

810-27-1-4-.13 Payroll Factor .

(a) *Payroll Factor: In General.*

(1) The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the tax period by the taxpayer for compensation in the production of business income, and the denominator of which is the total compensation paid for the production of business income everywhere during the tax period.

(2) The total amount "paid" to employees is determined upon the basis of the taxpayer's accounting method. If the taxpayer has adopted the accrual method of accounting, all compensation properly accrued shall be deemed to have been paid. Notwithstanding the taxpayer's method of accounting, compensation paid to employees may, at the election of the taxpayer, be included in the payroll factor by use of the cash method if the taxpayer is required to report such compensation under that method for unemployment compensation purposes.

The payroll factor includes only compensation which is attributable to the business income subject to apportionment. The compensation of any employee on account of activities which are connected with the production of nonbusiness income shall be excluded from the factor.

(i) EXAMPLE: The taxpayer uses some of its employees in the construction of a storage building which, upon completion, is used in the regular course of the taxpayer's trade or business. The wages paid to those employees are treated as a capital expenditure by the taxpayer. The amount of those wages is included in the payroll factor.

(ii) EXAMPLE: The taxpayer owns various securities from which nonbusiness income is derived. The management of the taxpayer's investment portfolio is the only duty of Mr. X, an employee. The salary paid to Mr. X is excluded from the payroll factor.

(3) The term "compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services. Payments made to an independent contractor or any other person not properly classifiable as an employee are excluded. Only amounts paid directly to employees are included in the payroll factor. Amounts considered paid directly include the value of board, rent, housing, lodging, and other benefits or services furnished to employees by the taxpayer in return for personal services provided that such amounts constitute income to the recipient under the federal Internal Revenue Code. In the case of employees not subject to the federal Internal Revenue Code, e.g., those employed in foreign countries, the determination of whether such benefits or services would constitute income to the employees shall be made as though such employees were subject to the federal Internal Revenue Code.

(4) The term "employee" means (A) any officer of a corporation, or (B) any individual who, under the usual common-law rules applicable in determining the

employer-employee relationship, has the status of an employee. Generally, a person will be considered to be an employee if he is included by the taxpayer as an employee for purposes of the payroll taxes imposed by the Federal Insurance Contributions Act; except that, since certain individuals are included within the term "employees" in the Federal Insurance Contributions Act who would not be employees under the usual common-law rules, it may be established that a person who is included as an employee for purposes of the Federal Insurance Contributions Act is not an employee for purposes of this regulation.

(5) *Year to year consistency.* In filing returns with this state, if the taxpayer departs from or modifies the treatment of compensation paid used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

(6) *State to state consistency.* If the returns or reports filed by the taxpayer with all states to which the taxpayer reports under Article IV of the Multistate Tax Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the treatment of compensation paid, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

(b) *Payroll Factor: Denominator.* The denominator of the payroll factor is the total compensation paid for the production of business income everywhere during the tax period. Accordingly, compensation paid to employees whose services are performed entirely in a state where the taxpayer is exempt from taxation, for example, by Public Law 86-272, is included in the denominator of the payroll factor.

*EXAMPLE:* A taxpayer has employees in its state of legal domicile (State A) and is taxable in State B. In addition the taxpayer has other employees whose services are performed entirely in State C where the taxpayer is exempt from taxation under the provisions of Public Law 86-272. As to these latter employees, the compensation will be assigned to State C where their services are performed (i.e., included in the denominator but not the numerator of the payroll factor) even though the taxpayer is not taxable in State C.

(c) *Payroll Factor: Numerator.* The numerator of the payroll factor is the total amount paid in this state during the tax period by the taxpayer for compensation in the production of business income. The tests in section 40-27-1, Article IV.14. to be applied in determining whether compensation is paid in this state are derived from the Model Unemployment Compensation Act. Accordingly, if compensation paid to employees is included in the payroll factor by use of the cash method of accounting or if the taxpayer is required to report such compensation under that method for unemployment compensation purposes, it shall be presumed that the total wages reported by the taxpayer to this state for unemployment compensation purposes constitute compensation paid in this state except for compensation excluded under Regulation 810-27-1-4-.13(a) to 810-27-1-4-.14. The presumption may be overcome by satisfactory evidence that an employee's compensation is not properly reportable to this state for unemployment compensation purposes.

(d) *Payroll Factor: Under the Completed Contract Method of Accounting* For taxpayers utilizing the completed contract method of accounting, the payroll factor shall include all payroll costs attributed to the contracts completed during the tax period. Payroll costs not directly attributed to the completed contract projects, such as administrative salaries, shall be reported as otherwise provided in this regulation.

Author: Peter M. Petrillo, Jr.

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