

## RULE

### Department of Revenue Policy Services Division

#### Corporate Deductions; Add-Back of Certain Intangible Expenses; Interest and Management Fees (LAC 61:I.1115)

Under the authority of R.S. 47:1511 and in accordance with the provisions of R.S. 47:287.82 and the Administrative Procedure Act, R.S. 49:950 et seq., the Department of Revenue, Policy Services Division has adopted LAC 61:I.1115.

The primary purpose of this regulation is to implement Act 16 of the 2016 First Extraordinary Session of the Louisiana Legislature. This Rule is hereby adopted on the day of promulgation.

#### Title 61

#### REVENUE AND TAXATION

#### Part I. Taxes Collected and Administered by the Secretary of Revenue

#### Chapter 11. Corporation Income Tax

#### §1115. Corporate Deductions; Add-Back of Certain Intangible Expenses; Interest and Management Fees

A. General. R.S. 47:287.82 provides that otherwise deductible interest expenses and costs, intangible expenses and costs, and management fees directly or indirectly paid to a related member shall be added back to the corporation's gross income.

B. Exceptions. The taxpayer shall make the add-back unless:

1. the item of income corresponding to the taxpayer's expense, cost, or fee, was in the same taxable year subject to a tax based on or measured by the related member's net income in Louisiana or any other state; or

2. the item of income corresponding to the taxpayer's expense, cost, or fee, was in the same taxable year subject to a tax based on or measured by the related member's net income in a foreign nation which has in force an income tax treaty with the United States, if the recipient was a "resident" as defined in the income tax treaty with the foreign nation; or

3. the transaction giving rise to the expense, cost, or fee between the taxpayer and the related member did not have as a principal purpose the avoidance of any Louisiana tax; or

4. the expense, cost, or fee that was paid or accrued to a related member was "passed through" by the related member or members to an unrelated third party in an arms-length transaction via a corresponding expense, cost, or fee payment; or

5. the add-back is unreasonable. The add-back will be considered unreasonable if the taxpayer establishes that, based on the entirety of the taxpayer's particular facts and circumstances, the add-back adjustments would increase the taxpayer's Louisiana income tax liability to an amount that bears no reasonable relation to the taxpayer's Louisiana presence.

C. Definitions

*Indirectly Paid*—interest expenses and costs, intangible expenses and costs, and management fees subject to add-back include expenses, costs, and fees incurred by a taxpayer

if the expense is related to an intermediate expense, cost, or fee incurred in a transaction between one related member and a second related member.

a. *EXAMPLE.* Corporations B and C are related members with respect to Corporation A. Corporation A is a Louisiana taxpayer that sells products it purchases from Corporation B on a cost plus basis. Corporation B licenses intangible property from Corporation C and makes intangible expense payments to Corporation C based in part on the sales Corporation B makes to Corporation A. To the extent the intangible expenses Corporation B pays to Corporation C are reflected in the costs of the products Corporation A purchases from Corporation B, the direct intangible expenses of Corporation B are considered to be indirect intangible expenses of Corporation A. Furthermore, Corporation A is deemed to directly pay an intangible expense to Corporation B and indirectly pay an intangible expense to Corporation C.

*Intangible Expenses*—includes but is not limited to:

a. expenses, accruals, and costs for, related to, or directly or indirectly incurred in connection with the acquisition, use, maintenance, management, ownership, sale, exchange, or any other disposition of intangible property. "Intangible property" includes stocks, bonds, financial instruments, patents, patent applications, trade names, trademarks, service marks, copyrights, mask works, trade secrets, "know how", and similar types of intangible assets;

b. costs related to, or incurred in connection directly or indirectly with, factoring transactions or discounting transactions;

c. royalty, patent, technical, and copyright fees;

d. licensing fees;

e. other similar expenses, accruals, and costs.

*Management Fees*—includes but is not limited to expenses and costs, including intercompany administrative charges, pertaining to accounts receivable, accounts payable, employee benefit plans, insurance, legal matters, payroll, data processing, including assembled workforce and/or employment data processing, purchasing, procurement, organizational matters, business structuring matters, taxation, financial matters, securities, accounting, marketing, reporting, and compliance matters or similar activities.

*Related Entity*—

a. a stockholder who is an individual, or a member of the stockholder's family set forth in 26 U.S.C. 318 if the stockholder and the members of the stockholder's family own, directly, indirectly, beneficially or constructively, in the aggregate, at least 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, trusts and corporations own directly, indirectly, beneficially or constructively, in the aggregate, at least 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 *Internal Revenue Code* if the taxpayer owns, directly, indirectly, beneficially or constructively, at least 50 percent of the value of the corporation's outstanding stock. The attribution rules of the Internal Revenue Code shall apply for purposes of determining whether the ownership requirements of this definition have been met.

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

- a. a related entity;
- b. a related party;
- c. a component member as defined in subsection (b) of 26 U.S.C. 1563;
- d. a person to or from whom there is attribution of stock ownership in accordance with subsection (e) of 26 U.S.C. 1563; or

e. a person that, notwithstanding its form of organization, bears the same relationship to the taxpayer as a person described in Subparagraphs a to c, inclusive.

*Related Party*—any member of a controlled group of corporations as defined in 26 U.S.C. 1563, or any other person that would be a member of a controlled group if rules similar to those of 26 U.S.C. 1563 were applied to that person.

*Reported and Included in Income for Purposes of a Tax on Net Income*—to the extent reported and included in post-allocation income or apportioned income for purposes of a tax applied to the net income apportioned or allocated to the taxing jurisdiction.

*State*—a state of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

*Subject to a Tax Based on or Measured by the Related Member's Net Income*—that the receipt or accrual of the payment by the recipient related member is reported and included in income for purposes of a tax on net income, and not offset or eliminated in a combined or consolidated return which includes the payor.

#### D. Operating Rules

1. Upon request by the secretary of the Louisiana Department of Revenue, the taxpayer shall produce documentation substantiating any exceptions to add-back claimed by the taxpayer.

2. The exceptions described in Paragraphs B.1. and B.2 of this Section. (corresponding item of income subject to tax) are allowed only to the extent the recipient related member includes the corresponding item of income in post-allocation income or apportioned income reported to the taxing jurisdiction or jurisdictions. Income offset or eliminated in a combined reporting regime would not qualify for the subject to tax exception.

a. EXAMPLE. Corporation A, a Louisiana taxpayer, incurs a \$100 intangible expense in a transaction with Corporation B, a related member with respect to Corporation A. Corporation B files an income tax return in State B where it apportions and/or allocates 5 percent of its income, but files no other income tax returns. Only \$5 of the intangible expense was allocated/apportioned to State B. Corporation A must add-back \$95 of the otherwise deductible \$100 intangible expense incurred in the transaction with Corporation B.

3. Upon request of the secretary of the Louisiana Department of Revenue, the exception described in Paragraph B.3 of this Section. (non-tax business purpose for conducting a transaction) must be supported by contemporaneous documentation. Documentation shall be considered contemporaneous if the documentation is in existence and compiled before the due date (including extensions) for the filing of a return containing the transaction(s). Mere statements or assertions that a transaction was intended to allow for better management or greater utilization of intangible assets, or similarly unsubstantiated claims are not sufficient to establish a principal non-tax business purpose. Examples of principal non-tax business purposes include:

a. EXAMPLE. Taxpayer purchases administrative services such as accounting, legal, human resources, purchasing, etc., from a Related Member and does so at rates comparable to rates that would be charged by third party service providers.

b. EXAMPLE. Taxpayer borrows funds from a Related Member and does so at an interest rate and with other terms that are comparable to rates and terms that would be required by an unrelated third party lender.

c. EXAMPLE. Taxpayer incurs royalty expense in connection with the use of intangible assets provided by a Related Party. The royalty rates and other terms of agreement are comparable to rates and terms that would be required by an unrelated third party.

4. The exception described in Paragraph B.4 of this Section. (expense "passed through" to an unrelated third party) is limited if the expenses, costs, and fees paid to a related member are greater than the expenses, costs, and fees the related member pays to unrelated third parties because only a portion of the expenses, costs, and fees incurred in connection with a transaction with a related member is considered to have "passed through" to the unrelated third parties.

a. EXAMPLE. Taxpayer A, a Louisiana taxpayer, incurs a \$100 management fee to Related Member B. Related Member B receives a total of \$400 of related member management fee income (\$100 from Taxpayer A plus \$300 from other related payors). Related Member B pays \$200 of management fees to unrelated third parties. Related Member B will be deemed to have passed through to unrelated third parties only 50 percent of the interest expense/income it received from Taxpayer A. Only \$50 of Taxpayer A's \$100 related member management fee payment to Related Member B will be deemed to have been passed through to unrelated third parties and qualify for the exception described in section B.4. (expense "passed through" to an unrelated third party).

5. With respect to both interest and intangible expenses, if the interest or intangible expense rate charged the taxpayer by the related member exceeds the interest or intangible expense rate charged the related member by unrelated third party payees, then the excess expense will not qualify for the exception described in section B.5 (add-back is unreasonable) and must be added back. If multiple transaction arrangements exist between the taxpayer and the related member, or the related member and the unrelated third-party, then a weighted average rate should be calculated by dividing total expense by total amounts of each base amount used to determine the expense amounts. The weighted average rate should then be used to determine the existence of non-qualifying excess interest or intangible expense.

a. EXAMPLE. Taxpayer B incurs interest expense of \$100 during its taxable year to its parent Company A (a related member) in order to service a \$1,000 debt between B and A. Company A's related member interest rate is 10 percent calculated by dividing its related member interest expense (\$100) by its related member debt (\$1000). Company A makes interest expense payments of \$200 to Unrelated Lenders C and D to service the \$4,000 of total debt existing between A and Unrelated Lenders C and D. A's weighted average unrelated third party interest rate is five percent (5 percent) calculated by dividing total unrelated third party interest expense (\$200) by total unrelated third party interest bearing debt (\$4,000). Company B's non-qualifying excess interest is \$50. Company B's debt to Company A (\$1,000) is multiplied by the excess interest rate Company B incurred over Company A's average interest rate to unrelated lenders (10 percent-5 percent).

6. With respect to interest expense, if the taxpayer's debt over asset percentage exceeds the consolidated unrelated third-party debt over asset percentage of its federal consolidated group (as represented by interest-bearing debt reported on the schedule L balance sheet(s) included in the consolidated and pro forma federal income tax returns), then

the interest expense associated with the excess debt must be added back and cannot qualify for the exception described in Paragraph B.5 of this Section. (add-back is unreasonable). The debt over asset test only applies to the unreasonable exception.

a. EXAMPLE. Company A and Taxpayer B are related members. Taxpayer B's separate company federal income tax return Schedule L balance sheet shows \$1,500 of assets and \$1,000 of interest bearing debt which produces a debt over asset percentage of 66.7 percent. The Company A and Subsidiaries' federal consolidated income tax return Schedule L balance sheet shows \$6,000 of assets and \$3,000 of unrelated third party interest bearing debt which produces a debt over asset percentage of 50 percent. Because Taxpayer B's debt over asset percentage of 66.7 percent, exceeds the group's unrelated third party debt over asset percentage, 50 percent, the amount of Taxpayer B's related member interest expense that may qualify for the exception described in section B.5. (add-back is unreasonable) is limited. The limitation is calculated by multiplying B's assets (\$1,500) by the lower of the taxpayer's debt over asset percentage or the group's unrelated third party debt over asset percentage (50 percent) and then multiplying the product (\$750) by the lower of the taxpayer's related member interest rate or the related member's unrelated third party interest rate (5 percent), which yields an ultimate limitation of \$37.50.

AUTHORITY NOTE: Promulgated in accordance with R.S. 47:1511.

HISTORICAL NOTE: Promulgated by the Department of Revenue, Policy Services Division, LR 44:000 (April 2018).

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Secretary

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