



MULTISTATE TAX COMMISSION

**Multistate Tax Commission
Minutes of the Executive Committee Teleconference
June 20, 2008, 2:00 p.m. Eastern**

Present:

States	Industry
Tim Russell, AL	Deborah Bierbaum, AT&T
Michael Mason, AL	Todd Lard, COST
John Theis, AR	Diann Smith, Sutherland, Asbill & Brennan
Ben Miller, CA	
Richard Moon, CA	MTC Staff
Ed Many, GA	Joe Huddleston
Christina Loftus, LA	Elliott Dubin
Omar Davis, MO	Les Koenig
Michael Fatale, MA	Sheldon Laskin
Cory Fong, ND	Shirley Sicilian
Donnita Wald, ND	Roxanne Bland
Rebecca Abbo, NM	
Janelle Lipscomb, OR	
Nancy Prosser, TX	
Rod Marelli, UT	
Jan Bianchi, WA	
Steve Heinrich, WA	

I. Welcome

Omar Davis, Executive Committee Chair, opened the meeting.

II. Public Comment

Diann Smith, Sutherland, Asbill & Brennan, thanked Shirley Sicilian, MTC General Counsel and Sheldon Laskin, MTC Counsel, for their work in preparing the materials for this teleconference.

III. Model Telecommunications Apportionment Regulation

Ms. Sicilian explained that the purpose of this teleconference is for the Executive Committee to consider the proposed regulation for a Bylaw 7 survey. She explained that the Bylaw 7 survey asks Compact members whether they could consider the proposal for adoption in their respective states. If a majority of states answer affirmatively, the proposal will be presented to the Commission for adoption as an MTC Uniformity recommendation. At this stage the Executive Committee has three options in dealing with this proposal. It can: (1) approve the proposal for the Bylaw 7 survey (with or without amendment); (2) reject the proposal and end the project; or (3) reject the proposal and remand it to the Uniformity Committee for further work. She also noted that the Executive Committee discussed the proposal at its May 2008 meeting and requested a memorandum from staff delineating the issues involved.

Ms. Sicilian informed the Executive Committee of the background that gave rise to this proposal. Telecommunications companies were originally excluded from the UDITPA rule because they were regulated by states. Today, most telecommunications companies are no longer regulated and so are arguably covered under UDITPA, but the current language may not be applicable. The proposed rule applies to apportioning the income earned by any entity engaged in providing telecommunications services, such as cable, VoIP, etc., in addition to regular telephone companies. Under the proposal, the general rule applies unless otherwise provided. Special rules are provided for sourcing for the sales factor numerator and the definition of property included in the property factor.

Under UDITPA's general rule, telecommunications receipts sourcing for sales factor purposes would be based on cost of performance. The proposal at issue provides a special rule for sourcing receipts for services at retail and wholesale. For retail, the Uniformity Committee decided to follow a market approach based as closely as possible on that in the SSUTA. Industry representatives objected to the inclusion of ancillary and prepaid services and bundling in the rule; the Supplemental Hearing Officer's Report accepted the industry's recommendation for the ancillary and prepaid services, but not bundling. This is the only issue outstanding for sourcing services at retail. Regarding sourcing of receipts from wholesale services, the Uniformity Committee determined these sales be sourced by proxy using the FCC's table 15.6 (estimation of revenues by State). Industry objected. These objections were addressed by both the original Hearing Officer's Report as well as the Supplemental report which do not recommend changes to what the Uniformity Committee drafted. The proposal also includes a throwout provision for sourcing under the sales factor, to which the industry objects. The issues for consideration then, are bundling, throwout and using the FCC's table for sourcing wholesale transactions. Regarding the property factor, the Uniformity Committee recommends the exclusion of outerjurisdictional property (undersea cables, etc.) but the industry has objected. The original Hearing Officer's Report does not recommend a change in this provision. Finally, Ms. Sicilian noted that the industry objects to the proposed rule in its entirety, as it believes there is no need for a special rule and that the issues concerning cost of performance should be clarified instead, or should be put on hold pending consideration by NCCUSL.

Mr. Laskin, the Hearing Officer for this proposal, noted the reason why the recommendation that the bundling proposal not be amended is because its default rule addresses the industry's concerns. He further corrected a typographical error on page 2 of the Supplemental report regarding ancillary services.

Deborah Bierbaum, AT&T noted that the proposal's bundling language does not address industry concerns. The bundling rule as set forth is completely opposite from that contained in Streamlined. Under Streamlined, if a company can break apart the costs of the services included in the bundle using its books and records then it is required to do so; but if not, the entire bundle becomes taxable regardless of whether it includes a nontaxable service. The current proposal assumes that a company's books and records will show how to separate the bundle. She further noted that this issue has not been addressed.

Ms. Sicilian noted that because this is an income tax proposal, the Streamlined fall back rule—to tax all services included in the bundle—is not helpful. There must be a way to source the receipts from the sale of the bundle. She asked Ms. Bierbaum if there is ever a situation where the services made available in a bundle are not available separately. Ms. Bierbaum responded that it is possible, depending on the carrier and whether it only sells certain services in a particular package. She further noted that the Streamlined sourcing rules, and even the MTC rules, provide that when telecommunications are sold other than on a call-by-call basis, the sales are sourced to the customers' primary place of use. The current regulation forces a provider to make an arbitrary allocation that doesn't comport with Streamlined. The proposal should not force companies to break apart a bundle if they cannot do so, and should be changed to a sourcing procedure that is already recognized, like primary place of use. She argued the proposal as drafted is not workable, as it does not reflect how the industry currently journalizes its revenues.

Ms. Sicilian noted that the proposal reflects the more general rule that the price of services included in a bundle should be prorated across the services and weighted based on the price of each service if sold separately. This way, a company will have some idea of how much income was generated by each service, and can source the same as if each service was sold separately. Ms. Bierbaum noted that the problem is that the proration is based on the individual price of each item. She reiterated her belief that the Streamlined methodology be used, and that if a bundle cannot be separated using the company's books and records, then the entire bundle should be sourced to the customer's primary place of use.

Ms. Sicilian noted that the proposal already has a fall back provision: books and records. It does not have a third fallback provision, which would be primary place of use if a company cannot break out the services in the bundle from its books and records. Ms. Bierbaum suggested that the proposal should delete the requirement for "arbitrary calculation" and use primary place of use. Following the rule contained in the proposal will only engender arguments between states and industry on audit. She argued the rule should not be used as it was rejected by Streamlined years ago.

Ms. Smith asked why the Uniformity Committee did not want to use books and records as the first rule. Ms. Sicilian responded we are trying to source receipts from the sale of services. Receipts relate to price charged to the consumer for the services, not the company's cost of providing the services. The books and records rule looks to the cost of providing an individual services, not the price. It is usually clear what prices are being charged for individual services, but often difficult to determine what the costs are for providing those individual services are under the books and records. Furthermore, it is not clear how the costs relate, if at all, to price. Ms. Bierbaum noted again that if a company can prove the cost of individual services through its books and records, it should do so and use primary place of use as a fallback.

Michael Fatale, MA, noted that the small print on most customers' bill breaks out the bundled services. Ms. Bierbaum noted that this information is also available through a company's books and records but if the prices are separately stated on a bill, then it is not considered a bundled service pursuant to the rules under the Streamlined Sales and Use Tax Agreement.

Ms. Bierbaum next objected to the rule requiring the use of FCC Table 15.6 to source wholesale revenues, as it is not based on state by state data provided by the carriers; rather, it is an estimate compiled from a number of sources and in addition, is two years old by the time the table is published, and finally, the estimate is not based on any individual company's revenues. For example, a carrier in a particular that has a number of wholesale sales but not much infrastructure will not want to use this information but a company with a great deal of infrastructure will want to use the data to shift income out of a state, creating issues on audit. She noted that industry was advised this rule was retained in the proposal because industry cannot agree among itself on how the rule should be structured but that this is not the issue. The alternatives are that if wholesale revenues can be broken down into service types, then the existing rule should be used. If there is revenue that cannot be broken down, then a company should use FCC Table 15.6 because of the small amounts involved. Ms. Smith noted that this is a unique rule in corporate taxation in that for wholesale sales, sourcing is based on where the ultimate customer is located, not the location of the seller. Industry has a general objection for a special "look-through" rule for telecommunications companies when it doesn't always know who the ultimate consumer might be. Todd Lard, COST noted that this is one of the two issues commented upon by his organization; normally COST does not comment on industry regulations but that this particular proposal has ramifications outside of the telecommunications area. He suggested that the Executive Committee take especial note of how much this proposal deviates from the norm. Use of FCC Table 15.6 is not much different than using population as a proxy.

Mr. Laskin noted that as Hearing Officer, he was presented with no alternative to the existing rule. Ms. Sicilian noted that the concept required a general rule and that though the industry objects, no alternative general rule was presented except cost of performance by any segment of the industry, and the Uniformity Committee did not wish to take the COP route. She noted that the Uniformity Committee is aware that the table is not a perfect proxy, but that it is also not a "look through" approach. In the absence of being able to base a general rule on data that we can expect to be available for each company, a

proxy was needed. The alternative proposed by Ms. Bierbaum is not much different from the proposed rule: Ms. Bierbaum suggests the use whatever company data is available to determine where to source the sales, and then use Table 15.6 if company data is unavailable. The current proposal requires the use of Table 15.6 first; if income distortion results, then look to company-specific data.

Mr. Laskin asked how, in the absence of a general rule, a company would source such income. Ms. Bierbaum noted that the type of wholesale revenue should be considered; depending on type, there are regulations that source that type of revenue stream as opposed to reviewing data that is two years old and is not reflective of any company in operation. To use the table is automatically distortive, and will engender litigation.

Ms. Sicilian noted that one factor for choosing Table 15.6 was uniformity in each state. All would use the table and then the fallback rule if necessary. Where the sale is delivered is a good indicator of where the sale should be sourced.

Mr. Lard noted that the throwout rule is still a cause for concern as it is not equitable. In practice, a taxpayer is required to go through a series of sourcing rules and if the taxpayer is ultimately not taxable, the revenue is thrown out. He noted that NJ has a similar rule and it has been the subject of a great deal of litigation. This is the first time the MTC has advocated throwout in any of its proposals and predicted it will cause problems, even beyond the telecommunications industry. Ms. Bierbaum noted that IL recently adoption market-based rules for apportionment and that the MTC might want to review those rules to draft a rule of its own.

Ms Sicilian noted that the Uniformity Committee wanted to use a throwback rule, to be consistent with our other model rules, but concluded that it did not make sense as it was unclear as to where the origin should be located for this industry. That is why the Committee chose the throwout option. Mr. Laskin noted that though it is not a final decision, a NJ court recently ruled that use of throwout is not unconstitutional.

Mr. Davis, Chair, closed the discussion and noted the Executive Committee's three options in determining where to move this proposal next: Approve with or without amendment and refer to the Bylaw 7 survey process; reject the proposal and end the project; or reject the proposal and remand to the Uniformity Committee for further development. He asked whether any Executive Committee or Compact member would vote for rejecting the proposal in its entirety and end the project. There was no response. He then asked whether any Executive Committee or Compact member wished to reject the proposal and remand to the Uniformity Committee. There was no response. The Chair then asked for a motion to adopt the proposal, with amendments as recommended in the Hearing Officer's Report and Supplemental Report, and refer the proposal to a Bylaw 7 survey. Jan Bianchi, WA so moved, which was seconded by Tim Russell, AL.

The Chair decided to address the motion's constituent parts separately rather than withdraw the motion in its entirety. The Chair first asked for a roll call vote of the Executive Committee and Compact Member States present on whether to adopt the Hearing Officer's Report:

AL: Yes
AR: Yes
CA: Yes
GA: Yes
MO: Yes
ND: Yes
OR: Yes
TX: Yes
UT: Yes
WA: Yes

The proposal, with amendments, was adopted unanimously with no abstentions. Since the prior vote was unanimous, the Chair dispensed with a second roll call vote and instead asked Executive Committee and Compact Member States whether there were any objections to referring the proposal to the survey process. There were none, and the Chair declared that the proposal had been so referred.

The Executive Committee recessed the open session to go into closed session. On reconvening, there being nothing to report on the closed session, the meeting was adjourned.