Additional Comment by Benjamin F. Miller with Respect to Testimony
Offered at the Hearing of March 28, 2013 in Washington D.C.
Proposed Amendment to Section 17 of Article IV

At the hearing of March 28, 2013 the hearing officer inquired of me as to how the place of delivery would be determined under proposed Section 17(a)(3) relating to the delivery of a service. In my oral comments I stated that billing address would be used. I would like to amend my oral statement.

The touchstone for determining where delivery is should be information that is available to the taxpayer. It would be my recommendation that a hierarchy needs to be established with respect to where delivery occurs. This hierarchy can be established through regulations. Suggestions for this hierarchy are:

1) In the case of a service is being provided for an activity that is primarily or exclusively associated with a state such as the providing of legal services for a suit brought in a particular jurisdiction or with respect to providing services with respect to the construction of something within a particular jurisdiction delivery would be in that state.

2) If the recipient of the service is located in a single state, delivery would be in that state. This would normally be particularly appropriate with respect to an individual.

3) Delivery would occur at the location of the office which ordered the service.

4) Delivery would occur at the address where the bill is sent.

With respect to 3) and 4) it could be appropriate to rely upon approximations in the case of a service provided to a multijurisdictional entity where the service would be utilized throughout the jurisdictions in which the recipient of the service does business.

From: HUMPHREY Gary D [mailto:gary.d.humphrey@state.or.us]
Sent: Thursday, March 28, 2013 6:04 PM
To: Loretta King
Subject: Written Comments -- MTC Article IV Recommended Amendments

Loretta,

The MTC and participating states have developed and refined the recommended amendments to Article IV of the Compact for the past few years. Members of the public and representatives of business have participated in discussions of the proposed amendments and their input has been helpful in drafting the proposed amendments. The amendments are ready for consideration by the states and I urge the Executive Committee to approve the proposed amendments for the next step of the adoption process.

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April 4, 2013

Delivered by Electronic Transmission

Professor Richard D. Pomp
Hearing Officer for the Multistate Tax Commission
Alva P. Loiselle Professor of Law
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Hartford, Connecticut

Re: Comments on Multistate Tax Compact Article IV Recommended Amendments

Dear Hearing Officer Pomp:

Please accept these comments concerning the Multistate Tax Commission's "Multistate Tax Compact Article IV Recommended Amendments."

These comments focus in the first instance not on the substance of any specific provision, but instead on the standards for evaluating any proposal relating to the apportionment of the income of multijurisdictional enterprises. These initial comments seek to clarify the meaning of uniformity and how success in achieving uniformity can be measured. Following this initial discussion of uniformity, I provide comments on certain portions of the proposed Article IV amendments.

The Meaning and Measurement of Uniformity

Recommendation: The Multistate Tax Commission and its Hearing Officer should evaluate amendments to Article IV using a definition of uniformity as fairness in taxation. Achieving uniformity means applying corporation taxes uniformly to all corporate taxpayers—large and small, in-state and multijurisdictional—in proportion to the business activity that each taxpayer conducts within a state. Legal consistency should not be used as the test of achieving uniformity because such a limited test can yield inequitable or non-uniform tax results. Further, the range of comparison of the impacts of any given amendment should include corporations whose activities are entirely within the boundaries of a state in addition to various types of multijurisdictional taxpayers in order to understand properly the equity or fairness effects of any given proposal.

News reports at the hearing on March 23 indicate that commentators frequently discussed whether or not a particular approach would advance the purpose of uniformity. A careful reading of those comments indicates that uniformity was often used to mean the degree to which states consistently adopt the same legal provision applying to multistate taxpayers. From this perspective, legal consistency is taken to be the equivalent of achieving uniformity in taxation. That view is erroneous. Legal consistency can be a helpful, but not always necessary, tool to achieving uniformity in taxation—but it does not constitute uniformity in and of itself.

Uniformity in corporate income taxation is something much more fundamental than mere rote consistency in state laws. Uniformity in corporate taxation occurs when taxpayers in a given jurisdiction are taxed in a uniform or equitable manner. It is a circumstance in which a multijurisdictional enterprise is as fully and equally accountable for reporting the income it earns in a state as is a small business that operates entirely within that same state. The "income earned in the state" is determined in a manner to fairly represent the extent of the multijurisdictional taxpayer's business activities in the state (the overarching Article IV/UDITPA policy standard). The taxes paid by taxpayers, small and large, will be proportionate to the business activities they conduct in the state. Thus, the taxes will be fairly related to the benefits the taxpayers receive from public services that support the conduct of their business activities in the state. The principle of uniformity in taxation requires that no corporation be able to artificially shift income away from the state to be reported elsewhere or nowhere through various elections, tax planning strategies, evasion schemes or other artificial mechanisms. Uniformity is achieved when corporations subject to the tax are fully and fairly accountable for the income they earn in relation to the extent of business activities conducted in each jurisdiction.

Legal consistency often supports uniformity in taxation, but not always. One example is the original "greater cost of performance" provision for the sourcing of certain sales receipts among jurisdictions. That provision has allowed some service sector taxpayers to manipulate the assignment of income among the states using diverse accounting methods with the net result of generating large quantities of "nowhere income." As originally written and generally enacted, did this provision achieve legal consistency? Yes. Did it achieve uniformity in taxation properly understood as fairness? No. A bad law that is consistently enacted in state after state that allows some multijurisdictional taxpayers to manipulate income reporting in ways that other corporations cannot fails the standard of uniformity in taxation.

Nor is legal consistency always necessary to achieve reasonable uniformity among corporate taxpayers, large and small. In a number of cases, modest variations in legal provisions do not produce substantial variations in the uniform and equitable taxation of corporations.

Uniformity in taxation arises from provisions in the state constitutions and laws, the U.S. Constitution and extensive federal and state case law. Broadly speaking, this

body of law requires uniform, equal or fair treatment of taxpayers in relation to each other. Thus, this concept of uniformity as fairness in taxation is much richer and more complete than the superficial "uniformity" reduced to mere legal consistency.

Implicit in the discussion above, is that the frame of reference for discussions of multijurisdictional tax issues is often too narrow. For example, participants in the March 28 hearing typically evaluated proposals and issues in terms of how they might affect only multijurisdictional taxpayers. Left out of the discussion are in-state taxpayers who would be required to pay for services enjoyed by multijurisdictional taxpayers if the latter do not pay their proportionate share of taxes. Treating apportionment issues as "inside baseball" involving only state tax experts and multijurisdictional companies and their hired advocates is a mistake. Fair and effective apportionment exists not for the private benefit of multijurisdictional enterprises. Rather, it exists to serve the public interest in tax equity and to protect in-state taxpayers from having to unfairly pay for public services required by multijurisdictional economic activity and vice versa. When experts and policy-makers make comparisons of how of certain apportionment provisions affect different multistate taxpayers, they should include in-state businesses in those comparisons as well. One cannot understand the uniformity (fairness) impact of various policy scenarios without comparing how an in-state taxpayer is taxed in relation to multistate taxpayers.

For example, single sales factor apportionment is often discussed in terms of comparing the tax treatment of a multistate taxpayer that produces but does not sell within a state with the tax treatment of another multistate taxpayer that sells into but does not produce in the state. This comparison leaves out the in-state corporation that bears a greater tax on business activities than a multistate taxpayer engaging in production, but few or no sales, in the state—even though the multistate taxpayer conducts comparable or more extensive business activities. Failure to include the in-state corporation in the analysis of the single sales factor ignores the inequitable, non-uniform treatment of the in-state corporation as compared to the multistate taxpayer with production activities, but few if any sales, in the state.

Factor Weighting

Recommendation: The Multistate Tax Commission should not, in the present policy environment, attempt to move states in the direction of a commonly adopted formula that advances uniformity in taxation. Any such attempt will be futile and likely counterproductive. If the Commission recommends to states any amendments to Article IV, the amendments should allow states to choose their own factor weighting—perhaps limited to a defined period such as ten years or twelve years. The Commission should address factor weighting by initiating a systematic study process that also engages a broader range of state officials with tax administrators in research, evaluation and dialogue on the factor weighting issue.

Two Less Desirable Options: If the Commission judges it necessary to make a factor weighting recommendation, one option would be to propose language that would permit states to choose either the traditional single factor formula or a double-weighted sales formula. Increasing the sales factor weighting beyond double-weighting increases the degree of inequitable or non-uniform tax results among taxpayers engaging in comparable levels of business activity within a state—with the greatest lack of uniformity (fairness) in taxation occurring with a single sales factor formula. Another option would be for the Commission to recommend language that allows states to choose any factor weighting, but require specific taxpayers to adjust their income apportionment if the tax results vary too greatly from an acceptable standard of uniform results. For example, the language could require a taxpayer to use a double-weighted sales, three-factor formula in all states where it does business if either of these circumstances arises:

1. The total income it reports to all states is less than 90% or more than 110% of the double-weighted apportionment result, or
2. Its apportioned income to any single state is less than 80% or more than 120% of the double-weighted result for that state.

Reject Taxpayer Election: Under no circumstances should the Commission recommend that factor weighting be subject to election by multijurisdictional taxpayers.

Discussion: State legislatures have over the last decade or so switched rapidly to diverse apportionment formulas that overweight or rely solely on the sales factor. Lobbying by select corporate interests has succeeded in creating the perception that single sales factor apportionment, in particular, would increase manufacturing jobs. Aiding this trend were predictions by economist Austan Goolsbee that single sales factor apportionment was a magic economic elixir that would dramatically boost manufacturing jobs in any given state—until most or all states adopted it, at which point the elixir would suddenly lose its stimulating effects.

This perception is not supported by reality. The predictions of increasing manufacturing employment were already disproven by the experience of Iowa, the state that pioneered single sales factor apportionment. From 1970 to 2010, manufacturing jobs declined in Iowa in both absolute and relative terms.[1] There were fewer manufacturing jobs in Iowa in 2010 than in 1970. In 1970, manufacturing jobs were 17.1% of total Iowa employment, and 10.6% in 2010. The decline in the share of Iowa manufacturing jobs was not as great as in the rest of the nation. However, that fact is due in part to the slow growth in the Iowa workforce compared to the U.S. workforce (Iowa population grew by 7.9% from 1970 to 2010, while the U.S. population grew by 51.9%) and to the slower growth of Iowa jobs in other sectors compared to the rest of the nation.

[1] Center for Industrial Research and Service (CIRAS), Manufacturing in Iowa 2012 Iowa State University Extension and Outreach.

As single sales factor apportionment has spread, manufacturing job trends do not provide any clear and convincing support for the economic claims promised by advocates of the measure. Data compiled by the Center on Budget and Policy Priorities (CBPP) for changes in manufacturing jobs by state from 2001 to 2011 indicates no major difference between states using a single sales factor and states using the equally weighted formula throughout the period. States in both groups are distributed comparably across the range from best to worst records of changes in manufacturing jobs (with overall decline being the dominant trend).

The fact that states continue to adopt single sales factor apportionment despite no substantial economic support for it is a measure of the uphill challenge the Commission would face if it attempted to convince states to return to a common, multifactor formula. The better course is to systematically gather corporate tax data and conduct research to document facts about the economic and tax equity effects of varying apportionment formulas. The Commission is uniquely positioned to work with states using tax return data to bring clear facts to the discussion about factor weighting. Further, in a process that should be publicly funded to ensure its independence, the Commission should structure a dialogue with executive and legislative branch officials appointed by relevant state authorities on the evidence of the impacts of diverse factor weighting schemes. This process could be timed to end in a sufficient number of years prior to the expiration of a period during which Article IV would be silent on the subject of factor weighting so that states could then consider implementing, perhaps in stages, a common factor approach that achieves uniform tax results.

If the Commission judges it necessary to address factor weighting, there are options along the lines suggested above that could permit some variation among the states while limiting the adverse effects of single sales factor apportionment has on the uniform and equitable treatment of different types of corporations. If options of this type are pursued, the Commission would need to accompany those recommendations with documentation that the single sales factor approach unfairly burdens in-state companies and some multijurisdictional corporations, while granting near-charity status to a favored few—all without any convincing economic benefits. However, the misperceptions created about the positive economic effects of single sales factor apportionment are likely to be hard to overcome in the immediate future, which is why the original recommendation is the better course.

Finally, taxpayer elections of factor weighting would sacrifice the public interest in tax equity and uniformity to private interests in tax minimization. The tax results even among electing multijurisdictional taxpayers would be non-uniform and inequitable. Moreover, because only multijurisdictional taxpayers would enjoy the benefit of elections, in all cases smaller, in-state only corporations would unfairly pay a proportionately greater amount of tax. Existing taxpayer elections that are limited to multijurisdictional taxpayers and that substantially allow certain

corporate taxpayers to reduce their tax liabilities are already problem. Further, elections of this type deserve greater scrutiny under the state constitutional prohibitions against the surrender of a state's sovereign taxing authority to private parties. Elections that are potentially questionable under the standards of some state constitutions and that undermine tax equity should be firmly rejected.

Extent of Apportionable Income

Recommendation: The Commission should adopt the proposed language that makes the boundaries of apportionable income coterminous with the constitutional limit.

Discussion: If the Commission were to recommend new language defining the boundaries of apportionable income that did not correspond to the constitutional limit, new problems would arise. Where the boundaries were perceived by the tax practitioner community to be less than the constitutional limit, efforts would be undertaken to explore new opportunities for tax planning that will create greater inequities among taxpayers. Taxpayers would increasingly assert new positions to widen the perceived gap between the new language and the constitutional limits—and a new round of litigation would arise over the explorations of new tax planning territory. On the other hand, if the taxpayer community perceived that any portion of the new language ventured beyond the constitutional limit, another separate line of litigation would emerge. Extended litigation over the boundaries of "business" and "non-business" income has in recent years finally achieved a state of quiet equilibrium. It should not be disturbed by new language that could be perceived as drawing new boundaries inside or outside the constitutional limit. Thus, conforming the boundaries of apportionable income to the constitutional limit is the best course of action.

If there are ambiguities about the constitutional limits, the Commission and the states have available to them educational mechanisms and regulatory authority to address specific items that require greater clarity from time to time.

Sourcing of Sales of Services and Intangibles

Recommendation: Replacing the "greater cost of performance" rule with language that is oriented to assigning sales to a market location is perhaps the greatest area of need in updating Article IV. While private sector commentators at the March 28 hearing raised some issues that the Hearing Officer needs to weigh, none of those issues appear to justify rejecting a market-based sourcing rule for services and intangibles that corresponds to the purpose of the sales factor, which is to measure the contribution of the market to the earning of income. The Commission should adopt the proposed language with necessary technical adjustments that the Hearing Officer may recommend that do not interfere with the overall direction and purpose of the proposed amendments.

Discussion: The "greater cost of performance" rule for sourcing services and intangibles has for decades invited egregious manipulation of income reporting by some multijurisdictional taxpayers that significantly undermines the equitable and uniform application of corporate tax law. The need to put an end to manipulative income reporting by some taxpayers is great and overweighs the issues raised around the edges of the proposed language by some in the tax practitioner community.

This letter covers all of the comments on the proposed Article IV amendments that I have at this time. I would be glad to respond to any questions concerning any portion of these comments. I would also do my best to respond to questions on additional issues not covered here.

Thank you for this opportunity to comment on these important issues.

Sincerely,

Dan R. Bucks