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May 10, 2016

Via E-Mail

Demesia Padilla
Chair, Executive Committee

Multistate Tax Commission
444 N. Capitol Street, NW
Suite 425
Washington, DC 20001

Re: COST Comments on Hearing Officer’s Report on Proposed Sections 1 and 17 Regulations

Dear Secretary Padilla:

On behalf of the Council On State Taxation (COST), I submit these written comments to express our support and concerns regarding Hearing Officer Brian Hamer’s Recommendations on Proposed Draft Amendments to the Commission’s Model General Allocation and Apportionment Regulations, set forth in the Hearing Officer Report dated May 1, 2016. Please share our comments and suggested language changes with the other members of the Executive Committee.

COST appreciates the Hearing Officer’s consideration of the comments we submitted on March 7, 2016 (attached). We strongly support the Hearing Officer’s suggested changes allowing taxpayers to adjust their “reasonable approximation” methodology prospectively without burdensome procedural requirements. We would, however, like to reiterate the importance of several additional changes to the proposed regulations that we recommended but were not supported by the Hearing Officer. Finally, we would like to comment on an additional issue relating to unintended consequences that may result from changes to the definition of “receipts,” particularly for the financial services industry.

About COST

COST is a nonprofit trade organization based in Washington, D.C. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of nearly 600 multistate and international businesses. COST’s objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

The Hearing Officer Report

COST appreciates the Hearing Officer's thoughtful examination and consideration of the comments we submitted relating to the proposed amendments to Commission's model general allocation and apportionment regulations. Several of the Hearing Officer's suggested changes should be adopted by the Executive Committee. Specifically, COST supports all of the Hearing Officer's suggested changes to Reg. IV.17.(a)(7)(D) that would allow a taxpayer to change its reasonable approximation method on a prospective basis without establishing that the new method "improves the accuracy" of assigning the receipts and without the other additional record retention requirements in the subsection. As the hearing officer concluded:

Nevertheless, I think it is reasonable to allow taxpayers to adjust their methodology without in effect having to justify the change so long as the new methodology meets the general requirements of section 17. What is essential is that the methodology used in any year is lawful, and I see no compelling reason to require taxpayers to in effect jump through another hoop because of a decision made in a prior year.... COST also proposes that language be stricken from this provision that requires taxpayers to retain and provide to the tax administrator documents that explain the nature and extent of any change, and the reason for the change. This suggestion also seems reasonable to me. If a taxpayer can defend its sourcing methodology in any year under the requirements of the statute and regulations, that ought to be sufficient. (MTC Hearing Officer Report at 11-12).

In addition, COST supports the Hearing Officer's recommendation to add a new first sentence to proposed Reg. IV.17.(a)(7)(C) to avoid confusion regarding tax agencies' authority to modify a taxpayer's reasonable approximation method by clarifying that subsection is subject to the general rules applicable to original returns as set forth in proposed Reg. IV.17.(a)(7)(B).

While COST supports the Hearing Officer's recommended changes listed above, we would also reiterate our support for several other changes in the proposed regulations that were detailed in our letter of March 7, 2016 but not endorsed by the Hearing Officer. These include allowing taxpayers to change their reasonable approximation method on an amended return; the elimination or raising of the percentage threshold for utilizing the customer billing address safe harbor; and the elimination of the presumption relating to production intangible sourcing. (see attached letter).

Additional Concerns with "Receipts" Definition

The proposed draft amendments to Reg. IV.2.(a)(6)(F) reflect provisions within the revised Compact Article IV, Section 1 that "receipts of a taxpayer from hedging transactions and from the maturity, redemption, sale, exchange, loan or other disposition of cash or securities, shall be excluded." While the proposed draft amendments' adoption of this language is faithful to the recent Article IV changes, the amendments fail to recognize the distortive impact this may have on many financial institutions by excluding significant income streams from receipts subject to apportionment. This provision is also inconsistent with the definition of receipts used for purposes of the MTC's Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions.

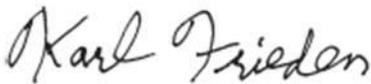
COST recognizes the MTC Section 18 work group is currently examining model regulatory language to address instances in which the exclusion of certain receipts from the receipts factor would lead to distortion in the apportionment of a taxpayer's income. This effort, however, will be insufficient to the extent: 1) it is completed after the Section 1 rule amendments are finalized or 2) a state adopts the Section 1 rule changes along with the Section 17 changes, but not the Section 18 changes currently being developed. States lacking special financial services apportionment rules (such as those included within the model MTC statute) that adopt the proposed draft amendments to Reg. IV.2.(a)(6)(F) will distort the apportionment factors of financial institutions (or similarly situated companies) by excluding major income streams from receipts subject to apportionment. The proposed draft amendments therefore should recognize that receipts generated as part of a taxpayer's primary business (*e.g.*, broker-dealers, banks) should be excepted from the operation of this exclusion.

Further, Reg. IV.(a)(6)(F) provides: "The taxpayer's treatment of the receipts as hedging receipts for accounting or federal tax purposes may serve as indicia of the taxpayer's primary purpose [of engaging in the activity giving rise to the receipts], but shall not be determinative." In providing the taxpayer's accounting or federal tax treatment constitute "indicia" but are not "determinative," the proposed draft amendments create uncertainty, provide undue latitude to the taxing authority to make audit adjustments, and certainly will produce controversy. As such, we recommend this provision be removed.

Conclusion

As highlighted above, the Hearing Officer's Report on the proposed Sections 1 and 17 Model Market-Based Sourcing Regulations addresses several provisions that we believe should be adopted as modified before the regulations are approved, and COST makes further recommendations beyond the findings of the report. COST respectfully requests that the Executive Committee make the above changes to the proposed regulations to ensure that taxpayers and tax agencies are treated in an even-handed manner and that the regulations provide flexibility for taxpayers consistent with the goals of the fair and efficient tax administration.

Sincerely,



Karl Frieden

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director