



To: Robynn Wilson, Chair
Members of the Income & Franchise Tax Uniformity Subcommittee

From: Shirley Sicilian, General Counsel

Date: January 20, 2011

Subject: Compact Art.IV Amendments, including §§ 17, 1(g), and 9

In July, 2011, the uniformity committee forwarded its recommended amendments for compact Art.IV.17 (sales factor sourcing for services and intangibles) and Art.1(g) (definition of “sales”) to the executive committee for consideration for public hearing. On December 1, 2011, the executive committee reviewed the drafts and asked that the uniformity committee clarify §§ 17(a)(4) and (5), which source receipts from transactions involving intangible property. The drafting group has met weekly since early December and has produced a draft clarification for the uniformity committee’s consideration.

In the process of drafting these clarifications, the drafting group noted that the term “sale(s)” carries a different meaning in different provisions of UDITPA. In some provisions, the term “sale(s)” refers to a type of transaction distinct from other types of transactions like leases, licenses, or rentals (e.g. the reference to “sales of tangible personal property” in §16). In other provisions, the term “sale(s)” is intended more broadly to include these other types of transactions or receipts from those transactions (e.g., the definition of “sales” in §1(g) and the reference to the “sales factor” in §9). The drafting group noted that in § 17 - in both the current rule and the draft amendments - the term is used in both senses (e.g., “Sales, other than sales of tangible personal property...”). The drafting group had produced a draft of Compact Article IV that would simply substitute the term “receipts” for the term “sales” where the broader meaning is intended. These would be purely technical amendments for clarification and compatibility with the other revisions in §17.

The following drafts are attached for Subcommittee’s consideration and discussion.

Attachment A: Draft §17 as approved by the uniformity committee in July, 2011 and submitted to the executive committee in December, 2011

Attachment B: Draft §17 with further clarifications to §§17(a)(4) and (5) suggested by the drafting group

Attachment C: Article IV in its entirety, showing draft amendments to §1(g) (definition of “sales”), §17 (sales factor sourcing for services and intangibles), and §9 (factor weighting) and clarification to address the two meanings of “sales”.

Attachment A



MULTISTATE TAX COMMISSION

Uniformity Committee
Proposed Model Compact Art. IV.17 Recommended Amendments
As recommended to the executive committee
July 24, 2011

- 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 a sale 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;
 - (4) In the case of, lease or license of intangible property; or sale or other exchange of such property if the receipts from such sale or exchange derive from payments that are contingent on the productivity, use, or disposition of the property; if and to the extent the intangible property is used in this state, provided that intangible property used in marketing a good or service to a consumer is used in this state if the good or service that is marketed using the intangible property is purchased by a consumer who is in this state; and
 - (5) In the case of sale of intangible property other than that referenced in section (4), above; where the property sold is a contract right, government license, or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area; if and to the extent the intangible property is used in or otherwise associated with this state, provided that any sale of intangible property not otherwise described in this section (5) or section (4) above shall be excluded from the numerator and the 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 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.]

Attachment B



MULTISTATE TAX COMMISSION

Drafting Group

Draft Model Compact Art. IV.17

Showing Uniformity Committee proposed amendments, with draft revisions to address Executive committee's request for clarification of §17(a)(4) and (5)

January 20, 2012

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- 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 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.]

Attachment C



MULTISTATE TAX COMMISSION

Drafting Group

Draft Compact Art. IV

***Showing Uniformity Committee proposed amendments, with draft revisions to address:
(1) Executive committee's request for clarification of §17(a)(4) and (5), and
(2) Technical amendments for compatibility and clarification re "sales"***

January 20, 2012

1. As used in this Article, unless the context otherwise requires:

(a) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(b) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

(c) "Compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

(d) "Financial organization" means any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank, small loan company, **sale** finance company, investment company, or any type of insurance company.

(e) "Nonbusiness income" means all income other than business income.

(f) "Public utility" means any business entity (1) which owns or operates any plant, equipment, property, franchise, or license for the transmission of communications, transportation of goods or persons, except by pipeline, or the production, transmission, **sale**, delivery, or furnishing of electricity, water or steam; and (2) whose rates of charges for goods or services have been established or approved by a Federal, State or local government or governmental agency.

(g) ~~"Sales" means all gross receipts of the taxpayer not allocated under paragraphs of this Article.~~

UNIFORMITY COMMITTEE PROPOSAL, WITH DRAFT EDITS TO ADDRESS "SALE" ISSUE:

"SalesReceipts" means gross ~~receipts of amounts received by~~ 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 amounts received by~~ 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.

(h) "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any Territory or Possession of the United States, and any foreign country or political subdivision thereof.

(i) "This State" means the State in which the relevant tax return is filed or, in the case of application of this Article to the apportionment and allocation of income for local tax purposes, the subdivision or local taxing district in which the relevant tax return is filed.

2. Any taxpayer having income from business activity which is taxable both within and without this State, other than activity as a financial organization or public utility or the rendering of purely personal services by an individual, shall allocate and apportion his net income as provided in this Article. If a taxpayer has income from business activity as a public utility but derives the greater percentage of his income from activities subject to this Article, the taxpayer may elect to allocate and apportion his entire net income as provided in this Article.

3. For purposes of allocation and apportionment of income under this Article, a taxpayer is taxable in another State if (1) in that State he is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that State has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the State does or does not do so.

4. Rents and royalties from real or tangible personal property, capital gains, interest, dividends or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in paragraphs 5 through 8 of this Article.

5. (a) Net rents and royalties from real property located in this State are allocable to this State.

(b) Net rents and royalties from tangible personal property are allocable to this State: (1) if and to the extent that the property is utilized in this State, or (2) in their entirety if the taxpayer's commercial domicile is in this State and the taxpayer is not organized under the laws of or taxable in the State in which the property is utilized.

(c) The extent of utilization of tangible personal property in a State is determined by multiplying the rents and royalties by a fraction the numerator of which is the number of days of physical location of the property in the State during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, tangible personal property is utilized in the State in which the property was located at the time the rental or royalty payer obtained possession.

6. (a) Capital gains and losses from sales of real property located in this State are allocable to this State.

(b) Capital gains and losses from sales of tangible personal property are allocable to this State if (1) the property had a situs in this State at the time of the sale, or (2) the taxpayer's commercial domicile is in this State and the taxpayer is not taxable in the State in which the property had a situs.

(c) Capital gains and losses from sales of intangible personal property are allocable to this State if the taxpayer's commercial domicile is in this State.

7. Interest and dividends are allocable to this State if the taxpayer's commercial domicile is in this State.

8. (a) Patent and copyright royalties are allocable to this State: (1) if and to the extent that the patent or copyright is utilized by the payer in this State, or (2) if and to the extent that the patent or copyright is utilized by the payer in a State in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this State.

(b) A patent is utilized in a State to the extent that it is employed in production, fabrication, manufacturing, or other processing in the State or to the extent that a patented product is produced in the State. If the basis of receipts from patent royalties does not permit allocation to States or if the accounting procedures do not reflect States of utilization, the patent is utilized in the State in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized in a State to the extent that printing or other publication originates in the State. If the basis of receipts from copyright royalties does not permit allocation to States or if the accounting procedures do not reflect States of utilization, the copyright is utilized in the State in which the taxpayer's commercial domicile is located.

~~9. All business income shall be apportioned to this State by multiplying the income by a fraction the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three.~~

UNIFORMITY COMMITTEE PROPOSAL, WITH DRAFT EDITS TO ADDRESS "SALE" ISSUE:

All business income shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus two times the sales receipts factor, and the denominator of which is four.

10. The property factor is a fraction the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this State during the tax period and the denominator of which is the average value of all of the taxpayer's real and tangible personal property owned or rented and used during the tax period.

11. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

12. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period; but the tax administrator may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

13. The payroll factor is a fraction the numerator of which is the total amount paid in this State during the tax period by the taxpayer for compensation and the denominator of which is the total compensation paid everywhere during the tax period.

14. Compensation is paid in this State if:

(a) the individual's service is performed entirely within the State;

(b) the individual's service is performed both within and without the State, but the service performed without the State is incidental to the individual's service within the State; or

(c) some of the service is performed in the State and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the State, or (2) the base of operations or the place from which the service is directed or controlled is not in any State in which some part of the service is performed, but the individual's residence is in this State.

15. The ~~sales-receipts~~ factor is a fraction the numerator of which is the total ~~sales-receipts~~ of the taxpayer in this State during the tax period and the denominator of which is the total ~~sales-receipts~~ of the taxpayer everywhere during the tax period.

16. ~~Sales-Receipts from the sale~~ of tangible personal property are in this State if:

(a) the property is delivered or shipped to a purchaser, other than the United States Government, within this State regardless of the f.o.b. point or other conditions of the ~~sale~~; or

(b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this State and (1) the purchaser is the United States Government or (2) the taxpayer is not taxable in the State of the purchaser.

17. ~~Sales, other than sales of tangible personal property, are in this State if:~~

~~(a) the income-producing activity is performed in this State; or~~

~~(b) the income-producing activity is performed both in and outside this State and a greater proportion of the income-producing activity is performed in this State than in any other State, based on costs of performance.~~

WORK GROUP CLARIFICATION OF UNIFORMITY COMMITTEE PROPOSAL, WITH DRAFT EDITS TO ADDRESS "SALE" ISSUE:

17(a) ~~SalesReceipts~~, other than ~~sales-receipts~~ described in Section 16, are in this State if the taxpayer's market for the ~~sales-receipts~~ is in this state. The taxpayer's market for ~~sales-receipts~~ 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 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-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 sale-receipt 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.]

18. If the allocation and apportionment provisions of this Article do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- (a) separate accounting;
- (b) the exclusion of any one or more of the factors;
- (c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this State; or
- (d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.