



Sourcing Income of Electrical Industry

To: Robynn Wilson, Income and Uniformity Committee Chair

From: Bruce Fort, Counsel, and Ken Beier, Training Director, Multistate Tax Commission

Date: July 17, 2014

Re: Summary of State Responses to Survey Regarding State Practices for Apportioning Income of Electrical Industry Participants

The Income and Franchise Tax Subcommittee continues to consider whether to initiate a uniformity project to develop a model regulation for apportioning the income of electricity suppliers, including utilities, producers, traders and transmission companies.¹ In support of that evaluation, staff sent out a survey to members of the uniformity committee in late June seeking responses from their states to a series of questions addressed to current practices and procedures. Eight states responded to the survey. A copy of the survey is attached. The state responses will be maintained in the MTC's project files.

The first questions asked whether the states imposed income-based taxes on regulated and unregulated utilities, including electrical wholesalers, and asked the states to describe their general apportionment systems, including variations from the standard UDITPA formula. The responding states all imposed income-based taxes on both regulated and unregulated utilities.

The third question asked states to identify their written guidance regarding the apportionment of electrical industry profits and nexus rules. States responded that generally they had no written guidance on those topics.

The fourth question addressed to the states was whether electricity was treated as tangible personal property for income and sales/use taxes. Most states had written guidance defining electricity as a tangible for sales/use purposes but little or no guidance as to whether electricity should be considered a tangible for income tax purposes.

¹ There has also been some discussion of undertaking a similar project for natural gas suppliers and pipeline transportation companies (see below).

The fifth question was addressed to state compliance efforts. Most states reported they either did not have sufficient information to respond to the inquiry or had not encountered significant compliance issues with respect to regulated utilities. The states lacked information or did not respond regarding non-regulated utilities.

The sixth question asked states whether they would impose income and sales/use tax nexus on an out of state electrical provider whose only contact with the state was the sale of electricity in the state, where that electricity might be used in the state or transported elsewhere. The states were not in agreement with nexus standards in those situations.

The seventh question asked whether this project would be useful to state states or whether the Uniformity Committee should concentrate its efforts elsewhere. Four states responded positively, one state gave an ambiguous answer and three states felt the Committee should concentrate on other objectives.

The last question asked states whether a similar model regulation project should be developed for the natural gas industry, e.g. pipelines. The states generally responded positively to this suggestion; one state was neutral but said it would not oppose such a project.

We want to thank those states that took the time to respond to the survey. We hope the survey will help focus our discussions of whether to undertake this project.



Survey of State Practices for Sourcing Income of Electrical Industry

To: Robynn Wilson, Income and Uniformity Committee Chair
Uniformity Committee Members

From: Bruce Fort, Counsel, and Ken Beier, Training Director, Multistate Tax Commission

Date: June 25, 2014

Re: Survey of State Practices and Experiences in Taxing Income of Electrical Industry

Dear Uniformity Committee Members:

As you may be aware, the Income and Franchise Tax Subcommittee continues to consider whether to initiate a uniformity project to develop a model regulation for apportioning the income of electricity suppliers, including utilities, producers, traders and transmission companies.¹ In support of that evaluation, we are sending out this survey to our membership to solicit information on your state's experiences and current practices. We hope you can take some time to complete this survey and return it to us by **July 11, 2014**.

Please note that we will treat your responses to Question 5 regarding audit experiences as confidential as allowed under Section One of the MTC's Public Participation Policy, <http://www.mtc.gov/About.aspx?id=108>, and applicable state laws since they could be used to identify information regarding particular taxpayers. Your answers to other questions about current state laws and policies may not be protected from disclosure under our Public Participation Policy. MTC staff will prepare a compilation of state responses.

By way of background for this survey, CCH's *State Tax Guide* suggests that a majority of states treat electricity as a tangible product for purposes of sourcing income from its sale, with a smaller number of states treating electricity as a service and a few states treating electricity as "intangible" property. Some court decisions in recent years have suggested that the sale of electricity should be treated as the sale of a service. See *Appeal of PacifiCorp*, 2002-SBE-005, 9/12/2002; *EUA Ocean State Corp., et al. v. Commissioner of Revenue*, Dkt. No. C258405-406

¹ There has also been some discussion of undertaking a similar project for natural gas suppliers and pipeline transportation companies (see survey question 8, below).

(04/24/2006). Other courts have reached the opposite conclusion, holding that electricity is a tangible. See *Exelon Corporation v. Dept. of Revenue*, 234 Ill. 2d 266, 917 N.E. 2d 899 (2009).

Currently, only two states, Massachusetts and Oregon, have comprehensive rules for sourcing income from sales of electricity; at least one other state is considering adoption of a special apportionment rule for electrical generation and transmission providers.

We hope your answers to this survey will assist our committee in determining whether to undertake this project, and if so, the scope of any proposed model regulation.

Please feel free to contact us if you have any questions about the survey or the project generally. Survey answers should be directed to Ken Beier, address noted below.

Sincerely,

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Ken Beier
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954-372-0381

- c. Confidential Revenue Rulings or Filing Agreements (please protect confidentiality):

- 4. Does your state have any written guidance addressed to the nature of electricity as (a) tangible personal property; (b) a service; or (c) intangible property or “other” for purposes of business activity taxes, sales and use taxes, and credits and exemptions for manufacturers or other industries? If so, please describe the substance and nature of that guidance :

- a. Business Activity Taxes: _____
_____;

- b. Sales and Use Taxes: _____
_____;

- c. Exemptions, Deductions and Credits Applicable to Industry: _____

- 5. Does your state have experience in auditing: (a) regulated, or (b), unregulated utilities operating within your state for business activity tax liability? If so, please describe the nature and results of your audit experience, e.g., determining whether income was properly sourced; inconsistent reporting positions; non-filing or nexus issues; throw-back of sales; and no-change audits (i.e., substantial compliance determinations):

- 6. To the extent not answered previously, would your state impose: (a) business activity taxes or (b) excise, sales or use taxes, on an out-of-state entity whose only contact with the state was the in-state sale of electricity:

i. to a wholesaler or end customer where the electricity was destined for ultimate use outside of the state;

ii. to a wholesaler or end customer where the electricity was intended for use within the state?

7. Based on the current state of your written guidance to taxpayers and audit and compliance experiences generally, would you support the development of a model regulation establishing sourcing and nexus standards for sales of electricity for business activities taxes, or do you think the uniformity committee should focus its efforts elsewhere? Please elaborate if you can.

8. Would your state be interested in a similar model regulation project addressing taxation of interstate sales of natural gas, including regulated and unregulated utilities as described in question 1, above?

9. Additional Comments, Questions and Concerns:

10. Please provide your contact information for further follow-up. And Thank You!
