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

From: Shirley Sicilian, General Counsel  

Date: February 24, 2012  

Subject: Model Compact Art. IV.18 Amendments (Distortion Relief)  

The Executive Committee has asked the Uniformity Committee to consider amendments to the model Compact Art. IV.18 (Distortion Relief). This memo provides:

- Background (section I)  
- Draft language (section II)  
- Policy questions - raised during the November 2011 meeting (section III)  

I. Background  

The Executive Committee requested Uniformity Committee review section 18 of the Compact and suggest revisions to clarify authority for adoption of industry-wide and issue-wide special apportionment rules. The Commission’s current longstanding regulations acknowledge this authority, and several such regulations have been adopted.

John Warren, who represented the State of California at ULC during the original drafting of UDITPA, recently remarked:

The original drafters probably thought of Section 18 as a tool to be used to avoid gross distortion under the facts of a particular taxpayer. The adopting states and the MTC, however, have chosen to use it in a much broader way. It has become the authority for devising special factors and formulas for whole industries, and this is to be applauded.  
Written comments to the MTC 2005 Annual Meeting; Boise, Idaho  

The Commission’s efforts to modernize Section 17 and other Compact provisions will hopefully minimize the need to use section 18 in crafting special rules, and presumably relieve much of the pressure currently brought to bear on the equitable apportionment provisions. Nonetheless, the economy will certainly continue to change. There will always be a need to fill statutory gaps in tax policy. Ideally, these gaps should be filled uniformly across taxpayers, and not only on an ad-hoc basis. The authority to do so can be made clearer.

1 MTC Reg. IV.18(a)
II. Draft Language

The Drafting Group\(^2\) developed the following language for the Subcommittee’s consideration. The Subcommittee discussed the draft in November, 2011, but did not direct changes at that time.

*Mark-up of Compact Art.IV.18*

Sec. 18. (a) 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:

1. separate accounting;
2. the exclusion of any one or more of the factors;
3. the inclusion of one or more additional factors which will fairly represent the taxpayer’s business activity in this State; or
4. the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer’s income.

(b)(1) If the allocation and apportionment provisions of this Article do not fairly represent the extent of business activity in this State of taxpayers engaged in a particular industry or in a particular transaction or activity, the tax administrator may, in addition to the authority provided in section (a), establish appropriate rules or regulations for determining alternative allocation and apportionment methods for such taxpayers.

(b)(2) A regulation adopted pursuant to this section shall be applied uniformly, except that with respect to any taxpayer to whom such regulation applies, the taxpayer may petition for, or the tax administrator may require, adjustment pursuant to Section 18(a).

*Excerpt from Current MTC Reg. IV.18(a) for Comparison*

... In the case of certain industries such as air transportation, rail transportation, ship transportation, trucking, television, radio, motion pictures, various types of professional athletics, and so forth, the foregoing regulations in respect to the apportionment formula may not set forth appropriate procedures for determining the apportionment factors. Nothing in Article IV.18. or in this Regulation IV.18. shall preclude [the tax administrator] from establishing appropriate procedures under Article IV.10. to 17. for determining the apportionment factors for each such industry, but such procedures shall be applied uniformly.

III. Policy Questions discussed November, 2011

1. Should the draft language of (b)(1) reference “regulations” or should it reference “procedures”? The current MTC regulation speaks in terms of “procedures,” but note that it is “regulations” that

---

\(^2\) The drafting group includes Ben Miller and Melissa Potter (CA-FTB), Ted Spangler (ID), Gary Humphrey, Janielle Lipscomb, and Jeff Henderson (OR), Michael Fatale (MA), Joe Garrett and Holly Coon (AL), and Commission Staff Shirley Sicilian and Bruce Fort. The drafting group has been regularly joined by Wood Miller (MO), Donnita Wald and Mary Loftsgard (ND), and Phil Horwitz (CO).
3. Set forth the “procedures.” The current draft has been modified from the November version: “regulations” is changed to “rules or regulations.” This change is intended to reflect differences in how states refer to guidance that is subject to the administrative procedures act. Some states use the term “regulations,” some use “rules,” and some use “rules and regulations.”

2. Should “separate accounting” be deleted from the list in (a), or be limited to allocable income? Note that states have occasionally addressed distortion by applying separate accounting in lieu of formulary apportionment - e.g., separately accounting for the income of a real estate investment firm by attributing the gain from each real estate sale to the state where the real estate is located, rather than apportioning the sum of the gains based on the 3-factor formula.

3. Should “combined reporting” be added to the list in (a)? Note, when this effort was before the ULC, the executive committee explicitly determined it did not want to address combined reporting. The concern at that time was that dealing with combined reporting in the context of this UDITPA project would jeopardize completion of our work on critical provisions such as §17. Also note, several state courts have found combined reporting to be inherent in UDITPA apportionment itself, not limited to a method of distortion relief under UDITPA § 18(a)(4).