



*Working together since 1967 to preserve federalism and tax fairness*

To: Omar Davis, Chair  
and MTC Executive Committee

From: Shirley Sicilian, General Counsel

Date: June 16, 2008

Subject: **Proposed Special Rule for Telecommunication Service Apportionment**

---

## **I. The Question before the Executive Committee**

In July, 2003, the Uniformity Committee recommenced its project to develop a model special rule for apportioning income from provision of telecommunication services.<sup>1</sup> Public comment was received and the proposal was deliberated at each Uniformity Committee meeting, and a number of teleconferences, between July 2003 and July 2007, when the Uniformity Committee formally approved a draft model rule. In July 2007, the Executive Committee approved the model for public hearing, which was held October 2007. The hearing officer submitted recommendations in April 2008.

The proposal is now before the Executive Committee for consideration to approve a bylaw 7 survey. A bylaw 7 survey would ask affected Compact member states if they are willing to consider adopting the proposal in their states. If a majority answers in the affirmative, then the proposal may be submitted to a vote of the Compact member states at the Commission meeting in July. If the proposal passes that vote, then it would be adopted as a Commission model rule. Any state that wishes to implement the rule would then need to go through the state's normal legislative or regulatory adoption processes.

The Committee has three options: (1) it may approve the proposal, with or without amendments, for a bylaw 7 survey; (2) it may reject the proposal and end the project; (3) it may reject the proposal and direct it back to Uniformity Committee for further development. The Executive Committee discussed its options at its May 2008 meeting and requested a teleconference for further discussion.

---

<sup>1</sup> The project had originally been commenced, but was then stayed, in the late 1990's.

## **II. Summary of Proposal and Areas of Controversy**

### **A. Telephone Companies Excluded from UDITPA Rule**

Both UDITPA and Article IV of the Compact (which contains UDITPA nearly word for word) exclude rate-regulated public utilities from their scope of application. At the time UDITPA and the Compact were created, telephone companies were clearly excluded as public utilities. Today, some telecommunications companies may still be considered rate-regulated public utilities and excluded from UDITPA. There is no model uniform apportionment rule for these companies. Other telecommunications companies are no longer considered rate-regulated public utilities and are now arguably subject to UDITPA. These companies are coming under a rule which was never intended to apply to them. In addition, other regulated and non-regulated entities, such as cable companies, electric companies and others, are engaged in providing telecommunications services. It is not clear in all cases whether UDITPA applies to the income from these companies' provision of telecommunication service.

### **B. Proposed Special Rule Apportions Income from Provision of Telecommunications Service**

The proposal would create a model rule for apportioning net income from the provision of telecommunications services (Proposed rule, §1). The rule would apply uniformly regardless of whether the telecommunication service income is earned by a traditional telephone company, a VOIP company, a cable company, an electric company, or any other type of entity. (Proposed rule, §2) Segments of the telecommunications industry argue there is not a need for a special rule.

### **C. Under Proposed Special Rule, UDITPA Rule Applies Except Where Otherwise Provided**

Under the proposed special rule, the general apportionment rules of UDITPA apply except where otherwise provided. There are two areas where the special rule deviates from the general UDITPA provisions: (1) sales factor numerator sourcing, and (2) one exception to the property factor definition.

- *Sales Factor - Numerator Sourcing*

The general UDITPA rule attributes sales of services to a state's sales factor numerator if the greater of the income producing activity occurred in that state, as measured by the cost of performance.

For retail sales, the proposed special rule substitutes a market approach (Proposed rule, §3.ii.A-F and H). The approach is based as closely as possible on the Streamlined Sales & Use Tax Agreement. Under both the special rule and SSUTA, receipts from calls sold on a call-by-call basis are attributed to the numerator of the state where the call originates and terminates and the service address is located. Receipts for calls sold on any other basis are sourced to the place of primary use. There are special rules for attributing

receipts from ancillary services, air-to-ground radiotelephone service, pre-paid and post-paid calling services, pre-paid wireless calling service, mobile telecommunications service, and private communication service. There is also a provision for how to source bundled services (Proposed rule, §3.ii.I.). Industry representatives have objected to the sales factor numerator sourcing provisions for two retail services: ancillary and pre-paid. Industry representatives also objected to the special rule's provisions for bundled services. The Hearing Officer's Supplemental Report recommends adoption of the industry suggestions for sourcing the two retail services. It does not recommend changes to the bundled services provision.

For wholesale sales, the proposed special rule uses a proxy approach based on a Federal Communications Commission table which sources industry wholesale sales by state (Proposed rule, §3.ii.G.). Industry representatives have objected to the proxy approach for sourcing wholesale sales. (Proposed rule, §3.ii.) The Hearing Officer's original Report addressed this issue and did not recommend a change.

The special rule includes a throwout provision for sales that would be attributable to a state in which the taxpayer is not taxable (Proposed rule, §3.ii.I.). Industry representatives have objected to the throwout rule. The Hearing Officer's original Report addressed this issue and did not recommend a change.

- *Property Factor – Exclusion of Outer-Jurisdictional Property*

The general UDITPA rule includes tangible and real property in the property factor. The proposed special rule excludes outer-jurisdictional property, such as undersea cables or satellites (Proposed rule, §3.i.). Industry representatives have objected to the exclusion of outerjurisdictional property. The Hearing Officer's original Report addressed this issue and did not recommend a change.