



To: Executive Committee, Multistate Tax Commission
From: Wood Miller, Uniformity Committee Chair
Re: **[STAFF PREPARED DRAFT]**
Issues Referred Concerning Public Comments on Draft Amendments to the
General Allocation and Apportionment Regulations
Date: July 20, 2016

Background

Two years ago, the Commission approved changes to UDITPA¹ (see attached). These changes, among other things, narrowed the definition of “receipts” (Sec. 1(g)), and adopted market sourcing for receipts from services and certain intangibles (Sec. 17). In turn, this created a need to replace obsolete regulations and draft market sourcing rules. The Uniformity Committee was urged to prioritize this task. It created the Sec. 1 and Sec. 17 work groups, which met weekly by phone for over a year.² In December 2015, the full committee approved draft amendments. A public hearing was held with Brian Hamer acting as hearing officer. He took comments and reported recommendations at the Committee’s May 12th meeting. There, additional issues were raised and all were referred to the Uniformity Committee for its review.

The Uniformity Committee has held six phone meetings at which 10-15 states were represented along with members of the public. Materials and minutes of these meetings are available on the MTC website, here: <http://www.mtc.gov/Uniformity/Project-Teams/Section-17-Model-Market-Sourcing-Regulations>.³ Unless otherwise specified, references to documents in this report can be found on this web page. The Uniformity Committee has considered all of the issues referred, received additional public comments, held discussion, voted, and now makes this report.⁴

¹ Compact Art. IV.

² Jennifer Hays of Kentucky headed up the Sec. 1 Work Group and Michael Fatale headed up the Sec. 17 Work Group. The Uniformity Committee is grateful for their leadership as well as for the efforts of all the members who participated in those work groups and in the committee review process.

³ This web page also contains the current draft amendments, the Hearing Officer’s Report, copies of written comments received from the public, staff memos and analysis, and the full archives of the Sec. 1 and Sec. 17 work groups.

⁴ In addition, another web page contains background information on the changes to UDITPA, including staff memos, drafts, comments, and the report of the hearing officer, Professor Rick Pomp, here: <http://www.mtc.gov/Uniformity/Article-IV>.

EXECUTIVE SUMMARY

Issues 1-6 were raised during the hearing process and the recommendation of the hearing officer as well as public comments were considered. Issues 7-9 were raised after the hearing process so that there is no hearing officer recommendation to consider.

Issue No 1 – Amendments or Changes to Sourcing Method Used on Past Return:

If the sourcing method used in an original return complies with the regulations, the regulations provide that neither taxpayers nor the tax administrator can amend or change that method. COST asks that the limitation on taxpayers be removed.

Recommendation: Both the Uniformity Committee and the Hearing Officer rejected this change but both agree that language should be included to clarify that the limitation imposed on the tax administrator applies to the same extent, regardless of a later provision in the regulations. (See Full Report below.)

Issue No 2 – Limitations on Changes to Sourcing Method by Taxpayer Prospectively

The regulations impose specific requirements on a taxpayer's ability to make a prospective change from a sourcing method used in the past. The change must improve the accuracy of sourcing, the taxpayer must give notice of the change on the return, and the taxpayer must maintain and provide records upon request. COST suggested removing the specific requirements since any method selected must still comply with Sec. 17.

Recommendation: The Uniformity Committee rejected this change (contrary to the Hearing Officer, who recommended it be made). If the Executive Committee decides the specific requirements are not necessary, the Uniformity Committee recommends that the notice requirement be retained. (See Full Report below.)

Issue No. 3 – The 5% Limitation on the Use of Customer Address

In certain situations, rather than requiring a more particular determination of the market for assignment of receipts, the regulations allow the use of the customer's billing address, but only if the receipts from that customer do not exceed 5% of the taxpayer's total receipts. COST suggested that the 5% limit was too low and should be raised.

Recommendation: The Uniformity Committee agreed with the Hearing Officer that the 5% limit should not be raised.

Issue No. 4 – The Presumptions Used for Sourcing Production Intangibles.

The draft regulations provide a rule for sourcing of receipts from so-called production intangibles. The rule provides a presumption that if the tax administrator can establish that use of a production intangible takes place in the state, then all of the receipts may be assigned to that state unless the taxpayer demonstrates that a portion of the use takes place outside the state. COST commented that this is unfair and burdensome to taxpayers.

Recommendation: The Uniformity Committee agreed with the Hearing Officer that the presumption is not unreasonable and the taxpayer should know or be able to determine where use occurs. But the Hearing Officer also recommended a clarification with which the Uniformity Committee agrees. (See Full Report below.)

Issue No. 5 – Certain Changes Suggested by Ben Miller

Ben Miller had made several suggestions with respect to various issues during the public hearing process.

Recommendation: The Uniformity Committee recommended accepting the changes recommended by the Hearing Officer.

Issue No. 6 – ABA Suggestion on Non-Binding Mediation

The American Bar Association suggested including a provision (taken from Alabama’s regulations) that would commit the state to non-binding mediation in any case where a taxpayer is subject to different sourcing methodologies regarding intangibles or services.

Recommendation: The Uniformity Committee agreed with the Hearing Officer’s determination that this suggestion would not be practical.

Issue No. 7 – Treatment of Hedging Receipts

Public comments contend that the Commission’s changes to Sec. 1(g) did not remove receipts from hedging from the receipts factor and, therefore, the regulations should provide rules for sourcing of those receipts under Sec. 17.

Recommendation: Because it is clear that hedging receipts are excluded from the definition of “receipts” (and that this was done intentionally), it would be inconsistent to treat them as included and to source them under Sec. 17. In certain situations, however, they might be included and sourced under Sec. 18. (A Sec. 18 work group has been formed to address this and other issues.)

Issue No. 8 – Treatment of Receipts from Dividends and Interest

Public comments contend that receipts from dividends and interest should be treated as included in “receipts” under Sec. 1, and sourced under Sec. 17.

Recommendation: Receipts from dividends and interest should not be treated as included in “receipts” or sourced under Sec. 17. Furthermore, language should be proposed to clarify this. (See full report, Issue No. 8, below.)

Issue No. 9 – Delay Issuance of Proposed Amendments

Public comments contend that the Commission should delay final approval of draft amendments to regulations under Sec. 1 and Sec. 17.

Recommendation: The Committee does not recommend delay in approving the draft amendments to the regulations. The Committee believes it is essential to issue the market sourcing regulations as soon as possible to foster consistent sourcing of receipts for states that are adopting market sourcing.

FULL REPORT

Issues Raised as Part of the Hearing Process

Issue No. 1:

References:

- *Hearing Officer Report, pp. 10-11, 16*
- *Comments of the Council on State Taxation*
- *COST Comments on the Hearing Officer's Report on Proposed Sections 1 and 17 Regulations*
- *Minutes of the June 16, 2016 Uniformity Committee call.*

Issue: The draft Sec. 17 regulations allow flexibility in choosing a sourcing method. They also provide rules for when a sourcing method can be amended or changed. Reg. IV.17.(a)(7)(B)—“subparagraph (B)” —provides that if a method used on an original return properly assigns receipts in accordance with Sec. 17 regulations, then neither the taxpayer nor the tax administrator may subsequently amend or change that method.

Suggestion: COST suggested removal of the limitation on taxpayers.

Hearing Officer Recommendation: The Hearing Officer rejected this suggestion, in large part because the limitation fairly applies to both taxpayers and tax administrators. But he noted a separate issue. Subparagraph (C), which follows the regulation at issue, gives the tax administrator authority to change a sourcing method to “more accurately assign receipts.” The intent of this section, read as a whole, is to allow the administrator to require a change where the method fails to comply with the Sec. 17 sourcing regulations. But, the Hearing Officer worried that the language in (C) could be read to eliminate the limit on the tax administrator under subparagraph (B). He therefore recommend that a provision be added to subparagraph (C) that: “The provisions contained in this Reg.IV.17.(a)(7)(C) are subject to Reg. IV.17.(a)(7)(B).”

Uniformity Committee's Recommendation: The Committee voted to adopt both of the hearing officer's recommendations—to reject COST's suggestion that the limitation on taxpayers in subparagraph (B) be removed, but also to make clear that the same limitation applies to tax administrators by adding to subparagraph (C): “The provisions contained in this Reg. IV.17.(a)(7)(C) are subject to Reg. IV. 17.(a)(7)(B).”

Reasons for Recommendation: In general, the Committee found the Hearing Officer's recommendation to be reasonable. As to the rejection of COST's suggestion, there were also some who commented that a sourcing method might be subject to the doctrine of elections, and so not subject to amending on that basis as well.

Issue No 2:

References:

- *Hearing Officer Report, pp. 11-12, 16-7*
- *Comments of the Council on State Taxation*
- *COST Comments on the Hearing Officer's Report on Proposed Sections 1 and 17 Regulations*
- *Additional Information for June 30 Call*
- *Minutes of the June 23 and June 30, 2016 Uniformity Committee calls.*

Issue: Reg. IV.17.(a)(7)(D) imposes specific requirements on a taxpayer's ability to prospectively change a sourcing method used in the past: (1) the change must improve the accuracy of sourcing, (2) the taxpayer must give notice of the change on the return, and (3) the taxpayer must maintain and provide records upon request.

Suggestion: COST suggested removing the specific requirements.

Hearing Officer's Recommendation: The Hearing Officer agreed with the suggestion and recommended removal of the specific requirements for prospective changes in method.

Uniformity Committee's Recommendation: The Committee voted to reject the Hearing Officer's recommendation and retain the specific requirements as drafted. But, in the event that the Executive Committee wishes to remove them, the Committee also voted to recommend that the notice requirement be retained as follows:

~~"Taxpayer Authority to Change a Method of Assignment on a Prospective Basis. In filing its original return for a tax year, a taxpayer may change its method of assigning its receipts under Reg. IV.17, including changing its method of approximation, from that used on previous returns. However, the taxpayer may only make this change for purposes of improving the accuracy of assigning its receipts consistent with the rules set forth in Reg. IV.17, including, for example, to address the circumstance where there is a change in the information that is available to the taxpayer as relevant for purposes of complying with these rules. Further, a taxpayer that seeks to change its method of assigning its receipts must disclose, in the original return filed for the year of the change, the fact that it has made the change and must retain and provide to the [tax administrator] upon request documents that explain the nature and extent of the change, and the reason for the change. If a taxpayer fails to adequately disclose the change or retain and provide the required records upon request, the [tax administrator] may disregard the taxpayer's change and substitute an assignment method that the [tax administrator] determines is appropriate."~~

Reasons for Recommendation: This issue was discussed at length and additional public comment was taken. There was some concern that it may not be clear when a change in method improves the accuracy of sourcing under the Sec. 17 rules generally. But that same requirement is also imposed on the tax administrator when requiring a prospective change under a different provision (Reg. IV.17.(a)(7)(E)). The Uniformity Committee listened to the concerns expressed by COST and others, understands that general requirements already provide a framework to which any prospective change in method would have to comply. But they expressed concern that allowing unlimited prospective change in sourcing methods used from year to year was not reasonable.

Issue No. 3:

References:

- *Hearing Officer Report, p. 12*
- *Comments of the Council on State Taxation*
- *COST Comments on the Hearing Officer's Report on Proposed Sections 1 and 17 Regulations*
- *Minutes of the June 30, 2016 Uniformity Committee call*

Issue: In certain situations, rather than requiring a more particular determination of the market for assignment of receipts, the regulations allow the use of the customer's billing address, but only if the receipts from that customer do not exceed 5% of the taxpayer's total receipts.

Suggestion: COST suggested that the 5% limit was too low and should be raised.

Hearing Officer Recommendation: The Hearing Officer recommended that the suggestion to raise the 5% limit be rejected.

Uniformity Committee Recommendation: The Uniformity Committee also voted to recommend against raising the 5% limit.

Reasons for Recommendation: The members of the Sec. 17 work group noted that this 5% limit had been discussed at some length during the work group calls and that the group had determined the limit was reasonable.

Issue No. 4:

References:

- *Hearing Officer Report, pp. 13-14, 17*
- *Comments of the Council on State Taxation*
- *COST Comments on the Hearing Officer's Report on Proposed Sections 1 and 17 Regulations*
- *Minutes of the June 30, 2016 Uniformity Committee call.*

Issue: The draft regulations provide a rule for sourcing of receipts from so-called production intangibles to the location where “use for which the fees are paid” takes place. But they also provide for two presumptions. First, (for non-related customers) if the place of actual place of use is unknown, it is presumed that the use takes place in the state of the customer’s domicile or residence. Second, if the tax administrator can establish that the actual use takes place, in part, in the state, then all of the receipts may be assigned to that state unless the taxpayer demonstrates the portion of use that takes place outside the state.

Suggestion: COST commented that presuming 100% of use takes place in a state if the tax administrator determines any use takes place there is unfair and burdensome to taxpayers.

Hearing Officer Recommendation: The Hearing Officer did not find the presumption criticized by COST to be unreasonable, in as much as it is just a presumption and the taxpayer should know or be able to determine where use occurs. But the Hearing Officer did find the order of the two presumptions confusing. He recommended changing the order of the presumptions as follows:

If the [tax administrator] can reasonably establish that the actual use of intangible property pursuant to a license of a production intangible takes place in part in [state], it is presumed that the entire use is in this state except to the extent that the taxpayer can demonstrate that the actual location of a portion of the use takes place outside [state]. In the case of a license of a production intangible to a related party, the taxpayer must assign the receipts to where the intangible property is actually used. In the case of a license of a production intangible to a party other than a related party where the location of actual use is unknown, it is presumed that the use of the intangible property takes place in the state of the licensee's commercial domicile (where the licensee is a business) or the licensee’s state of primary residence (where the licensee is an individual). If the [tax administrator] can reasonably establish that the actual use of intangible property pursuant to a license of a production intangible takes place in part in [state], it is presumed that the entire use is in this state except to the extent that the taxpayer can demonstrate that the actual location of a portion of the use takes place outside [state]. In the case of a license of a production intangible to a related party, the taxpayer must assign the receipts to where the intangible property is actually used.

Uniformity Committee Recommendation: The Committee voted to recommend accepting the Hearing Officer’s change.

Reasons for Recommendation: The Committee agreed that this clarifies how the presumptions would work and would not otherwise change the presumptions.

Issue No. 5

References:

- *Hearing Officer Report, pp. 14-15, 17-18*
- *Comments by Ben Miller*
- *Minutes of the June 30, 2016 Uniformity Committee call.*

Issue and Suggestion: Ben Miller had made several suggestions with respect to various issues during the public hearing process. (He did not submit any subsequent comments.)

Hearing Officer Recommendation: The Hearing Officer recommended that certain (minor) changes be made as a result of Ben's comments (see pages 14 & 15, and 17 & 18 of the Hearing Officer's Report).

Uniformity Committee Recommendation: The Committee recommended adoption of the Hearing Officer changes.

Reasons for Recommendation: The committee agreed that these changes are acceptable.

Issue No. 6:

References:

- *Hearing Officer Report, pp. 13-14*
- *Comments of the ABA Tax Section – SALT Committee*
- *Minutes of the June 30, 2016 Uniformity Committee call.*

Issue and Suggestion: The American Bar Association suggested including the following language in the regulations (taken from Alabama regulations):

Whenever a taxpayer is subject to different sourcing methodologies regarding intangibles or services, by the [State Tax Agency] and one or more other state taxing authorities, the taxpayer may petition for, and the [State Tax Agency] shall participate in, and encourage the other state taxing authorities to participate in, non-binding mediation in accordance with alternative dispute resolution rules promulgated by the Multistate Tax Commission from time to time, regardless of whether all the state taxing authorities are members of the Multistate Tax Compact.

Hearing Officer Recommendation: The Hearing Officer did not recommend adoption of the ABA suggestion.

Uniformity Committee Recommendation: The Committee also voted against adoption of the ABA suggestion for the same reasons given by the Hearing Officer. While the Hearing Officer noted that the mediation would be nonbinding, he was not convinced it would be practical. The Hearing Officer noted that tax administrators could consider claims by taxpayers that they are subject to multiple taxation as part of existing formal and informal procedures.

Issues Raised After the Hearing Process

Issue No. 7:

References:

- *Staff Memo re: Referral of Issues from the Executive Committee*
- *FIST Coalition – Comments Received June 2*
- *FIST Coalition – Comments Received May 11*
- *COST Comments on Hearing Officer’s Report on Proposed Sections 1 and 17 Regulations*
- *E&Y Email Dated May 9*
- *E&Y Additional Comments on Hearing Officer Report*
- *Minutes of the July 7, 2016 Uniformity Committee call*

Issue: Whether to provide in the draft amended regulations that hedging receipts are included in “receipts” under Sec. 1 and also provide sourcing rules for those receipts under Sec. 17.

Arguments: The Financial Institution State Tax (FIST) Coalition, through its representative Karen Boucher, as well as Joe Huddleston of E&Y, and representatives of COST provided written comments. In general, these comments question whether the narrowing of the definition of “receipts” effectively excluded receipts from hedging and whether this was the intent of the Commission. The comments also urged the Uniformity Committee to consider including receipts from hedging, or from some types of hedging, in the receipts factor and providing for the sourcing of those receipts under Sec. 17. The comments also provided information on how other states may treat receipts from hedging and securities.

Uniformity Committee Recommendation: The Uniformity Committee voted against recommending any changes to the draft amended regulations that would treat hedging receipts as included under the definition of “receipts” and sourced under Sec. 17 market sourcing rules. The Committee instead notes that any issues related to inclusion or sourcing of hedging receipts should be addressed by the Sec. 18 work group.⁵

Reasons for the Recommendation: The definition of “receipts” now clearly and explicitly excludes receipts from hedging. But because the public comments also raised questions of whether this was intended, the following additional information is provided.

Prior to the hearing process on the proposed changes to Art. IV (UDITPA), the change to the definition of “receipts,” while excluding receipts from hedging, made an exception for securities dealers, as follows:

“Receipts’ means all gross receipts of the taxpayer that are not allocated . . . , 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 **other than a securities dealer** from hedging transactions and from the maturity, redemption, sale, exchange, loan or other disposition of cash or securities, shall be excluded.”

⁵ Meetings of the Sec. 18 work group were suspended during this period since it was not clear what the Executive Committee would do in response to these and other issues which the Uniformity Committee felt were best addressed under Sec. 18 regulations.

The Report of the Hearing Officer on the UDIPA changes (Pomp Report) noted that while receipts of securities dealers might be included under this exception, the receipts would not be subject to sourcing under changes to Sec. 17 and would instead be thrown out (that is, excluded from the numerator and denominator). (See pages 100 and 110 of the online report here:

[http://www.mtc.gov/uploadedFiles/Multistate Tax Commission/Pomp%20final%20final3.pdf](http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Pomp%20final%20final3.pdf).)

In response to the Pomp Report, in order to reconcile the definition of “receipts” and the throw-out provision of Sec. 17, the Uniformity Committee decided to recommend that the exception for securities dealers be removed. The Executive Committee also considered the matter and agreed, as summarized in the Minutes of the Executive Committee meeting from May 8, 2014 (available here:

[http://www.mtc.gov/uploadedFiles/Multistate Tax Commission/Committees/Executive C ommittee/Scheduled Events/47th Annual Meetings/2014-05-08%20Minutes%20of%20Executive%20Committee.pdf](http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Committees/Executive_Committee/Scheduled_Events/47th_Annual_Meetings/2014-05-08%20Minutes%20of%20Executive%20Committee.pdf).)

“The hearing officer had noted a conflict between Art. IV(1)(g) and the proposed Art. IV.17(a)(4)(ii)(C). Under Art. IV.1(g), gross receipts of a securities dealer are included in the receipts factor. But those receipts would be thrown out under Art. IV.17(a)(4)(ii)(C). The Uniformity Committee provided two proposed ways to deal with the discrepancy: strike the phrase “other than a securities dealer” in Art. IV.1(g), or add a new subsection to Art. IV.17 essentially inserting the securities dealer carve-out. The Uniformity Committee recommended the first solution. Upon a motion duly made by Mr. Johnson to recommend consideration of the Uniformity Committee's recommendation to strike the phrase by the Commission, the motion passed by voice vote.”

Up until the removal of the exception for securities dealers, the change to the definition of “receipts” was generally referred to as the exclusion of receipts from the treasury function, since its effect would generally have been to exclude receipts from investments of companies whose ordinary business involves other activities. The removal of the exception for securities dealers, however, effectively made the exclusion of receipts from hedging applicable to all taxpayers.

As part of the recent calls where this issue was discussed, the Uniformity Committee also accepted written comments on how other states treat hedging receipts or receipts from investment in securities for purposes of the receipts factor. While some states allow inclusion of *net* receipts it does not appear that other states generally allow inclusion of *gross* receipts or that they allow taxpayers not engaged in the securities business to generally include such receipts. Nor does there appear to be a standard definition of “hedging.” (Note that in addition to hedging, the change to the definition of “receipts” also excludes other receipts from securities transactions so that many receipts from hedging would be excluded under that provision as well.)

Issue No. 8:

References:

- *Staff Memo re: Referral of Issues from the Executive Committee*
- *Additional Information on Receipts, July 7, 2016*
- *FIST Coalition – Comments Received June 2*
- *FIST Coalition – Comments Received May 11*
- *E&Y Email Dated May 9*
- *COST Comments on Hearing Officer’s Report on Proposed Sections 1 and 17 Regulations*
- *Minutes of the July 14, 2016 Uniformity Committee (Designated “Minutes of the Prior Call”)*

Issue: Whether to provide in the draft amended regulations that receipts from dividends and interest are included in “receipts” under Sec. 1 and also provide sourcing rules for those receipts under Sec. 17.

Arguments: The FIST Coalition argued that the exclusion from the definition of “receipts” of receipts from the “loan of . . . cash or securities” did not describe all interest (for example, interest from installment sales or a portfolio of loans made). It also argued that dividends are not excluded by the change to the definition of “receipts” which excludes receipts “from the maturity, redemption, sale, exchange, loan or other disposition of cash or securities.” The Coalition and others were also concerned that while the Commission’s model Formula for the Apportionment and Allocation of Net Income of Financial Institutions (adopted pursuant to Art. IV. Sec. 18) provides for sourcing for taxpayers that have significant receipts from loan and investment activities, not all states have adopted those rules or would apply them to certain taxpayers.

Recommendation from the Uniformity Committee: The Uniformity Committee recommends that receipts from dividends and interest not be treated as included in the definition of receipts or sourced under Sec. 17. It also recommends that language be proposed to clarify that receipts from dividends and interest are not generally included in the receipts factor.

The proposed clarifications are as follows (new changes are highlighted in yellow):

Reg. IV.(2)(a)

(5) “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 **business apportionable** income, in which the income or loss is recognized ~~(or under the Internal Revenue Code, and, where the income of foreign entities is included in apportionable income, amounts which would behave been~~ recognized **under the Internal Revenue Code** if the ~~transaction relevant transactions or entities~~ were in the United States) ~~under the Internal Revenue Code.~~ Amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold. **Gross receipts, even if business income, do not include such items as, for example:**

(6) “Receipts” means **all** ~~gross receipts of the taxpayer that are not allocated under paragraphs of Article IV, and that are received from transactions and activity in the regular course of the taxpayer’s trade or business;~~ **and that are not excluded as receipts of a taxpayer from hedging transactions and from the maturity, redemption, sale, exchange,**

loan or other disposition of cash or securities. The following are additional rules for determining "receipts" in various situations:

[INSERT New Subparagraph (A) and renumber]

(A) Interest and Dividends

- (i) "Receipts" does not include interest, except when that interest is incidental to the sale of goods or services and can be attributed to the market for those goods and services by the taxpayer in a manner consistent with Art. IV, Sec. 16 or 17, as appropriate, and the applicable regulations.
- (ii) To the extent dividends are deemed included in the definition of "receipts," they would, nevertheless, be excluded ("thrown out") under Art. IV, Sec. 17(a)(4)(ii)(C). See Reg. IV.17.(a)(1).

Reg. IV.17.(a). Receipts Factor: Sales Other Than Sales of Tangible Personal Property in This State: General Rules.

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.

(1) Market-Based Sourcing.

Receipts, other than receipts described in Article IV.16 (from sales of tangible personal property) are in [state] within the meaning of Article IV.17 and this Reg. IV.17 if and to the extent that the taxpayer's market for the sales is in [state]. In general, the provisions in this section establish uniform rules for (1) determining whether and to what extent the market for a sale other than the sale of tangible personal property is in [state], (2) reasonably approximating the state or states of assignment where the state or states cannot be determined, (3) excluding receipts from the sale of intangible property from the numerator and denominator of the receipts factor pursuant to Article IV.17.(a)(4)(ii)(~~Ce~~), and (4) excluding receipts from the denominator of the receipts factor, pursuant to Article IV.17.(a)(4)(ii)(Ce) where the state or states of assignment cannot be determined or reasonably approximated, or where the taxpayer is not taxable in the state to which the receipts are assigned as determined under Article IV.3 and applicable regulations. Interest and other incidental receipts received along with receipts from transactions or activities subject to the market-based rules under Section 17 may be included in the receipts factor denominator to the extent they can be attributed to the market for receipts from those transactions or activities in a manner consistent with these rules. Dividends and any other receipts from intangibles for which no provision is made for sourcing pursuant to Art. IV, Sec. 17(b) are excluded from the numerator and the denominator of the receipts factor pursuant to Art. IV, Sec. 17(a)(4)(ii)(C).

Reasons for Recommendation: As the Pomp Report recognized, receipts may now be excluded because of any one of the following:

- Changes to the definition of "receipts" excluding receipts that do not meet the transactional test;

- Changes to the definition of “receipts” eliminating certain receipts; or
- Changes to Sec. 17, which now sources only certain receipts from intangibles (that is, transactions where there is a clear market) and applies a “throw-out” rule to other receipts from intangibles.⁶

But even before the change to UDITPA, Commission regulations recognized that certain receipts are inherently difficult to source and those receipts should be excluded from the receipts factor. (See Reg. IV.18.(c)(3) which applies this principle to receipts from dividends received on stock, royalties received on patents or copyrights, or interest received on bonds, debentures or government securities.)

The Committee reviewed the reasons for the changes to Art. IV, and the exclusion of certain receipts, as well as the Sec. 17 rules sourcing only certain categories of intangible receipts and throwing out other receipts, and determined that there was no basis to include dividends or interest in “receipts” generally or to provide for sourcing rules under Sec. 17.

Despite this conclusion, the Committee also determined that the draft regulations do not address the question clearly and that certain regulations might suggest that dividends or interest could be generally included. In particular, the current un-amended regulations contain a definition of “gross receipts,” which is also part of the narrower definition of “receipts.” That regulatory definition of “gross receipts,” provides that interest and dividends are included in “gross receipts.” (It should also be noted that in the prior definition of “receipts,” “all” gross receipts were included, but the changes adopted by the Commission also struck the word “all.”)

⁶ The Hearing Officer Report referred to this as the “belt and suspenders” approach saying: Some might argue that the treasury function and hedging are so significant that they merit a “belts and suspenders” approach, being both thrown out under Draft Art. IV.17(a)(4)(ii)(C) as well as in Draft Art. IV.1(g).”

Issue No. 9:

References:

- *Staff Memo re: Referral of Issues from the Executive Committee*
- *FIST Coalition – Comments Received June 2*
- *FIST Coalition – Comments Received May 11*
- *E&Y Email Dated May 9*
- *COST Comments on Hearing Officer’s Report on Proposed Sections 1 and 17 Regulations*
- *Minutes of the July 14, 2016 Uniformity Committee (Designated “Minutes of the Prior Call”)*

Issue: Whether the final approval of draft amendments to regulations under Sec. 1 and Sec. 17 should be delayed.

Arguments: The FIST Coalition, COST and Joe Huddleston argued that the draft amendments should be delayed for various reasons, including:

- To address the treatment of receipts from hedging;
- To address the treatment of receipts from securities, include interest and dividends;
- To address other issues that may come up as the implementation of the regulations proceeds or as people further study the regulations.

Recommendation of the Uniformity Committee: The Committee does not recommend delay in approving the draft amendments to the regulations. Because receipts from hedging, interest, or dividends are not subject to inclusion under Sec. 1 or sourcing under Sec. 17, It is not necessary to delay adoption of these regulations for that reason. As for needing to wait to see if other issues might arise, the majority of the sourcing regulations have been through a vetting process when adopted by Massachusetts, in addition to the process used by the Commission. Moreover, these general regulations are regularly revisited when new issues arise and the Uniformity Committee has an ongoing commitment to keep these regulations up-to-date.

Reasons for the Recommendation:

Most importantly, the Committee believes it is essential to issue the market sourcing regulations as soon as possible to foster consistent sourcing of receipts for states that are adopting market sourcing rules. In addition to there being no reason for delay and an important reason to move ahead with approval, the Committee has a Sec. 18 work group which has planned to review whether the general exclusion of receipts from hedging and from dividends and interest will be distortive and what rules might be needed to address this problem. (The work of that Sec. 18 group was suspended during this review process.)

ATTACHMENT

The Commission in 2014 adopted the following changes (among others):

Sec. 1(g):

(g) "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.

Sec. 17. (a) Receipts, other than receipts described in Section 16, are in this State if the taxpayer's market for the sales is in this state. The taxpayer's market for sales is in this state:

(1) in the case of sale, rental, lease or license of real property, if and to the extent the property is located in this state;

(2) in the case of rental, lease or license of tangible personal property, if and to the extent the property is located in this state;

(3) in the case of sale of a service, if and to the extent the service is delivered to a location in this state; and

(4) in the case of intangible property,

(i) that is rented, leased, or licensed, if and to the extent the property is used in this state, provided that intangible property utilized in marketing a good or service to a consumer is "used in this state" if that good or service is purchased by a consumer who is in this state; and

(ii) that is sold, if and to the extent the property is used in this state, provided that:

(A) a contract right, government license, or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area is "used in this state" if the geographic area includes all or part of this state;

(B) receipts from intangible property sales that are contingent on the productivity, use, or disposition of the intangible property shall be treated as receipts from the rental, lease or licensing of such intangible property under subsection (a)(4)(i); and

(C) all other receipts from a sale of intangible property shall be excluded from the numerator and denominator of the receipts factor.

(b) If the state or states of assignment under subsection (a) cannot be determined, the state or states of assignment shall be reasonably approximated.

(c) If the taxpayer is not taxable in a state to which a receipt is assigned under subsection (a) or (b), or if the state of assignment cannot be determined under subsection (a) or reasonably approximated under subsection (b), such receipt shall be excluded from the denominator of the receipts factor.

(d) [The tax administrator may prescribe regulations as necessary or appropriate to carry out the purposes of this section.]