



MULTISTATE TAX COMMISSION

Working Together Since 1967 to Preserve Federalism and Tax Fairness

**Model Compact Art. IV.17 Amendments
Income & Franchise Tax Uniformity Subcommittee Working Draft**

**Showing Requested Amendments in “Track Change”
May 3, 2010 -- For Discussion Purposes Only**

17(a) Sales, other than sales described in Section 16, are in this State if the taxpayer’s market for the sale is in this state. The taxpayer’s market for the sale is in this state:

(1) In the case of sales of services, if and to the extent:

- i. the service is delivered to a ~~customer~~ location in this state;
- ii. the location to which the service is delivered cannot be readily determined and the office from which the customer placed the order for the service is in this state; or
- iii. the location to which the service is delivered and the office from which the customer placed the order for the service cannot be readily determined, and the customer’s billing address is in this state.

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

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

(4) In the case of sale, lease or license of intangible property, if and to the extent the intangible property is used by the payor in this state.

(b) If the taxpayer is not taxable in a state to which a sale is assigned, or if the state of assignment is not readily determinable under subsection (a), such sale shall be excluded from the denominator of the sales factor.

Committee Direction to Drafting Group – March 3, 2010:

- Make market sourcing explicit. ► **Drafted.**
- Is “if and to the extent” sufficient to convey that partial sourcing is required where delivery is to multiple locations, and how? (ratio based on cost of service in each state, price of service in each state, or something else?)? ► **Do by Regulation.**
- Expand throwout to cover situations where the source state is not readily determinable even under the final “cascade.” ► **Drafted.**
- Cascade for intangibles? (Maybe only throwout was requested.) ► **Use throwout**



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Income & Franchise Tax Uniformity Subcommittee**

**Policy Checklist showing Preliminary Subcommittee Direction
Follow-up Questions in Bold
May 3, 2010**

- 1) Should the purpose of the sales factor be to reflect the taxpayer's market?
 - Yes. And statute should explicitly source to the market state.

 - 2) Do the section 17 provisions based on "income producing activity" and "cost of performance" reflect the taxpayer's market?
 - No.

 - 3) If section 17 does not reflect the taxpayer's market, how should it be amended to do so?
 - a) Should sections 16 and 17 be merged if the purpose of the two is the same?
 - If reasonable to draft that way. But no policy change to Section 16.

 - b) How should receipts from sales of services be sourced?
 - Cascading rule, based on location of delivery—
 - To state of delivery, including drop-shipment delivery.
 - If not "readily determinable", then to the office from which the customer placed the order for the service.
 - If not "readily determinable", then to the customer's billing address.
- (1) Does "readily determinable" provide sufficient statutory direction regarding the steps the taxpayer should take before sourcing under ii or iii?**
- (2) If not:**
- (a) Should additional statutory direction be added (e.g., "If the location to which the service is delivered cannot be specifically identified, the delivery location shall be reasonably approximated.")**

 - (b) Are ii and iii still necessary if additional direction requires a reasonable approximation, or should they be eliminated so that a**

**taxpayer who is unable to make a “reasonable approximation”
would fall to (b) (throwout)?**

- c) How should receipts from sale or licensing of intangible property be sourced?
 - Receipts from lease or licensing -- to the “location where the intangible property is used.”
 - Receipts from sale --- reconsider after discussion on definition of gross receipts.
- (1) How is “use” defined?**
- d) How should receipts from lease of tangible property be sourced?
 - To the “location of the tangible property.”
 - e) How should receipts from sale or lease of real property be sourced?
 - To the “location of the real property.”
- 4) Should the rule allow for sourcing a single receipt to multiple states?**
- Yes. Want to reflect the idea of proportionality and allow sourcing of only part of the receipt to the state.
- 5) Should section 17 contain a throwback (or throwout) provision, similarly to section 16?**
- Throwout
 - Should apply if state to which receipt sourced not able to tax.
 - Should apply if state to which receipt sourced not readily determinable.

March 2010 Additional Policy Questions
(also integrated into master policy checklist, above)

- I. **“To the Extent.”** Including this language could suggest receipts may be sourced among multiple states, rather than to a single state. Should the rule allow for sourcing a single receipt to multiple states?
- **Yes. Want to reflect the idea of proportionality and allow sourcing of only part of the receipt to the state.**
- II. **“Customer” and “Payor.”** The use of the term “customer” suggests receipts are sourced to the location of the taxpayer’s customer, rather than “looking through” to where the ultimate customer is located if the service is resold or drop-shipped. Use of the term “payor” is more likely to allow for the alternative: receipts could be sourced to the location of the ultimate consumer.
- **Source to location of delivery, including drop-shipment delivery.**
- III. **“Sales.”** Sourcing to the “location of use” seems reasonable for leasing or licensing of intangibles. But it may not work well for sales of intangibles since the taxpayer presumably would not know where the intangible is used once it is sold. Should there be a separate rule for sales of intangibles, or perhaps use of throwback (assigning to the taxpayers office as MA does) or throwout?
- **Source lease or license to location of use. Leave “sale” in for now and reconsider after discussion on definition of gross receipts.**
- IV. **Intangibles.** Should the rule for intangibles include a cascade assignment approach similar to that used for services?
- **Yes. Use throwout. (Additional cascading?)**
- V. **Throwout.** Under the draft, throwout applies to receipts from transactions that would be sourced to a location where the taxpayer does not have nexus. Should application of throwout apply more broadly to receipts from transactions where the application of the rule, even taking into account the cascade alternatives, cannot be determined?
- **Yes. Expand to include situations where even final cascade is not readily determinable.**
- VI. **Receipts from Sale of Business Assets.** The overarching goal of the sales factor is to source receipts from sales (or leases) to the taxpayer’s market for its product and the draft is intended to reflect that market. But the definition of receipts may also include receipts from the sale of production assets used in the taxpayer’s business. Is the appropriate goal for these receipts to source to the market for the taxpayer’s product? Or would a more appropriate goal be to source these types of assets to the location of the asset or of the taxpayer’s business (e.g, if the asset is an intangible asset; perhaps throwout achieves this?)? Or, has the value of these assets already been reflected in the property factor, in which case the value (in the form of receipts) need/should not be reflected in the sales factor (market reflection) at all.
- **The Subcommittee will come back to this question after determining the definition of gross receipts.**



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**Section 17 Drafting Group Recommendations for
Issues to be Addressed through Regulation, Official Comments or Both**

May 3, 2010

General Issues

1. “If and to the Extent” – define method for apportioning receipt. May need to provide general rule (e.g., cost of service, price of service, or some other) and special rules (e.g., mileage for transport industries, circulation for publications, viewership for broadcasting, percent of time for situations so addressed under current regulations, etc.)
2. Define “delivery.”
3. Define “location.” E.g., for purposes of delivery to an email address, the office from which the services are ordered, mobile tangible property, etc.
4. Distinguish services, intangibles, and tangibles.

Services

5. Dock Sales

Intangibles

6. Specify use is presumed to occur if not readily apparent. E.g., cascading presumptions from “commercial domicile of customer,” to “billing address,” etc.

Lease of Tangible Property

7. Regulations should address mobile property, in transit, etc.

UDITPA Coalition
MTC Draft Section 17 Statute
Issues

I. Definitional Issues – Sourcing of Services

- A. What does “delivered to” mean?
 - Concept of physical delivery
 - Concept of contractual delivery
- B. Who is the “customer”?
 - Taxpayer’s customer
 - Ultimate customer
- C. What is the “location”?
 - State of incorporation
 - Principal place of business
 - Commercial domicile
 - Headquarters
 - Permanent establishment
- D. Example – Who is the customer and where are fulfillment services delivered.

II. Definitional Issues – Sourcing of Intangibles

- A. How is “use” defined?
- B. Will the MTC look to federal rules and regulations for the sourcing of intangibles (I.R.C. § 861 and accompanying regulations)?

III. Definitional Issues – Intangibles vs. Services

- A. How are “services” defined?
- B. How are “intangibles” defined?
- C. Will the MTC look to federal rules (I.R.C. § 861 and accompanying regulations)?

IV. Cascading Approach

- A. Customer office from which order was placed
 - Multistate Issues – Services or intangibles delivered to/used in multiple states
- B. Customer’s billing address

V. Guiding Principles

- A. Is “delivered to” or “use” an all-or-nothing rule?
- B. To what extent will the MTC look to sales tax rules (especially the SSUTA) in establishing sourcing rules.
- C. To what extent will the MTC look to federal rules (I.R.C.) and international rules (OECD) establishing sourcing rules?
- D. What is the role of administrability?