

# Financial Institutions State Tax Coalition

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June 2, 2016

Wood Miller  
Uniformity Committee Chair  
Multistate Tax Commission  
444 N. Capitol Street NW  
Suite 425  
Washington, DC 20001

## **Re: Proposed Draft Amendments to the Commission’s Model General Allocation and Apportionment Regulations**

On behalf of the Financial Institutions State Tax (“FIST”) Coalition, I am submitting these written comments regarding the proposed draft amendments to the Multistate Tax Commission’s model general allocation and apportionment regulations. The FIST Coalition respectfully requests that: 1) the draft amended Regulations IV.1 and IV.17 (“Sections 1 and 17 Regulations”) be revised to reflect the sourcing of interest and dividends; and 2) either i) the Sections 1 and 17 Regulations not be adopted until the Section 18 Regulations are adopted; or ii) the Sections 1 and 17 Regulations be modified to provide that the exclusion of hedging and security transactions not be adopted for financial service entities until special industry regulations have been adopted.

## **RECEIPTS DEFINITION DOES NOT EXCLUDE INTEREST AND DIVIDENDS**

The comments below further support the FIST Coalition’s comments to the Commission’s Executive Committee that the revised “receipts” definition does NOT exclude interest from lending, and interest and dividends on investments and that the sourcing of such items should be included in the Section 17 Regulations.

## **Revised UDITPA Definition of Receipts does NOT Exclude Interest and Dividends**

The revised Art. IV. Sec. 1(g) definition of receipts is:

“Receipts” means all gross receipts of the taxpayer that are not allocated under paragraphs of this article, and that are received from transactions and activity in the regular course of the taxpayer’s trade or business; **except 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.** (Emphasis added)

This definition excludes receipts “from the maturity, redemption, sale, exchange, loan or other disposition” of cash or securities, but does NOT exclude receipts from holding securities or loans as long as they are from transactions and activity in the regular course of the taxpayer’s business.

Thus, interest and dividends earned on working capital would be included within the definition of receipts.

If the intention had been to exclude interest, dividends and lending transactions from the receipts definition, wouldn't the exclusion language be structured in the following manner:

except that **interest, dividends, and** 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.

or

except that **dividends and** receipts of a taxpayer from **lending and** hedging transactions and from the maturity, redemption, sale, exchange, loan or other disposition of cash or securities, shall be excluded.

### **Definition of Gross Receipts Clearly Includes Interest and Dividends**

Draft Reg. IV.2.(a)(5) includes interest and dividends within the definition of gross receipts:

“Gross receipts” are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or **the use of property or capital** (including rents, royalties, **interest and dividends**) **in a transaction which produces apportionable income** in which the income or loss is recognized under the Internal Revenue Code, and, where the income of foreign entities is included in apportionable income, amounts which would have been recognized under the Internal Revenue Code if the relevant transactions or entities were in the United States. Amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold. (Emphasis added)

Based on this definition, interest and dividends from transactions that produce apportionable income are included in the receipts factor (unless excluded elsewhere). Draft Reg. IV.1 includes numerous examples of interest and dividends that constitute apportionable income.

(c)(3) *Example (i)*: The taxpayer operates a multistate chain of department stores, selling for cash and on credit. Service charges, **interest**, or time-price differentials and the like are received with respect to installment sales and revolving charge accounts. These amounts **are apportionable income**.

(c)(3) *Example (iv)*: The taxpayer is engaged in a multistate money order and traveler's check business. In addition to the fees received in connection with the sale of the money orders and traveler's checks, the taxpayer earns interest income by the investment of the funds pending their redemption. The **interest income is apportionable income**. (Emphasis added)

(c)(3) *Example (v)*: The taxpayer is engaged in a multistate manufacturing and selling business. The taxpayer usually has working capital and extra cash totaling \$200,000 which it regularly invests in short-term interest bearing securities. The **interest income is apportionable income**. (Emphasis added)

(c)(4) *Example (i)*: The taxpayer operates a multistate chain of stock brokerage houses. During the year, the taxpayer receives dividends on stock that it owns. The **dividends are apportionable income**. (Emphasis added)

(c)(4) *Example (ii)*: The taxpayer is engaged in a multistate manufacturing and wholesaling business. In connection with that business, the taxpayer maintains special accounts to cover such items as workmen's compensation claims, etc. A portion of the moneys in those accounts is invested in interest-bearing bonds. The remainder is invested in various common stocks listed on national stock exchanges. Both the **interest income and any dividends are apportionable income**. (Emphasis added)

(c)(4) *Example (iii)*: The taxpayer and several unrelated corporations own all of the stock of a corporation whose business consists solely of acquiring and processing materials for delivery to the corporate owners. The taxpayer acquired the stock in order to obtain a source of supply of materials used in its manufacturing trade or business. The **dividends are apportionable income**. (Emphasis added)

(c)(4) *Example (iv)*: The taxpayer is engaged in a multistate heavy construction business. Much of its construction work is performed for agencies of the federal government and various state governments. Under state and federal laws applicable to contracts for these agencies, a contractor must have adequate bonding capacity, as measured by the ratio of its current assets (cash and marketable securities) to current liabilities. In order to maintain an adequate bonding capacity the taxpayer holds various stocks and interest-bearing securities. Both the **interest income and any dividends received are apportionable income**. (Emphasis added)

## **Receipts Factor Includes Gross Receipts**

According to draft Reg. IV.17.(a):

In general, Article IV.17. provides for the inclusion in the numerator of the receipts factor of **gross receipts** arising from transactions other than sales of tangible personal property.

As noted above, the definition of gross receipts includes interest and dividends.

## **List of Specifically Excluded Receipts does NOT Include Interest and Dividends**

Draft Reg. IV.2.(a)(6)(G) identifies specific revenues that are excluded from receipts and the list of excluded items does NOT include interest or dividends:

Receipts, even if apportionable income, are presumed not to include such items as, for example:

- 1) damages and other amounts received as the result of litigation;
- 2) property acquired by an agent on behalf of another;

- 3) tax refunds and other tax benefit recoveries;
- 4) contributions to capital;
- 5) income from forgiveness of indebtedness;
- 6) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code; or
- 7) Amounts realized as a result of factoring accounts receivable recorded on an accrual basis.

### **The Words “Loan” and “Cash” in “Receipts” Definition Were Not Intended to Refer to Basic Lending Transactions**

The FIST Coalition contends that the word “loan” in the above receipts definition was meant to address security lending transactions and NOT other lending transactions and/or the use of the word “cash” in the definition was meant to address hedging against foreign exchange rates, rather than a lending transaction.

The May 3, 2012 MTC staff document provided to the Executive Committee summarizing the UDITPA Rewrite does NOT indicate that dividends, interest and lending transactions will now be excluded from the receipts factor. It would seem that if the new definition was meant to exclude such items, the MTC staff would have informed the Executive Committee and member states of this outcome.

Moreover, based on the revised “receipts” definition, assuming the receipt meets the transactional test, the only interest that would be excluded from the receipts factor would be that from the loan of cash. What is a “loan of cash”?

If interest on installment sales are included in the receipts factor, why would interest from a loan used to purchase property not be included in receipts? For example, if an auto dealer sells a car over a 60-month installment plan, the interest would be included in the auto dealer’s receipts factor, but if the loan was made by an entity that is not financial institution, then it appears the transaction likely would be considered a loan of cash and the interest would NOT be included in the lender’s receipts factor? If the auto dealer makes the installment sale and then sells that installment note to a party that is not a financial institution, the purchase of the note would not be “loan of cash” and accordingly the interest would be a receipt for the purchaser of the note.

Is a credit card transaction a “loan of cash”? What if the credit card is the retailer’s private label credit card, is that an installment sale or a “loan of cash”?

What is the support for assuming the terms “loan of cash” was intended to cover lending transactions? Since a “loan of cash” is an ambiguous term and is not defined in the UDITPA rewrite or draft regulations could it be that the word “cash” in the exclusion phrase was meant to exclude the hedging of foreign exchange rates and/or the word “loan” in the exclusion phrase was meant to identify security lending transactions?

## **EXCLUSION OF HEDGING AND SECURITY TRANSACTIONS SHOULD NOT BE ADOPTED PRIOR TO ADOPTION OF SPECIAL INDUSTRY REGULATIONS**

For securities dealers, market makers and similar taxpayers, receipts from securities and hedging transactions reflect the contribution of the taxpayer's market to the earning of income and should be included in their receipts factor.

Throughout the rewrite of UDITPA and the amendments to the related regulations, it has been noted that the exclusion of security and hedging transactions is not appropriate for security dealers and similar financial service entities. Accordingly, the FIST Coalition believes that as it relates to such financial service entities, the exclusion of hedging and security transactions from the receipts factor should not be adopted prior to adoption of special industry regulations.

While it can be argued that pending the subsequent adoption of special industry regulations in the future such entities do have other receipts that would be included in the factor, the exclusion of security and hedging transaction receipts will change the apportionment percentage. The exclusion of such receipts for several years while the regulations are being worked on, likely will result in years of litigation arguing that the temporary exclusion distorts the taxpayer's business income in determining its receipts factor.

### **CONCLUSION**

The FIST Coalition requests that the draft Section IV.1 and IV.17 Regulations be modified to: 1) address the sourcing of interest and dividends; and 2) provide that until industry regulations are adopted, taxpayers that deal in securities and hedging will continue to apportion their income in the same fashion as the state laws and regulations provided as of 12/31/2015 and will not be bound by the provisions in the amended regulations. In the alternative, the Coalition requests that the draft amended Regulations IV.1 and IV.17 not be adopted until the Section 18 Regulations are completed to ensure that other issues that are more fitting under the Section 17 Regulations are identified.

Please contact me if you have any questions regarding the above comments.

Sincerely,

*Karen Boucher*

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Managing Member