



## Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #321

### **Corporate Income and Franchise Tax -- Treatment Of Certain Sales In Sales Factor Of Apportionment Formula (General Fund Taxes -- Individual and Corporate Income Taxes)**

[LFB 2005-07 Budget Summary: Page 183, #12]

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#### **CURRENT LAW**

For purposes the apportionment formula for multi-state businesses under the individual and corporate income and franchise taxes, sales, other than the sales of tangible personal property, are usually considered to be in Wisconsin if the income-producing activity is performed wholly in Wisconsin. If the income-producing activity is performed both in and outside the state, the sales are divided among those states having jurisdiction to tax such businesses in proportion to the direct costs of performance in rendering the service in each state.

#### **GOVERNOR**

Modify current law provisions for determining the location of receipts from sales, other than sales of tangible personal property, used in computing the sales factor of the apportionment formula for apportioning the income of corporations, including insurance companies, and nonresident individuals, and estates and trusts engaged in business within and outside of Wisconsin. Specify the treatment of certain types of sales, other than sales of tangible personal property, for computing the sales factor of the apportionment formula.

#### **DISCUSSION POINTS**

1. Under Wisconsin law, formula apportionment is used if a corporation's Wisconsin business activities are an integral part of a unitary business that operates both within and outside the state. In these cases, the corporation adds its total gross income from its in-state and out-of-state

unitary activities, subtracts deductions, and multiplies the amount of net income by its apportionment ratio as determined by the Wisconsin apportionment formula. The income of nonresident individuals and estates and trusts engaged in business within and outside the state is also subject to apportionment.

Currently, for most corporations, the apportionment ratio or fraction is based on three factors: property, payroll, and sales. Specifically, the apportionment ratio is determined by adding three fractions--the corporation's property value in Wisconsin divided by its total property value, the corporation's payroll in Wisconsin divided by its total payroll, and the corporation's sales in Wisconsin divided by its total sales -- double weighting the sales factor, and dividing the aggregate sum by four.

2. Under provisions included in 2003 Wisconsin Act 37, use of a single sales factor apportionment formula for most multistate corporations will be phased-in over three years, beginning in 2006. The phase-in will follow a similar pattern for most corporations. For tax years beginning before January 1, 2006, income will be apportioned using the current apportionment formula with the sales factor representing 50% of the apportionment ratio, and the property and payroll factors each representing 25%. For tax years beginning after December 31, 2005, and before January 1, 2007, the sales factor will be increased to 60% of the apportionment ratio, and the property and payroll factors will each be decreased to 20%. For tax years beginning after December 31, 2006, and before January 1, 2008, the sales factor will be increased to 80%, and the property and payroll factors will each be decreased to 10%. For tax years beginning after December 31, 2007, a single sales factor apportionment formula will be used to apportion income to Wisconsin. Special provisions govern financial institutions and insurance companies. Except for gas and electric utility companies, other public utilities will continue to apportion income under current law provisions.

3. As noted, the sales factor is a fraction, the numerator of which is the total sales of the taxpayer in Wisconsin, and the denominator is the total sales of the taxpayer everywhere. Sales are included in the sales factor computation for the period in which the income is recognized for Wisconsin.

4. Generally, all gross receipts from transactions and activities conducted in the regular course of a taxpayer's trade or business are included in the sales factor. Among other things, sales include receipts from sales of inventory and services, rents from real property and tangible personal property, and gross royalties and franchise fees from income-producing activities. Nonbusiness receipts and certain business receipts are not included in the definition of sales. Examples of these items include receipts and gain or loss from the sale of securities or the sale of nonbusiness real or tangible personal property. Attachment 1 provides additional detail regarding which items are included in, and excluded from, the definition of sales under the apportionment provisions.

5. In computing the sales factor, sales of tangible personal property are generally considered to be in (sourced to) Wisconsin if the property is delivered or shipped to a purchaser within Wisconsin, regardless of the f.o.b. (free on board) point or other conditions of the sale.

6. Sales of tangible personal property that are shipped from Wisconsin to a purchaser in another state are considered entirely in Wisconsin if the taxpayer (seller) is not subject to income and franchise taxation in the state of destination. These types of sales are known as "throwbacks" and are single-weighted in the apportionment formula. In addition, sales of tangible personal property ordered from an office in the state, but shipped from an out-of-state supplier to an out-of-state customer are considered throwback sales if neither the supplier nor the customer are subject to the taxing jurisdiction of the states in which they are located. These types of sales are called double throwbacks because they are not assigned to the shipping or destination states, but to the state in which the sale occurred. Double throwback sales are also single-weighted in the apportionment formula. Sales to the federal government are only considered to be in Wisconsin if they are shipped from a location within the state and are delivered to the federal government at a location within the state or if they are "throwback" sales. Federal throwback sales are single-weighted in the apportionment formula. The throwback rule is designed to ensure that all sales are accounted for in the numerator of at least one state where the entity is taxable. However, inconsistent throwback rules among states create the potential for having the same sales thrown back to more than one state.

7. Sales, other than sales of tangible personal property (including sales to the federal government), are sourced to Wisconsin as follows:

a. Gross receipts are attributed to Wisconsin if the income-producing activity that gave rise to the receipts is performed wholly within Wisconsin. "Income producing activity" means the act or acts directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit. This activity does not include transactions performed on behalf of the taxpayer, such as those conducted on its behalf by an independent contractor. The income producing activity includes, but is not limited to the following:

(1) The rendering of personal services by employees, or the utilization of tangible and intangible property by the taxpayer in performing a service.

(2) The sale, rental, leasing, licensing the use of, or other use of real property.

(3) The rental, leasing, licensing the use of, or other use of tangible personal property.

(4) The sale, licensing the use of, or other use of intangible personal property such as patents, copyrights, trademarks, trade names, and similar items.

b. Under the current statutes and administrative rules, receipts from sales where the income producing activity is performed partly within and partly outside Wisconsin are assigned to Wisconsin based on the ratio of direct costs of performing the services in Wisconsin to the to the direct costs of performing the services in all states having jurisdiction to tax the business. "Costs of performing" means direct costs determined in a manner consistent with generally accepted accounting principles, and in accordance with accepted conditions or practices in the trade or business of the taxpayer. Special rules for determining when receipts from certain income-producing activities are sourced to Wisconsin are as follows:

(1) Gross receipts from the sale, lease, rental, or other use of real property are sourced to

Wisconsin if the real property is located in Wisconsin.

(2) Gross receipts from the rental, lease, licensing the use of, or other use of tangible personal property is assigned to Wisconsin, if the property is within Wisconsin during the entire period of rental, lease, license, or other use. If the property is within and outside Wisconsin during the period of rental, gross receipts attributable to Wisconsin are based upon the ratio that the time the property was used in Wisconsin bears to the total time the property were used in all states having jurisdiction to tax the business during each year. However, if mobile property, such as automobiles and trailers, is within and outside Wisconsin during the period of rental, gross receipts are attributed to the situs where the property is customarily kept or garaged. For mobile property that is not customarily kept at any location, gross receipts are attributed to the situs where the property first comes into the lessee's possession.

(3) Gross receipts from the performance of personal services are attributable to Wisconsin if the services are performed entirely in Wisconsin. If the services are performed partly within and partly outside Wisconsin, gross receipts are attributable to Wisconsin based upon the ratio that compensation and other direct costs of performing the services in Wisconsin bear to total compensation and other direct costs of performing the services in all states having jurisdiction to tax the business during the tax year. Where services are performed in a state that does not have jurisdiction to tax the business, gross receipts are attributed to Wisconsin, if the compensation related to performing the services is allocated to Wisconsin.

8. The bill's provisions would modify, by varying levels of significance, the sourcing rules for sales, other than sales of tangible personal property, for the purposes of the sales factor of the apportionment formula used under the state individual and corporate income and franchise tax. The bill would specify the treatment of receipts from the: (a) lease, licensing, or rental of real property; (b) lease, licensing, or rental of tangible personal property; (c) lease, licensing, or rental of mobile property; (d) use of computer software; (e) sale, licensing, or use of intangible property; and (f) state of services.

9. *Lease, Licensing, or Rental of Real Property.* Gross receipts from the lease, rental, or licensing of real property owned by the taxpayer and the sublease of real property would be considered to be in Wisconsin if the real property was located in the state. This provision would codify in the statutes the current treatment of such receipts.

10. *Lease, Licensing, or Rental of Tangible Personal Property.* With the exception of gross receipts from the lease, rental, or licensing of moving property, gross receipts from the lease, rental, or licensing of tangible personal property owned by the taxpayer and the sublease of tangible personal property would be treated as in the state, if the property was located in the state during the entire period of the lease, rental, licensing, sublease, or other use. If the property were used in and outside of Wisconsin during the period of the lease, rental, licensing, or sublease, gross receipts would be treated as in Wisconsin to the extent the property was used in the state. The proportion of use in Wisconsin would be determined by multiplying the gross receipts from the lease, rental, licensing, sublease, or other use of the property by a fraction having the numerator be the total time the property was used in the state in the tax year, and having the denominator be the total time the

property was used in all states having jurisdiction to impose an income tax on the taxpayer in the tax year. The provision would codify in the statutes the current sourcing of such receipts. In addition, it would establish a specific method for determining the allocation of receipts among states where the property was used.

11. *Lease, Licensing, or Rental of Moving Property.* Gross receipts from the lease, rental, or licensing of moving property, including motor vehicles, rolling stock, aircraft, vessels, or mobile equipment owned by the taxpayer, and the sublease of moving property would be considered in Wisconsin to the extent the property was used in the state. The proportion of moving property that would be considered in the state would be determined as follows:

a. The proportion of use of a motor vehicle or rolling stock in the state would be determined by multiplying the gross receipts from the lease, rental, licensing, or sublease of the motor vehicle or rolling stock by a fraction with the numerator equal to the number of miles traveled within the state by the motor vehicle or the rolling stock while leased, rented, licensed, or subleased in the tax year, and having the denominator equal the total number of miles traveled by the motor vehicle or rolling stock while leased, rented, licensed, or subleased in the tax year.

b. The proportion of use of an aircraft in Wisconsin would be determined by multiplying the gross receipts from the lease, rental, licensing, or sublease of the aircraft by a fraction with the numerator being the number of takeoffs and landings of the aircraft in the state in the tax year while leased, rented, licensed, or subleased, and with the denominator being the total number of takeoffs and landings of the aircraft in the tax year while leased, rented, licensed, or subleased.

c. The proportion of use of a vessel or mobile equipment in the state would be determined by multiplying the gross receipts from the lease, rental, licensing, or sublease of the vessel or mobile equipment by a fraction having a numerator equal to the number of days that the vessel or mobile equipment is in Wisconsin in the tax year while leased, rented, licensed, or subleased, and having a denominator equal to the number of days in the tax year that the vessel or mobile equipment was leased, rented, licensed, or subleased.

d. If the taxpayer is unable to determine the use of moving property in the tax year while the property is leased, rented, licensed, or subleased, the moving property would be conclusively deemed to be used in the state in which the property was located at the time the lessee, renter, licensee, or sublessee took possession of the property in the tax year.

These provisions would modify current law provisions used to allocate gross receipts from moving property. In general, current law requires that such receipts be assigned to Wisconsin if the property is customarily kept in Wisconsin. The bill would allocate gross receipts to the state based on the proportion of total use of the property in the state. At times, it is difficult to determine a location meeting the customarily kept criterion under current law.

12. The most substantive changes to the sourcing of gross receipts relate to computer software and the sale, licensing, or leasing of services or intangibles.

13. *Use of Computer Software.* Gross receipts from the use of computer software would be considered in Wisconsin if the purchaser or licensee used the computer software at a location in the state. Computer software would be treated as being used at a location in the state if the purchaser or licensee uses the computer software in the regular course of business operations in the state, or if the purchaser or licensee is an individual whose domicile is in the state. If the purchaser or licensee used the computer software in more than one state, the gross receipts would be divided among the states having jurisdiction to impose an income tax on the taxpayer in proportion to the use of computer software in those states. To determine computer software use in Wisconsin, DOR could consider the number of users in each state where the software was used, the number of site licenses or workstations in Wisconsin, and any other factors that reflect the use of computer software in Wisconsin. If a taxpayer was not subject to income tax in the state to which the gross receipts from the use of software were attributed, and the taxpayer's commercial domicile was in Wisconsin, 50% of those gross receipts would be included in the numerator of the sales factor of the state apportionment formula.

14. *Sales, Licensing, or Use of Intangible Property.* Gross receipts from the sale, licensing, or use of intangible property in the ordinary course of the taxpayer's trade or business would be defined as sales related to the production of business income and included in the sales factor of the apportionment formula. Gross royalties and other gross receipts received for the sale or use of intangible property, including, but not limited to, patents, copyrights, trademarks, trade names, service names, franchises, licenses, plans, specifications, blueprints, processes, techniques, formulas, designs, layouts, patterns, drawings, manuals, technical know-how, contracts, and customer lists, would be considered in Wisconsin if the user, purchaser, or licensee used the intangible property at a location in the state. Intangible property would be treated as used at a location in the state if the user, purchaser, or licensee uses the property in the operation of a trade or business at a location in the state, for personal use in the state, or if the user, purchaser, or licensee was an individual whose domicile was in the state. If the user, purchaser, or licensee used the intangible property in more than one state, the gross royalties and other gross receipts from the sale or use of intangible property would be divided among the states having jurisdiction to impose an income tax on the taxpayer in proportion to the use of intangible property in those states. In order to determine the property use in Wisconsin, DOR could consider the number of licensed sites in each state, the volume of property manufactured, produced, or sold at locations in the state, or any other factors that reflected the use of intangible property in Wisconsin. If the taxpayer was not subject to income tax in the state in which the gross royalties or other gross receipts were attributed, and the taxpayer's commercial domicile was in Wisconsin, 50% of those gross royalties or other gross receipts would be included in the numerator of the sales factor of the apportionment formula. Gross receipts and gain and loss from the exchange, as well as the sale, of securities would not be included in the definition of sales to be included in the sales factor of the state apportionment formula.

15. *Services.* Gross receipts from services would be considered in Wisconsin if the purchaser of the service received the benefit of the service in the state. The benefit of a service would be considered as received in Wisconsin if any of the following applied:

- a. The service relates to real property that is located in the state.

b. The service relates to tangible personal property that is located in the state at the time that the service is received or that tangible personal property is delivered directly or indirectly to customers in the state.

c. The service is provided to an individual who is physically present in the state at the time that the service is received.

d. The service is provided to a person engaged in a trade or business in the state and relates to that business.

If the purchaser of a service received a benefit of a service in more than one state, the gross receipts from the performance of the service would be included in the numerator of the sales factor of the apportionment formula according to the portion of the service received in the state. If the taxpayer were not subject to income tax in the state in which the benefit of the service was received, the benefit of the service would be considered received in Wisconsin, to the extent that the taxpayer's employees or representatives performed services from a location in Wisconsin. Fifty percent of the taxpayer's receipts that would be treated as received in the state would be included in the numerator of the sales factor of the apportionment formula.

16. DOR would be authorized to promulgate administrative rules that would specify how income should be apportioned, if the income from sales, other than sales of tangible personal property, could not be ascertained with reasonable certainty by the methods specified in the proposed modifications.

"Commercial domicile" would be defined as the location from which a trade or business is principally managed and directed, based on any factors DOR determined were appropriate, including the location where the greatest number of employees of the trade or business work, have their office or base of operations, or from which the employees are directed or controlled.

"Domicile" would mean an individual's true, fixed, and permanent home where the individual intends to remain permanently and indefinitely and to which, whenever absent, the individual intends to return, except that no individual could have more than one domicile at any time.

"State" would mean a state of the United States, the District of Columbia, the commonwealth of Puerto Rico, or any territory or possession of the United States, unless the context requires that state only means Wisconsin.

These provisions would first apply to tax years beginning on or after January 1, 2005.

17. In general, current law requires gross receipts from services, computer software, and intangibles to be sourced to Wisconsin if the income producing activity is performed in Wisconsin. If the income producing activity occurs in more than one state, including Wisconsin, the receipts are divided among the states having jurisdiction to tax in proportion to the direct costs of performance. Under the bill, receipts would be sourced to Wisconsin if the intangible property or computer software were located in the state, or if the services are performed in the state. If the property is

used, or service provided, in more than one state, the receipts would be divided among the states based on the proportionate use of the property, or proportionate performance of the service. DOR would have authority to determine proportionality factors, such as the number of sites for the property or services, to use in assigning receipts to the state. In cases where the taxpayer was not subject to income tax in the state where the gross receipts would ordinarily be sourced, but the taxpayer's commercial domicile was in Wisconsin, 50% of the gross receipts would be sourced to Wisconsin. Attachment 2 provides a comparison of the sourcing rules under current law and those included in AB 100.

18. Thirty-four states, including Wisconsin, source receipts from services and intangibles using the income-producing activity test. Four states source receipts from services to the state where the benefit is received. Ten states assign receipts from intangibles to the state where the intangible property is used. Attachment 3 provides a comparison, for selected states, of the treatment of receipts from royalties, licensing intangibles, and sales of services. The selected states are those that provide for a different treatment of such receipts than Wisconsin.

19. The method of sourcing sales for the sales factor of the apportionment formula assigns gross receipts from the sale of tangible personal property on a destination basis. By comparison, receipts from intangibles, computer software, and services are assigned to the state where the income-producing activity occurs, measured by the cost of performance. In practice, income-producing activity is origin-based, so that receipts are usually assigned to the headquarters or domicile of the business. This is inconsistent with the destination-based treatment of sales of tangible personal property, and can create compliance and administrative problems in distinguishing between tangible products and intangible products or services. For example, PacifiCorp of California attempted to classify sales of electricity as sales of tangible personal property for purposes of the sales factor of the California corporate apportionment formula (*in re PacifiCorp*, California State Board of Equalization, 2002). There can also be different treatment of vendors of equivalent or similar products delivered in conventional form. Under current provisions, receipts from software that was shrink-wrapped and delivered to a customer would be assigned to the destination state, while receipts for the same software that was transmitted over the Internet and downloaded would be assigned to the headquarters state. In addition, the current treatment of receipts for services and intangibles counteracts the intent of the single sales apportionment formula for in-state businesses that provide services or lease, license, or provide computer software and intangible property. In general, receipts from such activities would be assigned to the state in which such businesses have most of their employees and payroll. In these cases, firms located in Wisconsin would not benefit from single sales factor apportionment. Under the Governor's proposal, these businesses would have their taxes reduced.

20. The "income-producing activity" and "costs of performance" criteria are difficult to identify and subject to interpretation. Determining the relevant income-producing activity can cause problems for taxpayers. For example, assume a company develops software in California, and transfers it to a server in Nevada from which customers download the software. The California company contracts with a third party to operate the server, and the customer's payments are made to a bank account in Nevada. In this case it would be difficult to determine if the income-producing activity happened in California or Nevada. Cost of performance serves as a proxy for income-

producing activity in assigning receipts to multiple states. However, there are no specific rules for determining where costs of performance occur. For example, in the computer software industry, taxpayers need to know if they should include the costs of research and development, marketing, maintenance of servers, technical support, or home office expenses. Wisconsin generally determines where the income-producing activity occurred and the direct costs of performance on a case-by-case basis. Using a destination-based sourcing rule, as provided under AB 100, is viewed as an improvement in the method of assigning sales receipts to states, since it is easier to identify where the property or service is used or located.

21. However, switching to a destination-based sourcing rule would not eliminate problems in identifying the location to where receipts are assigned. For example, it is often difficult to know the destination of products that can be delivered over the Internet, and many of these products can be used at multiple locations. Determining the costs of performance may basically consist of determining the expense of maintaining remote telecommunications equipment such as servers or modems. Yet the seller may be unable to identify which pieces of equipment facilitated any particular sale. Moreover, an origin-based sourcing rule would be substantially simpler than a destination-based rule for small taxpayers whose production is located in one or a few states but whose customers are in substantially more states. This would also be true of the use of an origin-based sourcing rule for sales of tangible personal property.

22. States that allocate all receipts to the state where the greater portion of the income-producing activity occurs effectively have throwback rules. This results in income being apportioned to a state with jurisdiction to tax the business. As noted, the bill would require 50% of gross receipts to be included in the numerator of the sales factor, if the taxpayer was not subject to income tax in the state where the receipts were considered received, and the taxpayer's commercial domicile was in Wisconsin. Essentially, this would establish a throwback rule for assigning the receipts from the lease, licensing, rental, sales, or use of computer software, intangible property, or services. It would ensure that the receipts were accounted for in the numerator of the sales factor in a state where the business was taxable. Use of a destination-based sourcing rule without throwbacks can result in "nowhere income" being generated. "Nowhere income" is income that is not apportioned to any state where the business is taxable. To generate such income, the business locates its production or warehouse facilities in a state without a throwback rule. It sells from this state to customers in a state in which the business does not have nexus and is not subject to that state's income tax. Income from these sales would not be taxable in either state, resulting in untaxed income. Instead of a throwback rule, a few states use a throw out rule, which removes sales where the business is not taxable from both the numerator and denominator of the sales factor. However, as noted, throwbacks can result in double taxation. Different state rules can cause the same sales to be taxed in more than one state. Twenty-four states have throwback rules for tangible personal property, while twenty-two have no throwback rule. Twenty-two states assign receipts from intangible property to the state in which the greatest portion of the income-producing activity occurs. Four states have a throwback rule for such receipts, while seven have a throw out rule.

23. Some businesses will pay more income or franchise taxes under these provisions. These would be firms whose income-producing activity or costs of performance factors were outside of Wisconsin, but whose services or intangibles are located or provide benefits in the state.

In many cases, these would be businesses with larger physical presences in other states. For example, a service provider would pay more taxes than under current provisions if its cost of performance factors, such as administrative and training facilities were out of state. However, businesses with employees and facilities in Wisconsin could pay more if intangibles, such as trademarks or patents, were owned by out-of-state subsidiaries but licensed for use by the Wisconsin parent.

24. One purpose for the proposed changes in sourcing receipts is to address tax avoidance through passive investment companies (PICs). An example would be a corporation that manufactures vehicles in Wisconsin and in several other states and that establishes a subsidiary in Michigan to hold the company's intangible property, including patents, trademarks, and trade names. The business purpose for the subsidiary would be to better track the intangible property and the income it generated. The Michigan subsidiary would not own any real or tangible personal property in Wisconsin, or have employees in the state. The subsidiary's only connection with Wisconsin would be ownership of the patents, trademarks, and trade names being used in the state. The parent company pays royalties to the Michigan subsidiary for each vehicle manufactured. Under current law, the Michigan subsidiary may have nexus with, and be taxable by, Wisconsin as a result of holding the intangible property used by the parent company in the state. However, the subsidiary would be required to source its income based on the location of its income-producing activities, and it is unclear what those activities are. Under the proposed law change, the Michigan subsidiary would determine the amount of income sourced to Wisconsin based on the amount of royalties received for use of the intangible property. Chart 1 (which is attached) provides an example of the structure of a PIC.

25. As noted, some businesses would pay more income and franchise taxes, and some businesses would have their income and franchise taxes reduced as a result of the proposed law change. In some cases, there could be a significant change in tax liability, when compared to current law. The actual impact would depend on the situation of each individual business. As a result, it is likely that there would be a change in state individual and corporate income and franchise tax revenues if the proposed law change were adopted. However, there are no data available to estimate the fiscal effect. As a result, the fiscal effect would be unknown.

## **ALTERNATIVES**

1. Adopt the Governor's recommendation to change the method of sourcing receipts from sales, other than sales of tangible personal property, for purposes of the sales factor of the apportionment formula, under the state individual income and franchise taxes.

2. Adopt the Governor's recommendations to change the method of sourcing receipts from one or more of the following types of sales for purposes of the sales factor of the apportionment formula, under the state individual income and franchise taxes.

- a. The lease, licensing, or rental of real property.
- b. The lease, licensing, or rental of tangible personal property.

- c. The lease, licensing, or rental of moving property.
  - d. The use of computer software.
  - e. The sale, licensing, or use of intangible property.
  - f. Services.
3. Maintain current law.

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Attachments



## ATTACHMENT 1

### Definitions of "Gross Receipts" and "Sales" Under the Income and Franchise Tax Apportionment Provisions

"Gross receipts" 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, are 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. "Sales" includes, but is not limited to, the following items related to the production of business income:

- a. Gross receipts from the sale of inventory.
- b. Gross receipts from the operation of farms, mines, and quarries.
- c. Gross receipts from the sale of scrap or by-products.
- d. Gross receipts from personal and other services.
- e. Gross rents from real property or tangible personal property.
- f. Interest on trade accounts and trade notes receivable.
- g. A partner's share of the partnership's gross receipts, or a member's share of the limited liability company's (LLC) gross receipts.
- h. Gross management fees.
- i. Gross royalties from income-producing activities.
- j. Gross franchise fees from income-producing activities.

Nonbusiness receipts are excluded from the sales factor. In addition to nonbusiness receipts, certain business receipts are also excluded. The following items are among those that are not included in "sales":

- a. Gross receipts and gain or loss from the sale of tangible business assets (except a, b, and c above).
- b. Gross receipts and gain or loss from the sale of nonbusiness real or tangible personal property.
- c. Gross rents and rental income or loss from real property or tangible personal property, if that real property or tangible personal property is not used in the production of business income.

- d. Royalties from nonbusiness real property or nonbusiness tangible personal property.
- e. Proceeds and gain or loss from redemption of securities.
- f. Interest and dividends (except interest under f. above).
- g. Gross receipts and gain and loss from the sale of intangible assets. (except those under a above).
- h. Dividends deductible by corporations in determining net income.
- i. Gross receipts and gain or loss from the sale of securities.
- j. Proceeds and gain or loss from the sale of receivables.
- k. Refunds, rebates, and recoveries of amounts previously expended or deducted.
- l. Other items not includable in apportionable income.
- m. Foreign exchange gain or loss.
- n. Royalties and income from passive investments in patents, copyrights, trademarks, trade names, plans, specifications, blueprints, processes, techniques, formulas, designs, layouts, patterns, drawings, manuals, and technical know-how.
- o. Pari-mutuel wager winnings and purses.

## ATTACHMENT 2

### Apportionment of Sales Other Than Tangible Personal Property Comparison of Current Law and Proposal in Budget Bill

Source of Income	Current Treatment	Proposed Treatment (AB 100)
Receipts from leasing real property	Included in the numerator of the sales factor if the property is located in Wisconsin.	Same as current treatment.
Receipts from leasing tangible personal property	Included in the numerator of the sales factor based on the ratio of the time the property was used in Wisconsin to the total time used in all states with jurisdiction to tax.	Same as current treatment.
Receipts from leasing transportation property	Included in the numerator of the sales factor if the property is customarily kept in Wisconsin; otherwise if the property is located in Wisconsin when lessee takes possession.	Included in the numerator of the sales factor based on usage in Wisconsin; otherwise if the property is located in Wisconsin when lessee takes possession.
Receipts from the use of computer software	Included in the numerator of the sales factor if the income-producing activity (licensing of the software) occurs in Wisconsin; otherwise based on the ratio of the direct costs of performance in Wisconsin to the total direct costs of performance in all states with jurisdiction to tax.	Included in the numerator of the sales factor if the software is used in Wisconsin; otherwise based on the ratio of the use in Wisconsin to the total use in all states with jurisdiction to tax. If taxpayer is not subject to tax in the state where the software is used but taxpayer's commercial domicile is in Wisconsin, 50% is treated as a Wisconsin receipt.
Receipts from royalties for the use of intangible property such as patents, trademarks, and franchises	Included in the numerator of the sales factor if the income-producing activity is performed in Wisconsin; otherwise based on the ratio of the direct costs of performance in Wisconsin to the total direct costs of performance in all states with jurisdiction to tax.	Included in the numerator of the sales factor if the intangible is used in a business in Wisconsin; otherwise based on the ratio of the use in Wisconsin to the total use in all states with jurisdiction to tax. If taxpayer is not subject to tax in the state where the intangible is used but taxpayer's commercial domicile is in Wisconsin, 50% is treated as a Wisconsin receipt.

Source of Income	Current Treatment	Proposed Treatment (AB 100)
Receipts from services	Included in the numerator of the sales factor if the service is rendered in Wisconsin; otherwise based on the ratio of the compensation and other direct costs of performance in Wisconsin to the total compensation and other direct costs of performance in all states with jurisdiction to tax.	<p>Included in the numerator of the sales factor if the purchaser of the service receives the benefit of the service in Wisconsin:</p> <ul style="list-style-type: none"> <li>• Service relates to real property located in Wisconsin.</li> <li>• Service relates to tangible personal property located in Wisconsin when the service is received or that is delivered to a customer in Wisconsin.</li> <li>• Service is provided to a person physically present in Wisconsin.</li> <li>• Service is provided to a person engaged in a trade or business in Wisconsin and relates to the Wisconsin business.</li> </ul> <p>If a person receives the benefit of the service in more than one state, the numerator includes the portion of the service received in Wisconsin. If the taxpayer is not subject to tax in the state where the benefit of the service is received, the benefit of the service is received in Wisconsin to the extent the taxpayer's employees performed service from a location in Wisconsin and 50% of the amount calculated is treated as a Wisconsin receipt.</p>

Source: Wisconsin Department of Revenue

# ATTACHMENT 3

## Comparison of States' Treatments of Sales of Services and Intangibles

Sales of Services	Delaware	Georgia	Iowa	Louisiana	Maryland	Minnesota	New Jersey	Ohio	Oklahoma	Rhode Island	Texas
<p>Receipts are sourced to the state if they were received from services performed in the state. § 12-218, G.S.</p>	<p>Receipts are sourced to the state if they were received from services rendered in the state. § 1903, Tit. 30, Code</p>	<p>Receipts are sourced to the state if they were received from customers within the state or are otherwise attributable to the state's marketplace. O.C.G.A. § 48-7-31</p>	<p>Receipts are sourced to the state if the recipient receives all the benefit of the service in the state. If the recipient receives some of the benefit in the state, the receipts are includable in proportion to the extent the recipient received benefit in the state. Iowa Regulation Rule 701.54.6(422)</p>	<p>Receipts are sourced to the state if they were derived from services rendered in the state. § 47:287.95, La R.S.</p>	<p>Receipts are sourced to the state if they were derived from customers within the state:                      - An individual domiciled in the state.                      - A business domiciled in the state.                      - For services related to real property, the location of the property. Maryland Reg. 03.04.03.08</p>	<p>Receipts are sourced to the state where the services are received. Receipts from the performance of services provided to a corporation, partnership, or trust may only be attributed to a state where it has a fixed place of doing business. If this is not readily determinable or is a state where the entity receiving the service does not have a fixed place of doing business, the services shall be deemed to be received at the location of the office of the customer from which the services were ordered or billed. Minn. Stats. § 290.191(5)(X).</p>	<p>Receipts are sourced to the state if the services were performed in the state. N.J.S.A. § 54:10A-6</p>	<p>Receipts are sourced to the state in proportion to the benefit received by the purchaser in the state to the benefit received by the purchaser everywhere. The physical location where the purchaser ultimately uses or receives the purchased services is paramount in determining the proportion of the benefit received in the state. § 5733.05(B)(2)(c)(i). Ohio R.C.</p>	<p>Not addressed in the law.</p>	<p>Receipts are sourced to the state if the services were performed in the state. RI General Laws § 44-11-14(a)(2)(i)</p>	<p>Receipts are sourced to the state if the services were performed in the state. § 171.1032, Tax Code                       Receipts from the sale of computer software services are sourced to the location where the services are performed. 34 TAC § 3.557(e)(6)</p>

ATTACHMENT 3 (continued)

Receipts from Licensing Intangibles (Copyrights, Patents, Trademarks, Trade Names, and Other Intellectual Property)											
Connecticut	Delaware	Georgia	Iowa	Louisiana	Maryland	Minnesota	New Jersey	Ohio	Oklahoma	Rhode Island	Texas
Receipts are sourced to the state if the intangibles were used in the state. § 12-218, G.S.	Nonapportionable income — allocated proportionately to the states in which the product or process protected by the patent is manufactured or used or in which the publication protected by the copyright is produced or printed. § 1903(b)(2), Tit. 30, Code	Receipts are sourced to the state if they were received from customers within the state or are otherwise attributable to the state's marketplace. O.C.G.A. § 48-7-31	Receipts are sourced to the state if the taxpayer's domicile is in the state. Iowa Regulation, Rule 701.54.2(422)	Nonapportionable income — allocated to the state or states in which the rights are used. § 47:287.93, La R.S.	Receipts are sourced to the state based on the average of the property and payroll factors. Maryland Reg. 03.04.03.08	Receipts are sourced to the state in which the property is used by the purchaser. If the property is used in more than one state, the receipts must be prorated according to the portion of use in the state. If the portion of use in the state cannot be determined, the receipts are excluded from the sales factor. Intangibles are used in the state if the purchaser uses them in the regular course of business operations in the state. § 290.191(5) (h) & (i), Minn. Stat.	Receipts are sourced to the state if the property used in the state. A patent or copyright is carried on in the state. N.J.S.A. § 54:10A-6	Receipts are sourced to the state to the extent that the receipts are based on the amount of use of the property in the state or on the right to use the property in the state § 5733.05(B)(2)(e) (f), Ohio R.C.	Nonapportionable income — allocated to the domiciliary state, unless the property has acquired a nonunitary business or commercial situs apart from the domicile of the taxpayer, in which case the income is allocated to that business or commercial situs, or the property is apportioned. 88 O.S. § 2358(A)(4)(b)	Receipts are sourced to the state to the extent that the patent or copy-right is used in the state by the person paying royalties. A patent is used in the state to the extent that it is employed in fabrication, manufacturing, production or other processing in the state or to the extent that a patented product is produced in the state. A copy-right is used in the state to the extent that the printing or other publications originate in the state. RI Instructions	Receipts from the use of a trademark, or license are sourced to the state to the extent that it is used in the state. Sales of intangibles, including sales or licensing of computer programs, are sourced based on the location of the payor. 34 TAC § 3.557

ATTACHMENT 3 (continued)

Receipts from Royalties																							
<b>Connecticut</b>	Receipts are sourced to the state if the intangibles were used in the state. § 12-218, G.S.	<b>Delaware</b>	Nonapportionable income — allocated proportionately to the states in which the product or process protected by the patent is manufactured or used or in which the publication protected by the copyright is produced or printed. § 1903(b)(2), Tit. 30, Code	<b>Georgia</b>	Receipts are sourced to the state if they were received from customers within the state or are otherwise attributable to the state's marketplace. O.C.G.A. § 48-7-31	<b>Iowa</b>	Receipts are sourced to the state if the taxpayer's commercial domicile is in the state. Iowa Regulation, Rule 701.54.2(422)	<b>Louisiana</b>	Nonapportionable income — allocated to the state or states in which the rights are used. § 47:287.93, La R.S.	<b>Maryland</b>	Receipts are sourced to the state based on the average of the property and payroll factors. Maryland Reg. 03.04.03.08	<b>Minnesota</b>	Receipts are sourced to the state in which the property is used by the purchaser. If the property is used in more than one state, the receipts must be prorated according to the portion of use in the state. If the portion of use in the state cannot be determined, the receipts are excluded from the sales factor. Intangibles are used in the state if the purchaser uses them in the regular course of business operations in the state. § 290.191(5) (f) & (g), Minn. Stat.	<b>New Jersey</b>	Receipts are sourced to the state if the property used in the state. A patent or copyright right is used in the state to the extent that activities under the patent or copyright are carried on in the state. N.J.S.A. § 54:10A-6	<b>Ohio</b>	Receipts are sourced to the state to the extent that the receipts are based on the amount of use of the property in the state or on the right to use the property in the state. § 5733.05(B)(2)(c) (f), Ohio R.C.	<b>Oklahoma</b>	Receipts are apportionable income; however, they are not included in the sales factor. O.S. § 2352(A)(5)(c)	<b>Rhode Island</b>	Receipts are sourced to the state to the extent that the patent or copyright is used in the state by the person paying royalties. A patent is used in the state to the extent that it is employed in fabrication, manufacturing, or other processing in the state. Receipts from a copyright royalty are sourced to the state to the extent that the copyright is utilized in printing or other publication in the state. 34 TAC § 3.557	<b>Texas</b>	Receipts from a patent royalty are sourced to the state to the extent that the patent is utilized in production, fabrication, manufacturing, or other processing in the state. Receipts from a copyright royalty are sourced to the state to the extent that the copyright is utilized in printing or other publication in the state. 34 TAC § 3.557

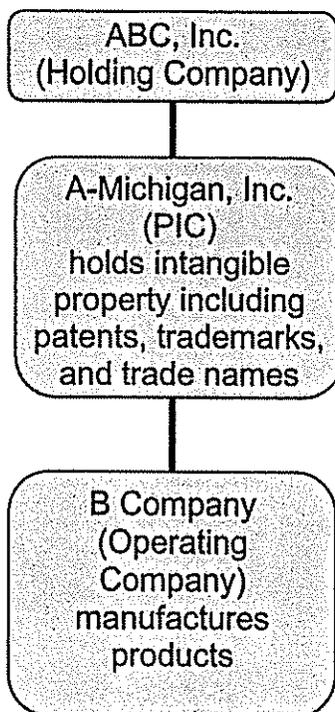
CCH Incorporated. *Multi-state Corporate Income Tax Guide 2004*  
Aspen Publishers. *2004 Multi-state Corporate Tax Guide*

Source: Wisconsin Department of Revenue



## Chart 1

### Example



1. Through a series of nontaxable transactions, ABC, Inc., became a holding company. It transferred its intangible property to a 100 percent owned Michigan subsidiary, A-Michigan, Inc. It transferred the operating business and the rest of its assets to B Company, a 100 percent owned subsidiary of A-Michigan, Inc.
2. B Company pays a royalty to A-Michigan, Inc., based on a percentage of the net sales of products. It deducts this royalty expense when computing Wisconsin net income.
3. A-Michigan, Inc., is not subject to tax in Michigan on its royalty income. While A-Michigan, Inc., has nexus with Wisconsin, its current position is that no tax is due to Wisconsin because the income-producing activity (licensing of the use of intangibles) occurs in Michigan.
4. Under the law change, A-Michigan, Inc., would be subject to Wisconsin franchise or income tax based on the royalties received from B Company for the products sold in Wisconsin. This reduces the tax savings that ABC, Inc., hoped to realize by establishing A-Michigan, Inc.