

July 25, 2016

Demesia Padilla
Executive Committee Chair
Multistate Tax Commission
444 N. Capital Street NW
Suite 425
Washington, DC 20001

Re: Draft Amendments to Sections 1 & 17 of the General Allocation and Apportionment Regulations regarding the treatment of receipts from hedging, interest, and dividends.

Dear Secretary Padilla:

The Securities Industry and Financial Market Association¹ (“SIFMA”) appreciates this opportunity to comment on the proposed recommendations made by the Uniformity Committee (“Committee”) regarding amendments to Sections 1 and 17 of the General Allocation and Apportionment Regulations. Specifically, SIFMA would like to express its concern with the recommendation to exclude receipts from lending activities, hedging transactions, security transactions, as well as interest and dividends from the definition of “receipts” under Section 1 regulations and instead consider such issue under Section 18 regulations. SIFMA respectfully requests that the Executive Committee either (1) reject the Committee’s recommendations all together until more appropriate consideration is given to the definition of “receipts;” or (2) accept the recommendations, but not adopt, and allow for industry to provide further comments and recommendations for consideration.

SIFMA appreciates the Committee’s efforts in developing updated model amendments to allow for a more reasonable level of uniformity among the states, and SIFMA understands its concern for addressing transactions that may otherwise be distortive within the current model rules. We realize that in recent years this has included hedging and securities transaction in certain situations. However, the proposed amendments that would support adoption of an “all or nothing” approach in addressing such transactions fails to provide for a fairer sourcing methodology for a large number of our members, and other similar taxpayers, as provided below.

I. The proposed amendments to “receipts” under Sec. 1 ignore the large number of taxpayers that primarily deal in lending, hedging, and securities transactions.

Under the Committee recommendations, Article IV, Section 1(g) is amended to read:

“Receipts’ means all gross receipts of the taxpayer that are not allocated under paragraphs of this article, and that are received from transactions and activity in the regular course of the taxpayer’s trade or business; except that receipts of a taxpayer from hedging transactions and from the maturity, redemption, sale, exchange, loan or other disposition of cash or securities, shall be excluded.”

¹ SIFMA represents the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over \$2.5 trillion for businesses and municipalities in the U.S., serving clients with over \$20 trillion in assets and managing more than \$67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

SIFMA represents broker-dealers, banks, and asset managers all of which will most certainly be impacted by the proposed amendments. The core business of many of our members is in the very activities that the Committee is recommending be excluded from the receipts factor, for example, a dealer in securities or commodities engaging in the purchase and sale of financial assets of commodities with customers. In some cases, receipts from hedging and securities transactions may be the predominate form of revenue, such as where a broker-dealer's revenue is the "spread" on the sale of securities, as opposed to actual commission fees.

In addition to securities broker-dealers, there are numerous other businesses for which the lending, hedging, and securities transactions also represent a substantial piece of their business activity and income therefrom. These include non-bank mortgage originators, consumer finance companies, investment management companies, asset managers, and holding companies for example. For those states which have adopted special apportionment rules for "financial institutions," these are examples of businesses that may not otherwise fall within such definition and as a result subject to the general corporate apportionment rules. Furthermore, it is common in today's business environment to have one affiliate that is responsible for managing the group's financing, and treasury functions, including managing all of the relevant market risk for the group.

As our members deal primarily in financial intermediation, hedging transactions play an absolutely vital role in managing the inventory risk of the securities in which they deal in or otherwise make a market in. Excluding such receipts from the sales factor would result in unintended consequences for example, having an apportionable income base without any sales factor representation could result for these types of businesses, thereby ultimately allowing for situations that inaccurately reflect a taxpayer's market for a large number of taxpayers, and running contrary to the Committee's intentions of providing a fairer apportionment methodology.

In addition, the Committee has recently recommended amendments clarifying that all interest and dividends should also be excluded from the definition of receipts.² We find this particularly troublesome as interest and dividends were not clearly identified as excluded receipts in the Committee's prior recommended definition, as provided above. Likewise, the example under Reg. IV.(a)(6)(F) which specifies, "Receipts from the maturity, redemption, sale, exchange, loan or other disposition of cash or securities are excluded from the definition of receipts whether or not those events or transactions are engaged in for the purpose of hedging," also makes no mention of any interest or dividends earned while holding such security or asset. Moving forward with such recommendation would not give the public ample opportunity to comment. As such, we respectfully request that the Executive Committee take this into consideration in its review of the Committee's report and allow for more time for industry to comment.

II. Businesses that primarily deal in lending, hedging and securities transactions should not be left to determine their apportionment under alternative apportionment provisions of Sec. 18.

It is our understanding that the Committee at one point included an exception for securities dealers in the draft regulations but opted to not include such exception since the Section 17 regulations did not provide for sourcing of receipts from hedging or receipts from securities. Instead of addressing in Section 17, the Committee appears to be recommending that such receipts be addressed under the Sec. 18 work group. However, we have absolutely no assurance that the Committee will actually

² See "Checklist – Referral of Issues from the Executive Committee." *Multistate Tax Commission*, July 14, 2016. Web. July 20, 2016. <http://www.mtc.gov/Uniformity/Project-Teams/Section-17-Model-Market-Sourcing-Regulations>. (See also "Draft of Minutes – Meeting of July 14, 2016").

take this issue up, or what the timing of such consideration would be. Hedging and securities transactions in many cases are intertwined with the underlying sale and simply discarding such activity from the definition of “receipts” under Sec. 1, instead of dealing with such separately under Sec. 17, risks not reasonably approximating the taxpayer’s market. Again, such course of action runs contrary to the Committee’s efforts to modernize Compact Art.IV.17 and other Compact provisions, and to minimize the need to use §18 in crafting special rules.

We also fundamentally have concerns with the Committee recommending that a business’ primary receipts be addressed not under regular apportionment provisions but within the context of the state’s alternative apportionment provisions; provisions that may be applied differently between the states and which historically have been open to much debate. In the event that these transactions are not appropriately addressed under Sec. 18, constitutional issues, particularly under the fair apportionment standard of the Complete Auto Test, may exist. It also raises questions for these businesses in determining whether nexus exists in those states that have adopted economic nexus standards which refer to the apportionment rules.

III. The Committee should consider those states that have already addressed hedging and securities transactions.

A number of states have already addressed the treatment of hedging and securities transactions for purposes of the sales factor and have opted to take a more focused approach than what the MTC is currently proposing.

Most recently, the Illinois Department of Revenue adopted regulations that define and provide for a basis of sourcing hedging receipts. Under 86 Ill. Admin. Code 100.3380(c)(6)(B), any income, gain or loss from a transaction properly identified as a hedge under 26 USC Sections 1221(b)(2)(A), 475(c)(3), or 1256(e)(2) is excluded from the sales factor. However, the regulation provides an exception for gains and losses on hedging transactions entered into to manage risks associated with the gross income the taxpayer expects from its sales of goods and services (for example, the effect of foreign currency fluctuations on the dollar amount of gross income the taxpayer will receive from sales to a particular foreign country) recognizing that these are best accounted for in the sales factor as adjustments to the gross receipts from the transactions whose risks are being hedged. Illinois further provides instances in which hedging transactions are included in gross receipts. We have attached a copy of the Illinois regulation for your reference.

Other states have adopted carve-outs for security broker-dealers or similar companies. For example, New Jersey provides that receipts used in the computation of the taxpayer’s net income for federal tax purposes, excluding certain receipts not included in the taxable income base, are included in the sales factor.³ Receipts from the services of registered securities or commodities brokers or dealers are sourced to New Jersey if the customer is located within the State.⁴ New Jersey also looks to the Internal Revenue Code in defining “securities” and “commodities.”

While we are not naïve enough to believe that these examples are free from issues, we offer them as examples to the Executive Committee of where states have addressed industries that deal primarily in hedging and securities transactions within the context of the general apportionment provisions as opposed to under Section 18, or similar provisions. These states have understood the need to specifically provide exceptions or carve-outs for certain taxpayers whose primary business consists of lending, hedging, and other securities transactions. As such we request that these examples not

³ N.J. Rev. Stat. § 54:10A-6(B)

⁴ N. J. Admin. Code §18:7-8.10(f)

be overlooked but incorporated into the recommendations as the Committee develops a more modern apportionment framework under Sections 1 and 17.

V. Conclusion

In conclusion, SIFMA respectfully requests that the Executive Committee either (1) reject the Committee's recommendations all together until more appropriate consideration is given to the definition of "receipts;" or (2) accept the recommendations, but not adopt, and allow for industry to provide further comments and recommendations for consideration. As outlined above, a number of issues remain with the proposed amendments that cause significant concerns to our members as they seek a fair apportionment methodology. While we recognize that it is the Committee's intent not to delay the advancement of its recommendations, we understand that such proceedings are already delayed and we respectfully request that the Executive Committee allow for additional time for the Committee and interested parties to address these issues before adopting.

We appreciate your consideration of our views and concerns, and we would appreciate the opportunity to discuss further the issues in this submission with you and your colleagues.

Please do not hesitate to contact me at 212-313-1233 for additional information or clarification of the aforementioned comments.

Sincerely,



Nancy Lancia
Managing Director
State Government Affairs

Cc: Wood Miller, Uniformity Committee Chair