MULTISTATE TAX COMMISSION
*Maximizing the synergies of multi-state tax cooperation*

**To: MTC Uniformity Committee Income and Franchise Tax Subcommittee**

**From: Lennie Collins, Chair, MTC Financial Institutions Work Group**

**Date: July 12, 2013**

**Subject: Status Report re Financial Institutions Work Group**

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The purpose of this memo is to supplement the staff memo to this subcommittee dated February 22, 2013, a copy of which is attached hereto.

Summary of the Project to Date

As further stated in the February 22, 2013 memo, the work group has focused on three aspects of the current rule for apportioning the income of financial institutions: (1) the definition of a financial institution, (2) the sourcing of financial institution specific receipts, and (3) the sourcing of financial institution loans in the property factor. The work group completed its work regarding definitions and the receipts factor in 2011 and has since focused on the property factor.

Current Status of the Work Group's Work on the Property Factor

At the March 2013 meeting, the Subcommittee provided the work group with the following policy questions to address regarding the property factor.

> Does SINAA reflect the policies behind the property factor? If not, should loans be retained in the property factor? If they should not be retained, should the property factor be included at all? If it is to be included, should there be alternative weighting for each of the factors?

The work group has decided to recommend that the property factor be retained. As further stated in the February 22, 2013 memo, there is a difference of opinion between the state and industry members of the work group regarding the treatment of the property factor for financial institutions. Industry believes the policy behind the property factor is achieved when intangible loan property is sourced to the location of the loan activity. Further, the industry members believe the goal of sourcing intangible loan property to the location of loan activity can be achieved by modifying the SINAA factors so as to eliminate solicitation as a factor in locating loans in the property factor while clarifying the remaining four factors (INAA) to reduce the time the states have indicated that it currently is taking them to audit the sourcing of loans. The work group considered other alternatives to SINAA in the event that loans were to be retained in the property factor. One possible alternative was the development of a "bifurcated" property factor, which would separately apportion tangible and intangible property. Elliott Dubin presented a brief description of this model as well as a mathematical formula to approximate the geographic location of loan pools that does not source the loan pools to a single state as current cost of performance rules do. The state members remain concerned that SINAA or a SINAA like approach is not capable of providing an auditable basis upon which to source the loans. During the work group teleconference on July 8, 2013, the state members decided to recommend to this committee at this time that intangibles be eliminated from the property factor, which would then include tangible property only. The industry members are not prepared to join this recommendation at this time.

Should the Commission propose a model statute that would eliminate loans from the property factor, industry has indicated that to mitigate the whipsaw effect on industry by staggered state adoption or by only a few states adopting the revision, effective date language should be added to delay adoption for a couple of years or until a certain number of states have adopted the revision.,

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**To: MTC Uniformity Committee Income and Franchise Tax Subcommittee**

**From: Sheldon H. Laskin, Counsel**

**Date: February 22, 2013**

**Subject: Status Report re Financial Institutions Work Group [ON MARCH 22, 2013, THIS MEMO WAS REVISED IN RESPONSE TO SUGGESTIONS MADE BY KAREN BOUCHER OF DELOITTE AND IS INTENDED TO BE A SUBSTITUTE FOR THE ORIGINAL MEMO OF FEBRUARY 22, 2013. THE REVISIONS ARE INDICATED IN RED.]**

The purpose of this memo is to inform the subcommittee of the current status of the work of the Financial Institutions work group.

Financial institutions are excluded from UDITPA, and thus from Article IV. The Commission began a project to develop a uniform model financial institutions apportionment rule in 1970, just three years after the Commission was created, but that project floundered and was eventually abandoned. The Commission then took up the challenge again in the mid-1980's. The project proceeded very slowly due to the complexity of the issues and serious conceptual disagreements between the state and industry representatives. But, nearly 10 years later, after creating an elaborate system of industry/state workgroups which met regularly in person as well as by telephone, the current rule was adopted in 1994.

This project began in 2007. The work group was charged with reexamining the Commission's 1994 model statute for the apportionment of income realized by financial institutions in light of the dramatic changes in the nature of that industry since then, and recommending amendments to the subcommittee. These changes were caused both by the deregulation of the industry as a result of the repeal of Glass-Steagall, and by technological innovations that allow financial institutions to provide a full range of services, such as mortgage loan and credit card application processing, credit approval and account servicing, entirely online.

The work group consists of representatives of MTC member states and of the financial industry ~~(Financial Institutions State Tax Coalition or "FIST")~~. The work group has met regularly by teleconference. Broadly speaking, the work group has worked to update three aspects of the current rule: (1) the definition of a financial institution, (2) the sourcing of financial institutions specific receipts, and (3) the sourcing of financial institutions loans in the property factor. After briefly identifying several issues regarding the application of the property factor to financial institutions,[1] the work group turned its attention to definitional issues and refining the receipts factor. That definitions and receipts factor work was completed in 2011.

The work group then returned to the property factor issues. The attached revised draft Financial Institutions Apportionment Property Factor Issues check list more completely summarizes the status of the work group's property factor progress to date. As stated in the draft check list, the work group reached agreement in ~~2011~~ mid- 2012 on proposed language to clarify the meaning of "change of material fact" as used in §4(i) of the current model. Those clarifications include explicitly describing: how sales of loans within the same controlled group should be treated, the treatment of the acquisition of the stock of an entity that owns the loans, and the treatment of the acquisition of a loan or pool of loans from an entity that is not within the same controlled group of corporations. Furthermore, the work group has agreed to language defining a controlled group of corporations.

~~Since 2011, the~~The work group has continued to ~~struggle with~~work on the application and scope of the property factor as applied to financial institutions. More specifically, the recent issues associated with the property factor are (1) should the apportionment formula for financial institutions continue to include a property factor, (2) if so, should loans continue to be included in the property

[1] These issues largely revolved around whether reliance on the SINAA (sourcing, investigation, negotiation, approval and administration) factors for sourcing loans in the property factor is administrable and if not, how they should be modified or replaced.

factor in light of current electronic banking practices, (3) if so, how (and if there is no good way to do so, should we reconsider including loans, or a property factor at all)? [2]

In May 2009, the work group articulated the state member goals regarding the property factor. As stated in a staff memo of May 22, 2009 to the work group, the state members "intent is not to recreate the 1994 apportionment outcome of sourcing property to particular states. Rather, the intent is to attempt to maintain the 1994 policy of sourcing property to location of loan activity." ~~FIST~~ Participating industry members take~~s~~ the position that this goal can best be achieved by modifying the SINAA factors so as to eliminate sourcing as a factor in locating loans in the property factor and retaining the remaining four factors (INAA). Recently, the state members have raised concerns similar to those associated with sourcing any intangible property, and have contemplated that it may not be possible to properly reflect loans in the financial institution's property factor. The state members therefore may want to reconsider whether the property factor should be eliminated entirely or alternatively, consider eliminating loans from the property factor. ~~FIST~~ Participating industry members are ~~is~~ of the view that the property factor should be retained and that the need for including loans in the property factor for financial institutions is supported by case law *Crocker Equipment Leasing, Inc. v. Department of Reve*nue, 838 P.2d 552 (OR 1992).

[2] Loan receipts are of course included in the receipts factor in the current model statute.