(4)(a), (c).

XYZ Financial Services ("XYZ") is a mutual fund service corporation that meets the job growth requirement of 830 CMR 63.38.7(5). For the 1998 taxable year, XYZ has $400,000 of gross income derived from brokerage services and $2,000,000 of gross income derived from mutual fund sales. The gross income derived from mutual fund sales consists of fees received from the RIC's described in the table below. The table also provides the average number of shares held by shareholders domiciled in Massachusetts and average number of total shares for each RIC for the taxable year.

Fund	Fees	Shares Held By MA Shareholders	Total Shares
Growth	$1,000,000	100	400
Income	$ 500,000	100	200
International	$ 500,000	50	200

XYZ has $1,000,000 in allowable deductions for the taxable year. $200,000 of these deductions are directly traceable to its brokerage services. $500,000 are directly traceable to its mutual fund sales. The remaining $300,000 deductions are not directly traceable to either XYZ's brokerage services or mutual fund sales and are therefore considered other allowable deductions.

XYZ must apportion its taxable net income derived from mutual fund sales to Massachusetts as follows.

Step 1: Determine Taxable Net Income from Mutual Fund Sales

a. Start with $2,000,000 of gross income derived from mutual fund sales.

b. Subtract deductions directly traceable to mutual fund sales:

$$\$2,000,000 - \$500,000 = \$1,500,000$$

c. Subtract the portion of other allowable deductions allocable to mutual fund sales:

$$\text{Allocable Portion} = \text{Other Allowable Deductions} \times \frac{\text{Total Mutual Fund Sales}}{\text{Total Gross Income}}$$

$$\text{Allocable Portion} = \$300,000 \times \frac{\$2,000,000}{\$2,400,000} = \$\ 250,000$$

$$\$1,500,000 - \$\ 250,000 = \$1,250,000$$

d. The resulting amount of $1,250,000 is taxable net income derived from mutual fund sales.

Step 2: Determine Sales Factor.

a. Separate mutual fund sales by individual RICs.

Growth Fund = $1,000,000
Income Fund = $ 500,000
International Fund = $ 500,000

63.38.7: continued

b. Multiply the separate amount of mutual fund sales for each RIC by the following fraction:

$$\frac{\text{average number of shares held by shareholders domiciled in Massachusetts}}{\text{average number of total shares}}$$

1. Growth Fund: $\$1{,}000{,}000 \times \frac{100}{400} = \$250{,}000$

2. Income Fund: $\$\ 500{,}000 \times \frac{100}{200} = \$250{,}000$

3. International Fund: $\$\ 500{,}000 \times \frac{50}{200} = \$125{,}000$

c. Add the resulting amounts to determine total mutual fund sales assigned to Massachusetts.

$$\$250{,}000 + \$250{,}000 + \$125{,}000 = \$625{,}000$$

d. Calculate sales factor: $\frac{\text{total mutual fund sales assigned to MA}}{\text{total mutual fund sales}}$

$$\frac{\$\ 625{,}000}{\$2{,}000{,}000} = 31.25\%$$

Step 3: Apportion Taxable Net Income Derived from Mutual Fund Sales to Massachusetts.

$$\$1{,}250{,}000 \times 31.25\% = \$\ 390{,}625$$

63.38.7: continued

(5) Job Growth Requirement.

(a) Required Employment Levels. A mutual fund service corporation meets the job growth requirement for a taxable year if it maintains an employment level equal to or greater than its jobs commitment level. A mutual fund service corporation's employment level for a taxable year is equal to the number of qualified employees in Massachusetts on the last day of the mutual fund service corporation's taxable year. If a mutual fund service corporation participates with other mutual fund service corporations in the filing of a combined return, the employment level for a taxable year for the combined group is equal to the total number of qualified employees of all combined group members in Massachusetts on the last day of the combined group's taxable year. A mutual fund service corporation's jobs commitment level is equal to the following amounts for the following taxable years:

1. For taxable years beginning on or after January 1, 1997 but before January 1, 1998; 105% of the base period employment level;

2. For taxable years beginning on or after January 1, 1998 but before January 1, 1999; 110% of the base period employment level;

3. For taxable years beginning on or after January 1, 1999 but before January 1, 2000; 115% of the base period employment level;

4. For taxable years beginning on or after January 1, 2000 but before January 1, 2001; 120% of the base period employment level;

5. For taxable years beginning on or after January 1, 2001 but before January 1, 2003; 125% of the base period employment level;

6. For taxable years beginning on or after January 1, 2003, all mutual fund service corporations are deemed to meet the job growth requirement and are required to apportion taxable net income from mutual fund sales to Massachusetts using the single factor apportionment percentage provided in 830 CMR 63.38.7(4)(a).

(b) Base Period Employment Level. The base period employment level of a mutual fund service corporation is the number of qualified employees of the mutual fund service corporation in Massachusetts as of January 1, 1996. In the case of a mutual fund service corporation participating in the filing of a combined return, the base period employment level shall be computed for the combined group as a whole, based upon the number of qualified employees in Massachusetts as of January 1, 1996 of all members of the combined group. A mutual fund service corporation must retain its payroll records documenting the number of its employees as of January 1, 1996 to assist the Commissioner in determining whether the mutual fund service corporation has met its required employment level for each taxable year beginning on or after January 1, 1997.

(c) Special Rule For New Mutual Fund Service Corporations. If a mutual fund service corporation was not engaged in business in Massachusetts on January 1, 1996, then its base period employment level shall be its average employment level for the first two years it is engaged in business in Massachusetts. Such mutual fund service corporation's jobs commitment level shall be its base period employment level increased by five percent for every taxable year after the year in which the base period employment level is established, until January 1, 2003. For taxable years beginning on or after January 1, 2003, all mutual fund service corporations are deemed to meet the job growth requirement and are required to apportion taxable net income from mutual fund sales to Massachusetts using the single factor apportionment percentage provided in 830 CMR 63.38.7(4)(a).

(d) Special Rule For Corporate Restructuring.

1. When the acquisition of a business or line of business or other corporate restructuring results in an increase in the number of qualified employees of the mutual fund service corporation, the base period employment level to be applied in the taxable year during which such restructuring occurs, and in all subsequent taxable years, shall be increased by the base period employment level of the acquired business or line of business. If the acquired business or line of business is not a mutual fund service corporation, it shall determine its base period employment level as though it were a mutual fund service corporation. See 830 CMR 63.38.7(5)(b).

2. When the divestiture of a line of business or other corporate restructuring results in a decrease in the number of qualified employees of a mutual fund service corporation, the base period employment level to be applied in the taxable year during which such restructuring occurs, and in all subsequent taxable years, shall be decreased by the base period employment level of the divested line of business only if the mutual fund service corporation can demonstrate that the corporate restructure will not result in any reduction in the number of jobs in Massachusetts.

63.38.7: continued

(e) Exception For Adverse Economic Conditions. A mutual fund service corporation that fails to meet the job growth requirement set forth in 830 CMR 63.38.7(5)(a), for any taxable year may nevertheless apportion its taxable net income derived from mutual fund sales using the single sales factor apportionment formula set forth in 830 CMR 63.38.7(4)(a), for that taxable year, if it can demonstrate to the Commissioner, in a manner prescribed by the Commissioner, that its failure to meet the required jobs commitment level for the taxable year was the direct result of adverse economic conditions.

1. Effect on one taxable year. If a mutual fund service corporation demonstrates adverse economic conditions for any one taxable year, the mutual fund service corporation may decrease its jobs commitment level for all subsequent taxable years beginning before January 1, 2002, by 5% of its base period employment level.

2. Effect on more than one taxable year. If a mutual fund service corporation demonstrates adverse economic conditions for more than one taxable year, the mutual fund service corporation may decrease its jobs commitment level for each taxable year affected by such conditions, and for all subsequent taxable years beginning before January 1, 2002. The amount of the decrease shall be 5% of the base period employment level multiplied by the number of taxable years during which adverse economic conditions are shown to exist. However, notwithstanding any such decrease, the jobs commitment level for taxable years beginning on or after January 1, 2002, and before January 1, 2004 shall not be less than the sum of the jobs commitment level for the most recent taxable year unaffected by adverse economic conditions and 5% of the base period employment level.

3. Adverse economic conditions defined. Adverse economic conditions shall exist with respect to any taxable year only where during any 12 month period ending during the taxable year either:

a. the Standard and Poor's 500 Stock Index decreases 10% or more compared to its level at the beginning of the 12 month period;

b. the average daily trading volume on the New York Stock Exchange decreases 15% or more compared to the average over the preceding 12 months; or

c. at any time during the taxable year, the total assets under management of the mutual funds served by the mutual fund service corporation decreases 12 and ½% or more compared to such total assets under management 12 months earlier.

(f) Combined Returns. When one or more mutual fund service corporations joins in the filing of a combined return, as provided by 830 CMR 63.32B.1, each mutual fund service corporation shall determine and apportion its taxable net income separately. However, for purposes of determining whether the job growth requirement and any adverse economic conditions apply, as provided above, such determinations are to be made based on a combined group basis, and not on a corporation by corporation basis. If the job growth requirement is met by the combined group, all of the mutual fund service corporations participating in the combined return will be eligible to apportion taxable net income from mutual fund sales to Massachusetts using the single factor apportionment percentage provided in 830 CMR 63.38.7(4)(a). If the job growth requirement is not met by the combined group, and the adverse economic conditions exception does not apply, none of the mutual fund service corporations participating in the combined return will be eligible to apportion taxable net income from mutual fund sales to Massachusetts using the single factor apportionment percentage provided in 830 CMR 63.38.7(4)(a). Instead, such corporations, as part of the combined group, must follow the rules under 830 CMR 63.38.7(4)(b).

(g) The following example illustrates the provisions of 830 CMR 63.38.7(5).

Example. Mutual Funds, Inc. is a calendar year taxpayer. It is the parent corporation of three subsidiary corporations, Global Securities, Investments USA, and Investments International, all of which participate in the filing of a Massachusetts combined return ("the MFI Group"). Because these corporations participate in the filing of a combined return, they compute their base period employment level on a combined group basis. The MFI Group has 1000 qualified employees on January 1, 1996. This number is the MFI Group's base period employment level. On December 31, 1997, the MFI Group has 1070 qualified employees. The MFI Group meets the job growth requirement for the 1997 taxable year because its employment level exceeds its jobs commitment level of 1050 (105% of 1000).

63.38.7: continued

On June 30, 1998, Mutual Funds, Inc. sells Investments International, whose base period employment level is 100, to an unrelated mutual fund service corporation based in New York, which has no plans to layoff or relocate any employees and does not do so. The MFI Group adjusts its base period employment level due to this corporate restructure to 900. On December 31, 1998, the MFI Group has 1001 employees. The MFI Group meets the job growth requirement for the 1998 taxable year because its employment level exceeds its job commitment level of 990 (110% of 900).

On September 15, 1998, Standard and Poor's 500 Stock Index is 865.27. On September 15, 1999, Standard and Poor's 500 Stock Index is 626.65, a 27.57% decrease. An adverse economic condition exists with respect to the MFI Group for its 1999 taxable year because the decrease in the Index exceeds 10%. On December 31, 1999, the MFI Group has only 1010 qualified employees. The MFI Group fails to meet its jobs commitment level of 1035 for 1999 (115% of 900). The MFI Group may nevertheless use the single sales factor apportionment formula set forth in 830 CMR 63.38.7(4)(a) because it can demonstrate that its failure to meet its jobs commitment level was a direct result of an adverse economic condition that occurred that year.

On December 31, 2000, the MFI Group has 1047 qualified employees. Because the MFI Group demonstrated adverse economic conditions in its 1999 taxable year, it may reduce its jobs commitment level for the 2000 taxable year by 5% of its base period employment level. Thus the MFI Group's job commitment level for the 2000 taxable year is 1035 (115% of 900) and not 1080 (120% of 900), as would be the case in the absence of adverse economic conditions. The MFI Group meets the job growth requirement for the 2000 taxable year because its employment level exceeds its job commitment level.

(6) Reporting Requirements.

(a) Annual Reporting Requirement. A mutual fund service corporation that is required to apportion its taxable net income derived from mutual fund sales to Massachusetts using the single factor apportionment percentage prescribed by 830 CMR 63.38.7(4)(a), must report certain information relating to its business operations to the Commissioner on an annual basis. Such information must be reported to the Commissioner, on a schedule prescribed by the Commissioner, and the schedule must be included in the mutual fund service corporation's annual tax return on which income derived from mutual fund sales is reported. All information supplied will be confidential under M.G.L. c. 62C, § 21.

(b) Record Retention. For each tax year in which a mutual fund service corporation uses the single factor apportionment percentage prescribed by 830 CMR 63.38.7(4)(a), the mutual fund service corporation must maintain general ledger trial balances or other suitable records that identify its income producing activities and the costs associated with them.

63.38.8: Apportionment of Income of Pipeline Companies

(1) Purpose, Outline, Effective Date.

(a) Purpose. The purpose of 830 CMR 63.38.8 is to provide an alternative apportionment rule, as provided in M.G.L. c. 63, § 38(j), for income received by pipeline companies that is derived from the transportation of mineral products.

(b) Outline. 830 CMR 63.38.8, is organized as follows:

1. Purpose, Outline, Effective Date;
2. Definitions;
3. Apportionment Percentage.

(c) Effective Date. The provisions of 830 CMR 63.38.8 shall be effective for taxable years beginning on or after December 16, 2016. The provisions of 830 CMR 63.38.8 as promulgated on December 30, 2005 are hereby repealed and replaced but remain applicable for taxable years beginning on or after December 30, 2005 and before December 16, 2016.

(2) Definitions. For the purposes of 830 CMR 63.38.8 the following terms have the following meanings unless the context requires otherwise:

Code, the Internal Revenue Code, as amended and in effect for the taxable year.

Commissioner, the Commissioner of Revenue or the Commissioner's duly authorized representative.

63.38.8: continued

Payroll Factor, the payroll factor as defined in M.G.L. c. 63, § 38(e). *See* 830 CMR 63.38.1(8).

Pipeline Company, any taxpayer engaged in the business of moving, conveying or transporting through a system or conduit of pipes any mineral products, such as oil, gasoline, or natural or casinghead gas, within the commonwealth and whose income is allocated or apportioned under or by reference to M.G.L. c. 63, § 38. For purposes of Pipeline Company, the term "system or conduit of pipes" includes transmission lines and connecting field and storage lines.

Property Factor, the property factor as defined in M.G.L. c. 63, § 38(d). *See* 830 CMR 63.38.1(7).

Sales Factor, the sales factor as defined in M.G.L. c. 63, § 38(f), with the adjustments in the numerator provided in 830 CMR 63.38.8.

Taxable Net Income, the part of the net income of a taxpayer, adjusted as required by M.G.L. c. 63, §38(a)(1) and (2), that is taxable both within and without Massachusetts and therefore apportionable under M.G.L. c. 63, § 38(c).

Taxpayer, any individual or entity that is entitled to or required to allocate or apportion income under or by reference to M.G.L. c. 63, § 38.

Traffic Unit, the movement of one unit of product such as one barrel of oil, one barrel of gasoline or 1,000 cubic feet of natural or casinghead gas through a pipeline for a distance of one mile.

(3) Apportionment Percentage. A pipeline company that has taxable net income that is taxable both within and outside of Massachusetts shall apportion its income to Massachusetts according to the provisions of M.G.L. c. 63, § 38(c) by multiplying the taxable net income by a fraction, the numerator of which is the property factor plus the payroll factor plus two times the sales factor, and the denominator of which is four. The property and payroll factors shall be computed in accordance with the provisions of M.G.L. c. 63, §§ 38(d) and (e) and 830 CMR 63.38.1. In computing the sales factor, the numerator consists of:

(a) the taxpayer's sales derived from the transportation of mineral products, multiplied by a fraction the numerator of which is the total number of traffic units in Massachusetts during the taxable year and the denominator of which is the total number of traffic units everywhere during the taxable year; plus

(b) the taxpayer's sales not derived from the transportation of mineral products that are assigned to Massachusetts in accordance with the provisions of M.G.L. c. 63, §§38(f) and 830 CMR 63.38.1.

63.38.10: Apportionment of Income of Electric Industry

(1) Statement of Purpose, Outline of Topics, Effective Date.

(a) Statement of Purpose. The purpose of 830 CMR 63.38.10 is to provide alternative apportionment rules, as provided in M.G.L. c. 63, § 38(j), for the electric industry. Generally, 830 CMR 63.38.10 provides rules for allocating and apportioning income derived from sales of electricity, unforced capacity, electricity brokerage services, ancillary services related to electricity, electricity transmission and distribution services, and from buying and selling financial instruments related to electricity. Except as modified by 830 CMR 63.38.10, the general allocation and apportionment provisions found in 830 CMR 63.38.1 continue to apply.

(b) Outlines of Topics. 830 CMR 63.38.10 is organized as follows:

1. Statement of Purpose, Outline of Topics, Effective Date;
2. Definitions;
3. Sales Factor Sourcing Rules;
4. Taxable in Another State;
5. Apportionment Percentage;
6. Examples.

(c) Effective Date. The provisions of 830 CMR 63.38.10 shall be effective for taxable years beginning on or after December 16, 2016. The provisions of 830 CMR 63.38.10 as promulgated on November 30, 2007 are hereby repealed and replaced but remain applicable for taxable years beginning on or after November 30, 2007 and before December 16, 2016.

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(2) Definitions. For purposes of 830 CMR 63.38.10 the following terms shall have the following meanings unless the context requires otherwise:

Affiliate, an individual or entity that is related to the taxpayer within the scope of Code § 267(b) or § 707(b)(1).

Agent, an individual or entity as defined in 830 CMR 63.38.1(2).

Alternative Energy Producer, an individual or entity that owns or operates a "cogeneration facility" or "small power production facility" as defined in M.G.L. c. 164, § 1 that does not engage in the retail sale of electricity other than sales to end-use customers that are within the confines of an industrial park that existed prior to March 1, 1982, and had, as of that date, electricity-generating capacity of more than 15 megawatts. *See* M.G.L. c. 164, § 1. *See* also 220 CMR 11.02: *General Definitions*.

Ancillary Services, services as defined in M.G.L. c. 164, § 1 that support generation, transmission, and distribution services including the following:

(a) reactive power/voltage control;
(b) loss compensation;
(c) scheduling and dispatch;
(d) load following;
(e) system protection service; and
(f) energy imbalance service.

Code, the Internal Revenue Code in effect for the taxable year.

Competitive Supplier, an individual or entity as defined in 220 CMR 11.02: *General Definitions* licensed by the Department of Telecommunications and Energy to sell electricity and supporting ancillary services to end-use customers.

Distribution Company, a company as defined in M.G.L. c. 164, § 1. *See also* 220 CMR 11.02: *General Definitions*.

Distribution Service, the delivery of electricity over lines which operate at a voltage level typically equal to or greater than 110 volts and less than 69,000 volts to an end-use customer within Massachusetts.

Electric Company, a company as defined in M.G.L. c. 164, § 1. *See also* 220 CMR 11.02: *General Definitions*.

Electric Utility, an individual or entity as defined in M.G.L. c. 164A, § 1.

Electricity Broker, an individual or entity as defined in 220 CMR 11.02: *General Definitions* that facilitates or arranges for the purchase and sale of electricity and supporting ancillary services to end-use customers, but generally does not sell electricity.

End-use Customer, a purchaser of electricity and/or distribution, transmission, and/or supporting ancillary services, and/or electricity brokerage services for any purpose other than resale in the regular course of business.

Generation Facility, plant or equipment used to produce, manufacture, or otherwise generate electricity, as defined in 220 CMR 11.02: *General Definitions*.

Generator, an individual or entity engaged in the business of producing, manufacturing, or generating electricity.

Installed Capacity, the maximum productive capacity, *i.e.*, megawatt capability, of an installed capacity resource, *e.g.*, generating facility, dispatchable load, external resource or transaction, or demand resource.

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ISO New England, a private not-for-profit corporation headquartered in Holyoke Massachusetts regulated by the Federal Energy Regulatory Commission (FERC) and designated by FERC to be the regional transmission organization for the New England region.

Located in Massachusetts, having a dwelling or other physical location or place of business in Massachusetts, *e.g.*, owning or leasing real or tangible property in Massachusetts or having one or more employees located in Massachusetts.

Payroll Factor, the payroll factor as defined in M.G.L. c. 63, § 38(e). *See also* 830 CMR 63.38.1(8).

Power Marketer, an individual or entity that generally becomes an owner of electricity for the purpose of selling it at wholesale but does not own a generation, transmission, or distribution facility.

Property Factor, the property factor as defined in M.G.L. c. 63, § 38(d). *See also* 830 CMR 63.38.1(7).

Retail Sale, a sale of electricity and/or distribution, transmission, and/or supporting ancillary services, or brokerage services, for any purpose other than resale in the regular course of business.

Sales, generally, "sales" as defined in M.G.L. c. 63, § 38(f). However, "sales" additionally shall include receipts from buying or selling financial instruments related to electricity (*e.g.*, derivatives, forwards, futures, swaps, options, basis contracts). Furthermore, in the case of a financial instrument, "sales" means gross receipts received under any purchase or sale contract net of any offsetting contract receipts.

Sales Factor, the sales factor as defined in M.G.L. c. 63, § 38(f), with the adjustments provided in 830 CMR 63.38.10.

Taxable Net Income, the part of the net income of a taxpayer, adjusted as required by M.G.L. c. 63, § 38(a)(1) and (2), that is taxable both within and without Massachusetts and therefore apportionable under M.G.L. c. 63, § 38(c).

Taxpayer, any individual or entity that is entitled or required to allocate or apportion income under or by reference to M.G.L. c. 63, § 38 that is engaged in the business of generating and/or selling:

(a) electricity;

(b) unforced capacity; or

(c) ancillary, transmission, or distribution services within Massachusetts including an electric company, electric utility, power marketer, alternative energy producer, electricity broker, competitive supplier, and marketing affiliate of a distribution company, and also including any individual or entity substantially engaged in the business of buying or selling financial instruments relating to electricity (*e.g.*, derivatives, forwards, futures, swaps, options, basis contracts).

The term Taxpayer does not include financial institutions as defined in M.G.L. c. 63, § 1.

Transmission Service, the delivery of power over lines that operate at a voltage level typically equal to or greater than 69,000 volts from generating facilities across interconnected high voltage lines to where the power enters a distribution system.

Unforced Capacity, the amount of installed capacity available at any given time and the measurement by which installed capacity is bought and sold.

(3) Sales Factor Sourcing Rules. For purposes of determining the sales described in 830 CMR 63.38.10(5)(a), sales shall be sourced to Massachusetts as follows:

(a) retail sales of electricity by a generator, an electric company or utility, a power marketer, an alternative energy producer, a competitive supplier, or similar vendor, or agent or affiliate of such, are “in Massachusetts” if, as a result of the sale, electricity is delivered to a location, metered or otherwise, in Massachusetts;

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(b) retail sales of brokerage services by an electricity broker or agent or affiliate of the electricity broker are "in Massachusetts" if, as a result of the sale, electricity is delivered to a location, metered or otherwise, in Massachusetts;

(c) wholesale sales of electricity by a generator or agent or affiliate of the generator are "in Massachusetts" to the extent that the generation facility that generated the electricity is located in Massachusetts;

(d) wholesale sales of electricity by an electric company or utility that does not itself generate the electricity sold, an agent or affiliate of such electric company or utility, a power marketer or similar vendor or an agent or affiliate of such power marketer or similar vendor are "in Massachusetts" as follows:

1. if the taxpayer's place of business from which a sales order or other contract originates is located in Massachusetts and the transaction is priced, traded, or settled by an exchange, marketplace, or intermediary located in Massachusetts, 100% of the receipts shall be sourced to Massachusetts;

2. if the taxpayer's place of business from which a sales order or other contract originates is not located in Massachusetts but the transaction is priced, traded, or settled by an exchange, marketplace, or intermediary located in Massachusetts, 20% of the receipts shall be sourced to Massachusetts;

3. if the taxpayer's place of business from which a sales order or other contract originates is located in Massachusetts but the transaction is priced, traded, or settled by an exchange, marketplace, or intermediary located in another state, 80% of the receipts shall be sourced to Massachusetts;

(e) sales of financial instruments relating to electricity (*e.g.*, derivatives, forwards, futures, swaps, options, basis contracts) are in Massachusetts applying the sourcing rules in 830 CMR 63.38.10(3)(d)1. through 3.;

(f) a sale of unforced capacity is "in Massachusetts" to the extent that the installed capacity resource to which it relates is located in Massachusetts;

(g) sales of transmission services are "in Massachusetts" in proportion to the ratio of the wire mileage of the taxpayer's transmission lines located in Massachusetts divided by the wire mileage of the taxpayer's transmission lines located everywhere;

(h) a sale of distribution services is "in Massachusetts" if, as a result of the sale, electricity is delivered to a location, metered or otherwise, in Massachusetts; and

(i) a sale of an ancillary service is "in Massachusetts" to the extent that the service (*e.g.*, generation, transmission, or distribution) to which it relates is "in Massachusetts." In such cases, the ratio of ancillary services in Massachusetts to ancillary services everywhere shall be the same as the ratio of related services in Massachusetts to related services everywhere.

(4) Taxable in Another State: Throwout. Any sales or receipts described in 830 CMR 63.38.10(3)(a) through (i) that would be sourced to a state in which the Taxpayer is not taxable shall be excluded from the numerator and denominator of the sales factor. For purposes of 830 CMR 63.38.10(4), a taxpayer is taxable in another state if:

(a) in that state the Taxpayer is subject to a net income tax, a franchise tax measured by net income, or a franchise tax for the privilege of doing business; or

(b) that state has jurisdiction to subject the Taxpayer to a net income tax, regardless of whether, in fact, that state does or does not subject the Taxpayer to the tax.

(5) Apportionment Percentage. Except as otherwise provided, a taxpayer as defined in 830 CMR 63.38.10(2) that has taxable net income that is taxable both within and outside of Massachusetts shall apportion its income to Massachusetts according to the provisions of M.G.L. c. 63, § 38(c) by multiplying the taxable net income by a fraction, the numerator of which is the property factor plus the payroll factor plus two times the sales factor, and the denominator of which is four. In the case of a manufacturing corporation as defined in M.G.L. c. 63, § 38(l)(1), single sales factor apportionment shall apply as required in M.G.L. c. 63, § 38(l)(2)(v). The property and payroll factors shall be computed in accordance with the provisions of M.G.L. c. 63, §§ 38(d) and (e) and 830 CMR 63.38.1. In computing the sales factor, the numerator shall consist of:

(a) the taxpayer's sales derived from generating and/or selling, transmitting, or distributing electricity, or from selling unforced capacity, electricity brokerage or ancillary services, or from buying and selling financial instruments related to electricity, that are sourced to Massachusetts in accordance with the provisions of 830 CMR 63.38.10; plus

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(b) the taxpayer's sales not derived from such activities that are sourced to Massachusetts in accordance with the provisions of M.G.L. c. 63, § 38(f) and 830 CMR 63.38.1.

(6) Examples. The following examples illustrate the provisions of 830 CMR 63.38.10. Nexus with Massachusetts and the states where customers are located is to be assumed on the part of the taxpayer in each example.

Example 1. Marina Light Corporation (MLC) is a generator of electricity and owns one generation facility located in Rhode Island. During the taxable year, most of the electricity generated from this facility is sold to two Massachusetts electric utilities and one non-Massachusetts electric company. They in turn sell the electricity to end-use customers or at wholesale. During the taxable year, each Massachusetts utility pays MLC $3,000,000 for the electricity it purchases. The non-Massachusetts electric company pays MLC $1,000,000. A small percentage of the electricity MLC generates is sold at retail to an end-use customer located in Massachusetts and electricity is delivered to a metered location in Massachusetts as a result. The Massachusetts end-use customer pays MLC $350,000 for the electricity it purchases.

In calculating MLC's sales factor, pursuant to sourcing rule 830 CMR 63.38.10(3)(a), only the $350,000 in retail sales to the Massachusetts end-use customer would be included in MLC's numerator as electricity is delivered to a metered location in Massachusetts as a result of the sale. None of the $7,000,000 in wholesale sales would be included as, pursuant to sourcing rule 830 CMR 63.38.10(3)(c), the generation facility that generated the electricity is not located in Massachusetts. MLC's sales factor is: $350,000 ÷ $7,350,000 = - .048

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Example 2. EnergyWise is a corporation that engages in energy trading activities. EnergyWise employs two power marketers in conducting such activities. One of these individuals resides in Massachusetts, the other resides in Connecticut. Each is a member of ISO New England, an exchange or marketplace located in Massachusetts, and utilizes the ISO marketplace in making sales. Each sells electricity to other power marketers located in and outside Massachusetts and to industrial end-use customers located in and outside Massachusetts.

The Massachusetts power marketer begins each sale by a phone call placed from or received at the Massachusetts office supplied to him by EnergyWise. During the taxable year, EnergyWise collects receipts from such sales as follows: $500,000 in wholesale sales from Massachusetts power marketers; $300,000 in wholesale sales from non-Massachusetts power marketers; $1,000,000 from industrial end-use customers located in Massachusetts; and $400,000 from industrial end-use customers located outside Massachusetts. In the first of the two final cases, electricity is delivered, as a result of the sale, to a metered location in Massachusetts; in the final case, electricity is delivered to a metered location outside Massachusetts.

The Connecticut power marketer similarly begins each sale by a phone call placed from or received at the Connecticut office supplied to him by EnergyWise. During the taxable year, EnergyWise collects receipts from such sales as follows: $200,000 in wholesale sales from non-Massachusetts power marketers; $100,000 in wholesale sales from Massachusetts power marketers; $100,000 from industrial end-use customers located outside Massachusetts; and $1,500,000 from industrial end-use customers located in Massachusetts. In the first of the two final cases, electricity is delivered, as a result of the sale, to a metered location outside Massachusetts; in the final case, electricity is delivered to a metered location in Massachusetts.

In calculating EnergyWise's sales factor, pursuant to sourcing rule 830 CMR 63.38.10(3)(a), the $1,000,000 in retail sales by the Massachusetts power marketer and the $1,500,000 in retail sales by the Connecticut power marketer to industrial end-use customers located in Massachusetts would be included in EnergyWise's numerator as electricity is delivered, as a result of the sale, to a metered location in Massachusetts. None of the $400,000 in retail sales by the Massachusetts power marketer or the $100,000 in retail sales by the Connecticut power marketer to industrial end-use customers located outside Massachusetts would be included however, as electricity is delivered, as a result of the sale, to a metered location outside Massachusetts. Additionally, pursuant to sourcing rule 830 CMR 63.38.10(3)(d)1., all of the wholesale sales by the Massachusetts power marketer, the $500,000 in sales to Massachusetts power marketers and the $300,000 in sales to non-Massachusetts power marketers, would be included in EnergyWise's numerator, as all of the sales originated in Massachusetts and were priced, traded, or settled by ISO New England, an exchange or marketplace located in Massachusetts. Finally, pursuant to sourcing rule 830 CMR 63.38.10(3)(d)2., only 20% of the wholesale sales by the Connecticut power marketer, or $40,000 of the $200,000 in sales to non-Massachusetts power marketers and $20,000 of the $100,000 in sales to the Massachusetts power marketers, would be included in EnergyWise's numerator, as all of the sales originated outside Massachusetts but were priced, traded, or settled by ISO New England, an exchange or marketplace located in Massachusetts. EnergyWise's sales factor is: ($1,000,000 + $1,500,000 + $500,000 + $300,000 + $40,000 + $20,000) ÷ $4,100,000 = .82

Example 3. To hedge its price risk due to the expected use of electricity in the summer months, the marketing department of RI Electric (RIE), a Rhode Island electric utility, contracts with Megafinancial Bank ("MFB"), a New York swap dealer, on February 1st and executes a fixed-for-floating electricity swap. The terms of the deal are as follows: RIE agrees to pay MFB $30 per megawatt-hour for 150,000 megawatt-hours of electricity. In return, MFB agrees to pay RIE the "floating" market price. The "floating" market price is to be based on the average daily real time locational marginal price ("LMP") on July 31st as reported by ISO-New England. The trade date is August 1st.

The average real time LMP per megawatt-hour for electricity reported by ISO-New England for July 31st is $32. On August 1,st MFB pays RIE the net difference or $300,000 ($2.00 per MWh x 150,000 MWh = $300,000). Additionally, on August 1st RIE buys 150,000 megawatt-hours of electricity for $32.00 per megawatt-hour and sells it to a Massachusetts end-use customer for $32.50 per megawatt-hour. Electricity is delivered to a metered location in Massachusetts as a result of the sale and RIE receives $75,000.

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In calculating RIE's sales factor, pursuant to sourcing rule 830 CMR 63.38.10(3)(d)2. and (3)(e), only 20% of the $300,000 from MFB, or $60,000, would be included in its numerator, as the sale originated outside Massachusetts but the "floating" market price component of the electricity swap contract is priced by reference to ISO-New England, an exchange or marketplace located in Massachusetts. Additionally, pursuant to sourcing rule 830 CMR 63.38.10(3)(a), the $75,000 retail sale to the Massachusetts end-use customer would be included in RIE's numerator as electricity is delivered to a metered location in Massachusetts as a result of the sale. RIE's sales factor is: ($60,000 + $75,000) ÷ $375,000 = .36

Example 4. Brightstar is a Massachusetts corporation that engages exclusively in wholesale energy trading activities. Brightstar employs two power marketers in conducting such activities. Both of these individuals utilize the New York ISO marketplace exclusively in pricing and making sales to other power marketers located in and outside Massachusetts. One of these individuals resides and works in Massachusetts; the other resides and works in New York. The Massachusetts power marketer begins each sale by a phone call placed from or received at his Massachusetts office. The New York power marketer begins each sale by a phone call placed from or received at his New York office.

Brightstar collects receipts from sales by its Massachusetts power marketer as follows: $200,000 in wholesale sales from non-Massachusetts power marketers and $10,000 in wholesale sales from Massachusetts power marketers. Additionally, Brightstar collects receipts from sales by its New York power marketer as follows: $600,000 in wholesale sales from non-Massachusetts power marketers and $100,000 in wholesale sales from Massachusetts power marketers.

In calculating Brightstar's sales factor, pursuant to sourcing rule 830 CMR 63.38.1(3)(d)3., 80% of the wholesale sales by the Massachusetts power marketer, or $160,000 of the $200,000 in wholesale sales to non-Massachusetts power marketers and $8,000 of the $10,000 in wholesale sales to Massachusetts power marketers, would be included in Brightstar's numerator, as all of the sales originated in Massachusetts but were priced, traded, or settled by New York ISO, an exchange or marketplace located in New York. None of the wholesale sales by the New York power marketer, neither the $600,000 in wholesale sales to non-Massachusetts power marketers nor the $100,000 in wholesale sales to Massachusetts power marketers, would be included in Brightstar's numerator however, as none of these sales originated in Massachusetts or were priced, traded, or settled by an exchange or marketplace located in Massachusetts. Brightstar's sales factor is: ($160,000 + $8,000) ÷ $910,000 = .18

Example 5. South Shore Electric Company (SSEC) generates from its generation facility in Massachusetts a small amount of electricity that it sells at wholesale to customers located in and outside Massachusetts. The total receipts from such sales is $1,000,000. Similarly, SSEC sells a small amount of transmission services to customers located in and outside Massachusetts. The total receipts from such sales is $1,800,000. The bulk of SSEC's business consists of sales of distribution services to Massachusetts and non-Massachusetts end-use customers. As to these latter distribution services, its Massachusetts sales total $10,000,000 and its non-Massachusetts sales total $4,000,000 during the taxable year. SSEC has 1,500 miles of transmission lines, 225 miles of which are located in Massachusetts.

In calculating SSEC's sales factor, pursuant to sourcing rule 830 CMR 63.38.10(3)(c), all of SSEC's wholesale sales of electricity, or $1,000,000, would be included in its numerator, as the generation facility that generated the electricity is located in Massachusetts. Additionally, pursuant to sourcing rule 830 CMR 63.38.10(3)(g), only $270,000 of SSEC's $1,800,000 in sales of transmission services would be included in its numerator. That figure is derived by dividing the wire mileage of SSEC's transmission lines located in Massachusetts, or 225 miles, by the wire mileage of SSEC's transmission lines located everywhere, or 1,500 miles and then by multiplying the result by SSEC's total receipts from sales of transmission services, or $1,800,000. Finally, pursuant to sourcing rule 830 CMR 63.38.10(3)(h), SSEC's numerator would include one last figure, the $10,000,000 in sales of distribution services to end-use customers located in Massachusetts. SSEC's sales factor is: ($1,000,000 + $270,000 + $10,000,000) ÷ $16,800,000 = .67

63.38.11: Apportionment of Income of Telecommunications Industry

(1) Statement of Purpose, Outline of Topics, Effective Date.

(a) Statement of Purpose. The purpose of 830 CMR 63.38.11 is to explain the allocation and apportionment of income derived from sales of telecommunications and ancillary services, pursuant to the Commissioner's authority under M.G.L. c. 63, § 38(j). 830 CMR 63.38.11 applies whether the telecommunications service income is earned by a traditional telephone company, a VOIP company, a cable company, an electric company or any other type of entity subject to the apportionment rules set forth in M.G.L. c. 63, § 38.

(b) Outline of Topics. 830 CMR 63.38.11 is organized as follows:

1. Statement of Purpose, Outline of Topics, Effective Date
2. General Rule
3. Definitions
4. Property Factor
5. Sales Factor

(c) Effective Date. The provisions of 830 CMR 63.38.11 shall be effective for taxable years beginning on or after January 1, 2009.

(2) General Rule. A taxpayer providing telecommunications or ancillary services that is subject to the apportionment rules set forth in M.G.L. c. 63, § 38 shall allocate and apportion its net income under the rules set forth in that section and the rules and regulations issued thereunder, except as modified by 830 CMR 63.38.11.

(3) Definitions. For purposes of 830 CMR 63.38.11 the following terms shall have the following meanings unless the context requires otherwise:

800 Service, a "telecommunications service" that allows a caller to dial a toll-free number without incurring a charge for the call. The service is typically marketed under the name "800", "855", "866", "877", and "888" toll-free calling, and any subsequent numbers designated by the Federal Communications Commission.

900 Service, an inbound toll "telecommunications service" purchased by a subscriber that allows the subscriber's customers to call in to the subscriber's prerecorded announcement or live service. "900 service" does not include collection services provided by the seller of the "telecommunications services" to the subscriber, or service or product sold by the subscriber to the subscriber's customer. The service is typically marketed under the name "900" service, and any subsequent numbers designated by the Federal Communications Commission.

Air-to-ground Radiotelephone Service, a radio service, as that term is defined in 47 CFR 22.99, in which common carriers are authorized to offer and provide radio telecommunications service for hire to subscribers in aircraft.

Ancillary Service, services that are associated with or incidental to the provision of telecommunications services, including but not limited to the following subcategories: detailed telecommunications billing, directory assistance, vertical service, conference bridging service and voice mail services. The term "ancillary service" is defined as a broad range of services and is broader than the sum of the subcategories.

Bundled Transaction, the retail sale of two or more products where:

(a) the products are otherwise distinct and identifiable; and

(b) the products are sold for one non-itemized price. For purposes of 830 CMR 63.38.11, a "bundled transaction" does not include the sale of any products in which the "sales price" varies, or is negotiable, based on the selection by the purchaser of the products included in the transaction. A transaction that otherwise meets the definition of a "bundled transaction" is not a "bundled transaction" if it is:

1. the "retail sale" of two products where the first product is essential to the use of the second product, and the first product is provided exclusively in connection with the second, and the true object of the transaction is the second;
2. the "retail sale" of more than one product, but the products are sourced the same under this special rule; or

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3. the "retail sale" of more than one product, but the sum of the "purchase price" or "sales price" of products which are sourced differently under this special rule is de minimis.

Call-by-call Basis, any method of charging for telecommunications services where the price is measured by individual calls.

Coin-operated Telephone Service, a "telecommunications service" paid for by inserting money into a telephone accepting direct deposits of money to operate.

Communications Channel, a physical or virtual path of communications over which signals are transmitted between or among customer channel termination points.

Conference Bridging Service, an ancillary service that links two or more participants of an audio or video conference call and may include the provision of a telephone number. Conference bridging service does not include the telecommunications services used to reach the conference bridge.

Customer, the person or entity that contracts with the seller of telecommunications services. If the end user of telecommunications services is not the contracting party, the end user of the telecommunications service is the customer of the telecommunication service. "Customer" does not include a reseller of telecommunications service or, for mobile telecommunications service, of a serving carrier under an agreement to serve the customer outside the home service provider's licenses service area.

Customer Channel Termination Point, the location where the customer either inputs or receives the communications.

Detailed Telecommunications Billing Service, an ancillary service of separately stating information pertaining to individual calls on a customer's billing statement.

Directory Assistance, an ancillary service of providing telephone number information, and/or address information.

End User, the person who utilizes the telecommunication service. In the case of an entity, "end user" means the individual who utilizes the service on behalf of the entity.

Fixed Wireless Service, a telecommunications service that provides radio communication between fixed points.

Home Service Provider, a home service provider as that term is defined in § 124(5) of Public Law 106-252 (Mobile Telecommunications Sourcing Act).

International, a "telecommunications service" that originates or terminates in the United States and terminates or originates outside the United States, respectively. United States includes the District of Columbia or a U.S. territory or possession.

Interstate, a "telecommunications service" that originates in one United States state, or a United States territory or possession, and terminates in a different United States state or United States territory or possession.

Intrastate, a "telecommunications service" that originates in one United States state, or a United States territory or possession, and terminates in the same United States state or a United States territory or possession.

Mobile Telecommunications Service, the same as that term is defined in § 124(7) of Public Law 106-252 (Mobile Telecommunications Sourcing Act).

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Mobile Wireless Service, a telecommunications service that is transmitted, conveyed or routed regardless of the technology used, whereby the origination and/or termination points of the transmission, conveyance or routing are not fixed, including, by way of example only, telecommunications services that are provided by a commercial mobile radio service provider.

Network Access Service, the provision by a local exchange telecommunication service provider of the use of its local exchange network by an inter-exchange telecommunication service provider to originate or terminate the inter-exchange telecommunication service provider's traffic carried to or from a distant exchange.

Outerjurisdictional Property, tangible personal property, such as orbiting satellites, undersea transmission cables and the like, that are owned or rented by the taxpayer and used in a telecommunications or ancillary service business, but that are not physically located in any particular state.

Paging Service, a telecommunications service that provides transmission of coded radio signals for the purpose of activating specific pagers; such transmissions may include messages and/or sounds.

Pay Telephone Service, a telecommunications service provided through any pay telephone.

Place of Primary Use, the street address representative of where the customer's use of the telecommunications service primarily occurs, which shall be the residential street address or the primary business street address of the customer. In the case of mobile telecommunications services, "place of primary use" shall be within the licensed service area of the home service provider.

Post-paid Calling Service, the telecommunications service obtained by making a payment on a call-by-call basis either through the use of a credit card or payment mechanism such as a bank card, travel card, credit card, or debit card, or by charge made to a telephone number which is not associated with the origination or termination of the telecommunications service. A post-paid calling service includes a telecommunications service, except a prepaid wireless calling service, that would be a prepaid calling service except for the fact that it is not exclusively a telecommunications service.

Prepaid Calling Service, the right to access exclusively telecommunications services, which must be paid for in advance and which enables the origination of calls using an access number or authorization code, whether manually or electronically dialed, and that is sold in predetermined units or dollars of which the number declines with use in a known amount.

Prepaid Wireless Calling Service, the sale of a telecommunications service that provides the right to utilize mobile wireless service as well as other non-telecommunications services including the download of digital products delivered electronically, content and ancillary services, which must be paid for in advance that is sold in predetermined units of dollars of which the number declines with use in a known amount.

Private Communications Service, a telecommunications service that entitles the customer to exclusive or priority use of a communications channel or group of channels between or among termination points, regardless of the manner in which such channel or channels are connected, and includes switching capacity, extension lines, stations, and any other associated services that are provided in connection with the use of such channel or channels.

Product, tangible personal property, digital good or service.

Property Factor, the property factor as determined under M.G.L. c. 63, § 38, as further modified by 830 CMR 63.38.11.

Sales Factor, the sales factor as determined under M.G.L. c. 63, § 38, as further modified by 830 CMR 63.38.11.

63.38.11: continued

Service Address, as follows:

(a) The location of the customer's telecommunications equipment, to which the customer's call is charged, and from which the call originates or terminates, regardless of where the call is billed or paid.

(b) If the location in 830 CMR 63.38.11: Service Address(a) is not known, "service address" means the origination point of the signal of the telecommunications services first identified by either the seller's telecommunications system or in information received by the seller from its service provider, where the system used to transport such signals is not that of the seller.

(c) If the location in 830 CMR 63.38.11: Service Address(a) and (b) are not known, the "service address" means the location of the customer's place of primary use.

Telecommunications Service, the electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points. The term "telecommunications service" includes such transmission, conveyance, or routing in which computer processing applications are used to act on the form, code or protocol of the content for purposes of transmission, conveyance or routing without regard to whether such service is referred to as voice over Internet protocol services or is classified by the Federal Communications Commission as enhanced or value added.

(a) The term "telecommunications service" is defined as a broad range of services. The term includes, but is broader than the sum of, the following subcategories:

1. 800 service;
2. 900 service;
3. wireline service;
4. fixed wireless service;
5. mobile wireless service;
6. paging service;
7. prepaid calling service;
8. prepaid wireless calling service;
9. private communication service;
10. value-added non-voice data service;
11. coin-operated telephone service;
12. international telecommunications service;
13. interstate telecommunications service;
14. intrastate telecommunications service;
15. network access service and pay telephone service.

(b) The term "telecommunications service" does not include:

1. Data processing and information services that allow data to be generated, acquired, stored, processed, or retrieved and delivered by an electronic transmission to a purchaser where such purchaser's primary purpose for the underlying transaction is the processed data or information;
2. Installation or maintenance of wiring or equipment on a customer's premises;
3. Tangible personal property;
4. Advertising, including but not limited to directory advertising;
5. Billing and collection services provided to third parties;
6. Internet access service;
7. Radio and television audio and video programming services, regardless of the medium, including the furnishing of transmission, conveyance and routing of such services by the programming service provider. Radio and television audio and video programming services shall include but not be limited to cable service as defined in 47 USC 522(6) and audio and video programming services delivered by commercial mobile radio service providers, as defined in 47 CFR 20.3;
8. "Ancillary services"; or
9. Digital products "delivered electronically", including but not limited to software, music, video, reading materials or ring tones.

(c) Examples of Included and Excluded Services.

Example 1. An entity provides dedicated network service to an entity which will resell that service as intrastate telecommunications service. Both entities are providing a telecommunications service.

Example 2. An entity provides an interstate telecommunications service to an internet service provider which will use that service in the provision of internet access service. The entity providing interstate telecommunications service is providing a telecommunications service. The entity providing internet service is not providing a telecommunications service.

Example 3. An entity primarily engaged in the provision of cable television provides an interstate telecommunications service. The entity is engaged in the provision of telecommunications service.

Value-added Non-voice Data Service, a service that otherwise meets the definition of "telecommunications services" in which computer processing applications are used to act on the form, content, code, or protocol of the information or data primarily for a purpose other than transmission, conveyance or routing.

Vertical Service, an ancillary service that is offered in connection with one or more telecommunications services, which offers advanced calling features that allow customers to identify callers and to manage multiple calls and call connections, including conference bridging services.

Voice Mail Service, an ancillary service that enables the customer to store, send or receive recorded messages. Voice mail service does not include any vertical services that the customer may be required to have in order to utilize the voice mail service.

(4) Property Factor. Outerjurisdictional property that is used by a taxpayer in providing a telecommunications or ancillary service shall be excluded from the numerator and denominator of the property factor.

(5) Sales Factor. Sales of telecommunications and ancillary services shall be included or excluded from the numerator and/or denominator of the sales factor as follows.

(a) Gross receipts from the sale of telecommunications services, other than those defined in 830 CMR 63.38.11(5)(c) through (g), which are sold on a call-by-call basis are in this state when:

1. the call originates and terminates in this state; or
2. the call either originates or terminates in this state and the service address is also located in this state.

(b) Gross receipts from the sale of telecommunications services, other than those defined in 830 CMR 63.38.11(5)(c) through (g), which are sold on other than a call-by-call basis, are in this state when the customer's place of primary use is in this state.

(c) Gross receipts from the sale of mobile telecommunications services, other than air-to-ground radiotelephone service and prepaid calling service, are in this state when the customer's place of primary use is in this state pursuant to the Mobile Telecommunications Sourcing Act.

(d) Gross receipts from the sale of pre-paid calling service, pre-paid wireless calling service and post-paid calling service are in this state when the origination point of the telecommunications signal is first identified in this state by either:

1. the seller's telecommunications system; or
2. information received by the seller from its service provider, where the system used to transport such signals is not that of the seller.

(e) Gross receipts from the sale of a private communications service are in this state:

1. if such service is for a separate charge related to a customer channel termination point, when the customer channel termination point is located in this state;
2. if under such service all customer termination points are located entirely within one state, when the customer channel termination points are located in this state;
3. if such service is for segments of a channel between two customer channel termination points located in different states and such segments of channel are separately charged, when the customer channel termination points are in this state, provided however that only 50% of such gross receipts shall be sourced to this state; and

63.38.11: continued

4. if such service is for segments of a channel located in more than one state and such segments are not separately billed, when the customer channel termination points are in this state, provided however that only a percentage of such gross receipts, determined by dividing the number of customer channel termination points in the state by the total number of customer channel termination points, are in this state.

(f) A portion of the total gross receipts from sales of telecommunications services to other telecommunication service providers for resale is in this state in an amount determined by multiplying such total gross receipts by a fraction, the numerator of which is "total carrier's carrier service revenues" for this state and the denominator of which is the sum of "total carrier's carrier service revenues" for all states in which the taxpayer is doing business, as reported by the Federal Communications Commission in its report titled Telecommunications Revenues by State, Table 15.6, or successor reports which include such information, for the most recent year available as of the due date of the return, determined without regard to extensions.

(g) Gross receipts attributable to the sale of an ancillary service are in this state when the customer's place of primary use is in this state.

(h) Gross receipts attributable to the sale of a telecommunications or ancillary service sold as part of a bundled transaction are in this state when such gross receipts would be this state in accordance with the provisions of 830 CMR 63.38.11(5)(a) through (g).

1. The amount of gross receipts attributable to the sale of a telecommunications or ancillary service which is sold as part of a bundled transaction shall be equal to the price charged by the taxpayer for such service when sold separately, adjusted by an amount equal to the quotient of:

a. the difference between:

i. the price charged by the taxpayer for the bundled transaction; and

ii. the sum of the prices charged by the taxpayer for each of the included products when sold separately; and

b. the number of products included in the bundled transaction.

Example. Bundler offers a package of services that includes monthly cable television access, Internet access and phone service for $90 a month. The price for these three services when sold separately is $120 a month, $50 for cable, $40 for Internet access and $30 for phone service. The amount of gross receipts attributable to the sale of the telecommunications services included in the bundle is determined as follows.

30 - [(120 - 90)/3)]
30 - [30/3]
30 - 10
20

2. If the amount of such gross receipts is not determinable under 830 CMR 63.38.11(5)(h)1., then they may be determined by reasonable and verifiable standards from taxpayer's books and records that are kept in the regular course of business for purposes including, but not limited to, non-tax purposes.

(i) Gross receipts from the sale of telecommunications services which are not taxable in the state to which they would be apportioned pursuant to 830 CMR 63.38.11(5)(a) through (g), shall be excluded from the denominator of the sales factor. For purposes of 830 CMR 63.38.11, a taxpayer is taxable in another state if:

1. in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, or a franchise tax for the privilege of doing business; or

2. that state has jurisdiction to subject the taxpayer to a net income tax, regardless of whether, in fact, that state does subject the taxpayer to the tax.

63.38B.1: Massachusetts Taxation of Security Corporations

(1) General.

(a) Purpose of Regulation. 830 CMR 63.38B.1 sets forth the rules for the Massachusetts tax treatment of security corporations under M.G.L. c. 63, § 38B.

(b) Organization. 830 CMR 63.38B.1 is organized as follows:

1. General.
2. Definitions.
3. Qualification for Security Corporation Classification.
4. Definition of Securities.
5. Requirement that Securities be Held Exclusively for Investment Purposes.
6. Procedure for Security Corporation Classification.
7. Continuing Status of Application and Classification; Change in Activities.
8. Election for Voluntary Withdrawal.
9. Revocation.
10. Submissions to the Security Corporations Unit.
11. Effective Date.

(2) Definitions.

Affiliate, for purposes of 830 CMR 63.38B.1, means a member of an affiliated group as defined under section 1504 of the Code.

Arm's Length Secondary Market, a venue for purchasing previously issued and outstanding securities that is not related to the seller, the purchaser, or the issuer of the securities being acquired. An arm's length secondary market may include a private investment firm that makes a market in securities or that otherwise brokers or acts as an intermediary in facilitating a purchase and sale of securities.

Bank Holding Company, a bank holding company as defined under the Code in effect for the tax year.

Code, the federal Internal Revenue Code in effect for the tax year.

Commissioner, the Commissioner of Revenue or the Commissioner's representative authorized to perform the duties of the Commissioner.

Debt Instruments, shall be deemed to include, without limitation, in addition to corporate bonds, debt obligations of the United States, its agencies or instrumentalities and of any state or political subdivision thereof, their agencies or instrumentalities.

Financial Institution, a financial institution as defined in M.G.L. c. 63, § 1.

Open Tax Year, any tax year for which additional assessments may be made by the Commissioner under the applicable statute of limitations.

REIT, a real estate investment trust as defined in the Code.

Related Member, as defined in M.G.L. c. 63, § 31I.

Regulated Investment Company, or RIC, an entity that is treated as a regulated investment company for the tax year under the Code.

Real Estate Mortgage Investment Conduit, or REMIC, an entity that is treated as a real estate mortgage investment conduit for the tax year under the Code.

Securities, securities as defined at 830 CMR 63.38B.1(4).

63.38B.1: continued

Security Corporation, every financial institution or business corporation that is engaged exclusively in buying, selling, dealing in, or holding securities on its own behalf and not as a broker, and either applies to the Commissioner to be classified as a security corporation before the end of the tax year and is so classified, or has been so classified by the Commissioner and that classification has not been revoked. A security corporation is subject to tax under the provisions of M.G.L. c. 63, § 38B, and is not subject to an excise imposed by M.G.L. c. 63, §§ 2, 32, 32D, or 39.

(3) Qualification for Security Corporation Classification.

(a) In General. In order to qualify for security corporation classification, the entity must satisfy a two-pronged test:

1. the instruments held by the entity must be securities; and
2. the securities must be acquired and held for investment purposes.

(b) Requirement that a security corporation be engaged exclusively in securities investment activities, namely buying, selling, dealing in, or holding securities on their own behalf and not as a broker. A corporation that is engaged in any business activity other than securities investment activity during any portion of its tax year is not entitled to classification as a security corporation.

Example (3)(b). ManufacturingCo is a corporation engaged in manufacturing with a tax year end of June 30th. On June 15, 2007 ManufacturingCo enters into a purchase and sale agreement to transfer its manufacturing assets on July 7, 2007. From July 1 through July 7, 2007, the first seven days of its tax year, ManufacturingCo derives income from the last of its manufacturing activities. On July 7, 2007 ManufacturingCo sells all if its manufacturing assets, investing the proceeds in various securities. From July 7, 2007 through June 30, 2008 ManufacturingCo engages exclusively in the buying, selling, holding and dealing in securities. ManufacturingCo is not entitled to classification as a security corporation for its tax year ending June 30, 2008, because it has engaged in a business other than a securities business for a portion of that tax year.

(c) A security corporation may engage in ancillary activity that is necessary or typical in the context of its securities investment business. Examples of this type of ancillary activity include: owning office furniture or supplies used in operating its business; engaging a payroll services company for payment of its staff; sponsoring employee benefits programs on behalf of its staff. Ancillary activities may include activities that are necessary to protect a corporation's assets from liabilities, or to meet obligations that may arise from a prior, discontinued business.

Example (3)(c). SecurityCo currently invests only in securities, but prior to 2002 it sold parts for heavy construction equipment. SecurityCo continues to maintain products liability insurance for potential liabilities arising from the continuing existence of the equipment. Generally, a security corporation does not purchase products liability insurance, but in this case, because the corporation maintains the insurance to insulate its assets from liabilities that could arise from its prior, discontinued business activities, the ownership of the insurance will not of itself preclude SecurityCo from obtaining security corporation classification.

(4) Definition of Securities.

(a) The definition of securities that applies to bank holding companies. As applied to bank holding companies, the term security means a security that is recognized as such under the general rules of Massachusetts case and statutory law. The scope of qualifying securities for these purposes will generally encompass any instrument qualifying as a security under the rules found at M.G.L. c. 63 § 38B(b½), and more fully explained in 830 CMR 63.38B.1(4)(b).

(b) The definition of securities that applies to entities that are not bank holding companies. As applied to entities that are not bank holding companies, for tax years that end on or after October 1, 2004, securities are defined under M.G.L. c. 63, § 38B(b½) to include:

63.38B.1: continued

1. Equity or debt instruments and options, futures and other derivatives, that are traded on and were acquired through a public exchange or another arm's length secondary market. These options, futures, and other derivatives may have as their underlying property either tangible goods, such as petroleum, grain, or livestock, or intangible items, such as securities.

Example (4)(b)(1.1). SubsidiaryCo is an investment subsidiary of ParentCo, a real estate developer. OtherCo is an unrelated company. SubsidiaryCo lends money to OtherCo and takes back a promissory note. Even though this security may in some circumstances be saleable on a secondary market, it does not qualify as a security in this case because it was not in fact purchased on an arm's length secondary market. SubsidiaryCo will not qualify as a security corporation.

Example (4)(b)(1.2). InvestCo invests in and holds securities. It approaches EquityCo, a major investment firm that pairs interested investors with sellers of suitable privately-held business interests to encourage private investment. EquityCo recommends that InvestCo purchase ten percent of the stock of CloseCo from a third party, which holds previously issued and outstanding stock of CloseCo. Neither EquityCo nor InvestCo are affiliates of CloseCo. Provided it meets all other requirements of this regulation, InvestCo's investment in CloseCo stock is an investment in a security acquired on an arm's length secondary market.

2. Bonds as defined in and issued pursuant to M.G.L. c. 23G, which includes bonds issued by the Massachusetts Development Finance Agency.
3. Cash and cash equivalents, including savings and checking accounts and certificates of deposit, and foreign currencies.
4. Interests in a REIT under section 856 of the Code or a RIC under section 851 of the Code, or a real estate mortgage investment conduit under section 860D of the Code, so long as none of the mortgages owned by the conduit were originated by the holder of the instrument or by an affiliate of the holder.
5. Mortgage-backed securities that are guaranteed by the Federal National Mortgage Association, the Government National Mortgage Association, the Federal Home Loan Bank or the Federal Home Loan Mortgage Corporation.
6. Collateralized mortgage obligations, so long as none of the mortgages that underlie the obligation were originated by the holder or by an affiliate of the holder.
7. Any other passive investment vehicles that, in the judgment of the Commissioner, should be considered to constitute "securities." Taxpayers may request guidance on specific questions about what qualifies as a security under this paragraph, by seeking a letter ruling under 830 CMR 62C.3.2.

a. Further explanation of the term "other passive investment vehicles." The Department will not treat a corporation as failing to qualify for classification as a security corporation solely because it holds on or after October 1, 2004 an equity interest in a business organized as a corporation that it purchased at arm's length but which is otherwise not described in section 38B(b ½)(1), for example, stock purchased from the original issuer. In order to meet this requirement, the taxpayer must be able to demonstrate to the satisfaction of the Commissioner, based on all the facts and circumstances, that the instrument was purchased and is held for passive investment purposes only; and neither the taxpayer nor any of its shareholders, officers, directors, or related members:

i. has either legal or effective control, directly or indirectly, of the business (whether through stock ownership, board representation, contract, or otherwise), either with respect to operations or with respect to any fundamental business matters, such as corporate governance, dividend policy, mergers and acquisitions, and financings, *etc.*;
ii. participates actively in management of the business, whether or not serving in a formal capacity such as an officer;
iii. is a related member of the business;
iv. holds a debt security, not otherwise named in 830 CMR 63.38B.1(4)(b), in the business, or is otherwise a creditor of the business.

63.38B.1: continued

Any decision on qualification as a security pursuant to 830 CMR 63.38B.1(4)(b)7. shall be in the Commissioner's discretion, and the taxpayer shall have the burden of satisfying the Commissioner with respect to both the applicable facts and circumstances and the application of the standards set out above. The Department in the future may issue further guidance to change, refine, or add to the requirements for qualification under section 38B(b ½)(7), and it is possible that such guidance will, on a prospective basis, further restrict or eliminate the potential for qualification.

(c) Transition Rule. A corporation shall not lose its status as a security corporation for a tax year that begins before October 1, 2004 if:

1. the instruments that it holds for the portion of the tax year ending on September 30, 2004 qualify as securities under M.G.L. c. 63, § 38B as it read prior to the effective date of the definition of "securities" set forth in M.G.L. c. 63, § 38B(b½) and 830 CMR 63.38B.1(4)(b), namely October 1, 2004; and

2. the instruments that it holds for the portion of the tax year beginning on October 1, 2004 qualify as securities as defined in 830 CMR 63.38B.1(4)(b).

(d) The new definition of "securities" will not be construed to preclude a security corporation from acquiring certain qualifying securities from an affiliate. The Department will not treat a corporation that owns securities that otherwise meet the definition set forth in 830 CMR 63.38B.1(4)(b)1. as failing to qualify as a security corporation solely because it acquires securities from an affiliate, provided the securities were initially acquired by the affiliate through a public exchange or other arm's length secondary market as part of the affiliate's securities investment activities.

(e) Ownership of REITs by Security Corporations. A security corporation may own an interest in a REIT. However, an ownership interest in a REIT that is a related member shall not be considered a qualifying security. This rule applies to bank holding companies and non-bank holding companies.

(f) Limitation on Scope of the Definition of Securities in 830 CMR 63.38B.1(4)(b). The definition of "securities" in 830 CMR 63.38B.1(4)(b) shall not be construed to limit the instruments that may be held by an investment partnership for purposes of the safe harbor set forth in M.G.L. c. 62, § 17(b).

(5) The Securities must be Acquired and Held Exclusively for Investment Purposes.

(a) 1. Analysis of Investment Intent. To qualify for security corporation classification, the corporation must engage in its activities for an investment purpose. This purpose includes the intent to conserve and augment capital and to provide income through judicious acquisition and retention of securities. Holding an instrument, even one that in another context may qualify as a security, for any purpose other than investment will disqualify an entity from security corporation classification. A corporation that holds securities, such as cash equivalent instruments, in circumstances where the funds invested in an instrument are used directly or by an affiliate for operational purposes, or are used as part of a cash management system, does not qualify as a security corporation.

2. Special Rule for Security Corporation Subsidiaries of Financial Institutions. Security corporations that are subsidiaries of financial institutions are permitted to deposit cash in an account of a related financial institution (the "related financial account") under certain conditions, notwithstanding the provisions in 830 CMR 63.38B.1(5)(a)1. This permission is limited to a security corporation that has generated cash from interest, dividends, or other qualifying income earned from its investments, or from the sale, redemption, or maturity of a security, and that deposits the cash in the related financial account solely on a temporary, short-term basis pending reinvestment of the cash by the security corporation in qualifying securities issued by unrelated issuers.

To be eligible for this exception, the following additional conditions must be met:

a. The related financial account must be established, and deposits made therein, on terms and conditions generally available to similarly-situated customers.

b. The security corporation must regularly (*e.g.* quarterly) declare and pay dividends or otherwise make distributions of all amounts of cash or other property on hand, except to the extent that such cash or other property is either held in cash or invested in qualifying securities issued by unrelated issuers or is deposited in the related financial account on terms meeting the standards set out in 830 CMR 63.38B.1.

63.38B.1: continued

c. Deposits by the security corporation in the related financial account must be limited in amount and time on deposit so as to reasonably reflect, and be commensurate with, a demonstrated need for holding cash in an interest-bearing account on a short-term, temporary basis pending reinvestment in qualifying securities issued by unrelated issuers (taking into account the availability to the security corporation of any other cash or property for purposes of investing in qualifying securities, including cash or other property contributed by its parent or other shareholders). Any amounts so deposited that are not promptly reinvested in such qualifying securities must be dividended or otherwise distributed by the security corporation to its parent or other shareholders.

d. In computing its net income, the related financial institution paying interest on the related financial account in which the security corporation is permitted to make temporary, short-term deposits of cash pursuant to 830 CMR 63.38B.1(5)(a)2. must add back otherwise deductible interest paid, accrued, or incurred to the security corporation, subject to the exceptional cases where such deductions are allowable, according to the provisions of M.G.L. c. 63, § 31J. The Department will closely examine requests for such addback exceptions, and the taxpayer must establish to the Department's satisfaction the reasonableness of the security corporation deposits in light of the standards set out in 830 CMR 63.38B.1.

e. The security corporation must maintain books and records establishing that it has met the standards set out in 830 CMR 63.38B.1, and be prepared to demonstrate to the satisfaction of the Department that it has met such standards.

Example (5)(a.1). LendCo is in the business of lending money for business and personal reasons, which it secures through promissory notes. The business of lending money is not the acquisition of securities for an investment purpose; thus LendCo is ineligible for security corporation classification.

Example (5)(a.2). InvestCo owns a variety of securities, including stock of BigCo that it purchased through a secondary market. InvestCo has negotiated loans with BigCo and has taken back promissory notes as a means of financing BigCo's operations. InvestCo is ineligible for security corporation classification, for two reasons: Because InvestCo is negotiating loans with BigCo, it is engaged in activities with respect to its holdings that go beyond an investment related purpose; and the notes themselves are not securities within the meaning of 830 CMR 63.38B.1(3)(b)1., because the notes were not acquired through a public exchange or other arm's length secondary market.

Example (5)(a.3). CloseCo is a closely held corporation. CloseCo holds, in addition to various securities, promissory notes received from its president and a principal stockholder of CloseCo as security for loans made for the accommodation of CloseCo's principals. The notes are unsecured and provide for a favorable rate of interest. CloseCo may not be classified as a security corporation for two reasons. First, the notes were not taken for investment purposes, but as security for loans made for the accommodation of CloseCo's principals. Second, the notes were not purchased on an arm's length secondary market.

Example (5)(a.4). ManufacturingCo is a corporation engaged in manufacturing. In 2007, ManufacturingCo sells its plant, equipment and other assets and ceases its manufacturing business, taking back from Buyer a promissory note that Buyer will repay over a fifteen-year period. After 2008, ManufacturingCo continues to hold the note, and engages in investing in a variety of securities. ManufacturingCo may not be classified as a security corporation for any year during which it holds the original note, because the note was not acquired for investment purposes.

(b) 1. In order to qualify as a security corporation, the taxpayer generally must exercise no management or control over the issuer of the instrument. The taxpayer can have no more than the ordinary rights typically possessed by a corporate shareholder, which include:

63.38B.1: continued

a. the right to elect directors;
b. the right to vote on the amendment of a corporate charter;
c. the right to agree to dissolution of the corporation; and
d. the right to agree to the sale of substantially all of the corporation's assets.

Example (5)(b)(1.1). ConsultCo owns a variety of securities. Recently, ConsultCo acquired an 8% limited partnership interest in a limited partnership (LP) that it purchased through a secondary market. The limited partnership is not in the business of dealing in securities. There are ten other limited partners invested in LP, each of which holds an 8% interest. ConsultCo's interest in LP gives it a variety of powers. ConsultCo has the right to vote on amendments to the underlying partnership agreement. It also has rights that exceed those granted to all limited partners under M.G.L. c. 109, which governs limited partnerships. For example, ConsultCo has the right to veto decisions concerning the business activities of the limited partnership; and it has the right to veto borrowing and investment activities of the limited partnership. While an interest in a limited partnership may be a security provided it meets all the requirements of 830 CMR 63.38B.1(4)(a), in this case the rights granted the limited partner exceed those allowed under 830 CMR 63.38B.1. The right to vote on amendments to the underlying partnership agreement is similar to rights given an ordinary corporate shareholder, and does not disqualify the corporation from security corporation classification. The right to veto business or investment decisions of the partnership, however, is not a right held by an ordinary investor, and will prevent the corporation from having security corporation classification.

Example (5)(b)(1.2). VentureCo generates capital through equity investments in high-risk ventures, such as in early-stage development companies. VentureCo introduces other investors to potential investments in companies in which Venture Co invests; VentureCo both extends lines of credit to the developing companies and arranges the extension of credit from lenders to them. It also advises management of the emerging businesses on best practices and strategies. Because VentureCo's activities include both investment activities and non-qualifying business activities, it does not qualify for security corporation classification.

Example (5)(b)(1.3). Parent Corporation owns several subsidiaries, including ManageCo, which contracts to manage publicly traded mutual funds, and InvestCo, which purchased shares in several funds managed by ManageCo through an arm's length secondary market. Provided InvestCo engages in no other disqualifying activity, it is eligible to be classified as a security corporation, notwithstanding ManageCo's contractual relationship with the purchased funds to provide management services.

Example (5)(b)(1.4). InvestCo purchases investments through stock exchanges and arm's length secondary markets. It purchases a 40% interest in NewCo, which gives it the right to vote to hire and fire managers. InvestCo has rights that exceed those ordinarily held by a corporate shareholder, and is ineligible for security corporation classification.

2. In order to qualify as a security corporation, a non-bank holding company must not own a controlling interest in a business entity. In addition to satisfying other requirements for qualification as a security corporation, a non-bank holding company security corporation's investment (whether direct or indirect) in the equity of a business entity (or options or interests exercisable or convertible into equity) must in any event not exceed 50% of the outstanding equity interests in that entity (determined as if options and instruments exercisable or convertible into equity are in fact exercised or converted), whether measured by vote or value. For example, a corporation will not be eligible for security corporation classification if it owns more than 50% of the stock of a subsidiary, or is a related member of the subsidiary.

63.38B.1: continued

Example (5)(b)(2). ParentCo owns 51% of HoldingCo, a holding company that it purchased through an arm's length secondary market. HoldingCo owns the stock of two corporations that perform business functions. ParentCo has no explicit rights to manage or control the business of HoldingCo. Because its interest in HoldingCo exceeds 50% of HoldingCo's outstanding equity interests, ParentCo is ineligible for security corporation classification.

(6) Procedure for Security Corporation Classification.

(a) Timing of the Application. A corporation seeking to be classified as a security corporation must submit an application to the Commissioner prior to the end of the tax year for which classification is sought.

(b) Information Required in the Application. A corporation that seeks security corporation classification must include in its application the following information:

1. the name, address, and federal identification number of the corporation;
2. the tax year for which classification is sought;
3. a balance sheet as of the first day of the tax year;
4. a balance sheet as of the date of the application (or as near as is reasonably possible);
5. an income statement for the period from the first day of the tax year to the date of the application;
6. a statement that the corporation will be in compliance with M.G.L. c. 63, § 38B for the remaining portion of the tax year, and specifically that the corporation will be engaged exclusively in buying, selling, dealing in and holding securities on its own behalf and not as a broker, and engage in its activities exclusively for investment purposes;
7. a statement that the corporation is or is not a regulated investment company or a bank holding company; and
8. the name and telephone number of the officer or representative who is to be contacted in case additional information is needed. If a representative, the application must include a duly executed power of attorney authorizing the Commissioner to discuss the application with that representative.

(c) Requirements for Statements Accompanying the Application. Any general balance sheet entries, such as "Investments," "Accounts Receivable," or "Marketable Securities" must be accompanied by a detailed schedule listing the applicable assets.

(d) Additional Information. In addition to the application described in 830 CMR 63.38B.1(6), the Commissioner may require a corporation seeking security corporation classification to submit additional information supporting its application.

(e) Application Submission Instructions. Applications for security corporation classification should be submitted to the Security Corporations Unit, as set forth in 830 CMR 63.38B.1(10).

(7) Continuing Status of Application; Change in Activities.

(a) Classification in Successive Years. Once a corporation has been classified as a security corporation, it may continue to file as a security corporation for successive years unless it is notified by the Commissioner that its classification has been revoked, provided that the corporation must in good faith believe that it continues to qualify as a security corporation.

(b) Required Notification to Commissioner of a Change in Corporate Activities or Other Facts that Might Affect Security Corporation Status. A corporation that has been classified as a security corporation must notify the Commissioner of any change in its activities or other facts that might impact its classification. Such notice should be submitted to the Security Corporations Unit, as set forth in 830 CMR 63.38B.1(10) before the end of the tax year in which such change occurs.

(8) Election for Voluntary Withdrawal.

(a) General. A corporation that has been classified as a security corporation may elect to withdraw from the classification.

(b) Time for Election. To be effective for a given tax year, a corporation's election to withdraw as a security corporation must be submitted to the Commissioner by the end of the tax year.

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(c) Information Required. A notice to withdraw as a security corporation must include the corporation's federal identification number and a brief statement of the reason for the request.
(d) Effect of Election. A notice to withdraw as a security corporation is effective for the tax year during which the security corporation submits the notice and for all succeeding tax years of the corporation.
(e) Notice Submission Instructions. A notice to withdraw from security corporation classification should be submitted to the Security Corporations Unit, as set forth in 830 CMR 63.38B.1(10).
(f) Retroactive Voluntary Withdrawal Not Allowed. After the end of a tax year, a security corporation may not seek to withdraw as a security corporation for a prior tax year.

Example (8)(f). SecurityCo elects to be classified as a security corporation and duly files its returns for tax years 2004 – 2007 as a security corporation. After filing, SecurityCo reviews its 2005 return and realizes that if it had been a business corporation it would have been entitled to a dividends received deduction for some of its income, which would have yielded a more favorable tax result. SecurityCo seeks to file an amended return as a business corporation for the year in question. SecurityCo is not permitted to change its status as a security corporation because the tax year is concluded.

(9) Revocation of Security Corporation Classification.
(a) Assessment. A corporation that has been classified as a security corporation is entitled to taxation under M.G.L. c. 63, § 38B for a given tax year only if it meets the requirements of that section for that year. Accordingly, if during any tax year a corporation that is classified under M.G.L. c. 63, § 38B fails to meet this section's requirements, the Commissioner may revoke the corporation's classification and assess the corporation for any amounts due under the corporate excise.
(b) Retroactive Revocation. Where the Commissioner finds that a corporation classified under M.G.L. c. 63, § 38B has failed to meet the requirements of that section for a prior tax year, the Commissioner may retroactively revoke the security corporation classification for that year and all subsequent years that the corporation failed to meet the classification requirements under M.G.L. c. 63, § 38B. Where the Commissioner has retroactively revoked a corporation's security corporation classification for a prior tax year, the Commissioner may assess that corporation under the applicable statute for all open tax years. The Commissioner has the discretion to treat a corporation that met the requirements of M.G.L. c. 63, § 38B in other open tax years as a security corporation for any such year.

(10) Submissions to the Security Corporations Unit.
(a) Taxpayers shall submit all required written applications and notices to the Security Corporations Unit at the following address:

Massachusetts Department of Revenue
Attn: Security Corporations Unit
200 Arlington Street, Room 4300
Chelsea, MA 02150

(b) Electronic Filing. Security corporations are subject to the general rules for electronic filing that apply to other corporations. Taxpayers are advised to review current electronic filing requirements on the Department of Revenue Web site, www.dor.state.ma.us.

(11) Effective Date. 830 CMR 63.38B.1 shall take effect for tax years beginning on or after January 1, 2006.

63.38M.1: Massachusetts Research Credit

(1) Statement of Purpose, Outline of Topics, Effective Date.

(a) Purpose of 830 CMR 63.38M.1. 830 CMR 63.38M.1 explains the calculation of the corporate excise credit for Massachusetts research expenses afforded by M.G.L. c. 63, § 38M.

(b) Outline of Topics. Following is a list of sections contained in 830 CMR 63.38M.1.

1. Statement of Purpose, Outline of Topics, Effective Date.
2. Definitions.
3. General.
4. Massachusetts Qualified Research Expenses.
5. Massachusetts Qualified Research Base Amount.
6. Massachusetts Basic Research Payments.
7. Controlled Groups and Entities Under Common Control.
8. Limitations on the Credit.
9. Interaction with Other Credits.
10. Carry Over of Unused Credit.
11. Mergers and Changes of Ownership.
12. Combined Groups.
13. Election to Calculate Massachusetts Qualified Research Expense Credit Separately for Defense Related Activities and Other Qualified Activities.

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14. Recordkeeping and Accounting Requirements.

(c) Effective Date. 830 CMR 63.38M.1 generally applies to expenses incurred on or after January 1, 1991. The election described in 830 CMR 63.38M.1(13) may be made for taxable years beginning on or after January 1, 1995. Changes in the effect of the election to use Massachusetts gross receipts described in 830 CMR 63.38M.1(5)(d)3., are generally effective for tax years beginning on or after January 1, 1997.

(2) Definitions. For purposes of 830 CMR 63.38M.1, the following terms shall have the following meanings, unless the context requires otherwise:

Aggregated group, a group of entities required to aggregate their activities under 830 CMR 63.38M.1(7), for purposes of determining the credit.

Basic Research, any research, the payments for which, are basic research payments under Section 41(e) of the Code.

Code, the Internal Revenue Code of the United States as amended and in effect on August 12, 1991.

Corporation, a corporation organized under or subject to M.G.L. c. 156B, and subject to the excise imposed by M.G.L. c. 63, § 32, or a corporation, association, or organization established under laws other than those of Massachusetts, and subject to the excise imposed by M.G.L. c. 63, § 39.

Credit or Massachusetts credit, the credit for research expenses allowed by M.G.L. c. 63, § 38M, as added by St. 1991, c. 176, § 6.

Defense Related Activities, any activity carried out in Massachusetts, relating to the business of researching, developing and producing for sale, pursuant to a contract or subcontract, of any arm, ammunition or implement of war designated in the munitions list published pursuant to 22 U.S.C. 2778, but only to the extent that such property is specifically designed, modified, or equipped for military purposes, or equipment for the National Aeronautics and Space Administration.

Federal Credit, the credit against the federal income tax allowed by Section 38(b)(4) of the Code, as determined under Section 41(a) of the Code.

Qualified Research, any research, the expenses related to which are qualified research expenses under Section 41(b) of the Code.

Research facility located in Massachusetts, a site, physically located in Massachusetts used to conduct qualified or basic research.

(3) General.

(a) Computation of Credit. The Massachusetts credit for research expenses for the taxable year shall be an amount equal to the sum of the following amounts:

1. 10% of the excess, if any, of Massachusetts qualified research expenses for the taxable year, as determined under 830 CMR 63.38M.1(4), over the Massachusetts qualified research base amount, as determined under 830 CMR 63.38M.1(5), plus

2. 15% of Massachusetts basic research payments for the taxable year, as determined under 830 CMR 63.38M.1(6).

(b) Eligibility for the Credit. The Massachusetts credit for research expenses is available to all domestic corporations subject to tax under M.G.L. c. 63, § 32, and all foreign corporations subject to tax under M.G.L. c. 63, § 39.

(c) Eligible Expenses. The credit applies only to research expenses incurred on or after January 1, 1991.

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(d) Effect on Net Income. In determining net income for a taxable year under M.G.L. c. 63, § 30.5(b), the deduction that may be taken with respect to any expenses that qualify for the credit must be determined by reducing the amount of such expenses for the taxable year by the amount of the credit determined for the taxable year under 830 CMR 63.38M.1(3)(a). For purposes of this provision, 830 CMR 63.38M.1(3)(d), the amount of the credit includes any amount of credit disallowed for the taxable year under the limitations described at 830 CMR 63.38M.1(8), but does not include any amount of credit carried over from previous taxable years under the provisions of 830 CMR 63.38M.1(10). Also, in determining net income for a taxable year, Subsection (c) of Section 280C of the Code, as amended and in effect for the taxable year, shall not apply.

(e) S Corporations. S corporations may apply the credit against their corporate excise liability under the non-income or, if applicable, the income measure of the corporate excise. The credit does not flow through to the individual shareholders of an S corporation.

(f) Unincorporated Flow-Through Entities. Unincorporated flow-through entities, such as partnerships and joint ventures, shall be treated as flow-through entities for purposes of determining the credit, unless the aggregation provisions of 830 CMR 63.38M.1(7), require otherwise. All amounts relevant to the calculation of the credit that are paid or received by such entities shall be attributed to the owners of the entities in accordance with Section 704 of the Code, as amended and in effect for the taxable year, and shall be taken into account in determining the credit for the taxable year during which the taxable year of the unincorporated flow-through entity ends.

(g) Accounting Rules. For all purposes under 830 CMR 63.38M.1, in determining when a research expense is incurred, corporations shall use the same method of accounting as they use to compute the federal credit under Section 41 of the Code.

(4) Massachusetts Qualified Research Expenses.

(a) General. A corporation's Massachusetts qualified research expenses for a taxable year are those expenses that meet both of the following requirements:

1. The expenses must be qualified research expenses under Section 41(b) of the Code; and

2. The expenses must have been incurred for research activity conducted in Massachusetts.

(b) Research Activity Conducted in Massachusetts. Expenses incurred for research activity conducted in Massachusetts are:

1. Wages. Wages paid for qualified services, as defined by Section 41(b)(2)(B) of the Code, performed in Massachusetts;

2. Supplies. Amounts paid for supplies, as defined by Section 41(b)(2)(C) of the Code, used or consumed in Massachusetts in conducting qualified research;

3. Computer fees. Amounts paid for the right to use computers located in Massachusetts in the conduct of qualified research that takes place in Massachusetts, to the extent such amounts are treated as in-house research expenses under Section 41(b)(2)(A)(iii) of the Code;

4. Contract research expenses. 65% of amounts paid to other persons as contract research expenses, as defined by Section 41(b)(3) of the Code, to the extent attributable to research activity conducted at a research facility located in Massachusetts.

Where such expenses relate to amounts paid for services performed both within and outside Massachusetts or tangible personal property used both within and outside Massachusetts, the amount of the expense must be prorated between Massachusetts and non-Massachusetts activity based on the ratio of days the service provider or tangible personal property was employed in research in Massachusetts to the total number of days the service provider or tangible personal property was employed in research both within and outside Massachusetts.

(5) Massachusetts Qualified Research Base Amount.

(a) General. The Massachusetts qualified research base amount is the product of the following amounts:

1. The Massachusetts fixed-base percentage, and

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2. The average annual gross receipts of the corporation for the four taxable years preceding the taxable year for which the credit is being determined, as computed under 830 CMR 63.38M.1(5)(d).

(b) Minimum Massachusetts Qualified Research Base Amount. Notwithstanding the provisions of 830 CMR 63.38M.1(5)(a), in no event shall the Massachusetts qualified research base amount for the taxable year for which the credit is being determined be less than 50% of the Massachusetts qualified research expenses as computed for the taxable year under 830 CMR 63.38M.1(4)(a).

(c) Massachusetts Fixed-Base Percentage.

1. General rule. Except as provided below, the Massachusetts fixed-base percentage is determined by dividing the corporation's aggregate Massachusetts qualified research expenses, as determined under 830 CMR 63.38M.1(4)(a), for all taxable years beginning after December 31, 1983, and before January 1, 1989, by the corporation's aggregate gross receipts for such taxable years, as computed under 830 CMR 63.38M.1(5)(d). However, in no event shall the Massachusetts fixed-base percentage exceed 16%. Massachusetts fixed-base percentage shall be rounded to the nearest 1/100 of 1%.

2. Start-up companies. If there are fewer than three taxable years beginning after December 31, 1983, and before January 1, 1989, in which the corporation had both (i) gross receipts, computed under Section 41(c)(3)(A) of the Code, attributable to Massachusetts sales, or, in the case of a corporation that makes the election to use federal gross receipts under 830 CMR 63.38M.1(5)(d), gross receipts, computed under Section 41(c)(3)(A) of the Code, whether or not attributable to Massachusetts sales, and (ii) Massachusetts qualified research expenses, as determined under 830 CMR 63.38M.1(4)(a), the Massachusetts fixed base percentage is 3%.

3. Inadequate Records. If a corporation cannot compute the Massachusetts fixed-base percentage as required by 830 CMR 63.38M.1(5)(a)1., due to inadequate accounts and records for the base period, the Massachusetts fixed base percentage is 16%.

(d) Gross receipts. For purposes of 830 CMR 63.38M.1(5)(a)2., the average annual gross receipts of the corporation for the four taxable years preceding the taxable year for which the credit is being determined shall be computed in the same manner as required under Section 41(c)(1)(B) of the Code, and for purposes of 830 CMR 63.38M.1(5)(c)1., aggregate gross receipts for the base period shall be determined in the same manner as required under Section 41(c)(3)(A) of the Code. Gross receipts may be reduced by returns and allowances as allowed under Section 41(c)(5) of the Code.

1. Election to use Massachusetts Gross Receipts. Notwithstanding the provisions of this subsection, 830 CMR 63.38M.1(5)(d), a corporation may elect to compute gross receipts using only those gross receipts attributable to Massachusetts sales, provided that the election shall apply to both the computation of the average annual gross receipts for purposes of 830 CMR 63.38M.1(5)(a)2., and aggregate gross receipts for purposes of 830 CMR 63.38M.1(5)(c)1.

2. Method of Election. The election may be made when filing the return for the first taxable year for which the credit is claimed and must be made thereafter in accordance with 830 CMR 63.38M.1 (5)(d)3. The election generally may not be made retroactively on an amended return or claim for abatement. However, subject to the limitations in M.G.L. c. 62C, § 37, and 830 CMR 62C.37.1, a corporation may make an election on an amended return for the earliest taxable year within that limitation period provided that the corporation was eligible for the credit for that taxable year and did not claim the credit on the return for that taxable year or any prior year. Corporations shall indicate their election by checking the appropriate box on Schedule RC, Research Credit or RC-A, Research Credit-Aggregation.

3. Election Effective for Three Taxable Years.

a. Generally a corporation will be bound by its choice to compute the credit using Massachusetts gross receipts or federal gross receipts for three consecutive taxable years commencing with the year in which the choice is made. Thereafter, the corporation may alter its choice prospectively in any subsequent taxable year, provided that any change in method shall be binding for the three year period commencing with the year of the change.

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b. If a corporation first claimed the credit for any taxable year commencing before January 1, 1997, it may change its method prospectively, as provided in 830 CMR 63.38M.1.(5)(d)3.a., in a taxable year commencing on or after January 1, 1997, provided that it used (or was bound by) the previous method for at least three taxable years. A corporation may not change its method for any taxable year commencing before January 1, 1997.

c. Any change of method permitted under 830 CMR 63.38M.1(5)(d)3. must be made on the return for the taxable year in which the change will take effect and may not be revoked or retroactively altered by filing an amended return or claim for abatement. However, in order to assist taxpayers who may have filed their 1997 returns prior to the promulgation of 830 CMR 63.38M.1 as amended, a corporation that is otherwise eligible to do so may change its method for its taxable year beginning during the 1997 calendar year either on its original return for that year or by filing an amended return for such taxable year on or before the due date, determined without regard to extensions, of the return for the next taxable year.

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4. Aggregated groups. All members of an aggregated group, as defined by 830 CMR 63.38M.1.(7)(b), must compute gross receipts in the same manner. If the group elects to base the computation of the credit on Massachusetts gross receipts, the election is binding on all members in subsequent taxable years as provided in 830 CMR 63.38M.1(5)(d)3. Entities that are members of an aggregated group when an election is made shall continue to be bound by the election for the three year period commencing with the year of the change, whether or not they remain part of the group. However, when an entity leaves an aggregated group and in any subsequent taxable year becomes a member of a new aggregated group, the entity shall compute gross receipts in the same manner as the new aggregated group.

5. Massachusetts gross receipts. Gross receipts attributable to Massachusetts sales for any taxable year shall include all gross receipts as computed under 830 CMR 63.38M.1(5)(d), that are included in the numerator of the corporate excise apportionment sales factor under M.G.L. c. 63, § 38(f), as determined for the taxable year in which the gross receipts are received or deemed received under M.G.L. c. 63. For purposes of determining gross receipts attributable to Massachusetts sales under 830 CMR 63.38M.1(5)(d)5., the throwback rule of M.G.L. c. 63, 38 (f) shall apply.

(e) Proration of Massachusetts Qualified Research Base Amount. For taxable years beginning before January 1, 1991, and ending before December 31, 1991, only, the Massachusetts qualified research base amount shall be multiplied by a fraction, the numerator of which is the number of days in such taxable year beginning on or after January 1, 1991, and the denominator of which is the total number of days in such taxable year.

(6) Massachusetts Basic Research Payments.

(a) General. Massachusetts basic research payments taken into account for purposes of 830 CMR 63.38M.1(3)(a)2., shall be equal to the excess of such Massachusetts basic research payments over the Massachusetts base period amount.

(b) Base Period. For purposes of determining Massachusetts basic research payments the base period is the three taxable year period ending with the taxable year immediately preceding the first taxable year of the corporation beginning after December 31, 1983. In all instances the base period determined under this provision, 830 CMR 63.38M.1(6)(b), will be identical to the base period determined for federal tax purposes under Section 41(e)(7)(B) of the Code.

(c) Massachusetts Basic Research Payments. A corporation's Massachusetts basic research payment for a taxable year are those expenses that are basic research payments for the taxable year under Section 41(e)(2) of the Code, and that relate to basic research activity conducted in Massachusetts.

1. Basic research activity conducted in Massachusetts. Basic research activity is conducted in Massachusetts to the extent that it is performed at a research facility located in Massachusetts, regardless of whether the organization conducting the research is organized under the laws of Massachusetts or another jurisdiction. Where a basic research project is conducted jointly at research facilities located within and outside Massachusetts, Massachusetts basic research payments include only the payment attributable to the portion of the project conducted within Massachusetts, determined by specific accounting.

2. Field research outside Massachusetts. Where a basic research project involves field research conducted outside Massachusetts, Massachusetts basic research payments include expenses attributable to the field research only to the extent that the results of the field research are used in basic research conducted at a research facility located in Massachusetts. Where the results of field research will be used at research facilities both within and outside Massachusetts the expenses attributable to the field research must be apportioned to Massachusetts using a fraction, the numerator of which is the number of research facilities located in Massachusetts at which the results of the field research will be used, and the denominator of which is the total number of research facilities at which the results will be used.

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(d) Massachusetts Base Period Amount. The Massachusetts base period amount is the sum of the following amounts:

1. The minimum Massachusetts basic research amount, plus
2. The Massachusetts maintenance of effort amount.

For taxable years beginning before January 1, 1991, and ending before December 31, 1991, only, the Massachusetts base period amount shall be multiplied by a fraction, the numerator of which is the number of days in such taxable year beginning on or after January 1, 1991, and the denominator of which is the total number of days in such taxable year.

(e) Minimum Massachusetts Basic Research Amount.

1. General. The minimum Massachusetts basic research amount is an amount equal to the greater of the two following amounts:

a. 1% of the average of the sum of the amounts paid or incurred during the base period for (i) any in-house research expenses as determined for the taxable year under Section 41(e)(4)(A)(i)(I) of the Code to the extent such expenses are attributable to research activity conducted in Massachusetts under 830 CMR 63.38M.1(4)(b), and (ii) any contract research expenses as determined for the taxable year under Section 41(e)(4)(A)(i)(II) of the Code to the extent such expenses are related to research activity conducted in Massachusetts under 830 CMR 63.38M.1(4)(b); or

b. The amount paid by the corporation for basic research during the base period that was treated as contract research expenses during the base period under the Code as in effect during the base period, as determined under Section 41(e)(4)(A)(ii) of the Code as amended and in effect on August 12, 1991, to the extent that such amounts were paid for research activity conducted in Massachusetts under 830 CMR 63.38M.1(6)(c).

2. Floor amount. In the case of a corporation that either (i) was not in existence for at least one taxable year (other than a short taxable year) during the base period, or (ii) had no Massachusetts basic research payments, as determined under 830 CMR 63.38M.1(6)(c), during the base period, the minimum Massachusetts basic research amount shall not be less than 50% of the Massachusetts basic research payments for the taxable year for which the credit is being determined.

3. Inadequate records. If a corporation cannot compute the Massachusetts minimum basic research amount as required by this provision, 830 CMR 63.38M.1(6)(e), due to inadequate accounts and records for the base period, the Massachusetts minimum basic research amount is 50% of the Massachusetts basic research payments for the taxable year for which the credit is being determined.

(f) Massachusetts Maintenance-of-Effort Amount. The Massachusetts maintenance-of-effort amount for a taxable year is determined by (i) multiplying the average of the nondesignated university contributions, as defined by Section 41(e)(5)(B) of the Code, paid to organizations organized under the laws of Massachusetts during the base period, by the cost-of living adjustment, as defined by Section 41(e)(5)(C) of the Code, and (ii) reducing the resulting amount, but not below zero, by the amount of nondesignated university contributions as defined by Section 41(e)(5)(B) of the Code, paid by the corporation to organizations organized under the laws of Massachusetts during the taxable year for which the credit is being determined.

(7) Controlled Groups and Entities Under Common Control.

(a) General. Two or more corporations that are members of the same controlled group, as defined by Section 41(f)(1)(A) of the Code, whether or not doing business in Massachusetts, must aggregate their activities as required by 830 CMR 63.38M.1(7)(b)-(i),for purposes of determining the credit. In addition, two or more entities, whether or not incorporated and whether or not doing business in Massachusetts, that are under common control, as defined by Section 41(f)(1)(B) of the Code, must aggregate their activities as required by 830 CMR 63.38M.1(7)(b)-(i). The credit allowable to a corporation subject to this provision, 830 CMR 63.38M.1(7)(a), is its share of the credit allowable to the entire aggregated group, determined under 830 CMR 63.38M.1(7)(b)-(i).

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(b) Aggregated Groups. An aggregated group is a group of related entities that are required to aggregate their activities with each other under 830 CMR 63.38M.1(7)(a) above. Aggregated groups must compute a single aggregated credit for the entire group in the manner required by 830 CMR 63.38M.1(7)(e), and must then allocate the amount of the aggregated credit in the manner required by 830 CMR 63.38M.1(7)(i), among the members of the aggregated group that are corporations doing business in Massachusetts. In determining the amount of the aggregated credit, all relevant expenses, payments, and receipts relating to transactions between members of an aggregated group shall be adjusted to reflect the fair market value of property and services sold or received.

(c) Certain Unincorporated Flow-Through Entities. Any unincorporated flow-through entity, such as a partnership or joint venture, whether or not a member of an aggregated group, that is owned to any extent by a member of an aggregated group, shall be treated as a flow-through entity for purposes of determining the aggregated credit. All amounts relevant to the calculation of the credit that are paid or received by such an entity shall be attributed to the owners of the entity as provided in 830 CMR 63.38M.1(3)(f). The separate existence of such entities shall be ignored for purposes of computing and allocating the aggregated credit.

(d) Other Unincorporated Entities. Any unincorporated entity that is a member of an aggregated group and is not treated as a flow-through entity under the provisions of 830 CMR 63.38M.1(7)(c), shall be treated as a separate entity for purposes of computing and allocating the aggregated credit.

(e) Computation of the Aggregated Credit. The aggregated credit for research expenses for the taxable year shall be an amount equal to the sum of the following amounts:

1. 10% of the excess, if any, of Massachusetts aggregated qualified research expenses for the taxable year, as determined under 830 CMR 63.38M.1(7)(f), over the Massachusetts aggregated qualified research base amount, as determined under 830 CMR 63.38M.1(7)(g), plus

2. 15% of Massachusetts aggregated basic research payments for the taxable year, as determined under 830 CMR 63.38M.1(7)(h).

(f) Aggregated Massachusetts Qualified Research Expenses. Aggregated Massachusetts qualified research expenses is the sum of the Massachusetts qualified research expenses, determined under 830 CMR 63.38M.1(4), of each member of the aggregated group that is not treated as a flow-through entity under 830 CMR 63.38M.1(7)(c), whether or not incorporated.

(g) Aggregated Massachusetts Qualified Research Base Amount. The aggregated Massachusetts qualified research base amount is determined under 830 CMR 63.38M.1(5)(a), in the same manner as for a single corporation, except as provided below:

1. Qualified research expenses. For all purposes relevant to the calculation, aggregated Massachusetts qualified research expenses, as determined for the entire group under 830 CMR 63.38M.1(7)(f), shall be substituted for Massachusetts qualified research expenses, as determined under 830 CMR 63.38M.1(4).

2. Gross receipts. Where the calculation involves gross receipts for a single taxable year, or for a period of taxable years, gross receipts for the relevant period shall be the sum of the gross receipts of all members of the aggregated group for that period, except gross receipts received by entities treated as flow-through entities and attributed to other members of the group under 830 CMR 63.38M.1(7)(c).

3. Start-up groups. The start-up provisions of 830 CMR 63.38M.1(5)(c)2., shall not apply to individual group members. However, where every member of an aggregated group, as comprised during the first taxable year for which the credit is claimed, is a start-up company under 830 CMR 63.38M.1(5)(c)2., during the first taxable year for which the credit is claimed, the Massachusetts fixed base percentage of the aggregated group is 3%.

4. Inadequate records. If any member of an aggregated group is unable to compute its base period aggregate Massachusetts qualified research expenses or base period aggregate gross receipts due to inadequate accounts and records for the base period, the Massachusetts fixed base percentage of the aggregated group is 16%.

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5. Minimum Aggregated Massachusetts Qualified Research Base Amount. Notwithstanding any other provision of 830 CMR 63.38M.1(7)(g), in no event shall the aggregated Massachusetts qualified research base amount for the taxable year for which the credit is being determined be less than 50% of aggregated Massachusetts qualified research expenses as computed for the taxable year under 830 CMR 63.38M.1(7)(f).

(h) Aggregated Massachusetts Basic Research Payments. The aggregated Massachusetts basic research payment is determined under 830 CMR 63.38M.1(6)(a), in the same manner as for a single corporation, except as provided below:

1. Basic research payments. Massachusetts basic research payments shall be the sum of the Massachusetts basic research payments, determined under 830 CMR 63.38M.1(6)(c), of each of the members of the aggregated group that is not treated as a flow-through entity under 830 CMR 63.38M.1(7)(c), whether or not incorporated. For purposes of computing Massachusetts basic research payments under this provision, members of the aggregated group that are not corporations and are not treated as flow-through entities under 830 CMR 63.38M.1(7)(c), must compute their Massachusetts basic research payments under 830 CMR 63.38M.1(6)(c), as though they were corporations.

2. Base period amount. The Massachusetts base period amount is the sum of the minimum Massachusetts basic research amounts, determined under 830 CMR 63.38M.1(6)(e), and the Massachusetts maintenance-of-effort amounts, determined under 830 CMR 63.38M.1(6)(f), of each of the members of the aggregated group that is not treated as a flow-through entity under 830 CMR 63.38M.1(7)(c), whether or not such entities are incorporated. For purposes of determining the sum of the members' Massachusetts maintenance-of-effort amounts under this provision, 830 CMR 63.38M.1(7)(h)2., only, the maintenance-of-effort amount for any member may be negative, but may not be used to reduce the minimum basic research amounts of the group or any member. For purposes of computing the Massachusetts base period amount under this provision, members of the aggregated group that are not corporations and are not treated as flow-through entities under 830 CMR 63.38M.1(7)(c), must compute their Massachusetts base period amounts under 830 CMR 63.38M.1(6)(d), as though they were corporations.

3. Floor amount. The floor amount provisions of 830 CMR 63.38M.1(6)(e)2., shall not apply to individual group members. However, where no member of the aggregated group, as comprised during the first taxable year for which the credit is claimed, both (i) existed for at least one taxable year (other than a short taxable year) during the base period, and (ii) made Massachusetts basic research payments, as determined under 830 CMR 63.38M.1(6)(c), during that base period taxable year, the minimum Massachusetts basic research amount for the aggregated group shall not be less than 50% of the Massachusetts basic research payments, as determined under 830 CMR 63.38M.1(7)(h)1., for the taxable year for which the credit is being determined.

4. Inadequate records. If any member of an aggregated group is unable to compute its minimum basic research amount due to inadequate accounts and records for the base period, the Massachusetts minimum basic research amount of the aggregated group is 50% of the group's aggregated Massachusetts basic research payments, determined under 830 CMR 63.38M.1(7)(h)1., for the taxable year for which the credit is being determined.

(i) Allocation of the Aggregated Credit. The aggregated credit, as determined under 830 CMR 63.38M.1(7)(e), shall be allocated in the following manner to each member of the aggregated group that is a corporation doing business in Massachusetts to determine such member's credit for the taxable year. Each such member's allocated share of the credit is the aggregated credit, as determined under 830 CMR 63.38M.1(7)(e), multiplied by a fraction, the numerator of which is the sum of the member's Massachusetts qualified research expenses, as determined under 830 CMR 63.38M.1(4), and the member's Massachusetts basic research payments, as determined under 830 CMR 63.38M.1(6), and the denominator of which is the sum of all such members' Massachusetts qualified

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research expenses, as determined under 830 CMR 63.38M.1(4), and Massachusetts basic research payments as determined under 830 CMR 63.38M.1(6). The amount of any credit generated by the activity of an unincorporated entity or corporation not doing business in Massachusetts and attributed to a corporation doing business in Massachusetts under this provision, 830 CMR 63.38M.1(7)(i), shall be deemed to be generated by the corporation doing business in Massachusetts for purposes of carrying the credit over to subsequent taxable years under 830 CMR 63.38M.1(10) through (12).

(j) Example. This example illustrates the aggregation of the Massachusetts qualified research credit for the XYZ Group. The Group is an aggregated group consisting of the following five entities: (1) Corporation X, which is doing business in Massachusetts; (2) Corporation Y, which is also doing business in Massachusetts; (3) Corporation Z, which is not doing business in Massachusetts; (4) Partnership A, which is 50% owned by X Corporation and 25% owned by Y Corporation; and (5) Massachusetts Business Trust B. No member of the Group made any basic research payments during the taxable year. The relevant Massachusetts qualified research expenses (MA QRE) and gross receipts for the current taxable year and the base period are provided in the following chart:

ENTITY	MA QRE	BASE PERIOD MA QRE	BASE PERIOD GROSS RECEIPTS	AVERAGE ANNUAL GROSS RECEIPTS OVER 4 PRECEDING TAXABLE YEARS
X	$ 25	$1000	$15,000	$40,000
Y	500	100	10,000	5,000
Z	0	100	10,000	20,000
A	4,000	0	0	1,000
B	50	0	3,000	7,500

The aggregated qualified research credit of the XYZ group is computed using the following steps:

Flow-Through. Because A is a partnership owned by members of the Group, its expenses and gross receipts are attributed to X and Y according to their ownership interest in A. Thus, $2,000 of A's Massachusetts qualified research expense flows through to X, and $1,000 of that expense flows through to Y. Similarly, $500 of A's average annual gross receipts for the previous four years flow through to X, and $250 of those receipts flow through to Y.

Aggregated Massachusetts Qualified Research Expenses. The Group's aggregated Massachusetts qualified research expenses are $3,575, determined by adding the $575 of Massachusetts qualified research expense incurred directly by X, Y, Z, and B, the $2,000 share of A's Massachusetts qualified research expenses attributed to X, and the $1,000 share of A's Massachusetts qualified research expenses attributed to Y.

Base Period Massachusetts Qualified Research Expenses. Base period Massachusetts qualified research expenses are $1,200, determined by adding the separately determined Massachusetts qualified research expenses incurred directly by X, Y, Z, and B. Note that if A had Massachusetts base period qualified research expenses, those expenses would be attributed to X and Y in the same manner as Massachusetts qualified research expenses and average annual gross receipts.

Base Period Gross Receipts. Base period gross receipts are $38,000, determined by adding the separately determined gross receipts of all members. Again, if A had base period gross receipts they would be attributed to X and Y in the same manner as Massachusetts qualified research expenses and average annual gross receipts.

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Average Annual Gross Receipts. Average annual gross receipts for the four previous taxable years are $73,250, determined by adding the $72,500 of average annual gross receipts received directly by X, Y, Z, and B, the $500 share of A's average annual gross receipts attributed to X, and the $250 share of A's average annual gross receipts attributed to Y.

Massachusetts Fixed Base Percentage. The Group's Massachusetts fixed base percentage is 3.16%, determined by dividing base period Massachusetts qualified research expenses of $1,200 by base period aggregate gross receipts of $38,000.

Aggregated Massachusetts Qualified Research Base Amount. The Group's aggregated Massachusetts qualified research base amount is $2,314.70, determined by multiplying the $73,250 of average annual gross receipts for the four previous years by the fixed base percentage of 3.16%.

Aggregated Massachusetts Qualified Research Credit. The Group's aggregated Massachusetts qualified research credit is $126.03, determined by reducing Massachusetts aggregated qualified research expenses of $3,575, by the $2,314.70 aggregated qualified research base amount, and multiplying the resulting amount by 10%.

Allocation of the Credit. The $126.03 aggregated qualified research credit must be allocated to X and Y, the members of the group that are subject to the corporate excise. The allocation is based on each corporation's qualified research expenses and basic research payments for the taxable year. Since neither corporation made any basic research payments, X has a qualified research credit of $72.40, determined by multiplying the aggregated qualified research credit of $126.03, by a fraction the numerator of which is X's qualified research expenses of $2,025 (including amounts that flow through from A) and the denominator of which is the total of X and Y's qualified research expenses of $3,525 (including amounts that flow through from A), and basic research payments of $0. Y's qualified research credit is $53.63, determined by multiplying the aggregated qualified research credit of $126.03, by a fraction the numerator of which is Y's qualified research expenses of $1,500 (including amounts that flow through from A) and the denominator of which is the total of X and Y's qualified research expenses of $3,525 (including amounts that flow through from A), and basic research payments of $0.

(8) Limitations on the Credit. The amount of the credit, including any credit carried over from previous taxable years under 830 CMR 63.38M.1(10), that a corporation may claim for a taxable year is limited in the following ways.

(a) $25,000 Limitation. The amount of the credit is limited to 100% of the corporation's first $25,000 of corporate excise liability, plus 75% of the corporation's corporate excise liability in excess of $25,000.

1. Calculation of corporate excise liability. For purposes of applying the $25,000 limitation, corporate excise liability is determined before the application of any credits. Corporate excise liability includes amounts due under both the income and non-income measures of the corporate excise.

2. Aggregated groups. A single $25,000 limitation applies to all the members of an aggregated group, as defined under 830 CMR 63.38M.1(7)(b), that are corporations doing business in Massachusetts. Whether such members file separate returns, or file as a combined group, the amount of corporate excise liability below which 100% of the credit is available must be reduced for each such member to an amount equal to $25,000, multiplied by a fraction, the numerator of which is the member's separately determined corporate excise liability and the denominator of which is the sum of the separately determined corporate excise liabilities of all such members.

(b) Minimum Corporate Excise Limitations. The credit may not be applied to reduce the minimum corporate excise imposed under M.G.L. c. 63, §§ 32(b), 39(b), or to reduce any amount of corporate excise imposed by M.G.L. c. 63, § 67.

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(c) Carry Over of Disallowed Credit. The amount of any credit that is not allowed for a taxable year due to the limitations described by 830 CMR 63.38M.1(8)(a), (b), may be carried over to subsequent taxable years as provided by 830 CMR 63.38M.1(10).

(d) M.G.L. c. 63, § 32C Inapplicable. In determining the amount of the credit allowable for a taxable year the provisions of M.G.L. c. 63, § 32C, shall not apply.

(9) Interaction With Other Credits.

(a) Ordering. Corporations that can claim both the research credit and any other credit allowed under M.G.L. c. 63, for a taxable year may apply the research credit in any order they desire with respect to such other allowable credits. Under most circumstances claiming the credit in the order listed on Forms 355A and 355B will benefit the corporation by giving priority to credits that lapse first. Corporations that depart from the order listed on Forms 355A and 355B for any taxable year must attach to their return for the taxable year and all subsequent taxable years an addendum reconciling the total amount of each credit claimed using the order adopted by the corporation with the total amount of each credit that would have been claimed using the order listed on the form.

(b) Application of Limitations. Where a corporation is eligible for both the research credit and a credit that is limited by M.G.L. c. 63, § 32C, the limitations on the research credit described at 830 CMR 63.38M.1(8), and the limitations imposed by M.G.L. c. 63, § 32C, shall be applied independently, based on the amount of corporate excise liability determined before the application of any credits. In determining the amount of corporate excise liability for purposes of applying the limitations on any credit, such amount need not be adjusted to reflect the amount of any other credit claimed, provided, however, that no credit may be used to reduce the corporate excise below the minimum corporate excise described at 830 CMR 63.38M.1(8)(b).

Example. Corporation A has a $100,000 corporate excise liability determined before the application of any credit. A has $60,000 of investment tax credit and $90,000 of research credit available. The maximum amount of the investment tax credit allowable under M.G.L. c. 63, § 32C, is $50,000 (50% of A's $100,000 corporate excise liability). The maximum amount of the research credit allowable under 830 CMR 63.38M.1(8)(a), is $81,250 (A's first $25,000 of corporate excise liability plus 75% of the remaining $75,000 of corporate excise liability). A may use up to the maximum amount of each credit in any order it desires to reduce its corporate excise liability to the minimum corporate excise. Thus, A may use the credit in any of the following three ways:

1. A may apply the full $50,000 of allowable investment tax credit to reduce its corporate excise liability to $50,000, and then apply $49,544 of the research credit to further reduce its corporate excise liability to the $456 minimum.

2. Alternatively, A may apply the full $81,250 of the allowable research credit to reduce its corporate excise liability to $18,750, and then apply $18,294 of the investment tax credit to reduce its corporate excise liability to the $456 minimum.

3. In addition, A may use any other combination of the allowable research credit and the allowable investment tax credit to reduce its corporate excise to the $456 minimum.

(10) Carry Over of Unused Credit.

(a) General. A corporation that does not use the full amount of the credit generated in a taxable year may carry the unused amount of the credit over to succeeding taxable years as follows:

1. Unlimited carry over. Amounts of the credit that are not used in a taxable year because of the $25,000 limitation described by 830 CMR 63.38M.1(8)(a), may be carried over to any succeeding taxable year.

2. 15 year carry over. Amounts of the credit that are not used in a taxable year because the amount of the credit exceeds the corporation's corporate excise liability for the taxable year, or because of the minimum corporate excise limitation described by 830 CMR 63.38M.1(8)(b), may be carried over to any of the 15 taxable years succeeding the taxable year in which the credit is generated.

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(b) Accounting for Unused Credit. Corporations must keep records distinguishing amounts of unused credit eligible for unlimited carry over from amounts of the credit eligible for 15 year carry over. In addition, corporations must keep records of the amount of credit eligible for carry over generated in each previous taxable year and the amount of such credit that was carried over and used in succeeding taxable years.

(c) Carry Over to Earliest Eligible Year. The unused, unexpired, amount of the credit generated in a taxable year must be carried over to the earliest succeeding taxable year for which it may be applied under the ordering rules applicable to the corporation under 830 CMR 63.38M.1(9). The unused, unexpired, amount of the credit generated in a taxable year must be used before any unused, unexpired, credit generated in a succeeding taxable year.

(d) Carry Over Amount. The amount of the credit generated in previous taxable years that may be carried over and applied for a taxable year is the total amount of unused, unexpired, credit generated in previous taxable years, that may be applied in the taxable year under 830 CMR 63.38M.1.

(e) Interaction With Current Credit. Where a corporation has available both an amount of credit generated in the current taxable year and an amount of credit carried over from previous taxable years, the corporation must apply any carry over amounts before applying the amount of credit generated in the current taxable year.

(11) Mergers and Changes of Ownership.

(a) Mergers. In the event of a merger of two or more corporations, the surviving corporation shall determine the amount of the credit, and the availability any credit carry over, under the provisions of 830 CMR 63.38M.1, subject to the following additional rules:

1. Effect of merger on calculation of qualified research base amount. For purposes of calculating the Massachusetts qualified research base amount under 830 CMR 63.38M.1(5), the surviving corporation shall add the separately calculated Massachusetts qualified research base amounts of all corporations absorbed in the merger to its own Massachusetts qualified research base amount.

2. Effect of merger on calculation of Massachusetts basic research payments. For purposes of calculating Massachusetts basic research payments under 830 CMR 63.38M.1(6), the surviving corporation's Massachusetts base period amount, as determined under 830 CMR 63.38M.1(6)(d), shall include the separately calculated Massachusetts base period amounts of all corporations absorbed in the merger.

3. Effect of merger on credit carry over. In the event of a merger of two or more corporations, the surviving corporation retains any amount of credit carry over, determined under 830 CMR 63.38M.1(10), that it separately generated before the merger. All of the credit carry over generated by a corporation absorbed in the merger is lost. The surviving corporation may not apply or carry over any amount of credit generated by a corporation that it absorbs. In the event of a consolidation of two or more previously existing corporations into a new corporation, the new corporation starts with no credit carry over. All of the credit carried over by the previously existing corporations is lost. The new corporation may not apply or carry over any amount of credit generated by any of the previously existing corporations before the consolidation.

4. Certain corporate changes distinguished. Transactions affecting a single corporation that do not terminate the existence of the corporation for Massachusetts tax purposes shall not be considered mergers for purposes of 830 CMR 63.38M.1(11). Such transactions include mere changes in identity, form, or place of organization of one corporation under Section 368(a)(1)(F) of the Code, and the recapitalization of a single corporation under Section 368(a)(1)(E) of the Code.

(b) Other Acquisitions. Where, after December 31, 1983, a corporation acquires the major portion of the trade or business of another person (a "predecessor") or the major portion of a separate unit of trade or business of a predecessor within the meaning of Section 41(f)(3)(A) of the Code, and where 830 CMR 63.38M.1(11)(a) does not apply, the acquiring corporation shall determine its Massachusetts qualified research base amount under 830 CMR 63.38M.1(5) by increasing its Massachusetts qualified research expense and gross receipts for the base period by so much of the amount of the Massachusetts qualified research expense and gross receipts of the predecessor as is attributable to the portion of such trade or business or unit of trade or business acquired by the corporation.

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(c) Certain Dispositions. Where, after December 31, 1983, a corporation disposes of the major portion of its trade or business or the major portion of a separate unit of its trade or business within the meaning of Section 41(f)(3)(A) of the Code, and where 830 CMR 63.38M.1(11)(b), applies to the transaction, the corporation making the disposition may determine its Massachusetts qualified research base amount under 830 CMR 63.38M.1(5) by reducing its Massachusetts qualified research expense and gross receipts for the base period by so much of the amount of its Massachusetts qualified research expense and gross receipts as is attributable to the portion of the trade or business or unit of trade or business disposed of by the corporation, provided that the corporation provides the acquirer such information as is necessary to make the calculations required by 830 CMR 63.38M.1(11)(b).

(12) Combined Groups.

(a) General. The amount of the credit shall be determined separately, under the provisions of 830 CMR 63.38M.1 for each corporation that is a member of a combined group, as defined at 830 CMR 63.32B.1(2).

(b) Limitations on the Credit. The limitations on the amount of the credit that a corporation may claim for a taxable year, described at 830 CMR 63.38M.1(8), shall apply to each member of a combined group separately, provided that members of an aggregated group must reduce the amount of corporate excise liability below which 100% of the credit is available as required by 830 CMR 63.38M.1(8)(a)2.. In applying those limitations, the corporate excise liability of each member of the combined group is the member's separately computed excise determined under 830 CMR 63.32B.1(8)(a).

(c) Sharing the Credit. A member of a combined group must use the amount of the credit available to it for a taxable year first to offset its own separately determined corporate excise liability for the taxable year. Where a member of a combined group cannot use the full amount of the credit available for a taxable year because the amount of the credit exceeds its separately determined corporate excise liability or because of the limitations on the credit described by 830 CMR 63.38M.1(8), that member may share the amount of the credit, including any carry over amounts, that it cannot use with other members of the combined group to the extent that such other members can apply the credit to their separately determined corporate excise liabilities for the taxable year under the limitations described by 830 CMR 63.38M.1(8). To the extent that the other members of the group cannot use the credit for the taxable year, the amount of unused, unexpired credit may be carried over to subsequent taxable years only by the member that generated the credit, and only to the extent permitted under 830 CMR 63.38M.1(10), and 830 CMR 63.38M.1(12)(d). Members of combined groups may share the credit in the manner described above regardless of whether the group filed a combined return for the taxable year in which the credit was generated.

(d) Carry Over. Subject to the carry over provisions of 830 CMR 63.38M.1(10), each member of a combined group may carry over any unexpired amounts of the credit that have not been used to reduce the corporate excise liability of any member of the combined group. Each member of a combined group may carry over amounts of unused, unexpired, credit only to the extent that such amounts are generated by the member itself. The combined group, therefore, has no credit or carry over of its own.

(13) Election to Calculate Massachusetts Qualified Research Expense Credit Separately for Defense Related Activities and Other Qualified Activities.

(a) General. For tax years beginning on or after January 1, 1995, the taxpayer may elect to compute the credit for Massachusetts qualified research expenses separately for defense related activities and other research activities. The election is made by checking the appropriate box on Massachusetts Schedules RC or RC-A. When making this election, the taxpayer must calculate qualified Massachusetts research expenses and the Massachusetts qualified research base amount separately for defense related activities and other qualified activities. Each calculation must be completed as provided in 830 CMR 63.38M.1(4) and 830 CMR 63.38M.1(5). The taxpayer must have adequate records as described in 830 CMR 63.38M.1(14)(d) in order to make this election. The election will not cause any expense not otherwise qualified for the Federal Credit to qualify for the Massachusetts Research Credit. This election also does not change the calculation of the portion of the credit pertaining to basic research payments as provided in 830 CMR 63.38M.1(3) and 830 CMR 63.38M.1(6).

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(b) Effect of Election. A taxpayer electing to calculate the credit in accordance with 830 CMR 63.38M.1(13) for a taxable period is not required to use that method for subsequent taxable years.

(c) Requirement that Defense Related Research be Pursuant to a Government Contract. Generally, for research to be considered defense related, otherwise qualified research must be both directly related to the fulfillment of a government contract or subcontract and be conducted while the contract is in effect. Otherwise qualified research expenses incurred prior to the execution of a government contract will generally not be considered defense related for purposes of calculating the credit. However, "independent research and development costs" and "bid and proposal costs" within the meaning of IRS Reg. §1.41-(5)(d)(4) will be considered research pursuant to a government contract if they are otherwise qualified research expenses.

(d) Aggregated groups. All members of an aggregated group, as defined by 830 CMR 63.38M.1(7)(b), must compute the Massachusetts qualified research expense credit for defense related activities and other qualified activities in the same manner. If the group elects to calculate the Massachusetts qualified research expense credit for defense related activities and other qualified activities separately, the election is binding on all members for that taxable period.

(e) Limitations on the Credit. The total qualified research expense credit attributable to defense related activities and other qualified activities is subject to the limitations in 830 CMR 63.38M.1(8).

(f) Calculation of Fixed-Base Percentage.

1. General Rule. The fixed-base percentage must be calculated separately for defense and non-defense related activities in accordance with 830 CMR 63.38M.1(5)(c).

2. Inadequate Records. Taxpayers having inadequate records to compute the separate fixed-base percentage must use a fixed-base percentage of 16%, as provided in 830 CMR 63.38M.1(5)(c)3. in both calculations.

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Example. Corporation B incurs $10,000 in Massachusetts qualified research expenses for defense related activities and $100,000 in Massachusetts qualified research expenses for non-defense related activities during a taxable year. It elects to calculate the credit in accordance with 830 CMR 63.38M(13) and has inadequate records to calculate the fixed-base percentage. The average annual gross receipts of the corporation for the four preceding taxable years were $200,000 for defense related activities and $500,000 for non-defense related activities. The tentative credit (before application of limitations in 830 CMR 63.38M.1(8) and carry over requirements in 830 CMR 63.38M.1(10)) attributable to defense related research expenses is 10% x [10,000-(.16)(200,000)] = 10% x (-22,000) = -2,200. Since this calculation results in a tentative credit of less than zero, Corporation B has no tentative credit attributable to defense related research expenses. However, the tentative credit attributable to non-defense related activities is 10% x [100,000-(.16)(500,000)] = 10% x [20,000] = 2,000. Thus, subject to the limitations in 830 CMR 63.38M.1(8) and 830 CMR 63.38M.1(10), the taxpayer is eligible for a credit due to its increase in non-defense qualified research expenses. Under the facts in this example, had corporation B failed to elect or qualify to make the election under 830 CMR 63.38M(13), it would not have been entitled to a credit for Massachusetts qualified research expenses for this taxable year since the calculation results in a number less than zero: 10% x [110,000 - (.16)(700,000)] = 10% x -2,000 = -200.

(g) Election to Use Massachusetts Gross Receipts. The taxpayer may elect to use Massachusetts gross receipts as provided in 830 CMR 63.38M.1(5)(d). Once the taxpayer files a return on which it either elects to use Massachusetts gross receipts or uses federal gross receipts to calculate the Massachusetts research credit, the taxpayer will be bound in subsequent taxable years as provided in 830 CMR 63.38M.1(5)(d)3., whether or not the taxpayer makes the election described in 830 CMR 63.38M.1(13).

(14) Recordkeeping and Accounting Methods.

(a) Fixed-Base Percentage and Average Annual Gross Receipts. A taxpayer must maintain records to substantiate the calculation of the fixed-base percentage in accordance with 830 CMR 63.38M.1(5)(c) and the average annual gross receipts in accordance with 830 CMR 63.38M.1(5)(d). Taxpayers filing as an aggregated group in accordance with 830 CMR 63.38M.1(7) must retain all such information for each member of the group.

(b) Allocation of Wages. A taxpayer with employee(s) performing both qualified research and other activities must maintain adequate records to substantiate the allocation of wages for qualified research expenses including the methods used to allocate such wages to qualified research.

(c) Employees Performing Qualified Research Activities. The following records must be maintained for each employee for whom the taxpayer claims part or all of his or her wages as qualified research expenses.

1. Name, taxpayer identification number, detailed job description, gross Massachusetts wages paid and Massachusetts wages included in the credit.

2. Time cards, internal written documents or other substantially contemporaneous records which verify percentage of time devoted to qualified research activities.

3. Organizational chart showing reporting structure for all departments, business units and individuals performing qualified research.

4. Detailed description of each department or business unit performing qualified research and the nature of the research performed.

5. Nothing in 830 CMR 63.38M.1(14)(c) shall be deemed to prohibit the use of sampling techniques whenever such techniques are considered appropriate and are mutually agreed to by both the Department of Revenue and the taxpayer.

(d) Election under 830 CMR 63.38M.1(13).

1. General. Taxpayers electing to calculate the credit in accordance with 830 CMR 63.38M.1(13) must maintain complete records of supporting data, including the records of accounting methods used in segregating data for the separate calculations. A taxpayer must use the same accounting methods for the period in which a credit is claimed and in calculating the Massachusetts qualified research base amount for both the defense related and non-defense related portions of the calculation.

2. Required Records. In order to make the election described in 830 CMR 63.38M.1(13), a taxpayer must, at a minimum, have adequate records to segregate gross receipts attributable to defense related activities from other gross receipts for the period for which the election is made and the four preceding taxable years.

63.38N.1: Economic Opportunity Area Credit

(1) Statement of Purpose, Effective Date.

(a) Purpose of 830 CMR 63.38N.1. 830 CMR 63.38N.1 explains the calculation of the economic opportunity area credit allowed by M.G.L. c. 62, § 6(g) and M.G.L. c. 63, § 38N.

(b) Effective Date. 830 CMR 63.38N.1 takes effect upon promulgation and applies to costs incurred on or after January 1, 1993.

(2) Definitions. For purposes of 830 CMR 63.38N.1 the following terms shall have the following meanings:

Certified Project, a project that has been approved by the Economic Assistance Coordinating Council for participation in the economic development incentive program pursuant to the provisions of M.G.L. c. 23A, § 3F.

Code, the Internal Revenue Code of the United States, as amended and in effect for the taxable year, unless otherwise specified.

Commissioner, the Commissioner of Revenue or the Commissioner's duly authorized representative.

Corporations, all entities taxable under M.G.L. c. 63.

Department, the Department of Revenue.

Economic Assistance Coordinating Council, the council established pursuant to M.G.L. c. 23A, § 3B.

Economic Opportunity Area, an area of Massachusetts which is designated by the Economic Assistance Coordinating Council as an economic opportunity area pursuant to M.G.L. c. 23A, § 3E.

Investment Tax Credit, the credit allowed by M.G.L. c. 63, § 31A.

Lease, any transfer of use or possession of real and tangible personal property for consideration, including licenses and subleases.

Participants, any person or corporation which as owner, lessor, or lessee of eligible property incurs costs or makes expenditures in connection with the purchase or lease of such eligible property in a certified project. A person or corporation does not qualify as a participant solelyby virtue of providing financing to participants in connection with a certified project.

Persons, individuals and entities taxable under M.G.L. c. 62.

(3) Taxpayers Eligible for the Credit.

(a) Corporations. The credit may be applied against any excise imposed by M.G.L. c. 63.

(b) Persons. The credit may be applied against the income tax imposed by M.G.L. c. 62.

(4) Eligible Property. Eligible property includes tangible personal property and other tangible property, including buildings and structural components of buildings, acquired, constructed, reconstructed or erected during the taxable year and used exclusively in a certified project in an economic opportunity area in Massachusetts and tangible personal property leased pursuant to an operating lease and used exclusively by the lessee in Massachusetts in a certified project in an economic opportunity area throughout the entire lease term, subject to the following requirements:

(a) the property must not be taxable under M.G.L. c. 60A (relating to motor vehicles);

(b) the property must be depreciable under Section 167 of the Code and have a useful life of four years or more; and

(c) Buildings and structural components of buildings must be acquired by purchase as defined under Section 179(d) of the Code.

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(5) Availability of the Credit.

(a) Owner. The credit is available to the owner of eligible property. Where more than one taxpayer participates in a certified project, the credit is available to each participant only for eligible property owned by the participant. If eligible property is owned by two or more participants, the credit shall be available to each participant in proportion to its ownership interest in such property. For purposes of 830 CMR 63.38N.1, an owner of eligible property is the taxpayer who, under section 167 of the Code, is entitled to take a depreciation deduction with respect to the eligible property.

1. If property is leased to a taxpayer pursuant to a capital lease, the taxpayer shall be treated as the owner of the property. A capital lease is any transaction which the taxpayer properly treats as a purchase for federal income tax purposes.

2. A lessee leasing eligible property from a regional business development corporation or authority authorized under M.G.L. c. 40D or a regional business development corporation organized as a non-profit corporation under any special act shall be deemed to be the owner of the property.

(b) Lessor. The credit is generally not available to the lessor of eligible property. However, the credit is available to a lessor for eligible property, other than tangible personal property, leased to a lessee provided the relationship between the lessor and the lessee is:

1. an individual and a corporation if such individual owns, directly or indirectly, 100% of the outstanding stock in the corporation;

2. a corporation and a partnership if the same persons own, directly or indirectly, 100% of the outstanding stock in the corporation and 100% of the capital interest or profit interest in the partnership;

3. a corporation and another corporation if the same persons own, directly or indirectly, 100% of the outstanding stock in each corporation;

4. the fiduciary of the trust that holds the leased property and the sole grantor of the trust;

5. the fiduciary of the trust that holds the leased property and the fiduciary of another trust if the same person is the sole grantor of both trusts;

6. the fiduciary of the trust that holds the leased property and the sole beneficiary of such property;

7. the fiduciary of the trust that holds the leased property and a corporation if the trust, the sole grantor of the trust, or the sole beneficiary of the trust owns, directly or indirectly, 100% of the outstanding stock in the corporation.

(c) Owner Leasing a Portion of Eligible Property. If an owner, as lessor, leases a portion of eligible property, the credit is available to the owner only with respect to that portion of the property that is not leased. If the owner claims a credit with respect to property and subsequently leases a portion of the property to another, the lease shall be treated as a disposition triggering the recapture rules under 830 CMR 63.38N.1(11) with respect to the portion of the property leased unless the relationship between the lessor and the lessee is described in 830 CMR 63.38N.1(5)(b)1. through 7.

(d) Lessee. The credit is available to a lessee of tangible personal property leased pursuant to an operating lease. The credit is not available to a lessee for real property leased pursuant to an operating lease. An operating lease is any transaction which the taxpayer properly treats as a lease for federal income tax purposes.

1. Limitation on Credit Available to Lessee. The credit is not available to a lessee if the lessor has previously received an economic opportunity area credit or the investment tax credit with respect to the property, except as follows:

a. if a lessor, who has previously received an economic opportunity area credit with respect to tangible personal property, subsequently leases the property to another pursuant to an operating lease, the lease shall be treated as a disposition triggering the recapture rules under 830 CMR 63.38N.1(11) with respect to the property leased. The lessee will be allowed credits which cumulatively shall not exceed the amount the lessor was required to, and did in fact, recapture pursuant to 830 CMR 63.38N.1(11).

b. if a lessor, who has previously received an investment tax credit with respect to tangible personal property, subsequently leases the property to another pursuant to an operating lease, the lease shall be treated as a disposition triggering recapture of the investment tax credit with respect to the property leased. The lessee will be allowed credits calculated pursuant to 830 CMR 63.38N.1(6)(b).

63.38N.1: continued

2. Documentation. The lessor and lessee must maintain documentation adequate to substantiate the credit claimed by the lessee. Without limitation, such documentation shall include a written statement signed by the lessor and stating the following:

a. the lessor's adjusted tax basis in the leased property at the beginning of the lease term;

b. the useful life of the property being used by the lessor for depreciation purposes and the remaining useful life at the commencement of the lease;

c. that the lessor has not claimed an economic opportunity area credit or investment tax credit with respect to the leased property, or if it has done so, the dollar amount of tax that it has recaptured (or will recapture in the tax year in which the lease commences) with respect to the leased property.

(6) Calculation of the Credit.

(a) Computation of Credit for Owner. The credit shall be equal to 5% of the basis of the property for federal tax purposes after deduction therefrom of any federally authorized tax credit taken with respect to such property acquired, constructed, reconstructed, or erected. In instances where multiple parties are entitled to the credit with respect to the same property, the total amount of credit generated with respect to any property shall not exceed 5% of the cost of such property.

If a portion of eligible property is leased pursuant to an operating lease, the cost attributed to the portion of property not under lease shall be the basis of property for federal tax purposes (after deduction therefrom of any federally authorized tax credit taken with respect to such property) minus the adjusted basis of the portion of property which is leased pursuant to an operating lease (after deduction therefrom for any portion of any federally authorized tax credit attributed to that portion of property).

(b) Computation of Credit for lessee. The lessee's credit for tangible personal property shall be 5% of the lessor's adjusted basis for federal tax purposes at the beginning of the taxable year, multiplied by a fraction, the numerator of which is the number of days of the taxable year during which the lessee leases the tangible personal property and the denominator of which is the number of days remaining in the useful life of such property at the beginning of the taxable year. Such useful life is the same as that used by the lessor for depreciation purposes when computing federal income tax liability. The maximum cumulative credit shall not exceed 5% of the lessor's adjusted basis for federal tax purposes at the beginning of the lease term. The lessee calculates and claims the credit annually during the term of the operating lease.

(c) Eligible Cost. For purposes of computing the credit for owners and lessees, the credit available with respect to a particular project is limited to:

1. the cost incurred on or after the date the project is certified pursuant to the provisions of M.G.L. c. 23A, § 3F; or

2. the cost incurred prior to the date a project is certified but only cost incurred on or after the date the taxpayer has notified the municipality in writing of its intention to have the project certified. Eligible cost does not include any cost incurred prior to the date of written notice to the municipality. The requirement in 830 CMR 63.38N.1(6)(c)2. that the notice be in writing is effective on July 13, 2007.

(d) Accounting Rules. For purposes of 830 CMR 63.38N.1, in determining when a cost is incurred, the method of accounting used by the taxpayer taking the credit shall be the same method of accounting properly used by that taxpayer for federal income tax purposes.

(7) Limitations on the Credit.

(a) 50% Limitation. The maximum amount of credits otherwise allowable in any taxable year shall not exceed 50% of the excise imposed by M.G.L. c. 62 or c. 63. For purposes of applying the 50% limitation, excise liability is determined before the application of any credits. For corporations subject to tax under M.G.L. c. 63, § 32 or § 39, the corporate excise liability includes amounts due under both the income and non-income measures of the corporate excise.

(b) Minimum Excise Limitation. Notwithstanding the 50% limitation set forth in 830 CMR 63.38N.1(7)(a), the credit may not be applied to reduce the minimum excise imposed under any provision of M.G.L. c. 63.

63.38N.1: continued

(8) Interaction with Investment Tax Credit. The economic opportunity area credit may not be taken for any property if the investment tax credit has been taken with respect to the same property.

(9) Ordering. Taxpayers that can claim both the economic opportunity area credit and any other credit for a taxable year may apply the economic opportunity area credit in any order they desire with respect to such other allowable credits.

(10) Carry Over of Unused Credit.

(a) General. A taxpayer that does not use the full amount of the credit generated in a taxable year may carry over the unused amount of the credit as follows:

1. Unlimited Carry Over. Credits that are not used in a taxable year because of the 50% limitation described by 830 CMR 63.38N.1(7)(a), may be carried over to any succeeding taxable year, subject to the provision contained in 830 CMR 63.38N.1(10)(a)3.

2. Ten Year Carry Over.

a. Credits that are not used in a taxable year because they exceed the taxpayers tax liability for the taxable year may be carried over to the next taxable year for a maximum of ten successive taxable years, subject to the provision contained in 830 CMR 63.38N.1(10)(a)3.

b. Credits that are not used in a taxable year because of the minimum excise limitation described by 830 CMR 63.38N.1(7)(b), may be carried over to the next taxable year for a maximum of ten successive taxable years, subject to the provision contained in 830 CMR 63.38N.1(10)(a)3.

3. Five Year Limitation. No credit can be carried over to a taxable year beginning more than five years after the certified project or economic opportunity area ceases to qualify as such under provisions of M.G.L. c. 23A.

(b) Accounting for Unused Credit. Taxpayers must keep records distinguishing amounts of unused credit eligible for unlimited carry over from amounts of the credit eligible for ten year carry over. In addition, taxpayers must keep records of the amount of the credit eligible for carry over generated in each previous taxable year and the amount of such credit that was carried over and used in succeeding taxable years.

(c) Effect of Merger on Credit Carry Over. In the event of a merger of two or more corporations or corporate trusts, the surviving entity retains any amount of credit carry over, determined under 830 CMR 63.38N.1(10), that is separately generated by the surviving entity before the merger. All of the credit carry over generated by an entity absorbed in the merger is lost. The surviving entity may not apply or carry over any amount of credit generated by the entity that it absorbs. Transactions affecting a single corporation or corporate trust that do not terminate the existence of the entity for Massachusetts tax purposes shall not be considered mergers for purposes of 830 CMR 63.38N.1(10)(c). Such transactions include mere changes in identity, form, or place of organization of one corporation under Section 368(a)(1)(F) of the Code, and the recapitalization of a single corporation under Section 368(a)(1)(E) of the Code.

(11) Recapture or Reduction of Credit Carry Over.

(a) General. If eligible property is disposed of or ceases to be used exclusively in a certified project in an economic opportunity area before the end of its useful life portions of the credit taken in any prior year that exceed the allowable credit must be recaptured and repaid as additional tax due in the year the property is disposed of or ceases to be used exclusively in a certified project within an economic opportunity area. To the extent that any credit carried over pursuant to 830 CMR 63.38N.1(10) that has not been taken exceeds the portion of the allowable credit, the carried over credit must be reduced. The Commissioner may assess additional tax under M.G.L. c. 62C on account of recapture of the economic opportunity area credit. No recapture or reduction in carry over is necessary if the property has been used exclusively in a certified project within an economic opportunity area for more than 12 consecutive years.

63.38N.1: continued

(b) Allowable Credit. If property is disposed of or ceases to be used exclusively in a certified project in an economic opportunity area before the end of its useful life, the original credit amount generated must be recalculated to determine the allowable credit. The allowable credit is calculated by multiplying the original credit generated with respect to the property by the following fraction. The numerator is the number of months that the taxpayer owned the property and used it exclusively in a certified project within an economic opportunity area. The denominator is the total number of months of useful life of the property at the time the property was first used.

(c) Amount of Recapture or Carry Over Reduction. If the amount of credit taken in prior years exceeds the allowable credit, the excess must be recaptured and paid as additional tax. If the full amount of the allowable credit has been taken, the entire amount of any carry over must be eliminated. If only a portion of the allowable credit has been taken, any carry over credit that exceeds the portion of the allowable credit must be eliminated. Any remaining credit may continue to be carried over.

Example 1: Taxpayer files a return for 2002 on September 15, 2003 stating that it generated $10,000 of credit on five-year property costing $200,000 and placed in service on January 1, 2002. The taxpayer uses $7,000 of credit and carries over the remaining $3,000 of credit. As of April 1, 2003, the taxpayer ceases to use the property in its certified project.

Under 830 CMR 63.38N.1(11)(c), the taxpayer is allowed credit from January 1, 2002 through April 1, 2003, which is 15 months. The allowable credit is $2,500 ($10,000 x 15/60).

Of the $7,000 of credit previously taken, $4,500 of it will have to be recaptured as additional tax in tax year 2003. The $3,000 of carry over will be eliminated as of 2003.

(d) Special Recapture Rule for Corporations with Property also Eligible for the Investment Tax Credit. It is a condition for taking the EOA credit that the taxpayer not take the 3% Massachusetts investment tax credit ("ITC") with respect to the same property. 830 CMR 63.38N.1(8). If a corporation eligible for the ITC allowed under M.G.L. c. 63, § 31A is required to recapture EOA credit because eligible property is no longer used exclusively in a certified project in an economic opportunity area, but the property continues to be in qualified use for purposes of the ITC, the taxpayer may either apply the recapture rules set forth in 830 CMR 63.38N.1(11)(a) through (c) to the 5% EOA credit; or recapture the entire amount of the EOA credit and eliminate any EOA credit carry over, but apply the ITC rules as if the EOA credit had not been taken. In the latter case, the Commissioner will require the corporation to recapture the EOA credit and reduce its EOA credit carry over by only the net difference between the amount of the EOA credit generated with respect to the property and the amount of the ITC that the corporation would have been eligible to claim with respect to the property had it not claimed the EOA credit.

Example 2: Same facts as in Example 1, except the taxpayer is a manufacturing corporation eligible for the ITC that would have been eligible to claim $6,000 ($200,000 x 3%) of ITC with respect to the property had it not claimed the EOA credit, and when the taxpayer ceases to use the property in its certified project it continues to use it in Massachusetts in its manufacturing business.

Under the ordinary recapture rules in 830 CMR 63.38N.1(11)(d), ¾ of the $10,000 or $7,500 would be subject to recapture/carry over elimination. The taxpayer may choose, however, to recapture and reduce its carry over by $4,000 – the difference between the 5% EOA credit and the 3% ITC. Accordingly, if it so chooses, $1,000 of EOA credit taken will be recaptured as additional tax and the $3,000 of credit carry over will be eliminated.

(12) Unincorporated Flow-through Entities. Unincorporated flow-through entities, such as partnerships and joint ventures, shall be treated as flow-through entities for purposes of determining the credit. All amounts relevant calculating the credit shall be attributed to the owners of the entities in accordance with Section 704 of the Code, as defined in M.G.L. c. 62, § 1, and shall be taken into account in determining the credit for the taxable year during which the taxable year of the unincorporated flow-through entity ends. If recapture is required, the owners of the flow-through entities must recapture.

(13) S Corporation Rules. Either the S corporation or its shareholders may take the credit with respect to any property, but not both.

63.38N.1: continued

(a) The credit may be applied against either or both the non-income or income (if applicable) measure of the S corporation's corporate excise subject to the limitations in 830 CMR 63.38N.1(7).

(b) Alternatively, the credit can be applied against the shareholders' income tax imposed by M.G.L. c. 62. In this case, all amounts relevant to the calculation of the credit are attributed to the shareholders of the S corporation and are taken into account in determining the shareholders' credit for the taxable year during which the taxable year of the S corporation ends.

(c) Shareholders cannot take the economic opportunity area credit if the S corporation is taking or has taken the investment tax credit with respect to the same property.

(d) If the shareholders of the S corporation take the credit with respect to any property, the S corporation must maintain adequate records to specifically identify that property and to distinguish it from property with respect to which the S corporation has taken the credit.

(e) If the S corporation takes the credit and does not use the full amount of the credit generated in a taxable year, the S corporation may carry over the unused amount of the credit to succeeding taxable years. Amounts carried over by the S corporation may be applied only to offset the S corporation's corporate excise liability. If recapture is required, the S corporation must recapture.

(f) If the shareholders of the S corporation take the credit and do not use the full amount of the credit generated in a taxable year, the shareholders may carry over the unused amount of the credit to succeeding taxable years. Amounts carried over by a shareholder may be applied only to offset the shareholder's tax liability. If recapture is required, the shareholders must recapture.

(14) Controlled Groups and Entities under Common Control. For purposes of determining whether a taxpayer has acquired or disposed of tangible personal property, corporations that are members of the same controlled group as defined in Section 41(f) of the Code and all entities, whether or not incorporated, under common control as defined in Section 41(f) of the Code shall be treated as a single taxpayer. Transfers of tangible personal property between members of the same controlled group or between entities under common control will be disregarded for purposes of generating a credit or triggering recapture of a credit already taken with regard to transferred property.

(15) Combined Groups.

(a) General. The amount of the credit shall be determined separately, under the provisions of 830 CMR 63.38N.1, for each corporation that is a member of a combined group, as defined at 830 CMR 63.32B.1(2).

(b) Limitations on the Credit. The limitations on the amount of the credit that a corporation may claim for a taxable year, described at 830 CMR 63.38N.1(7), shall apply to each member of a combined group separately. In applying those limitations, the corporate excise liability of each member of the combined group is the member's separately computed excise determined under 830 CMR 63.32B.1(8)(a).

(c) Sharing the Credit. A member of a combined group must use the amount of the credit available to it for a taxable year first to offset its own separately determined corporate excise liability for the taxable year. Where a member of a combined group cannot use the full amount of the credit available for a taxable year that member may share the amount of the credit that it cannot use with other members of the combined group to the extent that such other members can apply the credit to their separately determined corporate excise liabilities for the taxable year under the limitations described by 830 CMR 63.38N.1(7). Members of combined groups may share the credit in the manner described above regardless of whether the group filed a combined return for the taxable year in which the credit was generated.

3.38N.1: continued

(d) Carry Over. Subject to the carry over provisions of 830 CMR 63.38N.1(10), each member of a combined group may carry over any unexpired amounts of the credit that have not been used to reduce the corporate excise liability of any member of the combined group. Each member of a combined group may carry over amounts of unused, unexpired, credit only to the extent that such amounts are generated by the member itself. The combined group, therefore, has no credit or carry over of its own.

63.38R.1: Massachusetts Historic Rehabilitation Tax Credit

(1) Statement of Purpose, Effective Date.

(a) Statement of Purpose. 830 CMR 63.38R.1 explains the calculation of the historic rehabilitation tax credit established by M.G.L. c. 62, § 6J and M.G.L c. 63, § 38R (St. 2003, c. 141, §§ 22, 24 and 82, as amended by St. 2004, c. 65, §§ 5 through 9, 13 through 18, 54). Under the statute, the Commissioner, in consultation with the Massachusetts Historical Commission, shall authorize credits annually, for the period and amounts allowed under M.G.L. c. 62, § 6J and M.G.L. c. 63, § 38R.

(b) Outline of Topics. 830 CMR 63.38R.1 is organized as follows:

1. Statement of Purpose; Outline of Topics, Effective Date
2. Definitions
3. Amount of Credit
4. Certification of Rehabilitation; Chosen Projects; Written Notice
5. Chosen Projects; Application of Criteria
6. Application Process and Administrative Fees
7. Transferability of Credit
8. Allotment of Credit Among Partners, Members or Owners
9. First Tax Year for Claiming Credit
10. Carryforward of Credit
11. Limitations on Credit; Ordering of Credit
12. Recapture
13. Authorization to Take Further Actions

(c) Effective Date. 830 CMR 63.38R.1 takes effect April 13, 2004 and applies to tax years beginning on or after January 1, 2005.

(2) Definitions. For purposes of 830 CMR 63.38R.1, the following terms shall have the following meanings, unless the context requires otherwise:

Certified Rehabilitation, the rehabilitation of a qualified historic structure that has been approved and certified by the Chairperson of the Massachusetts Historical Commission as being consistent with the standards established by the Secretary of the United States Department of the Interior for rehabilitation of historic properties.

Chosen Projects, projects which have received second certification under 830 CMR 63.38R.1(4)(b).

Code, the Internal Revenue Code of 1986, as amended and in effect for the taxable year.

Commission, the Massachusetts Historical Commission.

Commissioner, the Commissioner of Revenue.

Completed Projects, chosen projects which have received final certification under 830 CMR 63.38R.1(4)(c) and which have been substantially rehabilitated and placed in service.

Placed in Service, this term shall have the same meaning as the term is given under section 47 of the Code and any federal regulations thereunder.

63.38R.1: continued

Project, any building or structure, submitted by the taxpayer to the Commission for certification of rehabilitation.

Qualified Historic Structure, any building or structure, located within the Commonwealth that is individually listed on the National Register of Historic Places or is a contributing building within a district that is listed on the National Register of Historic Places or has been determined by the Massachusetts Historical Commission to be eligible for listing on the National Register of Historic Places, and which all or any portion of which is owned, in whole or in part, by the taxpayer.

Qualified Rehabilitation Expenditure, any amount properly chargeable to a capital account and described in section 47(c)(2)(A)(i) of the Code, as amended and in effect for the taxable year, incurred in connection with the certified rehabilitation of a qualified historic structure, but the term shall not include personal property, personal use property or the cost of acquiring any building or interest therein.

Substantial Rehabilitation and Substantially Rehabilitated, the qualified rehabilitation expenditures of the building during the 24-month period selected by the taxpayer ending with or within the taxable year exceed 25% of the taxpayer's adjusted basis in such building and its structural components as of the beginning of such period. In the case of any rehabilitation that may reasonably be expected to be completed in phases set forth in architectural plans and specifications completed before the rehabilitation begins, the applicable period referred to in 830 CMR 63.38R.1(2): Substantial Rehabilitation and Substantially Rehabilitated shall be 60 months.

Taxpayer, a corporation or other entity subject to an excise imposed by M.G.L. c. 63 and a person, firm, partnership, trust, estate, limited liability company or other entity subject to the income tax imposed by M.G.L. c. 62.

(3) Amount of Credit.

(a) Calculation of Credit. The credit shall be equal to a percentage, not to exceed 20%, of the qualified rehabilitation expenditures made by the taxpayer with respect to a qualified historic structure which has received final certification and has been placed in service as provided for in 830 CMR 63.38R.1(9).

(b) Available Credit for Allocation. The Commission shall determine and account for the amount of credit available for allocation. The amount available in any given year shall be equal to the sum of:

1. the annual authorized credit amount for that year under M.G.L. c. 62, § 6J and M.G.L. c. 63, § 38R;

2. any recapture amounts;

3. any credit amount previously allocated to a chosen project under 830 CMR 63.38R.1(3)(c), which is disallowed by the Commission upon final certification under 830 CMR 63.38R.1(4)(c);

4. any credit amount previously allocated to a chosen project under 830 CMR 63.38R.1(3)(c), which is disallowed by the Commission upon the Commission's determination that the chosen project cannot move forward due to financial infeasibility or other impediment or the chosen project is materially changed from its plans as submitted and approved by the Commission when allocated the credit under 830 CMR 63.38R.1(3)(c); and

5. any credit amount authorized but not allocated in a previous year. Upon the Commission's determination that the project cannot move forward under 830 CMR 63.38R.1(3)(b)(4), the Commission shall issue a written notice to the chosen project containing a statement of reason for the Commission's determination. In no event shall the total amount of credits allocated during any given year exceed the amount that is available for allocation as set forth in 830 CMR 63.38R.1(3)(b).

63.38R.1: continued

(c) Allocation of Credit. The Commission shall allocate the available credit among projects chosen to receive second certification. Each chosen project shall be allocated a percentage, not to exceed 20%, of qualified rehabilitation expenditures as proposed and certified under 830 CMR 63.38R.1(4). The Commission shall apply the criteria set forth under 830 CMR 63.38R.1(5) and assess and prioritize each initially certified project within the deadlines set forth under 830 CMR 63.38R.1(6). After such assessment, the Commission may issue the second certification to one or more projects and allocate some or all of the available credit among such chosen projects.

(d) Credit Certificates. The Commission may issue a credit certificate to a completed project on or after the date it issues the final certification as allowed under 830 CMR 63.38R.1(4)(c). In no event shall the total amount of credit certificates issued for any given year exceed the total amount of credits that are available to be allocated for such year, as set forth in 830 CMR 63.38R.1(3)(b).

(e) Examples. The following examples illustrate the application of 830 CMR 63.38R.1(3).

Example 1. The annual authorized credit amount under M.G.L. c. 62, § 6J and M.G.L. c. 63, § 38R is $15 million per calendar year for five years. In calendar year 1 the Commission issues to ten projects second certifications totaling $11 million in allocated credits. The Commission will rollover into calendar year 2 the $4 million of unallocated credits. Therefore, in calendar year 2 the Commission may allocate up to $19 million in credits.

Example 2. The annual authorized credit amount under M.G.L. c. 62, § 6J and M.G.L. c. 63, § 38R is $15 million per calendar year for five years. In calendar year 1 the Commission issues to ten projects second certifications totaling $11 million in allocated credits and in calendar year 2 the Commission issues second certifications to twelve additional projects totaling $17 million in allocated credits. Therefore, at the end of calendar year 2 the cumulative authorized maximum is $30 million of which the Commission has allocated $28 million. The Commission will rollover into calendar year 3 the $2 million of unallocated credits. Therefore, in calendar year 3 the Commission may allocate up to $17 million in credits.

(4) Certification of Rehabilitation.

(a) Initial Certification. An initial certification is the certification by the Commission that the structure meets the definition of a qualified historic structure.

(b) Second Certification; Chosen Projects; Written Notice. A second certification is issued by the Commission prior to construction, certifying that if completed as proposed, the rehabilitation work will meet the standards required for a certified rehabilitation. The Commission may issue a second certification during or after the construction process.

1. Projects which receive second certification are chosen projects. The Commission shall allocate some or all of the available credit among chosen projects as provided for in 830 CMR 63.38R.1(3)(c).

2. The Commission shall issue a written notice to applicants for second certification within such time as prescribed by the Commission. A chosen project shall receive a written notice of acceptance that contains a statement detailing the allocation of credit as determined by the Commission under 830 CMR 63.38R.1(3)(c). An applicant that is not chosen for second certification shall receive a written notice that contains a statement of reason for its not having been selected.

(c) Final Certification. A final certification is issued by the Commission when construction is completed, certifying that the work was completed as proposed and that the costs are consistent with the work completed. Such final certification shall be acceptable as proof that the expenditures related to such construction qualify as qualified rehabilitation expenditures for purposes of the credit allowed under M.G.L. c. 62, § 6J or M.G.L. c. 63, § 38R and 830 CMR 63.38R.1

(5) Chosen Projects; Application of Criteria. Within the application schedule provided for in 830 CMR 38R.1(6)(a), the Commission shall assess each initially certified project's contribution to the significance of the area and the relative public benefit of its proposed rehabilitation to the Commonwealth by applying the following criteria:

(a) Affordable Housing. At least 25% of the tax credits shall be allowed for projects that contain affordable housing whenever possible and consistent with the criteria set forth in 830 CMR 63.38R.1(5).

63.38R.1: continued

(b) Preservation. The extent to which historic, architectural or cultural preservation is achieved for the features and portions of the structure and its site and environment. In considering the extent of historic preservation, the Commission will review the project's utilization of traditional materials and technology and the retention of historic fabric. The project, when necessary, will be consistent with local and state planning priorities for development or protection. In addition, the Commission will consider the extent to which the project complements other state revitalization efforts. The Commission will give consideration to the level of historic significance as defined by the National Register of Historic Places.

(c) Potential for Loss or Destruction. Consideration of the potential loss or destruction of the historic structure(s) but for the financial assistance of the credit by evaluating the overall condition of the property including, but not limited to, an assessment of deferred maintenance, water penetration or structural failure.

(d) Statement of Need. Assessment and demonstration of the impact and need for the financial assistance of the credit utilizing an evaluation of the extent of benefit from other funding sources.

(e) Geographic Diversity. The project's potential for enhancing the geographic distribution of tax credit allocations throughout the Commonwealth.

(f) Administration and Feasibility of the Project. The relative soundness and feasibility of the proposal as reflected in a budget that details eligible costs and a proposal consistent with the Secretary of Interior's Standards for the Rehabilitation of Historic Properties. Submission to the Commission of a conditions survey or work progress checklist. Compliance with relevant state laws or any pertinent Executive Orders such as Executive Orders regarding housing, affirmative action or sprawl and growth planning.

(g) Public Support. The extent to which the taxpayer has sought public comments or received public support for the project from public organizations including, but not limited to, the Statewide Preservation Organization, the National Trust for Historic Preservation and any local historical commission.

(h) State of Utility. The extent to which the project will transform a structure or site that currently lacks beneficial or practical use into one that reflects positively on the community and the Commonwealth.

(i) Economic Impact. The project's economic impact on the surrounding community and the Commonwealth as a whole.

The Commission shall determine, utilizing the criteria set forth in 830 CMR 38R.1(5) and within the application schedule provided for in 830 CMR 38R.1(6), which projects, if any, are eligible to receive second certification under 830 CMR 38R.1(4)(b). The Commission's determination is not an adjudicatory proceeding under M.G.L. c. 30A, § 1 and therefore is not subject to review under M.G.L. c. 30A, § 14.

(6) Application Process and Administrative Fees.

(a) Application Deadlines. Applications for initial, second and final certification are to be submitted to the Commission. Applications for initial and final certification are accepted and considered on a rolling basis. Applications for second certification are accepted and considered on a schedule as follows:

1. applications received by the Commission by April 30th will be considered for approval within such time as prescribed by the Commission;

2. applications received by the Commission by August 31st will be considered for approval within such time as prescribed by the Commission; and

3. applications received by the Commission by January 15th will be considered for approval within such time as prescribed by the Commission.

The Commission is not required to issue second certifications in all application cycles.

(b) Application Forms. Application forms can be obtained from the Commission.

(c) Initial Applications. Applications for certification may be accepted under the application schedule on or after April 13, 2004, provided, however, that the Commission shall not issue final certifications before January 1, 2005.

(d) Application Fees. The Commission may impose a fee for any stage of the application and certification process.

63.38R.1: continued

(7) Transferability of Credit.

(a) Transferors, Transferees. Any taxpayer allowed to take the historic rehabilitation credit may transfer the credit, in whole or in part, to any individual or entity, without the requirement of transferring any ownership interest in the project or any interest in the entity which owns the project. Transferees are entitled to apply the credits against the tax or excise with the same effect as if the transferee had incurred the qualified rehabilitation expenditures. For treatment of carryover credit, see 830 CMR 63.38R.1(10). The credit can be transferred only on or after the date a chosen project becomes a completed project. For recapture treatment, see 830 CMR 63.38R.1(12).

(b) Notice and Transfer Statement. The Commission, in consultation with the Department of Revenue, shall promulgate a form of transfer statement to be filed by the transferor of the rehabilitation credit. The transfer statement shall be required in addition to the transfer contract required in 830 CMR 63.38R.1(7)(c). Transfer Statement forms may be obtained from the Commission. The transferor shall file a transfer statement and a copy of the proposed transfer contract with the Department of Revenue prior to the transfer and shall further file with the Department of Revenue the executed transfer contract within 30 days after the completed transfer. The transfer statement shall provide the name and federal taxpayer identification number of each transferor and transferee. Further, such statement shall indicate the amount of historic rehabilitation credit transferred to each transferee. The statement shall also contain such other information as the Department of Revenue or the Commission may from time to time require.

(c) Transfer Contract Requirements. Any taxpayer transferring his or her credit must enter into a transfer contract with the transferee. The transfer contract must specify the following:

1. description and address for all structures in the project;
2. the date each structure in the project was placed in service;
3. the schedule of years during which the credit may be taken and the amount of credit previously taken for the project including all previous transferees; and
4. the amount of credit being transferred.

(d) Transferred Eligibility to Claim Credit. Any taxpayer who is a transferee of the historic rehabilitation credit may, provided all transfer and other requirements or limitations are met, apply such credit to either the tax imposed under M.G.L. c. 62 or the excise imposed under M.G.L. c. 63.

(8) Allotment of Credit Among Partners, Members or Owners. Historic rehabilitation tax credits allowed to a partnership, a limited liability company taxed as a partnership or multiple owners of property shall be passed through to the persons designated as partners, members or owners, respectively, *pro rata* or, without regard to their sharing of other tax or economic attributes of such entity, pursuant to an executed agreement among such persons designated as partners, members or owners documenting an alternative distribution method.

(9) First Tax Year for Claiming Credit. A taxpayer may apply the credit against the tax or excise imposed by M.G.L. c. 62 or M.G.L. c. 63, beginning with the tax year a chosen project becomes a completed project.

(10) Carryforward of Credit.

(a) Carryforward Period. Any taxpayer allowed a credit under M.G.L. c. 62, § 6J or M.G.L. c. 63, § 38R and 830 CMR 63.38R.1 for any taxable year may carry over and apply to the tax imposed by M.G.L. c. 62 or the excise imposed by M.G.L. c. 63, in any of the succeeding five taxable years, the portion, as reduced from year to year, of those credits which exceed such tax or excise for the taxable year. The carryover period, for any taxpayer, cannot exceed five taxable years after the close of the taxable year during which the chosen project becomes a completed project as provided for in 830 CMR 63.38R.1(9).

(b) Carryforward of Transferred Credits. A transferee shall use the credit in the year it is transferred. If the credit allowable for any tax year exceeds the transferee's tax liability for that tax year, the transferee may carry forward and apply in a subsequent taxable year the portion, as reduced from year to year, of those credits which exceed such tax for the taxable year; provided, however, that the carryover period cannot exceed five taxable years after the close of the taxable year during which the chosen project becomes a completed project as provided for in 830 CMR 63.38R.1(9).

63.38R.1: continued

(11) Ordering of Credit; Limitations on Credit.

(a) Ordering of Credit. The credit may be applied in combination with other credits allowed under M.G.L. c. 62 in any order. Similarly, the credit may be applied in combination with other credits allowed under M.G.L. c. 63 in any order.

(b) Minimum Excise Limitation. The credit may not be applied to reduce the minimum excise due under M.G.L. c. 63, §§ 32(b) and 39(b).

(c) 50% Limitation Inapplicable. In determining the amount of the credit allowable for a taxable year, the 50% limitation imposed by M.G.L. c. 63, § 32C does not apply.

(d) Combined Group Members. A taxpayer that participates in the filing of a combined Massachusetts return of income may apply the credit against the portions of the combined group's excise liability attributable to the taxpayer, determined in accordance with the provisions of 830 CMR 63.32B.1(8), and not against the excise liability of other group members.

(e) Credit Nonrefundable. The credit is nonrefundable.

(12) Recapture.

(a) Recapture. If, before the end of the five year period beginning on the date on which the chosen project becomes a completed project, the taxpayer disposes of such taxpayer's interest in the project, the taxpayer's tax for the taxable year in which such disposition occurs shall be increased by the recapture amount. Any carryforward credit shall be adjusted by reason of such disposition.

(b) Transferees; Recapture. Only taxpayers with an ownership interest on the date on which the chosen project becomes a completed project shall be subject to recapture. Transferees are not subject to recapture.

(c) Amount of Recapture. The recapture amount shall equal the amount of the credit taken by the taxpayer, including any transferred credit, minus the credit allowed for ownership, but not less than zero. The credit allowed for ownership shall be the product of the amount of the credit allowed multiplied by a ratio, the numerator of which is the number of months the rehabilitated structure is owned by the taxpayer, and the denominator of which is 60. Credit taken includes any credit transferred. The month of disposition is considered a month owned by the taxpayer.

(d) Partial Disposition. In the case of a partial disposition of the taxpayer's ownership interest in the project the recapture amount shall be pro rated.

(e) Examples. The following examples illustrate the application of 830 CMR 63.38R.1(12).

Example 1. Calendar year taxpayer is allowed $100,000 of credit for a completed project as of April 30, 2005. In tax year 2005, taxpayer takes $40,000 of credit on his return, transfers $10,000 of credit and carries forward $50,000 of credit. On April 30, 2006 taxpayer disposes of 100% of his interest in the project. The taxpayer has owned the project for 20% of the required time (12 months divided by 60 months) and is therefore allowed 20% of the $100,000 credit for ownership, or $20,000. The taxpayer has taken $50,000 of credit ($40,000 on his return plus the $10,000 transferred credit) and will have a $30,000 recapture tax in his 2006 tax year. The $50,000 carryforward is disallowed.

Example 2. Same facts as Example 1, except that in tax year 2005 taxpayer takes $10,000 of credit on his return, transfers $5,000 of credit and carries forward $85,000 of credit. The taxpayer has taken $15,000 of the credit but is allowed $20,000 of the credit for ownership. There is no recapture tax but the carryforward is reduced to $5,000.

Example 3. Same facts as Example 2, except the taxpayer disposes of 10% of his ownership interest on April 30, 2006. In this case, 10% of the taxpayer's $100,000 allowed credit is subject to recapture. The taxpayer has owned this portion ($10,000) of the project for 20% of the required time (12 months divided by 60 months) and is allowed 20% of the $10,000 credit for ownership, or $2,000. In addition, the taxpayer still is entitled to 90% of $100,000 of the allowed credit. Therefore, the taxpayer is allowed $92,000 of the credit. There is no recapture tax but the carryforward is reduced by $8,000.

63.38R.1: continued

(13) Authorization to Take Further Actions. Nothing in 830 CMR 63.38R.1 shall be deemed to limit the express or implied authority of the Commission or the Department of Revenue to take all actions deemed by the Commission or the Department of Revenue in their discretion to be consistent with the authority granted under M.G.L. c. 62, § 6J and M.G.L. c. 63, § 38R (St. 2003, c. 141, §§ 22, 24, 82 and St. 2004, c. 65, §§ 5 through 9, 13 through 18 and 54).

63.38T.1: Taxation of Unrelated Business Income of Exempt Organizations

(1) Statement of Purpose, Outline of Topics.

(a) Purpose. The purpose of 830 CMR 63.38T.1 is to explain the Massachusetts taxation, pursuant to M.G.L c. 62 or c. 63, of income from unrelated business activities of corporations, trusts and unincorporated associations exempt from taxation under section 501 of the Internal Revenue Code.

(b) Outline of Topics. 830 CMR 63.38T.1, is organized as follows:

1. Statement of Purpose, Outline of Topics;
2. Definitions;
3. Taxation of Exempt Corporations;
4. Taxation of Exempt Trusts;
5. Taxation of Exempt Unincorporated Associations;
6. Filing Requirement.

(2) Definitions. For purposes of 830 CMR 63.38T.1 the following terms have the following meanings unless the context requires otherwise:

Code, the Internal Revenue Code of the United States, as defined under M.G.L. c. 62 or M.G.L. c. 63, as applicable.

Commissioner, the Commissioner of Revenue.

Exempt Corporation, a domestic or foreign corporation, as defined in M.G.L. c. 63, § 30, that is exempt from taxation under section 501 of the Code.

Exempt Trust, a trust, as determined under Massachusetts law, that is exempt from taxation under section 501 of the Code, but not including a corporate trust, as defined in M.G.L. c. 62, § 1(j).

Exempt Unincorporated Association, an association, organization or similar enterprise that is exempt from taxation under section 501 of the Code and that is not an exempt corporation or exempt trust. This definition includes limited liability companies in the instance in which the LLC is not treated as a corporation within the meaning of M.G.L. c. 63 and the LLC is exempt from taxation under section 501 of the Code.

Federal Unrelated Business Taxable Income, income as determined under section 512 of the Code.

(3) Taxation of Exempt Corporations.

(a) General. An exempt corporation is subject to tax under M.G.L. c. 63, § 39 on its Massachusetts unrelated business taxable income. However, the property or net worth of the exempt corporation shall not be subject to tax under M.G.L. c. 63, § 39. Also, the exempt corporation shall not be subject to the minimum excise. The provisions of M.G.L. c. 63, § 39 and 830 CMR 63.39.1 shall be applicable to determine whether a foreign corporation exempt from taxation under § 501 of the Code is subject to the tax jurisdiction of Massachusetts.

(b) Massachusetts Unrelated Business Taxable Income. An exempt corporation's Massachusetts unrelated business taxable income is its federal unrelated business taxable income with the modifications referenced in 830 CMR 63.38T.1(3)(c).

63.38T.1: continued

(c) Adjustments. An exempt corporation shall add back to its unrelated business taxable income items that must be added back to income pursuant to M.G.L. c. 63. For example, any federal net operating loss deduction claimed under section 172 of the Code must be added back by such corporations. Further, to the extent that it has unrelated business taxable income, an exempt corporation may deduct items that are deductible under M.G.L. c. 63 that are directly connected with carrying on its unrelated trade or business, such as, where appropriate, the Massachusetts net operating loss (NOL) and carryover deduction provided in M.G.L. c. 63, § 30(5). Carryover of the NOL generated in any taxable years in which an exempt corporation was not subject to taxation in Massachusetts on its unrelated business taxable income shall not be allowed.

(d) Apportionment. If an exempt corporation has unrelated business taxable income that is taxable both within and without the commonwealth it may apportion its net income to the commonwealth pursuant to M.G.L. c. 63, § 38. The apportionment factors shall be determined only with respect to the unrelated business activity of the exempt corporation.

(e) Credits. The credits allowed to corporations under M.G.L. c. 63 are allowed to exempt corporations. However, the credits must be determined only with respect to the unrelated business activity of the corporation.

(f) Local Property Tax. The exempt corporation is not a domestic corporation or a foreign corporation for purposes of M.G.L. c. 59.

(g) Effective Date. 830 CMR 63.38T.1(3), is effective for tax years beginning on or after January 1, 2006.

(4) Taxation of Exempt Trusts.

(a) General. The Massachusetts unrelated business income of an exempt trust is subject to tax under M.G.L. c. 62, § 10. However, pursuant to M.G.L. c. 62, § 5(b), any stock bonus, pension, or profit-sharing trust qualifying under section 401 of the Code or any individual retirement account qualifying under section 408 of the Code is not subject to tax under M.G.L. c. 62.

(b) Massachusetts Unrelated Business Income. In the case of an exempt trust, Massachusetts unrelated business income is the exempt trust's federal gross income derived from any unrelated business activity with the modifications set forth in M.G.L. c. 62, § 2. In the case of a nonresident exempt trust, Massachusetts unrelated business income is the portion of its federal gross income from unrelated business activity that is derived from sources in Massachusetts.

(c) Trustee Deductions. The trustee of an exempt trust is entitled to any deductions allowed under M.G.L. c. 62 that are directly connected with carrying on the trust's unrelated trade or business. In addition, the trustee is allowed the deductions under M.G.L. c. 62, §§ 3A(a)(2), 3B(a)(2) and 3C(a)(2) for such net amount of Part A, Part B, and Part C adjusted gross income of the trustee as is pursuant to the terms of the trust currently payable to or irrevocably set aside for public charitable purposes, or to or for the benefit of an organization or organizations established and operated exclusively for charitable purposes. The deductions under M.G.L. c. 62, §§ 3A(a)(2), 3B(a)(2) and 3C(a)(2) may reduce the trust income to zero.

(5) Taxation of Exempt Unincorporated Associations.

(a) General. The Massachusetts unrelated business income of an unincorporated association is subject to tax under M.G.L. c. 62. For purposes of reporting the income, an exempt unincorporated association is considered an entity separate from its members and is required to file as a fiduciary on behalf of these members.

(b) Massachusetts Unrelated Business Income. In the case of an exempt unincorporated association, Massachusetts unrelated business income is the exempt unincorporated association's federal gross income derived from any unrelated business activity with the modifications set forth in M.G.L. c. 62, § 2.

(c) Deductions. An exempt unincorporated association is entitled to any deductions allowed under M.G.L. c. 62 that are directly connected with carrying on the association's unrelated trade or business.

(6) Filing Requirement. An exempt corporation, trust or unincorporated association is required to file a Massachusetts return if it has federal gross income from an unrelated trade or business of $1,000 or more even if the exempt organization's taxable income is zero.

63.39.1: Corporate Nexus

(1) General.

(a) 830 CMR 63.39.1 describes the circumstances under which a foreign corporation is subject to the tax jurisdiction of Massachusetts under M.G.L. c. 63, § 39.

(b) 830 CMR 63.39.1 is organized as follows:

1. General
2. Definitions
3. General Rule For Evaluating Corporate Tax Jurisdiction
4. Activities Within the Scope of M.G.L. c. 63, § 39
5. Exception for Solicitation Activities Protected By P.L. 86-272
6. Other Exceptions
7. Independent Contractors
8. Corporate Partners
9. Nexus Determinations
10. Examples

(2) Definitions.

Commissioner, the Commissioner of the Massachusetts Department of Revenue or the Commissioner's duly authorized representative.

Corporate Form, a form of organization recognized in Massachusetts as that of a foreign corporation under M.G.L. c. 63, § 30(2), whether or not the entity is described as a corporation by the state under whose laws the entity is organized.

Documentary Evidence, journals, books of account, invoices, expense reports, or other records that are maintained by the taxpayer in the regular course of its business. Generally, an affidavit or other document prepared in anticipation of, or in response to a tax audit, examination, or litigation is not documentary evidence.

Employee, any person who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee. A person is presumed to be an employee of a foreign corporation, rather than an independent contractor, if the foreign corporation treats that person as an employee for purposes of the payroll taxes imposed by the Federal Insurance Contributions Act.

Foreign Corporation, an entity defined as a foreign corporation under M.G.L. c. 63, § 30(2).

Independent Contractor, an independent contractor as defined in 830 CMR 63.39.1(7).

Licensed Public Warehouse, any building or part thereof maintained as a business for the public storage of goods, wares, and merchandise by a warehouseman licensed under the provisions of M.G.L. c. 105, provided however that any portion of a warehouse owned or leased by a consignor or consignee of tangible personal property stored in the warehouse is not a licensed public warehouse for purposes of M.G.L. c. 63, § 39.

Missionary Sales Activity, generating retail demand for the products of a manufacturer or distributor (and indirectly generating wholesale orders for those products) by promoting the products to retailers who typically order the products from a wholesaler or other middleman.

Office, a permanent or temporary location where a corporation makes sales or holds itself out to the public as conducting business. An in-home office of a corporation's sales representative is generally not an 'office' of the corporation for purposes of 830 CMR 63.39.1, provided that the representative does not publicly hold himself out as doing business on behalf of the corporation at that location, either by publishing the home address as a corporate business address or through other actions.

63.39.1: continued

Partner and Partnership, as a general rule, Partner and Partnership have the same meaning as in 26 U.S. Code § 7701, provided that Partner and Partnership shall also apply to other entities and their members treated as partnerships and partners for purposes of M.G.L. c. 62, § 17. Partnership does not include any trust or estate subject to taxation under M.G.L. c. 62 or any entity taxed as a corporation under M.G.L. c. 63

Representative, an employee of a corporation, or any person who otherwise acts on behalf of the corporation, provided that an independent contractor as defined in 830 CMR 63.39.1(7) is not a representative.

Sample or Display Area, a temporary location, such as a hotel room or trade show exhibit, where representatives of a foreign corporation exhibit samples, but do not make sales, approve orders for sales, or conduct any of the activities listed in 830 CMR 63.39.1(4)(d).

Samples, representative samples of the product of a foreign corporation that are used in sales demonstrations or are distributed in limited quantities, without charge, to acquaint existing or prospective customers with the corporation's products. Gemstones or other unique items held for sale by a sales representative are not samples.

(3) General Rule for Evaluating Corporate Tax Jurisdiction. M.G.L. c. 63, § 39, imposes an excise upon all foreign corporations that enjoy, under the protection of the laws of the Commonwealth, the powers, rights, privileges, and immunities derived from the corporate form of existence and operation. The Commissioner will construe M.G.L. c. 63, § 39, as asserting the tax jurisdiction of Massachusetts to the extent permitted by the Constitution and laws of the United States, unless a specific statutory exclusion from taxation exists. In general, a foreign corporation is subject to the tax jurisdiction of Massachusetts under M.G.L. c. 63, § 39, if it engages in any of the activities listed in 830 CMR 63.39.1(4), unless those activities fall within the exceptions described in 830 CMR 63.39.1(5) (relating to P.L. 86-272) or 830 CMR 63.39.1(6) (other exceptions).

(4) Activities Within the Scope of M.G.L. c. 63, § 39. Except as provided in 830 CMR 63.39.1(5) and (6), a foreign corporation must file a return in Massachusetts and pay the associated excise if any one or more of the following apply:

(a) the corporation is qualified to do business in Massachusetts under M.G.L. c. 181, § 4;

(b) the corporation actually does business in Massachusetts, whether or not it has qualified to do so. For purposes of M.G.L. c. 63, § 39, "doing business" includes:

1. the buying, selling or procuring of services or property;
2. the execution of contracts;
3. the exercise or enforcement of contract rights;
4. the maintenance of a place of business;
5. the employment of labor;
6. each and every other act, power, right, privilege, or immunity exercised or enjoyed in the Commonwealth as an incident to or by virtue of the powers and privileges acquired through corporate form;

(c) the corporation exercises or continues its charter within Massachusetts;

(d) the corporation owns or uses any part or all of its capital, plant, or other property in the Commonwealth in a corporate capacity (as opposed to a strictly fiduciary capacity). Without limitation, a corporation owns or uses property in Massachusetts if:

1. the corporation owns property that is held by another in Massachusetts under a lease, consignment, or other arrangement;
2. the corporation uses property in Massachusetts that it holds under a lease, license, or other arrangement;
3. the corporation maintains a stock of goods in Massachusetts (see, however, 830 CMR 63.39.1(6)(c), regarding property stored in a public warehouse).

63.39.1: continued

(5) Exception for Solicitation Activities Protected By P.L. 86-272.

(a) General; Preemption of State Law. A foreign corporation whose activities fall within those described in M.G.L. c. 63, § 39, and 830 CMR 63.39.1(4) nevertheless is not subject to Massachusetts taxation if Massachusetts is precluded from exercising its jurisdiction by P.L. 86-272 (15 U.S.C. §§ 381 *et seq*.). P.L. 86-272 currently precludes the imposition of the excise under M.G.L. c. 63, § 39, upon a foreign corporation if the sole activity of the corporation in Massachusetts is the solicitation by the corporation's representatives (in the name of the corporation or in the name of a prospective customer) of orders for the sale of tangible personal property, provided that the orders are sent outside Massachusetts for approval or rejection, and provided that the orders are filled by shipment or delivery by common carrier or contract carrier from a point outside of Massachusetts. Some examples of common solicitation activities are listed in 830 CMR 63.39.1(5)(c).

(b) Scope of P.L. 86-272. P.L. 86-272 restricts states' tax jurisdiction with respect to sales solicitation activities only if the taxpayer's activity is limited to solicitation of orders for the sale of tangible personal property. The protection from state net income taxes provided by P.L. 86-272 does not apply to solicitation activities under the following circumstances:

1. A combination of solicitation activities and other unprotected activities is not protected by P.L. 86-272. If a corporation engages both in protected solicitation activities and in any other activity that is not solicitation of orders for the sale of tangible personal property, it may not claim the immunity provided by P.L. 86-272;

2. Solicitation of orders for the sale or provision of services is not protected by P.L. 86-272. A corporation may not claim the immunity provided by P.L. 86-272 if it sells or provides a mixture of services and tangible personal property to its customers. Typical examples of the sale of a mixture of services and tangible personal property are photographic development, the fabrication of a customer's materials, the installation of equipment, and the provision of architectural or engineering services;

3. Solicitation of orders for the sale, lease, rental, license, or other disposition of real property or intangibles is not protected by P.L. 86-272.

(c) Activities Normally Considered to be Solicitation. The following are examples of activities that ordinarily fall within the scope of "solicitation" under P.L. 86-272.

1. Advertising campaigns incidental to missionary activities;

2. Carrying samples only for display or for distribution without charge or other consideration;

3. Owning or furnishing automobiles to sales representatives, provided that the vehicles are used exclusively for solicitation purposes;

4. Passing inquiries and complaints on to home office;

5. Incidental and minor advertising, i.e., a notice in a newspaper that a sales representative will be in town at a certain time;

6. Missionary sales activities;

7. Checking of customers' inventories (for re-order, but not for other purposes);

8. Maintaining a sample or display area for an aggregate of 14 calendar days or less during the tax year, provided that no sales or other activities inconsistent with solicitation take place;

9. Soliciting of sales by an in-state resident representative of the taxpayer; provided the representative maintains no in-state sales office or place of business;

10. Training sales representatives or holding periodic meetings of sales representatives.

(d) Activities That Are Not Solicitation. The following are examples of activities that fall outside of the scope of "solicitation" and are not protected by P.L. 86-272 unless they are *de minimis* within the meaning of *Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co.*, 112 S. Ct. 2447 (1992).

1. Making repairs or providing maintenance;

2. Collecting delinquent accounts;

3. Investigating creditworthiness;

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4. Installation or supervision of installation;
5. Conducting training courses, seminars or lectures;
6. Providing engineering functions;
7. Handling customer complaints (other than by referral to home office);
8. Approving or accepting orders;
9. Repossessing property;
10. Securing deposits on sales;
11. Picking up or replacing damaged or returned property, including stale or unsalable inventory;
12. Hiring, training, or supervising personnel (other than the training of sales representatives);
13. Providing shipping information and coordinating deliveries;
14. Carrying samples for sale, exchange or distribution in any manner for consideration or other value;
15. Holding meetings of directors, officers, or employees;
16. Supervising the operations of a franchisee or similar party;
17. Monitoring, inspecting, or approving work performed by an independent contractor under a warranty or similar contractual arrangement;
18. Maintaining sample or display area at one location in excess of 14 calendar days during the tax year;
19. Owning, leasing, maintaining or otherwise using any of the following facilities or property in-state:
    a. Repair shop;
    b. Parts department;
    c. Purchasing office;
    d. Employment office;
    e. Warehouse;
    f. Stock of goods (but see 830 CMR 63.39.1(6)(c) regarding property stored in a public warehouse);
    g. Mobile stores, i.e., trucks with driver salespersons;
    h. Real property or fixtures of any kind;
20. Consigning tangible personal property to any person, including an independent contractor;
21. Maintaining, by either an in-state or an out-of-state resident representative, an office or place of business;
22. Qualifying to do business in Massachusetts;
23. Owning an interest in any partnership, grantor trust, or other pass-through entity whose activities, if conducted directly by a foreign corporation, would give Massachusetts jurisdiction over the foreign corporation under the provisions of 830 CMR 63.39.1(4), unless the activities of the pass-through entity are limited to solicitation protected by P.L. 86-272.

(e) Rules of Construction. Whether the activities of a foreign corporation fall within the scope of "solicitation" within the meaning of P.L. 86-272 is a factual determination. The examples of activities provided in 830 CMR 63.39.1(5)(c) and (d), respectively, are intended as guidelines. They are not exhaustive and will not precisely describe the activities of many foreign corporations. In applying the guidelines to the particular circumstances and activities of individual foreign corporations, the Commissioner will employ the following rules of construction:

1. The term "solicitation" includes only actual requests for purchases and activities that are entirely ancillary to requests for purchases. An activity is entirely ancillary to the requesting of purchases only if it serves no independent business purpose apart from its connection to the soliciting of orders.
2. Activities conducted by a foreign corporation with respect to a particular order generally do not constitute "solicitation" if they occur after the order has been placed.
3. The effect of the activities listed in 830 CMR 63.39.1(5)(d) is cumulative. When determining whether a taxpayer's activities in excess of solicitation may be *de minimis*, all of these activities must be considered as a whole.

63.39.1: continued

4. If the Commissioner believes that a taxpayer engages in any activity listed in 830 CMR 63.39.1(5)(d), in Massachusetts, the Commissioner will require the taxpayer to carry the burden of substantiating any claim that its activities were *de minimis*. Documentary evidence will be given substantial weight in establishing the nature and extent of the taxpayer's activities. Affidavits or other evidence not contemporaneous with the events in question will be given little weight.

(6) Other Exceptions.

(a) General. A foreign corporation is not subject to the excise under M.G.L. c. 63, § 39, if its contacts with Massachusetts are limited exclusively to one or more of the activities listed in 830 CMR 63.39.1(6)(b) through (e). The activities listed below will not create jurisdiction even if they also fall within the scope of activities that would otherwise create jurisdiction under 830 CMR 63.39.1(4). For purposes of applying 830 CMR 63.39.1(6), the qualification to do business in Massachusetts under M.G.L. c. 181 is considered a contact with the Commonwealth that is independent of any other contacts that the foreign corporation may have with Massachusetts or activities that the foreign corporation may conduct in Massachusetts.

(b) Federal Limitations (Other than P.L. 86-272). A foreign corporation's activities will not subject it to the jurisdiction of Massachusetts under M.G.L. c. 63, § 39, if the Constitution or laws of the United States preclude the exercise of jurisdiction. For discussion of activities currently protected from the exercise of state tax jurisdiction by P.L. 86-272, see 830 CMR 63.39.1(5).

(c) Property in Transit or Public Warehouse. A foreign corporation is not subject to the corporate excise under M.G.L. c. 63, § 39, because of its ownership of tangible personal property in actual transit through Massachusetts in the possession and control of a common or contract carrier (provided, however, that this provision shall not preclude the exercise of jurisdiction over foreign carriers whose vehicles enter Massachusetts) or because of its ownership of tangible personal property stored in a licensed public warehouse in Massachusetts. The exemption from taxation provided by M.G.L. c. 63, § 39, for the ownership of goods stored in a licensed public warehouse will not be lost because of the shipment of those goods by common or contract carriers from the public warehouse to locations either within or outside of Massachusetts (provided, however, that the exemption does not extend to foreign carriers whose vehicles enter Massachusetts).

(d) Ownership of Shares. A foreign corporation is not subject to the corporate excise under M.G.L. c. 63, § 39, because of its mere ownership of shares of a corporation that does business in Massachusetts.

(e) Maintenance of Accounts. A foreign corporation is not subject to the corporate excise under M.G.L. c. 63, § 39, because of its depositing of funds or maintenance of securities brokerage accounts with financial institutions, unrelated to the foreign corporation, that do business in Massachusetts.

(7) Independent Contractors. For the purposes of determining whether a foreign corporation is subject to the excise under M.G.L. c. 63, § 39, the activities of employees, agents, or representatives, however designated, of the foreign corporation will be imputed to the corporation. An agent or representative may be an individual, corporation, partnership, or other entity. Activities of an independent contractor will not be imputed to the corporation. For purposes of 830 CMR 63.39.1(7), a person is an independent contractor only if all of the following conditions are met.

(a) The person is not an employee of the foreign corporation.

(b) The person is not subject, in the performance of activities on behalf of the foreign corporation, to the supervision or control (whether or not exercised) of the foreign corporation or any of that corporation's representatives. Whether a purported independent contractor is subject to the supervision or control of a foreign corporation or any of its representatives within the meaning of 830 CMR 63.39.1(7)(b) is a question of fact.

(c) The person holds himself out to the public as an independent contractor in the regular course of its business.

63.39.1: continued

(d) The person must regularly act on behalf of at least one bona fide principal apart from the foreign corporation. Partners, corporate affiliates, or other closely related parties are not separate principals for purposes of 830 CMR 63.39.1(7).

(e) The person may not approve orders on behalf of the foreign corporation or otherwise execute contracts on behalf of the foreign corporation, provided that:

1. to the extent permitted by P.L. 86-272, a person may sell or solicit orders for the sale of tangible personal property on behalf of a foreign corporation without losing the status of an independent contractor; and

2. a financial institution that holds itself out to the public as an investment advisor, providing investment advice and/or management services, including portfolio accounting or bookkeeping services, custodial services, and related financial services to unrelated third parties shall not lose the status of an independent contractor by virtue of any authority that it may have to execute contracts related to the purchase, sale, or management of securities on behalf of those third parties.

(8) Corporate Partners.

(a) General Rule--Partnership Activities Attributed to Partners. Except as provided by 830 CMR 63.39.1(8)(b)-(d), a foreign corporation uses its capital in Massachusetts, does business in Massachusetts, and is subject to the excise under M.G.L. c. 63, § 39, if the corporation is a general or limited partner in a partnership whose activities, if conducted directly by a foreign corporation, would subject that corporation to the corporate excise under the provisions of M.G.L. c. 63, § 39. In the case of a tiered partnership, as defined in 830 CMR 63.39.1(8)(b)3, the activities of the partnership(s) occupying the lower tier(s) of a tiered partnership arrangement are imputed, proportionally, to all partners holding interests in partnership(s) occupying higher tier(s). If a foreign corporate partner engages in a unitary business with a partnership in which it holds an interest, the activities of the partnership shall be deemed to be activities of the partner for purposes of determining whether taxation of the income of the partner is precluded by P.L. 86-272.

(b) Exception for Certain Partnerships Dealing in Securities. A foreign corporation is not subject to the excise under M.G.L. c. 63, § 39, by reason of its status as a limited partner in a partnership that is engaged exclusively in buying, selling, dealing in, or holding securities on its own behalf, and not as a broker, provided that the foreign corporation is not otherwise subject to the excise under M.G.L. c. 63, § 39. See generally M.G.L. c. 62, § 17.

1. In general, the exception in 830 CMR 63.39.1(8)(b) does not extend to an upper tier partnership in a tiered partnership arrangement, merely by virtue of the tiered structure.

2. If an upper tier partnership in a tiered partnership arrangement is a limited partner of a lower tier partnership that is engaged exclusively in buying, selling, dealing in, or holding securities on its own behalf, and not as a broker, the activities of the lower tier partnership will not, in themselves, subject corporate partners of the upper tier partnership to the excise under M.G.L. c. 63, § 39.

3. A tiered partnership arrangement is one in which some or all of the interests in one partnership (lower tier partnership) are held by a second partnership (upper tier partnership). A tiered partnership arrangement may have two or more tiers.

(c) Exception for Publicly Traded Partnerships. A foreign corporation that holds a limited partnership interest in a publicly traded partnership, as defined in Code § 7704, that conducts business activity in Massachusetts, is not subject to the excise under M.G.L. c. 63, § 39, unless the activities of that foreign corporation otherwise establish nexus with Massachusetts.

63.39.1: continued

(d) *De Minimis* Exception. Under circumstances specified in 830 CMR 63.39.1(8)(d)1.-2., the Commissioner ordinarily will treat the holding of a limited partnership interest by a foreign corporation as a *de minimis* connection with Massachusetts and will not seek to impose the excise under M.G.L. c. 63, § 39, on that corporate limited partner, despite the conduct of business activities by the partnership in Massachusetts. This *de minimis* rule applies only to foreign corporations that, apart from their limited partnership holdings, are not subject to the excise under M.G.L. c. 63, § 39. The *de minimis* rule does not apply to any limited partner that is subject to tax under M.G.L. c. 62 or to any general partner. The application of the *de minimis* rule is subject to the ownership attribution principles and other conditions stated in 830 CMR 63.39.1(8)(d)3. through 4.

1. The Commissioner ordinarily will treat a limited partnership interest of a foreign corporation as a *de minimis* connection with Massachusetts if the foreign corporation owns less than a 5% interest in the partnership and if neither the Massachusetts property of the partnership, nor its Massachusetts payroll, nor its Massachusetts sales, when multiplied by the foreign corporation's interest in the partnership, exceeds $10,000. The Massachusetts property, payroll, and sales of the partnership shall be calculated under the rules provided in M.G.L. c. 63, § 38. The interest of a limited partner in a partnership shall be its distributive share of the partnership's income, gain, loss, or credit, (whichever may be greatest) determined pursuant to Code § 704.

2. Under extraordinary circumstances, the Commissioner may agree that a limited partnership holding of a foreign corporation is a *de minimis* connection with Massachusetts, even if the test stated in 830 CMR 63.39.1(8)(d)1. is not satisfied. In order to obtain the Commissioner's agreement to *de minimis* treatment under 830 CMR 63.39.1(8)(d)2., a foreign corporation must establish to the Commissioner's satisfaction, during the course of an audit, by application for abatement, or by a determination under 830 CMR 63.39.1(9), that under the particular facts and circumstances applicable to the foreign corporation and the limited partnership, the connection between the foreign corporation and the Commonwealth is so inconsequential that the imposition of the corporate excise on the foreign corporation would constitute an unconstitutional extension of the tax jurisdiction of Massachusetts.

3. For purposes of applying the *de minimis* rule under 830 CMR 63.39.1(8)(d), a corporate limited partner is treated as owning all interests in a partnership that it owns either directly or indirectly, including all interests of any party whose direct or indirect stock ownership would be attributed to the corporate limited partner under the provisions of section 318 of the Internal Revenue Code. Furthermore, if a corporation owns (or is treated as owning) limited partnership interests in two or more partnerships that conduct business activity in Massachusetts, other than publicly traded partnerships as defined by Code § 7704, the Massachusetts property, payroll, and sales represented by those interests, as calculated above, must be aggregated when applying the *de minimis* rule.

4. Any corporate limited partner that claims not to be subject to the excise under M.G.L. c. 63, § 39, because of the *de minimis* rule stated in 830 CMR 63.39.1(8)(d) bears the burden of establishing its claim to the Commissioner's satisfaction. In order to provide its corporate limited partners with the information necessary to make a *de minimis* calculation, any partnership that is required to file Massachusetts Form 3 and that has limited interests held by foreign corporations shall complete Part III of that Form (Income Apportionment) and shall provide a copy of the completed form to any partner that requests one.

Example. The following example illustrates the provisions of 830 CMR 63.39.1(8)(d):

63.39.1: continued

Some Place Partners, L.P., (Partnership) is a limited partnership that owns an office building at One Some Place in Boston. The Partnership purchased the property for $5 million and receives $500,000 gross annual rent. The partnership has no payroll and no other property or sales in Massachusetts. Corporation X, a foreign corporation, is a limited partner with a 1% capital and income interest in the Partnership. Corporation X has no other contacts with Massachusetts. Corporation X is subject to excise under M.G.L. c. 63, § 39, and does not qualify for the *de minimis* exception of 830 CMR 63.39.1(8)(d) because the Massachusetts property attributable to Corporation X exceeds $10,000. Specifically: 0.01 x $5,000,000 = $50,000.

(9) Nexus Determinations.

(a) Applications. A foreign corporation may apply to the Commissioner for a determination of whether the corporation is subject to tax under M.G.L. c. 63, § 39, in a particular taxable year. A request for a nexus determination for a taxable year must be mailed to the Commissioner, at the address stated below, on or before the last day of the first quarter of the taxpayer's taxable year. The request should generally conform to the requirements of a request for a letter ruling under 830 CMR 62C.3.2, and, in addition, the corporation must complete a nexus questionnaire provided by the Commissioner. The Commissioner may choose to treat any request for a nexus determination as a letter ruling application and may issue and publish such a ruling as provided by 830 CMR 62C.3.2, but nexus determinations generally will not be published.

Foreign corporations that wish to request a nexus determination should write to:

Massachusetts Department of Revenue
Rulings and Regulations Bureau, Room 703
100 Cambridge Street
Boston, MA 02204

63.39.1: continued

(b) When Nexus Determinations Will Be Issued. The Commissioner ordinarily will make a nexus determination prospectively, regarding business activity that a taxpayer has not yet undertaken in Massachusetts, after receiving a proper request, but the Commissioner may decline to make a determination in any case, for any reason. The Commissioner ordinarily will not issue a determination to any taxpayer in either of the following circumstances.

1. The Commissioner ordinarily will not issue a determination if, at the time the application is made, the Department is investigating the taxpayer's nexus with Massachusetts in connection with an audit or other examination.

2. The Commissioner ordinarily will not issue a determination if the taxpayer is currently filing corporate excise returns in Massachusetts.

(c) Effect of Determination. A nexus determination extends only to the facts stated in the corporation's request. The nexus determination is not an acknowledgment of the accuracy or completeness of this factual statement. The Commissioner reserves the right to investigate the accuracy and completeness of the corporation's factual statement, either before or after a determination is made. If, after a nexus determination is made, the Commissioner determines that a foreign corporation has engaged in any activities not fully disclosed in its request for a determination that constitute doing business in Massachusetts, the Commissioner may assess excise, including interest and penalties, for any taxable year, including the year for which the determination is issued, within the applicable statute of limitations. (Generally, no statute of limitations applies to periods for which a taxpayer has failed to file a return.)

A valid nexus determination will be binding on the Commissioner with respect to the taxable year for which it is made. A determination that a foreign corporation does not have nexus with Massachusetts will be binding with respect to subsequent taxable years only if there is no change in the controlling law and only if the taxpayer files an affidavit, signed by an officer authorized to sign tax returns, stating that the taxpayer's Massachusetts activities have not changed from those described in its request for a determination. The affidavit must be filed annually by mailing on or before the last day of the first quarter of the taxpayer's taxable year to the address stated in 830 CMR 63.39.1(9)(a). A determination is automatically revoked if the affidavit is not timely filed. Notwithstanding any affidavit, however, the Commissioner may revoke or reverse a nexus determination prospectively at any time by giving written notice to the taxpayer.

(10) Examples. The following examples illustrate the provisions of 830 CMR 63.39.1. Except as stated in Example 7, the examples assume that the foreign corporations involved have not qualified to do business in Massachusetts.

Example 1(a). Abundant Acres, Inc., is a foreign corporation that operates as a real estate broker. Abundant Acres has no office or employees in Massachusetts, but it has registered with the Massachusetts Board of Registry for Real Estate Brokers and Salesmen, and it brokers the sale of Massachusetts real estate. Abundant Acres is subject to the excise under M.G.L. c. 63, § 39, because it is doing business in Massachusetts within the meaning of 830 CMR 63.39.1(4) and because its activities do not constitute solicitation of orders for the sale of tangible personal property. See 830 CMR 63.39.1(5).

Example 1(b). Alluvial Acres, Inc. (Alluvial) is a foreign corporation that is a registered Realtor/Broker in another state. It is not registered as a real estate broker in Massachusetts, it maintains no offices or agents in Massachusetts, and it owns or leases no real property in Massachusetts.

For a fee, Alluvial will provide space in its computer database to real estate sellers to list their properties. Each property is included in listings compiled for distribution to potential buyers interested in property in the seller's area. Alluvial conducts business by mail or telephone. It solicits property listings through advertisements in national and regional publications. Alluvial does not act as a broker with respect to the sale of Massachusetts real estate. It plays no part in negotiations or settlements, receives no commissions, and has no contact with buyers and sellers other than collecting and distributing information.

Alluvial is not doing business or exercising its charter in Massachusetts. It does not own or use any property in the Commonwealth. It is not subject to the excise under M.G.L. c. 63, § 39.

63.39.1: continued

Example 2. Barefoot Builders, Inc. (Barefoot) is a foreign corporation engaged in the leasing of construction vehicles. Barefoot leases vehicles to individuals and businesses in Massachusetts. It has no offices or employees in Massachusetts. Nevertheless, Barefoot is subject to the corporate excise under M.G.L. c. 63, § 39, because it owns property located in Massachusetts and it does not use that property for "solicitation" within the meaning of 830 CMR 63.39.1(5).

Example 3. Convoluted Computers, Inc. (Convoluted) is a foreign corporation that manufactures mainframe computers and peripherals. Convoluted has no offices in Massachusetts. It employs sales representatives who visit Massachusetts periodically to solicit orders. These representatives give presentations explaining the capacities and advantages of Convoluted's computers. The representatives also provide general price information to prospective customers, but they have no authority to accept orders. Final contract negotiations and execution of contracts occur at Convoluted's home office outside of the Commonwealth. Convoluted ships its products to Massachusetts by common carrier.

In addition to its sales representatives, Convoluted also employs technicians who install and service the machines purchased by Massachusetts customers. The technicians are based at Convoluted's home office and travel to the customer's facilities only for as long as the installation requires.

Because Convoluted employs workers in the Commonwealth, its activities fall within the scope of M.G.L. c. 63, § 39, unless they are protected by P.L. 86-272. Convoluted's sales representatives engage in protected solicitation activities. However, Convoluted's technicians are providing services, not soliciting sales of tangible property, so their activities are not protected. See 830 CMR 63.39.1(5)(b) and (5)(e). Since foreign corporations that engage in both protected and unprotected activities are subject to the Massachusetts corporate excise, Convoluted must file a return and pay the associated excise.

Example 4. Diffuse Deliveries, Inc. (Diffuse) is a foreign corporation engaged in interstate trucking. Diffuse's trucks frequently transport goods over the roads of Massachusetts, and may or may not pick up or deliver goods in the Commonwealth. Diffuse is subject to the Massachusetts corporate excise because it uses corporate property (trucks) and provides a service (transportation) in Massachusetts and because its activities are not solicitation of orders for the sale of tangible personal property.

Example 5. Eager Educators, Inc. (Eager) is a foreign corporation engaged in the business of conducting and marketing personal development training seminars. Eager either conducts seminars itself, using its own employees, or trains employees of client corporations to run seminars for those corporations. In either circumstance, Eager provides written course materials for each seminar participant. Eager has no offices in Massachusetts.

Eager provides its customers with a combination of services (training or instruction) and tangible property (course materials). Eager will therefore be subject to the Massachusetts corporate excise if it:

(a) conducts seminars in Massachusetts, using its own employees;

(b) contracts to allow one or more clients to conduct seminars in Massachusetts, and

1. the contract is executed in Massachusetts; or
2. Eager's employees come to Massachusetts to train, supervise, or advise client instructors, or to deliver course materials; or

(c) sends employees to trade shows or conventions in the Commonwealth or otherwise solicits sales of services in Massachusetts through sales personnel located in the Commonwealth.

Eager will not be doing business in Massachusetts and will not be subject to excise under M.G.L. c. 63, § 39, if its activities in Massachusetts are limited to one or both of the following:

1. solicitation of business by telephone from outside of the Commonwealth; or
2. advertising in trade journals distributed in Massachusetts.

63.39.1: continued

Example 6. Flirtatious Flavors, Inc. (Flirtatious) is a foreign corporation engaged in the manufacture and sale of candies. Flirtatious has no office or retail outlets in Massachusetts. However, it employs three full-time sales representatives who live in Massachusetts and who solicit sales in Massachusetts and other New England states. The sales representatives work out of their homes but do not store inventory there, and do not publicize their home addresses as business addresses of Flirtatious.

Flirtatious provides each of its sales representatives with a company-owned car. The cars are registered and principally used in Massachusetts. They are garaged at the sales representatives' homes, and are used by the representatives to visit customers.

Flirtatious employs workers and maintains a limited quantity of corporate property (company cars) in Massachusetts. However, its activities, including the activities in which its property is used, are limited to the solicitation of orders for the sale of tangible personal property. See 830 CMR 63.39.1(5). Therefore, it is not subject to the Massachusetts corporate excise.

Example 7. Geronimo Gents, Inc. (Geronimo) is a foreign corporation engaged in the retail sale of designer parachutes and fashionable gentlemen's parachuting attire. In 1988, Geronimo qualified to do business in Massachusetts and opened stores in Fall River and Newton Upper Falls. After high initial sales, Geronimo's profits plunged, and Geronimo abandoned its local operations in 1989. However, despite ceasing Massachusetts business activities, Geronimo remained qualified to do business in the Commonwealth until 1991.

The corporate excise under M.G.L. c. 63, § 39, is imposed not only when a corporation does business in Massachusetts, but also when it is qualified to do business in the Commonwealth. See 830 CMR 63.39.1(4)(a). The qualification to do business is not "solicitation." See 830 CMR 63.39.1(5)(d)22. Geronimo is subject to the corporate excise through its 1991 taxable year.

Example 8. Humble Homes is a foreign corporation that sells furniture. The company regularly delivers furniture that it has sold to locations in Massachusetts using its own delivery trucks. The delivery trucks are corporate property that the company owns or uses in Massachusetts in a corporate capacity within the meaning of 830 CMR 63.39.1(4)(d). The delivery of goods does not constitute "solicitation" of orders. Humble Homes is therefore subject to the excise under M.G.L. c. 63, § 39.

Example 9. Invisible Inc. is a foreign corporation that holds intangible assets. Invisible has no employees, tangible property, or sales. However, the majority of its corporate functions are performed in Massachusetts. These corporate functions include maintaining books and records, holding directors' meetings, and making day-to-day business decisions. The corporate functions are performed in Massachusetts by Invisible's directors or by employees of an affiliate. Invisible is subject to the excise under M.G.L. c. 63, § 39.

Example 10. Just Javelins, Inc. (Javelins) is a foreign corporation that manufactures sports equipment outside of Massachusetts. Javelins opens a securities account with a Massachusetts financial institution, Kindred, Inc., and retains Kindred as a financial advisor. Under an agreement signed by the two companies, Kindred has the authority to invest Javelins' assets in various securities. Officers of Javelins visit Kindred's office in Massachusetts two or three times per year, for one or two days per visit, to review the performance of Javelins' securities portfolio and to discuss future investment plans. Javelins has no other contacts with Massachusetts. Javelins is not doing business in Massachusetts and is not subject to tax under M.G.L. c. 63, § 39.

63.42.1: M.G.L. c. 63, § 42 Method of Apportionment

(1) General. If the allocation and apportionment provisions of M.G.L. c. 63 are not reasonably adapted to approximate the net income derived from business carried on within Massachusetts, a corporation or corporate trust may apply to the Commissioner to have its Massachusetts income determined by a method other than that provided in M.G.L. c. 63, § 38, M.G.L. c. 63, § 42. A utility corporation as defined in M.G.L. c. 63, § 52A(1)(a) may apply to the Commissioner to have its Massachusetts income determined by a method other than that provided in M.G.L. c. 63, § 38, as adjusted by M.G.L. c. 63, s. 52A(3). If the provisions of a regulation or regulations issued under M.G.L. c. 63, § 38(j) are not reasonably adapted to approximate the net income derived from business carried on within Massachusetts of a corporation to which such regulation applies, that corporation may apply to the Commissioner to have its Massachusetts income determined by a method other than that provided in the applicable regulation issued under M.G.L. c. 63, § 38(j).

(2) Definitions. For the purposes of 830 CMR 63.42.1, the following terms have the following meanings:

Alternative apportionment, a method, other than that provided in M.G.L. c. 63, § 38, or § 38 as adjusted by § 52A(3), or § 38 as adjusted by a regulation or regulations issued under M.G.L. c. 63, § 38(j), to determine a corporation's or corporate trust's Massachusetts income.

Applicant, a corporation or corporate trust as defined in 830 CMR 63.42.1, applying for permission to use alternative apportionment under M.G.L. c. 63, § 42 and 830 CMR 63.42.1.

Application, application for alternative apportionment made under M.G.L. c. 63, § 42.

Commissioner, the Commissioner of Revenue or the Commissioner's representative duly authorized to perform the duties of the Commissioner relating to M.G.L. c. 63, § 42 alternative apportionment.

Corporate Trust, an entity defined in M.G.L. c. 62, § 1(j), entitled to apportion income as provided in M.G.L. c. 62, § 8.

Corporation, a domestic corporation as defined in M.G.L. c. 63, § 30(1), a foreign corporation as defined in M.G.L. c. 63, § 30(2) or a utility corporation as defined in M.G.L. c. 63, § 52A(a).

Duly-filed return, a return filed as required by M.G.L. c. 62C, §§ 6, 11, 12 and 19; returns or amended returns filed on or before the due date or returns filed within any extension granted by the Commissioner under M.G.L. c. 62C, § 19. Duly-filed does not include amended returns filed after the due date.

Massachusetts income, income derived from business carried on in Massachusetts.

M.G.L. c. 63, § 42 alternative apportionment, a method other than that provided in M.G.L. c. 63, § 38, or § 38 as adjusted by § 52A(3), or § 38 as adjusted by a regulation or regulations issued under M.G.L. c. 63, § 38(j), to determine an applicant's Massachusetts income.

Statutory apportionment, the method of determining net income derived from business carried on within Massachusetts as provided in M.G.L. c. 63, § 38, or § 38 as adjusted by § 52A(3), or § 38 as adjusted by a regulation or regulations issued under M.G.L. c. 63, § 38(j).

(3) Application. If an applicant believes that the allocation and apportionment provisions of M.G.L. c. 63 are not reasonably adapted to approximate its net income derived from business carried on in Massachusetts, the applicant may apply to the Commissioner to have its Massachusetts income determined by an alternative apportionment method.

63.42.1: continued

(a) Application, Time of Application. An applicant makes application for Section 42 alternative apportionment by attaching an Application for Alternative Apportionment (Form AA-1) to its duly-filed tax return with tax payment and sending both the return and application to the address indicated on the return. Indicate an attached application by checking the appropriate box on the heading of the return. Place the application on top of the first page of the return. An application Form AA-1 is timely filed if it is attached to a duly-filed return. An application received by the Commissioner after the due date or the due date under a valid extension for receipt of the applicant's tax return will not be considered.

(b) Contents of Application.

1. Power of Attorney. The Commissioner or any duly authorized representative will discuss or disclose a applicant's confidential tax information with a representative of the applicant only if the representative properly completes and submits with the application for alternative apportionment a power of attorney on behalf of the applicant. The power of attorney must specifically authorize the representative to discuss an alternative apportionment method. If the power of attorney is not attached to the application, it must be submitted before any discussion or disclosure of tax information.

2. Statement of Reasons. An application must contain a statement of the reasons, supported by detailed facts, why the applicant believes that the allocation and apportionment provisions of M.G.L. c. 63 are not reasonably adapted to approximate its Massachusetts income. The applicant must show by clear and cogent evidence that the income attributed to Massachusetts using statutory apportionment is in fact out of all appropriate proportion to the business transacted in Massachusetts or that use of statutory apportionment has led to a grossly distorted result.

3. Proposed Alternative Method. An application must also contain a detailed description of its proposed alternative apportionment method. The applicant must provide a written summary justifying the proposed alternative method, attaching sufficient documentation to justify the figures used, their origin, nature and relation to the overall result reached.

4. Additional Information. The Commissioner may request from an applicant information in addition to that submitted by the applicant with its application. Upon receipt of such request the applicant must file with the Commissioner within the time specified by the Commissioner a statement under oath of its treasurer of the additional information required. If additional information is requested, submission of such information to the Commissioner's satisfaction is a prerequisite to the Commissioner's consideration of the application.

(c) Return, Payment. An application must be attached to a duly-filed tax return showing computation of tax using both statutory apportionment and the applicant's proposed alternative apportionment method. Tax is due as computed using statutory apportionment.

(4) Alternative Apportionment Method. The applicant's proposed alternative method may include, in respect to all or any part of the applicant's business activity, if reasonable:

(a) the exclusion of one or more factors;

(b) the inclusion of one or more additional factors which will fairly represent the applicant's Massachusetts business activity; or

(c) the employment of any other method to achieve a reasonable allocation and apportionment of the applicant's income.

(5) Compliance with 830 CMR 63.42.1. An applicant seeking permission to use alternative apportionment must strictly comply with the rules set out in 830 CMR 63.42.1. If an applicant fails to comply, such failure may result in denial of its application.

(6) Advance rulings ordinarily not available. Except in extraordinary circumstances the Commissioner will not issue a letter ruling (See 830 CMR 62C.3.2) on a proposed alternative apportionment method.

63.42.1: continued

(7) Application Considered. The Commissioner will consider each proper and timely filed application for alternative apportionment. If in the Commissioner's judgment the allocation and apportionment provisions of M.G.L. c. 63 are reasonably adapted to approximate the applicant's net income derived from business carried on in Massachusetts, the application will be denied; and the applicant's Massachusetts income will be determined using statutory apportionment. If in the Commissioner's judgment it appears that the allocation and apportionment provisions of M.G.L. c. 63 are not reasonably adapted to approximate the applicant's net income from business carried on in Massachusetts, an alternative apportionment method will be used to determine the applicant's Massachusetts income. As soon as possible after the Commissioner receives a properly completed and properly filed application for alternative apportionment and any additional information requested, the Commissioner will send the applicant a "Notice of Alternative Apportionment Denied", or a "Notice of Alternative Apportionment," or a "Notice of Intention to Impose Alternative Method."

(a) Application Withdrawal. An application for alternative apportionment may be withdrawn any time before a Notice of Alternative Apportionment is sent to the applicant. Withdrawal is accomplished by sending a letter requesting withdrawal attached to a copy of the application submitted (Form AA-1) to the Section 42 Process Person, Determination Bureau, Room 303, Department of Revenue, 100 Cambridge St., Boston, MA 02204. If withdrawal is proper and timely, statutory apportionment will be used to determine the applicant's Massachusetts income.

(b) Application Denied, Notice of Alternative Apportionment Denied. The Commissioner will notify the applicant in writing at the address provided on its application (Form AA-1) of the Commissioner's decision to deny its application.

(c) The Applicant's Proposed Alternative Apportionment Method Accepted, Notice of Alternative Apportionment. If the Commissioner determines that the allocation and apportionment provisions of M.G.L. c. 63 are not reasonably adapted to approximate the applicant's net income from business carried on in Massachusetts and that the applicant's proposed alternative apportionment method appears to be reasonably adapted to approximate its net income derived from business carried on in Massachusetts, the Commissioner may grant the applicant permission to use such method to determine its Massachusetts income. The Commissioner will notify the applicant in writing at the address provided on the application (Form AA-1) of permission to use the applicant's proposed alternative apportionment method (Notice of Alternative Apportionment). If the applicant receives permission to use its proposed method, and the applicant submitted a duly-filed tax return showing computation of the tax using both statutory apportionment and the applicant's proposed alternative apportionment method, as required in 830 CMR 63.42.1(3)(c), a refund of overpayment, with interest if due, will be made pursuant to M.G.L. c. 62C, § 36.

(d) The Applicant's Proposed Alternative Apportionment Method Rejected, Notice of Intention to Impose Alternative Method.

1. Notice. If the Commissioner determines that the allocation and apportionment provisions of M.G.L. c. 63 are not reasonably adapted to approximate the applicant's net income from business carried on in Massachusetts and that the applicant's proposed alternative apportionment method is not reasonably adapted to approximate its net income derived from business carried on in Massachusetts, the Commissioner will by reasonable methods determine the amount of the applicant's net income derived from business activity carried on in Massachusetts. The Commissioner will notify the applicant in writing at the address provided on its application (Form AA-1) of the Commissioner's decision to allow alternative apportionment and a description of the alternative method to be used (Notice of Intention to Impose Alternative Method).

2. Objections. The applicant has 35 days from the date on the Notice of Intention to Impose Alternative Method to advise the Commissioner of any objections to the Commissioner's proposed method. The applicant must make its objections in writing and send them to the Commissioner as instructed in the Notice of Intention to Impose Alternative Method.

63.42.1: continued

3. Imposition. The Commissioner's representative may further discuss with the applicant the Commissioner's method; and as a result the Commissioner may in his discretion revise his proposed method. If the method is revised, a new Notice of Intention to Impose Alternative Method will be sent to the applicant. If no objections are made, or those made do not warrant consideration in the Commissioner's opinion, the Commissioner will impose his method of alternative apportionment and send the applicant a Notice of Alternative Apportionment. The applicant is then required to submit its tax return showing computation of the tax using the Commissioner's alternative apportionment method. A refund of overpayment, with interest if due, will be made pursuant to M.G.L. c. 62C, § 36.

(e) Deemed Denial. If the Commissioner does not act upon an application for alternative apportionment before the expiration of nine months from the date the application was properly filed, the application is deemed denied. The Commissioner and the applicant may consent in writing to extend the time for the decision on the application.

(8) Permission Granted.

(a) Alternative Apportionment Method Used. If permission to use an alternative method of apportionment is granted and such method is used, the amount determined using the alternative apportionment method is the applicant's net income taxable under M.G.L. c. 63. The amount is in lieu of the determination otherwise required under M.G.L. c. 63, § 38, or § 38 as adjusted by M.G.L. c. 63, § 52A(3), or § 38 as adjusted by a regulation or regulations issued under M.G.L. c. 63, § 38(j).

(b) Permission Effective in Year of Application. Permission to use Section 42 alternative apportionment is effective only for the year for which permission is granted. If an applicant is granted permission and uses alternative apportionment in the year of application the Commissioner may require similar information from the applicant for the two subsequent tax years if it appears that statutory apportionment is not reasonably adapted to approximate for the applicable year the applicant's Massachusetts income, and the Commissioner may by reasonable methods determine the applicant's Massachusetts income in the same manner as if the applicant had applied for alternative apportionment. The Commissioner may, in his discretion, determine the applicant's Massachusetts income in either of the two years following the year of application by using the alternative method used by the applicant in the year of application or by using any reasonable method of apportionment. An applicant may apply for permission to use alternative apportionment in any year following its initial application. However, a new application does not alter the Commissioner's authority under M.G.L. c. 63, § 42 and 830 CMR 63.42.1 as to the two years succeeding any use of alternative apportionment.

(c) Prior Permission Revoked. Any grant of permission to use M.G.L. c. 63, § 42 alternative apportionment other than a grant of permission made through the application process described in 830 CMR 63.42.1, if not otherwise revoked or ineffective, is revoked as of the effective date of 830 CMR 63.42.1. Permission to use M.G.L. c. 63, § 42 alternative apportionment is now granted exclusively through the application process described in 830 CMR 63.42.1, effective only for the tax year for which application is made.

(d) Transition Rule. An applicant that has been given permission to use alternative apportionment issued before the promulgation date of 830 CMR 63.42.1 or has properly filed an application for such treatment under M.G.L. c. 63, § 42, is not required to submit a new application as required by 830 CMR 63.42.1 for any year as to which it has already filed its return. If it seeks to use alternative apportionment for any tax year for which the return is filed on or after the promulgation date of 830 CMR 63.42.1 it must apply in the manner outlined.

63.42.1: continued

(e) Penalties. If an applicant files and pays tax computing such tax using any method of apportionment other than statutory apportionment without first complying with the provisions of 830 CMR 63.42.1, or if the method for which permission was granted has not been properly followed, the return filed will be considered incorrect or insufficient within the meaning of M.G.L. c. 62C, § 28. If a person who has been notified by the Commissioner that he has filed an incorrect or insufficient return refuses or neglects within 30 days after the date of the notification to file a proper return or if a person files a false or fraudulent return, the Commissioner may determine the tax due and assess the tax at not more than double the amount so determined, in addition to any other penalties established by law.

(9) Abatement. If permission to use M.G.L. c. 63, § 42 alternative apportionment is denied, the applicant's tax is determined using statutory apportionment. If the applicant's proposed alternative apportionment method is rejected and the application is not withdrawn, the applicant's tax is determined using the Commissioner's alternative apportionment method. An applicant aggrieved by the denial of its application or aggrieved by the Commissioner's modification of its proposed alternative apportionment method may apply for abatement of tax paid as provided in M.G.L. c. 62C, § 37 and 830 CMR 62C.37.1. No tax will be abated on the ground that M.G.L. c. 63, § 42 alternative apportionment should have been used unless the corporation or corporate trust has properly applied for permission to use alternative apportionment under M.G.L. c. 63, § 42 and 830 CMR 63.42.1. Permission to use alternative apportionment is not effective retroactively and therefore will not be considered the basis for granting an abatement for any year earlier than the year for which the application was submitted.

(10) Corporations Filing a Combined Massachusetts Return. A corporation which is part of a group filing a Massachusetts combined return which believes that the allocation and apportionment provisions of M.G.L. c. 63 are not reasonably adapted to approximate its net income derived from business carried on within Massachusetts may submit an application for alternative apportionment. Each corporation seeking to use an alternative apportionment method must submit a separate application.

REGULATORY AUTHORITY

830 CMR 63.00: M.G.L. c. 63; c. 14, § 6(1); c. 62C, § 3.