



MULTISTATE TAX COMMISSION

REPORT

**Uniformity Committee Meeting
Radisson Hotel Salt Lake City Downtown
215 W. South Temple
Salt Lake City, Utah**

March 2, 2016

8:30 a.m. - 5:00 p.m. Mountain Time

1-719-457-1414

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

To: Wood Miller, Chair, Uniformity Committee

From: Chis Coffman, Chair, Section 18 Regulatory Working Group

Bruce Fort, Counsel, Multistate Tax Commission

Date: February 29, 2016

Background

The Uniformity Committee's Section 18 working group has been meeting telephonically on a weekly basis since January 19, 2016 to consider whether current model "special apportionment" regulations will require amendment and whether new regulations are appropriate in light of changes to Multistate Tax Compact Article IV, Sections 1 and 17 approved by the Commission in July of 2014. The working group has also considered whether additional regulations are appropriate in light of changes to Article IV, Section 18 approved by the Commission in 2015.

The working group is chaired by Chris Coffman of Washington and includes Holly Coon, Alabama, Phil Skinner, Idaho, Michael Fatale, Massachusetts, Don Jones, Oregon, Jennifer Hays, Kentucky (Legislature), Jason Weimer and Richard Botwright, Pennsylvania, and John Seibert, North Carolina, with additional and valuable participation from Wood Miller, Missouri, Matt Peyerl, North Dakota, Scott Pryor, Arkansas and other state officials and practitioners.

Potential Issues Identified

Several possible areas for model special apportionment rules were identified by the Section 1 and Section 17 regulatory working groups that have recently concluded their drafting efforts. The Uniformity Committee approved the creation of the Section 18 working group in December of 2015 and outlined a list of possible topics:

- (a) Potential Distortion from Excluding Functional Receipts – Address the possible distortion that could be caused by the exclusion of functional receipts from the definition of “receipts” for purposes of the receipts factor in certain circumstances.
- (b) Special Rules for Brokers – Consider exceptions to the definition of “receipts,” which now excludes receipts from securities and hedging, where these receipts might represent “transactional” receipts for certain taxpayers (e.g. brokers) as well as how possible distortion might be avoided (e.g. churning of investments).
- (c) Rules for Factoring Receivables – Consider whether receipts from factoring of receivables should ever be included in the receipts factor.
- (d) Distortion from Use of General Population Data – Address any situations where general population data, used under the draft Section 17 sourcing rules, might result in distortion and what methods might be used to address that distortion.
- (e) Possible De Minimis Rule – Consider whether there needs to be a *de minimis* rule for sourcing of receipts in certain instances so that the taxpayer may use a proxy for sourcing, or possibly throw out those receipts from the factor.
- (f) Conform Existing Special Industry Rules – Review existing special industry model apportionment regulations to see whether stylistic or substantive changes to those regulations were appropriate in light of changes to Sections 1 and 17.
- (g) New Section 18 Provision Regulations – Address additional regulations that might be needed to interpret and implement the amendments to Article IV, Section 18 made by the Commission in 2015.

Additionally, the working group has had some preliminary discussions of whether other special industry rules would be appropriate and whether a model regulation would be appropriate for inclusion of partnership factors in the apportionment formula.

Summary of Discussions

At the initial meetings the working group decided to hold off consideration of new special industry regulations until the topics outlined listed above were addressed. Some discussions have been held regarding each of these areas but the working group has not yet made any recommendations for presentation to the full uniformity committee. A summary of those discussions follows:

Potential Distortion from Excluding Functional Receipts

The working group has recently turned its attention to the question of how income reported by “non-operational” or “special purpose” subsidiaries should be apportioned

now that the “receipts” factor definition has been defined more narrowly. Article IV, Section 1(g) defines receipts as:

“...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.”

Because many states have eliminated the property and payroll factors from their apportionment formulas, it is possible that a “special purpose” subsidiary could have base income but no apportionment factors. This could be a particular problem for states which permit or require separate-entity filings. For combined filing states, inclusion of “factor-less” special purpose entities on a combined report should result in more predictable and appropriate sourcing outcomes, but it may affect the calculation of taxable income in “Joyce” states and could affect states with factor-based nexus standards.

The working group has begun consideration of a February 22 memorandum that outlined two possible approaches.¹ The first would be a broadly-written regulation that acknowledges the need to employ equitable apportionment principles but does not direct any particular approach. The second approach would include detailed “triggers” and would include detailed sourcing rules for otherwise excluded intangible income types, including capital gains, interest, dividends and possibly partnership income.²

Some committee members have expressed the view that a third option might be preferable: state a general rule, followed by a presumption favoring specific sourcing outcomes. The working group did not think that a general rule without more specific guidance would be appropriate.

Special Rules for Brokers

The working group has suggested that any regulation should start with a distinction between securities traded on one’s own account and securities traded on behalf of another, with only the commissions from the latter category being included in receipts. The working group has examined a proposed amendment to California’s market-based sourcing

¹ <http://www.mtc.gov/getattachment/Uniformity/Project-Teams/Section-18-Regulatory-Project/Section18otherincomeapportionmentmemo.pdf.aspx>.

² California has adopted a regulation for sourcing capital gain income where the gain involves stock or other intangible property representing the disposition of a business entity. Where the gain is primarily attributable to the goodwill value of the business, the gain would be apportioned according to the prior sales factor of the entity being sold; where the value of the entity being sold is primarily real or tangible personal property, the gain would be apportioned according to the entity’s payroll and property factors. See 18 CCR Sec. 25136-2.
[https://govt.westlaw.com/calregs/Document/I74966FD069C711E184FEE19022232FEB?viewType=FullText&originationContext=documenttoc&transitionType=CategoryPageItem&contextData=\(sc.Default\)](https://govt.westlaw.com/calregs/Document/I74966FD069C711E184FEE19022232FEB?viewType=FullText&originationContext=documenttoc&transitionType=CategoryPageItem&contextData=(sc.Default)). California’s FTB has also proposed a rule for apportioning interest of non-financial institutions. (See Footnote 3, below.)

regulation applicable to investment and securities transactions as the basis for an alternative approach to simply defining apportionable receipts.³

Rules for Factoring Receivables

Staff has been asked to address the accounting aspects of how factored receipts should be accounted for by accrual method taxpayers (virtually all corporations report income for tax purposes on an accrual basis). Staff has identified some possible issues and will report out on this shortly.

Distortion from Use of General Population Data

The working group has given only slight attention to this issue so far. Some members expressed their opinions that the current Section 17 draft appears to provide adequate protections against distortion.

Possible De Minimis Rule

The working group has not taken this matter up yet.

Conform Existing Special Industry Rules

This matter is subject to a separate report from staff to the Uniformity Committee. Staff has recommended several stylistic changes to existing regulations but has not recommended any substantive changes. Some committee members expressed a desire to modify the model regulations to reflect Article IV's elimination of the three-factor formula as the standard apportionment methodology. Additionally, it has been suggested that the special industry regulations pertaining to broadcasting and publishing may be superseded by the Section 17 regulations.

New Section 18 Provision Regulations

The working group has not started work on this topic. It has been suggested that states may wish to clarify that the "burden of proof" standards in this section override general administrative and tax burden of proof allocations.

Looking Forward

The working group continues to meet on a weekly basis, although the group may decide on a bi-weekly basis in the future. The working group hopes to have draft Section 18 regulations on some or all of these topics ready for presentation to the full committee for its July 2016 in-person meeting in Kansas City, Missouri.

³ https://www.ftb.ca.gov/law/regs/25136/07082014_Proposed_Language.pdf.