



MULTISTATE TAX COMMISSION

STAFF REPORT

Meeting of the Multistate Tax Commission Uniformity Committee

The Davenport Hotel
10 South Post Street
Spokane, Washington 99201

July 28, 2015
10 a.m. PST

This report is also available on the MTC website at mtc.gov. Follow the links to the meeting event.

To: Multistate Tax Commission Uniformity Committee
From: Helen Hecht, General Counsel
Subject: Article IV (UDITPA) Drafting Groups - Overview
Date: July 28, 2015

Introduction

In July 2014, the Commission adopted changes to Article IV (UDITPA) necessitating revisions or additions to uniform regulations, as follows:

1. Revision of Section 1's definition of "apportionable" (business) and "nonapportionable" (nonbusiness) income—expanding the definition of apportionable income to the limits constitutionally allowed, clearly separating the transactional and functional tests, and removing the word "regular" from the functional test.
2. Revision of Section 1's definition of "receipts"—now including only receipts that qualify under the transactional (not the functional) test, and explicitly excluding categories of receipts.

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3. Revision of Section 17's sourcing rule for receipts from transactions other than sales of tangible personal property—providing for market sourcing rather than predominant cost of performance, and excluding certain receipts from the receipts factor.
4. Revision of Section 18—providing explicitly for the issuance of special rules for industry-wide or other general application. (Note, the Commission is considering additional changes that would provide procedural protections to taxpayers in the application of Section 18).

In September 2014, the uniformity committee formed two workgroups to focus on regulations addressing the revisions to Article IV (UDITPA)—one group to address changes to Sec. 1 definitions, “receipts” in particular, and a second group to address market sourcing rules under Sec. 17. Those groups will give reports to this committee.

The MTC has existing model regulations of general application interpreting and applying the allocation and apportionment provisions of Article IV. Those regulations need to be revised substantially because of the revisions to UDITPA. The Sec. 1 workgroup has been going through those regulations in some detail. The Sec. 17 group, using Massachusetts regulations as a proposed baseline, is drafting a set of detailed market sourcing rules that will completely replace the general existing Sec. 17 regulations. Both groups have identified areas of overlap and issues that fall outside of their scope that they believe need to be addressed as well. The uniformity committee has not yet convened a group to address revisions to Sec. 18.

Recently, there have been questions raised by both workgroups concerning timing, scope of work, prioritization, and coordination, and both are seeking advice of the committee. This report provides some general information to the committee concerning these issues.

Timing

The uniformity process under the committee's rules and the Commission's bylaws generally requires the following steps:

1. Drafting by a workgroup and referral of a draft to the uniformity committee.
2. Consideration of the draft by the uniformity committee and referral to the executive committee.
3. Consideration of draft by the executive committee and referral to hearing.
4. After 60-day notice, public hearing held by hearing officer.
5. Compilation and presentation of a hearing report to the executive committee.
6. Consideration of the hearing report by the executive committee and referral of issues back to the uniformity committee if necessary.

7. Referral by the uniformity committee to the executive committee of a final draft.
8. Consideration of final draft by the executive committee and recommendation to Commission of the draft in that, or some revised form.
9. Bylaw 7 survey of the states (for a minimum of 30 days).
10. Consideration of recommended draft by the Commission (with 20 days' notice, generally at the annual meeting).

The uniformity committee generally meets in person in July, December, and March. The executive committee generally meets in July, December, and May. Most major actions by the executive committee are typically taken at in-person meetings. Uniformity committee meetings can be and often are called at other times and held telephonically.

Working backward from the July Commission meeting, there would need to be a final draft of regulations approved by a bylaw 7 survey no later than July 15, 2016. This means the survey would have to be sent by no later than June 15, 2016. If the executive committee recommended the draft to the Commission at its meeting in May, this would allow time for the survey, plus a slight buffer in case the executive committee wants the uniformity committee to address changes recommended by the hearing report.

Assuming that the executive committee would need to have the hearing officer's report available to review for at least 30 days ahead of the meeting in May, that means the report needs to be ready by about April 15, 2016. We should also allow sufficient time for the notice of a hearing and for the writing of a report, approximately 90 days. So the hearing would need to be noticed no later than around January 15, 2016. The executive committee would therefore either need to refer the draft for hearing at its in-person meeting in December 2015, or do so shortly thereafter.

Therefore, if the uniformity committee wishes to be able to have drafts considered by the Commission in 2016, those drafts should be ready for approval by the uniformity committee and referral to the executive committee no later than the December meeting.

Scope of Work

The Sec. 1 and Sec. 17 workgroups may raise some questions as to the scope of their work with this committee. Otherwise, it appears that the Sec. 1 group has been tasked with general definitional changes to Article 1 (mainly "receipts" but also "apportionable" and "nonapportionable" income), and the Sec. 17 group has been tasked with regulations for market sourcing of receipts other than receipts from sales of tangible personal property. Both groups have made a preliminary determination that Sec. 18 issues fall outside their scope of work. Related issues that have been discussed by both groups but not yet undertaken can be assigned to the existing workgroups, reserved or assigned to a new group.

Prioritization

There are two factors that might substantially affect prioritization and completion of the work. The first is whether the regulations can or should be divided up into parts (however determined) and passed serially. The second is whether certain related issues should be included in the work to be completed currently or instead be reserved until later. As to the first factor, staff believes that while there are both pros and cons to dividing the regulations and drafts into parts to be considered serially, this appears to be the best approach.

Most importantly, a number of states have already moved to market sourcing of receipts from intangibles and services (while most have used a slightly different approach as the MTC's revisions to Article IV). States could potentially adopt market sourcing without adopting changes to the definitions of apportionable/nonapportionable income or receipts. This is where rules appear most needed. Also, the need to address issues under Sec. 18 is somewhat different in that there may be multiple industries or circumstances that could be addressed over time. Therefore, it may be necessary to approach and to prioritize different parts of the possible regulations differently.

In addition, placeholders can be used to indicate that the committee intends to address an issue that may not be as great of a priority, while allowing the committee and the Commission to consider final rules in other areas. This would alleviate some concern over issues falling through the cracks. Also, it is likely that the nature of the changing economy and other factors will require some periodic re-visiting of new model regulations, so holding something back until it is "perfect" or has addressed every possible issue may be counterproductive. Finally, some work already appears to be further along and will likely be completed while other issues are still being studied.

Therefore, staff recommends that the committee take an approach that allows the regulations to be divided into parts, as seems reasonable and appropriate, and to allow those parts to proceed through the process separately if necessary.

As to the second issue—whether or not some work should be completed currently or reserved, staff recommends that this issue simply be considered by the committee and the workgroups whenever additional issues requiring discussion or drafting are raised. If issues are of lesser priority or can be effectively separated and reserved, it may help to organize and complete the work accordingly.

Coordination

As noted, there may be issues that overlap different workgroups. The workgroups may discuss these issues as part of their reports. The uniformity committee has options for handling these issues including: 1) assigning the issue to one of the groups, 2) asking the groups to consult with each other on the issue, 3) forming a separate group to consider the issue, 4) having the committee umpire the issue, etc. Any of these approaches and others may be appropriate to coordinate the work.