BEFORE THE DEPARTMENT OF REVENUE
OF THE STATE OF MONTANA

In the matter of the adoption of New Rules I though VI, and the amendment of ARM 42.26.201, 42.26.202, 42.26.203, 42.26.204, 42.26.205, 42.26.206, 42.26.207, 42.26.208, 42.26.210, 42.26.229, 42.26.230, 42.26.231, 42.26.232, 42.26.236, 42.26.241, 42.26.251, 42.26.252, 42.26.253, 42.26.254, 42.26.257, 42.26.259, 42.26.263, 42.26.302, 42.26.307, 42.26.308, 42.26.309, 42.26.312, 42.26.401, 42.26.602, 42.26.605, 42.26.606, 42.26.702, 42.26.704, 42.26.705, 42.26.802, 42.26.805, 42.26.807, 42.26.902, 42.26.903, 42.26.904, 42.26.905, 42.26.1002, 42.26.1003, 42.26.1102, 42.26.1103, 42.26.1202, and 42.26.1204 pertaining to the allocation and apportionment of income of multistate corporate taxpayers necessitated by House Bill 511, L. 2017 Also, in the matter of the adoption of New Rule VII (Finnigan Rule) and related amendment of ARM 42.26.255 and repeal of ARM 42.26.511 (Joyce Rule) pertaining to the department's method of administering the corporate income tax regarding unitary multistate taxpayers whose Montana activity is reflected through multiple entities	)	NOTICE OF PUBLIC HEARING ON PROPOSED ADOPTION, AMENDMENT, AND REPEAL

TO: All Concerned Persons

1. On November 2, 2017, at 10:30 a.m., the Department of Revenue will hold a public hearing in the Third Floor Reception Conference Room of the Sam W. Mitchell Building, located at 125 North Roberts, Helena, Montana, to consider the proposed adoption, amendment, and repeal of the above-stated rules. The hearing room is most readily accessed by entering through the east doors of the building facing Sanders Street.

2. The Department of Revenue will make reasonable accommodations for persons with disabilities who wish to participate in this public hearing or need an alternative accessible format of this notice. If you require an accommodation, contact the department no later than 5 p.m. on October 23, 2017, to advise us of the nature of the accommodation you need. Please contact Laurie Logan, Department of Revenue, Director's Office, P.O. Box 7701, Helena, Montana 59604-7701; telephone (406) 444-7905; fax (406) 444-3696; or e-mail lalogan@mt.gov.

3. The rules as proposed to be adopted provide as follows:

NEW RULE I NUMERATOR OF RECEIPTS FACTOR - SALES OTHER THAN SALES OF TANGIBLE PERSONAL PROPERTY - MARKET BASED SOURCING (1) In order to satisfy the requirements of this rule, a taxpayer's assignment of receipts from sales of other than tangible personal property must be consistent with the following principles:

(a) A taxpayer shall apply the principles set forth in this rule 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 shall determine its method of assigning receipts in good faith, and apply it 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 receipts, including the underlying assumptions, and shall provide those records to the department upon request.

(b) This rule provides various assignment methods that apply sequentially in a hierarchy. For each sale to which a hierarchical method applies, a taxpayer must make a reasonable effort to apply the primary method applicable to the sale before seeking to apply the next method in the hierarchy (and must continue to do so with each succeeding method in the hierarchy, where applicable). For example, in some cases, the applicable method first requires a taxpayer to determine the state or states of assignment, and if the taxpayer cannot do so, the method requires the taxpayer to reasonably approximate the state or states. In these cases, the taxpayer must attempt to determine the state or states of assignment (i.e., apply the primary method in the hierarchy) in good faith and with reasonable effort before it may reasonably approximate the state or states.

(c) A taxpayer's method of assigning its receipts, including the use of a method of approximation, where applicable, must reflect an attempt to obtain the most accurate assignment of receipts consistent with the regulatory standards set forth is this rule, 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.

(2) Methods of reasonable approximation.

(a) In general, this rule establishes uniform principles for determining whether and to what extent the market for a sale other than the sale of tangible personal property is in Montana. This rule also sets forth methods of reasonable approximation, which apply if the state or states of assignment cannot be determined. In some instances, the reasonable approximation must be made in accordance with these specific methods of approximation. In other cases, this rule 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 methods.

(b) Approximation based on known sales. In an instance where, applying the applicable principles set forth in [New Rule IV] (sale of a service), a taxpayer can ascertain the state or states of assignment of a substantial portion of its receipts from sales of substantially similar services ("assigned receipts"), but not all of those sales, and the taxpayer reasonably believes, based on all available information, that the geographic distribution of some or all of the remainder of those sales generally tracks that of the assigned receipts, it shall include receipts from those sales which it believes tracks the geographic distribution of the assigned receipts in its receipts factor in the same proportion as its assigned receipts. This principle 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.

(c) Where a taxpayer has receipts subject to this rule from transactions with a related-party customer, information that the customer has that is relevant to the sourcing of receipts from these transactions is imputed to the taxpayer.

(3) Methods with respect to the exclusion of receipts from the receipts factor.

(a) The receipts factor only includes those amounts defined as receipts under ARM 42.26.202.

(b) Certain receipts arising from the sale of intangibles are excluded from the numerator and denominator of the receipts factor pursuant to [New Rule VI(1)(d)].

(c) If a taxpayer cannot ascertain the state or states to which receipts of a sale are to be assigned pursuant to this rule (including through the use of a method of reasonable approximation, where relevant) using a reasonable amount of effort undertaken in good faith, the receipts must be excluded from the denominator of the taxpayer's receipts factor.

(d) If a taxpayer can ascertain the state or states to which receipts from a sale are to be assigned pursuant to this rule, but the taxpayer is not taxable in one or more of those states, the receipts that would otherwise be assigned to those states where the taxpayer is not taxable must be excluded from the denominator of the taxpayer's receipts factor.

(e) Receipts of a taxpayer from hedging transactions, or from holding cash or securities, or from the maturity, redemption, sale, exchange, loan, or other disposition of cash or securities, shall be excluded from the receipts factor.

(4) Changes in methodology and review by the department.

(a) Nothing in this rule is intended to limit the application of 15-31-312, MCA, or the authority granted to the department under 15-31-312, MCA. To the extent that regulations adopted pursuant to 15-31-312, MCA, conflict with provision of this rule, the regulations adopted pursuant to 15-31-312, MCA, control. If the application of this rule results in the attribution of receipts to the taxpayer's receipts factor that does not fairly represent the extent of the taxpayer's business activity in Montana, the taxpayer may petition for or the department may require the use of a different method for attributing those receipts.

(b) In any case in which a taxpayer files an original return for a taxable year in which it properly assigns its receipts using a method of assignment including a method of reasonable approximation, in accordance with this rule, 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 those cases, neither the department 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 those receipts for the taxable year. However, the department and the taxpayer may each subsequently, through the applicable administrative process, correct factual errors or calculation errors with respect to the taxpayer's application of its filing methodology.

(c) The department's ability to review and adjust a taxpayer's assignment of receipts on a return to more accurately assign receipts consistently with this rule includes, but is not limited to, each of the following potential actions:

(i) If a taxpayer fails to properly assign receipts from a sale in accordance with this rule, including the failure to properly apply a hierarchy of methods consistent with the principles of (1)(b) above, the department may adjust the assignment of the receipts in accordance with this rule.

(ii) If a taxpayer uses a method of approximation to assign its receipts and the department determines that the method of approximation employed by the taxpayer is not reasonable, the department may substitute a method of approximation that the department determines is appropriate or may exclude the receipts from the taxpayer's numerator and denominator, as appropriate.

(iii) If the department 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 department may require that the taxpayer apply its method of approximation in a consistent manner.

(iv) If a taxpayer excludes receipts from the denominator of its receipts factor on the theory that the assignment of the receipts cannot be reasonably approximated, the department may determine that the exclusion of those receipts is not appropriate, and may instead substitute a method of approximation that the department determines is appropriate.

(v) If a taxpayer fails to retain contemporaneous records that explain the determination and application of its method of assigning its receipts, including its underlying assumptions, or fails to provide those records to the department upon request, the department may treat the taxpayer's assignment of receipts as unsubstantiated, and may adjust the assignment of the receipts in a manner consistent with this rule.

(vi) If the department concludes that a customer's billing address was selected by the taxpayer for tax avoidance purposes, the department may adjust the assignment of receipts from sales to that customer in a manner consistent with this rule.

(vii) A taxpayer that seeks to change its method of assigning its receipts under this rule must disclose, in the original return filed for the year of the change, the fact that it has made the change. If a taxpayer fails to adequately disclose the change, the department may disregard the taxpayer's change and substitute an assignment method that the department determines is appropriate.

(viii) The department may direct a taxpayer to change its method of assigning its receipts 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 department determines that the change is appropriate to reflect a more accurate assignment of the taxpayer's receipts within the meaning of this rule, and determines that the change can be reasonably adopted by the taxpayer. The department will provide the taxpayer with a written explanation as to the reason for making the change. If a taxpayer fails to comply with the department's direction on subsequently filed returns, the department may deem the taxpayer's method of assigning its receipts on those returns to be unreasonable, and may substitute an assignment method that the department determines is appropriate.

AUTH: 15-1-201, 15-31-313, MCA
IMP: 15-1-601, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes adopting New Rule I to provide guidance in the implementation of House Bill (HB) 511, L. 2017. With the enactment of HB 511, corporate income tax taxpayers are required to use a market sourcing approach to sourcing receipts from sales other than sales of tangible personal property for purposes of the receipts apportionment factor. The new language added by HB 511 to 15-1-601, Article IV(17), MCA, is modeled after the Multistate Tax Commission's (MTC) Revised Model Compact Article IV. In support of the Revised Compact, the MTC also adopted apportionment regulations addressing the sourcing of receipts using the market sourcing approach. Proposed New Rule I is modeled after these apportionment regulations adopted by the MTC.

As proposed, New Rule I sets forth provisions under a market based sourcing approach for receipts from sales other than sales of tangible personal property. Section (1) addresses the principles to be applied when sourcing these types of receipts. Section (2) addresses the methods of reasonable approximation that are to be used when sourcing receipts of sales other than sales of tangible personal property to the Montana apportionment receipts numerator. Section (3) addresses the methods to be used with respect to the exclusion of certain receipts from the receipts apportionment factor. Section (4) sets forth the provisions to be used when there is a change in methodology and review of these methods by the department.

The department considers the adoption of New Rule I necessary in its implementation of HB 511, in that it provides essential guidance to taxpayers in sourcing various types of receipts under a market sourcing approach.

<u>NEW RULE II NUMERATOR OF RECEIPTS FACTOR - SALE, RENTAL, LEASE, OR LICENSE OF REAL PROPERTY</u> (1) In the case of a sale, rental, lease, or license of real property, the receipts from the sale are in Montana if and to the extent that the property is in Montana.

AUTH: 15-1-201; 15-31-313, MCA
IMP: 15-1-601, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes adopting New Rule II to provide guidance in the implementation of House Bill (HB) 511, L. 2017. With the enactment of HB 511, corporate income tax taxpayers are required to use a market sourcing approach to sourcing receipts from the sale, rental, lease, or license of real property for purposes of the receipts apportionment factor.

The new language added by HB 511 to 15-1-601, Article IV(17), MCA, is modeled after the Multistate Tax Commission's (MTC) Revised Model Compact Article IV. In support of the Revised Compact, the MTC also adopted apportionment regulations addressing the sourcing of receipts using the market sourcing approach.

Proposed New Rule II is modeled after these apportionment regulations adopted by the MTC. As proposed, New Rule II addresses when receipts from the sale, rental, lease, or license of real property are properly sourced to the Montana receipts apportionment numerator. The department considers the adoption of New Rule II necessary in its implementation of HB 511, in that it provides essential guidance to taxpayers in sourcing various types of receipts under a market sourcing approach.

NEW RULE III NUMERATOR OF RECEIPTS FACTOR - RENTAL, LEASE, OR LICENSE OF TANGIBLE PERSONAL PROPERTY (1) In the case of a rental, lease, or license of tangible personal property, the receipts from the sale are in Montana if and to the extent that the property is in Montana. If the property is mobile property that is located both within and without Montana during the period of the lease or other contract, the receipts assigned to Montana are the receipts from the contract period multiplied by the fraction computed under ARM 42.26.234(3) (as adjusted when necessary to reflect differences between usage during the contract period and usage during the taxable year).

AUTH: 15-1-201, 15-31-313, MCA
IMP: 15-1-601, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes adopting New Rule III to provide guidance in the implementation of House Bill (HB) 511, L. 2017. With the enactment of HB 511, corporate income tax taxpayers are required to use a market sourcing approach to sourcing receipts from the sale, rental, lease, or license of tangible personal property for purposes of the receipts apportionment factor. The new language added by HB 511, to 15-1-601, Article IV(17), MCA, is modeled after the Multistate Tax Commission's (MTC) Revised Model Compact Article IV. In support of the Revised Compact, the MTC also adopted apportionment regulations addressing the sourcing of receipts using the market sourcing approach. Proposed New Rule III is modeled after these apportionment regulations adopted by the MTC.

As proposed, New Rule III addresses when receipts from the rental, lease, or license of tangible personal property are properly sourced to the Montana receipts apportionment numerator. The department considers the adoption of New Rule III necessary in its implementation of HB 511, in that it provides essential guidance to taxpayers in sourcing various types of receipts under a market sourcing approach.

NEW RULE IV NUMERATOR OF RECEIPTS FACTOR - SALE OF A SERVICE (1) The receipts from a sale of a service are in Montana if and to the extent that the service is delivered to a location in Montana. In general, the term "delivered to a location" refers to the location of the taxpayer's market for the service, which may not be the location of the taxpayer's employees or property. The methods to determine the location of the delivery of service in the context of several specific types of service transactions are set forth in this rule.

(2) In-person services.

(a) Except as otherwise provided in this rule, 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. This 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, x-rays, and mental health care and treatment; child care; haircutting 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 location that is owned or operated by the service provider or 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 similar services, although they may involve some amount of in-person contact, are not treated as in-person services within the meaning of this rule.

(b) Method of determination. Except as otherwise provided, if the service provided by the taxpayer is an in-person service, the service is delivered to the location where the service is received. Therefore, the receipts from a sale are in Montana if and to the extent the customer receives the in-person service in Montana. In assigning its receipts from sales of in-person services, a taxpayer must first attempt to determine the location where a service is received as follows:

(i) If the service is performed with respect to the body of an individual customer in Montana (i.e., haircutting or x-ray services) or in the physical presence of the customer in Montana (i.e., live entertainment or athletic performances), the service is received in Montana.

(ii) If the service is performed with respect to the customer's real estate in Montana or if 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 Montana, the service is received in Montana.

(iii) If 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 within or outside Montana, the service is received in Montana if the property is shipped or delivered to the customer in Montana.

(c) Method of reasonable approximation. In an 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. If the state to which the receipts are to be assigned can be determined or reasonably approximated, but the taxpayer is not taxable in that state, the receipts that would otherwise be assigned to that state are excluded from the denominator of the taxpayer's receipts factor.

(3) Services delivered to the customer or on behalf of the customer, or delivered electronically through the customer.

(a) If the service provided by the taxpayer is not an in-person service within the meaning of (2) above, or a professional service within the meaning of (4) below, and the service is delivered to or on behalf of the customer, or delivered electronically through the customer, the receipts from a sale are in Montana if and to the extent that the service is delivered in Montana. For purposes of this rule, 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, or the direct or indirect delivery of advertising to the customer's intended audience. A service can be delivered to or on behalf of a customer by physical means or through electronic transmission. 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.

(b) Assignment of receipts. The assignment of receipts to a state or states in the instance of a sale 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 nature of the customer. Separate methods of assignment apply to services delivered by physical means and services delivered by electronic transmission (for purposes of this rule, a service delivered by an electronic transmission is not a delivery by a physical means). If a method of assignment set forth in this rule 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. If the state to which the receipts from a sale are to be assigned can be determined or reasonably approximated, but the taxpayer is not taxable in that state, the receipts that would otherwise be assigned to that state are excluded from the denominator of the taxpayer's receipts factor.

(i) 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 (i.e., where software is developed for a specific customer in a case where the transaction is properly treated as a service transaction for purposes of corporate taxation) where the taxpayer installs the custom software at the customer's site. This rule applies whether the taxpayer's customer is an individual customer or a business customer.

(A) Method of determination. In assigning the receipts from a 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 the service is delivered. If the taxpayer is able to determine the state or states where the service is delivered, it shall assign the receipts to that state or states.

(B) Method of reasonable approximation. If 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 the state or states.

(ii) 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 principles apply.

(A) Services delivered by electronic transmission to an individual customer.

(I) Method of determination. In the case of the delivery of a service to an individual customer by electronic transmission, the service is delivered in Montana if and to the extent that the taxpayer's customer receives the service in Montana. If the taxpayer can determine the state or states where the service is received, it shall assign the receipts from that sale to that state or states.

(II) Methods 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 the state or states. If 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 the state or states using the customer's billing address.

(B) Services delivered by electronic transmission to a business customer.

(I) Method of determination. In the case of the delivery of a service to a business customer by electronic transmission, the service is delivered in Montana if and to the extent that the taxpayer's customer receives the service in Montana. If the taxpayer can determine the state or states where the service is received, it shall assign the receipts from that sale to the state or states. For purposes of this rule, 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.

(II) Method 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 the state or states.

(III) Secondary method 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, the taxpayer shall reasonably approximate the state or states as set forth in this rule. In these cases, unless the taxpayer can apply the safe harbor set forth in (IV) below, the taxpayer shall reasonably approximate the state or states in which the service is received as follows: first, by assigning the receipts from 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 receipts from 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 receipts from the sale using the customer's billing address; provided, however, if the taxpayer derives more than 5 percent of its receipts from sales of services from any single customer, the taxpayer is required to identify the state in which the contract of sale is principally managed by that customer.

(IV) 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 (II) or (III) above, the state or states in which the service is received. In these cases, the taxpayer may, in lieu of the method stated in (II) or (III) above, apply the safe harbor stated in this subsection. Under this safe harbor, a taxpayer may assign its receipts from sales to a particular customer based upon the customer's billing address in a taxpayer year in which the taxpayer engages in substantially similar service transactions with more than 250 customers, whether business or individual, and does not derive more than 5 percent of its receipts from sales of all services from that customer. This safe harbor applies only for purposes of services delivered by electronic transmission to a business customer, and not otherwise.

(V) Related party transaction. In the case of a sale of a service by electronic transmission to a business customer that is a related party, the taxpayer may not use the secondary method of reasonable approximation in (III) above, but may use the method of reasonable approximation in (II) above, and the safe harbor in (IV) above, provided that the department may aggregate sales to related parties in determining whether the sales exceed 5 percent of receipts from sales of all services under that safe harbor provision if necessary or appropriate to prevent distortion.

(iii) 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.

(A) Method 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 Montana if and to the extent that the end users or other third-party recipients are in Montana. 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 Montana to the extent that the audience for the advertising is in Montana. 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 Montana to the extent that the end users or other third-party recipients receive the services in Montana. The methods in this subsection apply whether the taxpayer's customer is an individual 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.

(B) Method 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 the state or states.

(C) Select secondary methods of reasonable approximation.

(I) If a taxpayer's service is the direct or indirect electronic delivery of advertising on behalf of its customer to the customer's intended audience, and if the taxpayer lacks sufficient information regarding the location of the audience from which it can determine or reasonably approximate that location, the taxpayer shall reasonably approximate the audience in a state for the advertising using the following secondary methods of reasonable approximation. If 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 that 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 that area.

(II) If a taxpayer's service is the delivery of a service to a customer that then acts as the taxpayer's intermediary in reselling that 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 that 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 the services, relative to the total population in that area.

(III) When using the secondary reasonable approximation methods provided above, the relevant specific geographic area of delivery include only the area where the service was substantially and materially delivered or resold. Unless the taxpayer demonstrates the contrary, it will be presumed that the area where the service was substantially and materially delivered or resold does not include areas outside the United States.

(4) Professional services.

(a) Except as otherwise provided in this rule, professional services are services that require specialized knowledge and in some cases require a professional certification, license, or degree. These services include the performance of technical services that require the application of specialized knowledge. 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 services, credit card services (including credit card processing services), data processing services, legal services, consulting services, video production services, graphic and other design services, engineering services, and architectural services.

(b) Overlap with other categories of services.

(i) Certain services that fall within the definition of "professional services" set forth in this rule are nevertheless treated as "in-person services" within the meaning of (2) above, and are assigned under the methods of that section. 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 this rule, notwithstanding the fact that these services may involve some amount of in-person contact.

(ii) Professional services may in some cases include the transmission of one or more documents or other communications by mail or by electronic means. In some cases, all or most communications between the service provider and the service recipient may be by mail or by electronic means. However, in these cases, despite this transmission, the assignment methods that apply are those set forth in this section and not those set forth in (3) above, pertaining to services delivered to a customer or through or on behalf of a customer.

(c) Assignment of receipts. 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, the location of delivery in the case of professional services is not susceptible to a general method of determination, and must be reasonably approximated. The assignment of receipts from 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 receipts from a sale of a professional service, a taxpayer's customer is the person that contracts for the service irrespective of whether another person pays for or also benefits from the taxpayer's services. In any instance in which the taxpayer is not taxable in the state to which receipts from a sale is assigned, the receipts are excluded from the denominator of the taxpayer's receipts factor.

(i) Receipts from sales of professional services other than those services described in (c)(ii) below (architectural and engineering services), (c)(iii) below (services provided by a financial institution), and (c)(iv) below (transactions with related parties), are assigned in accordance with this section.

(A) Professional services delivered to individual customers. Except as otherwise provided in this section, 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 must be reasonably approximated as set forth in this section. In particular, the taxpayer shall assign the receipts from a 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 percent of its receipts from sales of all services from an individual customer, the taxpayer shall identify the customer's state of primary residence and assign the receipts from the service or services provided to that customer to that state.

(B) Professional services delivered to business customers. Except as otherwise provided in this section, 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 must be reasonably approximated as set forth in this section. In particular, unless the taxpayer may use the safe harbor set forth in (C) below, the taxpayer shall assign the receipts from 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 the place of customer management is not reasonably determinable, to the customer's place of order; and third, if the 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 percent of its receipts from sales of all services from a customer, the taxpayer is required to identify the state in which the contract of sale is principally managed by the customer.

(C) Safe harbor; large volume of transactions. Notwithstanding the provisions set forth in (A) and (B) above, a taxpayer may assign its receipts from sales to a particular customer based on the customer's billing address in any taxable year in which the taxpayer engages in substantially similar service transactions with more than 250 customers, whether individual or business, and does not derive more than 5 percent of its receipts from sales of all services from that customer. This safe harbor applies only for purposes of this rule and not otherwise.

(ii) 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 this rule. However, unlike in the case of the general method that applies to professional services, the receipts from a sale of an architectural service are 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 the state or states; and the receipts from a sale of an engineering service are assigned to a state or states if and to the extent that the services are with respect to tangible or real property located in the state or states, including real estate improvements located in, or expected to be located in, the state or states. These provisions apply whether or not the customer is an individual or business customer. In any instance in which architectural or engineering services are not described here, the receipts from a sale of these services must be assigned under the general method for professional services.

(iii) Services provided by a financial institution. The apportionment rules that apply to financial institutions are set forth at ARM Title 42, chapter 26, [subchapter 13, MAR Notice Number 42-2-986]. ARM Title 42, chapter 26, [subchapter 13] includes specific rules to determine a financial institution's receipts factor. However, the rules in ARM Title 42, chapter 26, [subchapter 13] also provide that receipts from sales, other than sales of tangible personal property, including services transactions that are not otherwise apportioned under that subchapter, are to be assigned pursuant to this rule. In any instance in which a financial institution performs services that are to be assigned pursuant to this rule including, for example, financial custodial services, those services are considered professional services within the meaning of this rule, and are assigned according to the general method for professional services transactions set forth in this rule.

(iv) Related party transactions. In any instance in which the professional service is sold to a related party, rather than applying the method for professional services delivered to business customers, the state or states to which the service is assigned is the place of receipt by the related party as reasonably approximated using the following hierarchy: 1.) If the service primarily relates to specific operations or activities of a related party conducted in one or more locations, then to the state or states in which those operations or activities are conducted in proportion to the related party's payroll at the locations to which the service relates in the state or states; or 2.) If the service does not relate primarily to operations or activities of a related party conducted in particular locations, but instead relates to the operations of the related party generally, then to the state or states in which the related party has employees, in proportion to the related party's payroll in those states. The taxpayer may use the safe harbor provided by this rule provided that the department may aggregate the receipts from sales to related parties in applying the 5 percent method if necessary or appropriate to avoid distortion.

AUTH: 15-1-201, 15-31-313, MCA
IMP: 15-1-601, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes adopting New Rule IV to provide guidance in the implementation of House Bill (HB) 511, L. 2017. With the enactment of HB 511, corporate income tax taxpayers are required to use a market sourcing approach to sourcing receipts from the sale of a service for purposes of the receipts apportionment factor. The new language added by HB 511, to 15-1-601, Article IV(17), MCA, is modeled after the Multistate Tax Commission's (MTC) Revised Model Compact Article IV. In support of the Revised Compact, the MTC also adopted apportionment regulations addressing the sourcing of receipts using the market sourcing approach. Proposed New Rule IV is modeled after these apportionment regulations adopted by the MTC.

As proposed, New Rule IV sets forth provisions under a market based sourcing approach for receipts from sales of services. Section (1) addresses the principles to be applied when sourcing receipts from sales of services to the Montana receipts apportionment factor numerator. Section (2) addresses the methods to be used specifically for in-person services such as warranty and repair services, carpentry, medical and dental services, and live entertainment and athletic services to name just a few. Section (3) addresses the methods to be used specifically for receipts from services delivered to the customer or on behalf of the customer, or delivered electronically through the customer. Section (4) specifically addressed receipts from professional services such as fiduciary services, tax preparation, accounting services, legal services, and engineering services to name a few.

The department considers the adoption of New Rule IV necessary in its implementation of HB 511, in that it provides essential guidance to taxpayers in sourcing various types of receipts under a market sourcing approach.

NEW RULE V NUMERATOR OF RECEIPTS FACTOR - LICENSE OR LEASE OF INTANGIBLE PROPERTY (1) General provisions.

(a) The receipts from the license of intangible property are in Montana if and to the extent the intangible property is used in Montana. In general, the term "use" is 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. The provisions that apply to determine the location of the use of intangible property in the context of several specific types of licensing transactions are set forth in (2) through (5) below. For purposes of the provisions set forth in this rule, a lease of intangible property is to be treated the same as a license of intangible property.

(b) In general, a license of intangible property that conveys all substantial rights in that property is treated as a sale of intangible property for purposes of [New Rule VI]. Note, however, that a sale or exchange of intangible property is treated as a license of that property where the receipts from the sale or exchange derive from payments that are contingent on the productivity, use, or disposition of the property.

(c) Intangible property licensed as part of the sale or lease of tangible property is treated as the sale or lease of tangible property.

(d) 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 are excluded from the denominator of the taxpayer's receipts factor.

(e) Nothing in this rule shall be construed to allow or require inclusion of receipts in the receipts factor that are not included in the definition of "gross receipts" pursuant to ARM 42.26.202, or related regulations, or that are excluded from the numerator and the denominator of the receipts factor pursuant to [New Rule VI(1)(d)]. To the extent that the transfer of either a security 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 denominator of the taxpayer's receipts factor.

(2) 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 such as a marketing intangible to a consumer, the royalties or other licensing fees paid by the licensee for that marketing intangible are assigned to Montana to the extent that those fees are attributable to the sale or other provision of goods, services, or other items purchased or otherwise acquired by consumers or other ultimate customers in

Montana. 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 Montana, it shall assign that amount or proportion to Montana. In the absence of actual evidence of the amount or proportion of the licensee's receipts that are derived from Montana consumers, the portion of the licensing fee to be assigned to Montana must be reasonably approximated by multiplying the total fee by a percentage that reflects the ratio of the Montana 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 that area. If 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 Montana must be reasonably approximated by multiplying the total fee by a percentage that reflects the ratio of the Montana population in the specific geographic area in which the licensee's goods, services, or other items are ultimately and materially marketed using the intangible property relative to the total population of that area. Unless the taxpayer demonstrates that the marketing intangible is materially used in the marketing of items outside the United States, the fees from licensing that marketing intangible will be presumed to be derived from within the United States.

(3) License of a production intangible. If 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 that right are assigned to Montana to the extent that the use for which the fees are paid takes place in Montana. 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 the manufacturing process, where the value of the intangible lies predominately in its use in that process. In the case of a license of a production intangible to a party other than a related party where the location of actual use is unknown, it is 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. If the department can reasonably establish that the actual use of intangible property pursuant to a license of a production intangible takes place in part in Montana, it is presumed that the entire use is in this state except to the extent that the taxpayer can demonstrate that the actual location of a portion of the use takes place outside Montana. In the case of a license of a production intangible to a related party, the taxpayer must assign the receipts to where the intangible property is actually used.

(4) License of a mixed intangible. If 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 department will accept the separate

statement for purposes of this rule. If a license of intangible property includes both a license of a marketing intangible and a license of a production intangible and the fees are to be paid in each instance are not separately and reasonably stated in the contract, it is presumed that the licensing fees are paid entirely for the license of the marketing intangible except to the extent that the taxpayer or the department can reasonably establish otherwise.

(5) License of intangible property where substance of transaction resembles a sale of goods or services.

(a) 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 these cases, the receipts from the licensing transaction are assigned by applying the provisions set forth in [New Rule IV(3)] 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 this section include, without limitation, the license of database access, the license of access to information, the license of digital goods, and the license of certain software, where the transaction of pre-written software that is treated as the sale of tangible personal property.

(b) Sublicenses. Pursuant to (a) above, the provisions of [New Rule IV(3)(b)(iii)] 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, the provisions set forth at [New Rule IV(3)(b)(iii)] 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. For this purpose, 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 that property (i.e., 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 that property is bundled with additional services or items of property.

AUTH: 15-1-201, 15-31-313, MCA
IMP: 15-1-601, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes adopting New Rule V to provide guidance in the implementation of House Bill (HB) 511, L. 2017. With the enactment of HB 511, corporate income tax taxpayers are required to use a market sourcing approach to sourcing receipts from the license or lease of intangible property for purposes of the receipts apportionment factor. The new language added by HB 511, to 15-1-601, Article IV(17), MCA, is modeled after the Multistate Tax Commission's (MTC) Revised Model Compact Article IV. In support of the Revised Compact, the MTC also adopted apportionment regulations addressing the sourcing of receipts using the market sourcing approach. Proposed New Rule V is modeled after these apportionment regulations adopted by the MTC.

As proposed, New Rule V addresses when receipts from the license or lease of intangible property are properly sourced to the Montana receipts apportionment numerator. The department considers the adoption of New Rule V necessary in its implementation of HB 511, in that it provides essential guidance to taxpayers in sourcing various types of receipts under a market sourcing approach.

NEW RULE VI NUMERATOR OF RECEIPTS FACTOR - SALE OF INTANGIBLE PROPERTY (1) Assignment of receipts. The assignment of receipts 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 this rule, a sale or exchange of intangible property includes a license of that 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 provisions that apply where the consideration for the transfer of rights is contingent on the productivity, use or disposition of property, see [New Rule V(1)].

(a) 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 receipts from the sale are assigned to a state if and to the extent that the intangible property is used or is authorized to be used within the state. If the intangible property is used or may be used only in this state the taxpayer shall assign the sale to Montana. If the intangible property is used or is authorized to be used in Montana and one or more other states, the taxpayer shall assign the receipts from the sale to Montana to the extent that the intangible property is used in or authorized for use in Montana, through the means of a reasonable approximation.

(b) 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 are assigned by applying the provisions set forth in [New Rule V], pertaining to the license or lease of intangible property.

(c) Sale that resembles a sale of goods or 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 are assigned by applying the provisions set forth in [New Rule V(5)], relating to licenses of intangible property that resemble sales of goods and services). Examples of these transactions include those that are analogous to the license transactions cited as examples in [New Rule V(5)].

(d) Excluded receipts. Receipts from the sale of intangible property are not included in the receipts factor in any case in which the sale does not give rise to gross receipts within the meaning of ARM 42.26.202. In addition, in any case in which the sale of intangible property does result in gross receipts within the meaning of ARM 42.26.202, those receipts are excluded from the numerator and denominator of the taxpayer's receipts factor if the receipts are not referenced in [New Rule I]. The sale of intangible property that is excluded from the numerator and denominator of the taxpayer's receipts factor under this provision includes, without limitation, the sale of a partnership interest, the sale of business "goodwill," the sale of an agreement not to compete, or similar intangible value. Also, in any instance in which the state to which the receipts from a sale is to be assigned can be determined or reasonably approximated, but where the taxpayer is not taxable in such state, the receipts that would otherwise be assigned to such state shall be excluded from the numerator and denominator of the taxpayer's receipts factor.

AUTH: 15-1-201, 15-31-313, MCA
IMP: 15-1-601, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes adopting New Rule VI to provide guidance in the implementation of House Bill (HB) 511, L. 2017. With the enactment of HB 511, corporate income tax taxpayers are required to use a market sourcing approach to sourcing receipts from the sale of intangible property for purposes of the receipts apportionment factor. The new language added by HB 511, to 15-1-601, Article IV(17), MCA, is modeled after the Multistate Tax Commission's (MTC) Revised Model Compact Article IV. In support of the Revised Compact, the MTC also adopted apportionment regulations addressing the sourcing of receipts using the market sourcing approach. Proposed New Rule VI is modeled after these apportionment regulations adopted by the MTC.

As proposed, New Rule VI addresses when receipts from the sale of intangible property are properly sourced to the Montana receipts apportionment numerator. The department considers the adoption of New Rule VI necessary in its implementation of HB 511, in that it provides essential guidance to taxpayers in sourcing various types of receipts under a market sourcing approach.

<u>NEW RULE VII APPLICATION OF THE FINNIGAN RULE</u> (1) In determining whether the activities of any company have been conducted within Montana beyond the protection of P.L. 86-272, the principle established in Appeal of Finnigan Corporation, 88-SBE-022 (8/25/1988) and Appeal of Finnigan Corporation, 88-SBE-22A, Opinion on Petition of Rehearing (1/24/1990), commonly known as the "Finnigan Rule," shall apply. When calculating the Montana apportionment numerators provided for in 15-31-306, 15-31-309, and 15-31-311, MCA, a group of corporations engaged in a unitary business as defined in 15-31-301, MCA, shall include Montana property, payroll, and receipts from all members of the unitary group as long as one or more members has nexus with Montana.

AUTH: 15-1-201, 15-31-313, MCA
IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes adopting New Rule VII to notify taxpayers of a change in the way the department administers the corporate income tax regarding unitary multistate taxpayers whose Montana activity is reflected through multiple entities. Historically, the department applied what is known as the "Joyce Rule," in ARM 42.26.511, which is proposed to be repealed in conjunction with the proposed adoption of this new rule and the proposed amendment of ARM 42.26.255, the "Finnigan Rule" in this same notice.

The "Joyce" and "Finnigan" rules both address issues surrounding the calculation of a unitary group's apportionment factor numerators. Under "Joyce," in order to include the apportionment factor numerators of a member of a unitary group, that individual member must have nexus within the taxing state. Under "Finnigan," the apportionment factor numerators of all members of a unitary group are included if just one member of the unitary group has nexus within the taxing state.

The department proposes the adoption of New Rule VII to limit the risk of manipulation of the apportionment factors of a unitary combined group. A corporate structure can separate nexus creating activities from sales or other revenue-generating activities. By applying the "Joyce" rules, this has a direct impact on the Montana apportionment factor. The purpose of the apportionment factors is to reflect the Montana business activity of the unitary group. The corporate structure of a unitary group should not alter the reflection of business activity in the apportionment factors.

When dealing with combined unitary groups, the department is seeing a trend in businesses with more diverse corporate structures. The department is also seeing more economic presence issues. These issues can have material effects on the apportionment factors, of which the intent is to reflect the business activity of the unitary group in Montana. The adoption of the "Finnigan" rules can help limit the risk of manipulation of the apportionment factors of unitary groups. The department believes applying the "Joyce" rules no longer adequately addresses these issues and by adopting the "Finnigan" approach, a combined unitary group will provide a more accurate reflection of its business activity in Montana.

The proposed adoption of this rule is unrelated to any new legislation being addressed in this same rulemaking notice.

4. The rules as proposed to be amended provide as follows, deleted matter interlined, new matter underlined:

<u>42.26.201 INTENT</u> (1) The ~~following~~ regulations <u>in this subchapter of ARM Title 42, chapter 26</u> are applicable to Article IV of the Multistate Tax Compact, 15-1-601, MCA, and to the Uniform Division of Income for Tax Purposes Act, 15-31-302 through 15-31-312, MCA~~.~~<u>, and are modeled after</u> ~~The~~ regulations ~~were~~ adopted by the Multistate Tax Commission ~~on February 21, 1973~~. Statutory references in the regulations are to 15-31-302 through 15-31-312, MCA, but also apply to the corresponding subsections of Article IV of the Multistate Tax Compact, 15-1-601, MCA.

(2) ~~These~~ <u>The</u> regulations <u>in this subchapter</u> are intended to set forth ~~rules~~ <u>methods</u> concerning the application of the apportionment and allocation provisions of Title 15, chapter 31, part 3, MCA, and Article IV of 15-1-601, MCA. The ~~apportionment rules~~ <u>provisions</u> set forth in ~~these regulations~~ <u>this subchapter</u> are applicable to any taxpayer having ~~business~~ <u>apportionable</u> income, regardless of

whether or not it has ~~nonbusiness~~ nonapportionable income, and the allocation rules are applicable to any taxpayer having ~~nonbusiness~~ nonapportionable income, regardless of whether or not it has ~~business~~ apportionable income.

(3) The only exceptions to ~~these~~ the allocation and apportionment rules contained in ~~these rules~~ this subchapter are set forth in ARM 42.26.261 through 42.26.264 pursuant to the authority of 15-31-312, MCA. Special rules pertaining to certain industries are referenced in other ~~subsections~~ subchapters of ~~this chapter~~ ARM Title 42, chapter 26.

(4) ~~These~~ The regulations in this subchapter are not intended to modify existing rules concerning jurisdictional standards.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA

IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, 15-31-321, 15-31-322, 15-31-323, 15-31-324, 15-31-325, 15-31-326, MCA

REASON: The department proposes amending ARM 42.26.201 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income" and the term "nonbusiness income" to "nonapportionable income." The department proposes striking the old terms and replacing them with the new terms, where applicable, to align the rule with the revised statute.

The department also proposes amending language throughout the rule to make the location of the regulations being referred to within the rule clearer. The current language in the rule uses terms such as "these regulations" and "apportionment rules." As proposed to be amended, the rule will instead reference the specific location of the regulations and rules as being in this same subchapter of ARM Title 42, chapter 26.

The department further proposes removing the date associated with the Multistate Tax Commission's adoption of the regulations of the Multistate Tax Compact in 1973 in (1), because it is an unnecessary detail to include in the rule. The department has its own rules to provide for these same regulations and leaving an old date in this informational section of the rule could potentially create confusion.

42.26.202 DEFINITIONS The following definitions apply to terms used in this subchapter:

(1) "Allocation" means the assignment of ~~nonbusiness~~ nonapportionable income to a particular state.

(2) and (3) remain the same.

(4) "Apportionment" means the division of ~~business~~ apportionable income between states by the use of a formula containing apportionment factors.

(5) "Average value of property" means the amount determined by averaging the values at the beginning and ending of the income tax year, but the department may require the averaging of monthly values during the income year or such averaging as necessary to effect properly the average value of the property. ~~(~~See ARM 42.26.237.~~)~~

(6) and (7) remain the same.

(8) "Billing address" means the location indicated in the books and records of

<u>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.</u>

(8) remains the same, but is renumbered (9).

<u>(10) "Business customer" means a customer that is a business operating in any form, including a sole proprietorship. Sales to a nonprofit organization, to a trust, to the U.S. Government, to a foreign, state, or local government, or to an agency or instrumentality of that government are treated as sales to a business customer and must be assigned for receipts apportionment purposes consistent with the rules for those sales.</u>

<u>(11) "Code" means the Internal Revenue Code as currently written and subsequently amended.</u>

(9) through (11) remain the same, but are renumbered (12) through (14).

~~(12)~~<u>(15)</u> "Gross receipts" means the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest, and dividends) in a transaction which produces ~~business~~ <u>apportionable</u> income, in which the income, gain, or loss is recognized (or would be recognized if the transaction were in the United States) under the federal IRC.

(a) remains the same.

(b) Gross receipts, even if ~~business~~ <u>apportionable</u> income, do not include, for example, such items as:

(i) through (ix) remain the same.

(x) amounts realized from the exchange of inventory, except those amounts actually received by the taxpayer and that exceeded any corresponding amounts paid to the other party, and which were to account for excess deliveries under the exchange agreement, as calculated on an annual basis. Thus, the net amount of payments received in excess of the net payments made during the year may be included in the ~~sales~~ <u>receipts</u> factor; and

(xi) remains the same.

(c) Exclusion of an item from the definition of "gross receipts" is not determinative of its character as ~~business or nonbusiness~~ <u>apportionable or nonapportionable</u> income.

(13) remains the same, but is renumbered (16).

<u>(17) "Individual customer" means a customer that is not a business customer.</u>

<u>(18) "Intangible property" generally means property that is not physical or whose representation by physical means is merely incidental and 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; ideas; contract rights including broadcast rights; agreements not to compete; goodwill and going concern value; securities; and except as otherwise provided, computer software.</u>

(14) through (17) remain the same, but are renumbered (19) through (22).

~~(18)~~<u>(23)</u> "Original cost" means the basis of the property for federal income tax purposes (prior to any federal income tax adjustments, except for subsequent capital additions, improvements thereto, or partial dispositions); or, if the property has no such basis, the valuation of such property for interstate commerce commission purposes. If the original cost of property is unascertainable under the foregoing valuation standards, the property is included in the property factory at its fair market value as of the date of acquisition by the taxpayer. ~~(~~See ARM 42.26.235.~~)~~

(24) "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.

(25) "Population" means the most recent population data maintained by the U.S. Census Bureau for the year in question as of the close of the taxable period.

(19) and (20) remain the same, but are renumbered (26) and (27).

(28) "Related party" means:

(a) a stockholder who is an individual, or a member of the stockholder's family, set forth in section 318 of the Code if the stockholder and the members of the stockholder's family own directly, indirectly, beneficially, or constructively, in the aggregate, over 50 percent 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, trust, and corporations own directly, indirectly, beneficially, or constructively, in the aggregate, over 50 percent 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, over 50 percent 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.

(29) "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 day-to-day execution and performance of a contract entered into by the taxpayer with the customer.

(21) through (24) remain the same, but are renumbered (30) through (33).

~~(25)~~(34) "Value of owned real and tangible personal property" means its original cost. ~~(~~See ARM 42.26.235.~~)~~

~~(26)~~(35) "Value of rented real and tangible personal property" means the product of eight times the net annual rental rate. ~~(~~See ARM 42.26.236.~~)~~

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA

IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, 15-31-321, 15-31-322, 15-31-323, 15-31-324, 15-31-325, 15-31-326, MCA

REASON: The department proposes amending ARM 42.26.202 to properly implement House Bill (HB) 511, L. 2017, which changed the term "business income" to "apportionable income," and the term "nonbusiness income" to "nonapportionable income." The department proposes striking the old terms and replacing them with the new terms, where applicable, to align the rule with the revised statute.

The department also proposes adding and defining terms proposed to be used in its new rules to implement HB 511, which adopted a market sourcing approach to sourcing receipts for apportionment factor purposes. The new language added by HB 511, to 15-1-601, Article IV(17), MCA, is modeled after the Multistate Tax Commission's (MTC) Revised Model Compact Article IV. In support of the Revised Compact, the MTC also adopted apportionment regulations, including definitions, addressing the sourcing of receipts using the market sourcing approach. The definitions the department is proposing are modeled after the apportionment regulations adopted by the MTC.

The new definitions proposed to be added to the rule include the terms "billing address" in new (8), "business customer" in new (10), "code" in new (11), "individual customer" in new (17), "intangible property" in new (18), "place of order" in new (24), "population" in new (25), "related party" in new (28), and "state where a contract of sale is principally managed by the customer," in new (29). These terms are used in New Rules I through VI that the department is proposing for adoption in this same notice.

The department further proposes correcting punctuation errors at the end of (5) and the end of newly numbered (23), (34), and (35). The department is removing unnecessary parentheses from rule citations.

The department considers these amendments to ARM 42.26.202 necessary in its implementation of HB 511, in that the definitions provide essential guidance to taxpayers in sourcing various types of receipts under a market sourcing approach.

<u>42.26.203 CONSISTENCY AND UNIFORMITY IN REPORTING</u> (1) In filing returns with this state, if the taxpayer departs from or modifies the manner in which income has been classified as ~~business income or nonbusiness~~ <u>apportionable or nonapportionable</u> income in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

(2) If the returns or reports filed by a taxpayer for all states to which the taxpayer reports under Article IV of the Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the classification of income as ~~business or nonbusiness~~ <u>apportionable or nonapportionable</u> income, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, Title 15, chapter 31, part 3, MCA

REASON: The department proposes amending ARM 42.26.203 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income," and the term "nonbusiness income" to "nonapportionable income." The department proposes striking the old terms and replacing them with the new terms, where applicable, to align the rule with the revised statute.

42.26.204 COMBINED REPORTS (1) If a particular trade or business is carried on by a taxpayer and one or more unitary affiliated corporations owned greater than 50 percent, the taxpayer is required to file a "combined report" whereby the entire ~~business~~ apportionable income of such trade or business is apportioned in accordance with 15-31-305 through 15-31-311, MCA.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, 15-31-321, 15-31-322, 15-31-323, 15-31-324, 15-31-325, 15-31-326, MCA

REASON: The department proposes amending ARM 42.26.204 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

42.26.205 TWO OR MORE BUSINESSES OF A SINGLE TAXPAYER (1) A taxpayer may have more than one "trade or business." In such cases, it is necessary to determine the ~~business~~ apportionable income attributable to each separate trade or business. The income of each business is then apportioned by an apportionment formula which takes into consideration the in-state and out-of-state factors which relate to the trade or business income being apportioned.
(2) remains the same.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, Title 15, chapter 31, part 3, MCA

REASON: The department proposes amending ARM 42.26.205 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

42.26.206 ~~BUSINESS~~ APPORTIONABLE AND ~~NONBUSINESS~~ NONAPPORTIONABLE INCOME DEFINED (1) Section 15-31-301, MCA, requires that every item of income be classified either as ~~business income or nonbusiness~~ apportionable or nonapportionable income. Income for purposes of classification as ~~business or nonbusiness~~ apportionable or nonapportionable includes gains and losses. ~~Business~~ Apportionable income is apportioned among jurisdictions by use of a formula. ~~Nonbusiness~~ Nonapportionable income is specifically assigned or allocated to one or more specific jurisdictions pursuant to express rules. An item of income is classified as ~~business~~ apportionable income if it falls within the definition of ~~business~~ apportionable income. In essence, all income which arises from the conduct of trade or business operations of a taxpayer is ~~business~~ apportionable income. An item of income is ~~nonbusiness~~ nonapportionable income only if it does not meet the definitional requirements for being classified as ~~business~~ apportionable income. For purposes of administration, the income of the taxpayer is ~~business~~ apportionable income unless clearly classifiable as ~~nonbusiness~~ nonapportionable income.

(2) ~~Business~~ Apportionable income means income of any type or class, and from any activity, that meets the relationship described either in (3), the "transactional test," or (4), the "functional test." The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, nonoperating income, etc., is of no assistance in determining whether income is ~~business or nonbusiness~~ apportionable or nonapportionable income. Accordingly, the critical element in determining whether income is "~~business~~ apportionable income" or "~~nonbusiness~~ nonapportionable income" is the identification of the transactions and activities which are the elements of a particular trade or business. In general, all transactions and activities of the taxpayer which are dependent upon or contribute to the operations of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be transactions and activities arising in the regular course of and will constitute integral parts of a trade or business. ~~(~~See ARM 42.26.207 for more specific examples of the classification of income as ~~business or nonbusiness~~ apportionable or nonapportionable income; see ARM 42.26.202 and 42.26.205 for further explanation of what constitutes a trade or business.~~)~~

(3) Under the transactional test, ~~business~~ apportionable income includes income arising from transactions and activity in the regular course of the taxpayer's trade or business.

(a) If the transaction or activity is in the regular course of the taxpayer's trade or business, part of which trade or business is conducted within this state, the resulting income of the transaction or activity is ~~business~~ apportionable income for this state. Income may be ~~business~~ apportionable income even though the actual transaction or activity that gives rise to the income does not occur in this state.

(b) remains the same.

(c) The transactional test also includes, but is not limited to: income from the sale of property used in the production of ~~business~~ apportionable income of a kind that is sold and replaced with some regularity, even if replaced less frequently than once a year.

(4) Under the functional test, ~~business~~ apportionable income includes income from tangible and intangible property, if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(a) ~~Business~~ Apportionable income need not be derived from transactions or activities that are in the regular course of the taxpayer's own particular trade or business. It is sufficient, if the property from which the income is derived is or was an integral, functional, or operative component used in the taxpayer's trade or business operations, or otherwise materially contributed to the production of ~~business~~ apportionable income of the trade or business, part of which trade or business is or was conducted within this state. Property that has been converted to ~~nonbusiness~~ nonapportionable use through the passage of a sufficiently lengthy period of time, generally, five years is sufficient, has lost its character as a business asset and is not subject to the rule of the preceding sentence.

(b) Income that is derived from isolated sales, leases, assignments, licenses, and other infrequently occurring dispositions, transfers, or transactions involving property, including transactions made in liquidation, including complete or partial liquidations, or the winding-up of business, is ~~business~~ apportionable income, if the property is or was used in the taxpayer's trade or business operations.

(i) Property that has been converted to ~~nonbusiness~~ nonapportionable use has lost its character as a business asset and is not subject to (4)(b).

(ii) Income from the licensing of an intangible asset, such as a patent, copyright, trademark, service mark, know-how, trade secrets, or the like, that was developed or acquired for use by the taxpayer in its trade or business operations, constitutes ~~business~~ apportionable income whether or not the licensing itself constituted the operation of a trade or business, and whether or not the taxpayer remains in the same trade or business from or for which the intangible asset was developed or acquired.

(c) Under the functional test, income from intangible property is ~~business~~ apportionable income when the intangible property serves an operational function. The relevant inquiry focuses on whether the property is or was held in furtherance of the taxpayer's trade or business, that is, on the objective characteristics of the intangible property's use or acquisition and its relation to the taxpayer and the taxpayer's activities.

(d) If the property is or was held in furtherance of the taxpayer's trade or business then income from that property may be ~~business~~ apportionable income even though the actual transaction or activity involving the property that gives rise to the income does not occur in this state.

(e) If, with respect to an item of property, a taxpayer takes a deduction from ~~business~~ apportionable income that is apportioned to this state or includes the original cost in the property factor, it is presumed that the item or property is or was integral to the taxpayer's trade or business operations. No presumption arises from the absence of any of these actions.

(f) Application of the functional test is generally unaffected by the form of the property (e.g., tangible or intangible property, real or personal property). Income arising from an intangible interest, as, for example, corporate stock or other intangible interest in a business or a group of assets, is ~~business~~ apportionable income when the intangible itself or the property underlying or associated with the intangible is or was an integral, functional, or operative component to the taxpayer's trade or business operations.

(g) Property that has been converted to ~~nonbusiness~~ nonapportionable use has lost its character as a business asset and is not subject to (4)(f).

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-302, MCA

REASON: The department proposes amending ARM 42.26.206 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income," and the term "nonbusiness income" to "nonapportionable income." The department proposes striking the old terms and replacing them with the new terms, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to accurately reflect the rule content as amended.

42.26.207 DETERMINATION OF ~~BUSINESS AND NONBUSINESS~~ APPORTIONABLE AND NONAPPORTIONABLE INCOME (1) Rental income from real and tangible property is characterized as ~~business~~ apportionable income if the property with respect to which the rental income was received is, or was, used in the taxpayer's trade or business and therefore is includable in the property factor under ARM 42.26.231 and 42.26.237. Property that has been converted to ~~nonbusiness~~ nonapportionable use has lost its character as a business asset and is not subject to the rule of the preceding sentence.

(2) Gain or loss from the sale, exchange, or other dispositions of real property or of tangible or intangible personal property constitutes ~~business~~ apportionable income if the property while owned by the taxpayer was used in, or was otherwise included in the property factor of, the taxpayer's trade or business. However, if such property was utilized for the production of ~~nonbusiness~~ nonapportionable income or otherwise was removed from the property factor before its sale, exchange, or other disposition, the gain or loss will constitute ~~nonbusiness~~ nonapportionable income. See ARM 42.26.232.

(3) Interest income is characterized as ~~business~~ apportionable income where the intangible with respect to which the interest was received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the acquiring and holding the intangible is an integral, functional, or operative component of the taxpayer's trade or business operations, or otherwise materially contributes to the production of ~~business~~ apportionable income of the trade or business operations.

(4) Dividends constitute ~~business~~ apportionable income where the stock with respect to which the dividends are received arises out of or was acquired in the regular course of the taxpayer's trade or business operations or where the acquiring and holding the stock is an integral, functional, or operative component of the taxpayer's trade or business operations, or otherwise materially contributes to the production of ~~business~~ apportionable income of the trade or business operations.

(5) Patent and copyright royalties are characterized as ~~business~~ apportionable income where the patent or copyright with respect to which the royalties were received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the acquiring and holding the patent or copyright is an integral, functional, or operative component of the taxpayer's trade or business operations, or otherwise materially contributes to the production of ~~business~~ apportionable income of the trade or business operations.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-302, MCA

REASON: The department proposes amending ARM 42.26.207 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income," and the term "nonbusiness income" to "nonapportionable income." The department proposes striking the old terms and replacing them with the new terms, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to accurately reflect the rule content as amended.

42.26.208 ALLOCATION OF INCOME AND DEDUCTIONS (1) In most cases an allowable deduction of a taxpayer will be applicable only to the ~~business~~ apportionable income arising from a particular trade or business or to a particular item of ~~nonbusiness~~ nonapportionable income. In some cases an allowable deduction may be applicable to the ~~business~~ apportionable incomes of more than one trade or business and/or to several items of ~~nonbusiness~~ nonapportionable income. In such cases, the deduction shall be prorated among such trades or business and such items of ~~nonbusiness~~ nonapportionable income in a manner which fairly distributes the deduction among the classes of income to which it is applicable.

(2) through (4) remain the same.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA

IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, 15-31-321, 15-31-322, 15-31-323, 15-31-324, 15-31-325, 15-31-326, MCA

REASON: The department proposes amending ARM 42.26.208 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income," and the term "nonbusiness income" to "nonapportionable income." The department proposes striking the old terms and replacing them with the new terms, where applicable, to align the rule with the revised statute.

42.26.210 TAXABLE IN ANOTHER STATE (1) remains the same.

(2) A taxpayer is not taxable in another state with respect to a particular trade or business merely because the taxpayer conducts activities in such other state pertaining to the production of ~~nonbusiness~~ nonapportionable income or business activities relating to a separate trade or business.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA

IMP: 15-1-601, 15-31-303, MCA

REASON: The department proposes amending ARM 42.26.210 to properly implement House Bill 511, L. 2017, which changed the term "nonbusiness income" to "nonapportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

42.26.229 PARTNERSHIPS AND DISREGARDED ENTITIES - ~~NONBUSINESS~~ NONAPPORTIONABLE INCOME (1) A partnership or disregarded entity that is not part of a unitary business operation of a corporate partner or disregarded entity owner will be treated as follows:

(a) The corporate partner's or disregarded entity owner's share of partnership or disregarded entity income will not be included in ~~business~~ apportionable income to be apportioned, but allocated to the states where the partnership or disregarded entity operates based upon the apportionment formula outlined in 15-31-305, MCA.

(2) Gain or loss from the sale of a non-unitary partnership or disregarded entity owner interest is allocable to this state in the ratio of the original cost of partnership or disregarded entity tangible property in this state to the original cost of partnership or disregarded entity tangible property everywhere, determined at the time of sale. In the event that more than 50 percent of the value of the assets of a partnership or disregarded entity consists of intangibles, gain, or loss from the sale of the partnership or disregarded entity owner interest shall be allocated to this state in accordance with the ~~sales~~ receipts factor of the partnership or disregarded entity for its first full tax period immediately preceding its tax period during which the partnership or disregarded entity interest was sold. If a disregarded entity does not have a tax period, the allocation will be made in accordance with the ~~sales~~ receipts factor of the partnership or disregarded entity for the 12 full calendar months preceding the month the interest was sold.

AUTH: 15-31-501, MCA
IMP: 15-31-304, 15-31-305, MCA

REASON: The department proposes amending ARM 42.26.229 to properly implement House Bill 511, L. 2017, which changed the terms "business income" to "apportionable income," "nonbusiness income" to "nonapportionable income," and "sales factor" to "receipts factor." The department proposes striking the old terms and replacing them with the new terms, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to reflect content of the rule as amended.

42.26.230 APPORTIONMENT FORMULA - EXCLUSIONS (1) If a taxpayer has property, payroll, or ~~sales~~ receipts assignable under 15-31-305 through 15-31-311, MCA, and attendant regulations to a location where it is not taxable under 15-31-303, MCA, the property, payroll, or ~~sales~~ receipts assigned to that location shall be excluded from the apportionment formula.

(2) remains the same.

AUTH: 15-31-313, 15-31-501, MCA
IMP: 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, MCA

REASON: The department proposes amending ARM 42.26.230 to properly implement House Bill 511, L. 2017, which changed the term "sales factor" to "receipts factor." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

42.26.231 PROPERTY FACTOR IN GENERAL (1) remains the same.

(2) Property used in connection with the production of ~~nonbusiness~~ nonapportionable income shall be excluded from the property factor.

(3) Property used both in the regular course of taxpayer's trade or business and in the production of ~~nonbusiness~~ nonapportionable income shall be included in the factor only to the extent the property is used in the regular course of taxpayer's trade or business. The method of determining that portion of the value to be included in the factor will depend on the facts of each case.

(4) remains the same.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-305, 15-31-306, 15-31-307, MCA

REASON: The department proposes amending ARM 42.26.231 to properly implement House Bill 511, L. 2017, which changed the term "nonbusiness income" to "nonapportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

42.26.232 PROPERTY USED FOR THE PRODUCTION OF ~~BUSINESS~~ APPORTIONABLE INCOME (1) and (2) remain the same.

(3) Property used in the regular course of the trade or business of the taxpayer shall remain in the property factor until its permanent withdrawal is established by an identifiable event such as its conversion to the production of ~~nonbusiness~~ nonapportionable income, its sale, or the lapse of an extended period of time (normally five years) during which the property is held for sale.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-305, 15-31-306, 15-31-307, MCA

REASON: The department proposes amending ARM 42.26.232 to properly implement House Bill 511, L. 2017, which changed the terms "business income" to "apportionable income" and "nonbusiness income" to "nonapportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to reflect content of the rule as amended.

42.26.236 VALUATION OF RENTED PROPERTY (1) Property rented by the taxpayer is valued at eight times its net annual rental rate.

(a) remains the same.

(b) Sub-rents are not deducted when the sub-rents constitute ~~business~~ apportionable income because the property that produces the sub-rents is used in the regular course of a trade or business of the taxpayer when it is producing such income. Accordingly, there is no reduction in its value.

(2) and (3) remain the same.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA

IMP: 15-1-601, 15-31-305, 15-31-306, 15-31-307, MCA

REASON: The department proposes amending ARM 42.26.236 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

42.26.241 PAYROLL FACTOR IN GENERAL (1) and (2) remain the same.

(3) The compensation of any employee on account of activities which are connected with the production of ~~nonbusiness~~ nonapportionable income shall be excluded from the factor.

(4) remains the same.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-305, 15-31-308, 15-31-309, MCA

REASON: The department proposes amending ARM 42.26.241 to properly implement House Bill 511, L. 2017, which changed the term "nonbusiness income" to "nonapportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

42.26.251 ~~SALES~~ RECEIPTS FACTOR IN GENERAL (1) Section 15-31-302, MCA, defines the term ~~"sales"~~ "receipts" to mean all gross receipts of the taxpayer not allocated under 15-31-304, MCA. Thus, for the purposes of the ~~sales~~ receipts factor of the apportionment formula for each trade or business of the taxpayer, the term ~~"sales"~~ "receipts" means all gross receipts derived by a taxpayer from transactions and activity in the regular course of such trade or business.

(2) The following are procedures for determining ~~"sales"~~ "receipts" in various situations:

(a) In the case of a taxpayer engaged in manufacturing and selling or purchasing and reselling goods or products, ~~"sales"~~ "receipts" includes all gross receipts from the sales of such goods or products (or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the tax period) held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. Gross receipts for this purpose means gross sales, less returns and allowances and includes all interest income, service charges, carrying charges, or time-price differential charges incidental to such sales. Federal and state excise taxes (including sales taxes) shall be included as part of such receipts if such taxes are passed on to the buyer or included as part of the selling price of the product.

(b) In the case of cost plus fixed fee contracts, such as the operation of a government-owned plant for a fee, ~~"sales"~~ "receipts" includes the entire reimbursed cost, plus the fee.

(c) In the case of a taxpayer engaged in providing services, such as the operation of an advertising agency or the performance of equipment service contracts or research and development contracts, ~~"sales"~~ "receipts" includes the gross receipts from the performance of such services including fees, commissions, and similar items.

(d) In the case of a taxpayer engaged in renting real or tangible property, ~~"sales"~~ "receipts" includes the gross receipts from the rental, lease, or licensing the use of the property.

(e) In the case of a taxpayer engaged in the sale, assignment, or licensing of intangible personal property such as patents and copyrights, ~~"sales"~~ "receipts" includes the gross receipts therefrom.

(3) In some cases, certain gross receipts should be disregarded in determining the ~~"sales"~~ "receipts" factor in order that the apportionment formula will operate fairly to apportion to this state the income of the taxpayer's trade or business as set forth in ARM 42.26.263.

(4) remains the same.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-305, 15-31-310, 15-31-311, MCA

REASON: The department proposes amending ARM 42.26.251 to properly implement House Bill 511, L. 2017, which changed the term "sales factor" to "receipts factor." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to reflect content of the rule as amended.

42.26.252 CONSISTENCY IN REPORTING WITH RESPECT TO ~~SALES~~ RECEIPTS (1) In filing returns with this state, if the taxpayer departs from or modifies the basis for excluding or including gross receipts in the ~~sales~~ receipts factor used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

(2) remains the same.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, Title 15, chapter 31, part 3, MCA

REASON: The department proposes amending ARM 42.26.252 to properly implement House Bill 511, L. 2017, which changed the term "sales factor" to "receipts factor." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to reflect content of the rule as amended.

42.26.253 DENOMINATOR OF ~~SALES~~ RECEIPTS FACTOR (1) The denominator of the ~~sales~~ receipts factor shall include the total gross receipts derived by the taxpayer from transactions and activity in the regular course of its trade or business, except receipts excluded under ARM 42.26.263.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, 15-31-321, 15-31-322, 15-31-323, 15-31-324, 15-31-325, 15-31-326, MCA

REASON: The department proposes amending ARM 42.26.253 to properly implement House Bill 511, L. 2017, which changed the term "sales factor" to "receipts factor." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to reflect content of the rule as amended.

42.26.254 NUMERATOR OF ~~SALES~~ RECEIPTS FACTOR (1) The numerator of the ~~sales~~ receipts factor shall include gross receipts attributable to this state and derived by the taxpayer from transactions and activity in the regular course of its trade or business. All interest income, service charges, carrying charges, or time-price differential charges incidental to such gross receipts shall be included regardless of the place where the accounting records are maintained or the location of the contract or other evidence of indebtedness.

(2) Intercompany revenues between members of the unitary group that are attributable to this state shall be excluded from the numerator of the ~~sales~~ receipts factor.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, 15-31-321, 15-31-322, 15-31-323, 15-31-324, 15-31-325, 15-31-326, MCA

REASON: The department proposes amending ARM 42.26.254 to properly implement House Bill 511, L. 2017, which changed the term "sales factor" to "receipts factor." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to reflect content of the rule as amended.

42.26.255 SALES OF TANGIBLE PERSONAL PROPERTY (1) through (6) remain the same.

(7) ~~If~~ For taxable years beginning before January 1, 2018, if a taxpayer whose ~~salesman~~ salesperson operates from an office located in this state makes a sale to a purchaser in another state in which the taxpayer is not taxable and the property is shipped directly by a third party to the purchaser, the following rules apply:

(a) and (b) remain the same.

(8) For taxable years beginning after December 31, 2017, for purposes of determining whether receipts are in Montana and included in the numerator of the receipts factor, if the activities of any member of a unitary group exceeds the activity protected under P.L. 86-272 then sales of tangible personal property into Montana,

from an out-of-state location, by any member of the unitary group, shall be included in Montana's receipts factor numerator.

(9) For taxable years beginning after December 31, 2017, if any member of a unitary group is taxable in another state, sales of tangible personal property from a Montana location into that state by any member of the unitary group shall not be included in Montana's receipts factor numerator.

(10) For taxable years beginning after December 31, 2017, if no member of a unitary group is taxable in another state, sales of tangible personal property from a Montana location into that state by any member of the unitary group shall be included in Montana's receipts factor numerator.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-305, 15-31-310, 15-31-311, MCA

REASON: The department proposes amending ARM 42.26.255 in conjunction with its proposed adoption of New Rule VII, and proposed repeal of ARM 42.26.511, in this same notice. The proposed amendment of this rule is unrelated to any new legislation being addressed in this same notice.

As proposed, New Rule VII notifies taxpayers of a change in the way the department administers the corporate income tax regarding unitary multistate taxpayers whose Montana activity is reflected through multiple entities. Historically, the department applied what is known as the "Joyce Rule" in ARM 42.26.511, which the department is proposing to repeal in this same notice in conjunction with proposing to adopt New Rule VII.

The "Joyce" and "Finnigan" rules both address issues surrounding the calculation of a unitary group's apportionment factor numerators. Under "Joyce," in order to include the apportionment factor numerators of a member of a unitary group, that individual member must have nexus within the taxing state. Under "Finnigan," the apportionment factor numerators of all members of a unitary group are included if just one member of the unitary group has nexus within the taxing state. The proposed amendments to ARM 42.26.255 set forth the provisions of the "Finnigan" rules in sourcing receipts in the Montana receipts numerator.

The additional language proposed to be added to (7) provides taxpayers with the applicable tax years for which the "Joyce" rule would still apply. The proposed addition of new (8) provides taxpayers with the tax years in which the "Finnigan" approach becomes effective, as well as provides the language necessary to invoke the "Finnigan" rules for sales of tangible personal property. The proposed addition of new (9) and (10) provides taxpayers with guidance for situations that require receipts being thrown back to Montana and situations where a throwback is not appropriate under the "Finnigan" rules.

42.26.257 SALES OTHER THAN SALES OF TANGIBLE PERSONAL PROPERTY - COSTS OF PERFORMANCE (1) Section 15-31-311, MCA, provides for the inclusion in the numerator of the ~~sales~~ receipts factor of gross receipts from transactions other than sales of tangible personal property (including transactions with the United States government). Under this section, gross receipts are attributed to this state if the income-producing activity, which gave rise to the receipts, is performed wholly within this state. Also, gross receipts are attributed to this state if, with respect to a particular item of income, the income-producing activity is performed within and without this state but the greater proportion of the income-producing activity is performed in this state, based on costs of performance.

(2) through (4) remain the same.

<u>(5) This rule is effective for tax years beginning before January 1, 2018. For tax years beginning after December 31, 2017, refer to [New Rule I through New Rule VI].</u>

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-305, 15-31-310, 15-31-311, MCA

REASON: The department proposes amending ARM 42.26.257 to properly implement House Bill (HB) 511, L. 2017, which changed the term "sales factor" to "receipts factor." The department proposes striking the old term and replacing it with the new term, where applicable in (1), to align the rule with the revised statute.

The department also proposes adding new (5) to include the effective date for the rule and to direct taxpayers to rules adopting the marketing based approach of sourcing receipts provided for in HB 511.

The department further proposes updating the catchphrase for the rule to make it clear that this rule addresses only those receipts that are sourced under the costs of performance approach for receipts apportionment factor purposes.

<u>42.26.259 SALE OF TANGIBLE AND INTANGIBLE PROPERTY COMPUTATION OF THE ~~SALES~~ RECEIPTS FACTOR</u> (1) remains the same.

(2) If a taxpayer derives receipts from the sale of tangible property or the sale or redemption of intangible property not held primarily for sale to customers in the ordinary course of its trade or business such receipts will constitute sales for inclusion in the ~~sales~~ <u>receipts</u> factor to the following extent:

(a) Only the net receipts from the sale of tangible or the sale or redemption of intangible property shall be included in the ~~sales~~ <u>receipts</u> factor.

(b) In the case where the taxpayer has multiple transactions from the sale of tangible or the sale or redemption of intangible property only the net gains in excess of net losses will be included in the ~~sales~~ <u>receipts</u> factor.

(c) Before the net receipts from the sale of tangible property or the sale or redemption of intangible property may be included in the ~~sales~~ <u>receipts</u> factor the sales transactions must constitute ~~business~~ <u>apportionable</u> income to the taxpayer.

AUTH: 15-31-313, 15-31-501, MCA
IMP: 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.259 to properly implement House Bill 511, L. 2017, which changed the terms "sales factor" to "receipts factor" and "business income" to "apportionable income." The department proposes striking the old terms and replacing them with the new terms, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to reflect content of the rule as amended.

42.26.263 SPECIAL COMPUTATIONS RELATED TO ~~SALES~~ RECEIPTS FACTOR (1) The following special criteria are established in respect to the ~~sales~~ receipts factor of the apportionment formula:

(a) Insubstantial amounts of gross receipts arising from incidental or occasional transactions or activities may be excluded from the ~~sales~~ receipts factor unless such exclusion would materially affect the amount of income apportioned to this state.

(b) ~~Where~~ For tax periods beginning before January 1, 2018, where the income-producing activity in respect to ~~business~~ apportionable income from intangible personal property can be readily identified, such income is included in the denominator of the ~~sales~~ receipts factor and, if the income-producing activity occurs in this state, in the numerator of the ~~sales~~ receipts factor as well. For example, usually the income-producing activity can be readily identified in respect to interest income received on deferred payments on sales of tangible property (ARM 42.26.251) and income from sale, licensing, or other use of intangible personal property (ARM 42.26.257).

(2) ~~Where~~ For tax periods beginning before January 1, 2018, where ~~business~~ apportionable income from intangible property cannot readily be attributed to any particular income-producing activity of the taxpayer, such income cannot be assigned to the numerator of the ~~sales~~ receipts factor for any state and shall be excluded from the denominator of the ~~sales~~ receipts factor. For example, where ~~business~~ apportionable income in the form of dividends received on stock, royalties received on patents or copyrights, or interest received on bonds, debentures, or government securities results from the mere holding of the intangible personal property by the taxpayer, such dividends and interest shall be excluded from the denominator of the ~~sales~~ receipts factor.

(3) Section 631 of the IRC (gains) which are attributable to internal transactions must be eliminated from the ~~sales~~ receipts factor. The ultimate sale to outsiders will be included in line 1 sales. IRC section 631(A) (log sales) and section 631(B) (gains) should be included in the factor at the gross sales price used to calculate the gain. IRC section 631(C) (gains) should be included to the extent of gross royalties received prior to the capital gains offset and prior to the netting of long-term capital gains and losses.

(4) Software transactions. A license or sale of prewritten software for purposes other than commercial reproduction (or other exploitation of the intellectual property rights) 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 these cases, the receipts are in Montana as determined under the rules for the sale of tangible personal property set forth in ARM 42.26.255. In all other cases, the receipts from a license or sale of software are to be assigned to Montana as determined otherwise under [New Rule I, New Rule IV, New Rule V, or New Rule VI] (i.e., depending on the facts, as the development and sale of custom software, as a license of a marketing intangible, as a license of a production intangible, as a license of intangible property where the substance of the transaction resembles a sale of goods or services, or as a sale of intangible property).

(5) Sales of licenses of digital goods or services.

(a) 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 are assigned by applying the same rules as are set forth in [New Rule IV], as if the transaction were a service delivered to 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.

(b) Telecommunication companies. In the case of a taxpayer that provides telecommunication or ancillary services and that is thereby subject to ARM Title 42, chapter 26, subchapter 12, receipts from the sale or license of digital goods or services not otherwise assigned for apportionment purposes pursuant to that subchapter are assigned pursuant to this section, by applying the rules set forth in [New Rule IV] as if the transaction were a service delivered to an individual or business customer. However, in applying these 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.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-305, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.263 to properly implement House Bill (HB) 511, L. 2017, which changed the terms "sales factor" to "receipts factor" and "business income" to "apportionable income." The department proposes striking the old terms and replacing them with the new terms, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to reflect content of the rule as amended.

The department also proposes amending the rule to address the treatment of software transactions and sales of licenses of digital goods or services enacted by HB 511, which adopted a market sourcing approach to sourcing receipts for apportionment factor purposes. The new language added by HB 511, to 15-1-601, Article IV(17), MCA, is modeled after the Multistate Tax Commission's (MTC) Revised Model Compact Article IV. In support of the Revised Compact, the MTC also adopted apportionment regulations, including definitions, addressing the sourcing of receipts using the market sourcing approach. The language the department is proposing to add to this rule is modeled after these apportionment regulations adopted by the MTC.

The language proposed to be added in new (4) specifically addresses the sourcing of receipts in the receipts apportionment factor numerator of software transactions, and the receipts from the sales of license of digital goods or services is proposed to be addressed in new (5).

The department considers these amendments to ARM 42.26.263 necessary in its implementation of HB 511, in that it provides essential guidance to taxpayers in sourcing various types of receipts under a market sourcing approach.

42.26.302 PROCEDURE (1) and (1)(a) remain the same.

(b) If a taxpayer files a water's-edge election after the 90-day deadline, the taxpayer must establish reasonable cause for failing to satisfy the 90-day deadline.

(i) Reasonable cause is defined in ARM 42.2.304. Examples of what ordinarily does or does not constitute reasonable cause are provided in ARM ~~42.3.105~~ 42.2.512.

(ii) through (4) remain the same.

AUTH: 15-31-501, MCA
IMP: 15-31-324, MCA

REASON: The department proposes amending ARM 42.26.302 to replace an incorrect ARM number reference in (1)(b)(i). The proposed change to this rule is housekeeping in nature and unrelated to any new legislation being addressed in this same rulemaking notice.

42.26.307 APPORTIONMENT AND ALLOCATION GENERALLY

(1) remains the same.

(2) Any taxpayer subject to the taxing jurisdiction of this state shall allocate all of its ~~nonbusiness~~ nonapportionable income or loss within or without this state in accordance with 15-31-304, MCA.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, MCA

REASON: The department proposes amending ARM 42.26.307 to properly implement House Bill 511 which changed the term "nonbusiness income" to "nonapportionable income." The department proposes striking the old term and replacing it with the new term, in (2), to align the rule with the revised statute.

42.26.308 APPORTIONMENT FORMULA (1) All ~~business~~ apportionable income of each trade or business of the taxpayer shall be apportioned to this state by use of the apportionment formula set forth in 15-31-305, MCA. The elements of the apportionment formula are the property factor (see ARM 42.26.231), the payroll factor (see ARM 42.26.241), and the ~~sales~~ receipts factor (see ARM 42.26.251) of the trade or business of the taxpayer.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-305, MCA

REASON: The department proposes amending ARM 42.26.308 to properly implement House Bill 511, L. 2017, which changed the terms "sales factor" to "receipts factor" and "business income" to "apportionable income." The department proposes striking the old terms and replacing them with the new terms where applicable, to align the rule with the revised statute.

<u>42.26.309 APPORTIONMENT FACTORS</u> (1) remains the same.

(2) The apportionment provisions of Title 15, chapter 31, part 3, MCA, and related regulations regarding the inclusion, valuation, and attribution of apportionment factors by location shall apply to the computation of Montana tax liability under a water's-edge election. Only property, payroll, and ~~sales~~ <u>receipts</u> of corporations actually included in the water's-edge combined group shall be considered.

AUTH: 15-31-501, MCA
IMP: 15-31-323, MCA

REASON: The department proposes amending ARM 42.26.309 to properly implement House Bill 511, L. 2017, which changed the term "sales factor" to "receipts factor." The department proposes striking the old term and replacing it with the new term, in (2), to align the rule with the revised statute.

<u>42.26.312 TREATMENT OF DIVIDENDS FOR PURPOSES OF A WATER'S-EDGE COMBINED RETURN</u> (1) Eighty percent of the dividends apportionable under this rule are to be excluded from income subject to apportionment where:

(a) through (e) remain the same.

(f) the limited inclusion of dividend income specified in this rule is in lieu of attempts to allocate expenses attributable to the generation of such dividend income. For apportionment factor purposes only the dividend income considered to be ~~business~~ <u>apportionable</u> income shall be included in the receipts factor numerator or denominator as appropriate.

AUTH: 15-31-501, MCA
IMP: 15-31-325, MCA

REASON: The department proposes amending ARM 42.26.312 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income." The department proposes striking the old term and replacing it with the new term, in (1)(f), to align the rule with the revised statute.

<u>42.26.401 SPECIAL RULES RELATED TO INSTALLMENT SALES</u>

(1) remains the same.

(2) The separate calculation shall be made as follows:

(a) for purposes of the ~~sales~~ <u>receipts</u> factor the total net gains from the sale shall be included in the ~~sales~~ <u>receipts</u> factor in the year of the sale unless specifically excluded from the ~~sales~~ <u>receipts</u> factor under another part of ARM 42.26.263;

(b) for purposes of calculating apportionable ~~business~~ income from the installment sale, the factors of the year of sale shall be utilized in apportioning the gain regardless of the year in which the income is reported; and

(c) the factors of the year of sale shall be applied to the gain from the sale as it is reported by the taxpayer to determine the amount of ~~business~~ <u>apportionable</u> income from the sale which is apportionable to this state, unless the gain is accelerated under ARM 42.26.276.

AUTH: 15-31-313, 15-31-501, MCA
IMP: 15-31-305, MCA

REASON: The department proposes amending ARM 42.26.401 to properly implement House Bill 511, L. 2017, which changed the terms "sales factor" to "receipts factor" and "business income" to "apportionable income." The department proposes striking the old terms and replacing them with the new terms where applicable, to align the rule with the revised statute.

42.26.602 GENERAL RULES FOR RAILROADS (1) Where a railroad has income from sources both within and without this state, the amount of ~~business~~ apportionable income from sources within this state shall be determined pursuant to Title 15, chapter 31, part 3, MCA, except as modified by regulation.

(2) For definitions, rules, and examples for determining ~~business and nonbusiness~~ apportionable and nonapportionable income, see ARM 42.26.206.

(3) Except as modified in this regulation, the apportionment factors shall be determined as follows:

(a) and (b) remain the same.

(c) the ~~sales~~ receipts factor in accordance with ARM 42.26.251 through 42.26.259, inclusive.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.602 to properly implement House Bill 511, L. 2017, which changed the terms "sales factor" to "receipts factor," "business income" to "apportionable income," and "nonbusiness income" to "nonapportionable income." The department proposes striking the old terms and replacing them with the new terms where applicable, to align the rule with the revised statute.

42.26.605 THE PAYROLL FACTOR (1) The denominator of the payroll factor is the total compensation paid everywhere by the taxpayer during the income year for the production of ~~business~~ apportionable income as provided in ARM 42.26.243. The numerator of the payroll factor is the total amount paid in this state during the income year by the taxpayer for compensation. With respect to all personnel except enginemen and trainmen performing services on interstate trains, compensation paid to such employees shall be included in the numerator as provided in ARM 42.26.244. With respect to enginemen and trainmen performing services on interstate trains, compensation paid to such employees shall be included in the numerator of the payroll factor in the ratio which their services performed in this state bear to their services performed everywhere. Compensation for services performed in this state shall be deemed to be the compensation reported or required to be reported by such employees for determination of their income tax liability to this state.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-305, 15-31-308, 15-31-309, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.605 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

42.26.606 THE ~~SALES (REVENUE)~~ RECEIPTS FACTOR (1) All revenue derived from transactions and activities in the regular course of the trade or business of the taxpayer which produces ~~business~~ apportionable income, except per diem and mileage charges which are collected by the taxpayer, is included in the denominator of the ~~revenue~~ receipts factor as provided in ARM 42.26.253. The numerator of the ~~revenue~~ receipts factor is the total revenue of the taxpayer in this state during the income year. The total revenue of the taxpayer in this state during the income year, other than revenue from hauling freight, passengers, mail and express, shall be attributable to this state in accordance with ARM 42.26.254 through 42.26.259.

(2) The total revenue of the taxpayer in this state during the income year for the numerator of the ~~revenue~~ receipts factor from hauling freight, mail, and express shall be attributable to this state as follows:

(a) and (b) remain the same.

(3) The numerator of the ~~sales (revenue)~~ receipts factor shall include:

(a) and (b) remain the same.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-305, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.606 to properly implement House Bill 511, L. 2017, which changed the terms "sales factor" to "receipts factor" and "business income" to "apportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to reflect content of the rule as amended.

42.26.702 GENERAL RULES FOR TRUCKING COMPANIES (1) Where a trucking company has income from sources both within and without this state, the amount of ~~business~~ apportionable income from sources within this state shall be determined pursuant to Title 15, chapter 31, part 3, MCA, except as modified by this rule. ARM 42.26.202 provides the definitions that are applicable to the numerator and the denominator of the property factor, as well as other apportionment factor descriptions.

AUTH: 15-31-313, 15-31-501, MCA
IMP: 15-31-301, MCA

REASON: The department proposes amending ARM 42.26.702 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

42.26.704 THE PAYROLL FACTOR (1) The denominator of the payroll factor is the compensation paid everywhere by the taxpayer during the income year for the production of ~~business~~ apportionable income as provided in ARM 42.26.243. The numerator of the payroll factor is the total compensation paid in this state during the income year by the taxpayer. With respect to all personnel, except those performing services within and without this state, compensation paid to such employees shall be included in the numerator as provided in ARM 42.26.244.

(2) remains the same.

AUTH: 15-31-313, 15-31-501, MCA
IMP: 15-31-308, 15-31-309, MCA

REASON: The department proposes amending ARM 42.26.704 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

42.26.705 THE ~~SALES (REVENUE)~~ RECEIPTS FACTOR (1) In general, all revenues derived from transactions and activities in the regular course of the taxpayer's trade or business which produces ~~business~~ apportionable income shall be included in the denominator of the ~~revenue~~ receipts factor as provided in ARM 42.26.253.

(2) The numerator of the ~~revenue~~ receipts factor is the total revenue of the taxpayer in this state during the income year. The total state revenue of the taxpayer, other than revenue from hauling freight, mail, and express, shall be attributable to this state in accordance with ARM 42.26.254 through 42.26.259.

(3) Numerator of the ~~sales (revenue)~~ receipts factor from freight, mail, and express. The total revenue of the taxpayer attributable to this state during this income year from hauling freight, mail, and express shall be:

(a) and (b) remain the same.

AUTH: 15-31-313, 15-31-501, MCA
IMP: 15-31-310, 15-31-311, MCA

REASON: The department proposes amending ARM 42.26.705 to properly implement House Bill 511, L. 2017, which changed the terms "sales factor" to "receipts factor" and "business income" to "apportionable income." The department proposes striking the old terms and replacing them with the new terms, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to reflect content of the rule as amended.

42.26.802 GENERAL STATEMENT (1) Where an airline has income from sources both within and without this state, the amount of ~~business~~ apportionable income from sources within this state shall be determined pursuant to Title 15, chapter 31, part 3, MCA, except as modified by this rule.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.802 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

42.26.805 THE ~~SALES (TRANSPORTATION REVENUE)~~ RECEIPTS FACTOR (1) The transportation revenue derived from transactions and activities in the regular course of the trade or business of the taxpayer and miscellaneous sales of merchandise, etc., are included in the denominator of the ~~revenue~~ receipts factor as provided in ARM 42.26.253. The numerator of the ~~revenue~~ receipts factor is the total revenue of the taxpayer in this state during the income year. The total revenue of the taxpayer in this state during the income year is the result of the following calculation:

(a) remains the same.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.805 to properly implement House Bill 511, L. 2017, which changed the term "sales factor" to "receipts factor." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to reflect content of the rule as amended.

42.26.807 AIRLINE REGULATION EXAMPLES (1) Assume the following facts for an airline for the tax year:

(a) through (d) remain the same.

(e) From its operations, it has total receipts of $50,000,000, ~~business~~ apportionable net income of $1,000,000 and no ~~nonbusiness~~ nonapportionable income. The total $50,000,000 is flight revenue; there is no nonflight revenue.

(f) remains the same.

(g) State X has a corporate tax rate of 10 percent. The airline's tax liability to state X would be determined as follows:

Property Factor:

Numerator		Denominator
43,200,000 (747s)		432,000,000 (747s)
+ 80,000,000 (727s)	+	400,000,000 (727s)
+ 10,000,000 (n.t.p.)	+	200,000,000 (n.t.p.)
133,200,000	/	1,032,000,000 = 12.91%

~~Sales~~ Receipts Factor:

Numerator		Denominator
43,200,000 (747s)		432,000,000 (747s)
+ 80,000,000 (727s)	+	400,000,000 (727s)
123,200,000	/	832,000,000 = 14.8%

departure ratio = 14.8%

7,403,846 (14.8% x 50,000,000) / 50,000,000 = 14.81%

Payroll Factor:

Numerator		Denominator
6,000,000 (nonflight)		40,000,000 (nonflight)
+ 8,880,000 (14.8% x 60,000,000 flight)	+	60,000,000 (flight)
14,880,000	+	100,000,000 = 14.88%

Average Ratio Equals the sum of the property, ~~sales~~ receipts, and payroll factors divided by 3.

(12.91% + 14.81% + 14.88%) /3 = 14.20%

Taxable Income in state X: .1420 x 1,000,000 = $142,000

Tax Liability to state X: .10 x $142,000 = $14,200

(2) Same facts except (1)(f) is changed to read:

(a) remains the same.

(b) State Y has a corporate tax rate of 6.5 percent. The airline's tax liability to state Y would be determined as follows:

Property Factor:

Numerator		Denominator
25,920,000 (747s)		432,000,000 (747s)
+ 124,000,000 (727s)	+	400,000,000 (727s)
+ 6,000,000 (n.t.p.)	+	200,000,000 (n.t.p.)
155,920,000	/	1,032,000,000 = 15.1085%

~~Sales~~ Receipts Factor:

Numerator		Denominator
25,920,000 (747s)		432,000,000 (747s)
+ 124,000,000 (727s)	+	400,000,000 (727s)

149,920,000 / 832,000,000 = 18.0192%

departure ratio = 18.0192%

9,009,600 (18.0192% x 50,000,000) / 50,000,000 = 18.0192 percent

Payroll Factor:

Numerator		Denominator
2,800,000 (nonflight)		40,000,000 (nonflight)
+10,811,520 (18.0192% x 60,000,000 flight) +		60,000,000 (flight)
13,611,520	/	100,000,000 = 13.6114%

Average Ratio Equals the sum of the property, ~~sales~~ receipts, and payroll factors divided by 3.

(15.1085% + 18.0192% + 13.6114%) / 3 = 15.5797%

Taxable Income in state Y: .155797 x 1,000,000 = $155,797

Tax Liability to state Y: .065 x $155,797 = $10,127

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA
IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.807 to properly implement House Bill 511, L. 2017, which changed the terms "sales factor" to "receipts factor," "business income" to "apportionable income," and "nonbusiness income" to "nonapportionable income." The department proposes striking the old terms and replacing them with the new terms, in (1)(e) and (g) and (2)(b), to align the rule with the revised statute.

42.26.902 LONG-TERM CONSTRUCTION CONTRACTS (1) When a taxpayer elects to use the percentage of completion method of accounting, or the completed contract method of accounting for long-term contracts (construction contracts covering a period in excess of one year from the date of execution of the contract to the date on which the contract is finally completed and accepted), and has income from sources both within and without this state from a trade or business, (for purposes of determining whether a taxpayer's operations are within or without, the test shall be for each separate entity in a combined group electing the completed contract method, rather than the combined group as a whole), the amount of ~~business~~ apportionable income derived from such long-term contracts from sources within this state shall be determined pursuant to this regulation. In such cases, the first step is to determine which portion of the taxpayer's income constitutes "~~business~~ apportionable income" and which portion constitutes "~~nonbusiness~~ nonapportionable income" pursuant to ARM 42.26.206 and 42.26.207. ~~Nonbusiness~~ Nonapportionable income is directly allocated to specific states pursuant to the provisions of ARM 42.26.221 inclusive. ~~Business~~ Apportionable income is apportioned among the states in which the business is conducted pursuant to the property, payroll, and ~~sales~~ receipts apportionment factors set forth in this regulation. The sum of the items of ~~nonbusiness~~ nonapportionable income directly allocated to this state, plus the amount of ~~business~~ apportionable income attributable to this state constitutes the amount of the taxpayer's entire net income which is subject to tax by this state.

AUTH: 15-31-313, 15-31-501, MCA
IMP: 15-31-301, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.902 to properly implement House Bill 511, L. 2017, which changed the terms "business income" to "apportionable income" and "nonbusiness income" to "nonapportionable income." The department proposes striking the old terms and replacing them with the new terms, where applicable, to align the rule with the revised statute.

42.26.903 APPORTIONMENT OF ~~BUSINESS~~ APPORTIONABLE INCOME

(1) ~~Business~~ Apportionable income, in general, is apportioned to this state by a three-factor formula consisting of property, payroll, and ~~sales~~ receipts regardless of the method of accounting for long-term contracts elected by the taxpayer. The total of the property, payroll, and ~~sales~~ receipts percentages is divided by three to determine the apportionment percentage. The apportionment percentage is then applied to ~~business~~ apportionable income to determine the amount apportioned to this state.

(2) Under the percentage of completion method of accounting for long-term contracts, the amount to be included each year as ~~business~~ apportionable income from each contract is the amount by which the gross contract price that corresponds to the percentage of the entire contract that has been completed during the income years exceeds all expenditures made during the income year in connection with the contract. In so doing, the account must be made of the material and supplies on hand at the beginning and end of the income year for use in each such contract.

(3) Under the completed contract method of accounting, ~~business~~ apportionable income derived from long-term contracts is reported for the income year in which the contract is finally completed and accepted. Therefore, a special computation is required to compute the amount of ~~business~~ apportionable income attributable to this state from each completed contract. Thus, all receipts and expenditures applicable to such contracts, whether complete or incomplete as of the end of the income year, are excluded from ~~business~~ apportionable income derived from other sources. For example, short-term contracts, interest, rents, royalties, etc., which are apportioned by the regular three-factor formula of property, payroll, and ~~sales~~ receipts.

(4) through (4)(b) remain the same.

(c) The property factor is computed in the same manner for all long-term contract methods of accounting and is computed for each income year even though under the completed contract method of accounting, ~~business~~ apportionable income is computed separately.

(5) through (5)(b) remain the same.

(c) The payroll factor is computed in the same manner for all long-term contract methods of accounting and is computed for each income year even though under the completed contract method of accounting, ~~business~~ apportionable income is computed separately.

(6) In general the numerator and denominator of the ~~sales~~ receipts factor shall be determined as set forth in ARM 42.26.253 and 42.26.254. However, the following special criteria are also applicable:

(a) remains the same.

(b) If the percentage of completion method is used, the ~~sales~~ receipts factor includes only that portion of the gross contract price which corresponds to the percentage of the entire contract which was completed during the income year.

(c) If the completed contract method of accounting is used, the ~~sales~~ receipts factor includes the portion of the gross receipts (progress billings) received or accrued, whichever is applicable, during the income year attributable to each contract.

(d) The ~~sales~~ receipts factor, except as noted in (6)(b) and (c), is computed in the same manner, regardless of which long-term method of accounting the taxpayer has elected, and is computed for each income year even though under the completed contract method of accounting, ~~business~~ apportionable income is computed separately.

(7) The total of the property, payroll, and ~~sales~~ receipts percentages is divided by three to determine the apportionment percentage. The apportionment percentage is then applied to ~~business~~ apportionable income to establish the amount apportioned to this state.

AUTH: 15-31-313, 15-31-501, MCA
IMP: 15-31-301, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.903 to properly implement House Bill 511, L. 2017, which changed the terms "business income" to "apportionable income" and "nonbusiness income" to "nonapportionable income." The department proposes striking the old terms and replacing them with the new terms, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to reflect content of the rule as amended.

42.26.904 COMPLETED CONTRACT METHOD - SPECIAL COMPUTATION

(1) The completed contract method of accounting requires that the reporting of income (or loss) be deferred until the year the construction project is completed or accepted. Accordingly, a separate computation is made for each such contract completed during the income year regardless of whether the project is located within or without this state, in order to determine the amount of income which is attributable to sources within this state. The amount of income from each contract completed during the income year apportioned to this state, plus other ~~business~~ apportionable income apportioned to this state by the regular three-factor formula such as interest income, rents, royalties, income from short-term contracts, etc., plus all ~~nonbusiness~~

nonapportionable income allocated to this state is the measure of income for the income year.

(2) through (2)(b)(ii) remain the same.

(iii) The percentages determined in (ii) for each year the contract was in progress are totaled. The amount of total income (or loss) from the contract is multiplied by the total percentage. The resulting income (or loss) is the amount of ~~business~~ apportionable income from such contract derived from sources within this state.

AUTH: 15-31-313, 15-31-501, MCA
IMP: 15-31-301, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.904 to properly implement House Bill 511, L. 2017, which changed the terms "business income" to "apportionable income" and "nonbusiness income" to "nonapportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

42.26.905 COMPUTATION FOR YEAR OF WITHDRAWAL, DISSOLUTION, OR CESSATION OF BUSINESS - COMPLETED CONTRACT METHOD

(1) remains the same.

(2) The amount of income (or loss) from each such contract to be apportioned to this state by the apportionment method set forth in ARM 42.26.904 shall be determined as if the percentage of completion method of accounting were used for all such contracts on the date of withdrawal, dissolution, or cessation of business. The amount of ~~business~~ apportionable income (or loss) for each such contract shall be the amount by which the gross contract price from each such contract which corresponds to the percentage of the entire contract which has been completed from the commencement thereof to the date of withdrawal, dissolution, or cessation of business exceeds all expenditures made during such period in connection with each such contract. In so doing account must be taken of the material and supplies on hand at the beginning and end of the income year for use in each such contract.

AUTH: 15-31-313, 15-31-501, MCA
IMP: 15-31-301, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.905 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

42.26.1002 GENERAL RULE (1) Except as specifically modified by this rule, when a person in the business of publishing, selling, licensing, or distributing newspapers, magazines, periodicals, trade journals, or other printed material has income from sources both within and outside of Montana, the amount of ~~business~~

<u>apportionable</u> income from sources within Montana from such business activity shall be determined pursuant to Title 15, chapter 31, part 3, MCA, and the supporting administrative rules.

AUTH: 15-1-201, 15-31-313, MCA
IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.1002 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

<u>42.26.1003 APPORTIONMENT OF ~~BUSINESS~~ APPORTIONABLE INCOME</u>
(1) through (8) remain the same.
(9) For purposes of this subchapter, the ~~sales~~ <u>receipts</u> factor will be determined as follows:
(a) The denominator of the ~~sales~~ <u>receipts</u> factor shall include the total gross receipts derived by the taxpayer from transactions and activity in the regular course of its trade or business, except receipts that may be excluded under ARM 42.26.251, 42.26.252, 42.26.253, 42.26.254, 42.26.255, 42.26.256, 42.26.257, 42.26.259, 42.26.261, 42.26.262, and 42.26.263.
(b) The numerator of the ~~sales~~ <u>receipts</u> factor shall include all gross receipts of the taxpayer from sources within Montana including, but not limited to, the following:
(i) and (ii) remain the same.
(iii) When specific items of advertisements can be shown, upon clear and convincing evidence, to have been distributed solely to a limited regional or local geographic area in which Montana is located, the taxpayer may petition, or the department may require, that a portion of such receipts be attributed to the ~~sales~~ <u>receipts</u> factor numerator of Montana on the basis of a regional or local geographic area circulation factor and not upon the basis of the circulation factor provided by (9)(b)(ii). Such attribution shall be based upon the ratio that the taxpayer's circulation to purchasers and subscribers located in Montana of the printed material containing such specific items of advertising bears to its total circulation of such printed material to purchasers and subscribers located within such regional or local geographic area. This alternative attribution method shall be permitted only upon the condition that such receipts are not double-counted or otherwise included in the numerator of any other state.
(iv) In the event that the purchaser or subscriber is the United States government or that the taxpayer is not taxable in a state, the gross receipts from all sources, including the receipts from the sale of printed material, advertising, and the sale, rental, or other use of the taxpayer's customer's lists, or any portion thereof that would have been attributed by the circulation factor to the numerator of the ~~sales~~ <u>receipts</u> factor for such state, shall be included in the numerator of the ~~sales~~ <u>receipts</u> factor of Montana if the printed material or other property is shipped from an office,

store, warehouse, factory, or other place of storage or business in Montana.

AUTH: 15-1-201, 15-31-313, MCA
IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.1003 to properly implement House Bill 511, L. 2017, which changed the terms "sales factor" to "receipts factor" and "business income" to "apportionable income." The department proposes striking the old terms and replacing them with the new terms, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to reflect content of the rule as amended.

42.26.1102 GENERAL RULE (1) When a person in the business of broadcasting film or radio programming, whether through the public airwaves, by cable, direct or indirect satellite transmission, or any other means of communication, either through a network (including owned and affiliated stations) or through an affiliated, unaffiliated, or independent television or radio broadcasting station, has income from sources both within and outside Montana, the amount of ~~business~~ apportionable income from sources within Montana shall be determined pursuant to Title 15, chapter 31, part 3, MCA, and the supporting Administrative Rules of Montana, except as modified by this rule.

AUTH: 15-1-201, 15-31-313, MCA
IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.1102 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

42.26.1103 APPORTIONMENT OF ~~BUSINESS~~ APPORTIONABLE INCOME
(1) The property factor shall be determined in accordance with 15-31-306, MCA, the payroll factor in accordance with 15-31-308, MCA, and the ~~sales~~ receipts factor in accordance with 15-31-310, MCA, except as modified by this rule.
(2) through (4) remain the same.
(5) For purposes of this subchapter, the ~~sales~~ receipts factor will be determined as follows:
(a) The ~~sales~~ receipts factor denominator shall include the total gross receipts derived by the taxpayer from transactions and activity in the regular course of its trade or business, except receipts excluded under ARM 42.26.263.
(b) The numerator of the ~~sales~~ receipts factor shall include all gross receipts of the taxpayer from sources within Montana including, but not limited to, the following:
(i) through (iii) remain the same.

(iv) receipts from the sale, rental, licensing, or other disposition of audio or video cassettes, discs, or similar media intended for home viewing or listening shall be included in the ~~sales~~ receipts factor as provided in ARM 42.26.257.

AUTH: 15-1-201, 15-31-313, MCA
IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.1103 to properly implement House Bill 511, L. 2017, which changed the terms "sales factor" to "receipts factor" and "business income" to "apportionable income." The department proposes striking the old terms and replacing them with the new terms, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to reflect content of the rule as amended.

42.26.1202 GENERAL RULE (1) Except as specifically modified by the rules in this subchapter, when a person providing telecommunications services generates ~~business~~ apportionable income from sources within and outside of Montana, the amount of such ~~business~~ apportionable income arising from sources within Montana shall be determined pursuant to Title 15, chapter 31, part 3, MCA, and the supporting administrative rules.

AUTH: 15-1-201, 15-31-201, 15-31-313, MCA
IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.1202 to properly implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute.

42.26.1204 ~~SALES~~ RECEIPTS FACTOR (1) through (7) remain the same.
(8) Gross receipts from the sale of telecommunications services which are not taxable in the state to which they would be apportioned pursuant to (1) through (6), shall be excluded from the denominator of the ~~sales~~ receipts factor.

AUTH: 15-1-201, 15-31-201, 15-31-313, MCA
IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes amending ARM 42.26.1204 to properly implement House Bill 511, L. 2017, which changed the term "sales factor" to "receipts factor." The department proposes striking the old term and replacing it with the new term, where applicable, to align the rule with the revised statute. The department also proposes updating the catchphrase for the rule to reflect content of the rule as amended.

5. The department proposes to repeal the following rule:

<u>42.26.511 APPLICATION OF THE JOYCE RULE</u>

AUTH: 15-1-201, 15-31-313, MCA
IMP: 15-1-601, 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, MCA

REASON: The department proposes repealing ARM 42.26.511 in conjunction with the proposed amendment of ARM 42.26.255, and the proposed adoption of New Rule VII, in this same notice, to notify taxpayers of a change in the way the department administers the corporate income tax regarding unitary multistate taxpayers whose Montana activity is reflected through multiple entities. To determine taxable nexus of these corporate groups, the department has historically applied this "Joyce Rule," ARM 42.26.511, and is now proposing to adopt and apply the "Finnigan Rule" (New Rule VII), to make these determinations.

The "Joyce Rule" and the "Finnigan Rule" both address issues surrounding the calculation of a unitary group's apportionment factor numerators. Under the "Joyce Rule," in order to include the apportionment factor numerators of a member of a unitary group, that individual member must have nexus within the taxing state. Under the "Finnigan Rule," the apportionment factor numerators of all members of a unitary group are included if just one member of the unitary group has nexus within the taxing state.

The department proposes the repeal of ARM 42.26.511, the amendment of ARM 42.26.255, and the adoption of New Rule VII, to limit the risk of manipulation of the apportionment factors of a unitary combined group. A corporate structure can separate nexus creating activities from sales or other revenue generating activities. By applying the "Joyce Rule," this has a direct impact on the Montana apportionment factor. The purpose of the apportionment factors is to reflect the Montana business activity of the unitary group. The corporate structure of a unitary group should not alter the reflection of business activity in the apportionment factors.

When dealing with combined unitary groups, the department is seeing a trend in businesses with more diverse corporate structures. The department is also seeing more economic presence issues. These issues can have material effects on the apportionment factors, of which the intent is to reflect the business activity of the unitary group in Montana. The adoption of the "Finnigan Rule" can help limit the risk of manipulation of the apportionment factors of unitary groups. The department believes applying the "Joyce Rule" no longer adequately address these issues and by adopting the "Finnigan Rule" approach, a combined unitary group will provide a more accurate reflection of its business activity in Montana.

The proposed repeal of this rule is unrelated to any new legislation being addressed in this same rulemaking notice.

6. Concerned persons may submit their data, views, or arguments, either orally or in writing, at the hearing. Written data, views, or arguments may also be submitted to: Laurie Logan, Department of Revenue, Director's Office, P.O. Box

7701, Helena, Montana 59604-7701; telephone (406) 444-7905; fax (406) 444-3696; or e-mail lalogan@mt.gov and must be received no later than November 13, 2017.

7. Laurie Logan, Department of Revenue, Director's Office, has been designated to preside over and conduct this hearing.

8. The Department of Revenue maintains a list of interested persons who wish to receive notices of rulemaking actions proposed by this agency. Persons who wish to have their name added to the list shall make a written request that includes the name and e-mail or mailing address of the person to receive notices and specifies that the person wishes to receive notice regarding a particular subject matter or matters. Notices will be sent by e-mail unless a mailing preference is noted in the request. A written request may be mailed or delivered to the person in 6 above or faxed to the office at (406) 444-3696, or may be made by completing a request form at any rules hearing held by the Department of Revenue.

9. An electronic copy of this notice is available on the department's web site at revenue.mt.gov/rules, or through the Secretary of State's web site at sos.mt.gov/ARM/register.

10. The bill sponsor contact requirements of 2-4-302, MCA, apply and have been fulfilled. The primary sponsor of House Bill 511, L. 2017, Representative Rob Cook, was contacted by regular mail on June 14, 2017 and September 20, 2017.

11. With regard to the requirements of 2-4-111, MCA, the department has determined that the adoption, amendment and repeal of the above-referenced rules will not significantly and directly impact small businesses. Documentation of the department's determination is available at revenue.mt.gov/rules or upon request from the person in 6.

/s/ Laurie Logan	/s/ Mike Kadas
Laurie Logan	Mike Kadas
Rule Reviewer	Director of Revenue

Certified to the Secretary of State October 2, 2017.