830 CMR 63.31.1 Add Back of Interest or Intangible Expense

830 CMR: DEPARTMENT OF REVENUE
830 CMR 63.00: Taxation of Corporations
830 CMR 63.00 is amended by adding the following section:
830 CMR 63.31.1: Add Back of Interest or Intangible Expense

(1) *Purpose, General Rule, and Outline*.

(a) *Purpose*. The purpose of 830 CMR 63.31.1 is to explain the add back of related member interest or intangible expense, as provided in M.G.L. c. 63, §§ 31I, 31J and 31K, including the add back of related member interest expense that derives from dividend notes or similar obligations, as referenced in M.G.L. c. 63, § 30.4. This regulation extends to the computation of "net income" under M.G.L. c. 63 generally, and therefore applies to foreign and domestic corporations, financial institutions and utility corporations.

(b) *General Rule*. Generally, a taxpayer must add back to net income related member interest and intangible expense. The add back rule applies, *inter alia*, to losses incurred in connection with factoring or discounting transactions; interest expense paid, accrued or incurred in connection with a dividend note or similar obligation; and certain acquisition interest expense that is paid, accrued or incurred to a person or entity that is not a related member. This general rule is subject to certain exceptions.

(c) *Exceptions to the General Rule*. Notwithstanding the provisions of 830 CMR 63.31.1(1)(b), a taxpayer is permitted to establish by clear and convincing evidence that a particular add back would be unreasonable, as further defined by this regulation. Also, a taxpayer is permitted to claim other specific exceptions to the general rule stated in 830 CMR 63.31.1(1)(b), as further explained by this regulation. A taxpayer that seeks to claim that the add back of a particular interest or intangible expense would be unreasonable or that otherwise claims an exception to the general rule stated in 830 CMR 63.31.1(1)(b) must do so on a schedule completed as required by the Commissioner and filed as part of its tax return.

(d) *Outline*. 830 CMR 63.31.1, is organized as follows:

(1) Purpose, General Rule, Exceptions to the General Rule, and Outline

(2) Definitions

(3) Add Back of Related Member Interest or Intangible Expense

(4) Exceptions to Add Back of Related Member Interest or Intangible Expense

(5) Add Back Exception when Related Member Resides in a Nation that is Party to a U.S. Bilateral Income Tax Treaty

(6) Filing Schedule; Claiming an Add Back Exception

(7) Requests for More Information; Procedure for Evaluating an Exception Claim

(8) No Limitations as to Other Agreements, Compromises or Adjustments

(9) Interaction with Determination as to Existence of Net Operating Loss

(10) Interaction with Taxation of a Related Member

(2) *Definitions*.

For the purposes of 830 CMR 63.31.1 the following terms have the following meanings unless the context requires otherwise:

" *Acquisition interest expense*," interest paid, accrued or incurred by a taxpayer with respect to debt to a person or entity that is not a related member where the debt was incurred to acquire the taxpayer's assets or stock in a transaction that is referenced in Code § 368.

" *Aggregate effective rate of tax*", the sum of the effective rates of tax imposed on a related member by a state or U.S. possession or foreign nation or any combination thereof.

" *Clear and convincing evidence*," evidence that is so clear, direct and weighty that it will permit the Commissioner to come to a clear conviction without hesitancy of the validity of the taxpayer's claim. This evidentiary standard requires a strong showing of proof that instills a degree of belief greater than is required under the preponderance of evidence standard.

" *Code*", the federal Internal Revenue Code as amended and in effect for the taxable year.

" *Economic substance*," a transaction has economic substance when it involves material economic risk and has material practical economic consequences other than the creation of a tax benefit.

" *Embedded royalty*," portion of a cost or expense paid, accrued or incurred by a taxpayer for property received from or services rendered by a related member that relates to intangible property owned by such related member or to an intangible expense paid, accrued or incurred by said related member in a direct or indirect transaction with one or more other related members.

" *Effective rate of tax*", as to any state or U.S. possession or foreign nation, the maximum statutory rate of tax imposed by the jurisdiction on a related member's net income multiplied by the apportionment percentage, if any, applicable to the related member under the laws of the jurisdiction. For purposes of this definition, the effective rate of tax as to any jurisdiction is zero where the related member's net income tax liability in the jurisdiction is computed on a combined or consolidated return that includes both the taxpayer and the related member and where the transactions giving rise to the interest or intangible expense between the taxpayer and the related member are substantially eliminated or substantially offset each other. When determining the effective rate of tax imposed upon a related member, it is not generally relevant whether and to what extent the related member's actual tax to be paid to one or more jurisdictions is reduced by deductions, losses, credits, etc. However, when computing the effective rate of tax for a jurisdiction in which a related member's net income is eliminated or offset by a credit or similar adjustment that is dependent upon the related member either maintaining or managing intangible property or collecting investment income in that jurisdiction, the maximum statutory rate of tax imposed by said jurisdiction shall be decreased to reflect the statutory rate of tax that applies to the related member as effectively reduced by such credit or similar adjustment.

" *Intangible expense*", includes, without limitation, (1) expenses, losses and costs for, related to, or in connection directly or indirectly with the direct or indirect acquisition, use, licensing, maintenance, or management, or ownership, or the sale, exchange, or any other disposition, of intangible property to the extent such amounts are allowed as deductions or costs in determining taxable income before operating loss deductions and special deductions for the taxable year under the Code; (2) losses related to, or incurred in connection directly or indirectly with, factoring transactions or discounting transactions; (3) royalties, fees, technical charges, and other costs or expenses paid or incurred for or related to the acquisition, use, licensing, maintenance, or ownership of patents, copyrights, trademarks and trade names, know-how, and other intangible property; (4) other similar expenses and costs; and (5) amounts directly or indirectly allowed as deductions under Code § 163 for purposes of determining taxable income under the Code to the extent such expenses and costs are directly or indirectly for, related to, or in connection with the direct or indirect acquisition, use, licensing, maintenance, management, ownership, sale, exchange or disposition of intangible property.

" *Intangible property*", patents, patent applications, trade names, trademarks, service marks, copyrights, mask works, know-how, trade secrets, and similar types of intangible assets.

" *Interest expense*", amounts directly or indirectly allowed as deductions under Code § 163 for purposes of determining taxable income under the Code, including acquisition interest expense, other than amounts that are included in the definition of "intangible expense." The term interest expense includes an expense paid, accrued or asserted in connection with a dividend of a note or similar obligation that states the requirement that such interest is to be paid by the corporation that dividends such obligation to its shareholder(s).

" *Related member*", a person that, with respect to the taxpayer during all or any portion of the taxable year, is: (1) a related entity, (2) a component member as defined in subsection (b) of Code § 1563; (3) a person to or from whom there is attribution of stock ownership in accordance with subsection (e) of Code § 1563; or (4) a person that, notwithstanding its form of organization, bears the same relationship to the taxpayer as a person described in (1) to (3), inclusive.

" *Related entity*", (1) a stockholder who is an individual, or a member of the stockholder's family set forth in Code § 318, if the stockholder and the members of the stockholder's family own, directly, indirectly, beneficially or constructively, in the aggregate, at least 50 per cent of the value of the taxpayer's outstanding stock; (2) a stockholder, or a stockholder's partnership, limited liability company, estate, trust or corporation, if the stockholder and the stockholder's partnerships, limited liability companies, estates, trusts and corporations own directly, indirectly, beneficially or constructively, in the aggregate, at least 50 per cent of the value of the taxpayer's outstanding stock; or (3) a corporation, or a party related to the corporation in a manner that would require an attribution of stock from the corporation to the party or from the party to the corporation under the attribution rules of the Code if the taxpayer owns, directly, indirectly, beneficially or constructively, at least 50 per cent of the value of the corporation's outstanding stock. The attribution rules of the Code shall apply for purposes of determining whether the ownership requirements of this definition have been met.

" *Statutory rate of tax*," the rate of tax that applies to the taxpayer under M.G.L. c. 63 without any consideration as to the taxpayer's apportionment percentage, if any.

" *Valid business purpose*," a good-faith business purpose, other than tax avoidance, that was, either alone or in combination with one or more other good-faith business purposes, the primary motivation for entering into a transaction. To qualify as a valid business purpose within the meaning of this regulation, the purpose or purposes must be commensurate with the value of the tax benefit claimed. For purposes of this definition, an intention to reduce taxes in any state or other jurisdiction or under the Code is not a valid business purpose.

(3) *Add Back of Related Member Interest or Intangible Expense*.

(a) *Intangible Expense Add Back*. For purposes of computing net income under M.G.L. c. 63, a taxpayer shall add back otherwise deductible intangible expense directly or indirectly paid, accrued or incurred to, or in connection directly or indirectly with one or more direct or indirect transactions with, one or more related members. This provision applies, *inter alia*, in the instance of an embedded royalty and also as to a loss related to or incurred directly or indirectly with a factoring or discounting transaction entered into with a related member.

(b) *Interest Expense Add Back*. For purposes of computing net income under M.G.L. c. 63, a taxpayer shall add back otherwise deductible interest expense directly or indirectly paid, accrued or incurred to one or more related members including related member interest expense that derives from a dividend note or a similar obligation. In addition, a taxpayer shall add back otherwise deductible acquisition interest expense.

(4) *Exceptions to Add Back of Related Member Interest or Intangible Expense*.

(a) *Full Exceptions*. The add back required by 830 CMR 63.31.1(3)(a) or (b) shall not be required in the following instances.

1. *Exception because add back would be unreasonable.* The taxpayer establishes by clear and convincing evidence that the add back would be unreasonable.

a. *Add back unreasonable where it would result in significant actual double taxation.* The add back adjustment will be considered unreasonable where the taxpayer establishes by clear and convincing evidence that the interest or intangible expense was paid, accrued or incurred to a related member that is taxed on the corresponding income by a state, U.S. possession or foreign jurisdiction or any combination thereof at an aggregate effective rate of tax that is within three percentage points of the taxpayer's statutory rate of tax. A taxpayer that seeks to claim this exception must file the applicable schedule with its tax return setting forth the information required by the Commissioner. For purposes of verifying the taxpayer's claim, the Commissioner requires that the taxpayer retain and produce upon request the relevant copy or copies of the tax returns of the related member(s) in question. The Commissioner may contest an exception that is claimed on this basis when, irrespective as to the taxpayer's claim and the numeric computation reflected therein, the underlying transaction lacks either a valid business purpose or economic substance or a principal purpose of the transaction was the avoidance of taxes. This exception does not apply in the instance of an acquisition interest expense.

Example 1. Orange Corp. is a corporation that is engaged in business in Massachusetts and is taxed at a statutory rate of tax of 9.5% under M.G.L. c. 63, § 39. Purple Corp. is a related member corporation that loans funds to Orange Corp. Purple Corp. apportions one-quarter of its income to each of the following four states and is taxed on the interest income at the maximum statutory rate noted: State A (7.5%), State B (8.25%), State C (8%), and State D (7%). Purple Corp. has no property, payroll or sales or any other activity in any other state or jurisdiction. Also, there is no basis to question whether the underlying transaction is supported by a valid business purpose or economic substance or whether a principal purpose of the transaction was the avoidance of taxes. Given these facts, Purple Corp.'s effective rate of tax in the four states referenced is 7.69% (the number obtained by multiplying for each state that state's statutory rate of tax by each state's respective apportionment percentage of 25%, then adding the four numbers together). Because Purple Corp. is actually taxed on the interest income in question at an aggregate effective rate of tax that is within 3% of the statutory rate of tax applied to Orange Corp., the Commissioner will recognize a full exception to the statutory add back for the interest paid by Orange Corp. to Purple Corp. in connection with the loan.

Example 2. Same facts as in Example 1, except that Orange Corp. files a combined report in State C that includes Orange Corp. and Purple Corp. where the transactions between Orange Corp. and Purple Corp. eliminate or offset.

Because Purple Corp.'s effective rate of tax in State C is now zero for purposes of this regulation, Purple Corp.'s aggregate effective rate of tax in the four states referenced is now 5.6875%. Since Purple Corp. is not actually taxed on the interest income at an aggregate effective rate of tax that is within 3% of the statutory rate of tax applied to Orange Corp., the Commissioner will not recognize a full exception to the statutory add back for Orange Corp. based upon the tax applied to Purple Corp. However, a partial add back exception will be available under 830 CMR 63.31.1(4)(b)1.

Example 3. Indigo Corp. is a corporation that is engaged in business in Massachusetts and is taxed at a statutory rate of tax of 9.5% under M.G.L. c. 63, § 39. Violet Corp. is a related member corporation that owns and manages intangible property and that licenses the use of such intangible property to Indigo Corp. Violet Corp. is subject to tax only in State A. Violet Corp. has no property, payroll or sales or any other activity in any other state or jurisdiction. The maximum statutory rate of tax to be applied to Violet Corp.'s net income in State A is 8.7%. However, State A confers a credit upon corporations that own or manage intangible property in that state that, in and of itself, results in Violet Corp. not owing any net income tax to that state. Because the effective rate of tax of Violet Corp. in State A is reduced to zero as a result of that state's credit for the management of intangible property, the Commissioner will not recognize a full exception to the statutory add back for Indigo Corp. under 830 CMR 63.31.1(4)(a)1.a.

b. *Add back unreasonable where taxpayer proves by clear and convincing evidence that underlying transaction was primarily motivated by valid business purpose and supported by economic substance.* The add back will also be considered unreasonable where the taxpayer establishes by clear and convincing evidence that it incurred the interest or intangible expense as a result of a transaction (1) that was primarily entered into for a valid business purpose and (2) that is supported by economic substance. However, a taxpayer will not carry its burden of demonstrating by clear and convincing evidence that a disallowance is unreasonable unless the taxpayer demonstrates that reduction of tax was not a principal purpose for the transaction. In cases that pertain to an interest expense this exception includes a requirement that the taxpayer establishes by clear and convincing evidence that the purported underlying debt is bona fide debt. The taxpayer must also establish by clear and convincing evidence that its interest or intangible expense reflects fair value or fair consideration. *See* M.G.L. c. 63, §§ 33, 39A.

In general, a taxpayer seeking to claim this exception must file a schedule with its tax return setting forth the information that is required by the Commissioner. The taxpayer must also prepare with its tax return and make available to the Commissioner upon his request, either with its tax return or otherwise as requested by the Commissioner, a supporting statement that includes the information referenced below, identifying any referenced documents where appropriate. Further, the taxpayer must include as part of its supporting statement any additional information and references to any additional documents that would be necessary or helpful for the Commissioner to evaluate the taxpayer's add back exception claim. Unless all relevant evidence is incorporated into the taxpayer's supporting statement and attachments, if any, the taxpayer's supporting statement must clearly identify the other evidence on which the taxpayer relies.

(1) *Specific statement as to the valid business purpose for the transaction that gave rise to the expense.* The taxpayer's business purpose or purposes for its transaction should be stated as specifically as possible and not stated in the abstract. Also, the taxpayer's business purpose or purposes should be related to discrete business activity that is conducted by the taxpayer or activity that the taxpayer is planning to conduct. General statements as to business purpose are insufficient to satisfy the clear and convincing evidence standard. In addition to its statement of business purpose, the taxpayer should identify each of the elements of the transaction that it relies upon to support a finding of economic substance. In the case of an intangible expense, the Commissioner will be skeptical of an asserted business purpose or an element of the transaction asserted to demonstrate economic substance where such purpose or element is generic to the intangible holding company structure and not specifically related to the operation of the taxpayer's business.

(2) *Description of the transaction.* The taxpayer's statement should provide a detailed description of the transaction that generated the claimed deduction. For example, if the deduction is claimed pursuant to a written contract, the taxpayer should briefly describe the transaction governed by the contract and should provide the date of the contract, the relevant terms, and a statement as to whether the transacting parties are in compliance with said terms. In the specific instance of a dividend note or similar obligation, the taxpayer should briefly describe the transaction and state the material terms of the note, including the date, term, and the principal and interest payment schedule. In the specific case of a discounting or factoring loss, the taxpayer should briefly describe the methodology by which the transfer price, and thus the loss, was determined. If the taxpayer entered into the transaction on the advice of a tax advisor, or if the terms of the engagement with a tax advisor measured the fee paid to the advisor directly or indirectly by reference to the actual or anticipated tax savings derived from the transaction, the taxpayer should note this fact. In these latter circumstances, the Commissioner is more likely to reject the exception claim. The taxpayer should also reference any other affirmative evidence that would tend to prove that tax avoidance was not a principal purpose for the transaction.

(3) *Basis for the payment amounts.* The taxpayer must state the basis for its determination that the amount of the claimed expense is substantially identical to what would be expended in an arm's length transaction under

substantially similar circumstances. In making this statement the taxpayer may make reference to appropriate rules concerning arm's length charges set forth in Code § 482, including the rules that relate to the imposition of an arm's length rate of interest. If for purposes of showing that the amount of its claimed expense was fair, the taxpayer is relying upon an appraisal or a study, the taxpayer should identify this appraisal or study and its preparer, and state the date on which it was issued and the general conclusions thereof. Where a taxpayer cannot show by clear and convincing evidence that the amount of its asserted deduction was fair, the Commissioner in his discretion may adjust the expense so that it will reflect fair value or fair consideration, or, alternatively, deny the taxpayer's exception claim in its entirety.

(4) *Statement that there was no "circular flow of funds."* The taxpayer's statement should indicate whether the claimed expense was actually paid and, if so, whether the cash was substantially returned to the taxpayer in whole or in part, including through the form of a loan or loans. In cases in which the cash was returned to the taxpayer either in whole or in part, the taxpayer should state when the cash was returned to the taxpayer and in what manner, including the terms of the loans or loans, if any. The Commissioner will generally reject an exception claim when it is based upon a purported expense with respect to which no actual transfer of funds was made or with respect to which funds were substantially returned to the taxpayer, either directly or indirectly, within a short period of time.

(5) *Statement as to the acquisition of intangibles*. In the case of an intangible expense, the taxpayer's statement should explain how the related member obtained the intangibles in question. In general, the Commissioner will be more likely to accept an asserted add back exception for an intangible expense when the intangibles were either developed by the related member that receives the payment or were purchased by the related member in a bona fide arm's length sales transaction.

(6) *Statement of capitalization for purposes of loan payments.* In the case of interest expense, the taxpayer's statement should briefly explain what the taxpayer's capital structure was at the time that it incurred the purported debt in question. In many instances a copy of the taxpayer's separate-company balance sheet on its Massachusetts tax return for the year the debt was incurred will suffice for this purpose. The Commissioner generally will also review the taxpayer's balance sheet for the year of the potential add back as part of his analysis of the adequacy of the taxpayer's capitalization. The taxpayer's statement may include such other information as the taxpayer believes may be helpful in assessing its capital structure.

(7) *Statement as to whether the loan is "acquisition debt."* In the case of interest expense, the taxpayer's statement should also indicate whether the interest expense constitutes acquisition interest expense within the meaning of this regulation. In general, an exception to the add back for an interest expense will not be regarded as appropriate in such cases.

Examples. The following examples are intended to illustrate the application of 830 CMR 63.31.1(4)(a)1.b. In each of these examples, it should be assumed, unless otherwise stated, that no other exception applies. Also, it should be assumed that in each case the taxpayer that requests the add back exception has filed a completed schedule referencing the claimed exception and required information as part of its tax return and has provided the Commissioner upon his request with a supporting statement that was prepared contemporaneously with the taxpayer's tax return. Further, it should be assumed that there are no additional material facts or circumstances that would alter the determination as stated in each example. In each case in which an example refers to a taxpayer's proof that its transaction was not "entered into for tax avoidance purposes," the example refers to proof as to whether the transaction was entered into for a valid business purpose and is supported by economic substance, as well as proof that the reduction of tax was not a principal purpose for the transaction.

Example 1. Pre-existing licensing contract between unrelated parties that become related parties but continue to stand in relation to each other as if unrelated; sufficient proof presented that add back exception is justified. Abel Corp. is engaged in manufacturing operations in Massachusetts and has been licensing technology from Baker Corp., an unrelated out-of-state corporation. Baker Corp. acquires a controlling interest in Abel Corp., but Abel Corp. continues to use Baker Corp's technology pursuant to the pre-existing licensing contract. Although Baker Corp. has acquired a controlling interest in Abel Corp., the two corporations continue to stand in relationship to one another as if they are unrelated. Consequently, Abel Corp. can establish that not only was the licensing transaction not entered into for tax avoidance purposes, but that the intangible expense continues to reflect an arm's length charge. The Commissioner will recognize an exception to the statutory add back for the royalties paid by Abel Corp. to Baker Corp. pursuant to the pre-existing licensing contract.

Example 2. Overstated intangible expense justifies denial of entire add back exception or arm's length adjustment. An out-of-state corporation, Carter Corp., licenses intangibles that it owns and has developed to unrelated out-of-state entities that manufacture and sell goods to which the intangibles relate. The unrelated entities pay a royalty fee to Carter Corp. that comprises payment for manufacturing-related intangibles and also for an exclusive right to sell the manufactured product within a defined region. Carter Corp. previously formed Delta Inc., a wholly owned corporation that is to operate stores in Massachusetts. Carter Corp. previously caused Delta Inc. to enter into a contract with it pursuant to which Delta Inc. has the exclusive right to sell products that are manufactured by another subsidiary of Carter Corp. within a certain territory. The terms of this licensing contract require Delta Inc. to pay Carter Corp. a royalty fee in connection with its in-state retail sales. Although Delta Inc., unlike Carter Corp.'s unrelated licensees, merely sells products that it purchases from Carter Corp., the percentage royalty that Delta Inc. seeks to deduct is similar to that paid by Carter Corp's unrelated licensees. It is assumed for purposes of this example that Delta Inc. can show that the transaction was not entered into for tax avoidance purposes. However, note that despite this assumption the royalty paid by Delta Inc. is apparently in excess of fair value. Therefore, in the absence of other facts to support the amount of Delta Inc.'s asserted royalty deduction, the Commissioner will either deny the claimed add back exception or adjust the royalty to correspond to an arm's length rate.

Example 3. Pre-existing loan between unrelated parties that become related parties; purported debt shown to be true debt. Exit Corp., a Massachusetts utility corporation that is subject to tax under M.G.L. c. 63, § 52A, has an outstanding loan in place with Fire Co., which is an unrelated corporation doing business outside the state. Fire Co. later acquires Exit Corp. and Exit Corp. continues to make interest payments to Fire Co. in accordance with the pre-existing loan agreement. Because the debt was bona fide when incurred and the parties continue to abide by the terms of the pre-existing loan agreement, the Commissioner will recognize an exception to the statutory add back for the interest paid by Exit Corp. to Fire Co.

Example 4. Related member's management operates in arm's length manner; purported debt shown to be true debt. Groom Corp. is engaged in manufacturing operations in Massachusetts and is acquired by Hire Corp., which is an out-of-state corporation that is in a service business. Although Hire Corp. formally controls Groom Corp. by reason of its acquisition, Hire Corp. permits the separate management of Groom Corp. to continue to independently run the operations of that entity. The management of Groom Corp. determines that Groom Corp. needs to take on debt to fund expansion of the manufacturing business. Although Groom Corp. could borrow funds from an unrelated party, its management decides to borrow these funds from Hire Corp. Groom Corp. and Hire Corp. then enter into a formal loan agreement and Groom Corp. subsequently uses the borrowed funds for bona fide business purposes as planned. Further, Groom Corp. makes regular payments on the loan in accordance with the loan terms. Assuming that the terms of the loan, including the stated interest rate, closely resemble what would be used in an arm's length transaction under substantially similar circumstances, the Commissioner will recognize an exception to the statutory add back.

Example 5. Dividend note; insufficient proof that transaction was not entered into for tax avoidance purposes. Idle Corp., an out-of-state corporation, enters into an agreement with an unrelated corporation, Sell Corp., to acquire Jewel Co., a Massachusetts utility corporation that is a wholly owned subsidiary of Sell Corp. Subsequent to the acquisition of Jewel Co., Jewel Co. declares a dividend of a note to Idle Corp. that substantially replicates the terms of Idle Corp.'s loan agreement with the unrelated lender. Jewel Co. seeks to claim significant tax savings in Massachusetts by reason of the use of the note. The dividend is declared in connection with Idle Corp.'s acquisition of Jewel Co., but, nonetheless, a principal purpose for use of the dividend note was to create tax deductions on the part of Jewel Co. Because this is so, the Commissioner will not recognize an add back exception for interest deductions that are asserted by Jewel Co. in connection with the dividend of the note.

Example 6. Use of NOLs in context of purported debt creates inference that transaction was entered into for tax avoidance purposes. An individual, Mr. Knoll, owns and operates Luther Corp., a profitable Massachusetts corporation. Mr. Knoll acquires Mother Inc., a second Massachusetts corporation engaged in a similar line of business, which Mr. Knoll will also manage. Mother Inc. is profitable during the tax year in question, but because it has substantial net operating losses from prior years, it will have not any Massachusetts tax liability for the tax year. In fact, there is a real risk that most of Mother Inc.'s net operating loss carry forwards will expire unused for Massachusetts purposes. Mr. Knoll causes Mother Inc. to loan monies to Luther Corp. to use in Luther Corp.'s general operations and also causes Luther Corp. to make regular payments on the loan. Most of the funds that are lent to Luther Corp. are not actually used in its general operations during the tax year at issue. These facts suggest that the loan transaction between Luther Corp. and Mother Inc. may have been entered into for tax avoidance purposes, i.e., generating interest income to Mother Inc. to absorb otherwise expiring NOLs. The Commissioner will not recognize an exception to the statutory add back for the interest deductions that are asserted by Luther Corp. if a principal purpose for the loan transaction was tax avoidance.

Example 7. Purported debt shown to be true debt; sufficient proof presented that transaction was not entered into for tax avoidance purposes. Niles Co. is a technology start-up corporation doing business in Massachusetts that is owned by two individuals, one of whom resides in Massachusetts and one of whom does not. Niles Co.'s rate of tax under the Massachusetts statute is 9.5%. The rate at which the Massachusetts resident is taxed is 5.3% and the rate at which the non-resident is taxed is 4.75%. To help fund the expansion of the business the two individuals loan monies to the corporation and execute notes reflecting arm's length interest and terms that would pass muster under Code § 482 (irrespective of whether Code § 482 applies to the transaction). There are no factors that suggest that the loan should be recharacterized as a contribution to capital. Further, Niles Co. uses the loan funds in its business, and makes regular payments on the loan in accordance with the loan terms. Because Niles Co. can make the requisite showing that the transaction was not entered into for tax avoidance purposes, the Commissioner will recognize a full exception to the statutory add back. Note that a full exception based on the notion of substantial actual double taxation would not be appropriate on these facts because neither of the two related individual shareholders is taxed at a rate of tax within 3% of Niles Co.'s statutory in-state rate. *See* 830 CMR 63.31.1(4)(a)1.a.

However, if a full exception were not appropriate, the Commissioner would recognize a partial exception to the statutory add back based upon the fact that each of the two individuals was actually taxed on the interest income in question. *See* 830 CMR 63.31.1(4)(b)1.

Example 8. Use of affiliated insurance company in context of purported debt creates inference that transaction was entered into for tax avoidance purposes. A parent corporation, Parent, owns a controlling interest in two subsidiaries, Result Corp. and Sister Inc., which conduct business operations solely in Massachusetts. Result Corp. conducts general business operations, whereas Sister Inc. is an insurance company within the meaning of M.G.L. c. 63, § 20, et seq. Parent capitalizes Sister Inc. with more money than it needs to conduct its insurance operations and then causes Sister Inc. to lend the excess cash to Result Corp. Interest payments made by Result Corp. to Sister Inc. are not taxable to Sister Inc. because insurance companies are only taxable on their insurance premiums. Result Corp. seeks to claim significant tax savings in Massachusetts by reason of this transaction. Assuming that a principal purpose for the loan transaction was tax avoidance, the Commissioner will not recognize an exception to the statutory add back for the interest deductions that are asserted by Result Corp.

Example 9. Dividend note; international tax restructuring suggests transaction was entered into for tax avoidance purposes. Total Co., a multinational corporation that is organized and has a headquarters in Freedonia, has significant operations in the U.S. and a U.S. commercial domicile in Massachusetts. Total Co. establishes a wholly-owned subsidiary, a U.S. holding company, Usher Corp., which is organized as a Delaware limited liability company and treated as a branch of its Freedonian parent for Freedonian tax purposes. Usher Corp. is an "eligible entity" that checks the box to be treated as a corporation for purposes of U.S. tax law, and is treated as a corporation for Massachusetts purposes as well. Also, Usher Corp. declares a dividend to its parent, Total Co., in the form of a note in the amount of $100 million, and then claims a deduction for the interest expense attributable to the note on its U.S. and Massachusetts tax returns. These facts suggest that that the interest expense is the result of a transaction that was entered into for tax avoidance purposes, and in fact Usher Corp. seeks to claim significant tax savings in Massachusetts by reason of the transaction. Assuming that a principal purpose for the transaction was tax avoidance, Usher Corp. must add back the interest expense on its Massachusetts tax return. Note that the failure to meet the requisite evidentiary burden on these facts would also prevent Usher Corp. from asserting the treaty exception set forth in 830 CMR 63.31.1(5), even assuming that Total Co. was a resident of a nation which has in force a comprehensive income tax treaty with the United States. The conclusions in this example are without regard to the ultimate impact of particular federal tax rules that may affect the treatment of the interest under the Code, because the add back analysis turns on whether there was a tax avoidance purpose for the restructuring.

Example 10. Purported debt shown to be true debt; sufficient proof presented that transaction was not entered into for tax avoidance purposes. Ms. Victor, who is a resident of Massachusetts, is the president and sole owner of Wire Inc., a C corporation that owns several video stores and is only doing business in this state. To help fund expansion of the business, Ms. Victor makes a loan of $100,000 to Wire Corp. on arms-length terms, and Wire Inc. executes a ten-year note reflecting these terms. Funding the business expansion appears to be the sole purpose for the loan and the transaction does not appear to have been entered into for tax avoidance purposes. There are no other circumstances suggesting that the loan should be re-characterized as a capital contribution, and also the required payments generally are made timely. The Commissioner will not add back the interest expense incurred by Wire Inc. because disallowing the deduction would be unreasonable in these circumstances, notwithstanding the fact that there is more than a 3% difference between Wire Inc.'s 9.5% Massachusetts rate and Ms. Victor's 5.3% Massachusetts tax rate. *S ee* 830 CMR 63.31.1(4)(a)1.a. In the seventh year of the loan, Ms. Victor turns over day-to-day management of Wire Corp. to her son and retires to Florida, where she establishes her exclusive tax domicile. Even though Florida imposes no personal income tax, the Commissioner will not add back the interest expense incurred by Wire Inc. for the years after Ms. Victor moves to Florida.

Example 11. Debt transaction structured for tax avoidance purposes. Same facts as example 10, except that Ms. Victor owns the corporation, Wire Inc., through her 100% interest in a corporation, Wave Co., that has been set up in a jurisdiction that imposes no corporate-level income tax. Rather than make the loan to Wire Inc. directly, Ms. Victor advances the funds to Wave Co. as a capital contribution, and Wave Co. then makes the loan to Wire Inc. Ms. Victor structures the transaction in this manner so that the interest on the loan will not be subject to state income tax. Although there is a valid business purpose for a loan between Ms. Victor and Wire Inc., there is no valid business purpose for the loan between Wave Co. and Wire Inc. Consequently, the Commissioner will not recognize an exception to the statutory add back on these facts.

Example 12. Use of structure to avoid tax by paying intangible expense to a related member based in a combination state indicates the transaction was entered into for tax avoidance purposes. Yoga Corp. operates retail stores in Massachusetts and other states in which it sells products that bear the company's trademarks. Yoga Corp. is taxable in each of the states in which it operates a retail store. Yoga Corp. is headquartered in a state that taxes the net income of Yoga Corp. and all of its "unitary" affiliates on a combined basis. Yoga Corp. saves money on its state taxes vis-à-vis Massachusetts and other "separate company tax reporting" states by separately incorporating a wholly owned subsidiary, Zero Inc., to serve as an intangibles holding company in the unitary state in which it is headquartered. To achieve the tax savings, Yoga Corp. transfers its trademarks to Zero Inc. and then begins paying a royalty for the use of these trademarks, based upon a percentage of sales made in Massachusetts and the other states. Yoga Corp. deducts royalty payments paid to Zero Inc. and thereby decreases its taxable income in separate company tax reporting states like Massachusetts. Zero Inc. is established with limited property and payroll, such that Zero Inc. is only taxable in the unitary state in which it is based, in which state it will file with its parent, Yoga Corp., on a combined basis. The royalty payments made between Yoga Corp. and Zero Inc. will "wash" in the unitary state and therefore do not have any tax consequences in that state. These facts suggest that the transaction between Yoga Corp. and Zero Corp. is entered into for tax avoidance purposes, and in fact Yoga Corp. seeks to claim significant tax savings in Massachusetts by reason of the transaction. Assuming that a principal purpose for the transaction was tax avoidance, the Commissioner will deny an add back exception. This is so despite the fact that Yoga Corp. may be able to claim that there are business benefits and efficiencies that result from the Zero Corp. restructuring.

Example 13. Use of structure to avoid tax by paying intangible expense to a related member based in a combination state indicates that transaction was entered into for tax avoidance purposes. Same facts as in Example 12, except that Yoga Corp. instead transfers its trademarks to a wholly owned subsidiary, Zorro Corp., that was previously incorporated in the unitary state in which Yoga Corp. is headquartered. Zorro Corp. is engaged in business activities that do not directly relate to the trademarks and was previously established in such a way that it has no nexus with other states. Although this structure does not rely upon a more traditional "intangibles holding company" whose activities are limited to the intangible property that it receives, the structure is intended to yield the same state tax benefit. Yoga Corp. deducts its royalty payments to Zorro Corp., whereas the royalty payments made between Yoga Corp. and Zorro Corp. "wash" and therefore have no tax consequences in the unitary state in which Zorro Corp. is taxed. These facts suggest that the transaction between Yoga Corp. and Zorro Corp. is entered into for tax avoidance purposes, and in fact Yoga Corp. seeks to claim significant tax savings in Massachusetts by reason of the transaction. Assuming that a principal purpose for the transaction was tax avoidance, the Commissioner will deny an add back exception. This is so despite the fact that Yoga Corp. may be able to claim that there are business benefits and efficiencies that result from the Zorro Corp. restructuring, and also may be able to claim that Zorro Corp. possesses business "substance" by reason of its pre-existing and ongoing business activities.

Example 14. Purported debt shown to be true debt; sufficient proof presented that transaction was not entered into for tax avoidance purposes. Calco is a California-based business that was formed in 1995. It owns a number of franchised fast-food restaurants, each of which is operated through a separate, direct subsidiary of Calco Inc., the corporate parent. Calco Inc. performs Calco's headquarters function and operates solely in California. The Calco group derives its income exclusively from sales at the fast-food restaurants. The group pays license fees for each of the restaurants to a large, unrelated multinational company that owns the intangibles associated with the restaurant chain. Calco has been expanding its operations steadily since its formation by acquiring more and more restaurants. Until 2001, all of its restaurants were located in California. Calco's practice in acquiring the restaurants has always been to set up a new subsidiary, determine the funds that is needed for the acquisition and operation of the restaurant, and capitalize the new subsidiary with such funds by using 60% equity and 40% debt. The loans between Calco Inc. and each of its subsidiaries reflect arm's length terms and these loans are not entered into for tax avoidance purposes. (Calco Inc. and its subsidiaries, until 2001, filed state tax returns only in California, and filed on a unitary basis in that state.)

In 2001, Calco acquires a restaurant in Massachusetts, which it will operate through a new subsidiary, Masscorp. Calco Inc. capitalizes Masscorp. the same way it has always capitalized its California subsidiaries. Calco executives realize at the time that Masscorp. is funded that this capital structure will potentially give rise to a tax benefit, because the interest expense may be deductible in Massachusetts and the interest income will be eliminated in the California unitary return. However, the loan with Masscorp. is not entered into for tax purposes because the same structure would have been used in the absence of a tax benefit. There are no other circumstances suggesting that the loan should be recharacterized as a capital contribution. Further, Masscorp. uses the loan funds in its business and makes regular payments on the loan in accordance with the loan terms. The Commissioner will not add back Masscorp.'s interest expense because disallowing the deduction would be unreasonable in these circumstances. (Note that notwithstanding this example, the Commissioner will determine what is an appropriate debt-equity ratio for all Massachusetts tax purposes on a case-by-case basis, taking into account all relevant facts and circumstances.)

Example 15. Factoring transaction creates inference of tax avoidance intent; insufficient proof that the transaction was not entered into for tax avoidance purposes. Shark Corp. is a corporation that is engaged in certain lending and service transactions. Shark Corp.'s business activities result in it having large amounts of different types of receivables, including loan receivables, accounts receivables and certain trade receivables. For business reasons, Shark Corp. wants to "securitize" its receivables and sell these security interests to investors. For purposes of effecting the securitization, Shark Corp. sets up a "special purpose subsidiary", Porpoise Corp., to which it sells the receivables at a discount. Since the price paid by Porpoise Corp. is less than the face amount of the outstanding receivables, Shark Corp. recognizes a loss from the affiliate transaction. In addition, Porpoise Corp. is set up in a state in which it will only pay a minimal corporate level income tax. These facts suggest that the factoring transaction between Shark Corp. and Porpoise Corp. was tax motivated. Shark Corp. claims that it is entitled to an exception for the loss that results from its factoring transaction because the securitization transactions have a business purpose. Also, Shark Corp. claims that the use of Porpoise Corp. permits a greater return to be received on the sale of the securitized receivables since the underlying receivables may no longer be subject to a potential bankruptcy on the part of Shark Corp. (a potential bankruptcy which is not imminent at the time of the transaction).

However, the additional return that is claimed to result from the use of the bankruptcy remote entity would be significantly less than the effect of the asserted tax loss to be realized by Shark Corp. from the discounting transaction. By reason of the latter loss, Shark Corp. seeks to claim significant tax savings in Massachusetts Assuming that a principal purpose for the transaction was tax avoidance, the Commissioner will deny the claimed add back exception. Note that even if a principal purpose for the transaction was not tax avoidance the prospect of a claimed additional return that would be, if realized, significantly less than the asserted tax loss does not provide a valid business purpose, as among other things, this purpose is not commensurate with the value of the tax benefit claimed.

Example 16. Restructuring to separate trademarks from the operating affiliate; insufficient proof that the transaction was not entered into for tax avoidance purposes. Pie Corp. is a multistate corporation with in-state stores that is engaged in the manufacture and sale of paint. Pie Corp. separates its trademarks and other similar intangible property (collectively "trademarks") from its operating business by transferring the trademarks in a Code § 351 transaction into a newly-formed subsidiary, Crust Corp., and Pie Corp. begins to license back these trademarks in return for royalties that Pie Corp. pays to Crust Corp. Crust Corp. is an out-of-state corporation that is subject to tax only in a jurisdiction that does not impose a corporate-level income tax. Crust Corp. rents office space and has two employees who enter into trademark license contracts with unrelated parties, collect and invest royalties paid by Pie Corp. and the unrelated parties, and also enter into contracts for marketing and quality control with respect to the trademarks. Pie Corp. assists Crust Corp. with respect to its unrelated-party licensing, investment of royalty receipts and the marketing and quality control contracts. All of Crust Corp's expenses are paid directly or indirectly by Pie Corp. or out of the royalties and investment returns received by Crust Corp. From time to time, Crust Corp. pays the licensing receipts and the investment returns to Pie Corp., either in the form of dividends, loans or payments that are made through one or more of the corporations' other affiliated entities.

These facts suggest that the licensing transaction between Pie Corp and Crust Corp. was tax-motivated, and in fact Pie Corp. seeks to claim significant tax savings in Massachusetts by reason of the transaction. Assuming that a principal purpose for the transaction was tax avoidance, the Commissioner will deny an add back exception on these facts. This is so despite the fact that Pie Corp. may be able to claim that because it is no longer the legal owner of the trademarks it has to license these trademarks from Crust Corp. to use in selling the branded products and that the arrangement helps the affiliated group to centrally manage its trademarks and to better evaluate the value of the marks. Note that it is not relevant whether there is economic substance that supports the taxpayer's transaction because, even assuming that there is, the taxpayer must also prove by clear and convincing evidence that the transaction is supported by a valid business purpose and that a principal purpose of the transaction was not tax avoidance.

Example 17. Payments made pursuant to a cash management system; purported debt not shown to be true debt. Sweep Co. is the out-of-state parent corporation of numerous subsidiaries engaged in various sales and service activities. On a daily basis all of the receipts of the subsidiaries are paid to Sweep Co. Sweep Co. invests these receipts on behalf of the affiliated enterprise and uses these funds to pay expenses for the subsidiaries and to provide funding to these subsidiaries on as needed basis. Various economies of scale result from this centralized cash management system. The books of the affiliated enterprise reference the advances to the various subsidiaries pursuant to the cash management account as being "loans." However, there are no notes that document specific advances to the subsidiaries as being loans. Also, there is no expectation that the various subsidiaries will in fact pay back the funds that are advanced to them with designated interest by a time-certain. Although the subsidiaries do cause their receipts to be paid to Sweep Co. on a daily basis, this would happen irrespective as to whether an individual subsidiary had received a prior advance. Finance Co., a lending corporation with in-state offices, is one of Sweep Co.'s subsidiaries. Finance Co. seeks an add back exception for certain payments that it makes to Sweep Co. that it claims constitute interest on bona fide debt. However, payments made pursuant to the cash management system do not constitute payments on bona fide debt. Therefore, an add back exception is not appropriate on these facts.

Example 18. Use of structure to avoid tax by paying intangible expense as an embedded royalty indicates the transaction was entered into for tax avoidance purposes. Box Corp., Bag Corp. and Paper Corp. are wholly owned subsidiaries of Parent Corp., a parent corporation that owns multiple affiliates all of which are collectively involved in the manufacture and sale of clothing. Box Corp. has retail operations in Massachusetts. Bag Corp., Paper Corp. and Parent Corp. are not subject to Massachusetts tax. Previously, Box Corp. paid an intangible expense to Paper Corp., a corporation that was not subject to tax in any state and that was the record owner of the trademarks and other intangible property that was used by the various corporations in Parent Corp.'s affiliated group. Subsequently, Paper Corp. transfers record ownership of the affiliated group's intangible property to Parent Corp. Parent Corp. then licenses the use of this intangible property to Bag Corp., which manufactures clothing using the intangible property and sells the clothing with an "embedded royalty" to Box Corp. Box Corp. seeks to deduct or otherwise reduce its income on account of the embedded royalty paid to Bag Corp., similar to the deduction that it previously asserted for the intangible expense paid to Paper Corp. These facts suggest that the transactions that generate the embedded royalty were entered into for tax avoidance purposes, and in fact Box Corp. seeks to claim significant tax savings in Massachusetts by reason of the transaction. Assuming that a principal purpose for the transaction was tax avoidance, the Commissioner will deny an add back exception. This is so despite the fact that Box Corp. may be able to claim that there are business benefits and efficiencies that result from the restructuring, and also may be able to claim that Bag. Corp. possesses business "substance." (Note that this same analysis would apply whether or not the embedded royalty transaction was a variation on a prior intangible expense transaction, as is the situation in this example.)

2. *Exception because add back applies to an intangible "conduit" expense*. In the case of an intangible expense (and not an interest expense), the taxpayer establishes by a preponderance of the evidence that, although a portion of the expense was paid, accrued or incurred to a related member, the related member during the same taxable year directly or indirectly paid, accrued or incurred such portion to a person that was not a related member and the transaction did not have tax avoidance as a principal purpose. This exception may be a full or partial exception depending upon the extent to which the requirement is met. In general, a taxpayer seeking to claim this exception must file a schedule with its tax return setting forth the information that is required by the Commissioner. The taxpayer must also prepare with its tax return and make available to the Commissioner upon his request, either with its tax return or otherwise, as requested by the Commissioner, a supporting statement that includes the following information, identifying any referenced documents where appropriate:

a. whether intangibles payments were made, first, between the taxpayer and a related member and second between the related member and an unrelated party;

b. whether the two sets of payments were identical in kind and amount and in all other respects (with an explanation as to any differences);

c. whether the payments were made in either case pursuant to one or more written agreements; and

d. how the taxpayer actually used the intangible property in question.

Further, the taxpayer should provide as part of its supporting statement any additional information and references to any additional documents that would be necessary or helpful for the Commissioner to evaluate the taxpayer's add back exception claim. Unless all relevant evidence is incorporated into the taxpayer's statement and attachments, if any, the taxpayer's statement should clearly identify the other evidence on which the taxpayer relies.

3. *Exception because add back applies in specific case of a foreign treaty.* The taxpayer establishes by clear and convincing evidence that it is entitled to the exception provided in 830 CMR 63.31.1(5).

4. *Exception because add back applies in case of overriding agreement as to alternative apportionment*. The taxpayer and the Commissioner agree in writing to the application or use of an alternative method of apportionment under M.G.L. c. 63, § 42. In these cases, the fact that the Commissioner grants relief under § 42 will not, by itself, entitle the taxpayer to an exception to the add back provisions, M.G.L. c. 63, §§ 31I and 31J. Rather, the Commissioner will determine on a case by case basis whether such an exception is appropriate, taking into account the nature of the § 42 relief granted and the purpose underlying both § 42 and the add back provisions.

(b) *Partial exceptions*. The add back required by 830 CMR 63.31.1(3)(a) or (b) shall not be required in part in the following instances.

1. The taxpayer establishes by clear and convincing evidence that a portion of the add back would be unreasonable. A portion of the add back will be considered unreasonable to the extent that the taxpayer establishes by clear and convincing evidence that the interest or intangible expense was paid, accrued or incurred to a related member that is taxed on the corresponding income by a state, U.S. possession or foreign jurisdiction. A taxpayer that seeks to claim this exception must file a schedule that sets forth the information required by the Commissioner. For purposes of verifying the taxpayer's claim, the Commissioner requires that the taxpayer retain and produce upon request the relevant copy or copies of the tax returns of the related member(s) in question. The Commissioner may contest an exception that is claimed on this basis when, irrespective as to the taxpayer's claim and the numeric computation reflected therein, the underlying transaction lacks either a valid business purpose or economic substance. This exception does not apply in the instance of acquisition interest.

2. In cases involving an intangible expense in which a partial exception would be warranted under 830 CMR 63.31.1(4)(a)2.

(5) *Add Back Exception when Related Member Resides in a Nation that is Party to a U.S. Bilateral Income Tax Treaty*. The add back required by 830 CMR 63.31.1(3)(a) or (b) shall not be required when the taxpayer establishes by clear and convincing evidence that each of the following requirements are met:

(a) the interest or intangible expense is paid, accrued or incurred to a related member that is not a controlled foreign corporation within the meaning of Code § 957;

(b) the related member is a resident of a nation which has in force a comprehensive income tax treaty with the United States;

(c) the expense is deductible under the Code;

(d) the transaction giving rise to the expense is supported by a valid business purpose and economic substance; and

(e) all of the terms of the transaction would have been agreed to in an arm's length negotiation between independent parties.

In general, a taxpayer seeking to claim this exception must file a schedule with its tax return setting forth the information that is required by the Commissioner. The taxpayer must also prepare with its tax return and make available to the Commissioner upon his request, either with its tax return or otherwise, a supporting statement that states that the above-referenced requirements have been met, and also provides additional detail concerning the requirements set forth in 830 CMR 63.31.1(5)(d) and (e). The latter detail must include the information required pursuant to 830 CMR 63.31.1(4)(a)1.b, in the manner set forth in that section. *See also* 830 CMR 63.31.1(4)(a)1.b, Example 9.

(6) *Filing Schedule; Claiming an Add Back Exception*. A taxpayer that seeks to claim an exception to the interest or intangible expense add back must do so on a schedule completed as required by the Commissioner and filed as part of its tax return. A taxpayer that completes and submits a schedule as required may take a claimed deduction on its tax return despite the fact that the underlying transaction may be subject to a statutory add back. The taxpayer retains the burden of proving that the application of the add back is unreasonable or that another exception applies. A taxpayer must state the basis for its claimed exception on the schedule and provide the additional information required by the Commissioner. In some cases, the schedule that is filed by a taxpayer must be further substantiated by a contemporaneous supporting statement that sets forth certain specific information, as more fully explained by this regulation. The supporting statement must be made available to the Commissioner upon his request, either with the taxpayer's tax return or otherwise.

(7) *Requests for More Information; Procedure for Evaluating an Exception Claim*. When a taxpayer claims an exception to an add back provision on its tax return without specifying the claimed exception on the schedule required by the Commissioner and providing the other information required by said schedule, the Commissioner will notify the taxpayer that it has filed an incorrect or insufficient return. *See* M.G.L. c. 62C, § 28. When a taxpayer claims an exception to an add back provision using the schedule, the Commissioner may request additional information or evidence in addition to that provided if he determines that this additional submission would be necessary or helpful to evaluate the taxpayer's asserted add back claim. This additional information or evidence may include, but is not limited to, that set forth on a taxpayer's supporting statement in instances where a supporting statement is required under this regulation and where the Commissioner does not request that the supporting statement be submitted with the taxpayer's tax return. If the taxpayer fails to respond to the Commissioner's request to provide additional information or evidence, the Commissioner will notify the taxpayer that it has filed an incorrect or insufficient return.

In cases in which the Commissioner does not accept a taxpayer's add back claim, either as filed or subsequent to the submission of additional requested information or evidence, the Commissioner will assess additional tax. In these cases, the Commissioner will send a Notice of Intention to Assess to the taxpayer and afford the taxpayer an opportunity for a hearing, as provided under M.G.L. c. 62C, § 26(b).

Failure to request additional information or evidence at the time that a taxpayer files a schedule as part of its tax return shall not be construed to mean that the Commissioner has approved the taxpayer's add back exception claim. A failure to make such a request at such time shall not mean that the Commissioner is foreclosed from requesting additional supporting information or evidence from the taxpayer at a later date.

(8) *No Limitations as to Other Agreements, Compromises or Adjustments*. Nothing in this regulation shall be construed to limit or negate the Commissioner's authority to enter into agreements and compromises otherwise allowed by law. Also, nothing in this regulation shall be construed to limit or negate the Commissioner's authority to make adjustments under M.G.L. c. 63, §§ 33 and 39A or to make adjustments otherwise allowed by law.

(9) *Interaction with Determination as to Existence of Net Operating Loss*. For purposes of computing a net operating loss pursuant to M.G.L. c. 63, § 30.5, the interest or intangible expense add back shall be included as part of the computation that is required under M.G.L. c. 63, §§ 30.3, 30.4.

Example. In year 1, a taxpayer that is based entirely in Massachusetts has a $100,000 net loss as computed under M.G.L. c. 63, §§ 30.3 and 30.4, prior to the determination as to any interest or intangible expense add back. However, the taxpayer is required to add back an interest expense of $300,000. Consequently, the net income of the taxpayer for year 1 on which tax is due is $200,000. In year 2, the taxpayer does not have a net operating loss carryforward, irrespective of the fact that it would have had a loss carryforward absent the application of the interest expense add back.

(10) *Interaction with Taxation of a Related Member*. Nothing in this regulation shall be construed to impact the taxation of a related member to which a taxpayer pays, accrues or incurs an interest or intangible expense, including the analysis whether the related member is subject to Massachusetts tax. In some cases, the in-state ownership and use of intangible property may subject a foreign corporation to Massachusetts tax. *See* Directive 96-2. Where a taxpayer pays, accrues or incurs an interest or intangible expense to a related member that is taxed on the corresponding income, either by Massachusetts or some other state, US possession or foreign nation, the taxpayer may be entitled to a full or partial add back exception as explained by this regulation at 830 CMR 63.31.1(4)(a)1.a and (b)1.

REGULATORY AUTHORITY
830 CMR 63.31.1: G.L. c. 14, § 6(l); G.L. c. 62C, § 3

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