MULTISTATE TAX COMMISSION

MEMORANDUM

To: Multistate Tax Commission Uniformity Committee

From: Helen Hecht, General Counsel

Regarding: Approved Minutes – Meeting of July 7, 2016 (By Phone)

Date: July 7, 2016

A meeting of the Uniformity Committee was held by phone on July 7, 2016 for the purpose of considering comments on draft amendments to the General Allocation and Apportionment Regulations – Sections 1 and 17 which were referred by the Executive Committee.

Attendees (those who identified themselves):

Wood Miller, MO DOR (Chair)
Chris Coffman, WA DOR (Vice Chair)
James Savage, VA DOR
Lenny Collins, NC DOR
Jennifer Hays, KY LRC
Karl Frieden, COST
Alysse McLoughlin, McDermott Will & Emery
Jamie Yesnowitz, Grant Thornton
Joe Huddleston, E&Y
Lynn Dender, Bank of America
Scott Fryer, Arkansas
Holly Coon, Alabama
Karen Boucher, FIST Coalition
Rebecca Paulson, U.S. Bank
Frank Crociata, NM DOR
Phil Horwitz, CO DOR
Matt Seltzer, Reed Smith
Helen Hecht, MTC
Bruce Fort, MTC
Lila Disque, MTC
Sheldon Laskin, MTC
Matt Peyerl, ND DOR
Phil Skinner, ID DOR
Nate Nielson, ID DOR
Steve Wynn, ID DOR
Frank Hales, Utah DOR

Gene Walborn, Montana DOR
Jeff Henderson, OR DOR
Don Jones, OR DOR
Dave Hesford, WA DOR

Wood Miller, chair asked for any changes to draft minutes of June 30, 2016 (as revised and posted on the web page). There were no changes and the minutes were approved without objection.

Wood noted that the committee was working from a checklist and that the remaining issues were the three issues raised for the first time before the Executive Committee, as follows:

1) Whether to provide a regulation including hedging receipts in "receipts" and sourcing under Section 17;
2) Whether to source interest and dividend income under Section 17; and
3) Whether to delay finalizing amendments to Sections 1 and 17 until work on Section 18 is complete.

Wood then asked for initial public comment.

Public Comment

Karl Frieden of COST noted that COST and FIST and others have raised the concerns of unintended consequences of the exclusions from the definition of receipts. This would apply to financial institutions and also to others that may not be classically financial institutions. There are taxpayers who derive receipts from hedging and security transactions and who derive business income from those activities. Some carve-out needs to be made for these types of taxpayers. Also, there may need to be clarification, whether dividends or interest receipts are included or excluded. The idea being that the receipts related to business income would be included. COST would strongly urge these provisions be adopted as part of Sec. 1 and Sec. 17 before they are finalized. According to COST, many states don't adopt Sec. 18 or special industry regulations and therefore they may not adopt the rules that the commission makes for that purpose. (He also noted that these issues were not brought up as part of the public hearing and so were not passed on by the hearing officer.)

Karen Boucher representing the FIST Coalition noted that for some taxpayers – hedging and securities receipts are a large part of ordinary income. There are ways that the commission could finalize the regulations here without fully addressing these issues – by including a caveat in the regulations explicitly saying that they don't address taxpayers that may need to include hedging or securities receipts in their receipts factor.

Joe Huddleston of E&Y stated that he concurs with both the statements of Karl and Karen. The focus of this discussion has been on broker/dealers, but there are any number of other industries that should be dealt with in Sec. 17, he believes. While states may treat these receipts differently, none of the states take the “nothing” approach that the MTC is taking.

Helen Hecht, MTC general counsel, gave a brief summary of the background related to the issues. She also noted that the three issues noted in the checklist were a general summary of the issues raised by those making public comment. Wood asked whether the committee would take up the issues generally in order. The committee did not object to this approach.

Issue No. 1

The following is a summary of the discussion of this issue:

- Wood commented that it appears the approach the work groups took to receipts from hedging was consistent with the amendments to Article IV, Sec.s 1 and 17.
- Phil Skinner, Idaho, commented that under the circumstances the only solution for the issues raised in public comments is to address these issues and concerns under Sec. 18.
- Chris Coffman, Washington, agreed that the committee could not do something that conflicts with the statutory language.
- Bruce Fort, MTC counsel, stated that the committee could look again at the definition of hedging since this was a Sec. 1 issue. He stated that there might be some things that aren’t hedging.
- Helen commented that the definition could also be addressed under Sec. 18 when considering whether any exceptions applied. She also commented that the Sec. 1 work group has looked at the issue.
- Jennifer Hays, Kentucky, noted that the work group had worked on the issue and determined that the definition of hedging should be left somewhat open.
- Bruce commented that Illinois has a definition of hedging.
- Steve Wynn, Idaho, commented that the work group had considered the Illinois definition and found that it did not work with our statutory language.
- Jennifer had the same recollection.
- Karen asked what about making these amendments not effective for certain taxpayers.
- Phil S. commented that this didn’t make sense in terms of giving any guidance.
- Holly Coon, Alabama, commented that since Art. IV excludes hedging and securities receipts – there didn’t seem much room to move under the Sec. 1 and 17 regulations.

- Michael Fatale, Massachusetts, noted that Massachusetts doesn't include hedging and securities receipts in the receipts factor and there doesn't seem to be problems. Most broker/dealers do have receipts because they have commissions and fees.
- Scott Fryer, Arkansas, was in support of defining what hedging is. But he was not in favor of doing more. Lynn Dender, of Bank of America, responded to Michael's comment about Massachusetts and noted that the state also has a broad definition of financial institutions and has specific rules that apply for that broader group.
- Karen noted that she believes this discussion is also related to the interest from lending issue. Many of the states have systems that won't work well with these rules. If they have a narrow definition of financial institutions, then there will be more taxpayers affected. Some states have bank taxes and they are also narrow. And some states simply don't have special industry rules.
- Michael questioned whether it was the use of financial institution rules what FIST wants.
- Karen responded that in general, yes, but that FIST believes some of the receipts that have been excluded actually fall under Sec. 1/17. For example, interest and dividends should be sourced under Sec. 17.
- Michael noted that financial institutions have long been subject to special rules.
- Karl noted that if the committee proceeds with the Sec. 1 and 17 regulations as is, because they don't think they have the flexibility to vary from the statutory language, then taxpayers have a situation in which the debate will be held in every state. So he asked - why not consider including the rules with these amendments.
- Phil Horwitz, Colorado, noted that the issues being discussed are essentially issues of application – rather than issues for a general model. There is nothing wrong with the model, except that it leaves a gap. So he asked why it wasn't possible just to recommend that the Sec. 18 group address this issue quickly.
- Phil S. again noted that he did not believe there was anything the committee could do under the Sec. 1/17 rules. He commented that he was more on the fence about interest and dividends. But he is not in favor of putting the regulations on hold.

Wood indicated that he was ready for a motion on Issue No. 1. Phil S. moved that the committee recommend to the Executive Committee that the issue of whether to include hedging receipts and where to source them if included not be addressed in Sec. 1 or 17 regulations since the amendment to Art. IV, Sec. 1 (definition of "receipts") explicitly excluding receipts from hedging, and that the response to the Executive Committee also include a comment that the Uniformity Committee would, instead, consider this issue under Sec. 18 regulations. MF asked if this was a proper motion. Phil S. noted that he believed that the issue was one that we had agreed to address under Sec. 18. The motion was approved. (MA–Y, NC-Y, ND-Y, AR-Y, AL-Y, MO-Y, CO-Y, UT-Y, NM-Y, MT-Y, ID-Y, WA-Y, OR-Y.)

Issue No. 2

Wood asked for additional public comment at this point:

Karen had two comments on interest and dividends, which are also in the written comments. First, the receipts definition really only deals with transactions, it would not therefore apply to interest or dividends. So there should be something in Sec. 17 regulations on the sourcing of interest and dividends. Also, she believes that the "loan of cash" was not about anything other than the treasury function. She believes the commission did not sufficiently publicize the fact that more than treasury function receipts would be excluded. She does not believe the intent was to really exclude all receipts from security or loan transactions. If that were the case then every entity that is not a financial institution will not be able to include those types of receipts.

Karl noted that there is a distinction between the issue of dividends and interest and the hedging issue. It does not appear that dividends and interest should be treated the same. The statute does not clearly exclude interest and dividends.

Wood then asked for committee discussion, summarized as follows:

- Chris didn't have a problem sourcing interest from loans but questioned whether dividends could be properly sourced.
- Wood echoed this concern – how would dividends be sourced. The income would still be apportionable, he noted, but it's not clear where the "market" for the dividend receipts is.
- Michael offered the thought that the language of Sec. 17 does not clearly address dividends. It speaks of the market for services and receipts from intangible transactions. Even if you say they are "receipts" there is no clear way to source dividends under Sec. 17.
- Karen noted that she viewed Sec. 18 as applying only to exceptional situations.
- Michael noted that there are many common situations that have been addressed under Sec. 18.
- Karl noted that the problem is that there are too many entities that do not fall under the financial institutions regulations and so are without guidance.
- Matt Peyerl, North Dakota asked whether fees for professional services sourced under Sec. 18 wouldn't include bank and financial services.
- Michael responded that they would. So entities would still have a receipts factor in many cases.
- Steve encouraged the committee members to look at the Sec. 17 saying it does not appear to be "all inclusive."

- Phil H. noted that even if it is true that Sec. 17 could address interest (on an acquired portfolio, for example) and dividends – then it seems that these are not "sales' of things like services or intangibles and therefore there is no market and it doesn't get sourced in the regular course of things.
- Phil S. remarked that while he had initially thought that under the definition of receipts, the issue of dividends and interest were different issues than hedging, he now believed that dividends and interest were better addressed under Sec. 18. He also noted that existing regs (being amended) would have "thrown out" dividends and interest in many cases.
- Michael also noted that there was a reason that Sec. 17 was drafted the way it was, with the different categories, because it was intended to be focused on particular receipts and the market for those receipts.
- Bruce noted that the way in which the Sec. 18 work group was going to approach these issues was more or less consistent with the financial institution regulations.
- Karen noted, however, that the Sec. 18 work group had agreed to limit the special rules to entities that had no receipts factor.
- Holly Coon, Alabama, noted that this issue especially affects the separate filing states where you have special purpose entities filing on a separate basis. But she also noted that even if you assume they are included in receipts, Sec. 17 does not provide a clear rule. So, when you put Sec. 1 together with Sec. 17 – it seems that the statute intends not to include these receipts. Also, Sec. 17 has a throw out rule that would apply if there is no clear market. The categories under Sec. 17 just don't work.
- Karen noted that it's not clear what a loan of cash is. If it's interpreted broadly, then it is a big exclusion.
- Helen noted that the additional information sent out with the reminder email for the call shows how the existing regulations treat interest/dividends and treasury function.

Wood recapped the discussion and gave his opinion that Sec. 17 regulations are not the place to address sourcing of dividends and interest. Chris made the suggestion to end the discussion and to take up issues 2 and 3 again on next week's call. HE also suggested that the committee discuss at that meeting how the report to the executive committee should look. Wood agreed and the meeting was adjourned.