MULTISTATE TAX COMMISSION

Art. IV.17 Draft Examples
April 10, 2012
For Discussion Purposes Only

Proposed Model

17(a) Sales, other than sales 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 sales 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 sale 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 sale shall be excluded from the denominator of the sales factor.

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

Intangible Sourcing Illustrations

1. ***In general, intangibles are sourced to the state where they are "used."*** IV.17 (a)(4)(i) and (ii). It's recognized that where taxpayer sells the intangible outright, the taxpayer will not necessarily have any continuing contact with the purchaser and thus will not know where its intangible will later be used. Therefore receipts from sales, as opposed to licenses, of intangibles are generally excluded from the sales factor. IV.17 (a)(4)(ii)(C). An exception is made for sales situations where the taxpayer makes a contingent sale and thus does have a continuing relationship with the purchaser. Essentially, contingency sales are treated as licenses because they resemble licenses. IV.17 (a)(4)(ii)(B). For example:
    a. Taxpayer licenses a patent for a manufacturing process. The licensee will manufacture its product using that process in this and one other state. A proportionate share of the gross receipts from the licensing transaction is sourced to this state.
    b. Taxpayer sells a patent outright at a fixed price. The purchaser will manufacture its product using that process in this and one other state. The gross receipts from this sale are not included in either the sales factor numerator or denominator of this state.
    c. Taxpayer structures a contingency sale, rather than a license, and the purchaser agrees to make monthly payments to the taxpayer based on the purchaser's volume of production using the patented process. The contingent purchaser will manufacture its product using that process in this and one other state. A proportionate share of the gross receipts from the licensing transaction is sourced to this state.

2. ***Marketing intangibles are deemed to be "used" in the state where a consumer purchases the good or service that uses the intangible.*** IV.17 (a)(4)(i). Marketing intangibles include trademarks and trade names used to commercially exploit a product or service, customer lists, distribution channels, and unique names, symbols, or pictures with important promotional value. For example:
    a. Taxpayer licenses the right to manufacture and sell clothing depicting its copyrighted characters (marketing intangibles). The manufacturer sells the clothing to consumers in this and one other state. A proportionate share of the gross receipts from the Taxpayer's licensing transaction is sourced to this state.
    b. Taxpayer licenses the right to manufacture to produce clothing depicting its trademarked characters (marketing intangibles). The manufacturer sells the clothing to a retailer. Retailer sells to consumers in this and one other state. A proportionate share of the gross receipts from the Taxpayer's licensing transaction is sourced to this state, but manufacturer doesn't know where retailer sells. Taxpayer will need to make a reasonable approximation. IV.17(b).
    c. Taxpayer enters a franchise agreement with a franchisee under which the franchisee is entitled to operate a restaurant utilizing the franchisor's trademark in this state and one other state. A proportionate share of the gross receipts from the portion of the Taxpayer's franchise agreement that reflects the use of the trade marks is sourced to this state.

3. ***Intangibles that grant the holder the right to perform an activity in a specific geographic area are deemed to be "used" in that geographic area.*** IV.17 (a)(4)(ii)(a). For example:
    a. Taxpayer sells its right to mine state lands. The gross receipts from the sale are sourced to this state.

b. Taxpayer sells its “gate rights” at an airport in this state. The gross receipts from the sale are sourced to this state.