MULTISTATE TAX COMMISSION

Working Together Since 1967 to Preserve Federalism and Tax Fairness

Income and Franchise Tax Subcommittee of the Uniformity Committee
Courtyard Marriott
170 Fourth Avenue North
Nashville, TN 37219
March 18, 2009, 8:30 A.M. to 2:30 P.M.

Minutes of the Meeting

I. Welcome and Introductions

The following persons attended the meeting, either in person or by telephone, of the Income/Franchise Tax Subcommittee meeting.

Name	State or Affiliation	Name	State or Affiliation
Michael Mason	AL	Rebecca Abbo	NM
Phil Horwitz	CO	Janielle Lipscomb	OR
Charles Wilson	DC	Andrew Glancy	WV
Ted Spangler[1]	ID	Private Sector	
Richard Cram[2]	KS	Todd Lard	COST
Michael Fatale	MA	MTC Staff or Consultants	
Stewart Binke	MI	Shirley Sicilian	Bruce Fort
Wood Miller[3]	MO	Ken Beier	Cathy Felix
Brenda Gilmer	MT	Roxanne Bland	Sheldon Laskin
Lennie Collins	NC	Elliott Dubin	Jeff Silver
Mary Loftsgard	ND		

1. Chair, Uniformity Committee
2. Chair, Sales/Use Tax Subcommittee
3. Chair, Income/Franchise Tax Subcommittee

II. Public Comment Period

There was no public comment at this time.

III. Reports and Updates

A. Report of Uniformity Projects in Progress

1. Model Amendments to Multistate Tax Compact Act Article IV and ULC UDITPA Effort

Ms. Shirley Sicilian, MTC General Counsel, updated the Subcommittee members on the progress of the project to amend UDITPA. She related that the Uniform Law Commissioner (ULC) UDITPA study committee has set a meeting for the end of March. The meeting agenda suggests the committee will address the issue that the MTC has raised:

- The definition of business/non-business income
- Distortion relief under section 18.
- Factor Weighting
- Definition of sales
- Sourcing of sales of tangible and intangible property under section 17

Furthermore, the ULC was seeking guidance on:

- Treatment of partnerships and LLC's
- Mandatory combined reporting
- Procedural issues
- "Pay to play"
- Tribunals

Ms. Sicilian noted that the National Conference of State Legislatures asked Walter Hellerstein for his views on the ULC revision of UDITPA. Professor Hellerstein replied that the states are not interested in uniformity now and thus, the project is not warranted. Ms. Sicilian further informed the subcommittee that the ULC website now has many useful documents from the development of UDITPA in the 1950's.

B. Federal Issues Affecting State Taxation

Ms. Roxanne Bland, MTC Counsel, updated the Subcommittee members on significant federal actions that could have negative impacts on state taxes.

1. H.R. 1083 Business Activity Tax Simplification Act of 2009

Ms. Bland reported that no hearings have been scheduled until the sponsors of the bill line up a majority of the members of the Subcommittee on Commercial and Administrative Law as cosponsors.

2. Mobile Workforce Tax Reform Act

Ms. Bland reported that the bill sponsors and the FTA are still working at ironing out differences

3. H.R. 1 American Recovery and Reinvestment Act of 2009 (Stimulus Bill)

Elliott Dubin, MTC Director of Policy Research, reported that the major effort of the stimulus package consists of spending and financial sector restructuring efforts. However, three tax

components may have adverse impacts on state taxes. The stimulus package extended the expensing of investment items for small businesses, extended the period of net operating losses for calendar years 2008 and 2009 to five years, and, the net income gained from restructuring debt (repurchasing debt when market price of that debt falls because of rising interest rates) would be deferred two years. Mr. Dubin explained that during the 10 year federal budget window, the net revenue from this section of the stimulus act is small; the major effect is a significant drop in reported net income in the first two years and smaller positive impacts in the following years. Thus states currently struggling could be adversely affected.

Because most states had decoupled from the IRS code during the last recession, the extension of small business expensing and extending the net operating losses would affect only those states have not yet decoupled from the IRS code.

IV. Project to Amend MTC Model Financial Institutions Apportionment Rule

A. Presentation of Working Group Policy Recommendations

Lennie Collins (NC) chairs the Working Group for this project. Mr. Collins explained to the Subcommittee that the Working Group is examining the current financial institutions apportionment rule to determine whether the rule should be revised in light of changes in the industry since its adoption in 1994. The over arching policy objective for the states is to have the sales (receipts) factor reflect the market.

The specific receipts factor recommendations include:

1. Sourcing ATM fees to the location of the ATMs
2. Merchant discount fees would be sourced to the location of the merchants, if possible. If this information is not easily obtained, the receipts would be sourced using a proxy based on the ratio of credit card interest and fees. The choice will be applied uniformly across states
3. The existing rule for the sourcing of receipts from trading and investment assets should be clarified to read that it applies only where the financial institution undertakes investment activity on its own, and not a third party's, behalf.

Two components of the receipts factor that are still under discussion are:

1. Receipts from investment and trading assets and activities on behalf of third party trust accounts.
2. Non-specified receipts and receipts that fall below a certain percentage of total receipts.

The overarching goal for defining the property factor is to clarify the rule for determining the location of the loan activity. The following considerations have guided the work group's approach to this issue and are the recommendations of the work group

1. Location of the loan – based on the location of the preponderance of substantive contacts

a. Allow the preponderance of contacts to be determined for categories of loans rather than on a loan by loan basis
b. Specify that the preponderance of contacts is based on the state with the greatest cost-of-performing the contact activity (solicitation, investigation, negotiation, approval, and administration – SINAA)
c. If the loan is made through the use of automated systems, the loan will be assigned to the location of those automated systems.

2. Clarify the definition of material change
a. Specify that the assignment to a controlled group member is not a material change that would justify reassigning the loan
b. Define controlled group based on Section 1563(a) of the U.S. Internal Revenue Code with some adjustments; e.g., substitute 50% ownership for 80% ownership

Overarching state goal is to base the rule on the activities of a financial institution rather than on financial activity, which may be engaged in by institutions in addition to financial institutions. Thus the work group recommends:

1. Retain Appendix A
2. Add investment banks if they are not already included.

B. Committee Discussion:

An issue was raised regarding loan fees: are they to be regarded as being in the nature of interest? The Subcommittee asked the work group to clarify that question in the model.

Ms. Sicilian said the next step is to arrange a teleconference for continued committee discussion and questions.

V. Project to Amend MTC Model Regulation IV. 18

A. Review of Alternative Amendments

Bruce Fort, MTC Counsel, informed the members of the Subcommittee those alternative proposals to amend Article IV.18. (See below) had been discussed at the Fall meeting in San Antonio. Of the five proposals discussed, the three alternatives below received the most positive votes at the meeting: Alternative 1: 7 votes; Alternative 2: 9 votes; Alternative 5 (now Alternative 3): 5 votes.

Article IV.18. permits a departure from the allocation and apportionment provisions of Article IV only in limited and specific cases. Article IV.18. may be invoked only in specific cases where unusual fact situations (which ordinarily will be unique and non recurring) produce incongruous results under the apportionment and allocation provisions contained in Article IV.

1. Article IV.18 permits a departure from the allocation and apportionment provisions of Article IV sections 4 through 17 where the extent of the taxpayer's business activity within the state would not be fairly represented under the allocation and apportionment provisions of those sections.

2. Article IV.18 permits a departure from the allocation and apportionment provisions of Article IV sections 4 through 17 where the extent of the taxpayer's business activity within the state would not be fairly represented under the allocation and apportionment provisions of those sections due to the nature of the taxpayer's business, operations or structure.

5. Article IV.18 permits a departure from the allocation and apportionment provisions of Article IV sections 4 though 17 only in limited and specific cases where unusual factual situations produce incongruous results under the apportionment and allocation provisions contained in those sections.

Optional Procedural Requirement:

[A Taxpayer seeking to invoke the provisions of [Section 18] must file a petition with the [Department] contemporaneously with the filing or an original or amended return, identifying the relief sought and the factual basis under which relief is sought, and must identify the differences in apportionment calculations should the relief be granted.]

B. Public Comment

There was no public comment.

C. Committee Discussion

Richard Cram (KS) noted that there was significant overlap between Alternative 2 and the current regulation. Brenda Gilmer (MT) inquired whether a "taxpayer" can get Section 18 relief if they currently use an apportionment method used for a specific industry. The sense was that relief can be granted for special industry apportionment regulations. Phil Horwitz (CO) stated that he (CO) prefers Alternative 1 to Alternative 2. However, Michael Fatale (MA) noted that the language is too restrictive. Ms. Sicilian explained that none of the alternative proposals prohibits the MTC from promulgating additional industry regulations.

CO moved to amend Alternative 3 by striking the words sections 4 through 17 and then sending the amended Alternative to the Full Uniformity Committee.

Ted Spangler (ID) asked the members not to vote yes on Alternative 3, but to choose Alternative 1 – 5 yes votes 6 no votes.

ID moved to adopt Alternative 1 with the deletion of phrase sections 4 through 17 and replace the words of these sections and replace with words Article IV. This less restrictive language also aids tax administrator to change apportionment regulations –two edged sword. The "taxpayers" also benefit from less restrictive language.

Mike Fatale (MA) stated that the term "fairly represented" is too restrictive. Courts would want more precise language. Yes votes: 4; No votes: 7.

CO moved that this project be retained for discussion – only 1 no vote.

VI. Project Regarding Income Earned by Non Corporate Income "Taxpayers" Derived from Ownership Interest in a Partnership or LLC

Sheldon Laskin, MTC Counsel, led the discussion of this project. The primary issues are: income and deduction shifting from corporate entities to entities not subject to corporate income taxes. Another issue is: should the Subcommittee deal with all instances where a non corporate "taxpayer" is part of a combined group; or, should the Subcommittee focus only on abusive transactions?

Other questions include:

- Should the non-corporate entities be subject to other forms of taxation?
- Should credit be given for gross premiums taxes paid if the non-corporate income taxpayer is an insurance company?
- Should capital contributions to an insurance company or the investment income of an insurance company be subject to a gross premiums tax?
- If a non-corporate income tax entity is included in a combined group, is that entity still non-taxable?

Michael Mason (AL) noted that the Unrelated Business Income Tax approach may trigger retaliatory gross premiums taxes in other states. Phil Horwitz (CO) opined that the project should focus only on abusive transactions – actual and potential. He also noted that all options to fix these problems have their own shortcomings.

A question was raised: How does one determine whether investment income is being used to avoid taxes or is necessary to pay current claims and provide reserves against future claims? Another question was raised: Should the working group focus only on insurance companies; or, on all non-taxable entities? Brenda Gilmer (MT) informed the members of the subcommittee that Federal tax rules define insurance companies and allow for taxation of a portion of insurance company income. She also noted that other types of entities pose similar issues –the paramount issue is what income is subject to tax?

Other comments:

- Some states combine insurance companies in the unitary group if they pay no premiums tax. There should be no retaliatory taxes in such a case.
- There are over 700 captive insurance companies in VT.
- It should be "easy" to create regulations just for captive insurance companies
- Do captive insurers re-insure with outside insurance companies? (Michael Mason AL)

MTC staff was directed to continue to work on this project and to investigate IRS treatment of insurance companies.

VII. New Business

Mr. Fort informed the members of the subcommittee that the MTC Model Addback statute did not address the issue of captive REITS in a unitary group that are sitused in a combined reporting state. He stated that the Model Addback statute is not well suited for separate entity states in which the rental payments are made to captive REITS in another state. Prior to becoming a combined reporting state, WI denied the deduction paid to a captive REIT.

CO moved that the Subcommittee direct MTC staff to proceed with this project to amend the Addback statute; and, to provide appropriate educational background. The motion carried unanimously.

VIII. Adjournment

The meeting was adjourned at 12:07 P.M. CST.