To: Wood Miller, Acting Chair
Members of MTC Income & Franchise Tax Uniformity Subcommittee

From: Shirley Sicilian, General Counsel

Date: July 15, 2010

Subject: Model Compact Art. IV.17 Amendment

I. Procedural Background

At its July, 2009 meeting, the Executive Committee directed that “revisions to Article IV of the Compact - specifically, the five areas suggested as focal points for ULC’s revision project - be referred to the Uniformity Committee and that [the Uniformity Committee] come back to the Executive Committee if the Uniformity Committee recommends the scope of issues be changed.” The five provisions are:

Primary concern -
1. Sales factor numerator sourcing for transactions other than sales of tangible personal property – Art.IV.17

Other important concerns -
2. Definition of Sales – Art.IV.1(g)
3. Definition of Business Income – Art.IV.1(a)
4. Factor Weighting – Art. IV.9
5. Distortion Relief Provision – Art.IV.18

The Subcommittee chose to work on these five provisions sequentially, beginning with revisions for sales factor sourcing, Art. IV.17. On June 22, 2010, after discussions covering two in-person meetings and five teleconferences, the Subcommittee completed its answers to an original and a follow-up list of policy questions regarding Art. IV.17.1 These question lists, showing the Subcommittee’s answers, are attachments A and B. The Subcommittee’s answers do not reflect its formal position at this point. Rather, the answers reflect its policy direction to the drafting committee, which has accordingly produced a first complete draft, attachments C(1) and C(2), for the Subcommittee’s further consideration and discussion at its July 25, 2010 in-person meeting.2 The only difference between C(1) and C(2) is that C(2) merges existing section 16 language.

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1 The in-person meetings were held December 1-2, 2009, and March 2-3, 2010. The five teleconferences were held January 22, 2010; February 3, 2010; February 17, 2010; May 13, 2010, and June 22, 2010. At its December, 2009 meeting, the subcommittee heard educational presentations from Professor Richard Pomp, Alva P. Loiselle Professor of Law, University of Connecticut School of Law; Mr. Prentiss Wilson, former Ernst & Young National Director of State and Local Tax Practice and Procedure; Professor Michael McIntyre, Professor of Law, Wayne State University Law School; and Professor Charles McClure, Herbert Hoover Business School, Stanford University.

2 The Drafting Committee included Joe Garrett, AL; Ben Miller and Melissa Potter, CA-FTB; Ted Spangler, ID; Michael Fatale, MA; Eric Smith, OR; and Staff – Bruce Fort and Shirley Sicilian.
II. Summary of Draft Proposal

- **Market Sourcing.** Art. IV.17 sources a receipt to the location of the “income-producing activity” that produced it. If that activity occurs in more than one state, then the receipt is sourced to the state with the “greater proportion of income-producing activity … based on costs of performance.” The Subcommittee found this rule tends to source to the location of production, thereby duplicating the purpose of property and payroll factors and missing the purpose of the sales factor, which is to recognize market states. The Subcommittee directed that the draft explicitly source to the market state.

- **Specified Location for Four Transaction Types.** Art. IV.17 sources receipts from all transactions other than sales of tangible personal property according to a single, “income-producing activity” rule. The Subcommittee found that the vagueness of this rule, perhaps necessitated by its enormously broad application to all but one type of transaction, makes it hard to apply, as a practical matter, to the various different categories of transactions. The Subcommittee directed that the draft more specifically define a reasonable location of “market” for each of four broad categories of transactions:
  - **Lease of tangible personal property – to the location of the property.** This rule is consistent with the current MTC model regulations, which hold that the income producing activity associated with a lease of tangible property takes place at the location of the property.
  - **Sale or lease of real property – to the location of the property.** This rule is consistent with the current MTC model regulations, which hold that the income producing activity associated with the sale or lease of real property takes place at the location of the property.
  - **Sale or lease of intangibles – to the location of use.** This rule is similar to UDITPA allocation rule for non-apportionable income from intangibles.
  - **Sale of services – to the location of delivery; and if that location cannot be determined, it shall be reasonably approximated.** This rule is similar to UDITPA sales factor sourcing for sales of tangible personal property.

- **Proportional, rather than “All or Nothing.”** Art. IV.17 sources an entire receipt to the single state with the “greater proportion of income producing activity.” The Subcommittee found the current rule can result in unnecessarily volatile and possibly arbitrary sourcing where activity, based on cost of performance, is spread nearly uniformly over several states. The Subcommittee directed that the amendment allow a single receipt to be sourced among multiple states, and the “to the extent that” language is intended to accomplish that direction.

- **Throwout.** Art. IV.16 contains a throwback rule to address the potential for “nowhere income.” But Art. IV.17 does not. The Subcommittee recognized that throwback is a difficult concept to apply in the case of services, and that the potential for “nowhere income” may be low under the current rule; which, by sourcing to the location of performance, tends to source to the location of property or payroll and thus to a state where nexus would likely exist. However, the proposed rule, like Art. IV.16, would source receipts to the market state. And although the existence of a market may generally allow for the exercise of nexus with respect to intangibles and service transactions unimpeded by P.L.86-272, the Subcommittee directed the inclusion of a throwout provision for whatever non-nexus situations may arise, and for situations where the specified sourcing rule is not determinable.
III. Next Steps

A. Substantive Review

1. Alternative Statutory Language

Of course, the Subcommittee’s goal is not to develop a receipts sourcing rule that will work perfectly for all types of taxpayers. The goal is to develop the rule that will work best for more taxpayers than any alternative rule. To that end, in December, 2009 the Subcommittee requested a set of policy criteria that could be used as a basis for comparing alternative options. Draft criteria, attachment D, were provided at the Subcommittee’s March, 2010 in-person meetings. Although the Subcommittee robustly discussed pro’s and con’s of various policy options as it answered the policy checklist (attachment A) over the course of two in-person meetings and five teleconferences, this next step allows the Subcommittee to step back and take a more systematic review of the draft that has resulted from that process.

Attachment E provides a list of industry sectors, and current gross output for each, to help the Subcommittee consider how different alternatives might measure up to the policy criteria for various segments of the economy. And attachment F provides a list of detailed questions which may be useful to the Subcommittee. These were developed by the CA-FTB to help it sort through possible regulatory guidance.

Alternatives for Sourcing Services

There are a several alternatives worthy of comparison for sourcing receipts from services. At least 14 states have already enacted an alternative to the UDITPA provision.3 Five of these – California, Michigan, Utah, Minnesota, and Texas – are MTC Compact member states. The states’ new language roughly falls into the following three categories, with Compact states indicated in bold italic:

- **Where Taxpayer’s Customer Receives a Benefit from the Service**: California, Georgia, Michigan, Ohio, Wisconsin, Utah4
- **Where Taxpayer’s Customer Receives the Service**: Maine, Minnesota5
- **Where Taxpayer Performs the Service**: Connecticut (relative time spent performing service), New Jersey, New York (relative time, value or other reasonable measure), Rhode Island (relative time spent performing service), South

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3 In addition, some states have moved to a proportional, rather than “greater of” cost of performance rule. See, e.g., Mississippi: Miss. Code Ann. § 27-7-23(c)(3); Miss. Reg. 35.III.8.06(III)(9)(c); North Carolina: N.C. Gen. Stat. §105-130.4(l)(3).


Streamlined Sales and Use Tax Sourcing is another alternative (See Attachment H).

Because the objective of each of these alternatives is to source to the market, the results should not diverge in most circumstances, but certainly could in some. Note also, the MTC has developed model special apportionment rules for financial institutions and virtually all of the large common carriage industries, including telecommunications, airlines, railroads, trucking companies, and television and radio broadcasting. Some of these industries did not originally come under the Compact’s general apportionment provisions. (See, Compact Art.IV.2, which excludes financial institutions and public utilities.) Many states that have not yet revised their general “income producing activity” or “cost of performance” rule, have nonetheless taken steps toward a more market-based approach to the extent they have adopted these special rules.

**Possible Refinements for the “Delivered” Approach**

If the Subcommittee is comfortable with sourcing service receipts to the location where the service is “delivered,” then refinements to that language could be considered. For example, the current draft allows that if the location of delivery cannot be determined, it shall be reasonably approximated. This language may not be necessary now that the “cascade” approach is no longer part of the draft (see attachment C(3) for the prior, cascade approach). Regulations may further define the presumed location of delivery for specific situations, including specific industry situations. And, existing section 18 could be relied on as the appropriate criteria for determining when a true deviation from the standard “delivered” rule may be made.

**Alternatives for Sourcing Intangibles**

There are also reasonable alternatives to the proposed rule for sourcing receipts from the sale or lease of intangibles. For example, a taxpayer is likely to know where its leased intangible is being used, but may not know that location in the case of a sale. Sales of intangibles, to the extent they represent receipts from the sale of business assets rather than inventory, could be simply excluded from the sales factor. Indeed, the Subcommittee indicated it would hold off on deciding how to source sales of intangibles until after it has dealt with amendments to the definition of “sales.”

**Alternatives for Throwout**

The choice of throwout could also be considered in light of the policy criteria. Throwback is an alternative option. And to the extent state courts have explicitly recognized the role of market activity and intangible property in creating nexus, the Subcommittee could consider a rule with neither throwout nor throwback. See also the

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COST Policy Paper on Throwback and Throwout, which was provided to the Subcommittee during the March, 2010 meetings (attachment I)

**Specific Regulatory Authority**

Most state statutes grant authority to the state department of revenue to draft regulations for all statutes that they are charged with administering. However, some statutory provisions specifically allow or require regulations, particularly where the authority goes beyond interpretational to quasi-legislative. Section 18 regulatory authority is an example. There may be other justifications. Do the provisions of section 17 require explicit regulatory authority assuming that the reasonable approximation language is retained in the statute or otherwise?

2. **Statutory versus Regulatory Language**

The Subcommittee has recognized that several terms in the draft statute need to be further defined. Attachment G is a list of those terms as recommended by the Subcommittee, the drafting committee, and the public for further definition either through additional statutory language, regulations, or other form of guidance. A representative from the Sutherland law firm provided a list of issues for the Subcommittee during its March, 2010 meetings. While some of these issues have now been addressed in the draft statute, most have been identified as appropriate to address through regulation (See “UDITPA Coalition – Draft Section 17 Statute – Issue, Attachment J.) The Subcommittee will want to review the draft statute and proposed regulation list to consider whether the line between statutory and regulatory language has been properly drawn.

**B. Procedural Options Going Forward**

The Subcommittee indicated it would like to complete recommended amendments for Art. IV.1(g) (definition of “sales”) before finalizing amendments to Art. IV.17. While working on the definition of “sales,” the Subcommittee could suggest to the Executive Committee that in the meantime it could seek more structured input at this point from taxpayer groups and academics on Art. IV.17, before referring it to the Executive Committee for public hearing.

The Subcommittee may also wish to establish work objectives and timelines for completing section 17 amendments and for reviewing each of the remaining four Compact provisions.

**IV. Attachments**

- A. Policy Question Checklist with Subcommittee’s Answers
- B. Additional Policy Questions with Subcommittee’s Answers

C. First Completed Drafts of Model Art.IV.17
   (1) Section 17 stand-alone
   (2) Section 17 merged with section 16
   (3) Prior Draft from June 22 for comparison
D. Policy Criteria for Comparing Alternative Statutory Language
E. List of Industry Segments and Gross Output for Each
F. Regulatory Examples from CA-FTB
G. List of Terms to be Further Defined by Regulation
H. Streamlines Sales & Use Tax Sourcing Rules
I. COST Policy Paper on Throwback and Throwout.
J. UDITPA Coalition MTC Draft Section 17 Statute Issues (from Sutherland)
1) Should the purpose of the sales factor be to reflect the taxpayer’s market?
   - Yes. And statute should explicitly source to the market state.

2) Do the section 17 provisions based on “income producing activity” and “cost of performance” reflect the taxpayer’s market?
   - No.

3) If section 17 does not reflect the taxpayer’s market, how should it be amended to do so?
   a) Should sections 16 and 17 be merged if the purpose of the two is the same?
      - If reasonable to draft that way. But no policy change to Section 16.
   b) How should receipts from sales of services be sourced?
      - To state of delivery, including drop-shipment delivery. If location of delivery cannot be determined, then must be reasonably approximated.
   c) How should receipts from sale or licensing of intangible property be sourced?
      - Receipts from lease or licensing -- to the “location where the intangible property is used.”
      - Receipts from sale --- reconsider after discussion on definition of gross receipts.
   d) How should receipts from lease of tangible property be sourced?
      - To the “location of the tangible property.”
   e) How should receipts from sale or lease of real property be sourced?
      - To the “location of the real property.”

4) Should the rule allow for sourcing a single receipt to multiple states?
   - Yes. Want to reflect the idea of proportionality and allow sourcing of only part of the receipt to the state.

5) Should section 17 contain a throwback (or throwout) provision, similarly to section 16?
   - Throwout
     - Should apply if state to which receipt sourced not able to tax.
     - Should apply if state to which receipt sourced not readily determinable.
Additional Policy Questions
(also integrated into master policy checklist, above)

I. “To the Extent.” Including this language could suggest receipts may be sourced among multiple states, rather than to a single state. Should the rule allow for sourcing a single receipt to multiple states?
   ➢ Yes. Want to reflect the idea of proportionality and allow sourcing of only part of the receipt to the state.

II. “Customer” and “Payor.” The use of the term “customer” suggests receipts are sourced to the location of the taxpayer’s customer, rather than “looking through” to where the ultimate customer is located if the service is resold or drop-shipped. Use of the term “payor” is more likely to allow for the alternative: receipts could be sourced to the location of the ultimate consumer.
   ➢ Source to location of delivery, including drop-shipment delivery. Remove reference to customer or payor.

III. “Sales.” Sourcing to the “location of use” seems reasonable for leasing or licensing of intangibles. But it may not work well for sales of intangibles since the taxpayer presumably would not know where the intangible is used once it is sold. Should there be a separate rule for sales of intangibles, or perhaps use of throwback (assigning to the taxpayers office as MA does) or throwout?
   ➢ Source lease or license to location of use. Leave “sale” in for now and reconsider after discussion on definition of gross receipts.

IV. Intangibles. Should the rule for intangibles include a cascade assignment approach similar to that used for services?
   ➢ No. Cascade for services rejected.

V. Throwout. Under the draft, throwout applies to receipts from transactions that would be sourced to a location where the taxpayer does not have nexus. Should application of throwout apply more broadly to receipts from transactions where the application of the rule, even taking into account the cascade alternatives if applicable, cannot be determined?
   ➢ Yes.

VI. Receipts from Sale of Business Assets. The overarching goal of the sales factor is to source receipts from sales (or leases) to the taxpayer’s market for its product and the draft is intended to reflect that market. But the definition of receipts may also include receipts from the sale of production assets used in the taxpayer’s business, Is the appropriate goal for these receipts to source to the market for the taxpayer’s product? Or would a more appropriate goal be to source these types of assets to the location of the asset or of the taxpayer’s business (e.g, if the asset is an intangible asset; perhaps throwout achieves this?)? Or, has the value of these assets already been reflected in the property factor, in which case the value (in the form of receipts) need/should not be reflected in the sales factor (market reflection) at all.
   ➢ The Subcommittee will come back to this question after determining the definition of gross receipts.
Current Compact Art. IV.16

16. Sales 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.

Current Compact Art. IV.17

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.

Draft Amended Compact Art. IV.17

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; provided, that if such location cannot be determined, it shall be reasonably approximated;
   (4) In the case of sale, lease or license of intangible property, if and to the extent the intangible property is used by the payor in this state; provided, that if the location of such use cannot be determined, it shall be reasonably approximated.

(b) If the taxpayer is not taxable in a state to which a sale is assigned, or if the state of assignment can not be determined under subsection (a), such sale shall be excluded from the denominator of the sales factor.
Current Compact Art. IV.16
16. Sales 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.

Current Compact Art. IV.17
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.

Draft Amended Compact Art. IV.17 with Art.16 provisions incorporated
17(a) Sales 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;
   (5) In the case of sale, lease or license of intangible property, if and to the extent the intangible property is used by the payor in this state; provided, that if the location of such use cannot be determined, it shall be reasonably approximated.
   (4) In the case of sale of a service, if and to the extent the service is delivered to a location in this state; provided, that if such location cannot be determined, it shall be reasonably approximated;
   (5) In the case of tangible personal property, [if and to the extent] 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 if 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.

(b) If the taxpayer is not taxable in a state to which a sale or lease is assigned pursuant to subsections (a)(1) through (a)(4), or if the state of assignment can not be determined under subsection (a), such sale shall be excluded from the denominator of the sales factor.
Model Compact Art. IV.17 Amendments
Income & Franchise Tax Uniformity Subcommittee Working Draft
June 22, 2010 – earlier version with “cascades”

Current Compact Art. IV.17
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.

Draft Amended Compact Art. IV.17

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 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
        i. the service is delivered to a location in this state;
        ii. the location to which the service is delivered cannot be determined, and
            it is reasonably approximated that the service is delivered to a location in
            this state; or
        iii. the location to which the service is delivered cannot be determined or
             reasonably approximated, and the location from which the customer
             placed the order for the service is in this state, or if such location is
             unknown, the customer’s billing address is in this state. This section
             17(a)(3)iii. shall not apply to sales of services between related parties.
    (4) In the case of sale, lease or license of intangible property, if and to the extent
        the intangible property is used by the payor in this state.

    (b) If the taxpayer is not taxable in a state to which a sale is assigned, or if the state of
        assignment can not be determined under subsection (a), such sale shall be
        excluded from the denominator of the sales factor.
Policy Criteria for Comparing Alternative Apportionment Options

February 19, 2010

1. Ease of Administration
   a. Is the information required readily available to the taxpayer? To the state?
   b. Can the elements be located geographically?
   c. Will the cost of administration be reasonable for both taxpayers and the state?

2. Transparency and Compliance
   a. Will the factors source to the location of the activity that they are intended to reflect?
   b. Is the proposal simple and workable such that taxpayers can generally comply?
   c. Does the proposal minimize the opportunity for manipulation of the apportionment result?

3. Constitutionality
   a. Nexus: Will the factors tend to source to states that reflect where the taxpayer is doing business and thus has nexus? For example, will the factor source to the location of the activity that that factor is intended to reflect? Will the definition of apportionable income reflect a rational relationship between the item of income subject to apportionment and the business activity conducted, in part, in the taxing state? See, e.g., Allied Signal v. Dir., Div. of Taxation, 504 U.S. 765 (1992).

   b. Non-Discrimination: Is the proposal non-discriminatory with respect to both interstate and purely in-state competitors?

   c. Fair Apportionment:
i. Internal Consistency - If applied by every state, will the proposal result in no more than 100% of the unitary business income being subject to tax? Does the proposal help assure that income is taxed once and only once - avoiding “nowhere income” and duplicative taxation See, e.g., Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983).

ii. External Consistency – Will the proposal reasonably reflect the manner in which income is earned? See, Container, id.

d. Fair Reflection of the Benefits: Will the measure of the tax reasonably reflect the relative extent of the taxpayer’s presence or activity in the state so that the taxpayer shoulders only its fair share of supporting the State’s provision of government services? See Commonwealth Edison v. Montana, 453 U.S. 609, 610 (1981).

4. Equity and Reasonableness.

a. Will the proposal promote horizontal equity by treating taxpayers in the same situation similarly?

b. Will the proposal promote vertical equity by distinguishing among taxpayers in a relevant way?

c. Is the proposal reasonably economically neutral? Will it minimize economic distortions that could arise from, e.g., creating incentives for taxpayers to use one type of production process over another?

d. Would transition to the proposal have an acceptable fiscal impact to the states and taxpayers?
### 2008 Gross Output in Millions by North American Industrial Classification Code

#### Industry Segment

<table>
<thead>
<tr>
<th>Industry Segment</th>
<th>Gross Output in Millions</th>
<th>% of Private</th>
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</thead>
<tbody>
<tr>
<td>Private goods-producing industries&lt;sup&gt;1&lt;/sup&gt;</td>
<td>$ 7,476,836.00</td>
<td>32%</td>
</tr>
<tr>
<td>Private services-producing industries&lt;sup&gt;2&lt;/sup&gt;</td>
<td>$ 15,990,793.00</td>
<td>68%</td>
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<tr>
<td>Private services-producing industries less wholesale and retail trade</td>
<td>$ 13,438,162.00</td>
<td>57%</td>
</tr>
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<td>Information-communications-technology-producing industries&lt;sup&gt;3&lt;/sup&gt;</td>
<td>$ 1,112,294.00</td>
<td>4.7%</td>
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</table>

1. Consists of agriculture, forestry, fishing, and hunting; mining; construction; and manufacturing.
2. Consists of utilities; wholesale trade; retail trade; transportation and warehousing; information; finance and insurance; real estate and rental and leasing; professional, scientific and technical services; management of companies and enterprises; administrative and waste management services; educational services; health care and social assistance; arts, entertainment, and recreation; accommodation and food services; and other services, except government.
3. Consists of computer and electronic products; publishing industries (includes software); information and data processing services; and computer systems design and related services.

<table>
<thead>
<tr>
<th>Industry</th>
<th>2008 Gross Output in Millions</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>All industries</td>
<td>$ 26,574,365.00</td>
<td>88%</td>
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<tr>
<td>Private industries</td>
<td>$ 23,467,629.00</td>
<td>88%</td>
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<tr>
<td><strong>Agriculture, forestry, fishing, and hunting</strong></td>
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<td></td>
</tr>
<tr>
<td>Farms</td>
<td>$ 335,264.00</td>
<td>1%</td>
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<tr>
<td>Forestry, fishing, and related activities</td>
<td>$ 46,806.00</td>
<td>0%</td>
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<tr>
<td><strong>Mining</strong></td>
<td>$ 590,296.00</td>
<td>2%</td>
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<tr>
<td>Oil and gas extraction</td>
<td>$ 323,368.00</td>
<td>1%</td>
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<tr>
<td>Mining, except oil and gas</td>
<td>$ 95,435.00</td>
<td>0%</td>
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<tr>
<td>Support activities for mining</td>
<td>$ 171,493.00</td>
<td>1%</td>
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<tr>
<td><strong>Utilities</strong></td>
<td>$ 441,976.00</td>
<td>2%</td>
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<tr>
<td><strong>Construction</strong></td>
<td>$ 1,278,105.00</td>
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<tr>
<td><strong>Manufacturing</strong></td>
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<td>Durable goods</td>
<td>$ 2,550,429.00</td>
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<td>Wood products</td>
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<td>Nonmetallic mineral products</td>
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<td>Primary metals</td>
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<td>Fabricated metal products</td>
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<td>Machinery</td>
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<td>Computer and electronic products</td>
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<td>Electrical equipment, appliances, and components</td>
<td>$ 117,788.00</td>
<td>0%</td>
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<tr>
<td>Motor vehicles, bodies and trailers, and parts</td>
<td>$ 399,880.00</td>
<td>2%</td>
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<tr>
<td>Other transportation equipment</td>
<td>$ 272,068.00</td>
<td>1%</td>
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<tr>
<td>Furniture and related products</td>
<td>$ 75,120.00</td>
<td>0%</td>
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<tr>
<td>Miscellaneous manufacturing</td>
<td>$ 152,443.00</td>
<td>1%</td>
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<tr>
<td>Nondurable goods</td>
<td>$ 2,675,936.00</td>
<td>10%</td>
</tr>
<tr>
<td>Industry</td>
<td>Amount</td>
<td>Percentage</td>
</tr>
<tr>
<td>---------------------------------------------</td>
<td>-------------</td>
<td>------------</td>
</tr>
<tr>
<td>Food and beverage and tobacco products</td>
<td>$746,544.00</td>
<td>3%</td>
</tr>
<tr>
<td>Textile mills and textile product mills</td>
<td>$57,786.00</td>
<td>0%</td>
</tr>
<tr>
<td>Apparel and leather and allied products</td>
<td>$34,241.00</td>
<td>0%</td>
</tr>
<tr>
<td>Paper products</td>
<td>$167,145.00</td>
<td>1%</td>
</tr>
<tr>
<td>Printing and related support activities</td>
<td>$101,267.00</td>
<td>0%</td>
</tr>
<tr>
<td>Petroleum and coal products</td>
<td>$726,002.00</td>
<td>3%</td>
</tr>
<tr>
<td>Chemical products</td>
<td>$638,371.00</td>
<td>2%</td>
</tr>
<tr>
<td>Plastics and rubber products</td>
<td>$204,581.00</td>
<td>1%</td>
</tr>
<tr>
<td>Wholesale trade</td>
<td>$1,267,189.00</td>
<td>5%</td>
</tr>
<tr>
<td>Retail trade</td>
<td>$1,285,442.00</td>
<td>5%</td>
</tr>
<tr>
<td>Transportation and warehousing</td>
<td>$842,254.00</td>
<td>3%</td>
</tr>
<tr>
<td>Air transportation</td>
<td>$159,817.00</td>
<td>1%</td>
</tr>
<tr>
<td>Rail transportation</td>
<td>$78,562.00</td>
<td>0%</td>
</tr>
<tr>
<td>Water transportation</td>
<td>$38,173.00</td>
<td>0%</td>
</tr>
<tr>
<td>Truck transportation</td>
<td>$290,144.00</td>
<td>1%</td>
</tr>
<tr>
<td>Transit and ground passenger transportation</td>
<td>$33,833.00</td>
<td>0%</td>
</tr>
<tr>
<td>Pipeline transportation</td>
<td>$28,002.00</td>
<td>0%</td>
</tr>
<tr>
<td>Other transportation and support activities</td>
<td>$155,156.00</td>
<td>1%</td>
</tr>
<tr>
<td>Warehousing and storage</td>
<td>$58,569.00</td>
<td>0%</td>
</tr>
<tr>
<td>Information</td>
<td>$1,224,009.00</td>
<td>5%</td>
</tr>
<tr>
<td>Publishing industries (includes software)</td>
<td>$338,204.00</td>
<td>1%</td>
</tr>
<tr>
<td>Motion picture and sound recording industries</td>
<td>$102,052.00</td>
<td>0%</td>
</tr>
<tr>
<td>Broadcasting and telecommunications</td>
<td>$644,134.00</td>
<td>2%</td>
</tr>
<tr>
<td>Information and data processing services</td>
<td>$139,619.00</td>
<td>1%</td>
</tr>
<tr>
<td>Finance, insurance, real estate, rental, and leasing</td>
<td>$4,845,786.00</td>
<td>18%</td>
</tr>
<tr>
<td>Finance and insurance</td>
<td>$2,169,260.00</td>
<td>8%</td>
</tr>
<tr>
<td>Federal Reserve banks, credit intermediation, and related activities</td>
<td>$980,177.00</td>
<td>4%</td>
</tr>
<tr>
<td>Securities, commodity contracts, and investments</td>
<td>$371,130.00</td>
<td>1%</td>
</tr>
<tr>
<td>Insurance carriers and related activities</td>
<td>$697,045.00</td>
<td>3%</td>
</tr>
<tr>
<td>Funds, trusts, and other financial vehicles</td>
<td>$120,908.00</td>
<td>0%</td>
</tr>
<tr>
<td>Real estate and rental and leasing</td>
<td>$2,676,525.00</td>
<td>10%</td>
</tr>
<tr>
<td>Real estate</td>
<td>$2,373,837.00</td>
<td>9%</td>
</tr>
<tr>
<td>Rental and leasing services and lessors of intangible assets</td>
<td>$302,689.00</td>
<td>1%</td>
</tr>
<tr>
<td>Professional and business services</td>
<td>$2,655,641.00</td>
<td>10%</td>
</tr>
<tr>
<td>Professional, scientific, and technical services</td>
<td>$1,588,231.00</td>
<td>6%</td>
</tr>
<tr>
<td>Legal services</td>
<td>$286,922.00</td>
<td>1%</td>
</tr>
<tr>
<td>Computer systems design and related services</td>
<td>$241,865.00</td>
<td>1%</td>
</tr>
<tr>
<td>Miscellaneous professional, scientific, and technical services</td>
<td>$1,059,444.00</td>
<td>4%</td>
</tr>
<tr>
<td>Management of companies and enterprises</td>
<td>$401,037.00</td>
<td>2%</td>
</tr>
<tr>
<td>Administrative and waste management services</td>
<td>$666,372.00</td>
<td>3%</td>
</tr>
<tr>
<td>Administrative and support services</td>
<td>$587,711.00</td>
<td>2%</td>
</tr>
<tr>
<td>Waste management and remediation services</td>
<td>$78,661.00</td>
<td>0%</td>
</tr>
<tr>
<td>Educational services, health care, and social assistance</td>
<td>$1,868,687.00</td>
<td>7%</td>
</tr>
<tr>
<td>Educational services</td>
<td>$224,909.00</td>
<td>1%</td>
</tr>
<tr>
<td>Health care and social assistance</td>
<td>$1,643,779.00</td>
<td>6%</td>
</tr>
<tr>
<td>Ambulatory health care services</td>
<td>$767,548.00</td>
<td>3%</td>
</tr>
<tr>
<td>Hospitals and nursing and residential care facilities</td>
<td>$741,287.00</td>
<td>3%</td>
</tr>
<tr>
<td>Service Type</td>
<td>Value</td>
<td>Percentage</td>
</tr>
<tr>
<td>----------------------------------------------------------------------------</td>
<td>-----------</td>
<td>------------</td>
</tr>
<tr>
<td>Social assistance</td>
<td>$134,943.00</td>
<td>1%</td>
</tr>
<tr>
<td><strong>Arts, entertainment, recreation, accommodation, and food services</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Arts, entertainment, and recreation</td>
<td>$220,675.00</td>
<td>1%</td>
</tr>
<tr>
<td>Performing arts, spectator sports, museums, and related activities</td>
<td>$124,028.00</td>
<td>0%</td>
</tr>
<tr>
<td>Amusements, gambling, and recreation industries</td>
<td>$96,648.00</td>
<td>0%</td>
</tr>
<tr>
<td>Accommodation and food services</td>
<td>$750,330.00</td>
<td>3%</td>
</tr>
<tr>
<td>Accommodation</td>
<td>$217,644.00</td>
<td>1%</td>
</tr>
<tr>
<td>Food services and drinking places</td>
<td>$532,686.00</td>
<td>2%</td>
</tr>
<tr>
<td><strong>Other services, except government</strong></td>
<td>$588,805.00</td>
<td>2%</td>
</tr>
<tr>
<td>Government</td>
<td>$3,106,736.00</td>
<td>12%</td>
</tr>
<tr>
<td>Federal</td>
<td>$1,043,875.00</td>
<td>4%</td>
</tr>
<tr>
<td>General government</td>
<td>$947,735.00</td>
<td>4%</td>
</tr>
<tr>
<td>Government enterprises</td>
<td>$96,140.00</td>
<td>0%</td>
</tr>
<tr>
<td>State and local</td>
<td>$2,062,861.00</td>
<td>8%</td>
</tr>
<tr>
<td>General government</td>
<td>$1,824,748.00</td>
<td>7%</td>
</tr>
<tr>
<td>Government enterprises</td>
<td>$238,113.00</td>
<td>1%</td>
</tr>
</tbody>
</table>

Source: Bureau of Economic Analysis –
CALIFORNIA FTB - Examples for Sales of Other Than Sales of Tangible Personal Property
July 7, 2010

1. Web Corp provides internet content to its subscribers and receives revenue from providing advertising services to other businesses. The advertisements are shown via the website to Web Corp subscribers and the fee collected is determined by reference to the number of times the advertisement is viewed and/or clicked on by viewers of the website.

2. Cell Phone Corp has multiple individuals who are customers throughout the U.S. In this state, Cell Phone Corp customers make and receive calls and have a billing address in this state.

3. Law Corp located in State C has a corporate client that is headquartered in State A and has manufacturing plants in this state and State B. Law Corp handles a major litigation matter for the client concerning a manufacturing plant owned by its client in this state. Lawyers from Law Corp travel to this state for depositions and the lengthy trial is also conducted in this state.

4. Small Corp, a corporation located in this state, provides limited bookkeeping services to clients both within and outside the state of California. Some clients have several operations among various states. For the past ten (10) years, Small Corp's only records for the sales of these services have consisted of invoices with the billing address for the client.

5. R&D Corp and Manu Co enter into a licensing contract whereby Manu Co as licensee is permitted to use technology that is owned by R&D Corp in connection with Manu Co's manufacture and sale of products for sale in a specified geographic region. Under the contract, Manu Co is required to pay R&D Corp a licensing fee that is a fixed percentage of the total volume of monthly sales made by Manu Co of products manufactured using the R&D Corp technology. Manu Co sells the products throughout the United States. The contract between the two companies does not break down the sales per state but does provide that R&D Corp can ask for a sales breakdown from Manu Co.

6. Accounting Corp is hired by and gives tax advice to Car Corp. Car Corp does business throughout the United States. Accounting Corp gives tax advice to Car Corp for all states where Car Corp does business. For purposes of this statute, the sales of Accounting Corp's services will be assigned to this state based on the service provided to Car Corp in this state as determined under the terms of the contract between Accounting Corp and Car Corp. If the terms of the contract do not break down the fees by state or otherwise determine the value of the services received in this state, then Accounting Corp's gross receipts can be reasonably approximated by using available public information indicating the market of Car Corp in this state.

7. Software Tech Support Corp located in this state provides technical support services to its customers, who are located throughout the United States, through a call center in this state. The typical customer telephones the call center to resolve an issue with software that they are using on their desktop. Software Tech Support Corp records information on the location for each customer that contacts it by phone. Software Tech Support Corp's records maintained in the regular course of business indicate that seven (7) percent of the calls handled by the call center originate from this state.

8. Payroll Services Corp contracts with Customer to provide all payroll services. Customer is headquartered in this state and has employees in a number of other states. The contract between the taxpayer and the Customer does not specify where the service will be used by the Customer. Customer's payroll department in this state accesses the website of Payroll Services Corp to distribute payroll to all of its locations.
General Issues

1. “If and to the Extent” – define method for apportioning receipt. May need to provide general rule (e.g., cost of service, price of service, or some other) and special rules (e.g., mileage for transport industries, circulation for publications, viewership for broadcasting, percent of time for situations so addressed under current regulations, etc.)

2. Define “delivery.”

3. Define “location.” E.g., for purposes of delivery to an email address, the office from which the services are ordered, mobile tangible property, etc.

4. Examples of “reasonable approximation.” Consider whether the location where the benefit is received may be a “reasonable approximation” of “location to which the service is delivered.”

5. Distinguish services, intangibles, and tangibles.

Services

6. Dock Sales

Intangibles

7. Define “use” and specify where “use” is presumed to occur if not readily apparent. E.g., could include cascading presumptions from “commercial domicile of customer,” to “billing address,” etc.

Lease of Tangible Property

8. Regulations should address mobile property, in transit, etc.
Compiler’s note: On June 23, 2007 the date in subsection B 4 was changed from “December 31, 2007” to December 31, 2009."

Compiler’s note: On September 5, 2008 Section 309 (B)(4) was amended to delete “Until December 31, 2009,” at the beginning of the first sentence and to replace “Prior to this date, these items” at the start of the second sentence with “Such sales.” The amendment became effect upon its adoption.

Section 310: GENERAL SOURCING RULES

A. Except as provided in Section 310.1, the retail sale, excluding lease or rental, of a product shall be sourced as follows:

1. When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location.

2. When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser (or the purchaser's donee, designated as such by the purchaser) occurs, including the location indicated by instructions for delivery to the purchaser (or donee), known to the seller.

3. When subsections (A)(1) and (A)(2) do not apply, the sale is sourced to the location indicated by an address for the purchaser that is available from the business records of the seller that are maintained in the ordinary course of the seller's business when use of this address does not constitute bad faith.

4. When subsections (A)(1), (A)(2), and (A)(3) do not apply, the sale is sourced to the location indicated by an address for the purchaser obtained during the consummation of the sale, including the address of a purchaser's payment instrument, if no other address is available, when use of this address does not constitute bad faith.

5. When none of the previous rules of subsections (A)(1), (A)(2), (A)(3), or (A)(4) apply, including the circumstance in which the seller is without sufficient information to apply the previous rules, then the location will be determined by the address from which tangible personal property was shipped, from which the digital good or the computer software delivered electronically was first available for
transmission by the seller, or from which the service was provided (disregarding for these purposes any location that merely provided the digital transfer of the product sold).

B. The lease or rental of tangible personal property, other than property identified in subsection (C) or subsection (D), shall be sourced as follows:

1. For a lease or rental that requires recurring periodic payments, the first periodic payment is sourced the same as a retail sale in accordance with the provisions of subsection (A). Periodic payments made subsequent to the first payment are sourced to the primary property location for each period covered by the payment. The primary property location shall be as indicated by an address for the property provided by the lessee that is available to the lessor from its records maintained in the ordinary course of business, when use of this address does not constitute bad faith. The property location shall not be altered by intermittent use at different locations, such as use of business property that accompanies employees on business trips and service calls.

2. For a lease or rental that does not require recurring periodic payments, the payment is sourced the same as a retail sale in accordance with the provisions of subsection (A).

3. This subsection does not affect the imposition or computation of sales or use tax on leases or rentals based on a lump sum or accelerated basis, or on the acquisition of property for lease.

C. The lease or rental of motor vehicles, trailers, semi-trailers, or aircraft that do not qualify as transportation equipment, as defined in subsection (D), shall be sourced as follows:

1. For a lease or rental that requires recurring periodic payments, each periodic payment is sourced to the primary property location. The primary property location shall be as indicated by an address for the property provided by the lessee that is available to the lessor from its records maintained in the ordinary course of
business, when use of this address does not constitute bad faith. This location shall
not be altered by intermittent use at different locations.

2. For a lease or rental that does not require recurring periodic payments, the payment
is sourced the same as a retail sale in accordance with the provisions of subsection (A).

3. This subsection does not affect the imposition or computation of sales or use tax on
leases or rentals based on a lump sum or accelerated basis, or on the acquisition of
property for lease.

D. The retail sale, including lease or rental, of transportation equipment shall be sourced
the same as a retail sale in accordance with the provisions of subsection (A),
notwithstanding the exclusion of lease or rental in subsection (A). “Transportation
equipment” means any of the following:

1. Locomotives and railcars that are utilized for the carriage of persons or property in
   interstate commerce.

2. Trucks and truck-tractors with a Gross Vehicle Weight Rating (GVWR) of 10,001
   pounds or greater, trailers, semi-trailers, or passenger buses that are:
   a. Registered through the International Registration Plan; and
   b. Operated under authority of a carrier authorized and certificated by
      the U.S. Department of Transportation or another federal authority to
      engage in the carriage of persons or property in interstate commerce.

3. Aircraft that are operated by air carriers authorized and certificated by the U.S.
   Department of Transportation or another federal or a foreign authority to
   engage in the carriage of persons or property in interstate or foreign commerce.

4. Containers designed for use on and component parts attached or secured on the
   items set forth in subsections (D)(1) through (D)(3).

Compiler’s note: The Governing Board issued an interpretation of Section 310C on April 18, 2006. That
interpretation can be found in the Library of Interpretations.

Compiler’s note: The Governing Board issued an interpretation of the definition of Section 310A on September 20,
2007. That interpretation can be found in the Library of Interpretations.
Throwback/Throwout

Policy Position

**Position:** Throwback and throwout laws seek to require companies to pay tax in one state on income that another state has chosen not to tax or is legally unable to tax. A company’s tax liability in one state should not be measured by its tax in another state. Throwback and throwout rules also discourage investment in a state. Such rules must not be adopted and must be repealed where they presently exist.

**Explanation:** Although throwback and throwout laws are different in their mechanical operation, the motivation for them and their flaws are similar. Generally speaking, throwback and throwout laws require a company, when calculating its tax in a state, to add income earned in another state if that other state chooses not to tax that income or is prohibited from taxing that income by the U.S. Constitution or by federal law.

A recent paper\(^1\) by three leading state tax economists addressed the case for and against these laws. They cite two frequent claims made in favor of such policies but note that “the validity of each is questionable.” The first claim proponents make is that throwback and throwout laws discourage tax planning. The authors conclude, however, that such laws fail to accomplish this goal and are in fact potentially damaging to the state’s economic climate “because firms are discouraged from locating in throwback states.” It should also be noted that “tax planning” is not only legal but the only responsible course of action for tax professionals. Failing to plan for the tax consequences of business activity is a breach of a tax professional’s fiduciary responsibility to employees, consumers and shareholders, all of whom would ultimately bear the burden if the business paid more in tax than was legally due.

The second claim proponents of throwback and throwout laws make is that such laws ensure that all corporate income is taxable in some state. The authors of the recent paper note that again these laws do not accomplish this goal and argue that there is “little practical reason why any state’s tax policy should be based on ensuring that out of state activity is properly included in some state’s tax base”. A corporation’s correct measure tax in a state is determinable without reference to the tax a corporation pays in other states. Throwback and throwout laws tax income that is, by definition, earned outside of the state, and such laws tax that income at the wrong rate and direct the resulting revenue to the wrong state.

In 2002, New Jersey became the first state in many years to adopt a throwback or throwout law. The New Jersey law also created a study commission to review the new provisions and evaluate them based on several principles of sound tax policy. The commission’s final report recommended repealing the law, saying that it “…does not more fairly measure a corporation’s business activities in a state.” The commission further concluded that the law “…is inconsistent with the basic premise of fair apportionment which requires each factor of the apportionment formula to reflect how the income of a corporation is earned.”\(^2\)

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I. Definitional Issues – Sourcing of Services
   A. What does “delivered to” mean?
      • Concept of physical delivery
      • Concept of contractual delivery
   B. Who is the “customer”?
      • Taxpayer’s customer
      • Ultimate customer
   C. What is the “location”?
      • State of incorporation
      • Principal place of business
      • Commercial domicile
      • Headquarters
      • Permanent establishment
   D. Example – Who is the customer and where are fulfillment services delivered.

II. Definitional Issues – Sourcing of Intangibles
   A. How is “use” defined?
   B. Will the MTC look to federal rules and regulations for the sourcing of intangibles (I.R.C. § 861 and accompanying regulations)?

III. Definitional Issues – Intangibles vs. Services
   A. How are “services” defined?
   B. How are “intangibles” defined?
   C. Will the MTC look to federal rules (I.R.C. § 861 and accompanying regulations)?

IV. Cascading Approach
   A. Customer office from which order was placed
      • Multistate Issues – Services or intangibles delivered to/used in multiple states
   B. Customer’s billing address

V. Guiding Principles
   A. Is “delivered to” or “use” an all-or-nothing rule?
   B. To what extent will the MTC look to sales tax rules (especially the SSUTA) in establishing sourcing rules.
   C. To what extent will the MTC look to federal rules (I.R.C.) and international rules (OECD) establishing sourcing rules?
   D. What is the role of administrability?