

CHAPTER 57-38.4

WATER'S EDGE METHOD ELECTION

57-38.4-01. Definitions. As used in this chapter, unless the context or subject matter otherwise requires:

1. "Affiliated corporation" means a parent corporation and any corporation of which more than fifty percent of the voting stock is owned directly or indirectly by the parent corporation or another member of the water's edge group.
2. "Domestic disclosure spreadsheet" means a spreadsheet that fully discloses the income reported to each state, the state tax liability, the method used for apportioning or allocating income to the various states, and other information provided for by rules as may be necessary to determine the proper amount of tax due to each state and to identify the water's edge group.
3. "Existing corporation" means a corporation that filed a North Dakota income tax return for any year after taxable year 1979 or was a successor to or unitary with a corporation that filed a North Dakota income tax return for any year after taxable year 1979.
4. "Foreign dividends" means any dividend received by a member of the water's edge group from any affiliated corporation incorporated outside the fifty states and District of Columbia, including amounts included in income computed under sections 951 through 954 of the Internal Revenue Code.
5. "Income from 80/20 corporations" means net book income after taxes of a corporation which is incorporated in the United States and eligible to be included in the federal consolidated return and which has twenty percent or less of its property and payroll as determined by factoring under chapter 57-38.1 assigned to locations inside the fifty states and the District of Columbia. For purposes of determining eligibility for inclusion in a federal consolidated return under this subsection, the eighty percent stock ownership requirements of section 1504 of the Internal Revenue Code shall be reduced to ownership of over fifty percent of the voting stock directly or indirectly owned or controlled by an includable corporation.
6. "New corporation" means a corporation that has not filed an income tax return in North Dakota for any year after the tax year 1979. A new corporation does not include a corporation which is a successor to or which is affiliated with a corporation that filed an income tax return in North Dakota for any year after the tax year 1979. A new corporation does not include a business reorganization or acquisition, except a corporation with no previous activity in North Dakota which acquires an existing corporation and increases and maintains the threshold activity of the existing corporation by twenty-five percent or more shall be treated as a new corporation.
7. "Threshold activity" means the yearly average combined property and payroll in North Dakota of a corporation and its affiliates for the previous three years.
8. "Water's edge group" includes the following entities:
 - a. Any affiliated corporation incorporated in the United States or a possession of the United States, as described in sections 931 through 936 of the Internal Revenue Code. Corporations incorporated in the United States must be eligible to be included in a federal consolidated return and must have more than twenty percent of its property and payroll, as determined by factoring under chapter 57-38.1, assigned to locations inside the fifty states, the District of Columbia, and possessions of the United States. For purposes of determining eligibility for inclusion in a federal consolidated return under this subsection, the

eighty percent stock ownership requirements of section 1504 of the Internal Revenue Code shall be reduced to ownership of over fifty percent of the voting stock directly or indirectly owned or controlled by an includable corporation.

- b. Domestic international sales corporations, as described in sections 991 through 994 of the Internal Revenue Code, and foreign sales corporations, as described in sections 921 through 927 of the Internal Revenue Code.
 - c. Export trade corporations, as described in sections 970 through 972 of the Internal Revenue Code.
 - d. Foreign corporations deriving gain or loss from a disposition of a United States real property interest to the extent recognized under section 897 of the Internal Revenue Code.
 - e. Any corporation incorporated outside the United States if over fifty percent of its voting stock is owned directly or indirectly by an affiliated corporation and if more than twenty percent of the average of its payroll and property is assignable to a location within the United States.
9. "Worldwide combined report" means a combined report with respect to a unitary affiliated group irrespective of the country or countries in which any member of the affiliated group is incorporated or conducts business activity.

57-38.4-02. Water's edge election. A corporation required to file a worldwide unitary combined report must do so unless it elects to apportion its income using the water's edge method.

1. A corporation electing to file using the water's edge method must comply with the following:
 - a. The election must be made on the return as originally and timely filed.
 - b. The corporation may not reduce taxable income for federal taxes deducted under subdivision c of subsection 1 of section 57-38-01.3.
 - c. The water's edge election is binding for five consecutive taxable years after making the election.
 - d. The corporation must file with the tax commissioner a domestic disclosure spreadsheet, after which the corporation must file a domestic disclosure spreadsheet only every third year while the election remains in effect.
2. All corporations electing the water's edge method must include the income and apportionment factors of the water's edge group. Foreign dividends and income from 80/20 corporations must be included as follows:
 - a. An existing corporation must include fifty percent of foreign dividends and sixty percent of income from 80/20 corporations. However, an existing corporation that increases and maintains a threshold activity by twenty-five percent or more, but not by business reorganization or acquisition, is only required to include thirty percent of foreign dividends and thirty percent of income from 80/20 corporations.
 - b. A new corporation must include thirty percent of foreign dividends and thirty percent of income from 80/20 corporations.

- c. For taxable years beginning after December 31, 1994, all corporations making the water's edge election may reduce the inclusion to include thirty percent of foreign dividends and thirty percent of income from 80/20 corporations.
3. In addition to the tax imposed under subsection 1 of section 57-38-30, there is imposed an additional tax of three and one-half percent of taxable income which must be levied, collected, and paid annually in the same manner as provided in chapter 57-38.

57-38.4-03. Conditions imposed by tax commissioner. The tax commissioner may impose necessary conditions other than the imposition of worldwide combination to prevent tax avoidance or to clearly reflect income in accordance with chapter 57-38.1.

57-38.4-04. Presumptions and burden of proof. A taxpayer and its affiliates are presumed to be a part of a unitary business and all income of that business is presumed to be apportionable business income except as otherwise provided in this chapter. A taxpayer has the burden of proof regarding the issue of whether or not a corporation is a member of a water's edge combined group.