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Via e-mail: Loretta King at lking@mtc.gov

Bruce Fort, Hearing Officer
Multistate Tax Commission
444 N. Capitol St. NW, Suite 425
Washington, DC 20001

RE: Proposed Amendment to Model Regulation IV.18.(a)

Dear Mr. Fort:

On January 25, 2010, pursuant to section 5(b)(1) of the Multistate Tax Commission's public participation policy, the Commission held a public hearing on its proposed amendment to Model Regulation IV.18.(a) and Sutherland, on behalf of a coalition of interested multistate taxpayers, offered oral comments on the proposed amendment. In support of the oral comments provided, Sutherland now submits the following written comments.

Executive Summary

Sutherland, on behalf of its coalition members, suggests that the Commission postpone amending the § 18 Regulation until after the completion of the Commission's project to revise Compact Article IV.18, the § 18 Regulation's underlying Uniform Statute. Alternatively, if the Commission decides to continue with the § 18 Regulation amendment project, Sutherland suggests that several other issues related to the Model Regulation IV.18.(a) be addressed concurrently. Sutherland suggests that, if amended, the § 18 Regulation should include: (a) language differentiating the § 18 relief standard from the Constitutional unfair apportionment standard articulated by the United States Supreme Court under the Due Process and Commerce Clauses; (b) an explicit statement that the burden of proof is on the party asserting § 18 relief; and (c) a provision that § 18 cannot be used on a taxpayer specific basis to alter the fundamental apportionment methodology adopted by the legislature.

Comments on the Proposed Amendment to Model Regulation IV.18.(a)

In a separate Uniformity Project, the Commission is currently considering amendments to five provisions of Article IV of the Commission's Compact, including possible changes to

Article IV.18, the uniform statutory provision that the § 18 Regulation interprets. Amendments to Article IV.18 may render obsolete or inconsistent provisions in the existing and proposed § 18 Regulation. Amendments to Article IV.18 would therefore necessarily require the Commission to revisit the § 18 Regulation, regardless of whether the current proposed amendment is adopted. If amendments to the § 18 Regulation are made only after a final decision on changes to Article IV.18 are made, then states and interested taxpayers will only need to go through the administrative procedures required to amend the regulations once. To conserve state and taxpayer resources, we therefore ask the Commission to postpone adopting any revisions to Model Regulation IV.18.(a) until after the Commission's review and revision of Article IV.18 is complete.

If the Commission nevertheless decides to move forward with amending the § 18 Regulation at this time, Sutherland asks that the amendments include language addressing several other issues as well. Because of non-uniform interpretations by states of identical statutes adopting UDITPA § 18, Sutherland recommends that the following three substantive revisions are necessary elements of any § 18 Regulation amendment.

First, the regulation should clarify that the § 18 statutory alternative apportionment rule (“fairly represent the extent of the taxpayer’s business activity in this state”) requires a different and lower standard for the utilization of the relief provision than the standard for proving unconstitutional unfair apportionment. *See Hans Rees Sons, Inc., v. Comm’r*, 283 U.S.123 (1931) (holding that the statute in question attributed a percentage of income “out of all appropriate proportion to the business transacted” in the state); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, (1978) (stating that an apportionment formula may only be overturned when application of the formula “has ‘led to a grossly distorted result,’” (citing *Norfolk & Western R.R. Co. v. State Tax Comm’n*, 390 U.S. 317 (1968)). Historically, courts and state tax authorities have differed on whether the standard for statutory alternative apportionment varies from the Constitutional standard. *Compare Twentieth Century-Fox Film Corp. v. Dep’t of Revenue*, 700 P.2d 1035 (1985) (overturning the Oregon Tax Court’s holding that the Oregon alternative apportionment statute was applicable only to remedy unconstitutional results), *and Union Pac. Corp. v. Idaho State Tax Comm’n*, 83 P.3d 116, (2004) (identifying the state’s standard for alternative apportionment as a different standard than the Constitution’s gross distortion requirement), *with Roger Dean Enterprises, Inc. v. Dep’t of Revenue*, 387 So.2d 358 (Fla. 1980) (stating that “[t]he [UDITPA] relief provision should be used where the statute reaches arbitrary or unreasonable results so that its application could be attacked successfully on constitutional grounds”). The states that recognize the existence of two different standards for applying alternative apportionment have the better position because such an interpretation is consistent with both traditional rules of statutory construction and with common sense. As the Oregon Supreme Court reasoned in holding that its statutory standard for alternative apportionment was lower than the Constitutional standard, any other construction would render the state tax authority powerless to request a variance because the state is never in the position to assert a constitutional violation of the fair apportionment requirement. *Twentieth Century-Fox Film Corp.* 700 P.2d 1035. Scholars have noted “there would hardly be a need for the equitable relief provision [of Section 18] if it were available only to avoid unconstitutional results.” Hellerstein & W. Hellerstein, *State Taxation* ¶ 9.20[3][a0] (3d ed. 2001—2009). An amendment to the

regulation adopting such a clarification would significantly reduce the inconsistency and uncertainty currently surrounding the statutory rule.

Second, although the principle appears self-evident to many, the § 18 Regulation amendments should include language clarifying that the burden of proof necessary to invoke alternative apportionment must rest on the party seeking application of the equitable relief provision. This principle has been recognized by many courts. *See Microsoft Corp. v. Franchise Tax Bd.*, 139 P.3d 1169 (2006). In past meetings and during the January 25th hearing, Commission members and staff raised concerns about including a burden of proof provision because of the possible effects of such a provision on industry specific alternative apportionment regulations. For purposes of avoiding controversy and in order to encourage adoption of some clarification language identifying the party on which the burden of proof falls (but without conceding that the party on which the burden of proof should rest varies based on whether § 18 is invoked to address an entire industry), our recommendation focuses only on taxpayer or transaction specific application of § 18. We make no comment as to the proper burden of proof in situations involving industry specific regulations.

Finally, the alternative apportionment regulation should ensure that alternative apportionment cannot be used by a state revenue department or court to apply a sourcing theory contrary to the fundamental theory adopted by the legislature as the state's standard statutory sourcing policy. For example, in the case of receipts from services or intangibles, a state revenue authority should not be able to assert under § 18 that a market sourcing theory should be used in the place of the cost-of-performance sourcing methodology in the state's standard sourcing statute. *See BellSouth Advertising & Publishing Corp. v. Chumley*, 2009 Tenn. App. LEXIS 576 (June 25, 2009)(Sutherland notes that the analysis adopted by this court is not consistent with standard rules of statutory construction or laws governing the scope of executive agency authority). There are numerous, equally valid sourcing methods; the legislature's choice to adopt one necessarily excludes the others. A state revenue agency cannot usurp its legislature's tax policy choice. The § 18 Regulation should make this restriction clear.

In sum, we request the Commission to postpone amending Model Regulation IV.18.(a) pending the outcome of its current project to amend Article IV of the Compact. Should the Commission decide to continue its project to amend the model regulation, we urge the Commission to include those elements of an appropriate alternative apportionment regime described above in the amended regulation. Thank you for your consideration in this matter. We look forward to discussing these issues further with the Commission if any questions arise as a result of these comments.

Sincerely,



Diann L. Smith

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