

# **Comments on the MTC's Proposed Amendments to Article IV Of the Multistate Tax Compact**

**Presented to the MTC Executive Committee  
Washington, DC  
May 8, 2014**

## **INTRODUCTION**

Sutherland Asbill & Brennan LLP respectfully submits the following comments concerning proposed amendments to Article IV of the Multistate Tax Compact ("Proposed Amendments"). In March of 2013, Sutherland formally commented on a number of substantive concerns with the Proposed Amendments. The MTC Hearing Officer (Professor Richard Pomp) considered all of Sutherland's comments; he rejected some and included others. We understand that broader policy pressures on state apportionment formulas make it difficult for the Hearing Officer and the MTC to consider all of our substantive comments. However, the Hearing Officer embraced many of our comments that would make Section 18 of the Compact apply in a much more equitable manner. Those comments have since been completely rejected by the MTC's Uniformity Committee. We ask the Executive Committee to adopt the Hearing Officer's Report with respect to Section 18 changes for the following reasons.

## **RESTORING EQUITY TO SECTION 18**

At a base level, apportionment formulas are used to divide a taxpayer's income among the states in which it does business. In a perfect world, all similar taxpayers should be subject to the same apportionment formula. In reality, however, a one-size-fits-all formula is ill-suited to some taxpayers' business operations. In those cases, taxpayers may ask for—or state revenue agencies can invoke—an alternative, non-statutory apportionment method. The process for invoking alternative apportionment is contained in Article IV, Section 18 of the Compact. Historically, alternative apportionment methods were seldom used—but in the rare instances they were used, they were used by regulation or fairly applied. State taxing authorities have accelerated their use of non-statutory apportionment methods in recent years, which has exposed inherent inequities in how they could be applied. Moreover, when a state invokes alternative apportionment, they usually do so years after an original return was filed, which amplifies the inequities. These inequities should be legislatively addressed in a uniform manner. The Hearing Officer offered a solution to restoring equity to Section 18. Unfortunately, the Uniformity Committee rejected the Hearing Officer's solutions to remedy inequities in the application of Section 18. The following solutions, originally proffered by the Hearing Officer, will make tax administrators *and* taxpayers more equitably apply Section 18 alternative apportionment:

1. *The burden of proof should be on the party invoking alternative apportionment.*
  - Alternative apportionment is a double-edged sword that can be invoked by either a taxpayer or a state. Yet some states place the burden on the taxpayer to prove the

statutory formula is appropriate if the state is seeking to deviate. The burden should be on the party who seeks to deviate from the standard statutory formula.

2. *No penalties should be imposed on a taxpayer where the tax administrator has successfully invoked alternative apportionment.*
  - Taxpayers that paid their taxes using the statutory apportionment method have been subject to penalties where states have invoked alternative apportionment years later. Penalties should not apply when the state invokes alternative apportionment because the taxpayer lacked the ability to use the alternative method at the time they filed the return.
3. *Tax administrators may not retroactively revoke their prior approval of a taxpayer's alternative apportionment method, unless there has been a material change in, or a material misrepresentation of, the facts provided by the taxpayer upon which the tax administrator reasonably relied.*
  - Some states have sought to retroactively revoke previously approved alternative apportionment methods when administrations change. Alternative methods can be revoked prospectively if they are no longer appropriate, but never retroactively.
4. *Alternative apportionment should only be used in limited non-recurring situations. Common fact patterns that arise should be dealt with in regulations.*
  - Deviation from a statutory apportionment method necessarily ignores the intent of the legislators and should be used sparingly. Yet states apply alternative apportionment to large groups of taxpayers with common facts. These situations are more fairly addressed by statutory changes or regulations that allow all common taxpayers to use a known rule and to participate in the development of that rule, either through the political process or through a public comment period.