

## CHAPTER 81-03-09 DIVISION OF INCOME

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### **81-03-09-01. General.**

The sections in this chapter are intended to set forth rules concerning the application of the apportionment and allocation provisions of the Uniform Division of Income for Tax Purposes Act, North Dakota Century Code chapter 57-38.1, and article IV of the multistate tax compact, North Dakota Century Code chapter 57-59.

The apportionment rules set forth herein are applicable to any taxpayer having business income, regardless of whether or not the taxpayer has nonbusiness income, and the allocation rules set forth herein are applicable to any taxpayer having nonbusiness income, regardless of whether or not the taxpayer has business income.

The only exception to these allocation and apportionment rules contained herein are those set forth in sections 81-03-09-32, 81-03-09-33, and 81-03-09-34, pursuant to the provisions of North Dakota Century Code section 57-38.1-18 and article IV(18) of North Dakota Century Code section 57-59-01.

These sections are not intended to modify existing rules concerning jurisdictional standards.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1, 57-59

### **81-03-09-02. Definitions.**

As used in this chapter, unless the context otherwise requires:

1. "Allocation" refers to the assignment of nonbusiness income to a particular state.
2. "Apportionment" refers to the division of business income between states by the use of a formula containing apportionment factors.
3. "Article IV" or any reference to the provisions thereof means article IV, division of income of the multistate tax compact, North Dakota Century Code section 57-59-01.
4. "Business activity" refers to the transactions and activity occurring in the regular course of a particular trade or business of a taxpayer.
5. "Internal Revenue Code" or any reference to the provisions thereof means the "United States Internal Revenue Code of 1954, as amended", as that term is defined in subsection 21 of North Dakota Century Code section 57-38-01.
6. "Taxpayer" means any corporation, partnership, firm, association, governmental unit or agency, or person acting as a business entity in more than one state.
7. "Uniform Division of Income for Tax Purposes Act" or any reference to any provisions thereof means the Uniform Division of Income for Tax Purposes Act as adopted by several of the states of the United States, and the Uniform Division of Income for Tax Purposes Act as enacted in the provisions of North Dakota Century Code chapter 57-38.1.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1, 57-59

### **81-03-09-03. Business and nonbusiness income defined.**

Subsection 1 of North Dakota Century Code section 57-38.1-01 and article IV(1)(a) of North Dakota Century Code section 57-59-01 define "business income" as income arising from transactions and activity in the regular course of the taxpayer's trade or business and 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. In essence, all income which arises from the conduct of trade or business operations of a taxpayer is business income. For purposes of administration of North Dakota Century Code chapter 57-38.1 and North Dakota Century Code chapter 57-59, the income of the taxpayer is business income unless clearly classifiable as nonbusiness income. Nonbusiness income means all income other than business income.

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, and so forth, is of no aid in determining whether income is business or nonbusiness income. Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is "business income" or "nonbusiness income" is the identification of the transactions and activity 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 activity arising in the regular course of and will constitute integral parts of a trade or business. See sections 81-03-09-04 and 81-03-09-08 for further explanation of a trade or business.

**History:** Amended effective November 1, 1991.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-01(1), 57-59-01 (art.IV(1)(a))

#### **81-03-09-04. Two or more businesses of a single taxpayer.**

A taxpayer may have more than one "trade or business". In such cases, it is necessary to determine the business 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 instate and outstate factors which relate to the trade or business the income of which is being apportioned.

The determination of whether the activities of the taxpayer constitute a single trade or business or more than one trade or business will turn on the facts in each case. In general, the activities of the taxpayer will be considered a single business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon, or contribute to each other and the operations of the taxpayer as a whole. The following factors are considered to be good indicia of a single trade or business, and the presence of any of these factors creates a strong presumption that the activities of the taxpayer constitute a single trade or business:

1. **Same type of business.** A taxpayer is generally engaged in a single trade or business when all of its activities are in the same general line. For example, a taxpayer which operates a chain of retail grocery stores will almost always be engaged in a single trade or business.
2. **Steps in a vertical process.** A taxpayer is almost always engaged in a single trade or business when its various divisions or segments are engaged in different steps in a large, vertically structured enterprise. For example, a taxpayer which explores for and mines copper ores; concentrates, smelts, and refines the copper ores; and fabricates the refined copper into consumer products is engaged in a single trade or business, regardless of the fact that the various steps in the process are operated substantially independent of each other with only general supervision from the taxpayer's executive offices.
3. **Strong centralized management.** A taxpayer which might otherwise be considered as engaged in more than one trade or business is properly considered as engaged in one trade or business when there is a strong central management, coupled with the existence of centralized departments for such functions as financing, advertising, research, or purchasing. Thus, a corporation may properly be considered as engaged in only one trade or business when the central executive officers are normally involved in the operations of the various divisions and there are centralized offices which perform for the divisions the normal matters which a truly independent business would perform for itself, such as accounting, personnel, insurance, legal, purchasing, advertising, or financing.

**History:** Amended effective November 1, 1991.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-01(1), 57-59-01 (art.IV(1)(a))

#### **81-03-09-05. Business and nonbusiness income - Application of definitions.**

Repealed effective November 1, 1991.

#### **81-03-09-06. Proration of deductions.**

In most cases an allowable deduction of a taxpayer will be applicable only to the business income arising from a particular trade or business or to a particular item of nonbusiness income. In some cases an allowable deduction may be applicable to the business income of more than one trade or business or to several items of nonbusiness income. In such cases the deduction shall be prorated among such trades or businesses and such items of nonbusiness income in a manner which fairly distributes the deduction among the classes of income to which it is applicable.

In filing returns with this state, if the taxpayer departs from or modifies the manner of prorating any such deduction used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

If the returns or reports filed by a taxpayer with all states to which the taxpayer reports under article IV of the multistate tax compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the application or proration of any deduction, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-01(1), 57-59-01 (art.IV(1)(a))

#### **81-03-09-07. Apportionment.**

If the business activity in respect to any trade or business of a taxpayer occurs both within and without this state, and if by reason of such business activity the taxpayer is taxable in another state, the portion of the net income or net loss arising from such trade or business which is derived from sources within this state shall be determined by apportionment in accordance with North Dakota Century Code sections 57-38.1-09 through 57-38.1-17 or article IV(9) through IV(17) of North Dakota Century Code section 57-59-01.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-02, 57-59-01 (art.IV(2))

#### **81-03-09-08. Combined report.**

If a particular trade or business carried on by a taxpayer and one or more affiliated corporations, nothing in either North Dakota Century Code chapter 57-38.1 or North Dakota Century Code chapter 57-59 or in this article shall preclude the use of a "combined report" whereby the entire business income of such trade or business is apportioned in accordance with North Dakota Century Code sections 57-38.1-09 through 57-38.1-17 or article IV(9) through IV(17) of North Dakota Century Code section 57-59-01.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-02, 57-59-01 (art.IV(2))

#### **81-03-09-09. Allocation.**

Any taxpayer subject to the taxing jurisdiction of this state shall allocate all of the taxpayer's nonbusiness income or loss within or without this state in accordance with North Dakota Century Code sections 57-38.1-04 through 57-38.1-08 or article IV(4) through IV(8) of North Dakota Century Code section 57-59-01.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-02, 57-59-01 (art.IV(2))

**81-03-09-10. Consistency and uniformity in reporting.**

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 income in returns for prior years, the taxpayer shall disclose in the return for the current year, the nature and extent of the modification.

If the returns or reports filed by a taxpayer for all states to which the taxpayer reports under article IV of the multistate tax compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the classification of income as business or nonbusiness income, the taxpayer shall disclose in the taxpayer's return to this state the nature and extent of the variance.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1, 57-59

**81-03-09-11. Taxable in another state - In general.**

Under both North Dakota Century Code section 57-38.1-02 and article IV(2) of North Dakota Century Code section 57-59-01, the taxpayer is subject to the allocation and apportionment provisions of North Dakota Century Code chapter 57-38.1 and article IV of North Dakota Century Code section 57-59-01 if it has income from business activity that is taxable both within and without this state. A taxpayer's income from business activity is taxable without this state if such taxpayer, by reason of such business activity, that is, the transactions and activity occurring in the regular course of a particular trade or business, is taxable in another state within the meaning of North Dakota Century Code section 57-38.1-03 or article IV(3) of North Dakota Century Code section 57-59-01. A taxpayer is taxable within another state if it meets either one of two tests.

1. If by reason of business activity in another state the taxpayer is subject to one of the types of taxes specified in subsection 1 of North Dakota Century Code section 57-38.1-03 or article IV(3)(a) of North Dakota Century Code section 57-59-01; namely, a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or
2. If by reason of such business activity another state had jurisdiction to subject the taxpayer to a net income tax, regardless of whether or not the state imposes such a tax on the taxpayer.

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 income or business activities relating to a separate trade or business.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-03, 57-59-01 (art.IV(3))

**81-03-09-12. Taxable in another state - When a taxpayer is "subject to" a tax.**

1. A taxpayer is "subject to" one of the taxes specified in either subsection 1 of North Dakota Century Code section 57-38.1-03 or article IV(3)(a) of North Dakota Century Code section 57-59-01 if the taxpayer carries on business activity in such state and such state imposes such a tax thereon. Any taxpayer which asserts that the taxpayer is subject to one of the taxes specified in either subsection 1 of North Dakota Century Code section 57-38.1-03 or article IV(3)(a) of North Dakota Century Code section 57-59-01 in another state shall furnish to the tax commissioner of this state upon the tax commissioner's request evidence to support such assertion. The tax commissioner of this state may request that such evidence include proof that the taxpayer has filed the requisite tax return in such other state and has paid any taxes imposed under the law of such other state; the taxpayer's failure to produce such proof may be taken into account in determining whether the taxpayer in fact is subject to one of the

taxes specified in either subsection 1 of North Dakota Century Code section 57-38.1-03 or article IV(3)(a) of North Dakota Century Code section 57-59-01 in such other state.

If the taxpayer voluntarily files and pays one or more of such taxes when not required to do so by the laws of that state or pays a minimal fee for qualification, organization, or for the privilege of doing business in that state but, does not actually engage in business activity in that state or does actually engage in some business activity, not sufficient for nexus, and the minimum tax bears no relation to the taxpayer's business activity within such state, the taxpayer is not "subject to" one of the taxes specified within the meaning of either subsection 1 of North Dakota Century Code section 57-38.1-03 or article IV(3)(a) of North Dakota Century Code section 57-59-01.

Example: State A has a corporation franchise tax measured by net income, for the privilege of doing business in that state. Corporation X files a return and pays the fifty dollar minimum tax, although it carries on no business activity in state A. Corporation X is not "taxable" in state A.

2. The concept of taxability in another state is based upon the premise that every state in which the taxpayer is engaged in business activity may impose an income tax even though every state does not do so. In states which do not, other types of taxes may be imposed as a substitute for an income tax. Therefore only those taxes enumerated in either subsection 1 of North Dakota Century Code section 57-38.1-03 or article IV(3)(a) of North Dakota Century Code section 57-59-01 which may be considered as basically revenue raising rather than regulatory measures shall be considered in determining whether the taxpayer is "subject to" one of the taxes specified in either subsection 1 of North Dakota Century Code section 57-38.1-03 or article IV(3)(a) of North Dakota Century Code section 57-59-01 in another state.

Example a: State A requires all nonresident corporations which qualify or register in state A to pay to the secretary of state an annual license fee or tax for the privilege of doing business in the state regardless of whether the privilege is in fact exercised. The amount paid is determined according to the total authorized capital stock of the corporation; the rates are progressively higher by bracketed amounts. The statute sets a minimum fee of fifty dollars and a maximum fee of five hundred dollars. Failure to pay the tax bars a corporation from utilizing the state courts for enforcement of its rights. State A also imposes a corporation income tax. Nonresident corporation X is qualified in state A and pays the required fee to the secretary of state but does not carry on any business activity in state A, although it may utilize the courts of state A. Corporation X is not "taxable" in state A.

Example b: Same facts as example a except that corporation X is subject to and pays the corporation income tax. Payment is prima facie evidence that corporation X is "subject to" the net income tax of state A and is "taxable" in state A.

Example c: State B requires all nonresident corporations qualified or registered in state B to pay to the secretary of state an annual permit fee or tax for doing business in the state. The base of the fee or tax is the sum of outstanding capital stock and surplus and undivided profits. The fee or tax base attributable to state B is determined by a three factor apportionment formula. Nonresident corporation X which operates a plant in state B, pays the required fee or tax to the secretary of state. Corporation X is "taxable" in state B.

Example d: State A has a corporation franchise tax measured by net income for the privilege of doing business in that state. Corporation X files a return based upon its business activity in the state but the amount of computed liability is less than the minimum tax. Corporation X pays the minimum tax. Corporation X is subject to state A's corporation franchise tax.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-03, 57-59-01 (art.IV(3))

**81-03-09-13. Taxable in another state - When a state has jurisdiction to subject a taxpayer to a net income tax.**

The second test, that of either subsection 2 of North Dakota Century Code section 57-38.1-03 or article IV(3)(b) of North Dakota Century Code section 57-59-01 applies if the taxpayer's business activity is sufficient to give the state jurisdiction to impose a net income tax by reason of such business activity under the constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provisions of Public Law 86-272, 15 U.S.C. 381-385. In the case of any "state" as defined in either subsection 8 of North Dakota Century Code section 57-38.1-01 or article IV(1)(h) of North Dakota Century Code section 57-59-01, other than a state of the United States or political subdivisions of such state, the determination of whether such "state" has jurisdiction to subject the taxpayer to a net income tax shall be made as though the jurisdiction standards applicable to a state of the United States applied in that "state". If jurisdiction is otherwise present, such "state" is not considered as without jurisdiction by reason of the provisions of a treaty between that state and the United States.

Example: Corporation X is actively engaged in manufacturing farm equipment in state A and in foreign country B. Both state A and foreign country B impose a net income tax but foreign country B exempts corporations engaged in manufacturing farm equipment. Corporation X is subject to the jurisdiction of state A and foreign country B.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-03, 57-59-01 (art.IV(3))

**81-03-09-14. Apportionment formula.**

All business income of each trade or business of the taxpayer shall be apportioned to this state by use of the apportionment formula set forth in either North Dakota Century Code section 57-38.1-09 or article IV(9) of North Dakota Century Code section 57-59-01. The elements of the apportionment formula are the property factor, see sections 81-03-09-15, 81-03-09-16, 81-03-09-17, 81-03-09-18, 81-03-09-19, 81-03-09-20, and 81-03-09-21; the payroll factor or see sections 81-03-09-22, 81-03-09-23, 81-03-09-24, and 81-03-09-25; and the sales factor, see sections 81-03-09-26, 81-03-09-27, 81-03-09-28, 81-03-09-29, 81-03-09-30, and 81-03-09-31, of the trade or business of the taxpayer.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-09, 57-59-01 (art.IV(9))

**81-03-09-15. Property factor - In general.**

The property factor of the apportionment formula for each trade or business of the taxpayer shall include all real and tangible personal property owned or rented by the taxpayer and used during the tax period in the regular course of such trade or business. The term "real and tangible personal property" includes land, buildings, machinery, stocks of goods, equipment, and other real and tangible personal property but does not include coin or currency.

Property used in connection with the production of nonbusiness income shall be excluded from the property factor. Property used both in the regular course of taxpayer's trade or business and in the production of nonbusiness 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 upon the facts of each case. The property factor shall reflect the average value of property includable in the factor. See section 81-03-09-21.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-10, 57-59-01 (art.IV(10))

### **81-03-09-16. Property factor - Property used for the production of business income.**

Property shall be included in the property factor if it is actually used or is available for or capable of being used during the tax period in the regular course of the trade or business of the taxpayer. Property held as reserves or standby facilities or property held as a reserve source of materials shall be included in the factor. For example, a plant temporarily idle or raw material reserves not currently being processed are includable in the factor. Property or equipment under construction during the tax period, except inventorable goods in process, shall be excluded from the factor until such property is actually used in the regular course of the trade or business of the taxpayer. If the property is partially used in the regular course of the trade or business of the taxpayer while under construction, the value of the property to the extent used shall be included in the property factor. 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 income, its sale, or the lapse of an extended period of time, normally, five years, during which the property is held for sale.

Example a: The taxpayer closed its manufacturing plant in state X and held such property for sale. The property remained vacant until its sale one year later. The value of the manufacturing plant is included in the property factor until the plant is sold.

Example b: Same as example a except that the property was rented until the plant was sold. The plant is included in the property factor until the plant is sold.

Example c: The taxpayer closed its manufacturing plant and leased the building under a five-year lease. The plant is included in the property factor until the commencement of the lease.

Example d: The taxpayer operates a chain of retail grocery stores. Taxpayer closed store A, which was then remodeled into three small retail stores such as a dress shop, drycleaning, and barber shop, which were leased to unrelated parties. The property is removed from the property factor on the date the remodeling of store A commenced.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-10, 57-59-01 (art.IV(10))

### **81-03-09-17. Property factor - Consistency in reporting.**

In filing returns with this state, if the taxpayer departs from or modifies the manner of valuing property, or of excluding or including property in the property 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.

If the returns of reports filed by the taxpayer with all states to which the taxpayer reports under article IV of the multistate tax compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the valuation of property and in the exclusion or inclusion of property in the property factor, the taxpayer shall disclose in the taxpayer's return to this state the nature and extent of the variance.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-10, 57-59-01 (art.IV(10))

### **81-03-09-18. Property factor - Numerator.**

The numerator of the property factor shall include the average value of the real and tangible personal property owned or rented by the taxpayer and used in this state during the tax period in the regular course of the trade or business of the taxpayer. Property in transit between locations of the taxpayer to which it belongs shall be considered to be at the destination for purposes of the property factor. Property in transit between a buyer and seller which is included by a taxpayer in the denominator of its property factor in accordance with its regular accounting practices shall be included in the numerator according to the state of destination. The value of mobile or movable property such as



construction equipment, trucks, or leased electronic equipment which are located within and without this state during the tax period shall be determined for purposes of the numerator of the factor on the basis of total time within the state during the tax period. An automobile assigned to a traveling employee shall be included in the numerator of the factor of the state to which the employee's compensation is assigned under the payroll factor or in the numerator of the state in which the automobile is licensed.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-10, 57-59-01 (art.IV(10))

**81-03-09-19. Property factor - Valuation of owned property.**

1. Property owned by the taxpayer shall be valued at its original cost. As a general rule "original cost" is deemed to be the basis of the property for federal income tax purposes, prior to any federal adjustments, at the time of acquisition by the taxpayer and adjusted by subsequent capital additions or improvements thereto and partial disposition thereof, by reason of sale, exchange, abandonment, and so forth.

Example a: The taxpayer acquired a factory building in this state at a cost of five hundred thousand dollars and eighteen months later expended one hundred thousand dollars for major remodeling of the building. Taxpayer files the taxpayer's returns for the current taxable year on the calendar year basis. Depreciation deduction in the amount of twenty-two thousand dollars was claimed on the building for its return for the current taxable year. The value of the building includable in the numerator and denominator of the property factor is six hundred thousand dollars as the depreciation deduction is not taken into account in determining the value of the building for purposes of the factor.

Example b: During the current taxable year, A corporation merges into Y corporation in a tax-free reorganization under the Internal Revenue Code. At the time of the merger, X corporation owns a factory which X built five years earlier at a cost of one million dollars. X has been depreciating the factory at the rate of two percent per year, and its basis in X's hands at the time of the merger is nine hundred thousand dollars. Since the property is acquired by Y in a transaction in which, under the Internal Revenue Code, its basis in Y's hands is the same as its basis in X's, Y includes the property in Y's property factor at X's original cost, without adjustment for depreciation, that is, one million dollars.

Example c: Corporation Y acquires the assets of corporation X in a liquidation by which Y is entitled to use its stock cost as the basis of the X assets under section 334(b) (2) of the Internal Revenue Code of 1954, that is, stock possessing eighty percent control is purchased and liquidated within two years. Under these circumstances, Y's cost of the assets is the purchase price of the X stock, prorated over the X assets. If original cost of property is unascertainable, the property is included in the factor at its fair market value as of the date of acquisition by the taxpayer.

2. Inventory of stock of goods shall be included in the factor in accordance with the valuation method used for federal income tax purposes.
3. Property acquired by gift or inheritance shall be included in the factor at its basis for determining depreciation for federal income tax purposes.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-11, 57-59-01 (art.IV(11))

**81-03-09-20. Property factor - Valuation of rented property.**

1. Property rented by the taxpayer is valued at eight times its net annual rental rate. The net annual rental rate for any item of rented property is the annual rental rate paid by the taxpayer

for such property, less the aggregate annual subrental rates paid by subtenants of the taxpayer. See sections 81-03-09-32, 81-03-09-33, and 81-03-09-34 for special sections where the use of such net annual rental rate produces a negative or clearly inaccurate value or where property is used by the taxpayer at no charge or rented at a nominal rental rate.

Subrents are not deducted when the subrents constitute business income because the property which produces the subrents 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.

Example a: The taxpayer receives subrents from a bakery concession in a food market operated by the taxpayer. Since the subrents are business income they are not deducted from rent paid by the taxpayer for the food market.

Example b: The taxpayer rents a five-story office building primarily for use in its multistate business, uses three floors for its offices and subleases two floors to various other businesses and persons such as professional people, shops, and the like. The rental of the two floors is incidental to the operation of the taxpayer's trade or business. Since the subrents are business income they are not deducted from the rent paid by the taxpayer.

Example c: The taxpayer rents a twenty-story office building and uses the lower two stories for its general corporation headquarters. The remaining eighteen floors are subleased to others. The rental of the eighteen floors is not incidental to but rather is separate from the operation of the taxpayer's trade or business. Since the subrents are nonbusiness income they are to be deducted from the rent paid by the taxpayer.

2. "Annual rental rate" is the amount paid as rental for property for a twelve-month period, that is, the amount of the annual rent. Where property is rented for less than a twelve-month period, the rent paid for the actual period of rental shall constitute the "annual rental rate" for the tax period. However, where a taxpayer has rented property for a term of twelve or more months and the current tax period covers a period of less than twelve months, due, for example, to a reorganization or change of accounting period, the rent paid for the short tax period shall be annualized. If the rental term is for less than twelve months, the rent shall not be annualized beyond its term. Rent shall not be annualized because of the uncertain duration when the rental term is on a month-to-month basis.

Example d: Taxpayer A which ordinarily files the taxpayer's return based on a calendar year is merged into taxpayer B on April thirtieth. The net rent paid under a lease with five years remaining is two thousand five hundred dollars a month. The rent for the tax period January first to April thirtieth is ten thousand dollars. After the rent is annualized, the net rent is thirty thousand dollars (two thousand five hundred dollars times twelve).

Example e: Same facts as in example a except that the lease would have terminated on August thirty-first. In this case, the annualized net rent is twenty thousand dollars (two thousand five hundred dollars times eight).

3. "Annual rent" is the actual sum of money or other consideration payable, directly or indirectly, by the taxpayer or for its benefit for the use of the property and includes:
  - a. Any amount payable for the use of real or tangible personal property, or any part thereof, whether designated as a fixed sum of money or as a percentage of sales, profits, or otherwise.

Example: A taxpayer, pursuant to the terms of a lease, pays a lessor one thousand dollars per month as a base rental and at the end of the year pays the lessor one percent of its gross sales of four hundred thousand dollars. The annual rent is sixteen thousand

dollars, twelve thousand dollars plus one percent of four hundred thousand dollars or four thousand dollars.

- b. Any amount payable as additional rent or in lieu of rents, such as interest, taxes, insurance, repairs, or any other items which are required to be paid by the terms of the lease or other arrangement, not including amounts paid as service charges, such as utilities, janitor services, and so forth. If a payment includes rent and other charges unsegregated, the amount of rent shall be determined by consideration of the relative values of the rent and the other items.

Example 1: A taxpayer, pursuant to the terms of the lease, pays the lessor twelve thousand dollars a year rent plus taxes in the amount of two thousand dollars and interest on a mortgage in the amount of one thousand dollars. The annual rent is fifteen thousand dollars.

Example 2: A taxpayer stores part of the taxpayer's inventory in a public warehouse. The total charge for the year was one thousand dollars of which seven hundred dollars was for the use of storage space and three hundred dollars for inventory insurance, handling and shipping charges, and cash on delivery collections. The annual rent is seven hundred dollars.

"Annual rent" does not include incidental day-to-day expenses such as hotel or motel accommodations, daily rental of automobiles, and so forth.

- 4. Leasehold improvements shall, for the purposes of the property factor, be treated as property owned by the taxpayer regardless of whether the taxpayer is entitled to remove the improvements or the improvements revert to the lessor upon expiration of the lease. Hence, the original cost of leasehold improvements shall be included in the factor.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-11, 57-59-01 (art.IV(11))

**81-03-09-21. Property factor - Averaging property values.**

As a general rule, the average value of property owned by the taxpayer shall be determined by averaging the values at the beginning and ending of the tax period. However, the tax commissioner may require or allow averaging by monthly values if such method of averaging is required to properly reflect the average value of the taxpayer's property for the tax period.

Averaging by monthly values will generally be applied if substantial fluctuations in the values of the property exist during the tax period or where property is acquired after the beginning of the tax period or disposed of before the end of the tax period.

Example: The monthly value of the taxpayer's property was as follows:

January	\$2,000.00	July	\$15,000.00
February	2,000.00	August	17,000.00
March	3,000.00	September	23,000.00
April	3,500.00	October	25,000.00
May	4,500.00	November	13,000.00
June	10,000.00	December	2,000.00
	<hr/>		<hr/>
	\$25,000.00		\$95,000.00
		Total	\$120,000.00

The average value of the taxpayer's property includable in the property factor for the income year is determined as follows:

\$120,000.00 divided by 12 = \$10,000.00

Averaging with respect to rented property is achieved automatically by the method of determining the net annual rental rate of such property as set forth in section 81-03-09-20.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-12, 57-59-01 (art.IV(12))

#### **81-03-09-21.1. Property factor - Intangible drilling costs.**

Intangible drilling and development costs incurred by oil and gas producing companies in connection with oil and gas properties must be included in the property factor. Intangible drilling and development costs include such elements as wages, fuel, repairs, hauling, draining, roadbuilding, surveying, geological works, construction of derricks, tanks, pipelines, and other physical structures necessary for the drilling of wells and their preparation for the production of oil and gas, and supplies incident to and necessary for the drilling of wells and clearing of ground.

The amount to be included in the property factor is the amount capitalized for financial reporting purposes using the successful effort accounting method. An election to expense intangible drilling costs for federal income tax purposes has no effect on their inclusion in the property factor.

Unproven properties must be included in the property factor until such time as they have been determined to be impaired and have been expensed for book purposes.

All costs relating to exploratory wells that have been capitalized and classified as uncompleted wells, equipment, and facilities (wells in progress or wells in process) must be included in the property factor until such time as the well is determined to be a dry hole and the costs have been expensed for book purposes.

Delay rentals, which are not capitalized for book purposes, are includable in the property factor at their net annual rental rate and are not capitalized times eight.

**History:** Effective July 1, 1985.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38-12, 57-38-13, 57-38-14, 57-38.1-02, 57-38.1-10, 57-38.1-11, 57-38.1-12, 57-59-01

#### **81-03-09-22. Payroll factor - In general.**

1. The payroll factor of the apportionment formula for each trade or business of the taxpayer shall include the total amount paid by the taxpayer in the regular course of its trade or business for compensation during the tax period.
2. The total amount "paid" to employees is determined upon the basis of the taxpayer's accounting method. If the taxpayer has adopted the accrual method of accounting, all compensation properly accrued shall be deemed to have been paid. Notwithstanding the taxpayer's method of accounting, at the election of the taxpayer, compensation paid to employees may be included in the payroll factor by use of the cash method if the taxpayer is required to report such compensation under such method for unemployment compensation purposes.

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

Example a: The taxpayer uses some of its employees in the construction of a storage building which, upon completion, is used in the regular course of taxpayer's trade or business. The wages paid to those employees are treated as a capital expenditure by the taxpayer. The amount of such wages is included in the payroll factor.

Example b: The taxpayer owns various securities which it holds as an investment separate and apart from its trade or business. The management of the taxpayer's investment portfolio is the only duty of Mr. X, an employee. The salary paid to Mr. X is excluded from the payroll factor.

3. The term "compensation" means gross wages, salaries, commissions, and any other form of remuneration paid directly to employees for personal services before deductions for deferred compensation plans, flexible spending plans, or any other deductions from the gross amounts as set forth in subsection 31 of North Dakota Century Code section 52-01-01. Payments made to an independent contractor or any other person not properly classifiable as an employee for unemployment compensation purposes are excluded. Amounts considered paid directly include the value of board, rent, housing, lodging, and other benefits or services furnished to employees by the taxpayer in return for personal services provided that such amounts constitute income to the recipient under the Internal Revenue Code. In the case of employees not subject to the Internal Revenue Code, that is, those employed in foreign countries, the determination of whether such benefits or services would constitute income to the employees shall be made as though such employees were subject to the Internal Revenue Code.
4. The term "employee" means any officer of a corporation, or any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. Generally, a person will be considered to be an employee if the person is included by the taxpayer as an employee for purposes of the payroll taxes imposed by the Federal Insurance Contribution Act, except that, since certain individuals are included with the term "employees" in the Federal Insurance Contribution Act who would not be employees under the usual common law rules, it may be established that a person who is included as an employee for purposes of the Federal Insurance Contribution Act is not an employee for purposes of this section.
5. In filing returns with this state, if the taxpayer departs from or modifies the treatment of compensation paid used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

If the returns or reports filed by the taxpayer with all states to which the taxpayer reports under article IV of the multistate tax compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the treatment of compensation paid, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

**History:** Amended effective June 1, 1992.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-13, 57-59-01 (art.IV(13))

#### **81-03-09-23. Payroll factor - Denominator.**

The denominator of the payroll factor is the total compensation paid everywhere during the tax period. Accordingly, compensation paid to employees whose services are performed entirely in a state where the taxpayer is immune from taxation, for example, by Public Law 86-272, is included in the denominator of the payroll factor.

Example: A taxpayer has employees in its state of legal domicile, state A, and is taxable in state B. In addition, the taxpayer has other employees whose services are performed entirely in state C where the taxpayer is immune from taxation by Public Law 86-272. As to these latter employees, the

compensation will be assigned to state C where their services are performed, that is, included in the denominator, but not the numerator, of the payroll factor, even though the taxpayer is not taxable in state C.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-13, 57-59-01 (art.IV(13))

**81-03-09-24. Payroll factor - Numerator.**

The numerator of the payroll factor is the total amount paid in this state during the tax period by the taxpayer for compensation. The tests in either North Dakota Century Code section 57-38.1-14 or article IV(14) of North Dakota Century Code section 57-59-01 to be applied in determining whether compensation is paid in this state are derived from the Model Unemployment Compensation Act. Accordingly, if compensation paid to employees is included in the payroll factor by use of the cash method of accounting or if the taxpayer is required to report such compensation under such method for unemployment compensation purposes, it shall be presumed that the total wages reported by the taxpayer to this state for unemployment compensation purposes constitutes compensation paid in this state except for compensation excluded under sections 81-03-09-22, 81-03-09-23, and 81-03-09-24. The presumption may be overcome by satisfactory evidence that an employee's compensation is not properly reportable to this state for unemployment compensation purposes.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-13, 57-59-01 (art.IV(13))

**81-03-09-25. Payroll factor - Compensation paid in this state.**

Compensation is paid in this state if any one of the following tests, applied consecutively, are met:

1. The employee's service is performed entirely within the state.
2. The employee's service is performed both within and without the state, but the service performed without the state is incidental to the employee's service within the state. The word "incidental" means any service which is temporary or transitory in nature, or which is rendered in connection with an isolated transaction.
3. If the employee's services are performed both within and without this state, the employee's compensation will be attributed to this state:
  - a. If the employee's base of operations is in this state; or
  - b. If there is no base of operations in any state in which some part of the service is performed, but the place from which the service is directed or controlled is in this state; or
  - c. If the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed but the employee's residence is in this state.

The term "base of operation" is the place of more or less permanent nature from which the employee starts the employee's work and to which the employee customarily returns in order to receive instructions from the taxpayer or communications from the employee's customers or other persons or to replenish stock or other materials, repair equipment, or perform any other functions necessary to the exercise of the employee's trade or profession at some other point or points. The term "place from which the service is directed or controlled" refers to the place from which the power to direct or control is exercised by the taxpayer.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-14, 57-59-01 (art.IV(14))

## **81-03-09-26. Sales factor - In general.**

1. Subsection 7 of North Dakota Century Code section 57-38.1-01 defines the term "sales" to mean all gross receipts of the taxpayer not allocated under North Dakota Century Code sections 57-38.1-04 through 57-38.1-08 and article IV(1)(g) of North Dakota Century Code section 57-59-01 defines the term "sales" to mean all gross receipts of the taxpayer not allocated under paragraphs 5 through 8 of article IV. Thus, for the purposes of the sales factor of the apportionment formula for each trade or business of the taxpayer, the term "sales" means all gross receipts derived by the taxpayer from transactions and activities in the regular course of such trade or business. The following are rules for determining "sales" in various situations.
  - a. In the case of a taxpayer engaged in manufacturing and selling or purchasing and reselling goods or products, "sales" 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" 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, research and development contracts, "sales" 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" 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" includes the gross receipts therefrom.
  - f. If a taxpayer derives receipts from the sale of equipment used in its business, such receipts constitute "sales". For example, a truck express company owns a fleet of trucks and sells its trucks under a regular replacement program. The gross receipts from the sale of the trucks are included in the sales factor.
2. In some cases, certain gross receipts should be disregarded in determining the sales factor in order that the apportionment formula will operate fairly to apportion to this state the income of the taxpayer's trade or business. See section 81-03-09-34.
3. In filing returns with this state, if the taxpayer departs from or modifies the basis for excluding or including gross receipts in the sales factor used in the returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

If the returns or reports filed by the taxpayer with all states to which the taxpayer reports under article IV of the multistate tax compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the inclusion or exclusion of gross receipts, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

**History:** Amended effective March 1, 1988.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-15, 57-59-01 (art.IV(15))

**81-03-09-27. Sales factor - Denominator.**

The denominator of the sales 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 section 81-03-09-34.

**History:** Amended effective March 1, 1988.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-15, 57-59-01 (art.IV(15))

**81-03-09-28. Sales factor - Numerator.**

The numerator of the sales 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.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-15, 57-59-01 (art.IV(15))

**81-03-09-29. Sales factor - Sales of tangible personal property in this state.**

1. Gross receipts from sales of tangible personal property, except sales to the United States government, see section 81-03-09-30, are in this state:
  - a. If the property is delivered or shipped to a purchaser within this state regardless of the free on board point or other conditions of sale; or
  - b. If the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and the taxpayer is not taxable in the state of the purchaser.
2. Property shall be deemed to be delivered or shipped to a purchaser within this state if the recipient is located in this state, even though the property is ordered from outside this state.

Example: The taxpayer, with inventory in state A, sold one hundred thousand dollars of its products to a purchaser having branch stores in several states including this state. The order for the purchase was placed by the purchaser's central purchasing department located in state B. Twenty-five thousand dollars of the purchase order was shipped directly to purchaser's branch store in this state. The branch store in this state is the "purchaser within this state" with respect to twenty-five thousand dollars of the taxpayer's sales.

3. Property is delivered or shipped to a purchaser within this state if the shipment terminates in this state, even though the property is subsequently transferred by the purchaser to another state.

Example: The taxpayer makes a sale to a purchaser who maintains a central warehouse in this state at which all merchandise purchases are received. The purchaser reships the goods to its branch stores in other states for sale. All of the taxpayer's products shipped to the purchaser's warehouse in this state is property "delivered or shipped to a purchaser within this state".



4. The term "purchaser within this state" shall include the ultimate recipient of the property if the taxpayer in this state, at the designation of the purchaser, delivers to or has the property shipped to the ultimate recipient within this state.

Example: A taxpayer in this state sold merchandise to a purchaser in state A. Taxpayer directed the manufacturer or supplier of the merchandise in state B to ship the merchandise to the purchaser's customer in this state pursuant to purchaser's instructions. The sale by the taxpayer is "in this state".

5. When property being shipped by a seller from the state of origin to a consignee in another state is diverted while en route to a purchaser in this state, the sales are in this state.

Example: The taxpayer, a produce grower in state A, begins shipment of perishable produce to the purchaser's place of business in state B. While en route, the produce is diverted to the purchaser's place of business in this state in which state the taxpayer is subject to tax. The sale by the taxpayer is attributed to this state.

6. If the taxpayer is not taxable in the state of the purchaser, the sale is attributed to this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state.

Example: The taxpayer has its head office and factory in state A. It maintains a branch office and inventory in this state. Taxpayer's only activity in state B is the solicitation of orders by a resident salesman. All orders by the state B salesman are sent to the branch office in this state for approval and are filled by shipment from the inventory in this state. Since taxpayer is immune under Public Law 86-272 from tax in state B, all sales of merchandise to purchasers in state B are attributed to this state, the state from which the merchandise was shipped.

7. If a taxpayer whose salesman 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. If the taxpayer is taxable in the state from which the third party ships the property, then the sale is in such state.
- b. If the taxpayer is not taxable in the state from which the property is shipped, then the sale is in this state.

Example: The taxpayer in this state sold merchandise to a purchaser in state A. Taxpayer is not taxable in state A. Upon direction of the taxpayer, the merchandise was shipped directly to the purchaser by the manufacturer in state B. If the taxpayer is taxable in state B, the sale is in state B. If the taxpayer is not taxable in state B, the sale is in this state.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-16, 57-59-01 (art.IV(16))

**81-03-09-30. Sales factor - Sales of tangible personal property to United States government in this state.**

Gross receipts from sales of tangible personal property to the United States government are in this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state. For the purposes of this section, only sales for which the United States government makes direct payment to the seller pursuant to the terms of a contract constitute sales to the United States government. Thus, as a general rule, sales by a subcontractor to a prime contractor, the party to the contract with the United States government, do not constitute sales to the United State government.

Example 1: A taxpayer contracts with general services administration to deliver X number of trucks which were paid for by the United States government. The sale is a sale to the United States government.

Example 2: The taxpayer as a subcontractor, to a prime contractor with the national aeronautics and space administration, contracts to build a component of a rocket for one million dollars. A sale by the subcontractor to the prime contractor is not a sale to the United States government.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-16, 57-59-01 (art.IV(16))

**81-03-09-31. Sales factor - Sales other than sales of tangible personal property in this state.**

1. **In general.** Both North Dakota Century Code section 57-38.1-17 and article IV(17) of North Dakota Century Code section 57-59-01 provide for the inclusion in the numerator of the sales 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. **Income-producing activity defined.** The term "income-producing activity" applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of obtaining gains or profits. Such activity does not include transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, income-producing activity includes, but is not limited to, the following:
  - a. The rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service.
  - b. The sale, rental, leasing, licensing, or other use of real property.
  - c. The rental, leasing, licensing, or other use of tangible personal property.
  - d. The sale, licensing, or other use of intangible personal property.

The mere holding of intangible personal property is not, of itself, an income-producing activity.

3. **Costs of performance defined.** The term "costs of performance" 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.
4. **Application.**
  - a. In general. Receipts, other than from sales of tangible personal property, in respect to a particular income-producing activity are in this state if:
    - (1) The income-producing activity is performed wholly within this state; or
    - (2) The income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

b. Special rules. The following are special rules for determining when receipts from the income-producing activities described below are in this state:

- (1) Gross receipts from the sale, lease, rental, or licensing of real property are in this state if the real property is located in this state.
- (2) Gross receipts from the rental, lease, or licensing of tangible personal property are in this state if the property is located in this state. The rental, lease, licensing, or other use of tangible personal property in this state is a separate income-producing activity from the rental, lease, licensing, or other use of the same property while located in another state; consequently, if property is within and without this state during the rental, lease, or licensing period, gross receipts attributable to this state shall be measured by the ratio which the time the property was physically present or was used in this state bears to the total time or use of the property everywhere during such period.

Example: Taxpayer is the owner of ten railroad cars. During the year, the total of the days each railroad car was present in this state was fifty days. The receipts attributable to the use of each of the railroad cars in this state are a separate item of income and shall be determined as follows:

$$\frac{(10 \times 50)}{365} \times \text{Total Receipts} = \text{Receipts attributable to this state}$$

c. Gross receipts for the performance of personal services are attributable to this state to the extent such services are performed in this state. If services relating to a single item of income are performed partly within and partly without the state, the gross receipts for the performance of such services shall be attributable to this state only if a greater portion of the services were performed in this state, based on costs of performance. Usually where services are performed partly within and partly without this state the services performed in each state will constitute a separate income-producing activity; in such case the gross receipts for the performance of services attributable to this state shall be measured by the ratio which the time spent in performing such services in this state bears to the total time spent in performing such services everywhere. Time spent in performing services includes the amount of time expended in the performance of a contract or other obligation which gives rise to such gross receipts. Personal service not directly connected with the performance of the contract or other obligation, as for example, time expended in negotiating the contract, is excluded from the computations.

Example 1: Taxpayer, a road show, gave theatrical performances at various locations in state X and in this state during the tax period. All gross receipts from performances given in this state are attributed to this state.

Example 2: The taxpayer, a public opinion survey corporation, conducted a poll by its employees in state X and in this state for the sum of nine thousand dollars. The project required six hundred man hours to obtain the basic data and prepare the survey report. Two hundred of the six hundred man hours were expended in this state. The receipts attributable to this state are three thousand dollars.

$$\frac{(200 \text{ man hours} \times \$9,000.00)}{600 \text{ man hours}}$$

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-17, 57-59-01 (art.IV(17))

### **81-03-09-32. Special rules - In general.**

Both North Dakota Century Code section 57-38.1-18 and article IV(18) of North Dakota Century Code section 57-59-01 provide that if the other allocation and apportionment provisions of either North Dakota Century Code chapter 57-38.1 or article IV of North Dakota Century Code chapter 57-59 do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the tax commissioner may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

1. Separate accounting;
2. The exclusion of any one or more of the factors;
3. The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or
4. The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

North Dakota Century Code section 58-38.1-18 and article IV(18) of North Dakota Century Code section 57-59-01 permit a departure from the other allocation and apportionment provisions of North Dakota Century Code chapters 57-38.1 and 57-59 only in limited and specific cases. North Dakota Century Code section 57-38.1-18 or article IV(18) of North Dakota Century Code section 57-59-01 may be invoked only in specific cases where unusual fact situations, which ordinarily will be unique and nonrecurring, produce incongruous results under the other apportionment and allocation provisions contained in North Dakota Century Code chapters 57-38.1 and 57-59.

In the case of certain industries such as air transportation, rail transportation, ship transportation, trucking, television, radio, motion pictures, and various types of professional athletics, the foregoing sections in respect to the apportionment formula do not set forth appropriate procedures for determining the apportionment factors.

Nothing in North Dakota Century Code section 57-38.1-18 and article IV(18) of North Dakota Century Code section 57-59-01 or in sections 81-03-09-32, 81-03-09-33, and 81-03-09-34 shall preclude the tax commissioner from establishing appropriate procedures under North Dakota Century Code sections 57-38.1-10 through 57-38.1-17 and article IV(10) through IV(17) of North Dakota Century Code section 57-59-01 for determining the apportionment factors for each such industry, but such procedures shall be applied uniformly.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-18, 57-59-01 (art.IV(18))

### **81-03-09-33. Special rules - Property factor.**

The following special subsections are established in respect to the property factor of the apportionment formula:

1. If the subrents taken into account in determining the net annual rental rate under section 81-03-09-20 produce a negative or clearly inaccurate value for any item of property, another method which will properly reflect the value of rented property may be required by the tax commissioner or requested by the taxpayer.

In no case, however, shall such value be less than an amount which bears the same ratio to the annual rental rate paid by the taxpayer for such property as the fair market value of that portion of the property used by the taxpayer bears to the total fair market value of the rented property.

Example: The taxpayer rents a ten-story building at an annual rental rate of one million dollars. Taxpayer occupies two stories and sublets eight stories for one million dollars a year. The net annual rental rate of the taxpayer must not be less than two-tenths of the taxpayer's annual rental rate for the entire year, or two hundred thousand dollars.

2. If property owned by others is used by the taxpayer at no charge or rented by the taxpayer for a nominal rate, the net annual rental rate for such property shall be determined on the basis of a reasonable market rental rate for such property.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-18, 57-59-01 (art.IV(18))

#### **81-03-09-34. Special rules - Sales factor.**

The following special subsections are established in respect to the sales factor of the apportionment formula:

1. Where substantial amounts of gross receipts arise from an incidental or occasional sale of a fixed asset used in the regular course of the taxpayer's trade or business, such gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory or plant will be excluded.
2. Insubstantial amounts of gross receipts arising from incidental or occasional transactions or activities may be excluded from the sales factor unless such exclusion would materially affect the amount of income apportioned to this state. For example, the taxpayer ordinarily may include or exclude from the sales factor gross receipts from such transactions as the sale of office furniture, business automobiles, and so forth.
3. Where the income-producing activity in respect to business income from intangible personal property can be readily identified, such income is included in the denominator of the sales factor and, if the income-producing activity occurs in this state, in the numerator of the sales 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 personal property, subdivision a of subsection 1 of section 81-03-09-26, and income from the sale, licensing, or other use of intangible personal property, subdivision d of subsection 2 of section 81-03-09-31.

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 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 factor.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-18, 57-59-01 (art.IV(18))

#### **81-03-09-35. Special rules - Railroads.**

The following special rules are established in respect to railroads:

1. **In general.** Where a railroad has income from sources both within and without this state, the amount of business income from sources within this state must be determined pursuant to this section. In such cases, the first step is to determine what portion of the railroad's income constitutes "business" income and which portion constitutes "nonbusiness" income under

North Dakota Century Code section 57-38.1-01 and article IV(1) of North Dakota Century Code section 57-59-01 and section 81-03-09-03. Nonbusiness income is directly allocable to specific states pursuant to the provisions of North Dakota Century Code sections 57-38.1-05 through 57-38.1-08 and article IV(5) to IV(8) of North Dakota Century Code section 57-59-01, inclusive. Business income is apportioned among the states in which the business is conducted pursuant to the property, payroll, and sales apportionment factors set forth in the regulation. The sum of the items of nonbusiness income directly allocated to this state, plus the amount of business income attributable to this state constitutes the amount of the taxpayer's entire net income which is subject to tax by this state.

2. **Business and nonbusiness income.** For definitions, rules, and examples for determining business and nonbusiness income, see sections 81-03-09-03 through 81-03-09-06.
3. **Apportionment of business income.**
  - a. In general. The property factor shall be determined in accordance with sections 81-03-09-15 through 81-03-09-21, inclusive, the payroll factor in accordance with sections 81-03-09-22 through 81-03-09-25, and the sales factor in accordance with sections 81-03-09-26 through 81-03-09-31, inclusive, except as modified in this regulation.
  - b. The property factor.
    - (1) Property valuation. Owned property shall be valued at its original cost and property rented from others shall be valued at eight times the net annual rental rate in accordance with North Dakota Century Code section 57-38.1-11 and article IV(11) of North Dakota Century Code section 57-59-01 and sections 81-03-09-19 and 81-03-09-20. Railroad cars owned and operated by other railroads and temporarily used by the taxpayer in its business and for which a per diem or mileage charge is made are not included in the property factor as rented property. Railroad cars owned and operated by the taxpayer and temporarily used by other railroads in their business and for which a per diem charge is made by the taxpayer are included in the property factor of the taxpayer.
    - (2) General definitions. The following definitions are applicable to the numerator and denominator of the property factor:
      - (a) "Original cost" is deemed to be 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 factor at its fair market value as of the date of acquisition by the taxpayer. Section 81-03-09-19.
      - (b) "Rent" does not include the per diem and mileage charges paid by the taxpayer for the temporary use of railroad cars owned or operated by another railroad.
      - (c) The "value" of owned real and tangible personal property shall mean its original cost. See North Dakota Century Code section 57-38.1-11 and article IV(11) of North Dakota Century Code section 57-59-01 and section 81-03-09-19.
      - (d) "Average value" of property means the amount determined by averaging the values at the beginning and ending of the income tax year, but the office of

state tax commissioner may require the averaging of monthly values during the income year or such averaging as necessary to effect properly the average value of the railroad's property. See North Dakota Century Code section 57-38.1-12 and article IV(12) of North Dakota Century Code section 57-59-01 and section 81-03-09-21.

- (e) The "value" of rented real and tangible personal property means the product of eight times the net annual rental rate. See North Dakota Century Code section 57-38.1-11 and article IV(11) of North Dakota Century Code section 57-59-01 and section 81-03-09-20.
  - (f) "Net annual rental rate" means the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.
  - (g) "Property used during the income year" includes property that is available for use in the taxpayer's trade or business during the income year.
  - (h) A "locomotive mile" is the movement of a locomotive (a self-propelled unit of equipment designed solely for moving other equipment) a distance of one mile [1.61 kilometers] under its own power.
  - (i) A "car mile" is a movement of a unit of car equipment a distance of one mile [1.61 kilometers].
- (3) The denominator and numerator of the property factor. The denominator of the property factor must be the average value of all of the taxpayer's real and tangible personal property owned or rented and used during the income year. The numerator of the property factor must be the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the income year.

In determining the numerator of the property factor, all property except mobile or movable property such as passenger cars, freight cars, locomotives, and freight containers which are located within and without this state during the income year must be included in the numerator of the property factor in accordance with North Dakota Century Code sections 57-38.1-10 through 57-38.1-12 and article IV(10)(11) (12) of North Dakota Century Code section 57-59-01, inclusive and sections 81-03-09-15 through 81-03-09-21, inclusive.

Mobile or movable property such as passenger cars, freight cars, locomotives, and freight containers which are located within and without this state during the income year must be included in the numerator of the property factor in the ratio which "locomotive miles" and "car miles" in the state bear to the total everywhere.

- c. The payroll factor. The denominator of the payroll factor is the total compensation paid everywhere by the taxpayer during the income year for the production of business income. See North Dakota Century Code sections 57-38.1-13 and 57-38.1-14 and article IV(13)(14) of North Dakota Century Code section 57-59-01 and sections 81-03-09-22 through 81-03-09-25. 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 must be included in the numerator as provided in North Dakota Century Code sections 57-38.1-13 and 57-38.1-14, and article IV(13)(14) of North Dakota Century Code section 57-59-01 and sections 81-03-09-22 through 81-03-09-25.

With respect to enginemen and trainmen performing services on interstate trains, compensation paid to such employees must 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 must 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.

d. The sales (revenue) factor.

- (1) In general. All revenue derived from transactions and activities in the regular course of the trade or business of the taxpayer which produces business income, except per diem and mileage charges which are collected by the taxpayer, is included in the denominator of the revenue factor. See North Dakota Century Code section 57-38.1-01 and article IV(1) of North Dakota Century Code section 57-59-01 and sections 81-03-09-03 through 81-03-09-06.

The numerator of the revenue 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 must be attributable to this state in accordance with North Dakota Century Code sections 57-38.1-15 through 57-38.1-17 and article IV(15)(16)(17) of North Dakota Century Code section 57-59-01 and sections 81-03-09-26 through 81-03-09-31.

- (2) Numerator of sales (revenue) factor from freight, mail, and express. The total revenue of the taxpayer in this state during the income year for the numerator of the revenue factor from hauling freight, mail, and express must be attributable to this state as follows:
  - (a) All receipts from shipments which both originate and terminate within this state.
  - (b) That portion of the receipts from each movement or shipment passing through, into, or out of this state is determined by the ratio which the miles traveled by such movement or shipment in this state bears to the total miles traveled by such movement or shipment from point of origin to destination.
- (3) Numerator of sales (revenue) factor from passengers. The numerator of the sales (revenue) factor must include:
  - (a) All receipts from the transportation of passengers (including mail and express handled in passenger service) which both originate and terminate within this state; and
  - (b) That portion of the receipts from the transportation of interstate passengers (including mail and express handled in passenger service) determined by the ratio which revenue passenger miles in this state bear to the total everywhere.

**History:** Effective July 1, 1985.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-01, 57-38.1-02, 57-38.1-05, 57-38.1-06, 57-38.1-07,

**81-03-09-36. Special rules - Airlines.**

The following special rules are established with respect to airlines:

1. **In general.** Where an airline has income from sources both within and without this state, the amount of business income from sources within this state shall be determined pursuant to



North Dakota Century Code chapter 57-38.1 and article IV of North Dakota Century Code section 57-59-01 of the multistate tax compact, except as modified by this section.

**2. Apportionment of business income.**

a. General definitions. The following definitions are applicable to the terms used in the apportionment factor descriptions:

- (1) "Value" of owned real and tangible personal property means its original cost. See North Dakota Century Code section 57-38.1-11 and article IV(11) of North Dakota Century Code section 57-59-01 and section 81-03-09-19.
- (2) "Cost of aircraft by type" means the average original cost or value of aircraft by type which are ready for flight.
- (3) "Original cost" means the initial federal tax basis of the property plus the value of capital improvements to such property, except that, for this purpose, it must be assumed that safe harbor leases are not true leases and do not effect the original initial federal tax basis of the property. See section 81-03-09-19.
- (4) "Average value" of property means the amount determined by averaging the values at the beginning and ending of the income year, but the office of the state tax commissioner may require the averaging of monthly values during the income year if such averaging is necessary to reflect properly the average value of the airline's property. See North Dakota Century Code section 57-38.1-12 and article IV(12) of North Dakota Century Code section 57-59-01 and section 81-03-09-21.
- (5) The "value" of rented real and tangible personal property means the product of eight times the net annual rental rate. See North Dakota Century Code section 57-38.1-11 and article IV(11) of North Dakota Century Code section 57-59-01 and section 81-03-09-20.
- (6) "Net annual rental rate" means the annual rental rate paid by the taxpayer.
- (7) "Property used during the income year" includes property that is available for use in the taxpayer's trade or business during the income year.
- (8) "Aircraft ready for flight" means aircraft owned or acquired through rental or lease (but not interchange) which are in the possession of the taxpayer and are available for service on the taxpayer routes.
- (9) "Revenue service" means the use of aircraft ready for flight for the production of revenue.
- (10) "Transportation revenue" means revenue earned by transporting passengers, freight, and mail, as well as revenue earned from liquor sales, and pet crate rentals, and so forth.
- (11) "Departures" means, for purposes of this section, all takeoffs, whether they be regularly scheduled or charter flights, that occur during revenue service.

b. Property factor.

- (1) Property valuation. Owned aircraft must be valued at its original cost and rented aircraft must be valued at eight times the net annual rental rate in accordance with North Dakota Century Code section 57-38.1-11 and article IV(11) of North Dakota Century Code section 57-59-01 and sections 81-03-09-19 and 81-03-09-20. The

use of the taxpayer's owned or rented aircraft in an interchange program with another air carrier will not constitute a rental of such aircraft by the airline to the other participating airline. Such aircraft must be accounted for in the property factor of the owner. Parts and other expendables, including parts for use in contract overhaul work, will be valued at cost.

- (2) The denominator and numerator of the property factor. The denominator of the property factor must be the average value of all of the taxpayer's real and tangible personal property owned or rented and used during the income year. The numerator of the property factor must be the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the income year.

In determining the numerator of the property factor, all property except aircraft ready for flight must be included in the numerator of the property factor in accordance with North Dakota Century Code sections 57-38.1-10 through 57-38.1-12 and article IV(10)(11)(12) of North Dakota Century Code section 57-59-01, inclusive. Aircraft ready for flight must be included in the numerator of the property factor in the ratio calculated as follows: Departures of aircraft from locations in this state weighted as to the cost and value of aircraft by type compared to total departures similarly weighted.

- c. The payroll factor. The denominator of the payroll factor is the total compensation paid everywhere by the taxpayer during the income year. The numerator of the payroll factor is the total amount paid in this state during the income year by the taxpayer for compensation. See North Dakota Century Code sections 57-38.1-13 and 57-38.1-14 and article IV(13)(14) of North Dakota Century Code section 57-59-01. With respect to nonflight personnel, compensation paid to such employees must be included in the numerator as provided in North Dakota Century Code sections 57-38.1-13 and 57-38.1-14 and article IV(13)(14) of North Dakota Century Code section 57-59-01. With respect to flight personnel (the air crew aboard an aircraft assisting in the operations of the aircraft or the welfare of passengers while in the air), compensation paid to such employees must be included in the ratio that departures of aircraft from locations in this state, weighted as to the cost and value of aircraft by type compared to total departures similarly weighted, multiplied by the total flight personnel compensation.
- d. Sales (transportation revenue) factor. 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, and so forth, are included in the denominator of the revenue factor. See North Dakota Century Code section 57-38.1-01 and article IV(1) of North Dakota Century Code section 57-59-01 and sections 81-03-09-03 through 81-03-09-06. Passive income items such as interest, rental income, dividends, and so forth, will not be included in the denominator nor will the proceeds or net gains or losses from the sale of aircraft be included. The numerator of the revenue 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: The ratio of departures of aircraft in this state weighted as to the cost and value of aircraft by type, as compared to total departures similarly weighted multiplied by the total transportation revenue. The product of this calculation is to be added to any nonflight revenues directly attributable to this state.
3. **Records.** The taxpayer must maintain the records necessary to arrive at departures by type of aircraft as used in these regulations. Such records are to be subject to review by the respective state taxing authorities or their agents.

**History:** Effective July 1, 1985.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38.1-01, 57-38.1-02, 57-38.1-09, 57-38.1-10, 57-38.1-11,

**81-03-09-37. Special rules - Trucking companies.**

The following special rules are established with respect to trucking companies:

1. **In general.** As used in this section, the term "trucking company" means a motor common carrier, a motor contract carrier, or an express carrier which primarily transports tangible personal property of others by motor vehicle for compensation. Where a trucking company has income from sources both within and without this state, the amount of business income from sources within this state shall be determined pursuant to this section. In such cases, the first step is to determine what portion of the trucking company's income constitutes business income and what portion constitutes nonbusiness under North Dakota Century Code section 57-38.1-01 and article IV(1) of North Dakota Century Code section 57-59-01 and section 81-03-09-03. Nonbusiness income is directly allocable to specific states pursuant to the provisions of North Dakota Century Code sections 57-38.1-05 through 57-38.1-08 and article IV(5) through IV(8) of North Dakota Century Code section 57-59-01. Business income is apportioned among the states in which the business is conducted and pursuant to the property, payroll, and sales apportionment factors set forth in this section. The sum of the items of nonbusiness income directly allocated to this state plus the amount of business income attributable to the state constitutes the amount of the taxpayer's entire net income which is subject to taxing in this state.
2. **Business and nonbusiness income.** For definitions, rules, and examples for determining business and nonbusiness income, see sections 81-03-09-03 through 81-03-09-06.
3. **Apportionment of business income.**
  - a. In general. The property factor must be determined in accordance with sections 81-03-09-15 through 81-03-09-21, the payroll factor in accordance with sections 81-03-09-22 through 81-03-09-25, and the sales factor in accordance with sections 81-03-09-26 through 81-03-09-31, except as modified by this section.
    - (1) Property valuation. Owned property must be valued at its original cost and property rented from others must be valued at eight times the net annual rental rate in accordance with North Dakota Century Code section 57-38.1-11 and article IV(11) of North Dakota Century Code section 57-59-01 and sections 81-03-09-19 and 81-03-09-20.
    - (2) General definitions. The following definitions are applicable to the numerator and denominator of the property factor, as well as other apportionment factor descriptions:
      - (a) "Average value" of property means the amount determined by averaging the values at the beginning and end of the income tax year, but the tax commissioner may require the averaging of monthly values during the income year or such averaging as is necessary to reflect properly the average value of the trucking company's property, in accordance with North Dakota Century Code section 57-38.1-12 and article IV(12) of North Dakota Century Code section 57-59-01 and section 81-03-09-21.
      - (b) "Mobile property" means all motor vehicles, including trailers, engaged directly in the movement of tangible personal property.
      - (c) "Mobile property mile" is the movement of a unit of mobile property a distance of one mile whether loaded or unloaded.

- (d) "Original cost" is deemed to be 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 ascertainable under the foregoing valuation standards, the property is included in the property factor at its fair market value as of the date of acquisition by the taxpayer in accordance with section 81-03-09-19.
  - (e) "Property used during the course of the income year" includes property which is available for use in the taxpayer's trade or business during the income year.
  - (f) "Purchased transportation" means the taxpayer's use of a motor vehicle owned and operated by another for the purpose of transporting tangible personal property for which a charge, whether based upon a per diem, mileage, or other basis is incurred.
  - (g) The "value" of owned real and tangible personal property means its original cost, in accordance with North Dakota Century Code section 57-38.1-11 and article IV(11) of North Dakota Century Code section 57-59-01 and section 81-03-09-19.
  - (h) The "value" of rented real and tangible personal property means the product of eight times the net annual rental rate, in accordance with North Dakota Century Code section 57-38.1-11 and article IV(11) of North Dakota Century Code section 57-59-01 and section 81-03-09-20.
- (3) The denominator and numerator of the property factor. The denominator of the property factor must be the average value of all the taxpayer's real and tangible personal property owned or rented and used during the income year. The numerator of the property factor must be the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the income year. In the determination of the numerator of the property factor, all property, except mobile property as defined in this section, must be included in the numerator of the property factor in accordance with North Dakota Century Code sections 57-38.1-10 through 57-38.1-12 and article IV(10)(11)(12) of North Dakota Century Code section 57-59-01 and sections 81-03-09-15 through 81-03-09-21.

Mobile property, as defined in this section, which is located within and without this state during the income year must be included in the numerator of the property factor in the ratio which mobile property miles in the state bear to the total mobile property miles. Mobile property located solely within this state during the income year must be included in the numerator of the property factor. A trucking company's property factor may be modified to include a portion of purchased transportation to more fairly represent the company's in-state activities. Absent clear and convincing evidence to show otherwise, forty percent of the purchased transportation contract must be included in the property factor as rental property and capitalized in accordance with section 81-03-09-20. In addition, the mileage related to the purchased transportation contract must be included in the mobile property miles.

- b. The payroll factor. The denominator of the payroll factor is the compensation paid everywhere by the taxpayer during the income year for the production of business income, in accordance with North Dakota Century Code sections 57-38.1-13 and 57-38.1-14 and article IV(13)(14) of North Dakota Century Code section 57-59-01 and sections 81-03-09-22 through 81-03-09-25.

With respect to personnel performing services within and without this state, compensation paid to such employees must 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 based on mobile property miles.

c. The sales factor.

- (1) In general. All revenue derived from transactions and activities in the regular course of the taxpayer's trade or business which produce business income must be included in the denominator of the revenue factor, in accordance with North Dakota Century Code section 57-38.1-01 and article IV(1) of North Dakota Century Code section 57-59-01 and sections 81-03-09-03 through 81-03-09-06.

The numerator of the revenue 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 North Dakota Century Code sections 57-38.1-15 through 57-38.1-17 and article IV(15)(16)(17) of North Dakota Century Code section 57-59-01 and sections 81-03-09-26 through 81-03-09-31.

- (2) The total revenue of the taxpayer attributable to this state during the income year from hauling freight, mail, and express shall be:
  - (a) Intrastate. All receipts from any shipment which both originates and terminates within this state.
  - (b) Interstate. That portion of the receipts from movements or shipments passing through, into, or out of this state as determined by the ratio which the mobile property miles traveled by such movements or shipments in this state bear to the total mobile property miles traveled by movements or shipments from points of origin to destination.

d. Records. The taxpayer shall maintain the records necessary to identify mobile property and to enumerate by state the mobile property miles traveled by such mobile property as those terms are used in this section. Such records are subject to review by the tax department or its agents.

e. De minimus nexus standard. Notwithstanding any provision contained herein, this section does not apply to require the apportionment of income to this state if the trucking company during the course of the income tax year neither:

- (1) Owns nor rents any real or personal property in this state, except mobile property.
- (2) Makes any pickups or deliveries within this state.
- (3) Travels more than twenty-five thousand mobile property miles within this state provided that the total mobile property miles traveled within this state during the income tax year does not exceed three percent of the total mobile property miles traveled in all states by the trucking company during that period.
- (4) Makes more than twelve trips into this state.

**History:** Effective November 1, 1987; amended effective May 1, 1991.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38, 57-38.1, 57-59

### **81-03-09-38. Special rules - Television and radio broadcasting.**

The following special rules are established in respect to the apportionment of income from television and radio broadcasting by a broadcaster that is taxable both in this state and in one or more other states.

1. **In general.** 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 without this state, the amount of business income from sources within this state must be determined pursuant to North Dakota Century Code chapter 57-38.1 and article IV of North Dakota Century Code section 57-59-01, and the regulations issued thereunder by this state, except as modified by this section. This section also applies to telecasting by cable television systems.
2. **Business and nonbusiness income.** For definitions and regulations for determining whether income must be classified as business or nonbusiness income, see sections 81-03-09-03 through 81-03-09-05.
3. **Definitions.** The following definitions are applicable to the terms contained in this section, unless, the context clearly requires otherwise:
  - a. "Film" or "film programming" means any and all performances, events, or productions telecast on television, including, but not limited to, news, sporting events, plays, stories, or other literary, commercial, educational, or artistic works, through the use of a videotape, disc, or any other type of format or medium. Each episode of a series of films produced for television constitutes a separate "film" notwithstanding that the series relates to the same principal subject and is produced during one or more tax periods.
  - b. "Outer-jurisdictional" property means certain types of tangible personal property, such as orbiting satellites, undersea transmission cables, and the like, that are owned or rented by the taxpayer and used in the business of telecasting or broadcasting, but which are not physically located in any particular state.
  - c. "Radio" or "radio programming" means any and all performances, events, or productions broadcast on radio, including, but not limited to, news, sporting events, plays, stories, or other literary, commercial, educational, or artistic works, through the use of an audiotape, disc, or any other format or medium. Each episode of a series of radio programming produced for radio broadcast constitutes a separate "radio programming" notwithstanding that the series relates to the same principal subject and is produced during one or more tax periods.
  - d. "Release" or "in release" means the placing of film or radio programming into service. A film or radio program is placed into service when it is first broadcast to the primary audience for which the program was created. Thus, for example, a film is placed into service when it is first publicly telecast for entertainment, educational, commercial, artistic, or other purpose. Each episode of a television or radio series is placed in service when it is first broadcast. A program is not placed in service merely because it is completed and therefore in a condition or state of readiness and availability for broadcast or, merely because it is previewed to prospective sponsors or purchasers.
  - e. "Rent" includes license fees or other payments or consideration provided in exchange for the broadcast or other use of television or radio programming.

- f. "Subscriber" to a television system is the individual residence or other outlet which is the ultimate recipient of the transmission.
  - g. "Telecast" or "broadcast", (sometimes used interchangeably with respect to television), means the transmission of television or radio programming, respectively, by an electronic or other signal conducted by radiowaves or microwaves or by wires, lines, coaxial cables, wave guides, fiber optics, satellite transmissions directly or indirectly to viewers and listeners or by any other means of communications.
4. **Apportionment of business income.** The property factor must be determined in accordance with North Dakota Century Code sections 57-38.1-10 through 57-38.1-12, subsections 10, 11, and 12 of article IV of North Dakota Century Code section 57-59-01, and sections 81-03-09-15 through 81-03-09-21. The payroll factor must be determined in accordance with North Dakota Century Code sections 57-38.1-13, 57-38.1-14, subsections 13 and 14 of article IV of North Dakota Century Code section 57-59-01, and sections 81-03-09-22 through 81-03-09-25. The sales factor must be determined in accordance with North Dakota Century Code sections 57-38.1-01, 57-38.1-15, 57-38.1-16, subsections 15 and 16 of article IV of North Dakota Century Code section 57-59-01, and sections 81-03-09-26 through 81-03-09-30, except as modified by this section.
5. **Property factor - In general.**
- a. In the case of rented studios, the net annual rental rate includes only the amount of the basic or flat rental charge by the studio for the use of a stage or other permanent equipment such as sound recording equipment and the like, except that additional equipment rented from other sources or from the studio not covered in the basic or flat rental charge and used for one week or longer, even though rented on a day-to-day basis, must be included. Lump-sum net rental payments for a period which encompasses more than a single income year must be assigned ratably over the rental period.
  - b. No value or cost attributable to any outer-jurisdictional film or radio programming property may be included in the property factor at any time.
6. **Property factor denominator.**
- a. All real property and tangible personal property, other than outer-jurisdictional and film or radio programming property, whether owned or rented, which is used in the business must be included in the denominator of the property factor.
  - b. Audio or video cassettes, discs, or similar medium containing film or radio programming and intended for sale or rental by the taxpayer for home viewing or listening must be included in the property factor at their original cost. To the extent that the taxpayer licenses or otherwise permits others to manufacture or distribute such cassettes, discs, or other medium containing film or radio programming for home viewing or listening, the value of said cassettes, discs, or other medium must include the license, royalty, or other fees received by the taxpayer capitalized at a rate of eight times the gross receipts derived therefrom during the income year.
  - c. Outer-jurisdictional, film and radio programming property must be excluded from the denominator of the property factor.
7. **Property factor numerator.**
- a. With the exception of outer-jurisdictional, film and radio programming property, all real and tangible personal property owned or rented by the taxpayer and used in this state during the tax period must be included in the numerator of the property factor.

- b. Outer-jurisdictional, film and radio programming property must be excluded from the numerator of the property factor.

Example: XYZ Television Company has a total value of all of its property everywhere of five hundred million dollars, including a satellite valued at fifty million dollars that was used to telecast programming into this state and one hundred fifty million dollars in film property of which one million dollars' worth was located in this state the entire tax year. The total value of real and tangible personal property other than film programming property, located in this state for the entire income year was valued at two million dollars, and the moveable and mobile property described in subdivision a was determined to be of a value of four million dollars and such moveable and mobile property was used in this state for one hundred days. The total value of property to be attributed to this state would be determined as follows:

Value of property permanently in state:	\$2,000,000
Mobile and moveable property:	\$1,095,600
(100/365 x \$4,000,000):	
Total value of property to be included in the state's property factor numerator without apportionment of outer-jurisdictional and film property	\$3,095,600
Total value of property to be used in the denominator (\$500,000,000-\$200,000,000)	\$300,000,000
Total property factor percent	.0103
(\$3,095,600/\$300,000,000):	

- 8. **Payroll factor denominator.** The denominator of the payroll factor must include all compensation, including residual and profit participation payments, paid to employees during the income year, including that paid to directors, actors, newscasters, and other talent in their status as employees.
- 9. **Payroll factor numerator.** Compensation for all employees must be attributed to the state or states as may be determined by the application of the provisions of North Dakota Century Code sections 57-38.1-13, 57-38.1-14, subsections 13 and 14 of article IV of North Dakota Century Code section 57-59-01, and sections 81-03-09-22 through 81-03-09-25.
- 10. **Sales factor denominator.** The denominator of the sales factor must 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 subsection 2.
- 11. **Sales factor numerator.** The numerator of the sales factor must include all gross receipts of the taxpayer from sources within this state, including the following:
  - a. Gross receipts, including advertising revenue, from live television, film or radio programming in release to or by television and radio stations located in this state.
  - b. Gross receipts, including advertising revenue, from television film or radio programming in release to or by a television or radio station, independent or unaffiliated, or network of stations for broadcast must be attributed to this state in the ratio, hereafter "audience factor" that the audience for such station, or owned and affiliated stations in the case of



networks, located in this state bears to the total audience for such station, or owned and affiliated stations in the case of networks.

- c. The audience factor for television or radio programming must be determined by the ratio that the taxpayer's in-state viewing and listening audience bears to its total viewing and listening audience. Such audience factor must be determined either by reference to the books and records of the taxpayer or by reference to published rating statistics provided the method used by the taxpayer is consistently used from year to year for such purpose and fairly represents the taxpayer's activity in the state.
- d. Gross receipts from film programming in release to or by a cable television system must be attributed to this state in the ratio, hereafter "audience factor", that the subscribers for such cable television system located in this state bears to the total subscribers of such cable television system. If the number of subscribers cannot be accurately determined from the books and records maintained by the taxpayer, such audience factor ratio must be determined on the basis of the applicable year's subscription statistics located in published surveys, provided that the source selected is consistently used from year to year for that purpose.
- e. Receipts from the sale, rental, licensing, or other disposition of audio or video cassettes, discs, or similar medium intended for home viewing or listening must be included in the sales factor as provided in North Dakota Century Code section 57-38.1-16, subsection 16 of article IV of North Dakota Century Code section 57-59-01, and section 81-03-09-29.

**History:** Effective June 1, 1992; amended effective September 1, 1997.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38, 57-38.1, 57-59

#### **81-03-09-39. Special rules - Publishing.**

The following special rules are established with respect to the apportionment of income derived from the publishing, sale, licensing, or other distribution of books, newspapers, magazines, periodicals, trade journals, or other printed material.

1. **In general.** 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 without this state, the amount of business income from sources within this state from such business activity must be determined under North Dakota Century Code chapter 57-38.1 and the rules adopted under that chapter.
2. **Definitions.** The following definitions are applicable to the terms contained in this rule, unless the context clearly requires otherwise.
  - a. "Outer-jurisdictional property" means certain types of tangible personal property, such as orbiting satellites, undersea transmission cables, and the like, that are owned or rented by the taxpayer and used in the business of publishing, licensing, selling, or otherwise distributing printed material, but which are not physically located in any particular state.
  - b. "Print or printed material" includes the physical embodiment or printed version of any thought or expression including a play, story, article, column, or other literary, commercial, educational, artistic, or other written or printed work. The determination of whether an item is or consists of print or printed material must be made without regard to its content. Printed material may take the form of a book, newspaper, magazine,

periodical, trade journal, or any other form of printed matter and may be contained on any medium or property.

- c. "Purchaser" and "subscriber" mean the individual, residence, business, or other outlet that is the ultimate or final recipient of the print or printed material. Neither of such terms means or includes a wholesaler or other distributor of print or printed material.
- d. "Terrestrial facility" includes any telephone line, cable, fiber optic, microwave, earth station, satellite dish, antennae, or other relay system or device that is used to receive, transmit, relay, or carry any data, voice, image, or other information that is transmitted from or by any outer-jurisdictional property to the ultimate recipient thereof.

3. **Apportionment of business income.**

a. The property factor.

(1) Property factor denominator. All real and tangible personal property, including outer-jurisdictional property, whether owned or rented, which is used in the business must be included in the denominator of the property factor.

(2) Property factor numerator. All real and tangible personal property owned or rented by the taxpayer and used in this state during the tax period must be included in the numerator of the property factor.

- (a) Outer-jurisdictional property owned or rented by the taxpayer and used in this state during the tax period must be included in the numerator of the property factor in the ratio that the value of such property which is attributable to its use by the taxpayer in business activities in this state bears to the total value of such property which is attributable to its use in the taxpayer's business activities everywhere.

The value of outer-jurisdictional property to be attributed to the numerator of the property factor of this state must be determined by the ratio that the number of uplinks and downlinks, sometimes referred to as "half-circuits", that were used during the tax period to transmit from this state and to receive in this state any data, voice, image, or other information bears to the total number of uplinks and downlinks or half-circuits that the taxpayer used for transmissions everywhere.

Should information regarding such uplink and downlink or half-circuit usage not be available or should such measurement of activity not be applicable to the type of outer-jurisdictional property used by the taxpayer, the value of such property to be attributed to the numerator of the property factor of this state must be determined by the ratio that the amount of time (in terms of hours and minutes of use) or such other measurement of use of outer-jurisdictional property that was used during the tax period to transmit from this state and to receive in this state any data, voice, image, or other information bears to the total amount of time or other measurement of use that was used for transmissions everywhere.

- (b) Outer-jurisdictional property must be considered to have been used by the taxpayer in its business activities within this state when such property, wherever located, has been employed by the taxpayer in any manner in the publishing, sale, licensing, or other distribution of books, newspapers, magazines, or other printed material and any data, voice, image, or other

information is transmitted to or from this state either through an earth station or terrestrial facility located in this state.

Example: One example of the use of outer-jurisdictional property is where the taxpayer either owns its own communications satellite or leases the use of uplinks, downlinks, or circuits or time on a communications satellite for the purpose of sending messages to its newspaper printing facilities or employees in a state. The state or states in which any printing facility that receives the satellite communications is located and the state from which the communications were sent would, under this rule, apportion the cost of the owned or rented satellite to their respective property factors based upon the ratio of the instate use of said satellite to its total usage everywhere.

Assume that ABC Newspaper Co. owns a total of four hundred million dollars of property everywhere and that, in addition, it owns and operates a communication satellite for the purpose of sending news articles to its printing plant in this state, as well as for communicating with its printing plants and facilities or news bureaus, employees, and agents located in other states and throughout the world. Also assume that the total value of its real and tangible personal property that was permanently located in this state for the entire income year was valued at three million dollars. Assume also that the total original cost of the satellite is one hundred million dollars for the tax period and that of the ten thousand uplinks and downlinks of satellite transmissions used by the taxpayer during the tax period, two hundred or two percent are attributable to its satellite communications received in and sent from this state. Assume further that the company's mobile property that was used partially within this state, consisting of forty delivery trucks, were determined to have an original cost of four million dollars and such mobile property was used in this state for ninety-five days.

The total value of property to be attributed to this state would be determined as follows:

Value of property permanently in state	\$3,000,000
Value of mobile property: $95/365$ or $(.2602) \times \$4,000,000$ :	\$1,048,000
Value of leased satellite property used instate $(.02) \times \$100,000,000$ :	\$2,000,000
Total value of property attributable to state:	\$6,048,000
Total property factor percent: $\$6,048,000/(\$500,000,000)$ :	.01209

- b. The payroll factor. The payroll factor must be determined in accordance with North Dakota Century Code chapter 57-38.1 and the rules adopted under that chapter.
- c. The sales factor.
  - (1) Sales factor denominator. The denominator of the sales factor must 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 North Dakota Century Code sections 57-38.1-15, 57-38.1-16, 57-38.1-17, and 57-38.1-18 and the rules adopted under those sections.

- (2) Sales factor numerator. The numerator of the sales factor must include all gross receipts of the taxpayer from sources within this state, including the following:
- (a) Gross receipts derived from the sale of tangible personal property, including printed materials, delivered or shipped to a purchaser or a subscriber in this state.
  - (b) Except as provided in subparagraph c, gross receipts derived from advertising and the sale, rental, or other use of the taxpayer's customer lists or any portion thereof must be attributed to this state as determined by the taxpayer's "circulation factor" during the tax period. The circulation factor must be determined for each individual publication by the taxpayer of printed material containing advertising and must be equal to the ratio that the taxpayer's in-state circulation to purchasers and subscribers of its printed material bears to its total circulation to purchasers and subscribers everywhere.  
  
The circulation factor for an individual publication must be determined by reference to the rating statistics as reflected in such sources as audit bureau of circulations or other comparable sources, provided that the source selected is consistently used from year to year for such purpose. If none of the foregoing sources are available, or, if available, none is in form or content sufficient for such purposes, then the circulation factor must be determined from the taxpayer's books and records.
  - (c) 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 this state is located, the taxpayer may petition, or the tax commissioner may require, that a portion of such receipts be attributed to the sales factor numerator of this state on the basis of a regional or local geographic area circulation factor and not upon the basis of the circulation factor provided by subparagraph b. Such attribution must be based upon the ratio that the taxpayer's circulation to purchasers and subscribers located in this state 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 is permitted only upon the condition that such receipts are not double counted or otherwise included in the numerator of any other state.
  - (d) If the purchaser or subscriber is the United States government or the taxpayer is not taxable in a state, the gross receipts from all sources, including the receipts from the sale of printed material, from advertising, and from 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 factor for such state, must be included in the numerator of the sales factor of this state if the printed material or other property is shipped from an office, store, warehouse, factory, or other place of storage or business in this state.

**History:** Effective April 1, 1995.

**General Authority:** NDCC 57-38-56

**Law Implemented:** NDCC 57-38, 57-38.1, 57-59