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December 18, 1995

Mr. Bob Hanson, Chair
Multistate Tax Commission
c/o North Dakota Office of the State Tax Commissioner
600 East Boulevard Avenue
Bismarck, ND 58505-0599

Re: *Final Report of Hearing Officer Regarding Amendments to MTC Reg.IV.18(h): Special Rule: Television and Radio Broadcasting*

Dear Chairman Hanson:

I have enclosed my "Final Report of Hearing Officer Regarding Proposed Amendments to Multistate Tax Commission Formula for the Uniform Apportionment of Net Income from Television and Radio Broadcasting (MTC Reg.IV.18(h)" for your information and review. A copy of this Final Report has also been distributed to the remainder of the Executive Committee, as well as to other member state representatives.

Of the 11 specific issues addressed during the public hearing process, the following three issues were the most significant:

Issue: Should the outer-jurisdictional property (mainly satellites) owned or rented by a broadcaster and used to broadcast programming into the states be included in the denominator of the property factor and attributed to those states' numerators or be thrown out of both numerator and denominator?

Recommendation: The treatment of this property should remain on "throwout" basis at this time. Should a taxpayer or a state wish to make a case for distortion under any particular fact pattern, Section 18 remains available. This issue should be included in a more broad based study than represented by the circumstances of the broadcast industry.

Issue: Should programming owned by a broadcaster that is broadcast into the states be included in the denominator of the property factor and attributed to those states' numerators or be thrown out of both numerator and denominator?

Recommendation: The treatment of this property should also remain on a "throwout" basis at this time. Should a taxpayer or a state wish to make a case for distortion under any particular fact pattern, again Section 18 remains available. This issue should also be included in a more broad based study than represented by the circumstances of the broadcast industry.

Issue: Should receipts derived from broadcasts into a state in which it is found that no taxing nexus exists be thrown back to another state, e.g., the state from which the signal was sent? The state of commercial domicile?

Recommendation: Receipts of a non-nexus taxpayer should not be thrown back or thrown out at this time. This issue should be included in a more broad based study of the application of a receipts throwback mechanism to services in general.

I believe that several of the broadcasting companies will support or not raise any objection to the Commission's adoption of the amended Regulation IV.18(h) found at Attachment 1 of the Final Report. Even though the issue of nexus remains a contentious one, the apportionment mechanism developed here with valuable industry input presents a reasonable approach until further studies noted above are completed. The Hearing Officer has made no specific recommendations with regard to nexus or the effect of those cases in the broadcast context.

The Final Report contains several additional specific recommendations of relative uncontroversial nature. It addresses most of the concerns that have been raised through state and industry comment.

I look forward to the Executive Committee's review of the Final Report at its January meeting. If I can offer any other insight, please let me know.

Very truly yours,

Alan H. Friedman
Hearing Officer

Multistate Tax Commission

FINAL REPORT OF HEARING OFFICER REGARDING PROPOSED AMENDMENTS TO MULTISTATE TAX COMMISSION FORMULA FOR THE UNIFORM APPORTIONMENT OF NET INCOME FROM TELEVISION AND RADIO BROADCASTING (MTC REG.IV.18(h))

Submitted by:

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Multistate Tax Commission

FINAL REPORT OF HEARING OFFICER REGARDING PROPOSED AMENDMENTS TO MULTISTATE TAX COMMISSION FORMULA FOR THE UNIFORM APPORTIONMENT OF NET INCOME FROM TELEVISION AND RADIO BROADCASTING (MTC REG.IV.18(h))

This Final Report concerns recommended amendments to Multistate Tax Commission Regulation IV.18(h) providing for a uniform method for the apportionment of net income earned by television and radio broadcasters. It is submitted pursuant to Article VII of the Multistate Tax Compact and Bylaw No. 7 of the Multistate Tax Commission. Those provisions require the Hearing Officer to submit to the Commission's Executive Committee a report which contains a synopsis of the hearing proceedings and a detailed recommendation for Commission action. In the case of a public hearing held pursuant to Article VII of the Compact, the final recommendation of the Hearing Officer is to include a draft of the proposed regulation or other uniformity recommendation which is the subject matter of the hearing. The specific amendments to MTC Reg.IV.18(h) that are recommended by the Hearing Officer are located at Attachment 1 to this Final Report.

This Final Report is divided into four sections: an introductory part (Section I); the Hearing Officer's recommendations for Commission action concerning the adoption of certain amendments to the current MTC Reg.IV.18(h) (Section II); a discussion of the major substantive issues raised by the proposed amendments (Section III); and a brief conclusion (Section IV). The Attachments to the Report have been selected from among many of documents that were either submitted during the process or otherwise available to the Hearing Officer.

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I.
INTRODUCTION AND BACKGROUND TO PROPOSED AMENDMENTS TO MTC REGULATION IV.18(h) (TELEVISION AND RADIO BROADCASTING).

A. *Original Adoption of MTC Reg.IV.18(h) (Television and Radio Broadcasting).*

On August 31, 1990, after public hearing, the Multistate Tax Commission adopted a regulation apportioning the net income of television and radio broadcasters. See, MTC Reg. IV.18(h) attached to this Report as Attachment 2. The regulation was adopted after a protracted period of time during which the industry representatives were given many opportunities to submit their views both to the Hearing Officer and directly to the Commission members. For a lengthy background, reference is made to three Hearing Officer reports dated June 14, 1989, January 20, 1990 and August 7, 1990.[1]

Much of the delay in adoption of the original MTC regulation was necessitated by having to address several novel and challenging Constitutional and other legal issues raised by industry representatives. Among the several issues raised by industry representatives and addressed by the Hearing Officer were:

1. whether the regulation should be applied retroactively;

2. the propriety of apportioning receipts by use of an audience factor;

3. the inclusion of compensation paid to non-employee talent for purposes of the payroll factor;

4. the apportionment of films in the property factor;

5. the throwout of "outer-jurisdictional" property from the property factor;

6. discrimination and First Amendment issues;

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[1] These Reports are not attached to this Final Report, but may be obtained by contacting the Multistate Tax Commission at 202-624-8699.

7. selective taxation and Commerce Clause issues;

8. whether the proposal was contrary to UDITPA'S statutory policies;

9. whether the proposal was intended to establish a new nexus standard for the broadcasting industry;

10. whether authority exists under Section 18 of the Compact (UDITPA) to promulgate the regulation;

11. whether tangible personal property, such as film property, must be *physically located* within the state in order to apportion some of its value there or whether a throwout approach for such property is reasonable;

12. whether a taxpayer must maintain an office or other fixed location within a state before a state could properly assign to it the gross receipts earned there; and

13. whether gross receipts should be apportioned on the basis of the ratio that the in-state viewing audience bears to worldwide viewing audience.

On August 31, 1990, the Commission responded to the public comments received on the uniformity proposal by adopting current version of MTC Reg.IV.18(h). See Attachment 2. However, during the four-year period subsequent to its adoption by the MTC, only a handful of states have actively considered the regulation for adoption in their states and less than that have either adopted all or a portion of the recommendation. It was within this context that the Executive Committee approved a new hearing in order to determine among other things, "(1) the extent of the adoption of the special rule by the member and non member states; (2) what other apportionment approaches are currently being taken by states; and (3) the need, if any, for modifications of said special rule for the purpose of increasing its uniform adoption among the states."

In order to focus on these issues more concretely, the Hearing Officer set forth in the Notice of Public Hearing (Attachment 3) several specific questions for public comment that will be discussed in part III of this Report. Two public hearings were then held, one in New York on December 5, 1994 and one in Los Angeles on December 9, 1994, along with one meeting held in Washington, D.C. on October 24, 1995. At the request of the National Association of Broadcasters, the Hearing Officer extended the closing of the public record so that additional comments could be received. Several written comments were received and they, along with other documents thought pertinent by the Hearing Officer, are appended to this Report as the following Attachments:

Attachment 1: Amendments to MTC Reg.IV.18(h): Special Rule: Television and Radio Broadcasting as recommended here by Hearing Officer (additions underlined/deletions struck through)

Attachment 2: MTC Reg.IV.18(h): Special Rule: Television and Radio Broadcasting (as originally adopted August 31, 1990)

Attachment 3: Notice of Proposed Amendments to MTC Reg.IV.18(h): Special Rule: Television and Radio Broadcasting (additions underlined/deletions struck through)

Attachment 4: Memorandum from James W. Hamilton and Wilbur F. Lavelle to Crawford H. Thomas dated June 24, 1968 - Report of Conference with Network Representatives - May 20, 1968

Attachment 5: Letter dated November 3, 1994 from Sam Ware (Audit Division, Oregon Department of Revenue)

Attachment 6: Letter dated December 4, 1994 from Frederick D. Herberich (General Counsel, Massachusetts Department of Revenue)

Attachment 7: Letter dated December 5, 1994 from Manuel F. Gallegos (Tax Information/Policy, New Mexico Taxation and Revenue Department

Attachment 8: Letter dated December 6, 1994 from Benjamin F. Miller (Legal Division, California Franchise Tax Board ("FTB"))

Attachment 9: Memo dated December 20, 1994 from Gene Corrigan

Attachment 10: Letter dated February 27, 1995 from Russell D. Uzes (Brobeck Phleger & Harrison) on behalf of Cox Enterprises Inc.

Attachment 11: Letter dated March 15, 1995 from Prof. Walter Hellerstein on behalf of Capital Cities/ABC, Inc. and the National Broadcasting Company, Inc.

Attachment 12: Letter dated April 21, 1995 from Alvan L. Bobrow (CBS Inc.)

Attachment 13: Letter dated April 21, 1995 from Linda Tremere (Hubbard Broadcasting, Inc.) on behalf of United States Satellite Broadcasting, Inc.

Attachment 14: Letter dated April 21, 1995 from Prentiss Willson, Jr. (Morrison & Foerster) on behalf of the National Association of Broadcasters

Attachment 15: Partial transcription of meeting of California FTB on August 3, 1995

Attachment 16: Letter dated August 22, 1995 from Gerald H. Goldberg (California FTB)

Attachment 17. Working draft dated November 1, 1995, of possible amendments to Reg. IV.18.(h) based on NAB Working Group meeting

Attachment 18. Memo dated December 6, 1995 from Arthur Angstreich (NBC), Alvan Bobrow (CBS), James Goldberg (Capital Cities/ABC), and Paul Thompson (Fox), with attached comments.

Attachment 19. Fax to Paul Thompson dated December 12, 1995

Attachment 20. Fax dated December 15, 1995 from NAB Working Group

II
RECOMMENDATIONS OF HEARING OFFICER

A. Introductory Comments.

The state tax issues relating to the multistate apportionment of income earned by broadcasters that deliver programming by telephone, fiber optic wire, cable, radio wave, microwave, satellite, or by other means of delivery across state lines are no simple matters. The variety and sophisticated methods of electronically distributing voice, data and video information and entertainment are quickly evolving, as are the types of companies that deliver them. Representatives of the broadcast industry point to this evolution and revolution, as well as the restructuring of the electronic media industry, have urged the states not to amend MTC Reg.IV.18(h) at this time.[2] But, while several of these tax issues are novel, the do not involve "rocket science", unless one feels it necessary first to understand how satellites are shot into orbit before they can be dealt with for tax purposes.

The industry representatives are also not alone in their opposition to the major substantive amendments that were initially proposed here. As discussed in more depth in Section III below, the California Franchise Tax Board has recently voted to oppose two of the major proposed amendments - the inclusion of outerjurisdictional (satellite) and programming properties in the property factor. See Attachments 8, 15, and 16 for the development of the position taken by the FTB. As will be noted below in Section III, the Hearing Officer is also convinced that there exists an initial reluctance on the part of several states to include film and radio programming properties in the property factor; and it is unclear whether a substantial number of states prefer that satellites be included in the property factor.

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2 This is not to say that industry members now support and embrace the regulation as originally adopted either. The full extent of industry support remains to be seen.

The primary goal of an MTC uniformity process should be the development of an apportionment rule that is fair, administrable and *likely to be adopted on a reasonably uniform basis by a significant number of states*. There is little to be gained by expending the member states' resources in the Commission's development and adoption of a uniform regulation, however constitutional, fair, administrable and reasonable it might be, if a significant number of states is not inclined to adopt it within a reasonable period of time. The Hearing Officer believes that there is some membership support for including satellite property in the property factor, but less support for including programming property in that factor. Therefore, because there is not substantial enough support for property factor inclusion at this time, it does not appear that significant uniformity will result from a recommendation to treat satellites and film and radio programming in a manner other than on a throwout basis. But, it is not the role of the Hearing Officer to prejudge the member states' wishes and the Bylaw 7 survey process should provide a significant measurement of the states' policy positions in this regard.

B. Recommended Adoption of Attachment 1.

A substantial number of states may eventually adopt MTC Reg.IV.(h), as originally adopted by the Commission, after it has been amended to correct and clarify a few of its less controversial provisions. The support or lack thereof by a significant number of industry members will necessarily play a role in the states' consideration of any amended regulation. A review of the public record submissions by industry representatives reflects a strong opposition to the amendments as initially proposed that would include outerjurisdictional and programming property in the property factor. On the other hand, various industry representatives have indicated support to one degree or another for the proposed amendments reflected in Attachment 1. Therefore, the Hearing Officer recommends adoption of Attachment 1, which includes proposed amendments of a less controversial nature, in the interest of obtaining as much uniformity in this area as is reasonably attainable.

C. *Additional Recommendations.*

1. FUTURE STUDY OF THE APPROPRIATE TREATMENT OF OUTERJURISDICTIONAL PROPERTY IN THE PROPERTY FACTOR.

Replete throughout the industry submissions is the suggestion that the treatment of outerjurisdictional properties in the property factor cuts across many more industries than broadcasting and, therefore, the appropriate factor treatment should be studied on a more general basis. The Hearing Officer agrees that such further study would be helpful to ensure the fairness of using or not using such property for apportionment purposes.

The Hearing Officer believes that the exclusion of such property from both the numerator and denominator of the property factor, in most circumstances, offers one fair approach, so long as the relief provision is available to address those circumstances in which outerjurisdictional property is owned or leased and represents a significant investment by the broadcaster. The Hearing Officer also believes that another fair method would be the inclusion of such property in the property factor, with attribution to the numerators of the states on a reasonable sourcing basis.

The Commission's Uniformity Committee has recently placed on its agenda this very topic - the treatment of outerjurisdictional property in the apportionment formula. This is the appropriate forum for the analysis of the issue on a broader basis than the industry by-industry rulemaking efforts such as involved here and in the Publishing Regulation (MTC Reg. IV.18(j)). Therefore, the Hearing Officer recommends that the treatment of outerjurisdictional property remain on a throwout basis as originally adopted by the Commission and await further review after the Uniformity Committee has made its recommendations.

2. Future Study of the Inclusion of a Throwout or Throwback Rule with Regard to Receipts when no Nexus Exists in State into which Programming is Broadcast

During the proceedings, the issue was raised as to whether the regulation should include a "throwback" or "throwout" of receipts provision if a broadcaster were found not be taxable in the state to which the broadcast is directed. The "throwback" concept, even in the context of the sale of tangible property under UDITPA and Compact Section 16(b), has not received universal acceptance. Such a provision currently exists in MTC Reg.IV.(j) (Publishing) at paragraph (3)(iii)B.4., but an insufficient number of states have yet taken up the Publishing Regulation for adoption. The Hearing Officer supports a more broad based study of the propriety of applying a throwback or throwout concept to the income producing activities of service providers. The current project directed by the California Franchise Tax Board in the area of the taxation of income from telecommunications may offer an appropriate vehicle for this more generalized study.

D. A Call for Prompt Adoption by the States.

It is also recommended, if the proposed amendments are approved by the Commission, that the member states *promptly* consider the amended version for adoption in their states.[3] It is only from adoption and application to the affected industry members can the states better educate themselves as to the nuances of the industry, as well as to the benefits and shortcomings of the regulation. The states would then be able to experience the regulation as applied, compare notes, and then work with industry representatives to further improve the regulation. Along this same line, the Working Group of the National Association of

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[3] If a member state believes that there should be some amount of apportionment of a broadcaster's net income based upon where the broadcasting signal is delivered, it should do so by regulation. Given the length of time that the Commission membership has been dealing with this subject matter, the failure to adopt the proposed regulation (or one apportioning the services on a basis other than Section 17 of UDITPA and the Compact) may present a stumbling block in one or more states by making such a modification on an *ad hoc* and retroactive basis more problematic.

Broadcasters suggests "a ten-year moratorium" should be placed on any further changes to the regulation by the Commission. See, Attachment 18, p. 3. The Hearing Officer has no recommendation in this regard.

E. A Closing Note on the Lack Of Uniformity.

Lastly, you will quickly note from the discussion of the specific issues below that the limited recommendations for amendment that are reflected in Attachment 1 were not easily arrived at by the Hearing Officer. Much of the discussion in this Final Report supports the merits of including, as does California, the satellite and programming properties in the property factor with the corresponding assignment of a portion of their value to the numerator of the state into which broadcasts are delivered. It is a close judgment call as to whether to include such property or to throw it out of the factors entirely. California has exercised reasonable judgment and applies an apportionment method that is sound in its theoretical approach. That is because one can, without crimson blush, reasonably conclude that satellites and programming are "used" within the state in which the audience views and listens to the programming.

Reasonable persons knowledgeable in state tax matters can certainly differ on whether the "throwout" approach, as supported by industry representatives, makes more sense as a matter of tax policy than inclusion of satellite and programming properties in the property factor. But given California's tax approach, the adoption of a "throwout" method also *throws out* uniformity, as well; and the states are not assured of any voluntary compliance by industry members to boot. By California maintaining its particular tax apportionment approach and not wishing other states to follow, a multistate broadcaster may, at least theoretically, find itself between the proverbial "rock and a hard place". This is because the multistate broadcaster may find itself in a situation in which it will have to argue that one state or another should retreat from its apportionment approach lest over-apportionment of income

result.[4] Thus far, it remains unlikely that the United States Supreme Court will take up this cause and order one state or the other to recede from either approach.[5]

III
DISCUSSION OF SPECIFIC ISSUES

A. Listing of Issues Presented for Discussion.

The Hearing Officer requested public comment on the following questions:

1. Whether the continuing objection by certain industry representatives of treating "outer-jurisdictional property" on a "throwout" basis should be reconsidered? If so, is the proposed amendment to Reg.IV.18(h)(4)(ii)B.1. and 3. set forth on Attachment A, appropriate?

2. Whether film and radio programming properties should be included in the property factor and sourced, for numerator purposes, based upon its use in the state in which the audience views the property? If so, is the proposed amendment to Reg.IV.18(h)(4)(ii)A., B. and C. set forth on Attachment A, appropriate?

3. Whether the "audience factor" provided for in Reg.IV.18(h)(4)(iv)(B)(2) and (3) should be amended to reflect changes in available information and to amend the fallback provision when industry-wide information is not available? If so, is the proposed amendment to Reg.IV.18(h)(4)(iv)(B)(2) and (3) set forth on Attachment A, appropriate?

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[4] More likely, this lack of uniformity will result in under-apportionment of income. Thus, one readily understands the thinking of the industry representatives in arguing to maintain the current MTC approach and not conform to the approach California has adopted.

[5] It remains to be seen whether the "external consistency" prong of the Commerce Clause will require, under any given fact pattern, the inclusion of the value of owned or rented satellites or programming in property factor. See, *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983); *Oklahoma Tax Comm'n. v. Jefferson Lines, Inc.*, ___ U.S. ___, No. 93-1677 (April 3, 1995).

4. Whether paragraph Reg.IV.18(h)(4)(iv)(B)(4) should be deleted in its entirety as not being properly reflective of income-producing activity.

5. What effect, if any, have cases such as *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992) and *Geoffrey, Inc. v. S.C. Tax Comm.*, 437 S.E.2d 13 (S.C. 1993), *cert. denied* 114 S.Ct. 550 (1993), have upon apportionment of broadcasters' income?

6. Should the definition of "audience factor" provided for in Reg.IV.18(h)(4)(iv)(B)(2) and (3) be extended to include the audience that may be located in other countries? If so, is the proposed amendment to Reg.IV.18(h)(4)(iv)(B)(2) and (3) set forth on Attachment A, appropriate?

7. Should the M.T.C. Reg.IV.18(h) be amended to address the specifically the allocation and apportionment issues arising from the production and distribution of licensed materials, such as radio and television programming, motion pictures, books, computer programming and the like?

8. Are the broadcasters who located within their home state whose signal is also sent out-of-state treated differently than the out-of-state broadcaster who sends its signal into the state? If so, how should the regulation be amended to treat all broadcasters equally?

9. What effect on the regulation occurs when a rating service, such as Arbitron, no longer rates the viewing or listening audiences?

10. What apportionment effect should result if a broadcaster varies its signal power during each day to include a larger or smaller audience?

11. Is the regulation sufficiently clear to provide that apportionment applies only when broadcasters are taxable in more than one state? If not, what amendment to the regulation is required to ensure such principle?

12. Any other suggested amendments to the regulation that would address the needs of states and industry members.

See, Attachment 3 setting forth the Notice of Public Hearing, the questions to be addressed, and a series of proposed amendments to MTC Reg.IV.18(h). Representatives of the industry and others provided valuable and constructive comments on the various proposals. Their contributions, even if not fully agreed with, are greatly appreciated; and from this debate a better understanding of the issues and differing perspectives has emerged.

B. Discussion of the Major Issues Involved.

1. INCLUSION OF SATELLITES IN THE PROPERTY FACTOR

Two of the above-listed 11 specific issues received most of the comments - the proposed inclusion of outer-jurisdictional properties, mainly satellites, and of film and radio properties in the property factor and the method to be used for their assignment to taxing states. The current Regulation, as originally adopted, used a "throwout" method for the treatment of these types of property; therefore, the value of these properties are currently excluded from both the numerator and the denominator of the property factor. The proposed amendments as initially set forth in the Notice of Public Hearing would have included these types of properties and assigned their value to the numerator of the states into which the programming was delivered.

It is important to set forth here the definition of the property factor as found in Article 10 of UDITPA and the Compact so that we can more accurately discuss what concepts are included under the definition. Those provisions set forth that the property factor is:

> "... a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property *owned or rented and used* in

> this State during the tax period and the denominator of which is the average value of all of the taxpayer's real and tangible personal property *owned or rented and used* during the tax period." (emphasis supplied).

Industry representatives uniformly take the position that an item of tangible personal property, such as a satellite, must be physically located within a state before it can be properly assigned to that state's property factor numerator. They suggest that tangible personal property can only be "used" in a state when it is *physically located* there. Since the typical application of UDITPA, since its inception in 1957, developed within the context of the more traditional industries of a mercantile or manufacturing nature, there was not the opportunity for an issue to be raised as to whether tangible personal property located outside a state should be included in its numerator. But, the broadcasting industry is not the typical industry that was contemplated by the National Conference of Commissioners on Uniforms State Laws; and it was certainly not intended by the National Conference that UDITPA apply in a totally mindless, lock-step fashion to emerging industries in the service sector.

A different apportionment rule with regard to income earned through broadcasting activity may be justified by two approaches. The first approach would be to construe provisions, such as found in the property factor under Article 10, as not limiting the factor numerator to property located within the state. This construction would be reasonable because no such limitation appears in the wording of Article 10; and the phrase "used in this State" reasonably encompasses property that may be located in another state, so long as that property is fairly apportioned to its use in the taxing state.

The second approach is that taken here - recognizing under Section 18 that the normal application of UDITPA to the broadcasting industry "does not fairly represent the extent of the taxpayer's business activity" within the taxing state. Having reached this conclusion, a Tax

Administrator can then fashion a "reasonable" formula under Section 18 to address the taxpayer or industry. It is this approach that is being considered in this proceeding.

Industry comments received regarding the proposed inclusion of satellite property in the property factor, with the exception of those of CBS Inc., clearly oppose the inclusion of the value of such property in both the numerator and denominator of the property factor. Alvan Bobrow of CBS argues that outerjurisdictional property is used "solely where its name implies, outside of any taxing jurisdiction". Mr. Bobrow further concludes that,"[a]s business property which generates income, outerjurisdictional property belongs in the denominator; since it is not located in any state, it cannot be fairly attributed to any state." His only concession for the use of a throwout mechanism for outerjurisdictional property is that "[i]t can be argued, however, that such treatment [inclusion in the denominator and not in any numerator] might appear distortive". See, Attachment 12., pp. 7-8. Mr. Bobrow offers the consolation that ([i]t is worth noting that while the value of outerjurisdictional property cannot be attributed to any state's numerator, income earned from the use of outerjurisdictional property does not escape taxation because it is included in the tax base.[6]

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6 The Hearing Officer's mathematical ability is often suspect, with good reason; but Mr. Bobrow is invited to accompany the Hearing Officer when it comes time to take a refresher course in math. The following example should show why Mr. Bobrow is incorrect when he suggests that no income earned from the use of outerjurisdictional property escapes taxation when the property is assigned to the denominator but to no state's numerator:

> Assume a television broadcasting company has a net profit from broadcasting operations and that it is taxable in three states (because it only broadcasts to the three states). Assume also that it owns a satellite used to broadcast its programming; that the satellite is in orbit over the Equator and has a historical cost of $40,000,000; that it has $60,000,000 in other property located equally in the three states; and that it had payroll, receipts and other property in the three states as shown below. If the satellite property were attributed fully (assume here in equal amounts of $13,333,333 to each state), the company's income would be attributed as follows and fully apportioned to the states in which it did business:

Professor Walter Hellerstein has submitted comments on behalf of ABC and NBC that articulate in some depth the theoretical position those industry members take against including satellite properties in the property factor. See, Attachment 11, pp. 3-10. The National Association

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	Property	**Payroll**	**Receipts**
State A:	40,000,000 100,000,000	15,000,000 30,000,000	120,000,000 300,000,000

Apportionment factor % = .43333

State B:	36,000,000 100,000,000	12,000,000 30,000,000	75,000,000 300,000,000

Apportionment factor %: .33666

State C:	24,000,000 100,000,000	3,000,000 30,000,000	105,000,000 300,000,000

Apportionment factor %: .23000

Since the apportionment factors percentages for the three states total 100% (.43333 +.33666 + .23000), 100% of the company's total net income will be apportioned for taxation. However, if the $40,000,000 of satellite property were not included in any state's numerators, the apportionment formula will look like this:

	Property	**Payroll**	**Receipts**
State A:	26,666,666 100,000,000	15,000,000 30,000,000	120,000,000 300,000,000

Apportionment factor %= .38886

State B:	22,666,666 100,000,000	12,000,000 30,000,000	75,000,000 300,000,000

Apportionment factor %: .30553

State C:	10.666,666 100,000,000	3,000,000 30,000,000	105,000,000 300,000,000

Apportionment factor %: .18555

Since the apportionment factor percentages for the three states will now total .87974 due to the exclusion of the value of the satellite from the numerators of their repective property factors, over 12% (.12026) of the company's net income will not be subject to any state tax.

of Broadcasters, through Mr. Prentiss Willson, has submitted written comments that effectively addressed many of the Hearing Officer's questions. Much of what these industry representatives had to say is instructive and the state representatives are requested to review their submissions. However, none of these comments have persuaded the Hearing Officer to conclude that satellites (and film properties) are not "used" within the state in which the signal containing the data (video and audio) is received.

Both Professor Hellerstein and Mr. Willson take issue with the suggestion that tangible property can be "used" in a state in which the property is not physically located. Professor Hellerstein suggests that such a notion "barely passes the red face test" (the test of whether one can make an argument without his or her face turning red).[7] After noting that the California courts have accepted the proposition that a satellite was "used" in California by virtue of its connection with an earth station there, Professor Hellerstein criticizes that conclusion as "a piece of science fiction." See discussion of *Communications Satellite Corp. v. Franchise Tax Board*, 203 Cal. Rptr. 779 (Ct. App., 1st Dist. 1984), *appeal dismissed*, 469 U.S. 1201 (1985) in Attachments 11 and 14 , pp. 5-6 and pp. 12-16, respectively.

Despite their having found the invisible connection between the earth station and the satellite to be of little taxing moment, Professor Hellerstein and Mr. Willson must surely recognize that the current law in California, as well as scientific and economic reality, is otherwise. See also Attachment 13 at p.3, where the United States Satellite Broadcasting, Inc. ("USSB") states that "[i[f a state intends to tax us based on our economic activity, then inclusion of our customer's satellite dishes is appropriate. *Our satellite is useless and of no economic benefit without those customer owned dishes.*" (Emphasis supplied).

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[7] Because the Hearing Officer sports a generous crop of facial hair, he finds the "red face" test to be inapplicable to the current proceedings; there could be no objective determination of whether something passed the test or not.

The Hearing Officer finds that the connection between a satellite and an earth station or other signal receiving device and the connection between a direct broadcast satellite and its customer's dish to be sufficiently the same or analogous for the purposes of this discussion. As underscored by the USSB, without that connection, the company relying upon the use of a satellite cannot perform the business activity of delivering messages and programming into the state and to its customers. The very purpose of having the orbiting satellite is rendered "useless" if that connection is not made. Severing the connection between the sender of the signal and the receiver prohibits the delivery of the communication (programming) sought to be delivered in the state through the use of the outerjurisdictional property. It is primarily this physical tie - the communication link between a business that performs its message-delivery services via satellites to the receiving devices located within the state in which the market exists - that distinguishes the broadcasters' circumstances from those using warehouses, factories or offshore oil drilling rigs whose principal business activities relate to the production of goods, not the delivery of the message.

The Hearing Officer notes that respective Sections 16 of UDITPA and Article IV. of the Multistate Tax Compact merely require that to be included in a state's property factor, the tangible property be both "owned or rented" and "used" within the state. A requirement that the property be "physically located" within the taxing state is nowhere within the statutory language.[8] The Hearing Officer concludes that satellite properties owned or rented by the taxpayer that are used to connect signals being sent from outside one state to the receiving equipment inside another state are "used" within the receiving state within the meaning of Section 16 of UDITPA and the Compact. Therefore, the value of satellite property used to deliver signals carrying messages, programming, audio, video or other type of data into a state

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8 Without even getting metaphysical, the Hearing Officer notes that satellites, by the sending of signals into a state for connection to receivers located there, have more than an ephemeral presence within the state, since it is beyond dispute that those signals possess physical properties.

can properly be included within both the numerator and denominator of the property factor.

In the opinion of the Hearing Officer, an apportionment rule may properly include satellite property in its apportionment formula either (1) because the satellite property is "used" in the state; or (2) because Section 18 of UDITPA and the Compact permit variations from the standard formula when the standard formula does not "fairly reflect" the income producing activity that occurs within the taxing state. So long as there is the requisite nexus found and the elements of the apportionment formula meet the internal and external consistency requirements of the Commerce Clause, an apportionment method which includes the satellite property should be sustainable against the typical constitutional challenge. See, *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983).

The conclusion that satellite property is "used" within the state in which the earth station, customer's satellite dish or other receiving equipment is located *supports*, but does not necessarily *require* the inclusion of such property in the property factor. Aside from meeting the above-mentioned legal requirements, any alternative or special formula that is adopted must also be "reasonable". See Section 18 of UDITPA and the Compact. So long as the apportionment method to be applied is "reasonable" and otherwise complies with constitutional requirements, it will be sustained, even though a better apportionment approach may be found to exist. Here, the throwout of satellite property addresses substantial administrative, record-keeping concerns and, if industry suggestions are correct - that the satellite is not used in the viewer's state - the throwout addresses that concern as well. With regard to those industry representatives that believe that satellites are used in the viewing state and that it is distortive under their fact situation not to include them in the property factor, the relief provision of Section 18 remains an appropriate method for asserting that position.

2. Inclusion of Film and Radio Programming Properties in the Property Factor.

Much of the discussion above with regard to the propriety of including outerjurisdictional property in the property factor applies with similar force to the issue of whether television and radio programming property should be included in the denominator of the property factor and assigned to the states' numerators on some rational basis, such as an audience or subscriber ratio. Because television and radio programming properties, at least for the present, are physically located somewhere on the earth's surface[9], traditional application of the UDITPA apportionment formula more firmly supports including such property in the taxpayer's denominator than it does regarding satellite property.

One of the initial positions of the National Association of Broadcasters was that should the current regulation be amended, the programming properties should be included in the denominator of the property factor and assigned for numerator purposes to the states in which such properties are used, i.e., "the site where they are physically located or the site from which the broadcast transmission occurs". Attachment 14, p.23. Though NAB labels as "fiction" the notion that film or radio programming property is "used" in the state in which it is viewed or heard, the dictionary definition describing when property is "used" suggests otherwise. In its ordinary meaning, property is considered to be "used" when it is "employed in accomplishing something".[10] Both types of property - satellite and programming - wherever located, are being "used" in the state of the viewing and or listening audience, because the satellite connection delivers the television or radio programming message there to be seen, heard and reacted to. That which is intended to be accomplished by the broadcaster - the delivery of the film or radio message - is accomplished by physically sending it through air and space

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9 What would theoretically prevent a broadcaster from digitizing its programming and storing it on a receptor in or attached to its satellite, thereby removing all of its valuable programming from being located on a tangible medium on earth?

10 Webster's Ninth New Collegiate Dictionary (Miriam-Webster, Inc. 1986).

to the location it is to be received for the purpose of viewing and listening. The mere sending of a signal by the broadcaster accomplishes nothing without it being received by the audience intended. Most certainly, the activity of flipping switches in one state with no delivery of the broadcast signal to an audience will not generate any income, only blank screens and silence.

The Hearing Officer has earlier concluded that the location from which programming properties are broadcast "is of minimal additional substantive significance". See, Second Supplemental Report of Hearing Officer Regarding Proposed Adoption of Multistate Tax Commission Regulation IV.18.(h) (Television and Radio Broadcasting), August 7, 1990, pp. 7-8. The comments received during the pending hearing have not changed this view. Therefore, the Hearing Officer concludes the obvious - that film and radio programming is "used" in the states to which its broadcast signal is directed and received. The Hearing Officer also concludes that an apportionment formula that assigns *all* of the value of programming to the numerator of either (1) the state *from which* such programming is broadcast by switch flipping (however accomplished) or (2) the state in which the programming happens to be located during tax periods after its broadcast is distortive and does not fairly reflect the income producing activity of the broadcaster in such states or in the states to which the programming is broadcast.

Similar to the discussion above with regard to apportioning the value of the satellite property, the assignment of a properly apportioned value of the programming properties to the state in which the audience receives it would be *supported* by law and based upon reasonable theoretical concepts. However, no such change from the current throwout mechanism is *required* or recommended at this time. What is being sought here is something more than an apportionment rule that merely meets all of the constitutional and other legal tests.

It should also be repeated here that California, one of the two states most connected to the broadcasting industry, opposes changing the current regulation in these two subject areas. On August 3, 1995,

the California Franchise Tax Board, on the basis of submissions by the California Broadcasters Association Coalition and, possibly others, voted to oppose the adoption of the initially proposed amendments to include outerjurisdictional property and television and radio programming in the property factor. See Attachments 15 and 16. Since the California Broadcasters Association Coalition has neither submitted any comments in this proceeding, nor shared with the Hearing Officer the comments it submitted to the Franchise Tax Board, the Hearing Officer cannot enlighten the member states as to that group's substantive and technical concerns.

What is more unsettling, however, is the irony that has arisen in this matter. Over twenty-five years ago, television network broadcasters met with California Franchise Tax Board representatives to address the method by which their income from television operations was to be apportioned. See Attachment 4. The networks attempted to persuade the FTB representatives to exclude or throw out film properties from the property factor. See Attachment 4, p. 6. That suggestion was then and has been consistently rejected by California, which has long since *included* programming properties in the property factor. Later, the FTB's position in this regard was solidified through the adoption of Regulation 25137-8. Under that regulation, such properties are *included* in the property factor and assigned to California based upon a ratio of California receipts over receipts everywhere. With respect to the inclusion of satellites in the property factor in California, the *Comsat* case affirmed the practice of the FTB of *including* such property in both the California numerator and denominator.

The effort in this amendment proceeding, in substantial part, was to develop an apportionment formula that would more closely mirror the long-standing apportionment approach followed by the California Franchise Tax Board. Instead of applying a throwout of satellite and programming property, the proposal before the Commission was to include this property on an apportioned basis. Instead of supporting the Commission states' adoption of an apportionment method more closely aligned to its own, the FTB suggest that the other states apply a different

apportionment method to the broadcasting industry. This will inevitably result in a lack of uniform apportionment, at least in theory, if not in practice.

Were all states actively to apply differing apportionment methods to the broadcasting industry, theoretically there would be a risk of either over or under apportionment of a multsitate broadcaster's net income. One could anticipate that sometime in the future, after a substantial number of states have adopted an apportionment method that is not in sync with California's that the industry might seek further relief from that state.[11] In any event, the industry may have reason to complain about the lack of uniformity among the states, simply upon having to maintain different information for the different apportionment formulae. In the long run, if the states into which programming is broadcast pursue the throwout approach suggested by California and industry representative and aggressively assert nexus and filing responsibility on out-of-state broadcasters, and if California remains with its apportionment approach (one with which this Hearing Officer takes no issue), then duplicative taxation may well result in some circumstances. However, the likelihood of this occurring, at least in this century, remains slim, so long as the other states remain fairly passive with respect to asserting filing responsibilities for out-of-state broadcasting industry members.

3. Information Used to Determine Audience Factor

An issue was raised regarding the current regulation's reliance upon private rating services, such as Neilsen, Arbitron, Birch-Scarborough Research and the like to determine the audience factor for receipts factor purposes. See, *e.g.*, Reg.IV.18(h)(iv)B.2. The concern expressed was two-fold. First, was the position of industry

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11 It would be another twist of irony should, down the line, the industry eventually succeed in convincing California to throwout film and satellite properties, basing its argument on the fact that many other states do so and the lack of uniformity causes disparities in tax treatments.

representatives that the best records reflecting audience data is to be found in the broadcasters' records. Second, is the fact that private statistic-keepers may go out of business or no longer keep such numbers. If so, then the fall-back provided in the current regulation to determine a state's audience factor would be determine the ratio between in-state population and U.S. population. See Reg.IV.18(h)(iv)B.2. and 3.

Public comments received have convinced the Hearing Officer that the current version of these sections, as well as the proposed version, is too restrictive on the type of records that are reviewable to determine the state audience factors for the purpose of determining the receipts factor. Based upon the comments received form industry representatives, the Hearing Officer concludes that one accurate and administrably feasible approach to determine the audience factor would be to refer to the taxpayer's records to determine this information. As with most other determinations, the taxpayer's records, if accurate and complete, provides the most accurate information of this type. Equally relevant, however, are records maintained by third parties that seek to measure the same activity for purposes other than the taxpayer's tax liabilities, e.g., audience ratings to establish fees for commercial time. These records would be found in other published statistical information reasonably relied upon by industry members. To this end, the Hearing Officer recommends the adoption of the amendments to Reg.IV.18(h)(4)(iv)B.2. and 3. as reflected on Attachment 1. to permit reference to both such sources - the taxpayer's books and records, as well as published survey statistics.

4. Deletion of MTC Reg.IV.18(h)(4)(iv)B.4.

Paragraph (4)(iv)B.4. of MTC Reg.IV.18(h), as originally adopted, created a throwout, in effect, of foreign receipts from the receipts factor. Thus, the tax base, which would include income derived from foreign broadcasts, was apportioned without reflection of the foreign-source receipts in the factor. This result would tend to unfairly, if not unconstitutionally, apportion foreign-generated income to the United States. Comments from industry representatives firmly support this

conclusion. See Attachments 11 and 14 at pp. 22-23 and 32, respectively. Therefore, the Hearing Officer recommends that the Commission delete this provision from the amended regulation in its entirety.

5. DEFINITION OF "AUDIENCE FACTOR" TO INCLUDE FOREIGN AUDIENCES IN MTC REG.IV.18(H)(4)(IV)B.2. AND 3.

To the extent that broadcasters conduct business outside of the United States, the current Regulation excludes consideration of the foreign audience in its definition of audience factor. This limitation is improper for the same reasons as set forth in the discussion immediately above. The limitation of the audience factor denominator to a U.S. audience only, but the inclusion of foreign receipts in the tax base ignores economic reality and may well be violative of the fair apportionment prong of the Commerce Clause. Therefore, the Hearing Officer recommends that MTC Reg.IV.18.(h)(4)(iv)B.2. and 3. be amended to provide for inclusion within the audience factor consideration of foreign audiences to the extent a broadcaster has an audience outside the United States.

6. TREATMENT OF PRODUCTION AND DISTRIBUTION OF LICENSED MATERIALS

Early in this process the Hearing Officer believed it could have been appropriate to explore the development of specific allocation and apportionment rules to address issues concerning the treatment of licensed materials. So, a simple question was posed to elicit comments to assist the Hearing Officer in deciding whether to make any recommendations with regard to income generated by licensing activities in the broadcasting context. The Hearing Officer received no such guidance, but came to the realization that this subject should await another day in a more appropriate and broad based forum.

The attribution of net income earned from the licensing of intangibles, such as programming, motion pictures, books, computer

programs and the like is a subject that cuts across many industries in addition to broadcasting. Because the subject is so broad and touches a core activity of so many different types of businesses and licensors, it deserves an in-depth review by the Uniformity Committee of the Commission before a lone Hearing Officer proceeds further. The collective input of the Uniformity Committee members is vital to provide the necessary background to the subject, as well as the initial discussions of the alternative directions that may be taken. Therefore, the Hearing Officer recommends that the Uniformity Committee consider the general topic of licensing for its agenda.

7. TREATMENT OF OUT-OF-STATE BROADCASTER VS. IN-STATE BROADCASTER

A question was raised as to whether the application of the currently adopted apportionment regulation resulted in a different apportionment result depending upon whether the broadcaster was broadcasting from within the state or from outside the state. The short answer is that it does not; nor should it be construed to apply differently depending upon the location of the broadcaster.

The current regulation, with or without adoption of the proposed amendments, applies alike to all broadcasters who are taxable in more than one state. If this is not clear from the wording of the regulation as adopted, then a proposed amendment to the first paragraph of the regulation makes that clear. As amended the that paragraph would provide that ---

> The following special rules are established in respect to the apportionment of income from television and radio broadcasting <u>by a broadcaster that is taxable in both this state and in one or nor other states</u>. (Proposed amended language underlined).

So long as a broadcaster derives income from broadcasting in two or more states and is taxable in two or more states, the apportionment calculations and result should not differ depending upon which state is applying the formula. The same apportionment result should flow from the application of regulation by the state in which the broadcaster is located as would flow from its application to the same circumstances by the state in which the audience is located.

8. EFFECT OF VARYING BROADCAST SIGNAL POWER

A question was raised during the proceedings as to what effect upon the apportionment result would occur when the broadcaster's signal power varied during its broadcast day. By varying its signal, a broadcaster varies the extent and size of its audience. Should the regulation be amended to address this issue? Very little was submitted during public comment on this issue; and the Hearing Officer does not believe that this activity is shown to be of such a pervasive occurrence or of severe nature to require it be addressed in the regulation.

The National Association of Broadcasters suggested that radio, as opposed to television broadcasters were subject to this variation in signal coverage. The NAB posed that audience coverage might be measured at various times during the broadcast day for this problem. The Hearing Officer concludes that requiring an increased number of audience measurements by all broadcasters would be overreacting to this problem. As Oliver Wendell Holmes once noted, "Insanity is often the logic of an accurate mind overtaxed." Should a broadcaster keep such additional records of audience measurement, it should be allowed to rely upon them. However, if no additional measurements are taken, and there remains this issue of expanding and contracting audiences, it is suggested that the audience factor be determined by looking solely at data that determine a broadcaster's Area of Dominant Influence ("ADI") or service area until more is understood by the states as to the impact of varying signals on the audience factor.[12]

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12 While the book of quotations is open, the following is offered from Voltaire:

9. NEXUS OVER THE OUT-OF-STATE BROADCASTER AND THE APPLICATION OF THE THROWBACK RULE

While specifically set forth in the questions contained in the Notice of Public Hearing, relatively few comments were received from industry representatives dealing with what effect, if any, do the *Quill* and *Geoffrey* cases have upon the apportionment of a broadcaster's income. A closely related question to nexus - the propriety of including a throwback of receipts rule - was also raised. See Attachment 6, Attachment 11, pp. 20-21, 26-28, and Attachment 14, pp. 35-36.

The members of the NAB Working Group have made it quite clear that even should a state adopt a proposed broadcaster apportionment regulation, they "have not and will not concede nexus in any jurisdiction with respect to any tax year in absence of clear, convincing and applicable judicial standards which mandate such a conclusion." See Attachment 18, p. 4. In addition, they admonished the Hearing Officer to avoid any nexus discussion similar to discussions that the Hearing Officer has included in other reports, because such discussion might "preclude the achievement of the broadcast industry consensus you [the Hearing Officer] seeks". See Attachment 18, p. 4. However, the submission on behalf of two of the members of the NAB Working Group, ABC and NBC, also recognizes that the issue of nexus is necessarily entwined with the throwout concept and the proper sourcing of receipts. See Attachment 11, pp. 20-21, 26-28.

The Hearing Officer seeks nothing more than to recommend a fair, administrable apportionment regulation for uniform adoption in a substantial number of states. Achieving "broadcast industry consensus" would be most helpful in this process. But, the Hearing Officer cannot

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"Perfection is attained by slow degrees; it requires the hand of time." Admittedly, since very few states have yet attempted to apportion income earned within their borders by local and national broadcasters, much more experience is required to develop a better understanding of the industry and its subtleties for the purpose of apportioning broadcasters' income.

fulfill his public duty to the Commission by avoiding discussion of related issues that are of importance to the states and other interested parties which will necessarily be addressed in the near future. The Hearing Officer has weighed the NAB Working Group's admonition to remain silent on the nexus issue and declines to heed it. One must assume that the broadcast industry members' avid (sometimes rabid) support for the principles underlying freedom of speech will win out; and a good faith public discussion of important legal concepts affecting both states and industry members will not be met with any punitive response. If not, so be it. Therefore, the Hearing Officer submits the following brief comments regarding the two related concepts of nexus and throwback.[13]

As an initial proposition, neither the current version of Regulation IV.18(h), nor the proposed amended version contain any provision purporting to establish or describe when nexus (jurisdiction to tax) over an out-of-state broadcaster is established. It is the opinion of the Hearing Officer that a state cannot, by mere adoption of a regulation apportioning the income of a business, create nexus over the business. The standards that govern whether nexus exists or not in the corporate income tax context reside under provisions of the United States Constitution and, if applicable, Public Law 86-272. Of course, a state could adopt a regulation describing a standard or description of circumstances under which the state asserts nexus exists; and, such a statement, if it was supported by the Constitution and other law, would be helpful in most instances. A state could also, if it wished to adopt such a policy, set forth a more limiting nexus standard than the law allows, thus advising prospective taxpayers that it is willing to forego the assertion of taxing jurisdiction under certain circumstances.

In the broadcasting industry, since most of its activities may be viewed as the delivering of a service - the transmission of messages,

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13 The Hearing Officer has set forth at great length his views upon nexus in the context of service providers in two prior Reports of Hearing Officer and will not clutter this report with repeating them in mantra-like fashion here. For those interested in that discussion, see Final Reports of Hearing Officer on apportionment of income derived from Publishing (MTC Reg.IV.18(j)) and from Financial Institutions.

entertainment, news, advertising and the like - Public Law 86-272 could not act to shield the broadcaster from nexus-creating activity. Therefore, what remains to be applied to determine whether tax jurisdiction is properly asserted under any fact pattern are the provisions of the Due Process and Commerce Clauses to the United States Constitution. The mere declaration that some activity or another creates nexus that is made part of any statute or regulation or guideline does not create that nexus; only the activities of the business actually engaged within the state determine whether taxing jurisdiction exists. Therefore, the Hearing officer has always assumed that no apportionment provision that is contained in any regulation could, by the mere force of its articulation, create nexus. This assumption remains with regard to the pending broadcast regulation.

The above discussion should in no way be understood that the Hearing Officer has any reasonable doubt that the typical out-of-state broadcaster has nexus for operational tax purposes in the states into which its signal is purposefully directed on any regular or systematic basis. Some out-of-state broadcasters may also engage in the more typical nexus-creating activities of sending representatives into the market state, owning or leasing a station or other property there, etc. Cable or broadcast network that has affiliate stations under contractual obligation to transmit network programming that enjoy the use of in-state cable wiring and transmitters to relay its programming will likely have nexus in those states into which it sends its signal for relay to or receipt by its audience or subscribers. This is not just a view held by the Hearing Officer, but pre-eminent experts in the field of state taxation believe that, for nexus purposes, there remains no significant distinction between delivery of a physical embodiment of information and the transmission of that same information by electronic signal.[14]

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14 In discussing nexus for sales and use tax purposes, Professor Hellerstein and Jerome Hellerstein have stated, "It may be that the time has come when the 'definite link' and 'minimum connection' with the States can be established, not merely by the delivery in the State of a physical document, such as a printed or duplicated report, but equally by a report delivered electronically by a telephone receiver or a computer terminal. Indeed, such a result would be justified by modern atomic physics, which has all but destroyed the distinction between physical objects and electrical or

Two written comments received supported the adoption of either a "throwback or a "throwout" of receipts that are attributed to a state in which the broadcaster is not taxable. See Attachment 6 and Attachment 8, paragraph nos. 5 and 12.[15] Attachment 6, submitted by the General Counsel of the Massachusetts Department of Revenue, requests the Commission to adopt a "thowback" or "throwout" of receipts when the broadcaster is not taxable in the state into which its signal and programming has been delivered in order to promote full accountability.

The failure to include either a "throwout" or "throwback" of receipts in either the proposed or adopted amendments to the regulation should not be taken to mean that such provisions are not consistent with one of the more important principles underlying UDITPA or the Compact - the full attribution of income for tax purposes and the avoidance of nowhere receipts or income. Several reasons, aside from sound tax policy, may lead a state away from insisting on full apportionment. The current effort by many states to entice industries to locate, expand or remain within their borders has led many a state to eschew certain tax policies in favor of "economic development". Electing not to throwback or throwout receipts is one tax expenditure for states to give companies.

While both UDITPA and Compact provisions include a throwback provisions where the sale of tangible personal property is delivered to a non-nexus state, no such specific throwback provisions apply when

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electronic impulses. Essentially the same benefit and protection are extended by the State and the same social costs are incurred....". Hellerstein and Hellerstein, State Taxation, § 18.06 (Warren Gorham Lamont 1992 ed.)

15 By virtue of the Franchise Tax Board's recent vote to oppose the proposed property factor changes and, therefore, to ignore at least that part of Attachment 8 as not reflective of the Board's position, the Hearing Officer is unsure of whether any other part of Attachment 8 currently reflects the Board's position. On the assumption that, absent sufficient industry support, the Franchise Tax Board would also not support a "throwback" or "throwout" of non-nexus receipts, only Attachment 6 will be looked to regarding this issue. However, since all of the remaining comments contained in Attachment 8 spring from an expertise that has been developed from the Board's long-standing involvement in tax issues regarding the entertainment industry and offer thoughtful advice, the Hearing Officer will not ignore them.

services are delivered to a non-nexus state. The Hearing Officer assumes that the drafters of UDITPA and the Compact looked to the operation of Section 17 - the sourcing of receipts from services to the state in which the majority of the cost of performance was located - to provide full sourcing in the service context. Over time, however, a growing and substantial dissatisfaction has developed with the application of Section 17's "all-or-nothing" cost of performance approach to receipt factor sourcing. Since it appears that their exists little prospect for much uniformity to be achieved as to this issue in the context of the interstate sale of broadcasting services, the proposal contained in Attachment 1 does not contain either a receipts throwout or throwback provision. However, the Hearing Officer strongly urges the member states to include this issue in its more general discussions of the apportionment treatment for income derived from services.[16]

The Commission does not yet have any formalized uniformity project regarding the general apportionment treatment of income from services or the application of throwback or throwout concepts in this area. However, the staff of the California Franchise Tax Board currently is reviewing, among other things, the principle apportionment issues arising within the context of the telecommunications industry. Since this industry (or more appropriately many different sub-industries falling under the general heading of "telecommunications") will allow a broad and varied analysis of alternative apportionment mechanisms for this large service sector, the Hearing Officer suggests that the FTB, if it finds it appropriate, include the following issues in its review -

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16 The Commission does not have any formalized uniformity project regarding the general apportionment treatment of income from services or the application of throwback or throwout concepts in this area. However, the staff of the California Franchise Tax Board currently is reviewing, among other things, the apportionment issues arising within the context of the telecommunications industry. Since this industry (or more appropriately many different sub-industries falling under the general heading of "telecommunications") will allow a broad analysis and approach to apportionment issues, the Hearing Officer suggests that the FTB's review include the property factor treatment, if any, for computer programming, film and radio programming and like intellectual properties that are physically located in one state, but transmitted for use in another.

1. the property factor treatment, if any, for computer programming, film and radio programming and like intellectual properties that are physically located in one state, but transmitted through a variety of methods of telecommunication for use in another; and

2. the throwback or throwout of receipts from services delivered by telecommunication into a state in which no tax nexus is found to exist.

IV.
CONCLUSION

The Hearing Officer submits these recommendations with the knowledge that the member states will review them carefully and with the hope that a significant number of them will adopt, within the reasonably near future, a fair and administrable method for apportionment of income of broadcasters. The rapidly occurring technological advancements in the area of broadcasting, as in the general area of telecommunications, provides reason enough to address the development of proper income apportionment methods now, as opposed to later or not at all. It is only through working with the industry in an effort to apply a common apportionment approach can many parties become involved, learn from one another, and improve and advance the effort and their relationships. In this process there was plenty of line drawing and sand shifting; but, in the end, if the a substantial part of the broadcast industry were to support the proposal reflected in Attachment 1 and a significant number of states were to adopt it, all parties should view the process as successfully completed.[17]

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17 The Hearing Officer also extends his appreciation to the many industry representatives that provided their respective reactions (often with vim and vigor ~~venim and total disdain~~) to the various proposals. It is through such exchange that any Hearing Officer can best understand the principles at stake and the appropriate places in the sand at which to draw lines.

This Final Report of Hearing Officer is submitted this 19th day of December, 1995.

Alan H. Friedman
Hearing Officer