



MEMORANDUM

To: The Multistate Tax Commission Executive Committee

From: Greg Matson, Executive Director

Subject: Referral by the Uniformity Committee of Draft Amendments to the Commission's General Allocation and Apportionment Regulations

Date: January 6, 2016

At the December 11, 2015 meeting of this Executive Committee, the Chair of the Commission's Uniformity Committee, Wood Miller, Missouri, reported that draft amendments to the Commission's General Allocation and Apportionment Regulations¹ had been approved by that committee and referred to this committee for its consideration. Those draft amendments are attached to this memo.²

After review and deliberation, the Executive Committee may determine what further action it wishes to take on the amendments, including directing that a public hearing be held pursuant to Compact, Article VII and Bylaw 7.

Background

The amendments are the result of a uniformity project, approved by this committee at its meeting on July 31, 2014. The amendments are necessitated by changes to the model Compact Article IV (UDITPA) Sections 1 and 17, adopted by the Commission on July 30, 2014. The Section 1 changes affected the definitions of "apportionable" and "nonapportionable" income and the definition of "receipts." The Section 17 changes affected how receipts from transactions other than sales of tangible personal property are attributed or "sourced" to a particular state for purposes of computing the receipts factor. Now Section 17 requires that the receipts be sourced to the market rather than to the place of the predominant cost of performance.

¹ The current model regulations are available at: http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/AllocationandApportionmentReg.pdf.

² The draft amendments proposed by both workgroups have been combined into a single set of amendments by Commission staff and non-substantive edits to correct errors in spacing, punctuation, or numbering have been made to the drafts as approved.

In September 2014, the Uniformity Committee began discussions of the needed regulations and shortly thereafter formed two workgroups—a Section 1 workgroup³ headed by Jennifer Hays, Kentucky and a Section 17 workgroup⁴ headed by Michael Fatale, Massachusetts. Over the course of the projects, these workgroups met regularly by phone, sometimes as often as weekly. The Commission is grateful for the efforts of these workgroups and by the members of the public that participated in the workgroup discussions.

The Commission created project pages on its website to archive information and documents for each workgroup. These project pages contain summaries of issues, research, analysis and working drafts of the amendments under discussion. The project page for the Section 1 workgroup is at: <http://www.mtc.gov/Uniformity/Project-Teams/Section-1-Model-Definition-of-Receipts%E2%80%9D-Regulation>. The project page for the Section 17 workgroup is at: <http://www.mtc.gov/Uniformity/Project-Teams/Section-17-Model-Market-Sourcing-Regulations>.

Section 1 Workgroup Amendments

The Section 1 workgroup amendments are in the nature of revisions to the existing model regulations, rather than the creation of a body of new regulations. The Section 1 workgroup draft amendments include amendments to address the following:

- Conforming amendments substituting the terms “apportionable income,” “non-apportionable income,” and “receipts” in place of “business income,” “nonbusiness income,” and “sales,” respectively, throughout the regulations, and substituting the term “trade or business” for the term “business” when used generically.
- Amending the regulations to reflect that while the transactional and functional tests are still used to define apportionable income, only the transactional test is used in the definition of “receipts” under the changes to Article IV, Section 1.
- Reorganizing certain regulations related to the definition of “receipts” to clarify that they relate to that definition and not to other exclusions from the receipts factor.
- Defining other terms used in the changes to Article IV, Section 1.
- Reviewing and amending examples, where necessary.

At its July, 2015, meeting, the Uniformity Committee reviewed the Section 1 workgroup’s draft and considered a number of issues raised by the workgroup, including:

³ State participants in the workgroup included Scott Fryer, Arkansas; Steve Wynn, Idaho; Nathan Nielson, Idaho; Donnita Wald, North Dakota; and Joseph DiNicola, Oregon.

⁴ State participants in the workgroup included Holly Coon, Alabama; Aaishah Hashmi, District of Columbia; Nirmail Dhaliwal, District of Columbia; Phil Skinner, Idaho; John Seibert, North Carolina; Jeffrey Henderson, Oregon; and Chris Coffman, Washington.

- Retention of the five-year rule for transitioning property from apportionable to nonapportionable income;
- Elimination of reserved language within the “Determination of a Unitary Business” portion of the regulations;
- Inclusion of a list of items that are or are not receipts;
- The need for additional definitions of certain terms; e.g., “hedging,” “securities,” etc.;
- Removal of substantial portions of the regulations related to Section 18 as a result of the changes to UDITPA, which remove the need for those regulations; and
- Treatment of insubstantial amounts of receipts for apportionment purposes.

Section 17 Workgroup Amendments

The Section 17 workgroup amendments are in the nature of a body of new regulations for the sourcing of receipts from transactions other than sales of tangible personal property, which would replace the entire section of regulations that addressed sourcing under the (old) predominant cost of performance rule.

In December 2014, after hearing a report from the Section 17 workgroup and a discussion of regulations in place in different states, the Uniformity Committee voted to use Massachusetts’ proposed market-based sourcing regulations as a template for the draft amendments.

The general sourcing approach taken in the draft amendments is to define the place of delivery (for services) or place of use (for intangibles) when possible and appropriate, and also to provide rules of reasonable approximation that may be used when it is not possible to determine the place of delivery or use. Receipts from services are treated in three general categories with rules that may differ to some extent depending upon whether the customer is an individual or a business customer. Receipts from license, lease or sale of intangibles are also broken down into categories. General rules define certain terms and determine when a taxpayer’s method of sourcing can be changed by the taxpayer or by the tax agency. A number of examples are provided to illustrate how the rules apply.

At its July, 2015, meeting, the Uniformity Committee reviewed the Section 17 workgroup’s draft and considered a number of issues raised by the workgroup, including:

- General handling of examples;
- Treatment of “Credit Card Processing Services;”
- Inclusion of a *de minimis* exception for sourcing of certain categories of service receipts;
- Need for modification of the “subject to tax” rules for throw-back and throw-out;
- Integration of Section 17 with Section 18’s “Equitable Apportionment” Rules; and
- Special rules for transactions with related parties.

Approval and Referral of the Draft Amendments to the Executive Committee

At its meeting on December 10, 2015, the Uniformity Committee, after reviewing and discussing the drafts and taking public input, determined the workgroups had satisfactorily addressed the various issues that had been raised, and voted to forward the draft amendments to the Executive Committee for consideration (with one minor change to the Section 1 draft amendments, reflected in the attached).⁵

⁵ A summary of the public input is included in draft minutes of the committee meeting which will be submitted for approval at the committee's next in-person meeting. The Council on State Taxation submitted written comments on the Section 17 draft amendments which are available on the project page on the MTC website (see the link provided on page 2).