ARIZONA CORPORATE TAX RULING

CTR 94-7

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

ISSUE:

Should the sales factor include receipts from **business income** from intangible assets which cannot be readily attributed to any particular income-producing activity?

APPLICABLE LAW:

Arizona Administrative Code (A.A.C.) rule R15-2-1145.A.7 provides that certain gross receipts should be disregarded in determining the sales factor in order that the apportionment formula will operate fairly to apportion income.

A.A.C. R15-2-1145.C provides that the denominator of the sales factor shall include all gross receipts from the taxpayer's business, except receipts excluded pursuant to R15-2-1148.D.

A.A.C. R15-2-1147.1.d provides that the mere holding of intangible personal property is not, of itself, an income-producing activity.

A.A.C. R15-2-1148.D.3 provides that where **business income** from intangible property cannot readily be attributed to a particular income-producing activity, and, thus, is not included in the numerator of the sales factor, such income shall also be excluded from the denominator of the sales factor. A.A.C. R15-2-1148.D is identical to Multistate Tax Commission (MTC) Reg. IV.18.(c).

DISCUSSION:

The issue is whether **business income**, such as dividends, royalties, and interest on bonds, which is derived from the mere holding of intangible personal property should be excluded from the sales factor.

A.A.C. R15-2-1145.A.7 and A.A.C. R15-2-1145.C both provide that certain business receipts may be excluded from the sales factor.

Unlike income from the sale of tangible personal property or real property, business income from intangible sources cannot always be assigned to a particular activity or location. Such income is, therefore, not assigned to the numerator of the sales factor for any state. When such income is included in the denominator of the sales factor, the result is less than a full allocation of income among the states. The Multistate Tax Commission adopted Reg. IV.18.(c) to preclude this situation and Arizona adopted a similar rule, A.A.C. R15-2-1148.D.3.

A.A.C. R15-2-1148.D.3 specifically states, in part, that:

> Where business 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 factor for any state and shall be excluded from the denominator of the sales factor. For example, where business income in the form of dividends received on stock, royalties received, 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 factor.

Some intangible business income can be tied to a particular activity or location and would be assigned to the numerator of that state and included in the sales factor.

For example, royalties from a worldwide licensing agreement could not be attributed to a specific location, but royalties from an oil well in Texas could be assigned to that state's sales factor. Interest received on accounts receivable from sales of tangible property would be included in the numerator of the sales factor for the state in which the goods were sold. However, interest received from the mere holding of securities could not be assigned to a particular state and would be excluded from the sales factor.

To ensure a full allocation of business income among the states and maintain a consistent basis for items included in the numerator and denominator of the sales factor, business income from intangible sources which cannot be attributed to a specific location and which is not included in the numerator should also be excluded from the denominator.

RULING:

Business income which is derived from the mere holding of intangible personal property and which cannot be readily attributable to an income-producing activity in a particular state shall be excluded from both numerator and denominator of the sales factor of the apportionment formula.

Harold Scott, Director
Signed April 26, 1994

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law which are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement which provides interpretation, details or supplementary information concerning the application of the law. **Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling**. See GTP 92-1 for more detailed information regarding documents issued by the Department of Revenue.