



ADMINISTRATIVE RULES OF MONTANA

42.26.206 APPORTIONABLE AND NONAPPORTIONABLE INCOME DEFINED

- (1) Section 15-31-301, MCA, requires that every item of income be classified either as apportionable or nonapportionable income. Income for purposes of classification as apportionable or nonapportionable includes gains and losses. Apportionable income is apportioned among jurisdictions by use of a formula. Nonapportionable income is specifically assigned or allocated to one or more specific jurisdictions pursuant to express rules. An item of income is classified as apportionable income if it falls within the definition of apportionable income. In essence, all income which arises from the conduct of trade or business operations of a taxpayer is apportionable income. An item of income is nonapportionable income only if it does not meet the definitional requirements for being classified as apportionable income. For purposes of administration, the income of the taxpayer is apportionable income unless clearly classifiable as nonapportionable income.
- (2) Apportionable income means income of any type or class, and from any activity, that meets the relationship described either in (3), the "transactional test," or (4), the "functional test." The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, nonoperating income, etc., is of no assistance in determining whether income is apportionable or nonapportionable income. Accordingly, the critical element in determining whether income is "apportionable income" or "nonapportionable income" is the identification of the transactions and activities which are the elements of a particular trade or business. In general, all transactions and activities of the taxpayer which are dependent upon or contribute to the operations of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be transactions and activities arising in the regular course of and will constitute integral parts of a trade or business. See ARM 42.26.207 for more specific examples of the classification of income as apportionable or nonapportionable income; see ARM 42.26.202 and 42.26.205 for further explanation of what constitutes a trade or business.
- (3) Under the transactional test, apportionable income includes income arising from transactions and activity in the regular course of the taxpayer's trade or business.
 - (a) If the transaction or activity is in the regular course of the taxpayer's trade or business, part of which trade or business is conducted within this state, the resulting income of the transaction or activity is apportionable income for this state. Income may be apportionable income even though the actual transaction or activity that gives rise to the income does not occur in this state.
 - (b) For a transaction or activity to be in the regular course of the taxpayer's trade or business, the transaction or activity need not be one that frequently occurs in the trade or business. Most, but not all, frequently occurring transactions or activities will be in the regular course

of that trade or business and will, therefore, satisfy the transactional test. It is sufficient to classify a transaction or activity as being in the regular course of a trade or business, if it is reasonable to conclude transactions of that type are customary in the kind of trade or business being conducted or are within the scope of what that kind of trade or business does. The transactional test includes, but is not limited to:

- (i) income from sales of inventory;
 - (ii) property held for sale to customers; and
 - (iii) services which are commonly sold by the trade or business.
- (c) The transactional test also includes, but is not limited to: income from the sale of property used in the production of apportionable income of a kind that is sold and replaced with some regularity, even if replaced less frequently than once a year.
- (4) Under the functional test, apportionable income includes income from tangible and intangible property, if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.
- (a) Apportionable income need not be derived from transactions or activities that are in the regular course of the taxpayer's own particular trade or business. It is sufficient, if the property from which the income is derived is or was an integral, functional, or operative component used in the taxpayer's trade or business operations, or otherwise materially contributed to the production of apportionable income of the trade or business, part of which trade or business is or was conducted within this state. Property that has been converted to nonapportionable use through the passage of a sufficiently lengthy period of time, generally, five years is sufficient, has lost its character as a business asset and is not subject to the rule of the preceding sentence.
 - (b) Income that is derived from isolated sales, leases, assignments, licenses, and other infrequently occurring dispositions, transfers, or transactions involving property, including transactions made in liquidation, including complete or partial liquidations, or the winding-up of business, is apportionable income, if the property is or was used in the taxpayer's trade or business operations.
 - (i) Property that has been converted to nonapportionable use has lost its character as a business asset and is not subject to (4)(b).
 - (ii) Income from the licensing of an intangible asset, such as a patent, copyright, trademark, service mark, know-how, trade secrets, or the like, that was developed or acquired for use by the taxpayer in its trade or business operations, constitutes apportionable income whether or not the licensing itself constituted the operation of a trade or business, and whether or not the taxpayer remains in the same trade or business from or for which the intangible asset was developed or acquired.
 - (c) Under the functional test, income from intangible property is apportionable income when the intangible property serves an operational function. The relevant inquiry focuses on whether the property is or was held in furtherance of the taxpayer's trade or business, that is, on the objective characteristics of the intangible property's use or acquisition and its relation to the taxpayer and the taxpayer's activities.

- (d) If the property is or was held in furtherance of the taxpayer's trade or business then income from that property may be apportionable income even though the actual transaction or activity involving the property that gives rise to the income does not occur in this state.
- (e) If, with respect to an item of property, a taxpayer takes a deduction from apportionable income that is apportioned to this state or includes the original cost in the property factor, it is presumed that the item or property is or was integral to the taxpayer's trade or business operations. No presumption arises from the absence of any of these actions.
- (f) Application of the functional test is generally unaffected by the form of the property (e.g., tangible or intangible property, real or personal property). Income arising from an intangible interest, as, for example, corporate stock or other intangible interest in a business or a group of assets, is apportionable income when the intangible itself or the property underlying or associated with the intangible is or was an integral, functional, or operative component to the taxpayer's trade or business operations.
- (g) Property that has been converted to nonapportionable use has lost its character as a business asset and is not subject to (4)(f).

Authorizing statute(s): 15-1-201, 15-31-313, 15-31-501, MCA

Implementing statute(s): 15-1-601, 15-31-302, MCA

History: NEW, Eff. 1/2/77; AMD, 1993 MAR p. 572, Eff. 4/16/93; AMD, 2001 MAR p. 2469, Eff. 12/21/01; AMD, 2011 MAR p. 2053, Eff. 9/23/11; AMD, 2017 MAR p. 2328, Eff. 1/1/18.