Dixon, Lisa (ANF)

From: Brad MacDougall
Sent: Tuesday, March 08, 2016 6:07 PM
To: Brad MacDougall; Dixon, Lisa (ANF)
Subject: AIM | DOR Regulatory Items
Attachments: TIR 15-10: Interest Rate on Overpayments and Underpayments; DD 15-2; Approval of Principal Reporting Corporation; Massachusetts Net Worth Tax Memo.pdf; AIM Testimony on Tax Policy.pdf; AIM_DOR comments market sourcing regs..pdf; AIM Comments on Proposed Market Sourcing Regulations.pdf; Comment response letter.pdf; Tax Analysts -- Massachusetts Group Calls Market-Based Sourcing Reg Burd....pdf; Massachusetts Net Worth Tax Memo.pdf; Sham reform.docx; AIM Working Draft Directive.pdf; Voluntary Disclosure.docx; Tax Audit Issues.pdf

Follow Up Flag: Follow up
Flag Status: Flagged

Lisa: below are items regarding DOR regulations, most of which were submitted before to DOR during the time of regulatory discussion. Shall I also submit to DOR?

1. **Networth** – See memo, need for DOR to take regulatory, administrative and regulatory steps to limit the application of "True Debt" reclassification to the net income portion of the corporate excise tax. This is something that the DOR can change now without legislation.

2. **Networth** - Specifically addressing some recent developments since the market sourcing regulations. Regarding (9)(e) of the apportionment regulation, 830 CMR 63.38.1. That provision excludes items (e.g. sales) from the apportionment factors that relate to items excluded from federal gross income. Below is the trail that best summarizes the discussions around whether the apportionment reg that was updated for market-based sourcing "fixed" the issue of net worth taxation of foreign entities, assumedly because the DOR believes the language that matches the combined return reg now applies to income and non-income measure (i.e. if the income is treaty protected from inclusion in the apportionment factor for income tax, same applies for non-income tax). It appears Rebecca believes so and promises guidance but as we also discussed, we have current circumstances where audit is issuing NIAs to foreign entities so it would be good to get this clarified ASAP. Key questions are 1) do they now view this as a non-issue, 2) are they going to issue guidance that supersedes TIR 10-16 and if so, 3) is this retro to open years or are they somehow of the belief it can be applied as of the effective date of the reg (1/1/14)?

3. **Market Sourcing** – See letters – regulations provide greater power over taxpayer while retaining certain rights for the DOR that a taxpayer cannot exercise.

4. **Notifications:** How taxpayers would be notified of a deemed abatement application when an amended return is filed and Mass DOR has not responded to the taxpayer by the date that the SOL to amend the return will expire. Arguably, a regulation governing procedures for a taxpayer to follow in amended a return would not discuss the procedures Mass DOR will follow in notifying the taxpayer that an amended return will be deemed to be an abatement application.

5. **Voluntary Disclosure Program**- See attachment, could be considered as the program is tested and taxpayers and DOR continue to improve program.

6. **Sham Transaction Doctrine** – needs to be reviewed (see attached)

7. **TIR 15-15**, which I understand to mean that a taxpayer has an automatic extension if the corporate taxpayer has paid in at least "50% of the total amount of tax ultimately due" in connection with the corporate excise return that is filed."

8. **TIR15-10** - Interest rates (see attachment) – AIM has filed legislation to have the interest rates equalized. DOR can change these rates.

9. **Review of 35A penalties**, how they are applied in the field.

10. **DD15-2 Principle Reporting Corporation** – Concern is whether the end of the last sentence essentially nullifies the whole point of the Directive: "except to the extent that the Commissioner affirmatively requires the combined group to file its combined report and associated corporate excise returns as otherwise specified in 830 CMR 63.32B.2(11)(a)." So, essentially, the DOR waives this technical requirement that the lead filer qualify under (11)(a), except when they don't. If you agree, I wonder if they'd be willing to tack on additional language such as *"...for good cause (i.e. substantive, non-presentational, reasons)." ?*

11. **Audit process** – see pdf attachments for administrative reforms

12. **Sham Reform (3A):** Explicitly limiting application of 3A along lines of AIM backed legislation or providing detailed guidance on when it will or won't be applied; Restricting DOR from applying 3A to ongoing effect of transactions that occurred before passage of 3A. If a taxpayer entered into a transaction prior to 2002 that met *Sherwin-Williams* standard, DOR should not be able to apply 3A to the effects of that transaction in years after 3A was adopted. We had an experience where DOR was looking into transfers from the 1980s and asserting 3A could be applied to ignore the current day effects of that transaction. This is unfair to taxpayers. 3A is a statute that requires taxpayer to meet an exacting standard of evidence to overcome a DOR challenge, if the transaction occurred before 3A even existed, how could a taxpayer be expected to keep documentation to establish that they met an exceedingly difficult VBP and econ substance standard when that standard didn't exist at the time the transaction occurred.

13. **Regulations:** Publishing all proposed and final regulations as word documents with redlines;

14. **Affiliated corporations:** Bar on imposing tax on affiliated corporations based purely on receipt of payments from MA taxpayers where the payments by the MA taxpayers are nondeductible (I don't think it is good policy for MA to be attacking IHCs through add-back and asserting nexus.);

15. **Refund claims:** Massachusetts should permit taxpayers to file refund claims for sales taxes paid to vendors. Currently, taxpayers must convince the vendor to file a refund claim on their behalf. This is an unfair system to most taxpayers and results in taxpayers only seeking refunds in cases where the dollars are very significant. The process ensures that only taxpayers that pay huge sums to large companies (or have significant self accruals) end up being able to recover overcharged sales tax. I'd be happy to give the example of my little sisters attempt to get a refund of tax charged by LinkedIn, needless to say, she did not have much luck despite numerous attempts, to getting anyone at the company to take her claim seriously;

16. **Audits:** Placing emphasis on auditors making all related adjustments that result from their audit, not just the initial adjustment that increases tax. As an example, you see a number of cases where auditor will make an income adjustment—for example, sham transactions to include income from

a subsidiary in parent—and then not make the corresponding apportionment adjustments that often offset that initial adjustment. Audit manual should be updated to emphasize common examples where this occurs.

17. **Certified Expansion Project:** Need to review DOR interpretation of Section 179. section 179 matter it would be important to at least have them apply the basis reduction on a prospective basis. Perhaps for tax years beginning on or after 1/1/2015, or for tax years ending on or after the date the directive is issued if the DOR wants to be more inclusive. As you note below, there has been confusion about this matter, so best to apply the guidance prospectively, even though we aren't talking about a law change. I think there is some history of the DOR using a prospective effective date when they are trying to clarify existing law. I believe the issue in that case was retirement plan deductions claimed by partners on their individual MA tax return.

18. **Tax amnesty: Clarity needed:** Follows is my reconciliation of the statutory provisions and the DOR release related to amnesty. If the statute precludes 2014 returns of any kind from being included, how does the release include returns filed in 2015? That would generally include all 2014 returns and 2015 returns filed in 2015 like monthly sales tax. It's plausible that DOR views the blue comma between "return" and "or" below as applying the 12/31/15 date ONLY to returns that have previously been filed (i.e. not unfiled returns), but what gives them the ability to include those returns in light of the statute? End of day, we are wondering if the 3 year lookback includes 2011 thru 2013 or 2012 thru 2014. *The MA website says:* Amnesty is available to any individual or business who has not currently registered with the Department of Revenue, who has not filed a tax return, or who has not reported the full amount of tax owed on a previously filed return for any tax return due on or before December 31, 2015. *And the statute says:* The tax amnesty program shall not apply to a tax liability of any tax type for a period commencing on or after January 1, 2014.

19. Overall reforms to ATB, procedures, board composition, filing fees.

aim
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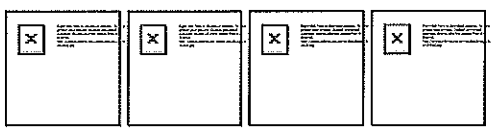

Dixon, Lisa (ANF)

From: Rulings and Regulations <RulesandRegs@dor.state.ma.us>
Sent: Friday, October 02, 2015 7:25 AM
To: bmacdougall@
Subject: TIR 15-10: Interest Rate on Overpayments and Underpayments

Title: **TIR 15-10:INTEREST RATE ON OVERPAYMENTS AND UNDERPAYMENTS**

Type of Document and Status: TIR; Issued

Tax Type: All taxes

Summary: This Technical Information Release announces the interest rate the Department charges on underpayments of tax and the rate of interest the Department pays on refunds of tax during the entire year of 2015.

Target Audience: All taxpayers

Link to Document: http://www.mass.gov/dor/businesses/help-and-resources/legal-library/tirs/tirs-by-years/2015-releases/tir-15-10.html

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Dixon, Lisa (ANF)

From: Rulings and Regulations <RulesandRegs@dor.state.ma.us>
Sent: Friday, August 28, 2015 11:48 AM
To: bmacdougall@
Subject: DD 15-2; Approval of Principal Reporting Corporation

Document Title: **DD 15-2: APPROVAL OF PRINCIPAL REPORTING CORPORATION**

Status: Directive; Issued

Tax type: Corporate Excise

Summary: This directive explains that where a combined report is filed in good faith on behalf of a combined group by a corporation that is not one of the entities specifically designated by 830 CMR 63.32B.2(11)(a) to act as a principal reporting corporation, such corporation is deemed to be approved as the group's principal reporting corporation pursuant to said section except in circumstances where otherwise required by the Commissioner.

Target Audience: Taxpayers that are members of a combined group; Tax Practitioners.

Link to Document: http://www.mass.gov/dor/businesses/help-and-resources/legal-library/directives/directives-by-years/2015-directives/dd-15-2.html

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Appeals Court argument illustrates need for legislative action to reign in Massachusetts' sham transaction doctrine

Editor's Note: Michael Jacobs and Robert Weyman are attorneys with AIM member law firm Reed Smith LLP. Mike and Rob are members of Reed Smith's State Tax Group and focus their practices on corporate state tax controversy and planning matters.

Pending litigation at the Massachusetts Appeals Court, *Allied-Domecq v. Commissioner*, should concern Massachusetts taxpayers that have structured their business in a manner that resulted in a Massachusetts tax benefit.[1] Arguments by the Commonwealth in *Allied-Domecq* illustrate that Massachusetts' current "sham transaction" statute was drafted too broadly and could create an impossible burden for taxpayers trying to organize their business in a tax efficient manner. Legislative action is needed to protect unwary taxpayers from potentially impossible evidentiary burdens at audit.

By way of background, Allied-Domecq's appeal arose from a typical business restructuring—the centralization of business functions in one affiliate. Starting in 1996, functions such as tax and audit were transferred from one affiliate to a corporate parent, as were the employees who performed those functions. This type of restructuring occurs all the time in large companies, however, in this case it drew the ire of the Massachusetts Department of Revenue because it created a large Massachusetts tax benefit for the affiliated group. The Department treated the transfer of employees and business functions as a "sham" for the 1996 – 2004 tax years and disregarded its effect for tax purposes—leading to a substantial tax assessment. This case is the first application of the Department's sham powers to deny the effect of an intercompany employee transfer among affiliates.

Even more troubling, however, were the Commonwealth's assertions regarding a 2003 law change (M.G.L. ch. 62C §3A) that codified and expanded the Department's powers to treat business transactions as "shams". The Commonwealth argued that under the new law, if the Department asserts that a business transaction is a sham, the taxpayer must show that the transaction had business purpose, economic substance, **and** the non-tax benefits of the transaction are **greater** than the tax benefits. If they cannot provide "clear and convincing" evidence of equal or greater non-tax benefit—a very high legal standard—then the taxpayer loses the tax benefit.

This standard is unreasonably burdensome and broad, and will inevitably ensnare good corporate citizens in burdensome tax audits for making common business decisions. However, as currently written, the statute actually *supports* the Department's interpretation. For example, suppose a taxpayer decides to create a separate affiliated corporation to hold the assets, employees, and management of a promising new product that it hopes to launch. The company is deciding on the state of incorporation, and chooses Delaware over Massachusetts or any other state. Like many companies, this decision is made in part because the company is familiar with the Delaware's laws of incorporation and business registration process, and the company values the relative predictability of Delaware's corporate legal system. However, suppose that the choice to

[1] *Allied-Domecq Spirts and Wines USA, Inc. v. Commissioner of Revenue,* Appellate Tax Board Docket Numbers C282807, C293684, and C297779 (May 22, 2013) *appeal pending* Massachusetts Appeals Court, Docket Number 2013-P-0984.

incorporate in Delaware also means the taxpayer pays $10 million less tax than if they incorporated in Massachusetts. Even though the choice to incorporate in Delaware has clear business purpose and economic substance, would the taxpayer have any way of showing by clear and convincing evidence that the value of familiarity with Delaware corporate law is greater than $10 million a year?

If the taxpayer doesn't meet that burden, then under the Commonwealth's argument, this routine business decision—choosing a state of incorporation—could be disregarded as a "sham", leaving this taxpayer with an unexpected tax bill. And this could happen as a result of any number of routine business structuring decisions, such as choosing to organize a business as an LLC rather than a corporation, or choosing to capitalize an entity with debt as opposed to equity.

At oral argument in *Allied-Domecq*, even some members of the Court seemed surprised by the statutory language and one justice questioned, for example, what a taxpayer would do if they thought that a particular business transaction would have a large non-tax benefit that never materialized. Would they not only have to suffer the business failure, but also be hit by a tax assessment because the transaction—undertaken with good business intent—did not ultimately produce non-tax benefits "commensurate" with the tax savings?

Given the unreasonably burdensome evidentiary standard placed on taxpayers and broad language that invites Departmental overreach by applying the statute to standard business transactions, it is clear that the current sham transaction statute needs to be amended.

During the 2011 – 2012 Legislative session, AIM supported legislation that would amend M.G.L. ch. 62C §3A by (1) removing the requirement that the non-tax benefits of a business transaction exceed the tax benefits; and (2) by making clear that the Department cannot "sham" basic business transactions such as choice of corporate form or state of incorporation. We think this proposal would have limited the uncertainty regarding the Massachusetts tax treatment of tax efficient business structuring decisions, while preserving the Department's power to target abusive transactions lacking economic substance. We hope to see it reintroduced.

AIM's initiative would bring Massachusetts more into line with federal and common law standards regarding the sham transaction doctrine, and would remove a cloud of uncertainty that currently hangs over many routine business structuring decisions by Massachusetts taxpayers.

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DECEMBER 29, 2014

Massachusetts Group Calls Market-Based Sourcing Reg Burdensome

Neil Downing

Summary by taxanalysts

A prominent business group in Massachusetts has told the state Department of Revenue that its proposed regulation on market-based sourcing is complicated and burdensome.

Full Text Published by taxanalysts®

A prominent business group in Massachusetts has told the state Department of Revenue that its proposed regulation on market-based sourcing is complicated and burdensome.

Associated Industries of Massachusetts (AIM), which represents about 4,500 employers in the state, said in a letter to the DOR, "While detail can be helpful, as an entire body of work, these regulations represent a voluminous and overly complex manner of implementing market sourcing regulations."

The proposed 71-page regulation creates opportunities for the DOR "to over assess a taxpayer," Bradley MacDougall of AIM said in a December 4 letter to the DOR. The proposed regulation is also "inconsistent with other states and imposes the most costly version of market sourcing in the country," MacDougall said.

AIM urged the DOR "to turn this complex regime into one that contains the fundamental principles for creating a sound tax regime, most notably, equity and fairness, certainty, economy of calculation and simplicity."

AIM also posted an article about the issue on its blog on December 19, written by Michael Jacobs and Robert Weyman, both with AIM-member law firm Reed Smith LLP.

Asked for the DOR's response, DOR spokeswoman Maryann Merigan told Tax Analysts on December 19 that the DOR "asked for comments and received a considerable number of them on the revised regulation and has responded by clarifying language in some of the provisions and incorporating more than 60 examples to provide additional clarity."

Merigan added, "It is the Department's goal to provide the taxpayer with certainty through a thorough and thoughtful revision of this regulation."

Massachusetts is at the forefront of developing rules for market-based sourcing. (Prior coverage.)

The Multistate Tax Commission's Uniformity Committee on December 11 voted to instruct the work group charged with designing market-based sourcing model regulations to use as its starting draft the package of rules proposed in Massachusetts. (Prior coverage.)

Background

A provision in a transportation revenue bill, enacted by the Massachusetts legislature on July 24, 2013, changed the apportionment formula for corporate income tax purposes to reflect market-based sourcing. (Prior coverage.)

To implement the law, the DOR issued an initial draft regulation on March 25; many practitioners found it complex and potentially difficult for taxpayers to apply.

The DOR on October 30 issued a revised working draft regulation on a new market-based sourcing law designed to address practitioner and taxpayer concerns. (Prior coverage.)

The revised working draft provides more detail and more examples to help clarify the department's position, Michael Fatale, chief of the DOR's Rulings and Regulations Bureau, told Tax Analysts at the time.

In its December letter, AIM raised concerns about provisions in the revised draft that involve a safe harbor provision, tiering rules, the treatment of professional services, the regulation's relationship to other apportionment rules, issues involving transportation services, and other matters.

For example, AIM said that the revised draft does not appear to include a provision to allow for a reasonable approximation of the sourcing of professional service receipts.

"Is this because it is assumed that the taxpayer will always know the billing address of its customer? What if this is not the case, does the sale have to be thrown out, or can a reasonable approximation be used? Taxpayers should be allowed to make a reasonable approximation for sourcing of professional services as they do for personal services and all other services," AIM said.

The Greater Boston Chamber of Commerce, which represents about 1,500 businesses, has also provided comments on the regulation to the DOR, said Jim Klocke of the chamber. "It's an important issue. It affects a lot of companies," Klocke told Tax Analysts on December 19. He said he hopes that the comments the DOR receives on the matter will be reflected in the regulation's final version.

Tax Analysts Information

Jurisdiction: Massachusetts
Subject Areas: Sourcing
Apportionment
Corporate taxation
Author: Neil Downing

Institutional Author: Tax Analysts
Tax Analysts Document Number: Doc 2014-30281
Tax Analysts Electronic Citation: 2014 STT 248-5

Thursday, December, 4, 2014

By Email rulesandregs@dor.state.ma.us

Mr. Michael Fatale, Chief
Rulings and Regulations Bureau
Massachusetts Department of Revenue
100 Cambridge Street
Boston, MA 02114

RE: Proposed Regulation 830 CMR 63.38.1: Apportionment of Income

Dear Mr. Fatale:

On behalf of our members, AIM wishes to submit comments regarding the proposed regulation 830 CMR 63.38.1: Apportionment of Income.

AIM appreciates that the Department of Revenue's effort to respond to AIM's request for an extension during the initial comment period from May 1st to May 19th. Second, we appreciate the effort made by the department to provide taxpayers guidance with this complex law change.

The comments offered in this letter reflect the key concerns that AIM has identified with the current draft of the regulation. AIM has also attached a copy of AIM's original comments filed with the department on May 19. In total AIM has provided 13 pages of written comments and provided the department with direct feedback through several meetings.

The market sourcing law became effective as of January 1, 2014 and by September of 2015 taxpayers will be submitting their 2014 tax returns under the new market sourcing law and regulations. It should be noted that the enabling statute for market sourcing was approximately 3 pages. However, the regulations being considered by the Department of Revenue fills 71 pages. While detail can be helpful, as an entire body of work, these regulations represent a voluminous and overly complex manner of implementing market sourcing regulations.

There are two particular and troubling aspects with the regulations that were not eliminated from the working draft and remain in the proposed regulation:

1. The regulations create opportunities for the department to over assess a taxpayer not according to law, but by disallowing a taxpayer the same rights and rules afforded to the department. A state agency that is charged with administering, enforcing and litigating the tax code should not be able write the rules in manner that further extends the significant power of the department by

diminishing the rights of the taxpayer. There needs to be greater consideration of equal treatment. For instance, why should the department be afforded the opportunity to amend past returns that could yield a higher tax rate, but the taxpayer is not able to amend those same past returns and is only able to amend them prospectively?

2. The regulations are inconsistent with other states and imposes the most costly version of market sourcing in the country. For instance, the 5% rule is an extremely granular rule for identifying and the provisions for market services and professional services is a first of its kind. The rules are outliers compared to any other states. The 5% rule should be eliminated and the department should use the billing address. Further, the static nature of these rules will negatively impact future services.

AIM urges the department to turn this complex regime into one that contains the fundamental principles for creating a sound tax regime, most notably, equity and fairness, certainty, economy of calculation and simplicity. As written, certain aspects of this new regime maximize the opportunity for disputes that will only result in greater litigation costs for both the taxpayer and the Commonwealth. The Department must view these concerns in light of opportunity costs for the state, the taxpayer and the residents of the Commonwealth. Taxpayer investments tied up in audit and litigation disputes are investments diverted from job creation, and economic growth.

AIM urges the Department to consider the following key issues through the taxpayer perspective that includes the broader business enterprise including information technology deployment, integration with business operations, and the full range of challenges and cost burdens that employers face as a result of these draft regulations.

Here are some of the key issues raised by AIM members:

Safe Harbor

AIM remains concerned that the 5% rule is a way for the department to create an uneven playing field with taxpayer by using the rules a way to override the safe harbor.

Further guidance is requested in section (9)(d)(4)(c)(ii)(B)(2)(d) with the definition of "customer" for the safe harbor exemption of 1,000 or more customers. If a taxpayer provides services to a single multi-state entity, but sends bills for services for the same customer to 20 different addresses, does this customer count as 1 customer or 20 customers for safe harbor purposes. Assume in this case that there are 20 different services provided, each managed and controlled at the address where the bill is sent to.

Tiering Rules

On page 46, tiering rules did not change from the originally proposed working draft regulations and continue to include the rule regarding 5% of sales of services to any one customer. The existence of this

requirement places an administrative burden on the taxpayer and further provides the DOR with opportunities to create dispute and assess greater taxes.

Again, we strongly believe that the 5% rule should be eliminated entirely or at a minimum increase the amount to a minimum of 10%.

Professional Services

On page 27, the revised regulations appears to indicate that professional services must use the specific rules (the hierarchy) rather than some other approximation. However, para. (9)(d)(1)(e)) provides that in the case of professional services, the provided rules of reasonable approximation must be followed (see para. (9)(d)(1)(e)). The regulations could be clarified by indicating whether a taxpayer can reasonably approximate the assignment of receipts from professional services if the taxpayer cannot obtain any of the information required under the ordering rules set forth in the regulation.

In section (9)(d)4.d, there does not appear to be any provision in the regulation to allow for a reasonable approximation of the sourcing of professional service receipts. Is this because it is assumed that the taxpayer will always know the billing address of its customer? What if this is not the case, does the sale have to be thrown out, or can a reasonable approximation be used? Taxpayers should be allowed to make a reasonable approximation for sourcing of professional services as they do for personal services and all other services.

Professional service providers who work with large multi-state clients will likely work on multiple matters during the year for the same client. For example, a law firm which represents a multi-state financial institution could be engaged to work on hundreds of loan closings during the year. In this case different loan officers within the financial institution, located in different states, would likely be the primary manager of the law firm's services for each separate loan. The law firm, however, probably only has a single engagement letter with the financial institution which covers all of the matters on which they work during the year. If the law firm assigns its receipts based on the single location where the engagement letter was ordered this will have the unintended result of aggregating each separate matter performed for the client. A better alternative would be to allow the taxpayer to reasonably approximate where the benefit of each separate service was received if the location of each person who is the primary manager cannot be determined.

Further in section (9)(d)(4)(d)(i), the discussion of whether a service is a professional service or an in-person service includes examples of professional services which will be sourced using the rules for in-person services. The working draft listed medical, dental and child care services as examples of such services. The proposed regulation adds "carpentry" to this list of professional services to be apportioned by use of the in-person rules. Carpentry does not appear to be the type of service that most taxpayers would consider a professional service, unless the DOR is relying on the fact that "specialized knowledge" is required. If so, this would seem to greatly expand the number of services that fall into the

category of professional services. The DOR should clarify what types of services they view as professional services and how the "specialized knowledge" description is applied.

Changes in Methodology: Commissioner Review

On page 28, proposed regulations contain areas of concern.

Specifically section (g)(i) Indicates that the method applied by the taxpayer "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." The next sentence states that, "in such cases" neither the Commissioner nor the taxpayer (through the form of an audit adjustment, amended return, abatement application or otherwise) may modify the taxpayer's methodology for assigning sales for that year. However, the Commissioner and the taxpayer can correct factual errors or calculation errors with respect to the application of the methodology.

While section (g)(ii) indicates in B and D that the Commissioner can change the methodology used. This appears to directly conflict with (g)(i), above.

Further, section (g)(ii) A, C and E contain other powers for the Commissioner to make adjustments.

However, (g)(iii) allows a taxpayer to change methodology only on a prospective basis with disclosure, and only for purposes for improving accuracy, such as when better information becomes available. Here are some suggestions for correcting these imbalances:

1. In B and D, indicate that the Commissioner and taxpayer may agree to a substitute method of approximation. We could also add that "if they cannot agree, then the taxpayer has the right to go to the early mediation program."
2. Allow the taxpayer to amend under the same circumstances that (g)(iii) allows for prospective changes or at least to present evidence on audit that better information has subsequently become available for the returns being audited.

Further concerns with this area of the proposed regulation include section (g)(iv), which provides that the Commissioner has to provide a written explanation for the reason for requiring a taxpayer to make a prospective change in methodology. AIM believes that this should be amended to make it clear that the Commissioner has to state in writing: 1) Why the change is needed to reflect a more accurate assignment of sales and 2) Why the Commissioner's method results in better accuracy.

Another concern is that section (g)(iv) should be amended in the last sentence and should include language indicating that the Commissioner and taxpayer may agree to a substitute method of approximation. It could also be further amended to include: "if they cannot agree, then the taxpayer has the right to go to the early mediation program."

Critical to the operation of section (9)(d)1.d(i) is a determination of whether a method of assignment is "reasonable" or "not reasonable". Taxpayers are not allowed to amend their filing from one reasonable method to another reasonable method. Likewise, the DOR is only allowed to adjust a taxpayer's filing if the method of assignment used is not reasonable. It will be critical that the same standard of

reasonableness be applied for both taxpayers and the DOR. Otherwise the integrity of the tax system will be questioned if taxpayers are held to a different standard when requesting a refund by amending their return than the DOR is in seeking an audit assessment.

Consideration should be given to adding a more definitive statement that the DOR may not adjust a taxpayers method of assignment if it is considered to be reasonable, to be consistent with the requirement that a taxpayer may not amend their return if their original method of assignment was reasonable.

Relationship to other apportionment rules

Section (9)(d)1.f. provides that no provision of the market based sourcing rules is to supersede industry –specific alternative apportionment regulations. However, the sourcing rules provided in 830 CMR 63.38.1(9)(d)4.b(iii) related to transportation and moving services are in direct conflict with 830 CMR 63.38.3, Apportionment of income of motor carriers. This latter regulation uses a concept of revenue miles to apportion revenue of motor carriers. The proposed regulation uses the location of the transportation delivery to source receipts. The DOR needs to resolve this conflict and provide clear guidance as to which regulation will control the sourcing of receipts from transportation and moving services.

Transportation services

Section (9)(d)4.b(iii)(A) raises questions concerning the election for sourcing of round trip tickets could use further clarification. What is the result of not making the election, are round trip tickets sourced 100% to the destination where the customer will be returning to? Is the election an annual election, or does it apply to all years after the first year in which it is made? What if a ticket is for travel from A to B, B to C, and C to A, would it be reasonable to divide the ticket into three separate receipts, 33% each under the election, as compared to the 50/50 split for a one destination round trip ticket?

Services delivered through or on behalf of customer

These rules goes beyond the statutory authority, is contradictory with the rest of the regulations. It should be removed.

In section (9)(d)4.c(B)3, all of the examples provided to illustrate the concept of services delivered through or on behalf of a customer deal with advertising services. Consideration should be given to having a broader range of examples of services that are delivered through or on behalf of a customer.

For example, assume Company A operates call centers throughout the country and contracts with Company B, a mail order company, to answer telephone calls from individuals placing orders for products found in Company B's catalogues. Would receipts from the providing of call center services be assigned to the location of the individual making the call to place an order as opposed to either the

location Company B or the location of the call center? Likewise, should brokers who receive a commission for making a sale source the receipt to the location of the party to whom they made the sale to or the location of the principal who paid their commission and on whose behalf they made the sale. Providing a broader range of examples will provide additional guidance for taxpayers.

Primary residence, individual customers

In section (9)(d)4.d(ii)(A), the definition of primary residence requires some clarification. Is this the state where the taxpayer is physically present for the most number of days during the year, or the state where the taxpayer is required to file a resident tax return using the tests of domicile and statutory resident? If the latter, how would a service provider be able to determine where an individual customer files their resident tax return? This is not information that is generally available or that the service provider likely has a right to ask for. Further guidance as to how the state of primary residence is determined would be helpful to taxpayers.

License of production intangible

Section (9)(d)5.c includes a presumption that if any use of a production intangible is in Massachusetts then 100% of the use is deemed to be in Massachusetts unless the taxpayer can demonstrate that some use is also outside of Massachusetts. This places an undue burden on the taxpayer to refute the presumption of 100% sourcing to Massachusetts. A more balanced and equitable approach would be to require the taxpayer and DOR to agree on a reasonable approximation of the use, instead of a presumption that the receipts are 100% sourced to Massachusetts if the DOR determines that any of the use is in Massachusetts.

Excluded sales

In section (9)(d)6.a(v), the current apportionment regulation states that income-producing activity includes the sale of a partnership interest and makes reference to the partnership's property and payroll factors to determine whether the gross receipts are sourced to Massachusetts. The proposed regulation, however, provides that a sale of a partnership interest, that is not otherwise a security, is an excluded sale and the receipt is not included in the numerator or denominator of the sales factor. By excluding any measure of the receipt from sale of a partnership interest from the apportionment factor there will be a significant risk that Massachusetts will tax income that under the U.S. constitution does not have a connection with Massachusetts and cannot be taxed. There should be some reasonable method for including receipts from the sale of a partnership interest in the apportionment factor as opposed to excluding these receipts from the apportionment factor.

For the same reason, having a broad exclusion for all sales of intangible property except those that are specifically referenced in the regulation can lead to more income being taxed in Massachusetts than is allowed by federal law. The exclusion of receipts from a sale of securities or business goodwill is excluded by statute from the sales factor calculation. But to extend this exclusion to a much broader

range of intangible sales, such as the sale of a patented technology as described in Example 9 of 830 CMR 63.38.1(9)(d)6.b, is problematic. The preferable approach would be to require taxpayers to determine a reasonable approximation for assignment of these receipts.

Thank you for taking AIM's perspective into consideration. We look forward to working with you as the Department continues to formulate these regulations.

Sincerely,

Bradley A. MacDougall
Vice President – Government Affairs
Associated Industries of Massachusetts

cc: Amy Pitter, Commissioner
Kevin W. Brown, General Counsel
David S. Davenport, Deputy General Counsel and Senior Policy Advisor

aim
Associated Industries of Massachusetts

May 19, 2014

By Email rulesandregs@dor.state.ma.us

Mr. Michael Fatale, Chief
Rulings and Regulations Bureau
Massachusetts Department of Revenue
100 Cambridge Street
Boston, MA 02114

Dear Mr. Fatale:

On behalf of our members, AIM wishes to submit comments regarding Working Draft Regulation 830 CMR 63.38.1: Apportionment of Income. First, we appreciate the Department of Revenue's effort to respond to AIM's request for an extension in the comment period from May 1st to May 19th. Second we appreciate the effort made by the Department to provide taxpayers guidance with this comprehensive and complex law change. The Department is to be commended for the thorough and thoughtful analysis presented in the Working Draft.

The comments offered in this letter will hopefully further the fundamental principles for creating a sound tax regime, most notably, equity and fairness, certainty, economy of calculation and simplicity, which minimize the risk for uneven audit decisions and greater litigation cost for both the taxpayer and the Commonwealth. In some situations, the provisions impose an "affirmative duty" for taxpayers to obtain information that may not be legally accessible to them. We also are mindful of identifying provisions which may be unadministrable for implementation and compliance purposes and impose a prohibitive cost burden for information technology (IT) upgrades and overall costs necessary to comply.

AIM urges the Department to consider the following key issues through the taxpayer perspective that includes the broader business enterprise including information technology deployment, integration with business operations, and the full range of challenges and cost burdens that employers face as a result of these draft regulations.

Here are some of the key issues raised by AIM members:

Reasonable approximation

AIM recognizes the DOR's attempt to define reasonable approximation. However, in some instances, taxpayers believe that this term is vague and is not defined in the draft. Taxpayers need guidance in order to comply with this standard and to have some certainty of the amount of tax they owe.

Special rule of reasonable approximation

What amount would constitute a "substantial amount of sales" that would justify the use of the special rule? Taxpayers need guidance in order to comply with this standard and to have some certainty of the amount of tax they owe.

Subsequent change in method of assignment and Commissioner review

Critical to the operation of section 830CMR 63.38.1(9)(d)1.d(i) is a determination of whether a method of assignment is "reasonable" or "not reasonable". Taxpayers are concerned that they are not allowed to amend their filing from one reasonable method to another reasonable method. Likewise, the DOR is only allowed to adjust a taxpayer's filing if the method of assignment used is not reasonable. It is critical that the same standard of reasonableness be applied for both taxpayers and the DOR. Otherwise the integrity of the tax system will be questioned if taxpayers are held to a different standard when requesting a refund by amending their return than the DOR is in seeking an audit assessment.

As currently drafted, the regulation says that, if the Commissioner determines that the taxpayer's method of approximation is "unreasonable", then the Commissioner can 1) substitute a method that he finds reasonable or 2) exclude the sales from the numerator and denominator of the factor. Taxpayers are concerned that the regulations as drafted provide the Commissioner with unfettered authority to impose whatever methodology desired by the Department to the detriment of the taxpayer based only on a finding of "unreasonableness." AIM urges the department to add additional language requiring that the Commissioner should have the burden of proof to explain in writing why the taxpayer's method is unreasonable and why the Department's substitute methodology is reasonable.

Taxpayers are concerned that once the first return is filed using a "reasonable approximation", any change in methodology in a future year must be disclosed (reason, nature, extent of change). Does this mean that if a taxpayer develops or upgrades their information technology system in future years that the taxpayer will be penalized for changing their methodology?

This new tax regime impacts a broad range of taxpayers, and imposes significant burdens on companies to determine and apply the best sourcing methods, utilizing systems that have not yet been programmed or populated with data required for tax compliance and 2014 estimated tax filings. AIM believes that the regulations should provide that a method of reasonable approximation that may be changed via amended return or as part of the audit of a return with respect to the first three years during which the new rules are in effect beginning on or after January 1, 2014. The addition of this provision would help to defray some of the burden required to implement systems necessary to comply with the regulation.

AIM also believes that the regulations should provide that the Commissioner will permit taxpayers to change, prospectively, to a new reasonable method of approximation as a matter of course as long as the new method is determined to be at least as accurate as the method it displaces.

Relationship to other apportionment rules

Section 830 CMR 63.38.1(9)(d)1.f provides that no provision of the market based sourcing rules is to supersede industry–specific alternative apportionment regulations. However, the sourcing rules provided in 830 CMR 63.38.1(9)(d)4.b(iii) related to transportation and moving services are in direct conflict with 830 CMR 63.38.3, Apportionment of Income of Motor Carriers. This latter regulation uses a concept of revenue miles to apportion revenue of motor carriers. The proposed regulation uses the location of the transportation delivery to source receipts. The DOR needs to resolve this conflict

and provide clear guidance as to which regulation will control the sourcing of receipts from transportation and moving services.

Services delivered to the customer or through or on behalf of customer

All of the examples provided in section 830 CMR 63.38.1(9)(d)4.c(B)3 to illustrate the concept of services delivered through or on behalf of a customer deal with advertising services. Consideration should be given to having a broader range of examples of services that are delivered through or on behalf of a customer.

For example, assume Company A operates call centers throughout the country and contracts with Company B, a mail order company, to answer telephone calls from individuals placing orders for products found in Company B's catalogues. Would receipts from the providing of call center services be assigned to the location of the individual making the call to place an order as opposed to either the location of Company B or the location of the call center? Likewise, should brokers who receive a commission for making a sale source the receipt to the location of the party to whom they made the sale or the location of the principal who paid their commission and on whose behalf they made the sale? Providing a broader range of examples will provide additional guidance for taxpayers.

Transportation services

A number of issues concerning the election for sourcing of round trip tickets could use further clarification in section 830 CMR 63.38.1(9)(d)4.b(iii)(A). What is the result of not making the election -- are round trip tickets sourced 100% to the destination to which the customer will be returning? Is the election an annual election, or does it apply to all years after the first year in which it is made? What if a ticket is for travel from A to B, B to C, and C to A, would it be reasonable to divide the ticket into three separate receipts, 33% each under the election, as compared to the 50/50 split for a one destination round trip ticket?

Engineering services

Section 830 CMR 63.38.1(9)(d)4.d(iii) provides a special rule for the sourcing of engineering services. The rule provides that such services are sourced to the state where the real or tangible property for which the services are rendered is located. Our concern is that the term "engineering" is very broad and can include a number of very different activities. Engineering services related to structures and machinery are the type of services likely intended to be covered by this special rule. But the term engineering services can also be described to include software development, contract R&D, process improvement, and other activities not related to real or personal property. The Department should provide further guidance as to the types of engineering services which will be sourced by this section and which services will not.

Professional services - Sourcing for business customers

Taxpayers are concerned that their record systems do not currently collect information that would indicate where our customer manages the contract of sale. Customers are under no obligation to tell the service provider this information and the taxpayer cannot legally compel them to do so. For example, some taxpayer's process customer orders via telephone or computer and the taxpayer is not aware of the location from which the order is placed by the customer is currently being collected. Even if the

information is available, integrating this information with the taxpayer's general ledger system to link it with receipts would be expensive, not currently available in 2014, and require significant programming. Billing address is a much more reasonable and easily administered standard. AIM urges the department to add additional language requiring that the Commissioner should have the burden of proof to explain in writing why the taxpayer's method is unreasonable and why the Department's substitute methodology is reasonable.

Professional services – sourcing for individual customers

The definition of primary residence in section 830 CMR 63.38.1(9)(d)4.d(ii)(A) requires some clarification. Is this the state where the taxpayer is physically present for the most number of days during the year, or the state where the taxpayer is required to file a resident tax return using the tests of domicile and statutory resident? If the latter, how would a service provider be able to determine where an individual customer files their resident tax return? This is not information that is generally available or that the service provider has a right to request. Further guidance as to how the state of primary residence is determined would be helpful to taxpayers.

Taxpayers are also concerned that based on current records, the location of an individual's "primary residence" is not knowable. For the vast majority of customers, the corporate taxpayer expects the billing address would be the same as the primary residence of the customer. However, this may not be the fact in every case. AIM urges the department to review this requirement and the need for the department to demand unknowable information from corporate tax filers.

Large taxpayers - Sourcing for individual and business customers

Large corporate taxpayers have hundreds of thousands of customers, so undertaking the due diligence necessary to comply with the cascading rules would be a significant and burdensome task. Also, it is not clear whether the analysis would be required on an annual basis, which would add to the burden.

AIM believes that an example should be added to the regulation that allows taxpayers with a certain number of customers (e.g., 100 customers, 500 customers, etc.) to use the billing address as the primary sourcing rule rather than the location from which the contract is managed or the order is placed.

Professional services – sourcing for multi-state clients

In section 830 CMR 63.38.1(9)(d)4.d, there does not appear to be any provision in the regulation to allow for a reasonable approximation of the sourcing of professional service receipts. Is this because it is assumed that the taxpayer will always know the billing address of its customer? What if this is not the case, does the sale have to be thrownout, or can a reasonable approximation be used? Taxpayers should be allowed to make a reasonable approximation for sourcing of professional services as they do for personal services and all other services.

Professional service providers who work with large multi-state clients will likely work on multiple matters during the year for the same client. For example, a law firm which represents a multi-state financial institution could be engaged to work on hundreds of loan closings during the year. In this case different loan officers within the financial institution, located in different states, will be the primary manager of the law firm's services for each separate loan. The law firm, however, probably only has a single engagement letter with the financial institution which covers all of the matters on which they

work during the year. If the law firm assigns its receipts based on the single location where the engagement letter was ordered this will have the unintended result of aggregating each separate matter performed for the client. A better alternative would be to allow the taxpayer to reasonably approximate where the benefit of each separate service was received if the location of each person who is the primary manager cannot be determined.

Reasonably determinable

The cascading rules for sourcing sales to both individual and business customers require that the taxpayer show that one level of information is not "reasonably determinable" before moving to the next level.

Taxpayers believe that a billing address is a much easier methodology for taxpayers to comply with and for the DOR to audit. Taxpayers do not understand why the billing address is not the primary (or only) rule for sourcing sales to individuals and business customers. The cascading system that is currently outlined in the draft adds unnecessary complication and uncertainty for both taxpayers and the DOR.

AIM urges the department to add additional language requiring that the Commissioner should have the burden of proof to explain in writing why the taxpayer's method is unreasonable and why the Department's substitute methodology is reasonable.

Affirmative duty

AIM believes that this standard is unreasonable and it can be impossible to comply with in some situations especially when the taxpayer does not and cannot find out where the client is managing the contract. AIM urges the Department to remove this requirement, since it adds an unnecessary layer of complexity to an already complicated regime.

License of production intangible

Section 830 CMR 63.38.1(9)(d)5.c includes a presumption that if any use of a production intangible is in Massachusetts then 100% of the use is deemed to be in Massachusetts unless the taxpayer can demonstrate that some use is also outside of Massachusetts. This places an undue burden on the taxpayer to refute the presumption of 100% sourcing to Massachusetts. A more balanced and equitable approach would be to require the taxpayer and DOR to agree on a reasonable approximation of the use, instead of a presumption that the receipts are 100% sourced to Massachusetts if the DOR determines that any of the use is in Massachusetts.

Excluded sales

In section 830 CMR 63.38.1(9)(d)6.a(v) the current apportionment regulation states that income-producing activity includes the sale of a partnership interest and makes reference to the partnership's property and payroll factors to determine whether the gross receipts are sourced to Massachusetts. The proposed regulation, however, provides that a sale of a partnership interest, that is not otherwise a security, is an excluded sale and the receipt is not included in the numerator or denominator of the sales factor.

By excluding any measure of the receipt from sale of a partnership interest from the apportionment factor there will be a significant risk that Massachusetts will tax income that under the U.S. Constitution does not have a connection with Massachusetts and cannot be taxed. There should be some reasonable method for including receipts from the sale of a partnership interest in the apportionment factor as opposed to excluding these receipts from the apportionment factor.

For the same reason, having a broad exclusion for all sales of intangible property except those that are specifically referenced in the regulation can lead to more income being taxed in Massachusetts than is allowed by federal law. Receipts from a sale of securities or business goodwill are excluded by statute from the sales factor calculation. But it is problematic to extend this exclusion to a much broader range of intangible sales, such as the sale of a patented technology as described in Example 9 of 830 CMR 63.38.1(9)(d)6.b. The preferable approach would be to require taxpayers to determine a reasonable approximation for assignment of these receipts.

Software transactions

Section 830 CMR 63.38.1(9)(d)7.a deals with the sourcing of receipts from software sales. According to this section, the sale of a license for pre-written software transferred on a tangible medium is treated differently than a sale that is delivered electronically. This distinction is not consistent with legislation promulgated in 2005 to treat the electronic transfer of prewritten software as a sale of tangible property for sales tax purposes. Technical Information Release 05-15 further explains this treatment of electronic transfers of prewritten software. The Department should be consistent in the characterization of electronic transfers of prewritten software for both sales tax and income tax apportionment purposes. Accordingly, the receipts from such sales should be sourced as sales of tangible personal property, not as receipts from the license of intangible property.

Bundling

In cases in which services are governed by two or more different sourcing methods, AIM urges the Department to review the sourcing rules for "bundled" services and urge that any approach avoid the imposition of significant new data maintenance requirements on taxpayers.

Thank you for taking AIM's perspective into consideration. We look forward to working with you as the Department continues to formulate these regulations.

Sincerely,

Bradley A. MacDougall
Vice President – Government Affairs
Associated Industries of Massachusetts

cc: Amy Pitter, Commissioner
Kevin W. Brown, General Counsel
David S. Davenport, Deputy General Counsel and Senior Policy Advisor

AP 637: Voluntary Disclosure Program for the Settlement of Uncertain Tax Issues

637.1 Introduction

The Voluntary Disclosure Program for the Settlement of Uncertain Tax Issues (the "Program") is a pilot program intended to provide taxpayers with the opportunity to come forward voluntarily to disclose and propose settlement of uncertain tax issues. The pilot program is currently open to business taxpayers.

The Department of Revenue (the "Department") is committed to resolving tax disputes in a fair and expeditious manner. The Department likewise is committed to encouraging voluntary compliance with the Commonwealth's tax laws. The Department is aware that in the course of preparing its tax return(s), a taxpayer may identify an issue(s) for which the proper tax treatment is uncertain. Generally, an "uncertain tax issue" is one for which there is no clear statutory guidance or controlling case law, and which has not been addressed by the Department in a regulation, letter ruling, or other public written statement. Further, the issue must not have been addressed as part of a prior audit of the taxpayer, a prior application for abatement or amended return filed by the taxpayer, or a prior ruling request made by the taxpayer. An "uncertain tax issue" may be a purely legal issue, or an issue that is fact intensive and to which the application of established law is unclear. Generally, an "uncertain tax issue" is one for which a taxpayer would be required to maintain a reserve in accordance with ASC 740: Accounting for Uncertainty in Income Taxes (formerly FIN 48).

The Program is designed to offer a process through which uncertain tax issues may be resolved on an expedited basis, generally within four months. However, the Department retains the discretion to determine that the Program is not appropriate for specific cases.

~~.2~~ 637.2 Eligibility

The Program is available to business taxpayers for tax returns filed pursuant to G.L. c. 62C, §§ 11, 12, or 16, and which are open for assessment under the provisions of G.L. c. 62C, § 26.

Generally, the total amount of any potential tax liability attributable to the uncertain tax issue(s) must be $100,000 or more, exclusive of interest and/or penalties.

Tax returns which are currently under audit or for which the taxpayer has received notice of an impending audit are not eligible for the Program.

The Department will consider settlement of an uncertain tax issue(s) where: (1) the taxpayer has presented its position on the issue(s) and the Department agrees that the tax treatment of the issue(s) is uncertain; and (2) the

taxpayer has fully disclosed and documented the issue(s) and the facts associated with that issue(s).

~~____.3~~637.3 Procedures

~~____.3.1~~637.3.1 Application Process

~~____.3.1.1~~637.3.1.1 Initial Evaluation

Initially, a taxpayer may contact the Department on an anonymous basis to identify and explain the uncertain tax

issue(s) for which it seeks resolution. The Department will review the information provided and make a determination as to whether it is appropriate to commit resources to the matter and to attempt to negotiate a settlement of the uncertain tax issue(s).

To initiate the process, the taxpayer ~~or its~~'s authorized representative should submit a letter to the Department requesting voluntary disclosure and settlement of an uncertain tax issue(s) in accordance with AP~~____~~. 637. The letter should be addressed to:
Massachusetts Department of Revenue
Voluntary Disclosure Unit
200 Arlington Street, Room 4300
Chelsea, MA 02150

The letter should include the following:

* A statement of the relevant facts and an explanation of the uncertain tax issue(s) that it seeks to resolve, including an explanation as to why the issue(s) is uncertain; and

* The tax period(s) in dispute and an estimate of the amounts in dispute by period.

The Department will review the information provided by the taxpayer and make a determination as to whether the matter is appropriate for inclusion in the Program. The information provided will be reviewed jointly by managers of the Audit and Resolution Divisions. ~~Within 30 days of the initial~~Generally, the Department will complete its review within 30 days of receipt of the taxpayer's submission. Within this review period, the Department may contact ~~by~~ the taxpayer's representative to seek additional information or otherwise discuss the uncertain tax issue(s). Upon completion of its review, the Department will notify the taxpayer's representative in writing as to whether the matter has been accepted into the Program. Depending upon the situation, this notification may include a brief discussion of the uncertain tax issue(s), such as a summary of areas that the Department believes need further development.

If the matter is accepted into the program, the Department will agree to waive all penalties that may be imposed, including penalties that may be imposed under G.L. c. 62C, §§ 35A and 35D, with regard to the uncertain tax issue(s), provided that the taxpayer has acted in good faith in pursuing the transaction(s) or other matter(s) giving rise to the voluntary disclosure request and in presenting the facts, and analysis thereof, to the Department throughout the voluntary disclosure process.

If the Department agrees to accept the matter into the Program, the taxpayer will have 45 days from the date of the acceptance letter to decide whether it wishes to proceed with the Program. The taxpayer must notify the Department of its decision in writing within 45 days of the date of the acceptance letter.

~~.3.1.2~~637.3.1.2 Application upon Acceptance into the Program

If the taxpayer decides to proceed with the Program, it will be required to identify itself at the time that it notifies the Department of its decision. The taxpayer will also be required to provide the following information and/or documentation:

* A description of the taxpayer's business activities, including its business activities in Massachusetts;

* The tax period(s) at issue, the date on which the return(s) was filed, and a statement as to whether the tax period(s) is open under the three year statute (G.L. c. 62C, § 26(b)) or the six year statute (G.L. c. 62C, §§ 26(h) and (i));

* A calculation of the tax amount potentially in dispute by period, including a detailed explanation as to how the amount per period was calculated;

* A detailed explanation of the uncertain tax issue(s);

* A detailed description of the facts giving rise to the uncertain tax issue(s) in question;

* A position statement setting forth the taxpayer's legal analysis of the uncertain tax issue(s);

* Copies of all documents relevant to the uncertain tax issue(s) and facts in question;

* A statement as to whether the taxpayer or any of its affiliates has undergone any federal and/ or other state audits or proceedings which addressed the uncertain tax issue(s) and, if so, the outcome of the audits or proceedings with regard to the uncertain tax issue(s);

* A statement as to whether the uncertain tax issue(s) involves a listed transaction;

* A statement as to whether the uncertain tax issue(s) was raised or addressed during a past audit of the taxpayer or any of its affiliates by the Department;

* A statement as to whether the taxpayer or any of its affiliates previously contacted the Department regarding the uncertain tax issue(s) by means of a letter ruling request or other form of contact;

* A statement as to whether the taxpayer or any of its affiliates entered into any prior settlement agreement involving the uncertain tax issue(s) with the Department;

* A request for a conference, if desired;

* Contact information;

* Settlement Proposal: The letter should include a detailed proposal for settling the uncertain tax issue(s). The taxpayer's settlement proposal should take into consideration the impact, if any, that the proposed settlement may have on any net operating loss and/or credit carryovers. The taxpayer may include in its proposal a provision regarding the resolution of future tax periods. While the Department will consider the inclusion of such a provision in any potential settlement, the Department is not required under this Program to settle future tax periods; and

* Signature(s): The submission must be signed under the pains and penalties of perjury by an authorized individual, including a representative authorized under a Power of Attorney (Form M-2848). The submission must include the following attestation: "Under the penalties of perjury, I declare that to the best of my knowledge and belief, the facts presented in this request, and all accompanying statements and enclosures, are true, correct, and complete."

~~.3.3~~637.3.2 Additional Documentation

As part of its review of the taxpayer's voluntary disclosure and settlement request, the Department may ask the taxpayer to provide documentation in addition to that which was submitted with the taxpayer's request.

~~.3.4~~637.3.3 Conference

After receiving the voluntary disclosure and settlement request, the Department will schedule a conference, if requested by the taxpayer. In some cases, the Department may determine that a conference would be beneficial to its review of the taxpayer's request and schedule a conference, even if one has not been requested by the taxpayer. The conference may be conducted either in person at the Department's offices located in Boston, Massachusetts, or by telephone.

Conferences are informal and do not apply the rules of evidence or require testimony given under oath. No transcript or formal record of the proceedings

is made. However, the Department may request that matters alleged as fact be stated under the pains and penalties of perjury.

Generally, a resolution will not be reached during the conference. After the conference, the Department will prepare a settlement recommendation which will include a summary of the information presented at the conference.

~~.4~~637.4 Settlement Consideration

~~.4.1~~637.4.1 Settlement Recommendations

Upon completion of its evaluation of the taxpayer's submission, the Department will prepare a settlement recommendation for review by the Settlement Review Board. The Settlement Review Board consists of the Senior Deputy Commissioner (or his/her designee, the Taxpayer Advocate), the General Counsel, and the Director of the Office of Appeals. Following its review, the Settlement Review Board will authorize the Department to pursue settlement on specified terms.

~~.4.2~~637.4.2 Settlement Discussions

After a settlement recommendation has been reviewed and settlement terms approved, the Department will contact the taxpayer or its designated representative to discuss the case and negotiate a settlement.

As part of any settlement, the taxpayer may be required to file amended returns for the tax periods in question. For transaction taxes, spreadsheets would be acceptable.

~~.4.3~~637.4.3 Completion of Settlement and Effect of Settlement Agreement

When the taxpayer and the Department have agreed to settlement terms, the taxpayer (or its designated representative) and the Department must sign a written settlement agreement reflecting those terms.

To the extent that the statute of limitations for assessment remains open, the Department may audit the taxpayer's returns for the period(s) in question. Generally, the Department will not make audit adjustments with regard to the issue(s) subject to the settlement agreement, except as otherwise may be provided in the terms of the agreement. However, as part of any audit, the Department may verify the calculation of the tax associated with the issue(s) subject to the settlement agreement, including the impact of any other adjustments the Department may propose for the tax period(s) at issue, and make appropriate adjustments.

Once a settlement agreement has been signed, the matter in question may not be reopened absent fraud, omission of a material fact, misrepresentation of a material fact, or mutual mistake relating to a material fact.

Additionally, settlements may not be regarded as precedent in any other matter, including other settlements, whether

or not involving the same taxpayer.

~~.4.4~~637.4.4 Settlement Not Reached

In the event that the parties are unable to reach an agreement, the voluntary disclosure case will be closed. The Department will issue a letter to the taxpayer or its authorized representative indicating that the voluntary disclosure case has been closed.

In the event that the parties are unable to reach an agreement, the Department will not be precluded from utilizing the information provided to it during the voluntary disclosure process for purposes of auditing the taxpayer's return(s) or defending any subsequent appeal of such an audit.

In the event that the taxpayer's return(s) for the tax period(s) at issue are audited and tax assessed with regard to one or more uncertain tax issues that were disclosed through the Program, any penalties that may otherwise be imposed, including penalties that may be imposed under G.L. c. 62C, §§ 35A and 35D, with regard to the uncertain tax issue(s) will be waived, provided the taxpayer acted in good faith in pursuing the transaction(s) or other matter(s) giving rise to the voluntary disclosure case and in presenting the facts, and analysis thereof, to the Department throughout the voluntary disclosure process.

In the event that the taxpayer's return(s) for the tax period(s) at issue are audited and tax assessed with regard to the uncertain tax issue(s) that was disclosed through the Program, all administrative appeal options remain open to the taxpayer. In any subsequent appeal of such an audit, any conference or hearing request submitted to the Office of Appeals will not be assigned to any appeals officer who participated in the review of the taxpayer's voluntary disclosure and settlement submission.

ASSOCIATED INDUSTRIES OF MASSACHUSETTS
100 YRS

Leadership is our business

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June 9, 2015

Representative Jay Kaufman, House Chair
Senator Michael J. Rodriques, Senate Chair
Members of the Joint Committee on Revenue
State House
Boston, MA 02133

RE: AIM Testimony on Tax Policy

Dear Chairman Kaufman, Chairman Rodriques, and Members:

Associated Industries of Massachusetts (AIM) and its thousands of employer members recognize that the creation of a job and a person's ability to do it weave together every important aspect of social and economic stability: the desire for a better life; the ability to support a family; the confidence to start a business; and the need to support efficient government management of services like education, health care, and public safety.

As AIM celebrates its 100th anniversary, we urge legislative members to review *AIM's BluePrint for the Next Century,*[1] which highlights many of the issues before the Committee today. To create the Blueprint, AIM spoke with hundreds of business owners and managers with the goal of collecting ideas for ensuring that the Bay State remains a global economic powerhouse.

We also spoke to people outside the business community – elected officials; economists; academics; journalists; high school teachers; students; and labor unions. Our conversations took place in regional meetings and human resources roundtables, in speeches to business groups, through an online survey, on social media and in statewide webcasts.

Our respondents identified two key issue priorities that are relevant to this committee.

First, to encourage a uniformly strong business climate by creating a competitive economic structure across all industries, geographic regions and populations rather than picking winners and losers.[2]

[1] http://blog.aimnet.org/aim-issueconnect/topic/blueprint-for-the-next-century
[2] http://blog.aimnet.org/aim-issueconnect/blueprint-for-the-next-century-a-uniformly-strong-business-climate

Second, to address regulations by establishing a world-class state regulatory system that ensures the health and welfare of society in a manner that meets the highest standards for efficiency, predictability, transparency and responsiveness.[3]

Tax policy does matter and it is a fundamental aspect of how Massachusetts is evaluated for its ability to create a strong business climate. The state's tax rate(s) and tax laws do have a direct impact on businesses ability to remain, grow or decide to locate in Massachusetts. The state's administration, enforcement, dispute resolution and litigation of the Commonwealth's tax code is where Massachusetts is routinely considered to be a negative outlier compared to other states.

AIM urges this committee and the legislature to consider how any proposed tax policy supports a strong business climate, creates a world-class regulatory regime and how it is evaluated against principles of a good tax regime, which includes: equity; certainty; convenience of payment; economy of collection simplicity; neutrality; economic growth and efficiency; transparency and visibility; minimum tax gap; and appropriate government revenues.

AIM's legislative priorities for 2015-2016 focus on and seek to improve various aspects of tax policy administration. In particular, AIM wishes to specifically highlight and strongly support legislation to clarify the net-worth measure of the corporate excise. AIM also wishes to express strong opposition to legislation regarding so-called tax haven legislation. AIM has attached memo's regarding both proposals.

Regarding AIM's position on other legislation before this committee today, below is a list of those that we support and those we oppose.

Thank you for taking AIM's views into account and please feel free to contact me if you have any questions or need any further information.

Sincerely,

Bradley A. MacDougall
Vice President for Government Affairs

[3] http://blog.aimnet.org/aim-issueconnect/blueprint-for-the-next-century-regulation

Attachment A:

	AIM Supports
H.2458	An Act relative to the schedule of payment of estimated corporate taxes
H.2480	An Act relative to estimated quarterly corporate tax payments
H.2548	An Act to clarify the net-worth measure of the corporate excise
H.2549	An Act clarifying the application of the throw out rule for corporate excise sales factor apportionment purposes
S.1546	An Act to clarify the net-worth measure of the corporate excise
S.1565	An Ac to clarify the net-worth measure of the corporate excise
S.1577	An Act to clarify the application of the throw out rule for corporate excise sales factor purposes
	AIM Opposes
H.2477	An Act closing a certain corporate tax haven loophole
S.1508	An act to eliminate the tax deduction for direct-to-consumer pharmaceuticals marketing
S.1509	An Act relative to excessive executive compensation
S.1524	An Act closing a corporate tax haven loophole

Attachment B: AIM and MTF Memo on Clarifying the Net worth Tax

Attachment C: AIM Memo on So-Called Tax Haven Legislation

Massachusetts Taxpayers Foundation

Massachusetts, unlike many other states, has a non-income measure of the corporate excise tax, often referred to as the net worth tax. The net worth tax is a separate component of the corporate excise tax, with its own set of rules. Businesses in Massachusetts have raised two separate but related concerns with the state's administration of this tax. The following sections detail these two issues:

- the first outlines the Department of Revenue's (DOR) inconsistent approach in determining what constitutes debt or equity when computing the net worth tax (Section 1 in this memo); and
- the second explains DOR's aggressive pursuit of foreign (non-U.S.) companies in collecting the net worth tax (Section 2 in this memo).

Already among a dwindling group of states with a so-called balance sheet tax, in both cases DOR's approach casts Massachusetts as an even more extreme outlier. A legislative proposal (Section 3 in this memo) is attached that would address these concerns.

Section 1: Determining Debt/Equity for the Net Worth Tax

Over the last several months, Massachusetts businesses have raised serious concerns about DOR's practices in administering the state's net worth tax, specifically as it relates to adjustments that are being made to taxpayer balance sheets to inflate a taxpayer's net worth and corresponding tax.

It is extremely important to AIM and MTF, and the scores of companies we represent, for Governor Baker and the legislature to rectify this issue as soon as possible by including clarifying language—in an outside section of the fiscal 2016 budget—that reinforces the Legislature's original intent when it enacted the net worth tax. Swift action on this issue will avoid further negative effects on the state's current and prospective employers while making it clear that DOR has overstepped its authority in the administration of this tax.

A very common issue for taxpayers in the net worth tax regime is tied to centralized cash management; this is a common practice for complex businesses. Such arrangements can create intercompany debt, as recorded and reported in separate company financial statements. However, DOR asserts that such debt is instead equity. Once "reclassified" by DOR, a taxpayer's net worth tax base can be substantially inflated, subjecting the entity to a higher net worth tax. This approach ignores state law that requires using a taxpayer's books and records (i.e. financial statements) to determine the net worth tax liability and instead applies DOR-developed rules. By disregarding the books and records, DOR overturns 50 years of established practice and procedural application of the net worth tax.

Massachusetts repeatedly ranks among the worst states nationally for tax predictability, and DOR's administration of the net worth tax creates yet one more area of uncertainty. This practice will create unexpected, large tax liabilities for major employers within the state and make it more attractive for businesses to move out of state.

Sections one and two of the attached proposed legislation clarify that, for purposes of the net worth tax, DOR should treat debt and equity as they are accounted for in financial statements. The proposed

language affirms statutory authority and judicial precedent by stating that the standard accounting methods used in financial statements will also be the method by which DOR must determine the net worth tax liability.

Net Worth Tax Technical Background and DOR Approach

- The Massachusetts corporate excise tax is comprised of two separate taxes: (1) a net income tax; and (2) a property-based tax. At issue here is the tax based on property, as measured by a company's net worth.

- State statute requires net worth to be computed using book value, on a separate company (not combined or affiliated-group) basis. Our courts have construed the net worth tax statute as requiring the use of generally accepted accounting principles (GAAP) in computing net worth. Accordingly, intercompany obligations that are treated as debt under GAAP are to be treated as debt for net worth tax purposes. As the Supreme Judicial Court opined, this approach aims to "simplify" the tax and attract new industry "create(ing) a more favorable tax climate in Massachusetts."

- DOR is seeking to overturn longstanding rules through the audit and appeals process. It is now creating its own computation for computing the net worth tax and abandoning the use of book value. In so doing, DOR is departing from legislative intent, judicial precedent articulated by the Supreme Judicial Court, and 50 years of consistent practice and procedure.

- DOR is disregarding these valid, normal business transactions and creating its own accounting method and, by extension, a second set of financial statements for Massachusetts tax purposes only.

Implications of DOR's policy

- DOR's stance means that all companies, both Massachusetts-based and out-of-state, that have a significant physical presence in Massachusetts could be substantially harmed.

- The DOR position represents bad policy because the companies that provide thousands of jobs in Massachusetts could be severely punished.

- If this interpretation is applied broadly—and GAAP is no longer the controlling method for determining the net worth tax base—it would require businesses to re-create financial statements to suit DOR's specific demands. This is a tremendous undertaking and would add a substantial administrative burden on businesses.

Section 2: Net Worth Tax on Foreign Companies

The second issue of concern with the state's administration of the net worth tax relates to foreign (non-U.S.) corporations that have U.S. affiliates doing business in Massachusetts.

Under federal law and international treaties, states cannot require a foreign corporation to pay corporate income taxes if that business is not subject to U.S. income taxation. However, DOR has asserted that

foreign entities that receive royalties from affiliates doing business in Massachusetts have nexus in the state, and therefore must file the separate corporate non-income (i.e. net worth) tax.

While this application may be technically within the bounds of state law, it is undoubtedly an aggressive one. Massachusetts is in the minority as a state that still imposes a balance sheet tax on corporations, but extending its reach to foreign entities that do not do business in the U.S. under federal law certainly makes it an outlier. This undercuts the water's edge concept, which is a key aspect of Massachusetts combined reporting.

Section three of the attached proposed legislation would limit the state's ability to collect the net worth tax from foreign entities by modifying the sales factor calculation in the apportionment formula so that a foreign entity that is not subject to federal or state income taxes would likewise not be subject to the net worth tax as that entity would have a Massachusetts apportionment of zero for determining its net worth liability.

Section 3: Legislative Proposal

SECTION 1. Paragraph 8 of Section 30 of chapter 63, as amended by section 105 of chapter 165 of the acts of 2014, is hereby amended by striking out the last sentence and inserting in place thereof the following sentence:-

In determining whether an item shown on the books of a corporation is to be treated as reflecting debt or equity, the taxpayer's treatment of the item for accounting purposes shall be considered to be controlling, unless the commissioner establishes that such treatment is not in accordance with the accounting standards used by that taxpayer for making financial reports to shareholders, such as, without limitation, Generally Accepted Accounting Principles or International Financial Reporting Standards; and in determining the book value of any asset, the commissioner may disallow any reserve, in whole or in part, established with respect thereto which, in his judgment, is not reasonable and proper.

SECTION 2. By this act the general court clarifies its original intention that the treatment of an item on the books of a corporation shall be controlling in determining its net worth. This act shall be effective upon its passage, and shall be applicable to all open tax years.

SECTION 3. Section 38(f) of chapter 63 is hereby amended by inserting after the phrase "'sales' shall not include" by adding the following phrase:-

"an item of income of a corporation that is organized outside of the United States to the extent that such item is exempt from United States federal income tax either by virtue of a federal income tax treaty or otherwise, or"

For additional information regarding these topics contact Brad MacDougall, at Associated Industries of Massachusetts (AIM) or Carolyn Ryan at the Massachusetts Taxpayers Foundation (MTF)

MASSACHUSETTS TAX ADMINISTRATION

The following need to be addressed legislatively or at the administrative level to improve the fairness and equity of the audit process in Massachusetts.

1. The ability of auditors to use, or threaten to use, jeopardy assessments on companies solely to keep the statute of limitations open
    a. Jeopardy assessments are intended to address situations where there is risk that the taxpayer will leave the state or place property out of the reach of the state before the state can collect taxes that the taxpayer owes.
    b. It should not be used by auditors to force taxpayers to keep audits open/extend statutes of limitations where there is no risk that the taxpayer will leave the state without paying any taxes that are due.
    c. Other procedures can, and should be, developed to address situations where a taxpayer is not providing the Department with sufficient information to conduct the audit prior to the statute of limitations expiring.
2. Timely and complete end of audits
    a. Auditors often draw audits out over long periods without issuing assessments even though taxpayers have submitted requested documentation.
    b. This will generally mean that a taxpayer must deal with multiple requests for extension of waivers (and risk the threat of a jeopardy assessment, as discussed above, if they do not comply).
    c. The scope of audit also should be reasonable (i.e., in sales tax cases, a materiality threshold for receipts and other proof should be instituted).
3. R&D Credit
    a. Base period of 1982-84 that is currently used makes it difficult to find documents to establish proof because of the age of the sources.
    b. If one member of a combined group cannot meet the data requirement, the Department will deny the credit to all members.
    c. Adoption of the rolling base period used by IRS for federal tax purposes is more fair and easier to substantiate.
    d. Should work to revive recent initiative to adopt rolling base period.
4. Protective Orders
    a. Need to preserve confidentiality of documents which contain sensitive customer information and competitive information at Appellate Tax Board. There is currently no mechanism for getting a protective order for information submitted to ATB.
    b. Same issue with auditors. Documents containing confidential information can still be exchanged by Department of Revenue with taxing authorities of other states that are party to tax information sharing agreements with Massachusetts.

ASSOCIATED INDUSTRIES OF MASSACHUSETTS
100 YRS

Leadership is our business

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Sent via: rulesandregs@dor.state.ma.us

July 01, 2015

Rebecca Forter
Rosann M. Hansen
Rules and Regulations
Massachusetts Department of Revenue

Re: Working Draft Directive 15-XX: Approval of Principal Reporting Corporation

Dear Ms. Forter and Ms. Hansen:

AIM appreciates the opportunity to comment on Working Draft Directive 15-XX: Approval of Principal Reporting Corporation. Overall, the working draft appears to set forth a taxpayer friendly approach, that would reduce paperwork and filings. This is appreciated.

However, AIM is concerned about language that creates ambiguity by reserving the right for the Department of Revenue (department) to require the taxpayer to use a principal reporting corporation otherwise required under the statute and regulations.

Specifically, it appears that the last sentence essentially nullifies the purpose of the Directive: "except to the extent that the Commissioner affirmatively requires the combined group to file its combined report and associated corporate excise returns as otherwise specified in 830 CMR 63.32B.2(11)(a)." Essentially, the department waives this technical requirement that the lead filer qualify under (11)(a), except when they don't.

AIM encourages the department to consider adding additional language that would indicate greater transparency and therefore predictability in the instances that the department determines that a taxpayer does not qualify. Such language could include "...for good cause (i.e. Substantive, non-presentational, reasons)". This type of language would help to provide greater transparency between taxpayer and the department as well as consistency of application of rulings.

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Thank you in advance for considering AIM's comments. Please feel free to contact me should you have any questions.

Sincerely,

Bradley A. MacDougall
Vice President for Government Affairs

Massachusetts Taxpayers Foundation

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AMY PITTER
COMMISSIONER
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The Commonwealth of Massachusetts
Department of Revenue
Rulings and Regulations Bureau
P.O. Box 9566
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January 2, 2015

Jessica Seney
Director of Government Affairs
Greater Boston Chamber of Commerce
265 Franklin Street, 12th Floor
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Bradley A. MacDougall
Vice President – Government Affairs
Associated Industries of Massachusetts
One Beacon Street, 16th Floor
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Dear Ms. Seney and Mr. MacDougall:

Thank you for your recent comments regarding the proposed amendments to DOR Regulation 830 CMR 63.38.1, Apportionment of Income. The amended regulation has now been filed in final form with the Secretary of the Commonwealth and is scheduled to be published today. As you know, throughout the development of the amended regulation, the Department has sought the input of the taxpayer and practitioner communities, through formal public comment as well as informally at forums and conferences. The various comments that the Department received through multiple channels on both the initial working draft and the subsequent proposed regulation have greatly helped to improve the final document.

The recent legislative revisions to the corporate income apportionment provisions (Mass. Gen. Laws, c. 63, sec. 38) relating to the sales factor as applied to sales "other than sales of tangible personal property" necessarily require taxpayers to change their methods of reporting such sales. The Department has endeavored to limit the administrative burden necessitated by those changes by incorporating significant flexibility for taxpayers into the regulation, in part

relying on the concept of "reasonable approximation" provided for in the statute. The Department has also included a large number of examples in the amended regulation in order to further explain and illuminate the application of the amended regulation, both in general and as to particular types of businesses and service industries that are likely to be affected. We are gratified to have heard from many practitioners and taxpayers that they appreciate the flexibility as well as the level of detail and the examples in the regulation.[1]

We are providing this letter as a word of thanks, and also to explain our response and general thinking with respect to some of the comments we have received, which we hope you will find helpful.

The recently enacted statutory revisions to Section 38(f) of Chapter 63 were worded in relatively general terms. Consequently, the Department has sought in the amended regulation to provide specific transaction-based guidance. The working draft of the regulation circulated in May established a conceptual framework for the regulation that distinguished among various types of service and intangibles-based transactions. From the comments we received, taxpayers and tax practitioners seemed generally satisfied with this approach to the regulatory framework, but requested that the Department revise the rules to make them easier to apply and fairer in their application.

For example, in response to the working draft of the amended regulation that was circulated last May, the Department received comments requesting the inclusion of safe harbors in some of the regulatory rules governing service transactions. The Department added two safe harbors to the proposed regulation that was circulated in October, and at that time received additional comments requesting that these safe harbors be made more accessible. In response to these comments, the Department has in the final regulation broadened the availability of the safe harbors.

Similarly, in the working draft of the amended regulation, the Department included an "extrapolation" rule that was not specifically referenced in the statute, as a means to simplify compliance. This rule permits taxpayers that have insufficient information regarding the delivery location of a sale to approximate such location based on sales for which the taxpayer does have sufficient information. Several of the comments that the Department recently received with respect to the proposed regulation specifically requested that the Department expand its

[1] We also note that the Multistate Tax Commission, at a meeting held on December 11, 2014, endorsed the Massachusetts rules as a starting place for a model regulation that could be used by states nationwide. In part, that endorsement was based on the fact that the Massachusetts regulation provides a significant amount of detailed taxpayer guidance.

application across a wider spectrum of services addressed by the regulation, in particular so as to be available for "professional services". In response to these comments, the Department has in the final regulation extended the extrapolation rule to the professional services category.

In response to other comments on the proposed regulation, the Department has provided guidance to taxpayers in the form of additional examples. In particular, the Department clarified the section regarding services delivered "on behalf of a customer," including the addition, as requested, of additional examples of such types of services. Also, the Department revised the rules on "professional services," as specifically requested, to clarify the assignment of sales in the case of potential overlap between the category encompassing such professional services and the category of "in-person services."

Although the Department addressed many of the recent comments received with respect to the proposed regulation, in some cases the Department concluded the particular comment could not reasonably be addressed or, alternatively, that the comment should be addressed in a different manner than that proposed by the commenter. For example, in both the working draft of the amended regulation and the subsequent proposed regulation, the Department endeavored to be clear that taxpayers and the Department are subject to similar limitations with respect to their authority to adjust returns that apply a reasonable method of assigning sales. The working draft of the regulation provided taxpayers with considerable flexibility to make use of the concept of reasonable approximation, but taxpayers were nonetheless concerned that the Department might have the ability to make an adjustment to a taxpayer's chosen method of assignment of sales even where the method was otherwise reasonable. The proposed regulation made clear that neither the taxpayer nor the Department may modify a taxpayer's methodology retrospectively in any case where the taxpayer has properly assigned its sales, including where the taxpayer has used a method of reasonable approximation that is in accordance with the regulatory rules.[2]

Notwithstanding these efforts to refine the rules with respect to methods of reasonable approximation, the Department recently received some further comments suggesting that the proposed regulation failed to place taxpayers and the Department "on equal footing."[3] The basis for this perception seems to be that while the regulation would restrict the ability of the taxpayer to make retroactive changes to the approximation method used on past returns, it would allow the

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[2] The proposed and final versions of the regulation also expressly allow a taxpayer to change its method of reasonable approximation on a prospective basis, in order to improve the accuracy of the approximation, and similarly allow the Commissioner to require a change in method of approximation to be used prospectively on future taxpayer returns, in order to improve the accuracy of the method of approximation.

[3] *See, for example*, Michael Jacobs and Robert Weyman, "AIM Proposes Improvements to Tax Rules," Dec. 19, 2014, *available at*: http://blog.aimnet.org/aim-issueconnect/aim-proposes-improvements-to-tax-rules.

Department to review on audit whether the taxpayer employed a reasonable methodology in accordance with the regulation. The Department disagrees with this objection, and we thought it would be helpful to share with you the reasons for this.

The ability of the Department to review a taxpayer's chosen methodology to ensure that it satisfies the regulatory criteria is a fundamental part of the audit process. In general, taxpayers and the Department cannot be placed on an "equal footing" in the audit process. As with many aspects of tax reporting in a self-assessment system, the taxpayer has the ability -- and responsibility -- to report its pertinent information in accordance with statutory and regulatory rules and guidance, which in this instance includes the opportunity in many situations for the taxpayer to adopt its own method of reasonable approximation for assigning sales. The Department must in turn be afforded an opportunity to review a taxpayer's chosen method to ensure that such method does in fact satisfy the statutory and regulatory requirements. Therefore, the Department refrained from making additional changes to the structure of the reasonable approximation provisions.

Thank you again for your comments. I hope this information is helpful to you and your members.

Sincerely,

Michael T. Fatale
Chief, Rulings and Regulations Bureau

Cc: Amy A. Pitter, Commissioner
Kevin W. Brown, General Counsel
David S. Davenport, Deputy Commissioner and Senior Policy Counsel