



INFORMATION NOTICE CORPORATION TAXES 2016-1

February 19, 2016

I. PURPOSE

On July 9, 2013, the Pennsylvania General Assembly passed Act 52-2013,¹ which contained an add-back provision (the "**Add-Back**") that disallows corporate income tax deductions for transactions between affiliated members for tax years beginning after December 31, 2014. Part II of this notice interprets, explains, and illustrates the application and scope of the Add-Back. Part III follows with a discussion of the exceptions to the Add-Back. Finally, Part IV explores the application of the credit mechanism.

II. APPLICATION AND SCOPE OF THE ADD-BACK

The Add-Back disallows deductions for royalties, licensing, or other fees paid, accrued, or incurred² by a corporation subject to Pennsylvania Corporate Net Income Tax ("**CNIT**")³ to an affiliated entity for tax years beginning after December 31, 2014. The Add-Back disallows all intangible costs or expenses paid by a PA Corporate Taxpayer to an affiliated entity unless an express statutory exception applies. While the relevant statutory language and this notice describe the Add-Back and its exceptions, the Add-Back does not limit the Department of Revenue's authority to deny deductions resulting from fraudulent or sham transactions.⁴

A. Applicable Intangible Assets

The Add-Back refers to direct or indirect costs or expense deductions claimed by a PA Corporate Taxpayer as a result of transactions with an affiliated entity (the definition of which is set forth in the statute⁵) and expressly disallows costs or expense deductions incurred by a PA Corporate Taxpayer in connection with the following intangible assets:

- patents
- patent applications
- trade names
- trademarks

¹ See H.B. 465, P.L. 270, § 19, adding 72 P.S. § 7401(3)1.(t).

² For simplicity, this Notice refers to expenses or costs that are paid, accrued, or incurred as "paid."

³ A corporation subject to CNIT is referred to herein as a "**PA Corporate Taxpayer**."

⁴ See 72 P.S. § 7401(3)1.(t)(1).

⁵ 72 P.S. § 7401(10)(defining "affiliated entity").

- service marks
- copyrights
- mask works⁶

The list of intangible assets is not exhaustive. The Add-Back also applies to “other similar expenses or costs.”⁷ Furthermore, the classification or label of a transaction is not determinative—whether it be called a royalty, license, lease, franchise right, know how, trade secret, contract right, management fee, or otherwise. Rather, the substance of a transaction is determinative. The Add-Back applies whenever a PA Corporate Taxpayer pays an intangible expense to an affiliated entity to acquire, use, maintain, manage, sell, exchange, or otherwise acquire or dispose of an intangible asset.⁸

B. Direct or Indirect Intangible Expense or Cost

A direct intangible expense or cost arises from a transaction between a PA Corporate Taxpayer and an affiliated entity, whereby the PA Corporate Taxpayer obtains one or more legal rights to an intangible asset directly from an affiliated entity.⁹ An indirect transaction with an affiliated entity occurs where the transaction is effectuated through one or more intermediaries.¹⁰ Thus, a PA Corporate Taxpayer is subject to the Add-Back even where the PA Corporate Taxpayer and the affiliated entity are not parties to the same agreement with respect to acquisition, use, maintenance, sale, exchange or other acquisition or disposition of an intangible asset.

The Add-Back disallows indirect intangible costs or expenses in at least two instances. First, as discussed in more detail below, the Add-Back disallows expenses or costs paid

⁶ 72 P.S. 7401(8)(defining “intangible expense or cost”).

⁷ Id.

⁸ See 72 P.S. § 7401(8). The Add-Back applies to “royalties, licenses or fees paid for the acquisition, use, maintenance, management, ownership, sale, exchange or other disposition” of an intangible asset. Property rights are often described through a metaphor as a “bundle of rights” or a “bundle of sticks.” The “bundle of rights” or a “bundle of sticks” is an abstract notion that describes property as a collection of rights. It is a legal construct that explains each legal right with respect to property is a separate and distinct right. Thus, all property—whether it be tangible or intangible—has (or could hypothetically have) numerous legal rights, such as a bundle of sticks, where each stick is a separate legal right. For example, the right to use and the right to sublicense are separate legal rights. See Denise R. Johnson, Reflection on Bundle of Rights, 32 VT. L. REV. 247, 247 (2007) (discussing of the bundle of rights).

⁹ Royalties paid pursuant to a trademark licensing agreement between a PA Corporate Taxpayer and an affiliated entity are an example of a direct intangible expense or cost as the PA Corporate Taxpayer and the affiliated entity are both parties to the same agreement.

¹⁰ Unlike a direct cost or expense, an indirect intangible cost or expense deduction arises where the PA Corporate Taxpayer and the affiliated entity are not parties to the same contractual agreement with respect to an intangible asset.

by a PA Corporate Taxpayer to an affiliated entity to acquire or use an intangible asset if the PA Corporate Taxpayer amortizes the expenses or costs of the intangible asset. Second, the Add-Back disallows indirect expenses or costs that are not themselves royalty or licensing expenses per se, but are included in other costs, such as cost of goods sold. The second category of intangible costs or expenses is often referred to as “embedded costs.” A more detailed discussion of embedded costs is included below.

1. Amortization of Intangible Property

The Add-Back disallows deductions of the purchase price of an intangible asset that was acquired by a PA Corporate Payer from an affiliated entity. While all or part of the purchase price of an intangible asset is amortized for federal income tax purposes, the acquisition of an intangible asset from an affiliated entity results in indirect expenses that are disallowed by the Add-Back.¹¹ The amortization expenses are disallowed for CNIT because they are “intangible expenses or costs . . . paid, accrued or incurred . . . indirectly in connection with one or more transactions with an affiliated entity.”¹²

2. Embedded Intangible Costs

Embedded intangible costs are included within the definition of an “intangible expense or cost” and are, therefore, subject to the Add-Back.¹³ Embedded intangible costs are expenses paid to acquire, use, maintain, manage, sell, exchange, or otherwise dispose of (or otherwise acquire) an intangible asset, where the purported cost or expense is included in deductions or expenses that are called something other than “[r]oyalties, licenses or fees paid,”¹⁴ such as cost of goods sold or a separate service charge (e.g., management fees).

Example 1: Corporations B and C are affiliated entities with respect to Corporation A. Corporation A is subject to CNIT, while Corporation B and C are not subject to CNIT. Corporation A purchases products from Corporation B, and Corporation B licenses trademarks from Corporation C and, as such, incurs costs or expense deductions with respect to Corporation C.¹⁵ The diagram depicting the transactions contemplated in

¹¹ The Internal Revenue Code allows an amortization deduction of certain intangible assets over a 15-year period, beginning in the month the intangible was acquired. I.R.C. § 197(a). That section permits the amortization of, among other things, goodwill, a patent, and knowhow.

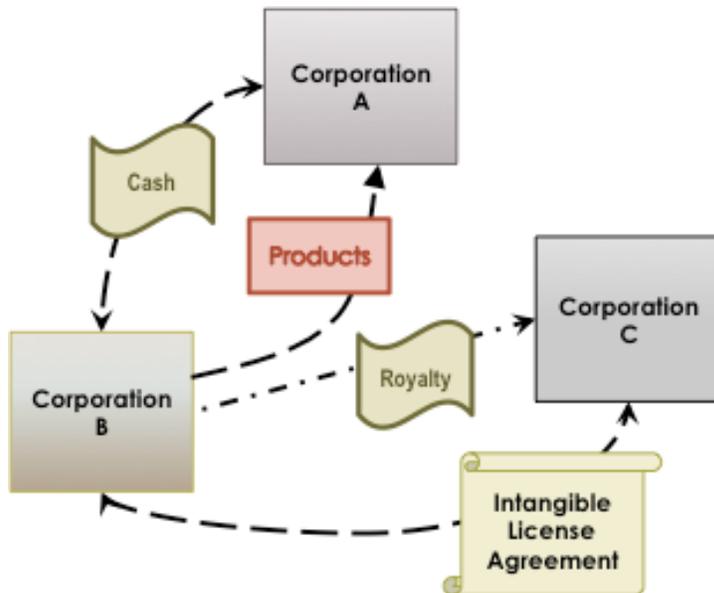
¹² This is consistent with other state add-back provisions. See, e.g., Ga. Comp. R. & Regs. r. 560-7-3-.05(3)(c); see also, *Kimberly-Clark Corp. v. Commissioner of Revenue*, 981 N.E.2d 208 (Mass. Ct. App. 2013) (holding that the Massachusetts’s statute covered an “embedded” or indirect royalty payment).

¹³ See 72 P.S. 7401(8)(defining “intangible expense or cost”).

¹⁴ See 72 P.S. § 7401(8).

¹⁵ This example is conceptually identical to one contained in the Alabama and Georgia regulations discussed in the comments to the Multistate Tax Commission’s “Model Statute Requiring the Addback of

Example 1 is set forth below.



In Example 1, Corporation A's deductions are disallowed to the extent they compensate or reimburse Corporation B for the use of trademarks, which Corporation B licensed from Corporation C. Corporation A's deductions for payments to Corporation B are subject to the Add-Back to the extent the amount Corporation A paid for the goods purchased included costs or fees for Corporation B's use of the trademarks. In other words, Corporation A indirectly paid intangible costs or expenses from intangible assets licensed from an affiliated entity.

Example 2: Assume the same facts of the previous example, except Corporation A does not acquire products from Corporation B, but rather pays a "management fee" to Corporation B.

The label of the transaction between Corporation A and B as a "management fee" is not determinative. As in the previous example, the "management fee" is disallowed to the extent it compensates or reimburses Corporation B for the cost of using a trademark.

C. Interest Expenses

In addition to disallowing intangible expenses or costs, the Add-Back also disallows

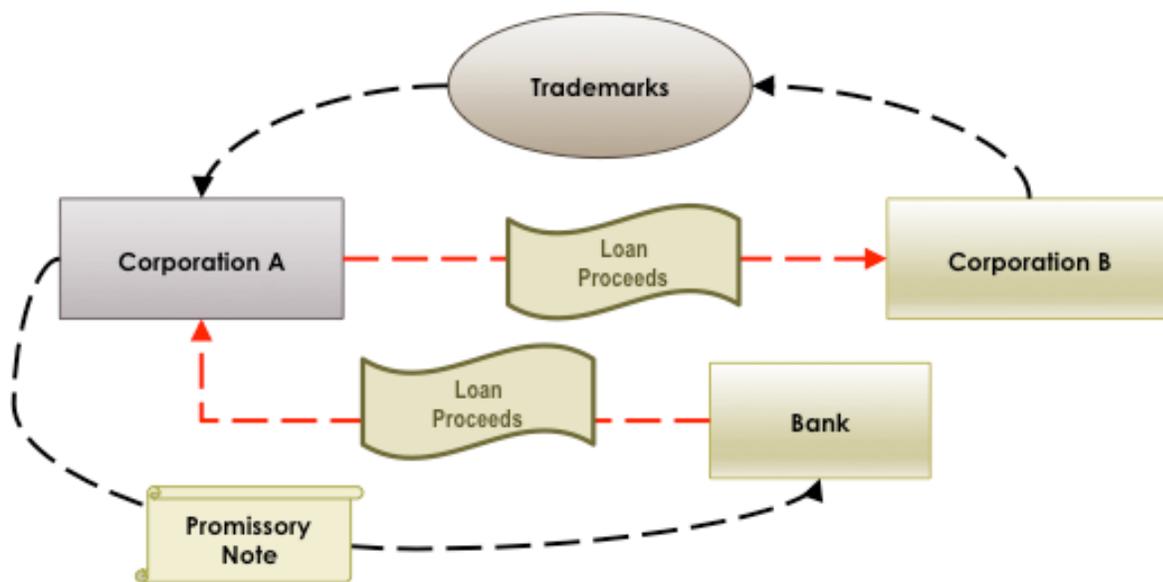
Certain Intangible and Interest Expenses," adopted by the MTC on August 17, 2006. See Ga. Comp. R. & Regs. r. 560-7-3-.05(3)(a).

interest expenses that are “directly related” to an intangible expense or cost.¹⁶ Interest paid to an affiliated entity is presumed “directly related” to the acquisition or use of an intangible asset where the PA Corporate Taxpayer and the affiliated entity engage in any intangible transaction during the tax year in which the interest was paid. It is not necessary to trace the source and application of funds among the affiliated entities.

Example 3: Corporation B is an affiliated entity with respect to Corporation A. Corporation A acquires trademarks from Corporation B in exchange for an interest-bearing promissory note. The interest paid by Corporation A is disallowed by the Add-Back as the interest expense is incurred as a result of obtaining an intangible asset from an affiliated entity. (The face value or principal of the note also reflects the cost of the trademarks that are disallowed by the Add-Back to the extent such costs are amortized by Corporation A.)

Example 4: Same facts as Example 3, except Corporation A does not obtain the trademarks from Corporation B in exchange for an interest-bearing promissory note. Rather, Corporation A obtains a loan from a third-party bank. Corporation A subsequently repays the loan to the bank periodically over a number of years and incurs interest expense with respect to its loan from the bank.

The diagram depicting the transactions contemplated in Example 4 is set forth below.



¹⁶ See 72 P.S. § 7401(9)(defining “interest expense or cost”).

As determined in the previous example, the expenses or costs paid by Corporation A in exchange for trademarks acquired from an affiliate entity are disallowed. Additionally, the interest expenses or costs paid by Corporation A on the loan from the bank are deductions directly related to an intangible property transaction with an affiliated entity. Furthermore, the interest deductions are presumed to be directly related to an intangible property transaction because the PA Corporate Taxpayer (Corporation A) engaged in an intangible property transaction with an affiliated entity during the tax year in which the PA Corporate Taxpayer claimed the interest deduction.

Example 5: Corporation A and B are affiliated entities. Corporation A desires to purchase real estate in State X. Corporation A borrows funds from Corporation B to acquire the real estate. The loan is subject to interest at 1% above the prime interest rate. Is the interest paid by Corporation A to Corporation B subject to the Add-Back?

The interest paid by Corporation A is disallowed, unless Corporation A substantiates that the interest paid was not “directly related” to the acquisition, use, or disposition of an intangible asset. Corporation A rebuts the presumption if it demonstrates that the loan proceeds it received from Corporation B were used to acquire the real estate (i.e., the proceeds were not used to acquire an intangible asset). The PA Corporation demonstrates it did not use the proceeds to acquire an intangible asset where the loan documents and the purchase agreement demonstrate the funds borrowed from Corporation B were used to acquire the real estate.

III. Add-Back Exceptions

The Add-Back identifies exceptions that, if satisfied, override the disallowance of intangible expenses paid to an affiliated entity. The Add-Back exceptions are:

- Principal Purpose/Arm’s Length
- Foreign Treaty
- Conduit

A PA Corporation that asserts an exception to the Add-Back must maintain contemporaneous documentation to support the exception and produce the requested documentation upon the Department of Revenue’s request.

A. Principal Purpose and Arm’s Length Exception

An exception to the Add-Back applies for PA Corporate Taxpayers that establish that (i) the transaction did not have a principal purpose of avoiding CNIT and (ii) the transaction was conducted at arm’s length rates and terms.

1. Principal Purpose Analysis

The first element of the exception requires proof that the principal purpose of the transactions that generated the intangible expense was not to avoid CNIT. Technically, the statute uses the phrase "a principal purpose" to explain the exception. Whether the statute says "a principal purpose," "the principal purpose," or "the primary purpose" is irrelevant as all these phrases have the same meaning.¹⁷ That is, there can be only one principal purpose and that is the single and most significant reason for which a transaction was conducted.

The principal purpose must be a valid business purpose, other than the avoidance of CNIT, that was, either alone or in combination with one or more other business purposes, the primary motivation for entering into a transaction. The principal purpose is determined by evaluating the taxpayer's proffered reasons for the original and any subsequent transaction that produced the tax deduction.

The non-tax business purposes for conducting a transaction must be supported by contemporaneous documentation. Mere statements or assertions that a transaction was intended to allow for better management or greater utilization of intangible assets, or similarly unsubstantiated claims are not sufficient to establish a principal non-tax business purpose.

The avoidance of CNIT is presumed for transactions between or among affiliated entities that generate intangible expenses or deductions that did not change the overall economic position of the PA Corporate Taxpayer and its affiliated entities (other than tax effects) in a meaningful way.

2. Arm's Length Analysis

The Principal Purpose/Arm's Length Exception also requires PA Corporate Taxpayers to substantiate that the intangible expenses were at "arm's length rates and terms." The terms are considered arm's length where the terms of the transaction under consideration are such as would have been arrived at in independent transactions with or between unrelated parties under similar circumstances.

3. Substantiation Requirements

PA Corporate Taxpayers have the burden of substantiating that the transactions giving rise to the expense deductions satisfy both the principal purpose and arms-length rates

¹⁷ See Nathan Giesselman, A Significant Problem Defining a 'Significant Purpose' and the Significant Difficulties that Result, 111 Tax Notes 1119 (June 5, 2006) (discussing the varying meaning of principal purpose under the I.R.C.).

requirements. The documentation supporting an intangible expense deduction must demonstrate that the principal purpose of the transaction was to improve the economic position of the corporation apart from tax effects. In addition, other evidence may be required to show that: (i) the transaction, in fact, conformed to the documentation and (ii) the transaction was necessary for and had a reasonable chance of accomplishing the proffered principal purpose.

B. Foreign Treaty Exception

1. Scope and Applicability

The Add-Back provides an exception for transactions between a PA Corporate Taxpayer and "an affiliated entity domiciled in a foreign nation which has in force a comprehensive income tax treaty with the United States providing for the allocation of all categories of income subject to taxation, or the withholding of tax, on royalties, licenses, fees and interest for the prevention of double taxation of the respective nations' residents and the sharing of information."¹⁸

The Add-Back does not define the phrases "foreign nation" or "comprehensive income tax treaty." For purposes of the Add-Back, "foreign nation" is an established sovereign government that is recognized as such by the United States Department of State. "Comprehensive income tax treaty" means a convention or agreement, entered into by the United States and approved by Congress, with a foreign government for the allocation of all categories of income subject to taxation or the withholding of tax on interest, dividends, and royalties for the prevention of double taxation of the respective nations' residents and the sharing of information.

Example 6: Corporation A, a foreign corporation domiciled in a jurisdiction that is a party to a comprehensive income tax treaty with the United States, owns directly or indirectly 100 percent of the outstanding shares of three United States domestic subsidiaries (Corporation B, Corporation C, and Corporation D). Corporation B and Corporation C utilize certain technology developed by Corporation A in their daily operations of manufacturing products for resale. Corporation D holds the legal rights to such technologies within the United States. Corporation B and Corporation C pay royalties to Corporation D for the right to use the technology developed by Corporation A in its daily operations. Corporation D pays annual royalties to Corporation A based on the amount of royalties it receives from Corporation B and Corporation C.

Intangible expenses paid to Corporation D by Corporation B and C as well as the intangible expenses paid by Corporation D to Corporation A qualifies for the foreign treaty exception.

¹⁸ 72 P.S. § 7401(3)1.(t)(3)(foreign nation treaty exception).

2. Substantiation Requirements for Claiming the Foreign Treaty Exception

PA Corporate Taxpayers that seek the foreign treaty exception must provide the following information to the Department of Revenue upon request:

- the name and federal identification number of the foreign affiliated entity;
- the country of domicile of the foreign affiliated entity; and
- the amount of the intangible expense or interest expense.

C. Conduit Exception

The Add-Back does not disallow intangible expenses or costs where, and to the extent that, the affiliated entity pays expenses to an unaffiliated entity for the same intangible asset. A PA Corporate Taxpayer that seeks to claim the conduit exception must substantiate its claim.

IV. Application of the Credit Mechanism

The Add-Back provides a credit, in certain situations, to PA Corporate Taxpayers subject to the Add-Back (the credit is referred to herein as the "**Add-Back Credit**"). The Add-Back Credit is determined in accordance with the following statutory provision:

In calculating taxable income . . . when the taxpayer is engaged in one or more transactions with an affiliated entity that was subject to tax in this Commonwealth or another state or possession of the United States on a tax base that included the intangible expense or cost, or the interest expense or cost, paid, accrued or incurred by the taxpayer, the taxpayer shall receive a credit against tax due in this Commonwealth in an amount equal to the apportionment factor of the taxpayer in this Commonwealth multiplied by the greater of the following:

(A) the tax liability of the affiliated entity with respect to the portion of its income representing the intangible expense or cost, or the interest expense or cost, paid, accrued or incurred by the taxpayer; or

(B) the tax liability that would have been paid by the affiliated entity under subparagraph (A) if that tax liability had not been offset by a credit.

The credit issued . . . shall not exceed the taxpayer's liability in this Commonwealth attributable to the net income taxed as a result of the

[Add-Back] . . . ¹⁹

A. Add-Back Credit Limitation

The Add-Back Credit is limited to the increase in the payor corporation's CNIT liability due to the application of the Add-Back. The Add-Back Credit limitation, therefore, is determined by the excess of the PA Corporate Taxpayer's CNIT liability determined with the Add-Back in excess of its CNIT liability without the Add-Back. See the examples below for illustrations of the Add-Back Credit limitation.

B. Applicability to Non-Income Taxes

The Add-Back Credit applies only to the net income taxes paid by the affiliated entity with respect to amounts received from the payor that were disallowed by the Add-Back. The Add-Back Credit does not apply to taxes based upon capital, gross receipts taxes, or business and occupational taxes.

C. Taxes Paid to Combined Reporting States

In general, the Add-Back Credit does not apply to state income taxes paid in combined reporting states. The state income taxes paid by the affiliated entity is excluded in the computation of the Add-Back Credit if the PA Corporate Taxpayer and the affiliated entity file on a combined, consolidated, or unitary basis in a manner whereby the intangible expenses of the PA Corporate Taxpayer and the corresponding income of the affiliated entity are eliminated in determining the aggregate state net income tax of both entities. Disregarding state income taxes paid by the affiliated entity in a combined reporting state is required by the Add-Back because the inclusion of both the PA Corporate Taxpayer's expense and the affiliated entity's income eliminates the income "subject to tax" in such tax jurisdictions.²⁰

D. Mathematics of the Add-Back Credit

The amount of the Add-Back Credit is determined through a formula, calculated by multiplying the Pennsylvania apportionment percent of the PA Corporate Taxpayer by the aggregate state corporate net income tax liability of the affiliated entity in states

¹⁹ 72 P.S. § 7401(3)1.(t) (emphasis added).

²⁰ See e.g., Connecticut Special Notice, No. 2003(22) (July 8, 2004); see also, Ga. Code Ann. § 48-7-28.3(d)(1)(B) ("such combined income tax report or return, consolidated income tax report or return, or other report or return results in the elimination of the tax effects from transactions directly or indirectly between the taxpayer and the related member"); Ala. Admin Code § 810-3-35-.02(3)(e) (" 'Subject to a tax based on or measured by the related member's net income' means that the receipt of the payment by the recipient related member is reported and included in income for purposes of a tax on net income, and not offset or eliminated in a combined or consolidated return which includes the payor. ").



for which the PA Corporate Taxpayer and the affiliated entity filed on a combined basis, but the total tax liability of the affiliate entity is determined without regard to any income tax credits the affiliated entity used to reduce its state income tax liability.²¹

The Add-Back Credit is calculated with the following formula:

$$PA \text{ Apportionment \% of PA Corp Taxpayer} \times \frac{\text{Aggregate State Corp. Tax Income Tax Liability for the Affiliated Entity in Separate Company States}}{\text{Aggregate Gross Income (before expenses) of Affiliated Entity}} \times \text{Affiliated Entity's Gross Intangible Income from PA Corp Taxpayer}$$

The application of the formula is demonstrated in the illustrations included in the next section.

As the formula demonstrates, the Add-Back Credit is a function of the aggregate amount of corporate net income taxes paid by the affiliated entity (without regard to tax credits) on the income paid to it by a PA Corporate Taxpayer for the acquisition, use, maintenance, management, ownership, sale, or exchange of an intangible asset. If the affiliated entity does not have any corporate state net income tax liability in separate company states, the PA Corporate Taxpayer does not receive an Add-Back Credit.²² The Add-Back Credit is based on the affiliated entity's actual state corporate net income tax liability (but only in separate company states), ignoring tax credits, but including any applicable net operating loss deductions.

E. Illustrations of the Add-Back Credit

Example 7:

Corporation A, a PA Corporate Taxpayer, licenses trademarks from Corporation B, an affiliated entity. Corporation A had \$6,000,000 of gross income, and incurred \$3,000,000 in expenses, including \$1,000,000 of royalties expense to Corporation B, for which it claimed deductions. Corporation A filed corporate income tax reports in several states, including Pennsylvania, and apportioned 75% of its net taxable income to Pennsylvania.

Corporation B had \$3,000,000 of gross income, including \$1,000,000 of royalty income from Corporation A. Company B had \$750,000 of expenses. Corporation B was subject to corporate income tax in State 1 and State 2 and had a 25% apportionment factor for State 1. Corporation B's corporate net income tax liability to State 1 was \$36,563.

²¹ If the affiliated entity receives one or more credits against its state income taxes, the affiliated entity's corporate net income tax liability is determined without regard to such credit.

²² For a numerical illustration see Example 8.



In addition, Corporation B received a \$20,000 jobs credit from State 1, which decreased Corporation B's State 1 income tax liability from \$36,563 to \$16,563.

Corporation A and B were included in a combined state income tax report in State 2, where Corporation A's royalty expense was eliminated by Corporation B's royalty income.

Assuming a 6.5% corporation net income tax rate in State 1 and State 2, Corporation A has a \$9,141, Add-Back Credit, which is determined as follows:

$$PA \text{ Apportionment \% of PA Corp Taxpayer} \times \frac{\text{Aggregate State Corp. Tax Income Tax Liability for the Affiliated Entity in Separate Company States}}{\text{Aggregate Gross Income (before expenses) of Affiliated Entity}} \times \text{Affiliated Entity's Gross Intangible Income from PA Corp Taxpayer}$$

$$75\% \times \frac{36,563}{3,000,000} \times 1,000,000 = \$9,141$$

The detailed calculations for Example 7, both for Corporation A and Corporation B, are included in **Exhibit A**.

Example 8:

Assume the same facts as Example 7, except Corporation B had \$3,500,000 of expenses (rather than \$750,000 as it had in Example 7), which caused Corporation B to have a \$500,000 net operating loss for the year.

Corporation A does not receive an Add-Back Credit because Corporation B did not have any state income tax liability as it had an operating loss. Corporation A's Add-Back Credit is determined as follows:

$$PA \text{ Apportionment \% of PA Corp Taxpayer} \times \frac{\text{Aggregate State Corp. Tax Income Tax Liability for the Affiliated Entity in Separate Company States}}{\text{Aggregate Gross Income (before expenses) of Affiliated Entity}} \times \text{Affiliated Entity's Gross Intangible Income from PA Corp Taxpayer}$$

$$75\% \times \frac{0}{3,000,000} \times 1,000,000 = 0$$

The detailed calculations for Example 8 are included in **Exhibit B**.

EXHIBIT A

Details for Example 7

Example 7

	PA CNIT TAX LIABILITY		Tax Liability of Affiliated Entity
	Corporation A (without the Add-Back)	Corporation A (with the Add-Back)	Corporation B (Subject to Tax on State 1)
Income from Intangibles			1,000,000
Other Income	6,000,000	6,000,000	2,000,000
Total Income	6,000,000	6,000,000	3,000,000 E
Expenses			
Royalty Expense	(1,000,000)	0	0
Other Expenses	(2,000,000)	(2,000,000)	(750,000)
Net Income Before Apport.	3,000,000	4,000,000	2,250,000
Apportionment %	75%	75% C	25%
Net Income Subject to Tax	2,250,000	3,000,000	562,500
Tax Rate	9.99%	9.99%	6.50%
Tax (Before Add-Back Credit)	224,775 A	299,700 B	36,563 D
Add-Back Credit		9,141 (C X F)	
Add-Back Credit Limitation		74,925 (B- A)	

Effective Tax Rate of Affiliated Entity	1.219%	(D/E)
Intangible Income from Payor	1,000,000	
Affiliated Entity Tax on Intangibles	12,188	F

Note that the amount used in the (D/E) calculation is Corporation B's State 1 income tax liability **without reduction for the State 1 jobs credit.**

EXHIBIT B

Details for Example 8

Example 8

	PA CNIT TAX LIABILITY		Tax Liability of Affiliated Entity									
	Corporation A (without the Add-Back)	Corporation A (with the Add-Back)	Corporation B (Subject to Tax on State 1)									
Income from Intangibles			1,000,000									
Other Income	6,000,000	6,000,000	2,000,000									
Total Income	6,000,000	6,000,000	3,000,000 E									
Expenses												
Royalty Expense	(1,000,000)	0	0									
Other Expenses	(2,000,000)	(2,000,000)	(3,500,000)									
Net Income Before Apport.	3,000,000	4,000,000	(500,000)									
Apportionment %	75%	75% C	25%									
Net Income Subject to Tax	2,250,000	3,000,000	(125,000)									
Tax Rate	9.99%	9.99%	6.50%									
Tax (Before Add-Back Credit)	224,775 A	299,700 B	- D									
Add-Back Credit		<u>-</u> (C X F)										
Add-Back Credit Limitation		<u>75,000</u> (B- A)										
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;">Effective Tax Rate of Affiliated Entity</td> <td style="width: 20%;">0.00%</td> <td style="width: 20%;">(D/E)</td> </tr> <tr> <td> Intangible Income from Payor</td> <td><u>1,000,000</u></td> <td></td> </tr> <tr> <td>Affiliated Entity Tax on Intangibles</td> <td><u>-</u></td> <td>F</td> </tr> </table>				Effective Tax Rate of Affiliated Entity	0.00%	(D/E)	Intangible Income from Payor	<u>1,000,000</u>		Affiliated Entity Tax on Intangibles	<u>-</u>	F
Effective Tax Rate of Affiliated Entity	0.00%	(D/E)										
Intangible Income from Payor	<u>1,000,000</u>											
Affiliated Entity Tax on Intangibles	<u>-</u>	F										
Add-Back Credit Limitation		<u><u>-</u></u> (B- A)										