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Mr. Lennie Collins
Director
Income Tax Division
North Carolina Department of Revenue
501 N Wilmington St.
Raleigh, NC 27604

RE: Motion Picture Association of America, Inc. Comments on Proposed Rules Regarding Market-Based Sourcing

Dear Director Collins:

On behalf of the Motion Picture Association of America, Inc.,* I am pleased to offer the attached comments on the Proposed Rules Regarding Market-Based Sourcing published by the Department on October 3, 2016.

The Proposed Rules, as applied to broadcasters, would make North Carolina an outlier among the states. The attached comments offer a more contemporary approach to sourcing broadcaster receipts.

The Proposed Rules rely on a "viewing audience" method for sourcing broadcaster receipts. The viewing audience method is used by a minority of fifteen states, all of which adopted the method between 12 and 25 years ago when reliable state-by-state viewing audience data was generally available from most third-party distributors (The sole exception is Massachusetts,

* Paramount Pictures Corporation, Sony Pictures Entertainment Inc., Twentieth Century Fox Film Corporation, Universal City Studios LLC, Walt Disney Studios Motion Pictures, Warner Bros. Entertainment Inc. and CBS Corporation as an affiliate member.

which adopted the audience method by administrative action in 2016). Moreover, four of the states using the viewing audience method (New York, California and Connecticut) adopted it as an economic incentive to the MPAA member companies to maintain and grow their operations in those states. The more recent evolution of the broadcast industry into streaming and mobile viewing has made ultimate viewing locations increasingly indeterminable. As a result, the audience method has become an unworkable and unreliable anachronism.

Of the remaining states, eleven, including North Carolina, have for decades relied on the "cost of performance" method of sourcing receipts. This method generally sources receipts based on where the costs of performance were incurred in producing the revenue – a test which generally results in sales being sourced to the "origin" state, thus duplicating the property and payroll factors.

The clear trend across the country is to abandon both the viewing audience and cost of performance methods of sourcing broadcaster receipts in favor of the commercial domicile approach reflected in the attached comments and supported by the MPAA members. The commercial domicile method sources receipts to the location of the distributors and advertisers who represent the broadcasters' customer base. The commercial domicile method avoids the uncertainties and inaccuracies of the viewing audience method while reflecting the market or "destination" state unlike the cost of performance method. The virtue of the commercial domicile approach is reflected in the fact that it is the only method of sourcing broadcaster receipts adopted by legislative action in the last decade. Attached to this letter is a chart (Exhibit A) outlining the sourcing methods in effect across the United States (also attached is Exhibit B, which summarizes the states with commercial domicile apportionment).

Thank you in advance for consideration of these comments. Please contact me or the MPAA's Legislative Advocate Dave Horne if you would like to discuss them in detail.

Sincerely,

Attachments

MOTION PICTURE ASSOCIATION OF AMERICA, INC.

COMMENTS OF MOTION PICTURE ASSOCIATION OF AMERICA, INC. TO PROPOSED RULES REGARDING MARKET-BASED SOURCING

17 NCAC 05G.0101 *et seq.*

These comments are submitted on behalf of the Motion Picture Association of America, Inc. ("MPAA") regarding proposed amendments to the North Carolina Administrative Code published in the North Carolina Register on October 3, 2016 (the "Proposed Rules"). The Proposed Rules were published under the authority of section 38.4 of H 1030 (S.L. 2016-94) and would, if they become effective, implement and administer market-based sourcing principles for apportionment purposes.

ABOUT MPAA

The MPAA is the trade association representing the nation's leading producers of motion pictures and television programs, distributed on film, home video, the Internet, satellite, cable, subscription and over-the-air television broadcast. MPAA member companies own and operate all of the national broadcast networks and most of the national cable program networks (together the "Networks"). The Networks function as wholesalers of programming to other parties, such as cable television and satellite television systems, local broadcast television stations, and new media companies such as Internet content distributors. The Networks generate revenue in the form of license fees paid by content distributors. The Networks also generate revenue from national advertisers who pay the Networks to include advertisements in the programming licensed to the distributors.

BACKGROUND

North Carolina imposes a corporate income tax on the net income of corporations doing business in the state and a franchise tax on the capital stock, surplus and undivided profits (or, commencing in 2017, the net worth) of corporations organized or doing business in the state. Corporations subject to these taxes and also doing business in one or more other states are required to apportion their apportionable income or franchise tax base among those states using a three-factor formula based on the ratio of North Carolina property, payroll and sales to property, payroll and sales everywhere. The sales factor is given triple weight in this formula for the 2016 taxable year and quadruple weight for the 2017 taxable year. Beginning with the 2018 taxable year, apportionable income and the net worth franchise tax base will be apportioned using the sales factor alone.

Under current law, receipts from sales of tangible personal property are sourced to North Carolina if the property is received by the purchaser in North Carolina. N.C. Gen. Stat. §105-130.4(*l*)(2). Receipts from the sale of services are sourced to North Carolina if and to the extent the activities that give rise to the income occur in North Carolina. N.C. Gen. Stat. §105-

130.4(*l*)(3)c. Receipts from intangible property are sourced to North Carolina if they are received from sources in North Carolina. N.C. Gen. Stat. §105-130.4(*l*)(3)b.

H 1030 included a legislative proposal to replace the existing statutory rules for sourcing receipts from services and from intangibles with market-based sourcing rules. Specifically, the proposal provides that "[r]eceipts are in this State if the taxpayer's market for the receipts is in this State. *See* H 1030, §38.4.(c). More specifically, under the legislative proposal receipts from services would be sourced to North Carolina "if and to the extent the service is delivered to a location in this State," and income from intangibles would be sourced to North Carolina "if and to the extent the [licensed] property is used in this State." *Id.*

H 1030 required the Department of Revenue (the "Department") to propose rules to implement and administer these market-sourcing provisions. The rules proposed by the Department would become effective only if and when the General Assembly enacts market-sourcing legislation.

These comments relate to the Proposed Rules as they would apply, if they become effective, to revenue derived by the Networks from licensing and from the sale of advertising services.

THE PROPOSED RULES

The Proposed Rules are intended to implement the proposed statutory focus on "the taxpayer's market" as the determining factor for sourcing a taxpayer's receipts from sales of services or from intangible property.

Receipts from Intangibles

With respect to the licensing revenues, the Proposed Rules identify the license of a film, television or multimedia production or event for commercial distribution as a "marketing intangible." Prop. Rule 17 NCAC 05G.1102(b)(3). The Proposed Rules further provide:

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

Prop. Rule 17 NCAC 05G.1102(a).

The Proposed Rules go on to provide:

> "In the absence of actual evidence of the amount or proportion of the licensee's receipts that are derived from North Carolina consumers, the portion of the

licensing fee to be assigned to North Carolina shall be reasonably approximated by multiplying the total fee by a percentage that reflects the ratio of the North Carolina population in the specific geographic area where the licensee makes material use of the intangible property to regularly market its goods, services, or other items relative to the total population in that area."

Prop. Rule 17 NCAC 05G.1102(c).

The version of the Proposed Rules published on the Department's web site includes the following example illustrating this provision:

"*Example (ii)*. Program Corp, a corporation that is based outside North Carolina, licenses programming that it owns to licensees, such as networks, that in turn will offer the programming to their customers on television or other media outlets in North Carolina and in all other U.S. states. Each of these licensing contracts constitutes the license of a marketing intangible. For each licensee, assuming the Program Corp lacks evidence of the actual number of viewers of the programming in North Carolina, the component of the licensing fee paid to Program Corp by the licensee that constitutes Program Corp's North Carolina receipts is determined by multiplying the amount of the licensing fee by a percentage that reflects the ratio of the North Carolina audience of the licensee for the programming relative to the licensee's total U.S. audience for the programming."

Advertising Services

With respect to advertising services, the Proposed Rules provide:

"In the case of the delivery of a service by electronic transmission, where the service is delivered electronically to end users or other third-party recipients through or on behalf of the customer, the service is delivered in North Carolina to the extent that the end users or other third-party recipients are in North Carolina. For example, in the case of the direct, or indirect delivery of advertising on behalf of a customer to the customer's intended audience by electronic means, the service is delivered in North Carolina to the extent that the audience for such advertising is in North Carolina."

Prop. Rule 17 NCAC 05G.0905(1).

The Proposed Rules further provide that if the taxpayer cannot determine where the services are actually delivered to the end-users or other third-party recipients "but has sufficient information regarding the place of delivery that the taxpayer may reasonably approximate the state or states where the services are delivered, it shall reasonably do so." Prop. Rule 17 NCAC 05G.0905(2). If the taxpayer lacks sufficient information to make such a "reasonable approximation" it must use a "secondary rule of reasonable approximation." Specifically:

> "If a taxpayer is delivering advertising directly or indirectly to a known list of subscribers, the taxpayer shall reasonably approximate the audience for advertising in a state using a percentage that reflects the ratio of the state's subscribers in the specific geographic area in which the advertising is delivered relative to the total subscribers in that area. For a taxpayer with less information about its audience, the taxpayer shall reasonably approximate the audience in a state using the percentage that reflects the ratio of the state's population in the specific geographic area where the advertising is delivered relative to the total population in that area."

Prop. Rule 17 NCAC 05G.0905(3)(a).

The version of the Proposed Rules published on the Department's web site includes the following example illustrating this provision:

> "*Example (ii).* Network Corp, a corporation that is based outside North Carolina, sells advertising to business customers pursuant to which the customers' advertisements will run as commercials during Network Corp's televised programming as distributed by unrelated cable television and satellite television transmission companies. The receipts from Network Corp's sale of advertising time to the business customers are assigned to North Carolina to the extent that the audience for Network Corp's televised programming during which the advertisements will run is in North Carolina. If Network Corp cannot determine the actual location of the audience for its programming during which the advertisements will run, and lacks sufficient information regarding audience location to reasonably approximate the location, Network Corp must approximate the receipts from sales of advertising that constitute North Carolina sales by multiplying the amount of advertising receipts by a percentage that reflects the ratio of the North Carolina population in the specific geographic area in which the televised programming containing the advertising is run relative to the total population in that area."

COMMENTS

The MPAA submits that the Proposed Rules for sourcing receipts from intangibles and advertising services, as applied to the Networks, do not reflect the Networks' true market or the economics of the Networks' business. The Proposed Rules, as applied to the Networks, are also inconsistent with other market-based sourcing rules. Further, the Proposed Rules would present significant compliance issues for the Networks, and are not adaptable to technological changes in the way content is distributed. The MPAA recommends that the Proposed Rules be amended to include a more accurate, administrable and up to date set of market-based sourcing rules for Networks based on the location of the Networks' customers.

Receipts from Intangibles

The Proposed Rules treat license fees paid by distributors of television and other programming as receipts from marketing intangibles. As a preliminary matter, it should be noted that the Proposed Rules define a "marketing intangible" generally as the right to use intangible property, such as trade mark, in the marketing of other goods or services. While a license for the commercial distribution of programming does not obviously fall within this general definition, the Proposed Rules specifically identify such licenses as marketing intangibles.

The proposed sourcing rules for receipts from marketing intangibles, as applied to the Networks, reflect a misunderstanding of the Networks' market for their programming content and the economics of the Networks' business. Such rules are also inconsistent with other market-based sourcing rules.

The Proposed Rules Misidentify the Market for the Networks' Programming

The Proposed Rules would source the Networks' program licensing receipts to the location of the viewing audience for the licensed programs. This result is based on the mistaken premise that the viewing public constitutes the "market" for the Networks' licensing activities.

The Networks act as manufacturers and wholesalers, producing or acquiring content and marketing that content to third-party distributors. These distributors represent the Networks' customers and the market for their programming. The Networks have a direct contractual relationship with the distributors, and it is the payments received from the distributors that is being apportioned.

The Networks have no relationship with and derive no revenue from the viewing audience. Instead, it is the distributors who are in the business of building and maintaining the viewing audience as the retail market for the content they license from the Networks.

The Proposed Rules' failure to distinguish between wholesale and retail activities of Networks and distributors ignores the significant economic consequences of the Networks' business structure. When a Network, like any other producer, sells its products through a distributor, the Network foregoes the higher revenues that can be achieved by selling directly to consumers in exchange for not having to undertake the expense and risk of building and maintaining a consumer market. In effect, the Network cedes a portion of the total available profit to the distributor in exchange for the distributor's consumer marketing activities. The Network's conscious decision not to develop or maintain a consumer market makes it inappropriate to treat those consumers as the Network's market for the purpose of sourcing its program license receipts.

By effectively looking through the distributors to the ultimate consumers, the Proposed Rules tacitly presume that the transactions between a Network and a distributor lack business substance. North Carolina may have good reason to consider look through rules in specific related-party instances that lack business substance, but there is no justification to ignore the distinction between wholesale and retail markets as a general rule.

The Proposed Rules are Inconsistent with Other Sourcing Rules

The General Statutes and the Proposed Rules generally respect the distinction between wholesale and retail markets, consistent with the broader goal of identifying a taxpayer's direct marketplace for its goods and services and assigning its receipts accordingly. The proposed use of the viewing audience method to source Network program license receipts is anomalous and inconsistent with this goal.

For instance, North Carolina sources receipts from sales of tangible personal property to the state in which the property is delivered to the purchaser, even if the purchaser subsequently transfers the property elsewhere. *See* N.C. Gen. Stat. §105-130.4(*l*)(2); 17 NCAC 5C.1005(c). Under this rule, a sale from a manufacturer to a distributor is sourced to the state where the manufacturer delivers the product to the distributor, regardless of the location of the distributor's customer or the ultimate consumer. Thus, if a business delivers tangible personal property to an out-of-state distributor, those sales are not sourced to North Carolina, even if the distributor resells the products to North Carolina customers. Of course, the presence of consumers in North Carolina is not ignored. To the extent the distributor is taxable and has customers in North Carolina, the distributor's receipts from sales to North Carolina customers will be included in the numerator of its North Carolina sales factor.

There is no reason why the economic realities and consequences of dividing wholesale and retail activities and profits should be respected in the case of tangible personal property but not in the case of intangible property.

Advertising Services

The proposed sourcing rules for receipts from advertising services, as applied to the Networks, reflect a misunderstanding of the Networks' market for advertising services and the economics of the Networks' businesses. In addition, such rules are inconsistent with other market-based sourcing rules contained in the law and the Proposed Rules.

The Proposed Rules Misidentify the Market for the Networks' Advertising Services

The Proposed Rules would source the Networks' receipts from advertising services to the viewing audience of the advertisements sold. This result is based on the mistaken premise that the viewing public constitutes the "market" for the Networks' advertising services.

The Networks transact business with advertisers, not viewers. It is the advertisers, not the viewing public, who make up the "market" for the services offered by the Networks. It is advertisers with whom the Networks have privity of contract, to whom services are actually delivered, and whose payments constitute the receipts being apportioned. The Networks do not derive any advertising revenue from viewers.

The viewing audience approach taken by the Proposed Rules appears to be based on the theory that the Networks are delivering their advertising services directly to the viewer on behalf of the advertisers. In fact, the Networks do not "deliver" advertising to the viewing public. Rather, the Networks incorporate advertising into their programs and delivered the programs to distributors, including broadcast stations, cable and direct broadcast satellite systems and Internet distributors (such as Amazon or Yahoo). The distributors, as part of their business, re-deliver the advertising with the programming to which it is attached (and typically also incorporate their own advertising into the programs) to their own customers, the ultimate viewing public. The Network's services to their advertising customers are completed when programming content that includes the advertising is delivered to the distributor. The Networks do not undertake delivery to the viewing audience.

Sourcing advertising receipts by the location of the viewing audience also does not reflect a reasonable sense of how the Networks generate advertising revenue. The advertising sold by the Networks is designed to allow advertisers to target the audiences of specific programming content, without regard to where that target demographic happens to live or work. In other words, the Networks' national advertisers are targeting demographic – not geographic - slices of the viewing public, and consequently are not concerned with the location of viewers. As a result, the Networks' contracts with advertisers generally do not require advertisements to air in particular locations and do not provide for the reporting of such information. In addition, when the agreed-upon rating for a particular demographic purchased by an advertiser is not achieved, the advertiser receives a credit from the Network (known as a "make good") to reflect the value amount that was not achieved. This credit is provided without regard to any specific geographic locations reached or not reached.

<u>The Proposed Rules are Inconsistent with Other Sourcing Rules</u>

Aside from broadcast advertising, the Proposed Rules only look to the customer's "intended audience" in instances where the taxpayer engages in the business of delivering products or services to such audience; that is, where the "audience" is the direct market for the services at issue. When a retailer pays a service provider to provide phone-answering services to the retailer's customers, the Proposed Rules would source delivery of that service to locations from which customers place calls to the service provider. *See* Prop. Rule 17 NCAC 05G.0905 *Example (iv)*. Similarly, when a business pays a service provider to design and deliver print advertising to customers in the state, the proposed rules would source delivery of that service to the state. *See* Prop. Rule 17 NCAC 05G.0903, *Examples (i)* and *(ii)*. In each of these cases, the service provider is engaging in the business of delivering products or services to its direct customers in North Carolina. This is, in effect, an analogue to the sourcing of receipts from drop shipments of tangible personal property. *See* N.C. Gen. Stat. §105-130.4(l)(2) ("Direct delivery into this State by the taxpayer to a person or firm designate by the purchaser from within or without the State shall constitute delivery to the purchaser in this State.") As explained above, the Networks are in the business of content creation, and not the delivery of that content to the ultimate consumer. As a result, the rationale used to source receipts to the intended audience simply does not apply.

Compliance Issues

With respect to both license fees and advertising revenues, the viewing audience method included in the Proposed Rules will present significant compliance difficulties, raising the costs of compliance and administration for taxpayers and the Department and inviting controversy.

The Networks Lack the Data to Apply the Proposed Rules

It is an axiom of sound tax policy that a taxpayer should be able to determine its tax liability from its own business records. The Networks, however, do not possess records nor have access to reliable information about the location of the viewing audience.

Since the Networks generally have no contractual relationships with viewers, they have no billing information or other documentation in their files from which the location of the viewing audience can be determined.

The Networks also do not have access to viewing audience data from all of their distributor customers. Indeed, only about half the Networks' distributor customers currently provide the Networks access to such data, and the number of distributors providing access to such data continues to decline. For example, satellite television providers and direct to consumer Internet providers such as Netflix and Amazon do not provide viewer data to the Networks. While TV household information is available from a third-party rating service, the Nielsen Company, this information is not prepared in such a way as to provide reliable viewing audience location data. Nielsen's geographic data is based upon "Designated Market Areas," or "DMAs," which do not correspond to state boundaries. The Charlotte DMA, for instance, covers South Carolina as well as North Carolina. Furthermore, the Nielsen Company views its DMA boundaries and data as protected intellectual property and strictly prohibits any unauthorized use or reproduction of such data.

Without their own data about the viewing audience or access to reliable third-party viewing audience data, the Networks cannot, as a practical matter, determine the location of the viewing audience.

The Proposed Rules require taxpayers lacking viewing audience information to source receipts to North Carolina based on North Carolina's population relative to the entire U.S. or worldwide viewing population. *See* 17 NCAC 05G.0905(3)(a) (advertising services) and 17 NCAC 05G.1102(c) (revenue from intangibles). However, population is a very poor proxy for the actual viewing audience. As explained above, program content is targeted to demographic segments of the population, and these demographic segments are not distributed evenly over the United States. Rather, individual programs attract significantly larger audiences in certain geographic regions. For instance, *Nashville* on ABC draws heavily on southern viewers, as does all programming on *Country Music Television*.

While some degree of approximation may be inevitable in the application of any apportionment method, a method that is incapable of being applied except by reference to second order rules of approximation which require the use of extremely crude proxies cannot be considered reasonable or fair. Such a method would raise serious Constitutional concerns about whether the method "operates so as to reach profits which are in no just sense attributable to transactions within [the State's] jurisdiction." Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931).

The Viewing Audience Method Cannot Keep Up with Technological Change

Programming distribution methods are rapidly changing with the development of new technologies, making any audience measurement technique keyed to geography quickly obsolete. A significant and growing portion of viewers watch television programming on Internet-compatible devices such as laptop computers, smartphones, tablets, gaming consoles and even connected or "smart" television monitors. Many of these viewers are not cable or satellite subscribers. Many viewers download or stream content directly from MPAA member company websites or from third-party Internet distributors. The Internet distributors in turn sublicense the content to their customers. In some cases, Networks may be provided with the total number of viewers, but it is impossible to determine either the viewer's location or billing address. Third-party Internet distributors refuse to provide this information to MPAA members, and no research measurement technology exists to enable MPAA members to obtain this information from publicly-available sources. Further, even if such data were available, it would be inherently unreliable, since the very point of these new media devices is mobility. As a result, any attempt to source Network receipts based on the location of the viewing audience is doomed to speedy obsolescence.

The Networks do recognize that, as viewing habits change, television content packages will be offered by the Networks directly to viewers without intermediary distributors. In these transactions, the Networks will have a direct relationship with, will derive revenues from, and will have the billing address of these viewers. It would be appropriate and consistent with the Department's proposed market sourcing regulations to source such revenues to the viewer's billing address.

PROPOSED AMENDMENTS

The MPAA proposes that the viewing audience method be replaced with a fairer, more accurate and efficient method of sourcing the Networks' license and advertising revenues. Specifically, the MPAA proposes that such revenues be sourced to the commercial domicile of the distributors and advertisers whose payments to the Networks constitute the receipts being apportioned. A draft of proposed amendments is attached to these comments.

The distributors and advertisers are the Networks' direct customers and thus constitute the Networks' true market. Sourcing Network receipts to where these customers are located is this consistent with the goal of market-based sourcing.

The MPAA proposes that the location of the Networks' distributor and advertising customers is in each case the state from which its trade or business is primarily managed and directed, i.e., its headquarters or "commercial domicile." This location represents the place at which the ultimate licensing or advertising decisions are typically made. The concept of commercial domicile or place of management is in fact used in the Proposed Rules to source other professional and electronically delivered services. *See, e.g.*, Prop. Rule 17 NCAC 05G.0904(b)(2)(C) (place of management used as secondary rule of reasonable approximation for sourcing receipts from services delivered electronically to business customers); Prop. Rule 17 NCAC 05G.1004(2)(a) (place of management used as rule of reasonable approximation for sourcing receipts of professional services to business customers).

Commercial domicile sourcing not only conforms to basic market-based sourcing principles, but also represents a clear, efficient and administrable rule that will save taxpayers and tax administrators time and money and avoid costly, distracting and counterproductive controversies.

In addition to business customers, revenues from individual viewers is an increasing source of revenues for the Networks. If an individual viewer is the direct customer of the Networks, the revenues from such viewer would be sourced to North Carolina to the extent its billing address was in the State.

The commercial domicile approach reflects a modern best-practices approach. The states that currently use the viewing audience approach generally adopted it twenty to thirty years ago before the technological revolution in the way content is distributed. Over the past decade, many state legislatures have adopted sourcing methods for Network revenues that recognize the Networks' market as the location of their direct distributor and advertising customers. Those states include Michigan, Illinois, Oregon, Iowa, Texas and Florida.

In addition, Rhode Island and Tennessee recently adopted market-based sourcing regulations or administrative rules based on the same Multistate Tax Commission model rules on which the Proposed Rules were based. However, the regulations promulgated by each of these states adopted a commercial domicile approach to sourcing Network licensing and (in the case of Rhode Island) advertising receipts rather than the approach reflected in the Department's proposed regulations.

CONCLUSION

The MPAA applauds North Carolina's decision to adopt a market approach to sourcing receipts for apportionment purposes. The MPAA also recognizes the Department's thoughtful approach to drafting administrative rules to implement this decision and to provide taxpayers with detailed guidance. The MPAA submits, however, that the current draft of the Proposed Rules, as applied to the Networks, does not accurately identify the Networks' market and so would not accurately reflect the Networks' in-state business. The Networks' true market consists of the distributors and national advertisers with whom they have direct contractual relationships and from whom they derive the revenue being apportioned. The MPAA and its members therefore respectfully request the Department to consider the attached amendments to the Proposed Rules. The MPAA would welcome the opportunity to meet with the Secretary and his staff to discuss any questions or concerns they may have.

17 NCAC 05G .0102 DEFINITIONS
As used in this Subchapter, the following definitions shall apply:

(1) "Billing address" means the location stated in the books and records of the taxpayer as the primary mailing address relating to a customer's account as of the time of the transaction as kept in good faith in the regular course of business and not for tax avoidance purposes.

~~(1)~~(2) "Broadcast customer" means a person, corporation, partnership, limited liability company or other entity, such as an advertiser or platform distribution company, that has a direct connection or contractual relationship with the broadcaster under which the broadcaster derives revenue.

(3) "Broadcaster" means a taxpayer that is a television broadcast network, a cable program network, or a television distribution company. The term "broadcaster" does not include a platform distribution company.

~~(2)~~(4) "Business customer" means a customer that is a business operating in any form, including a sole proprietorship. Sales to a non-profit organization; a trust; the U.S. Government; a foreign, state or local government; or to an agency or instrumentality of that government are treated as sales to a business customer.

~~(3)~~(5) "Code" means as defined in G.S. 105-228.90.

(6) "Commercial domicile" means the principal place from which the trade or business of a business entity is directed or managed.

(7) "Film programming" means one or performances, events, or productions (or segments of performances, events, or productions) intended to be distributed for visual and auditory perception, including but not limited to news, entertainment, sporting events, plays stories, or other literary, commercial, educational, or artistic works.

~~(4)~~(8) "Department" means the North Carolina Department of Revenue.

~~(5)~~(9) "Good faith" means a state of mind consisting in honesty in belief or purpose, faithfulness to one's duty or obligation, observance of reasonable commercial standards of fair dealing in a given trade or business, or absence of intent to defraud or to seek unconscionable advantage.

~~(6)~~(10) "Individual customer" means a customer that is not a business customer.

~~(7)~~(11) "Intangible property" means property that is not physical or whose representation by physical means is merely incidental and includes,

(a) copyrights;
(b) patents;
(c) trademarks;
(d) trade names;
(e) brand names;
(f) franchises;
(g) licenses;
(h) trade secrets;
(i) trade dress;
(j) information;

(k) know-how;
(l) methods;
(m) programs;
(n) procedures;
(o) systems;
(p) formulae;
(q) processes;
(r) technical data;
(s) designs;
(t) literary,
(u) musical, or artistic compositions;
(v) information;
(w) ideas;
(x) contract rights including broadcast rights;
(y) agreements not to compete;
(z) goodwill and going concern value;
(aa) securities; and,
(bb) except as otherwise provided in these Rules, computer software.

~~(8)~~ (12) "Place of order" means the physical location where a customer places an order for a sale from a taxpayer, resulting in a contract with the taxpayer.

(13) "Platform distribution company" means a cable service provider, a direct broadcast satellite system, an Internet content distributor, or any other distributor that directly charges viewers for access to any film programming.

~~(9)~~ (14) "Population" means the most recent population data maintained by the U.S. Census Bureau for the year in question as of the close of the taxable period. Census data is available free of charge at census.gov/topics/population.html.

~~(10)~~ (15) "Reasonable" means agreeable to reason; just; proper. Ordinary or usual.

~~(11)~~ (16) "Related entity" means as defined in G.S. 105-130.7A.

~~(12)~~ (17) "Secretary" means the Secretary of Revenue.

~~(13)~~ (18) "State where a contract of sale is principally managed by the customer" means the primary location where an employee or other representative of a customer serves as the primary contact person for the taxpayer with respect to the day-today execution and performance of a contract entered into by the taxpayer with the customer.

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

17 NCAC 05G .0901 IN GENERAL

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

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

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

(2) "delivered on behalf of a customer" is one in which a customer contracts for a service but one or more third parties, rather than the customer, is the recipient of the service. This includes fulfillment services, or the direct or indirect delivery of advertising to the customer's intended audience. <u>The term does not include broadcast advertising services described in Rule .0906.</u>

(3) "delivered electronically through a customer" is a service that is delivered electronically to a customer for purposes of resale and subsequent electronic delivery in substantially identical form to an end user or other third-party recipient. <u>The term does not include broadcast advertising services described in Rule .0906.</u>

(c) A service can be delivered to or on behalf of a customer by physical means or through electronic transmission.

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

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

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

(1) Rule of Determination. In the case of the delivery of a service by electronic transmission, where the service is delivered electronically to end users or other third-party recipients through or on behalf of the customer, the service is delivered in North Carolina to the extent that the end users or other third-party recipients are in North Carolina. For example, in the case of the direct or indirect delivery of advertising on behalf of a customer to the customer's intended audience by electronic means, the service is delivered in North Carolina to the extent that the audience for the advertising is in North Carolina. In the case of the delivery of a service to a customer that acts as an intermediary in reselling the service in substantially identical form to third-party recipients, the service is delivered in North Carolina to the extent that the end users or other third-party recipients receive the services in North Carolina. The provisions in this Sub-Item apply whether the taxpayer's customer is an individual customer or a business customer and whether the end users or other third-party recipients to which the services are delivered through or on behalf of the customer are individuals or businesses.

(2) Rule of Reasonable Approximation. If the taxpayer cannot determine the state or states where the services are actually delivered to the end users or other third-party recipients either through or on behalf of the customer,

Formatted: Font: (Default) TimesNewRomanPSMT, Font color: Black, (none) but has sufficient information regarding the place of delivery that the taxpayer may reasonably approximate the state or states where the services are delivered, it shall reasonably do so.

(3) Select Secondary Rules of Reasonable Approximation.

(a) If a taxpayer's service is the direct or indirect electronic delivery of advertising on behalf of its customer to the customer's intended audience, and if the taxpayer lacks sufficient information regarding the location of the audience that the taxpayer may determine or reasonably approximate that location, the taxpayer shall reasonably approximate the audience in a state for the advertising using the following secondary rules of reasonable approximation. If a taxpayer is delivering advertising directly or indirectly to a known list of subscribers, the taxpayer shall reasonably approximate the audience for advertising in a state using a percentage that reflects the ratio of the state's subscribers in the specific geographic area in which the advertising is delivered relative to the total subscribers in that area. For a taxpayer with less information about its audience, the taxpayer shall reasonably approximate the audience in a state using the percentage that reflects the ratio of the state's population in the specific geographic area where the advertising is delivered relative to the total population in that area.

(b) If a taxpayer's service is the delivery of a service to a customer that then acts as the taxpayer's intermediary in reselling that service to end users or other third party recipients, and the taxpayer lacks sufficient information regarding the location of the end users or other third party recipients that the taxpayer may determine or reasonably approximate that location, the taxpayer shall reasonably approximate the extent to which the service is received in a state by using the percentage that reflects the ratio of the state's population in the specific geographic area where the taxpayer's intermediary resells the services, relative to the total population in that area.

(c) When using the secondary reasonable approximation methods provided above, the relevant specific geographic area of delivery includes only the areas where the service was substantially and materially delivered or resold. Unless the taxpayer demonstrates the contrary, it will be presumed that the area where the service was substantially and materially delivered or resold does not include areas outside the United States.

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Examples

Example (i). Cable TV Corp, a corporation that is based outside of North Carolina, has two revenue streams. First, Cable TV Corp sells advertising time to business customers pursuant to which the business customers' advertisements will run as commercials during Cable TV Corp's televised programming. Some of these business customers, though not all of them, have a physical presence in North Carolina. Second, Cable TV

Corp sells monthly subscriptions to individual customers in North Carolina and in other states. The receipts from Cable TV Corp's televised programming during which the advertisements run is in North Carolina. If Cable TV Corp is unable to determine the actual location of its audience for the programming, and lacks sufficient information regarding audience location to reasonably approximate the location, Cable TV Corp must approximate its North Carolina audience using the percentage that reflects the ratio of its North Carolina subscribers in the geographic area in which Cable TV Corp's televised programming featuring the advertisements is delivered relative to its total number of subscribers in that area. To the extent that Cable TV Corp's sales of monthly subscriptions represent the sale of a service, the receipts from these sales are properly assigned to North Carolina in any case in which the programming is received by a customer in North Carolina. In any case in which Cable TV Corp cannot determine the actual location where the programming is received, and lacks sufficient information regarding the location of receipt to reasonably approximate the location, the receipts from these sales of Cable TV Corp's monthly subscriptions are assigned to North Carolina where its customer's billing address is in North Carolina. Note that whether and to the extent that the monthly subscription fee represents a fee for a service or for a license of intangible property does not affect the analysis or result as to the state or states to which the receipts are properly assigned.

~~Example (ii). Network Corp, a corporation that is based outside of North Carolina, sells advertising time to business customers pursuant to which the customers' advertisements will run as commercials during Network Corp's televised programming as distributed by unrelated cable television and satellite television transmission companies. The receipts from Network Corp's sale of advertising time to its business customers are assigned to North Carolina to the extent that the audience for Network Corp's televised programming during which the advertisements will run is in North Carolina. If Network Corp cannot determine the actual location of the audience for its programming during which the advertisements will run, and lacks sufficient information regarding audience location to reasonably approximate the location, Network Corp must approximate the receipts from sales of advertising that constitute North Carolina sales by multiplying the amount of advertising receipts by a percentage that reflects the ratio of the North Carolina population in the specific geographic area in which the televised programming containing the advertising is run relative to the total population in that area.~~

Example (~~iii~~ii). Web Corp, a corporation that is based outside North Carolina, provides Internet content to viewers in North Carolina and other states. Web Corp sells advertising space to business customers pursuant to which the customers' advertisements will appear in connection with Web Corp's Internet content. Web Corp receives a fee for running the advertisements that is determined by reference to the number of times the advertisement is viewed or clicked upon by the viewers of its website. The receipts from Web Corp's sale of advertising space to its business customers are assigned to North Carolina to the extent that the viewers of the Internet content are in North Carolina, as measured by viewings or clicks. If Web Corp is unable to determine the actual location of its viewers, and lacks sufficient information regarding the location of its viewers to reasonably approximate the location, Web Corp must approximate the amount of its North Carolina receipts by multiplying the amount of receipts from sales of advertising by a percentage that reflects the North Carolina population in the specific geographic area in which the content containing the advertising is delivered relative to the total population in that area.

Example (~~iv~~iii). Retail Corp, a corporation that is based outside of North Carolina, sells tangible property through its retail stores located in North Carolina and other states, and through a mail order catalog. Answer Co, a corporation that operates call centers in multiple states, contracts with Retail Corp to answer telephone calls from individuals placing orders for products found in Retail Corp's catalogs. In this case, the phone answering services of Answer Co are being delivered to Retail Corp's customers and prospective customers. Therefore, Answer Co is delivering a service electronically to Retail Corp's customers or prospective customers on behalf of Retail Corp, and must assign the proceeds from this service to the state or states from which the phone calls are placed by the customers or prospective customers. If Answer Co cannot determine the actual locations from which phone calls are placed, and lacks sufficient information regarding the locations to reasonably approximate the locations, Answer Co must approximate the amount of its North Carolina sales by multiplying the amount of its fee from Retail Corp by a percentage that reflects the North Carolina population in the specific geographic area from which the calls are placed relative to the total population in that area.

Example (~~v~~iv). Web Corp, a corporation that is based outside of North Carolina, sells tangible property to customers via its Internet website. Design Co. designed and maintains Web Corp's website, including making changes to the site based on customer feedback received through the site. Design Co.'s services are delivered to Web Corp, the proceeds from which are assigned pursuant to Rule .0904(b). The fact that Web Corp's customers and prospective customers incidentally benefit from Design Co.'s services, and may even interact with Design Co. in the course of providing feedback, does not transform the service into one delivered "on behalf of" Web Corp to Web Corp's customers and prospective customers.

Example (~~vi~~v). Wholesale Corp, a corporation that is based outside North Carolina, develops an Internet-based information database outside North Carolina and enters into a contract with Retail Corp whereby Retail Corp will market and sell access to this database to end users. Depending on the facts, the provision of database access may be either the sale of a service or the license of intangible property or may have elements of both. Assume that on the particular facts applicable in this example Wholesale Corp is selling database access in transactions properly characterized as involving the performance of a service. When an end user purchases access to Wholesale Corp's database from Retail Corp, Retail Corp in turn compensates Wholesale Corp in connection with that transaction. In this case, Wholesale Corp's services are being delivered through Retail Corp to the end user. Wholesale Corp must assign its receipts from sales to Retail Corp to the state or states in which the end users receive access to Wholesale Corp's database. If Wholesale Corp cannot determine the state or states where the end users actually receive access to Wholesale Corp's database, and lacks sufficient information regarding the location from which the end users access to Wholesale Corp's database, and lacks sufficient information regarding the location from which the end users access the database to reasonably approximate the location, Wholesale Corp must approximate the extent to which its services are received by end users in North Carolina by using a percentage that reflects the ratio of the North Carolina population in the specific geographic area in which Retail Corp regularly markets and sells Wholesale Corp's database relative to the total population in that area. Note that it does not matter for purposes of the analysis whether Wholesale Corp's sale of database access constitutes a service or a license of intangible property, or some combination of both.

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

17 NCAC 05G .0906 BROADCAST ADVERTISING SERVICES

Notwithstanding anything herein to the contrary, receipts from a broadcaster's sale of advertising services to a broadcast customer are assigned to North Carolina if the commercial domicile of the broadcast customer is in North Carolina. For this purpose, "advertising services" means an agreement to include the broadcast customer's advertising content in the broadcaster's film programming.

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

17 NCAC 05G .1102 LICENSE OF A MARKETING INTANGIBLE

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

(b) License of a marketing intangible includes the following when it is intended to promote consumer sales:
 (1) the license of a service mark, trademark, or trade name;
 (2) copyrights; and
 ~~(3) the license of a film, television or multimedia production or event for commercial distribution; and~~
 (4)(3) a franchise agreement.

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

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

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

17 NCAC 05G .1106 LICENSE OF A BROADCAST INTANGIBLE

Where a broadcaster grants a license to a broadcast customer for the right to use film programming, the license fees paid by the licensee for such right are assigned to North Carolina to the extent that the broadcast customer is located in North Carolina. In the case of business customers, the broadcast customer's location is the broadcast customer's commercial domicile. In the case of individual customers, the broadcast customer's location is the customer's address as listed in the broadcaster's records.

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

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Examples

In these examples, assume that the customer is not a related entity.

Example (i). Crayon Corp and Dealer Co enter into a license contract under which Dealer Co as licensee is permitted to use trademarks that are owned by Crayon Corp in connection with Dealer Co's sale of certain products to retail customers. Under the contract, Dealer Co is required to pay Crayon Corp a licensing fee that is a fixed percentage of the total volume of monthly sales made by Dealer Co of products using the Crayon Corp trademarks. Under the contract, Dealer Co is permitted to sell the products at multiple store locations, including store locations that are both within and without North Carolina. Further, the licensing fees that are paid by Dealer Co are broken out on a per-store basis. The licensing fees paid to Crayon Corp by Dealer Co represent fees from the license of a marketing intangible. The portion of the fees to be assigned to North Carolina are determined by multiplying the fees by a percentage that reflects the ratio of Dealer Co's receipts that are derived from its North Carolina stores relative to Dealer Co's total receipts.

~~Example (ii). Program Corp, a corporation that is based outside North Carolina, licenses programming that it owns to licensees, such as cable networks, that in turn will offer the programming to their customers on television or other media outlets in North Carolina and in all other U.S. states. Each of these licensing contracts constitutes the license of a marketing intangible. For each licensee, assuming that Program Corp lacks evidence of the actual number of viewers of the programming in North Carolina, the component of the licensing fee paid to Program Corp by the licensee that constitutes Program Corp's North Carolina receipts is determined by multiplying the amount of the licensing fee by a percentage that reflects the ratio of the North Carolina audience of the licensee for the programming relative to the licensee's total U.S. audience for the programming. Note that the analysis and result as to the state or states to which receipts are properly assigned would be the same to the extent that the substance of Program Corp's licensing transactions may be determined to resemble a sale of goods or services, instead of the license of a marketing intangible.~~

Example (iii). Moniker Corp enters into a license contract with Wholesale Co. Pursuant to the contract Wholesale Co is granted the right to use trademarks owned by Moniker Corp to brand sports equipment that is to be manufactured by Wholesale Co or an unrelated entity, and to sell the manufactured equipment to unrelated companies that will ultimately market the equipment to consumers in a specific geographic region, including a foreign country. The license agreement confers a license of a marketing intangible, even though the trademarks in question will be affixed to property to be manufactured. In addition, the license of the marketing intangible is for the right to use the intangible property in connection with sales to be made at wholesale rather than directly to retail customers. The component of the licensing fee that constitutes the North Carolina receipts of Moniker Corp is determined by multiplying the amount of the fee by a percentage that reflects the ratio of the North Carolina population in the specific geographic region relative to the total population in that region. If Moniker Corp is able to reasonably establish that the marketing intangible was materially used throughout a foreign country, then the population of that country will be included in the population ratio calculation. However, if Moniker Corp is unable to reasonably establish that the marketing intangible was materially used in the foreign country in areas outside a particular major city, then none of the foreign country's population beyond the population of the major city is included in the population ratio calculation.

Example (~~iv~~iii). Formula, Inc and Appliance Co enter into a license contract under which Appliance Co is permitted to use a patent owned by Formula, Inc to manufacture appliances. The license contract specifies that Appliance Co is to pay Formula, Inc a royalty that is a fixed percentage of the gross receipts from the products that are later sold. The contract does not specify any other fees. The appliances are both manufactured and sold in North Carolina and several other states. Assume the licensing fees are paid for the license of a production intangible, even though the royalty is to be paid based upon the sales of a manufactured product (i.e., the license is not one that includes a marketing intangible). Because the actual use of the intangible property takes place in part in North Carolina, the royalty is assigned based to the location of that use rather than to the location of the licensee's commercial domicile, in accordance with Rule .1101. It is presumed that the entire use is in North Carolina except to the extent that the taxpayer can demonstrate that the actual location of some or all of the use takes place outside North Carolina. Assuming that Formula, Inc can demonstrate the percentage of manufacturing that takes place in North Carolina using the patent relative to the manufacturing in other states, that percentage of the total licensing fee paid to Formula, Inc under the contract will constitute Formula, Inc's North Carolina receipts.

Example (iv). Axel Corp enters into a license agreement with Biker Co in which Biker Co is granted the right to produce motor scooters using patented technology owned by Axel Corp, and also to sell the scooters by marketing the fact that the scooters were manufactured using the special technology. The contract is a license of both a marketing and production intangible, i.e., a mixed intangible. The scooters are manufactured outside North Carolina. Assume that Axel Corp lacks actual information regarding the proportion of Biker Co.'s receipts that are derived from North Carolina customers. Also assume that Biker Co is granted the right to sell the scooters in a U.S. geographic region in which the North Carolina population constitutes 25% of the total population during the period in question. The licensing contract requires an upfront licensing fee to be paid by Biker Co to Axel Corp and does not specify what percentage of the fee derives from Biker Co's right to use Axel Corp's patented technology. Because the fees for the license of the marketing and production intangible are not separately and reasonably stated in the contract, it is presumed that the licensing fees are paid entirely for the license of a marketing intangible, unless the taxpayer reasonably establishes otherwise. Assuming the taxpayer does not establish otherwise, 25% of the licensing fee constitutes North Carolina receipts.

Example (vi). Same facts as Example (iv), except that the license contract specifies separate fees to be paid for the right to produce the motor scooters and for the right to sell the scooters by marketing the fact that the scooters were manufactured using the special technology. The licensing contract constitutes both the license of a marketing intangible and the license of a production intangible. Assuming that the separately stated fees are reasonable, (1) no part of the licensing fee paid for the production intangible will be assigned to North Carolina, and (2) 25% of the licensing fee paid for the marketing intangible will be assigned to North Carolina.

Example (vii). Better Burger Corp, which is based outside North Carolina, enters into franchise contracts with franchisees that agree to operate Better Burger restaurants as franchisees in various states. Several of the Better Burger Corp franchises are in North Carolina. In each case, the franchise contract between the individual and Better Burger provides that the franchisee is to pay Better Burger Corp an upfront fee for the receipt of the franchise and monthly franchise fees, which cover, among other things, the right to use the Better Burger name and service marks, food processes and cooking know-how, as well as fees for management services. The upfront fees for the receipt of the North Carolina franchises constitute fees paid for the licensing of a marketing intangible. These fees constitute North Carolina receipts because the franchises are for the right to make North Carolina sales. The monthly franchise fees paid by North Carolina franchisees constitute fees paid for (1) the license of marketing intangibles (the Better Burger name and service marks), (2) the license of production intangibles (food processes and know-how) and (3) personal services (management fees). The fees paid for the license of the marketing intangibles and the production intangibles constitute North Carolina receipts because in each case the use of the intangibles is to take place in North Carolina. The fees paid for the personal services are to be assigned pursuant to Rule .0701.

Example (viii). Online Corp, a corporation based outside North Carolina, licenses an information database through the means of the Internet to individual customers that are resident in North Carolina and in other states. These customers access Online information database primarily in their states of residence, and sometimes, while traveling, in other states. The license is a license of intangible property that resembles a sale of goods or services and are assigned in accordance with Rule .1105. If Online Corp can determine or reasonably approximate the state or states where its database is accessed, it must do so. Assuming that Online Corp cannot determine or reasonably approximate the location where its database is accessed, Online Corp must assign the Receipts made to the individual customers using the customers' billing addresses to the extent known. Assume for purposes of this example that Online Corp knows the billing address for each of its customers. In this case, Online Corp's receipts from the sales made to its individual customers are in North Carolina in any case in which the customer's billing address is in North Carolina.

Example (~~ix~~viii). Net Corp, a corporation based outside North Carolina, licenses an information database through the means of the Internet to a business customer, Business Corp, a company with offices in North Carolina and two neighboring states. The license is a license of intangible property that resembles a sale of goods or services and are assigned in accordance with Rule .1105. Assume that Net Corp cannot determine where its database is assessed but reasonably approximates that 75% of Business Corp's database access took place in North Carolina, and 25% of Business Corp's database access took place in other dates. In that case, 75% of the receipts from database access are in North Carolina. Assume alternatively that Net Corp lacks sufficient information regarding the location where its database is accessed to reasonably approximate the location. Under these circumstances, if Net Corp derives 5% or less of its receipts from database access from Business Corp, Net Corp must assign the receipts under Rule .0904(b)(2)(C) to the state where Business Corp principally managed the contract, or if that state is not reasonably determinable to the state where Business Corp placed the order for the services, or if that state is not reasonably determinable to the state of Business Corp's billing address. If Net Corp derives more than 5% of its receipts from database access from Business Corp, Net Corp is required to identify the state in which its contract of sale is principally managed by Business Corp and must assign the receipts to that state.

Example (~~x~~ix). Net Corp, a corporation based outside North Carolina, licenses an information database through the means of the Internet to more than 250 individual and business customers in North Carolina and in other states. The license is a license of intangible property that resembles a sale of goods or services and receipts from that license are assigned in accordance with Rule.1105. Assume that Net Corp cannot determine or reasonably approximate the location where its information database is accessed. Also assume that Net Corp does not derive more than 5% of its receipts from sales of database access from any single customer. Net Corp may apply the safe harbor stated in Rule .0904(b)(2)(D), and may assign its receipts to a state or states using each customer's billing address.

Example (~~xi~~x). Web Corp, a corporation based outside of North Carolina, licenses an Internet-based information database to business customers who then sublicense the database to individual end users that are resident in North Carolina and in other states. These end users access Web Corp's information database primarily in their states of residence, and sometimes, while traveling in other states. Web Corp's license of the database to its customers includes the right to sublicense the database to end users, while the sublicenses provide that the rights to access and use the database are limited to the end users' own use and prohibit the individual end users from further sublicensing the database. Web Corp receives a fee from each customer based upon the number of sublicenses issued to end users. The license is a license of intangible property that resembles a sale of goods or services and are assigned by applying the methodology set forth in Rule .0905. If Web Corp can determine or reasonably approximate the state or states where its database is accessed by end users, it must do so. Assuming that Web Corp lacks sufficient information from which it can determine or reasonably approximate the location where its database is accessed by end users, Web Corp must approximate the extent to which its database is accessed in North Carolina using a percentage that represents the ratio of the North Carolina population in the specific geographic area in which Web Corp's customer sublicenses the database access relative to the total population in that area.

EXHIBIT A

STATE-BY-STATE INCOME TAX APPORTIONMENT RULES FOR BROADCASTERS

		Commercial Domicile	Legacy Viewing Audience (1)	Viewing Audience Adopted as Incentive to Broadcast Industry (2)	Cost of Performance	Market Sourcing or Other	Explanation
1	ALABAMA		X				
2	ALASKA				X		
3	ARIZONA				X		
4	ARKANSAS		X				
5	CALIFORNIA			X			
6	COLORADO		X				
7	CONNECTICUT			X			
8	DELAWARE				X		
9	FLORIDA	X					See Exhibit B.
10	GEORGIA		X				
11	HAWAII		X				
12	IDAHO		X				
13	ILLINOIS	X					See Exhibit B.
14	INDIANA				X		
15	IOWA	X					Abandoned legacy Viewing Audience rules in 2015. See Exhibit B.
16	KANSAS				X		
17	KENTUCKY				X		
18	LOUISIANA	X					Hybrid Commercial Domicile sourcing. See Exhibit B
19	MAINE					X	No industry specific rules for Broadcasters.
20	MARYLAND			X			Hybrid viewing audience rules.
21	MASSACHUSETTS		X				Viewing audience adopted via rule (2015).
22	MICHIGAN	X					See Exhibit B.
23	MINNESOTA					X	No industry specific rules for Broadcasters.
24	MISSISSIPPI				X		
25	MISSOURI				X		
26	MONTANA		X				
27	NEBRASKA				X		Broadcasters are one of several industries carved out from market sourcing that continue to use Costs of Performance.
28	**NEVADA**						**N/A - no Income Tax (gross receipts tax only).**
29	NEW HAMPSHIRE		X				
30	NEW JERSEY					X	Hybrid apportionment formula/sourcing.
31	NEW MEXICO		X				
32	NEW YORK STATE			X			
33	NORTH CAROLINA					X	
34	NORTH DAKOTA		X				
35	**OHIO**						**N/A - no Income tax (gross receipts tax only)**
36	OKLAHOMA					X	No industry specific rules for Broadcasters.
37	OREGON	X					Abandoned legacy Viewing Audience rules in 2014. Current law sunsets in 2017. See Exhibit B.
38	PENNSYLVANIA					X	Hybrid - COP for licensing revenue and viewing audience for advertising.
39	RHODE ISLAND	X					See Exhibit B.
40	SOUTH CAROLINA				X		
41	**SOUTH DAKOTA**						**N/A - no Income Tax.**
42	TENNESSEE	X					See Exhibit B.
43	TEXAS	X					Commercial Domicile/Location of Customers' Legal Domicile for licensing revenue. COP based sourcing for advertising revenue. See Exhibit B.
44	UTAH					X	No industry specific rules for Broadcasters.
45	VERMONT				X		
46	VIRGINIA				X		
47	**WASHINGTON**						**N/A - no Income Tax (gross receipts tax only).**
48	WEST VIRGINIA				X		
49	WISCONSIN					X	No industry specific rules for Broadcasters.
50	**WYOMING**						**N/A - no Income Tax.**

Footnotes:

(1) Legacy Viewing Audience Rules. The state adopted viewing audience rules years ago, prior to the evolution of the broadcast industry into streaming, mobile viewing, time shifted viewing, "direct to consumer" viewing, etc. Such rules were enacted when reliable by-state viewing audience data was generally available for all viewers. Most such legacy states adopted these rules prior to the ubiquity of the internet, telecom, and satellite distribution of TV content (eg., 1980s, early 1990s).

(2) California and New York, the first states to adopt a viewing audience method, continue to be the headquarters of all of the major broadcasters. Because the principal business operations of the broadcasters were in California and New York, those two states adopted the audience method as an economic incentive to encourage the industry to maintain and grow their businesses there. This method mitigated the harsh effects of California's historical all or nothing costs of performance rule or of New York's proportional costs of performance rule. Connecticut and Maryland adopted similar rules as an incentive for the same reasons.

EXHIBIT B

States with Commercial Domicile Apportionment Sourcing

Note: One additional state, not listed below, that utilizes a "cost of performance" apportionment method, has entered into a confidentiality agreement with the MPAA member companies, also providing for commercial domicile sourcing.

State	Summary
Michigan	In 2007, Michigan enacted market-based sourcing for apportionment purposes. Shortly thereafter, the State adopted a statute under which broadcasters apportion both advertising revenues and the license fees earned from cable and satellite system operators and Internet distributors based on the commercial domicile of the advertiser or licensee. Mich. Comp. Laws Ann. Section 208.1305(20).
Illinois	Similar to Michigan, subsequent to the enactment of market-based sourcing for apportionment purposes in 2009, additional legislation was enacted which clarified how the market-based sourcing statutes applied to broadcasters. This statute provides that advertising income and license fees earned from cable and satellite system operators and Internet distributors are sourced to the principal place of business of the Networks' direct customers (*i.e.*, commercial domicile). ILCS 5/304(a)(3)(B-1)(i), (B-2), (B-7) and (C-5).
Iowa	In 2015, Iowa enacted a statute to repeal a 25-year old viewing audience-based apportionment formula. The Governor and the legislature recognized that the viewing audience method was outdated given the significant changes in the rapidly evolving ways in which television content is seen. The new law modernizes the method for sourcing receipts within and without Iowa based on the commercial domicile of customers (*i.e.*, advertisers, cable and satellite operators and Internet distributors.

Florida	Florida has issued two rulings which conclude that the taxpayer's cable program networks should source both their advertising revenues and license fees from their distributors to Florida when the taxpayer's customers (advertisers, cable and satellite operators, Internet distributors) are located in Florida. The rulings indicate that a taxpayer's customers are considered to be located in Florida when the principal place from which their trade or business is directed or managed is within Florida (*i.e.*, their commercial domicile). Florida Technical Assistance Advisement, No. 13C1-004 (May 21, 2013); Florida Technical Assistance Advisement, No. 11C1-008 (Sep. 15, 2011).
Oregon	Oregon in 2014 enacted a statute to repeal a 25-year old viewing audience-based apportionment formula applicable to broadcasters. The Governor and the Legislature recognized the viewing audience method was outdated given the significant changes in the rapidly evolving ways in which television content is seen. The new law is intended to modernize the method for sourcing receipts within and without Oregon based on the commercial domicile of customers (*i.e.*, advertisers, cable and satellite operators and Internet distributors). Or. Rev. Stat. Sections 314.680, 314.682 and 314.684. Legislation will be introduced in the 2017 legislative session to extend the current 2017 sunset date.

Texas	House Bill 2896 was enacted in 2015, which provided certainty regarding apportionment for licensing fees. The new provision provides the apportionment of receipts from the distribution of television programming by national and local broadcasters similar to the method for apportioning receipts from other intangible property under Texas law. It adds a new section to the Texas Tax Code Section 171.106 to clarify that receipts from the distribution of programming by Texas television stations and national cable and television networks should be apportioned based on the "location of the payor rule," *i.e.*, the state of incorporation/ formation of the cable system operators and direct broadcast satellite operators.
Louisiana	In 2011, Louisiana adopted the commercial domicile standard of apportionment sourcing for broadcasters.
Rhode Island	Legislation enacted in June 2014 established mandatory unitary combined reporting, single sales factor apportionment, and market-based sourcing. The statute directed the Rhode Island Department of Revenue to promulgate regulations. The Department's regulations, adopted in 2015, endorse the concept that a broadcasters' "market" for corporate tax apportionment should be based on the location of their direct customers, *i.e.*, their commercial domicile.
Tennessee	Tennessee enacted general market sourcing legislation in 2015 (H.B. 644 for tax years beginning on or after 7/1/2016), and posted rules for public comment in February, 2016. In September, 2016 the state's rules became effective and included MPAA's Commercial domicile apportionment for broadcasters. Tenn. Comp. Rules & Regs. § 1320-06-01-.42