

TITLE 17 – DEPARTMENT OF REVENUE

Notice is hereby given in accordance with G.S. 150B-21.2 that the Department of Revenue intends to adopt the rules cited as 17 NCAC 05G .0101, .0102, .0201, .0301 - .0303, .0401, .0402, .0501 - .0505, .0601, .0701, .0801 - .0803, .0901 - .0905, .1001 - .1006, .1101 - .1105, .1201, .1301 - .1303.

Link to agency website pursuant to G.S. 150B-19.1(c): www.dor.state.nc.us

Proposed Effective Date: See S.L. 2016-94, s. 38.4(b)

Public Hearing:

Date: October 31, 2016

Time: 10:00 a.m.

Location: NC Dept of Revenue, Room 135, 501 N Wilmington St, Raleigh, NC 27604

Reason for Proposed Action: *The General Assembly enacted SL 2016-94 (H.B. 1030) which requires the Department of Revenue to adopt rules interpreting the substantive provision of G.S. 105-130.4(1) concerning the application of market-based sourcing of receipts for purposes of the sales factor.*

Comments may be submitted to: Lennie Collins, P.O. Box 871, Raleigh, NC 27602, phone 919-814-1163, fax 919-733-1821, email Lennie.collins@ncdor.gov

Comment period ends: January 3, 2017

Fiscal impact (check all that apply).

- State funds affected
- Environmental permitting of DOT affected
Analysis submitted to Board of Transportation
- Local funds affected
- Substantial economic impact (≥\$1,000,000)
- Approved by OSBM
- No fiscal note required by S.L. 2016-94, s. 38.4.(a)

CHAPTER 05 - CORPORATE FRANCHISE, INCOME, AND INSURANCE TAXES

SUBCHAPTER 05G – MARKET-BASED SOURCING FOR APPORTIONMENT OF INCOME

SECTION .0100 – GENERAL RULES

17 NCAC 05G .0101 SCOPE

The rules in this Subchapter do not apply to receipts from the sale of tangible personal property. Other receipts are in North Carolina when the taxpayer's market for the sales is in North Carolina. The rules of this Subchapter establish uniform rules for:

- (1) determining to what extent the market for a sale is in North Carolina;
- (2) reasonably approximating the state or states of assignment where the state or states cannot be determined;
- (3) excluding receipts from the sale of intangible property from the numerator and denominator of the sales factor pursuant to G.S. 105-130.4(1); and
- (4) excluding receipts from the denominator of the sales factor where the state or states of assignment cannot be determined or reasonably approximated.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .0102 DEFINITIONS

As used in this Subchapter, the following definitions shall apply:

- (1) "Billing address" means the location stated in the books and records of the taxpayer as the primary mailing address relating to a customer's account as of the time of the transaction as kept in good faith in the regular course of business and not for tax avoidance purposes.
- (2) "Business customer" means a customer that is a business operating in any form, including a sole proprietorship. Sales to a non-profit organization; a trust; the U.S. Government; a foreign, state or local government; or to an agency or instrumentality of that government are treated as sales to a business customer.
- (3) "Code" means as defined in G.S. 105-228.90.
- (4) "Department" means the North Carolina Department of Revenue.
- (5) "Good faith" means a state of mind consisting in honesty in belief or purpose, faithfulness to one's duty or obligation, observance of reasonable commercial standards of fair dealing in a given trade or business, or absence of intent to defraud or to seek unconscionable advantage.

- (6) "Individual customer" means a customer that is not a business customer.
- (7) "Intangible property" means property that is not physical or whose representation by physical means is merely incidental and includes,
- (a) copyrights;
 - (b) patents;
 - (c) trademarks;
 - (d) trade names;
 - (e) brand names;
 - (f) franchises;
 - (g) licenses;
 - (h) trade secrets;
 - (i) trade dress;
 - (j) information;
 - (k) know-how;
 - (l) methods;
 - (m) programs;
 - (n) procedures;
 - (o) systems;
 - (p) formulae;
 - (q) processes;
 - (r) technical data;
 - (s) designs;
 - (t) literary;
 - (u) musical, or artistic compositions;
 - (v) information;
 - (w) ideas;
 - (x) contract rights including broadcast rights;
 - (y) agreements not to compete;
 - (z) goodwill and going concern value;
 - (aa) securities; and,
 - (bb) except as otherwise provided in these Rules, computer software.
- (8) "Place of order" means the physical location where a customer places an order for a sale from a taxpayer, resulting in a contract with the taxpayer.
- (9) "Population" means the most recent population data maintained by the U.S. Census Bureau for the year in question as of the close of the taxable period. Census data is available free of charge at census.gov/topics/population.html.
- (10) "Reasonable" means agreeable to reason; just; proper. Ordinary or usual.
- (11) "Related entity" means as defined in G.S. 105-130.7A.
- (12) "Secretary" means the Secretary of Revenue.
- (13) "State where a contract of sale is principally managed by the customer" means the primary location where an employee or other representative of a customer serves as the primary contact person for the taxpayer with respect to the day-to-day execution and performance of a contract entered into by the taxpayer with the customer.

SECTION .0200 – GENERAL PRINCIPLES OF APPLICATION

17 NCAC 05G .0201 ASSIGNMENT OF RECEIPTS FROM SALES OF OTHER THAN TANGIBLE PERSONAL PROPERTY

A taxpayer's assignment of receipts from sales of other than tangible personal property shall comply with the following:

- (1) A taxpayer shall apply the rules set forth in this Subchapter based on objective criteria and shall consider all sources of information reasonably available to the taxpayer at the time of its tax filing including the taxpayer's books and records kept in the regular course of business. A taxpayer shall determine its method of assigning receipts in good faith, and apply it consistently with respect to similar transactions. A taxpayer shall retain contemporaneous records that explain the determination and application of its method of assigning its receipts, including its underlying assumptions, and shall provide those records to the Secretary upon request.
- (2) This Subchapter provides assignment rules that apply sequentially in a hierarchy. For each sale to which a hierarchical rule applies, a taxpayer shall make a reasonable effort to apply the primary rule applicable to the sale before seeking to apply the next rule in the hierarchy and shall continue to do so with each succeeding rule in the hierarchy.
- (3) A taxpayer's method of assigning its receipts shall reflect an attempt to obtain the most accurate assignment of receipts consistent with the standards set forth in this Subchapter, rather than an attempt to lower the taxpayer's tax liability.

Authority G.S. 105-130.4; S.L. 2016-94.

SECTION .0300 – RULES OF REASONABLE APPROXIMATION

17 NCAC 05G .0301 IN GENERAL

The Rules of this Subchapter set forth the process of reasonable approximation that apply if the state or states of assignment cannot be determined. In some instances, the reasonable approximation shall be made in accordance with specific rules of approximation prescribed in this Subchapter. In other cases, the applicable rule in this Subchapter permits a taxpayer to reasonably approximate the state or states of assignment, using a method that reflects an effort to approximate the results that would be obtained under the applicable rules or standards set forth in this Subchapter.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .0302 APPROXIMATION BASED UPON KNOWN SALES

When, by applying the applicable rules set forth in Sections .0900 through .1200 of this Subchapter, a taxpayer can ascertain the state or states of assignment of a substantial portion of its receipts from sales of substantially similar services and the taxpayer reasonably believes that the geographic distribution of the remainder of its sales tracks that of the assigned receipts, the taxpayer shall include the receipts from those sales in its sales factor in the same proportion as its assigned receipts. This Rule applies in the context of licenses and sales of intangible property where the substance of the transaction resembles a sale of goods or services.

History Note: Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .0303 RELATED ENTITY TRANSACTIONS

Where a taxpayer has receipts subject to this Subchapter from transactions with a related entity customer, information that the customer has regarding the sourcing of receipts from these transactions shall be imputed to the taxpayer.

Authority G.S. 105-130.4; S.L. 2016-94.

SECTION .0400 – EXCLUSION OF RECEIPTS FROM THE SALES FACTOR

17 NCAC 05G .0401 ALLOCATED GROSS RECEIPTS

The sales factor includes only gross receipts of the taxpayer that are not allocated under G.S. 105-130.4, and are received from transactions and activity in the regular course of the taxpayer's trade or business. Receipts addressed in G.S. 105-130.4(a)(7) shall be excluded.

Authority G.S. 105-130.4; G.S. 105-130.4(a)(7); S.L. 2016-5; S.L. 2016-94.

17 NCAC 05G .0402 UNASSIGNABLE GROSS RECEIPTS

When a taxpayer is unable to ascertain the state or states where receipts of a sale are to be assigned pursuant to the rules set forth in this Subchapter using a reasonable amount of effort undertaken in good faith, the receipts shall be excluded from the denominator of the taxpayer's sales factor pursuant to this Subchapter.

Authority G.S. 105-130.4; S.L. 2016-94.

SECTION .0500 - CHANGES IN METHODOLOGY

17 NCAC 05G .0501 ALTERNATIVE APPORTIONMENT

Nothing in this Subchapter limits the application of G.S. 105-122(c1)(2) or G.S. 105-130.4(t1). If the application of this Subchapter results in the assignment of receipts to the taxpayer's sales factor that the taxpayer believes does not fairly represent the extent of the taxpayer's business activity in North Carolina, the taxpayer may request the use of a different method for assigning those receipts.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .0502 ORIGINAL RETURNS

When a taxpayer files an original return for a taxable year in which it properly assigns its receipts using a method of assignment, including a method of reasonable approximation, in accordance with the rules in this Subchapter, the application of such method of assignment shall be deemed to be a correct determination by the taxpayer of the state or states of assignment to which the method is properly applied. In those cases, neither the Secretary nor the taxpayer may modify the taxpayer's methodology as applied for assigning those receipts for the taxable year, through the form of an audit adjustment, amended return, or abatement application. However, the Secretary and the taxpayer may each subsequently correct factual errors or calculation errors with respect to the taxpayer's application of its filing methodology.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .0503 SECRETARY'S AUTHORITY TO ADJUST A TAXPAYER'S RETURN

The Secretary's ability to review and adjust a taxpayer's assignment of receipts on a return to assign receipts consistent with the rules of this Subchapter, includes each of the following potential actions:

- (1) when a taxpayer fails to properly assign receipts from a sale in accordance with the rules set forth in this Subchapter, including the failure to apply a hierarchy of rules consistent with the principles of Rule .0201(2) of this Subchapter, the Secretary shall adjust the assignment of the receipts in accordance with the applicable rules in this Subchapter;

- (2) when a taxpayer uses a method of approximation to assign its receipts and the Secretary determines that the method of approximation employed by the taxpayer is not reasonable, the Secretary shall either substitute a method of approximation that the Secretary determines is appropriate or exclude the receipts from the taxpayer's numerator and denominator;
- (3) when the Secretary determines that a taxpayer's method of approximation has not been applied in a consistent manner with respect to similar transactions or year to year, the Secretary may require that the taxpayer apply its method of approximation in a consistent manner;
- (4) when a taxpayer excludes receipts from the denominator of its receipts factor on the basis that the assignment of the receipts cannot be reasonably approximated, the Secretary may determine that the exclusion of those receipts is not appropriate, and may instead substitute a method of approximation that the Secretary determines is appropriate;
- (5) when a taxpayer fails to retain contemporaneous records that explain the determination and application of its method of assigning its receipts, including its underlying assumptions, or fails to provide those records to the Secretary upon request, the Secretary shall treat the taxpayer's assignment of receipts as unsubstantiated, and shall adjust the assignment of the receipts in a manner consistent with the applicable rules in this Subchapter; or
- (6) when the Secretary concludes that a customer's billing address was selected by the taxpayer for tax avoidance purposes, the Secretary shall adjust the assignment of receipts from sales to that customer in a manner consistent with the applicable rules in this Subchapter.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .0504 TAXPAYER AUTHORITY TO CHANGE A METHOD OF ASSIGNMENT ON A PROSPECTIVE BASIS

A taxpayer may change its method of assigning its receipts every year in its original return, including changing its method of approximation, from that used on previous returns. However, the taxpayer may only make this change for purposes of improving the accuracy of assigning its receipts consistent with the rules set forth in this Subchapter. This includes addressing the circumstance where there is a change in the information that is available to the taxpayer as relevant for purposes of complying with these Rules. Further, a taxpayer that changes its method of assigning its receipts shall disclose, in the original return filed for the year of the change, the fact that is the taxpayer has made the change. The taxpayer shall retain and provide to the Secretary upon request documents that explain the nature and extent of the change, and the reason for the change. If a taxpayer fails to disclose the change or retain and provide the required records upon request, the Secretary may disregard the taxpayer's change and substitute an assignment method that the Secretary determines is appropriate.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .0505 SECRETARY AUTHORITY TO CHANGE A METHOD OF ASSIGNMENT ON A PROSPECTIVE BASIS

The Secretary may direct a taxpayer to change its method of assigning its receipts in tax returns that have not yet been filed, if upon reviewing the taxpayer's filing methodology applied in a prior tax year, the Secretary determines that the change reflects a more accurate assignment of the taxpayer's receipts within the meaning of this Subchapter, and determines that the change can be reasonably adopted by the taxpayer. The Secretary shall provide the taxpayer with a written explanation of the reason for making the change. When a taxpayer fails to comply with the Secretary's direction on future returns, the Secretary shall deem the taxpayer's method of assigning its receipts on those returns to be unreasonable, and shall substitute an assignment method that the Secretary determines is reasonable.

Authority G.S. 105-130.4; S.L. 2016-94.

SECTION .0600 - FURTHER GUIDANCE

17 NCAC 05G .0601 EXAMPLES

(a) The Secretary shall publish on the Department's website examples demonstrating the application of rules set forth in this Subchapter. The document is available at dornc.gov.

(b) The Secretary may issue further public written statements with respect to the rules set forth in this Subchapter. These statements may include guidance with respect to:

- (1) what constitutes a reasonable method of approximation within the meaning of the rules, and
- (2) the circumstances when a filing change for a taxpayer's method of reasonable approximation will be deemed appropriate.

Authority G.S. 105-130.4; S.L. 2016-94.

SECTION .0700 – SALE OF A SERVICE

17 NCAC 05G .0701 IN GENERAL

(a) The receipts from a sale of a service are in North Carolina to the extent that the service is delivered to a location in North Carolina. The term "delivered to a location" refers to the location of the taxpayer's market for the service, which may not be the location of the taxpayer's employees or property.

(b) The rules to determine the location of the delivery of a service in the context of several specific types of service transactions are set forth in Sections .0700 through .1000 of this Subchapter.

Authority G.S. 105-130.4; S.L. 2016-94.

SECTION .0800 – SALE OF IN-PERSON SERVICES

17 NCAC 05G .0801 IN GENERAL

(a) Except as otherwise provided in this Section, "in-person services" are services that are physically provided in person by the taxpayer, where the customer or the customer's real or tangible property upon which the services are performed is in the same location as the service provider at the time the services are performed. This Section includes situations where the services are provided on behalf of the taxpayer by a third-party contractor.

(b) Examples of in-person services include:

- (1) warranty and repair services;
- (2) cleaning services;
- (3) plumbing services;
- (4) carpentry;
- (5) construction contractor services;
- (6) pest control;
- (7) landscape services;
- (8) medical and dental services, including medical testing, x-rays, and mental health care and treatment;
- (9) child care;
- (10) hair cutting and salon services;
- (11) live entertainment and athletic performances; and
- (12) in-person training or lessons.

(c) In-person services include services within the description of this Rule that are performed at

- (1) a location that is owned or operated by the service provider; or
- (2) a location of the customer, including the location of the customer's real or tangible personal property.

(d) Professional services as described in Section .1000 of this Subchapter shall not be treated as in-person services within the meaning of this Section.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .0802 ASSIGNMENT OF RECEIPTS FROM SALE OF IN-PERSON SERVICES

Receipts from a sale of in-person services shall be assigned to North Carolina to the extent the customer receives the service in North Carolina. The taxpayer shall determine the location where a service is received as follows:

- (1) if the service is performed with respect to the body of an individual customer in North Carolina, such as hair cutting or x-ray services, or in the physical presence of the customer in North Carolina, such as live entertainment or athletic performances, the service is received in North Carolina;
- (2) if the service is performed with respect to the customer's real estate in North Carolina or if the service is performed with respect to the customer's tangible personal property at the customer's residence or in the customer's possession in North Carolina, the service is received in North Carolina; or
- (3) if the service is performed with respect to the customer's tangible personal property and the tangible personal property is to be shipped or delivered to the customer, whether the service is performed within or outside North Carolina, the service is received in North Carolina if the property is shipped or delivered to the customer in North Carolina.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .0803 REASONABLE APPROXIMATION

When the taxpayer cannot determine the state or states where a service was received pursuant to Rule .0802 of this Section, but the taxpayer has sufficient information regarding the location of receipt from which it can reasonably approximate the state or states where the service is received, the taxpayer shall reasonably approximate such state or states.

Authority G.S. 105-130.4; S.L. 2016-94.

SECTION .0900 - SERVICES DELIVERED TO A CUSTOMER OR ON BEHALF OF THE CUSTOMER, OR DELIVERED ELECTRONICALLY THROUGH THE CUSTOMER

17 NCAC 05G .0901 IN GENERAL

(a) If the service provided by the taxpayer is not an in-person service within the meaning of Rule .0801 of this Subchapter or a professional service as defined in Section .1000 of this Subchapter, and the service is delivered to or on behalf of the customer, or delivered electronically through the customer, the receipts from a sale are in North Carolina to the extent that the service is delivered in North Carolina.

(b) For purposes of this Section, a service:

- (1) "delivered to a customer" is a service in which the customer and not a third party is the recipient of the service.

- (2) "delivered on behalf of a customer" is one in which a customer contracts for a service but one or more third parties, rather than the customer, is the recipient of the service. This includes fulfillment services, or the direct or indirect delivery of advertising to the customer's intended audience.
 - (3) "delivered electronically through a customer" is a service that is delivered electronically to a customer for purposes of resale and subsequent electronic delivery in substantially identical form to an end user or other third-party recipient.
- (c) A service can be delivered to or on behalf of a customer by physical means or through electronic transmission.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .0902 ASSIGNMENT OF RECEIPTS FROM SALES OF SERVICES DELIVERED TO THE CUSTOMER OR ON BEHALF OF THE CUSTOMER, OR DELIVERED ELECTRONICALLY THROUGH THE CUSTOMER

- (a) The assignment of receipts to a state or states when a sale of a service is delivered to the customer or on behalf of the customer, or delivered electronically through the customer, shall depend upon the method of delivery of the service and the nature of the customer. Separate rules of assignment shall apply to services delivered by physical means and services delivered by electronic transmission. For purposes of this Section, a service delivered by an electronic transmission is not a delivery by a physical means.
- (b) If a rule of assignment set forth in this section depends upon whether the customer is an individual or a business customer, and the taxpayer acting in good faith cannot reasonably determine whether the customer is an individual or business customer, the taxpayer shall treat the customer as a business customer.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .0903 DELIVERY TO OR ON BEHALF OF A CUSTOMER BY PHYSICAL MEANS, WHETHER TO AN INDIVIDUAL OR BUSINESS CUSTOMER

- (a) Services delivered to a customer or on behalf of a customer through a physical means include:
- (1) Product delivery services where property is delivered to the customer or to a third party on behalf of the customer;
 - (2) The delivery of brochures, fliers or other direct mail services;
 - (3) The delivery of advertising or advertising-related services to the customer's intended audience in the form of a physical medium; and
 - (4) The sale of custom software, such as where software is developed for a specific customer in a case where the transaction is properly treated as a service transaction for purposes of corporate taxation where the taxpayer installs the custom software at the customer's site.
- (b) The following rules shall apply whether the taxpayer's customer is an individual customer or a business customer:
- (1) Rule of Determination. In assigning the receipts from a sale of a service delivered to a customer or on behalf of a customer through a physical means, a taxpayer shall determine the state or states where the service is delivered. If the taxpayer is able to determine the state or states where the service is delivered, it shall assign the receipts to that state or states.
 - (2) Rule of Reasonable Approximation. If the taxpayer is unable to determine the state or states where the service is delivered, but has sufficient information regarding the place of delivery that the taxpayer may reasonably approximate the state or states where the service is delivered, it shall reasonably approximate the state or states.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .0904 DELIVERY TO CUSTOMER BY ELECTRONIC TRANSMISSION

- (a) Services delivered by electronic transmission include services that are transmitted through the means of wire, lines, cable, fiber optics, electronic signals, satellite transmission, audio or radio waves, or other similar means, whether or not the service provider owns, leases, or otherwise controls the transmission equipment.
- (b) When a service is delivered by electronic transmission to a customer, the following rules apply:
- (1) Services Delivered By Electronic Transmission to an Individual Customer.
 - (A) Rule of Determination. When a service is delivered to an individual customer by electronic transmission, the service is delivered in North Carolina to the extent that the taxpayer's customer received the service in North Carolina. If the taxpayer is able to determine the state or states where the service is received, it shall assign the receipts from that sale to that state or states.
 - (B) Rules of Reasonable Approximation. If the taxpayer is unable to determine the state or states where the customer received the service, but has sufficient information regarding the place of receipt to reasonably approximate the state or states where the service is received, it shall reasonably approximate the state or states. If a taxpayer does not have sufficient information that it can determine or reasonably approximate the state or states in which the service is received, it shall reasonably approximate the state or states using the customer's billing address.
 - (2) Services Delivered By Electronic Transmission to a Business Customer.
 - (A) Rule of Determination. When a service is delivered to a business customer by electronic transmission, the service is delivered in North Carolina to the extent that the taxpayer's customer received the service in North Carolina. If the taxpayer can determine the state or states where the service is received, it shall assign the receipts from that sale to the state or states. For purposes of this Part the state or states where the service is

- received shall reflect the location where the service was directly used by the employees or designees of the customer.
- (B) Rule of Reasonable Approximation. If the taxpayer is unable to determine the state or states where the customer received the service, but has sufficient information regarding the place of receipt to reasonably approximate the state or states where the service is received, it shall reasonably approximate the state or states.
- (C) Secondary Rule of Reasonable Approximation. When a service is delivered to a business customer by electronic transmission where a taxpayer does not have sufficient information to determine or reasonably approximate the state or states in which the service is received, the taxpayer shall reasonably approximate the state or states as set forth in this Rule. In these cases, unless the taxpayer can apply the safe harbor set forth in Sub-Item (2)(D) of this Rule, the taxpayer shall reasonably approximate the state or states in which the service is received as follows: first, by assigning the receipts from the sale to the state where the contract of sale is principally managed by the customer; second, if the state where the customer principally manages the contract is not reasonably determinable, by assigning the receipts from the sale to the customer's place of order; and third, if the customer's place of order is not reasonably determinable, by assigning the receipts from the sale using the customer's billing address. However, if the taxpayer derives more than five percent of its receipts from sales of services from any single customer, the taxpayer shall identify the state in which the contract of sale is principally managed by that customer.
- (D) Safe Harbor. When a service is delivered to a business customer by electronic transmission, a taxpayer may not be able to determine, or reasonably approximate under Sub-Item (2)(B) of this Rule, the state or states in which the service is received. In these cases, the taxpayer may, in lieu of the rule stated in Sub-Item (2)(C) of this Rule, apply the safe harbor stated in this Sub-Item. Under this safe harbor, a taxpayer may assign its receipts from sales to a particular customer based upon the customer's billing address in a taxable year in which the taxpayer engages in substantially similar service transactions with more than 250 customers, whether business or individual, and does not derive more than five percent of its receipts from sales of all services from that customer.
- (E) Related Entity Transactions. When a service is delivered by electronic transmission to a business customer that is a related entity, the taxpayer may not use the secondary rule of reasonable approximation in Sub-Item (2)(C) of this Rule but may use the rule of reasonable approximation in Sub-Item (2)(B) of this Rule, and the safe harbor in Sub-Item (2)(D) of this Rule. The Secretary may aggregate sales to related entities in determining whether the sales exceed five percent of receipts from sales of all services under that safe harbor provision.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .0905 SERVICES DELIVERED ELECTRONICALLY THROUGH OR ON BEHALF OF AN INDIVIDUAL OR BUSINESS CUSTOMER

When a service is delivered electronically "on behalf of" or "through" a customer as defined in Rule .0901 of this Subchapter, the methodology provided under this Rule applies.

- (1) Rule of Determination. In the case of the delivery of a service by electronic transmission, where the service is delivered electronically to end users or other third-party recipients through or on behalf of the customer, the service is delivered in North Carolina to the extent that the end users or other third-party recipients are in North Carolina. For example, in the case of the direct or indirect delivery of advertising on behalf of a customer to the customer's intended audience by electronic means, the service is delivered in North Carolina to the extent that the audience for the advertising is in North Carolina. In the case of the delivery of a service to a customer that acts as an intermediary in reselling the service in substantially identical form to third-party recipients, the service is delivered in North Carolina to the extent that the end users or other third-party recipients receive the services in North Carolina. The provisions in this Sub-Item apply whether the taxpayer's customer is an individual customer or a business customer and whether the end users or other third-party recipients to which the services are delivered through or on behalf of the customer are individuals or businesses.
- (2) Rule of Reasonable Approximation. If the taxpayer cannot determine the state or states where the services are actually delivered to the end users or other third-party recipients either through or on behalf of the customer, but has sufficient information regarding the place of delivery that the taxpayer may reasonably approximate the state or states where the services are delivered, it shall reasonably do so.
- (3) Select Secondary Rules of Reasonable Approximation.
- (a) If a taxpayer's service is the direct or indirect electronic delivery of advertising on behalf of its customer to the customer's intended audience, and if the taxpayer lacks sufficient information regarding the location of the audience that the taxpayer may determine or reasonably approximate that location, the taxpayer shall reasonably approximate the audience in a state for the advertising using the following secondary rules of reasonable approximation. If a taxpayer is delivering advertising directly or indirectly to a known list of subscribers, the taxpayer shall reasonably approximate the audience for advertising in a state using a percentage that reflects the ratio of the state's subscribers in the specific geographic area in which the advertising is delivered relative to the total subscribers in that area. For a taxpayer with less information about its audience, the taxpayer shall reasonably approximate the audience in a state using the percentage that

reflects the ratio of the state's population in the specific geographic area where the advertising is delivered relative to the total population in that area.

- (b) If a taxpayer's service is the delivery of a service to a customer that then acts as the taxpayer's intermediary in reselling that service to end users or other third party recipients, and the taxpayer lacks sufficient information regarding the location of the end users or other third party recipients that the taxpayer may determine or reasonably approximate that location, the taxpayer shall reasonably approximate the extent to which the service is received in a state by using the percentage that reflects the ratio of the state's population in the specific geographic area where the taxpayer's intermediary resells the services, relative to the total population in that area.
- (c) When using the secondary reasonable approximation methods provided above, the relevant specific geographic area of delivery includes only the areas where the service was substantially and materially delivered or resold. Unless the taxpayer demonstrates the contrary, it will be presumed that the area where the service was substantially and materially delivered or resold does not include areas outside the United States.

Authority G.S. 105-130.4; S.L. 2016-94.

SECTION .1000 - PROFESSIONAL SERVICES

17 NCAC 05G .1001 IN GENERAL

(a) Except as otherwise provided in this Subchapter, "professional services" are services that require specialized knowledge and may require a professional certification, license, or degree. These services include the performance of technical services that require the application of specialized knowledge.

(b) Professional services include:

- (1) management services;
- (2) bank and financial services;
- (3) financial custodial services;
- (4) investment and brokerage services;
- (5) fiduciary services;
- (6) tax preparation;
- (7) payroll and accounting services;
- (8) lending services;
- (9) credit card services, including credit card processing services;
- (10) data processing services;
- (11) legal services;
- (12) consulting services;
- (13) video production services;
- (14) graphic and other design services;
- (15) engineering services; and
- (16) architectural services.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .1002 OVERLAP WITH OTHER CATEGORIES OF SERVICES

(a) Certain services that fall within the definition of "professional services" set forth in this Section shall be treated as "in-person services" within the meaning of Section .0800 of this Subchapter, and shall be assigned under the rules of that Section. Specifically, professional services that are physically provided in person by the taxpayer such as carpentry, certain medical and dental services, or child care services when the customer or the customer's real or tangible property upon which the services are provided is in the same location as the service provider at the time the services are performed are "in-person services" and are assigned as such, notwithstanding that they may also be considered to be "professional services."

(b) Professional services where the service is of an intellectual or intangible nature, such as legal, accounting, financial, and consulting services, shall be assigned as professional services under the rules of this Section, notwithstanding the fact that these services may involve some amount of in-person contact.

(c) Professional services may in some cases include the transmission of documents or other communications by mail or by electronic means. In these cases, the assignment rules that apply are those set forth in this Section, and not those set forth in Section .0900 of this Subchapter, pertaining to services delivered to a customer or through or on behalf of a customer.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .1003 ASSIGNMENT OF RECEIPTS

The location of delivery of professional services shall not be determined by a general rule of determination, but shall be reasonably approximated. The assignment of receipts from a sale of a professional service depends on whether the customer is an individual or business customer. When the taxpayer, acting in good faith, cannot reasonably determine whether the customer is an individual or business customer, the taxpayer shall treat the customer as a business customer. For purposes of assigning the receipts from a sale of a

professional service, a taxpayer's customer is the person that contracts for the service, irrespective of whether another person pays for or also benefits from the taxpayer's services.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .1004 PROFESSIONAL SERVICES OTHER THAN ARCHITECTURAL OR ENGINEERING SERVICES

Receipts from sales of professional services other than those services described in Rules .1005 - .1006 of this Section, shall be assigned as follows:

- (1) Professional Services Delivered to Individual Customers. Except as otherwise provided in Section .1000 of this Subchapter in any instance in which the service provided is a professional service and the taxpayer's customer is an individual customer, the state or states where the service is delivered shall be reasonably approximated as set forth in this Rule. The taxpayer shall assign the receipts from a sale to the customer's state of primary residence, or, if the taxpayer cannot reasonably identify the customer's state of primary residence, to the state of the customer's billing address. However, when the taxpayer derives more than five percent of its receipts from sales of all services from an individual customer, the taxpayer shall identify the customer's state of primary residence and assign the receipts from the service or services provided to that customer to that state.
- (2) Professional Services Delivered to Business Customers. When the taxpayer provides a professional service to a business customer, the state or states in which the service is delivered shall be reasonably approximated as set forth in this Rule. In particular, unless the taxpayer can use the safe harbor set forth in Item (3) of this Rule the taxpayer shall assign the receipts from the sale as follows:
 - (a) by assigning the receipts to the state where the contract of sale is principally managed by the customer;
 - (b) if the place of customer management is not reasonably determinable, to the customer's place of order; and
 - (c) if the customer place of order is not reasonably determinable, to the customer's billing address.When the taxpayer derives more than five percent of its receipts from sales of all services from a customer, the taxpayer is required to identify the state in which the contract of sale is principally managed by the customer.
- (3) Safe Harbor; Large Volume of Transactions. Notwithstanding the rules set forth in Items (1) and (2) of this Rule, a taxpayer may assign its receipts from sales to a particular customer based on the customer's billing address in any taxable year when the taxpayer engages in substantially similar service transactions with more than 250 customers, whether individual or business, and does not derive more than five percent of its receipts from sales of all services from that customer. This safe harbor applies only for purposes of this Rule.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .1005 ARCHITECTURAL OR ENGINEERING SERVICES WITH RESPECT TO REAL OR TANGIBLE PERSONAL PROPERTY

(a) Architectural and engineering services with respect to real or tangible personal property shall be professional services within the meaning of this Section. The receipts from a sale of an architectural service shall be assigned to a state or states to the extent that the services are with respect to real estate improvements located, or expected to be located, in the state or states. The receipts from a sale of an engineering service shall be assigned to a state or states to the extent that the services are with respect to tangible or real property located in the state or states, including real estate improvements located in, or expected to be located in, the state or states.

(b) This Rule shall apply regardless of whether or not the customer is an individual or business customer. In any instance in which architectural or engineering services are not described in this Rule, the receipts from a sale of these services must be assigned under Rule .1004 of this Section.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .1006 RELATED ENTITY TRANSACTIONS

When the professional service is sold to a related entity, rather than applying the rule for professional services delivered to business customers in Rule .1004(2) of this Section, the state or states where the service is assigned is the place of receipt by the related entity as reasonably approximated using the following hierarchy:

- (1) if the service primarily relates to specific operations or activities of a related entity conducted in one or more locations, then to the state or states where those operations or activities are conducted in proportion to the related entity's payroll at the locations to which the service relates in the state or states; or
- (2) if the service does not primarily relate to specific operations or activities of a related entity conducted in particular locations, but instead relates to the operations of the related entity generally, then to the state or states where the related entity has employees, in proportion to the related entity's payroll in those states. The taxpayer may use the safe harbor provided by Rule .1004(3) of this Section.

Authority G.S. 105-130.4; S.L. 2016-94.

SECTION .1100 – LICENSE OR LEASE OF INTANGIBLE PROPERTY

17 NCAC 05G .1101 IN GENERAL

(a) The receipts from the license of intangible property shall be assigned to North Carolina to the extent the intangible is used in North Carolina. The term "use" shall refer to the location of the taxpayer's market for the use of the intangible property that is being licensed and shall not refer to the location of the property or payroll of the taxpayer. This Section sets forth the rules to determine the location of the use of intangible property for several specific types of licensing transactions.

(b) A license of intangible property that conveys all substantial rights in that property shall be treated as a sale of intangible property for purposes of these rules. For purposes of Sections .1100 and 1200, a sale or exchange of intangible property shall be treated as a license of that property where the receipts from the sale or exchange derive from payments that are contingent on the productivity, use, or disposition of the property.

(c) Intangible property licensed as part of the sale or lease of tangible property shall be treated under these rules as the sale or lease of tangible property.

(d) Nothing in this Section shall be construed to allow or require inclusion of sales in the sales factor that are not included in the definition of "sales" pursuant to G.S. 105-130.4, or that are excluded from the numerator and the denominator of the sales factor pursuant to proposed G.S. 105-130.4(1)(6). To the extent that the transfer of either a security or business "goodwill" or similar intangible value, including "going concern value" or "workforce in place," is characterized as a license or lease of intangible property, receipts from such transaction shall be excluded from the numerator and the denominator of the taxpayer's sales factor.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .1102 LICENSE OF A MARKETING INTANGIBLE

(a) If a license is granted for the right to use intangible property in connection with the sale, lease, license, or other marketing of goods, services, or other items, such as a marketing intangible, to a consumer, the royalties or other licensing fees paid by the licensee for that marketing intangible shall be assigned to North Carolina to the extent that those fees are attributable to the sale or other provision of goods, services, or other items purchased or otherwise acquired by consumers in North Carolina.

(b) License of a marketing intangible includes the following when it is intended to promote consumer sales:

- (1) the license of a service mark, trademark, or trade name;
- (2) copyrights;
- (3) the license of a film, television or multimedia production or event for commercial distribution; and
- (4) a franchise agreement.

(c) In the case of the license of a marketing intangible, where a taxpayer has actual evidence of the amount or proportion of its receipts that is attributable to North Carolina, it shall assign that amount or proportion to North Carolina. In the absence of actual evidence of the amount or proportion of the licensee's receipts that are derived from North Carolina consumers, the portion of the licensing fee to be assigned to North Carolina shall be reasonably approximated by multiplying the total fee by a percentage that reflects the ratio of the North Carolina population in the specific geographic area where the licensee makes material use of the intangible property to regularly market its goods, services, or other items relative to the total population in that area.

(d) If the license of a marketing intangible is for the right to use the intangible property in connection with sales or other transfers at wholesale rather than directly to retail customers, the portion of the licensing fee to be assigned to North Carolina shall be reasonably approximated by multiplying the total fee by a percentage that reflects the ratio of the North Carolina population in the specific geographic area in which the licensee's goods, services, or other items are ultimately and materially marketed using the intangible property relative to the total population of that area. Unless the taxpayer demonstrates that the marketing intangible is materially used in the marketing of items outside the United States, the fees from licensing that marketing intangible shall be presumed to be derived from within the United States.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .1103 LICENSE OF A PRODUCTION INTANGIBLE

(a) If a license is granted for the right to use intangible property, other than in connection with the sale, lease, license, or other marketing of goods, services, or other items, and the license will be used in a production capacity (a "production intangible"), the licensing fees paid by the licensee for that right shall be assigned to North Carolina to the extent that the use for which the fees are paid takes place in North Carolina.

(b) License of a production intangible includes the license of a patent, a copyright, or trade secrets to be used in a manufacturing process, where the value of the intangible lies predominately in its use in that process.

(c) If the actual use of intangible property pursuant to a license of a production intangible takes place in part in North Carolina, the entire use is in this State except to the extent that the taxpayer is able to demonstrate that the actual location of a portion of the use takes place outside North Carolina.

(d) When a license of a production intangible to a related entity, the taxpayer shall assign the receipts to where the intangible property is actually used. When a license of a production intangible to a party other than a related entity where the location of actual use is unknown, the use of the intangible property takes place in the state of the licensee's commercial domicile when a business, or the licensee's state of primary residence when an individual.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .1104 LICENSE OF A MIXED INTANGIBLE

If a license of intangible property includes both a license of a marketing intangible and a license of a production intangible (a "mixed intangible") and the fees to be paid in each instance are separately and reasonably stated in the licensing contract, the Secretary will accept that separate statement for purposes of these Rules. If a license of intangible property includes both a license of a marketing

intangible and a license of a production intangible and the fees to be paid in each instance are not separately and reasonably stated in the contract, the licensing fees were paid entirely for the license of the marketing intangible, except to the extent that the taxpayer can reasonably establish otherwise.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .1105 LICENSE OF INTANGIBLE PROPERTY WHEN SUBSTANCE OF THE TRANSACTION RESEMBLES A SALE OF GOODS OR SERVICES

(a) When the license of intangible property resembles the sale of an electronically-delivered good or service, rather than the license of a marketing intangible or production intangible, the receipts shall be assigned by applying Rules .0904 and .0905 of this Subchapter. Transactions to be assigned under this Rule include the license of:

- (1) Database access;
- (2) Access to information;
- (3) Digital goods and
- (4) Certain software, where the transaction is not the license of pre-written software treated as the sale of tangible personal property.

(b) Sublicenses. The provisions of Rule .0905 of this Subchapter shall apply where a taxpayer licenses intangible property to a customer that in turn sublicenses the intangible property to end users as if the transaction were a service delivered electronically through a customer to end users. Rule .0905 of this Subchapter shall apply to services delivered electronically to a customer for purposes of resale and subsequent electronic delivery in substantially identical form to end users or other recipients shall also apply with respect to licenses of intangible property for purposes of sublicense to end users. For this purpose, the intangible property sublicensed to an end user shall not fail to be substantially identical to the property that was licensed to the sublicensor merely because the sublicense transfers a reduced bundle of rights with respect to that property, such as when the sublicensee's rights are limited to its own use of the property and do not include the ability to grant a further sublicense, or because that property is bundled with additional services or items of property.

Authority G.S. 105-130.4; S.L. 2016-94.

SECTION .1200 – SALE OF INTANGIBLE PROPERTY

17 NCAC 05G .1201 ASSIGNMENT OF RECEIPTS

The assignment of receipts to a state or states in the instance of a sale or exchange of intangible property depends upon the nature of the intangible property sold. For purposes of this Section, a sale or exchange of intangible property includes a license of that property where the transaction is treated for tax purposes as a sale of all substantial rights in the property and the receipts from the transaction are not contingent on the productivity, use, or disposition of the property.

- (1) In the case of a sale or exchange of intangible property where the property sold or exchanged is a contract right, government license, or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area, the receipts from the sale are assigned to a state to the extent that the intangible property is used or is authorized to be used within the state. If the intangible property is used or may be used only in this State, the taxpayer shall assign the receipts from the sale to North Carolina. If the intangible property is used or is authorized to be used in North Carolina and one or more other states, the taxpayer shall assign the receipts from the sale to North Carolina to the extent that the intangible property is used in or authorized for use in North Carolina, through the means of a reasonable approximation.
- (2) In the case of a sale or exchange of intangible property where the receipts from the sale or exchange are contingent on the productivity, use, or disposition of the property, the receipts from the sale shall be assigned by applying the rules set forth in Section .1100 of this Subchapter.
- (3) In the case of a sale or exchange of intangible property where the substance of the transaction resembles a sale of goods or services and where the receipts from the sale or exchange do not derive from payments contingent on the productivity, use, or disposition of the property, the receipts from the sale shall be assigned by applying the rules set forth in Rule .1105 of this Subchapter.
- (4) Receipts from the sale of intangible property are not included in the sales factor in any case when the sale does not give rise to receipts within the meaning of Rule .0401 of this Subchapter. In addition, in any case in which the sale of intangible property results in receipts within the meaning of Section .0400 of this Subchapter, those receipts shall be excluded from the numerator and the denominator of the taxpayer's sales factor if the receipts are not referenced in G.S. 105.130.4(1) The sale of intangible property that is excluded from the numerator and denominator of the taxpayer's sales factor under this provision includes the sale of business "goodwill," the sale of an agreement not to compete, or similar intangible value.

Authority G.S. 105-130.4; S.L. 2016-94.

SECTION .1300 – SPECIAL RULES

17 NCAC 05G .1301 SOFTWARE TRANSACTIONS

(a) A license or sale of pre-written software for purposes other than commercial reproduction, or other exploitation of the intellectual property rights, transferred on a tangible medium shall be treated as the sale of tangible personal property, rather than as either the

license or sale of intangible property or the performance of a service. In these cases, the receipts shall be in North Carolina as determined under the rules for the sale of tangible personal property set forth under G.S. 105-130.4 and applicable rules of this Subchapter.

(b) In all other cases, the receipts from a license or sale of software shall be assigned to North Carolina as determined otherwise under this Subchapter. This determination shall be based on the facts, and:

- (1) the development and sale of custom software as set forth in Section .0900 of this Subchapter;
- (2) the license of a marketing intangible, as set forth in Rule .1102 of this Subchapter;
- (3) the license of a production intangible, as set forth in Rule .1103 of this Subchapter;
- (4) the license of intangible property where the substance of the transaction resembles a sale of goods or services, as set forth in Rule .1105 of this Subchapter; or
- (5) as a sale of intangible property, as set forth in Rule .1201 of this Subchapter.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .1302 SALES OR LICENSES OF DIGITAL GOODS AND SERVICES

The receipts from the sale or license of digital goods or services, including, the sale of video, audio, and software products or similar transactions shall be assigned by applying the same provisions set forth in Rules .0904 or .0905 of this Subchapter, as if the transaction was a service delivered to an individual or business customer, or delivered through or on behalf of an individual or business customer. For purposes of the analysis, the terms of the contractual relationship or the characterization of the sale or the license shall not be relevant.

Authority G.S. 105-130.4; S.L. 2016-94.

17 NCAC 05G .1303 TELECOMMUNICATIONS COMPANIES

(a) When a taxpayer who provides telecommunications or ancillary services and that is subject to Multistate Tax Commission Reg. IV.18(i), receipts from the sale or license of digital goods or services not otherwise assigned for apportionment purposes pursuant to that Regulation shall be assigned pursuant to this Rule. The taxpayer shall apply Rules .0904 or .0905 of this Subchapter as if the transaction were a service delivered to an individual or business customer or delivered through or on behalf of an individual or business customer. MTC Reg. IV.18(i) is available at no charge at <http://www.mtc.gov/Uniformity/Adopted-Uniformity-Recommendations>.

(b) In applying these rules, if the taxpayer cannot determine the state or states where a customer receives the purchased product, it may reasonably approximate this location using the customer's place of "primary use" of the purchased product, applying the definition of "primary use" set forth in MTC Model Regulation for Sourcing Sales of Telecommunications and Ancillary Services, MTC Reg. IV.18(i).

Authority G.S. 105-130.4; S.L. 2016-94.