

NOTICE OF INTENT

Department of Revenue Policy Services Division

Special Adjustments by the Secretary (LAC 61:I.1138)

Under the authority of R.S. 47:287.480, R.S. 47:287.785, and R.S. 47:1511, and in accordance with the provisions of the Administrative Procedure Act, R.S. 49:950 et seq., the Department of Revenue, Policy Services Division, proposes to adopt LAC 61:I.1138 relative to special adjustments by the secretary.

In 1986, the Louisiana Legislature enacted Act 16 of the First Extraordinary Session which was comprised of Part II-A of Chapter 1 of Title 47, R.S. 47:287.2 through 785, the Louisiana Corporation Income Tax. Since its enactment in 1986, there has been no regulatory guidance as to the application of R.S. 47:287.480. This Rule will provide guidance to certain corporations as to how to properly determine and report their Louisiana taxable income. This proposed regulation is not intended to be a complete statement of all situations in which the secretary may require the application of R.S. 47:287.480.

Title 61

REVENUE AND TAXATION

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

Chapter 11. Income: Corporation Income Tax §1138. Special Adjustments by the Secretary

A. R.S. 47:287.480 authorizes the secretary to require the use of inventories, to allocate income and deductions among related taxpayers, and to require the use of consolidated statements when necessary in the secretary's opinion to clearly reflect the income of the taxpayer. The statute authorizes the secretary to use any, all, or a combination of these methods. The statute does not require the methods to be employed in concert or in any particular order. It is within the discretion of the secretary to determine which method or combination of methods the taxpayer must use. The secretary is not required to allege wrongdoing or tax avoidance by the taxpayer in order to require the use of these methods. A finding by the secretary that the method of determining Louisiana taxable income provided for in R.S.47:287.92-95 does not clearly reflect income is sufficient for the secretary to require the method or methods allowed under R.S. 47:287.480 that in the secretary's opinion more clearly reflect the taxpayer's Louisiana taxable income.

B. Application. The following are situations in which the secretary will generally require taxpayers to depart from the method of determining Louisiana taxable income provided for in R.S.47:287.92-95. This is not an exhaustive list of the situations in which the secretary will require a taxpayer to use the method or methods allowed under R.S. 47:287.480 that in the secretary's opinion more clearly reflect the taxpayer's Louisiana taxable income.

1. Intangible holding companies that receive income from the licensing or sub-licensing of intangible rights to affiliated companies that manufacture products. For purposes of this section, an intangible holding company is a corporation that derives at least 80 percent of its non-investment revenue from licensing or sublicensing of intangible rights to one or more affiliated persons. When an

intangible holding company generates income by licensing an intangible right to affiliated corporate licensees or sub-licensees that manufacture products and sell the products to other companies (wholesalers or retailers), it is the opinion of the secretary that the use of the method provided for in R.S.47:287.92-95 does not generally clearly reflect Louisiana taxable income. (For example, in the case of a trademark, when the licensee-manufacturer is located in Louisiana, under the method provided for in R.S.47:287.92-95 the intangible holding company would be required to allocate 100 percent of its income from the licensee to Louisiana, because the trademark is deemed to be used at the manufacturing facility. However, the separation of the intangible holding company and the manufacturer is artificial, because they are actually one business. The value of the trademark is wholly dependent upon the reputation of the product that in turn is wholly under the control of the manufacturer. And, the manufacturer creates and protects the value of the trademark. The method provided for in R.S.47:287.92-95 does not adequately address these synergies inherent in this type of business arrangement and does not result in a clear reflection of income because the value of each part of the business is inextricably related to the existence of the other part of the business.) Therefore, the secretary will generally require an intangible holding company that receives income from the licensing or sub-licensing of intangible rights to a related or affiliated manufacturing company and the manufacturing company to determine their Louisiana taxable income as follows.

a. Each company will be treated as a separate corporation and must each file its own income and franchise tax returns. However, the companies will make a consolidated income statement as the first step in the computation of their separate income tax.

b. The corporations will compute their consolidated net income on a consolidated statement, which will include the income and deductions of both corporations. Any inter-company items of income or deduction are eliminated.

c. Each corporation will compute its Louisiana net income or loss by apportioning and allocating its share of the consolidated net income to its separate return using the provisions of R.S. 47:287.92-95. The specific apportionment formula to be used by each corporation will be determined based on the primary business of the group as a whole. Generally, the separate apportionment ratio of each company will be computed by determining the relationship that its Louisiana revenue (sales), wages, and real and tangible property bear to the consolidated total revenue, wages, and real and tangible property. The Louisiana revenue, wages and property and the consolidated revenue, wages and property are to be determined after inter-company eliminations. The apportionment ratio so computed shall be applied to consolidated net apportionable income to determine the separate corporation's Louisiana apportionable income. Items of allocable income and expense, after eliminations, are attributed to the entity that produced the income.

d. Filing Requirements. Each consolidated report must include the following information:

i. a list of the corporations included in the consolidated statement and their federal and Louisiana taxpayer identification numbers;

ii. a combined profit and loss statement disclosing each corporation's statement of profit and loss;

iii. a schedule of inter-company eliminations, disclosing the various adjustments necessary for each corporation to convert the combined profit and loss statement to the consolidated income;

iv. apportionment formula calculations disclosing the total consolidated amount of property, payroll, and sales and each separate corporation's Louisiana amount of property, payroll and sales, all determined after eliminations;

v. schedules showing the computation of each corporation's Louisiana apportionable and allocable income, determined after eliminations; and

vi. schedules showing the computation of each corporation's tax credits, Louisiana net operating loss and federal income tax deduction.

C. Nothing in this regulation shall restrict the secretary's authority to otherwise provide for the administration of the provisions of R.S. 47:287.480.

AUTHORITY NOTE: Adopted in accordance with R.S. 47:287.480, R.S. 47:287.785, and R.S. 47:1511.

HISTORICAL NOTE: Adopted by the Department of Revenue, LR 31:

Family Impact Statement

The proposed adoption of LAC 61:I.1138, regarding special adjustments by the secretary should not have any known or foreseeable impact on any family as defined by R.S. 49:972(D) or on family formation, stability and autonomy. Specifically, the implementation of this proposed rule will have no known or foreseeable effect on:

1. the stability of the family;
2. the authority and rights of parents regarding the education and supervision of their children;
3. the functioning of the family;
4. family earnings and family budget;
5. the behavior and personal responsibility of children;
6. the ability of the family or a local government to perform this function.

Any interested person may submit written data, views, arguments or comments regarding this proposed Rule to Michael D. Pearson, Senior Policy Consultant, Policy Services Division, Office of Legal Affairs, P.O. Box 44098, Baton Rouge, LA 70804-4098. All comments must be received no later than 4:30 p.m., Tuesday, January 25, 2005. A public hearing will be held on Wednesday, January 26, 2005, at 10 a.m. in the Calcasieu Room, on the second floor of the LaSalle Building, 617 North Third Street, Baton Rouge, LA.

Cynthia Bridges
Secretary

FISCAL AND ECONOMIC IMPACT STATEMENT FOR ADMINISTRATIVE RULES RULE TITLE: Special Adjustments by the Secretary

I. ESTIMATED IMPLEMENTATION COSTS (SAVINGS) TO STATE OR LOCAL GOVERNMENT UNITS (Summary)

The implementation of this proposed regulation, which will provide guidance as to the application of R.S. 47:287.480 relative to special adjustments by the secretary, will have no impact on the agency's cost. The implementation of this proposed regulation will have no impact upon any local governmental units.

II. ESTIMATED EFFECT ON REVENUE COLLECTIONS OF STATE OR LOCAL GOVERNMENTAL UNITS (Summary)

This proposed regulation seeks to inform the taxpayer and provide guidance to certain corporations as to how to properly determine and report their Louisiana taxable income. Compliance will result in an indeterminable increase in revenue collections of state governmental units. There will be no effect on revenue collections of local governmental units.

III. ESTIMATED COSTS AND/OR ECONOMIC BENEFITS TO DIRECTLY AFFECTED PERSONS OR NONGOVERNMENTAL GROUPS (Summary)

There will be no effect on corporations that do business entirely in Louisiana.

This proposed regulation will affect multi-state corporations that employ these income shifting strategies. Additional paperwork for affected corporations will be minimal as most of these corporations are already making similar calculations for other states, and if the corporation is publicly traded, for the federal Securities and Exchange Commission. Affected corporations will however, be required to perform an additional calculation to determine their Louisiana apportionment factors.

IV. ESTIMATED EFFECT ON COMPETITION AND EMPLOYMENT (Summary)

This proposed regulation should have no effect on competition or employment.

Cynthia Bridges
Secretary
0412#058

H. Gordon Monk
Staff Director
Legislative Fiscal Office