

Update: MTC Section 17 Market-Sourcing Regulations Project

Work Group's Activities

- Meetings started Nov. 5, 2014
- Meet every Tuesday, 3pm EST
 - Produced a checklist with issues to address
 - Reviewed state market-sourcing regulations and selected those best suited to be a starting point (Massachusetts)
 - Analyzed section-by-section with drafter of the MA regulations; discussed examples; debated language and application; made edits as necessary
 - Assessed viability of general adoption of model regulations

**WORK IN
PROGRESS**

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At A Glance

Section 17		Massachusetts Market-Sourcing Statute & Regulation
		Taxpayer's market is:
Real property: Sale, Rental, Lease or License	<input checked="" type="checkbox"/>	Sourced to location of property
Tangible personal property: Rental, Lease or License	<input checked="" type="checkbox"/>	Sourced to location of property (exception for mobile property)
Services	<input checked="" type="checkbox"/>	Divides into 3 categories of services, and sources for each
Intangible property:	<input checked="" type="checkbox"/>	
Rental, Lease, or License	<input checked="" type="checkbox"/>	Sourced to the extent used in state
Sale	<input checked="" type="checkbox"/>	Sourced according to the nature of the intangible
Reasonable approximation	<input checked="" type="checkbox"/>	Addressed throughout
Throwout	<input checked="" type="checkbox"/>	Addressed throughout

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Justification for Regulatory Approach

- Hearing Officer report p. 81:

One thing seems clear (at least to the Hearing Officer): "one size will certainly not fit all." Key terms such as "delivery," "use," or "marketing intangibles," might be defined one way in the context of a specific industry but in a slightly different way in other contexts. The Hearing Officer fears that defining these and other critical terms in the abstract will be less useful than doing so in a particular context, responding to concrete and identifiable problems. In short, it might be more fruitful to tackle definitional issues on a narrower, industry-specific or transaction-specific basis. That is why criticism about the Draft being long on principle but short on detail is misguided. The details should be provided in the context of specific industries and transactions. The drafting would be greatly facilitated through a more narrow, industry, or transaction-oriented approach.

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Working Principles

General Policy Principles	Status/Consensus
<p>Should market sourcing rules seek to achieve the following:</p> <ol style="list-style-type: none"> 1. Consistency -- in the sourcing result 2. Harmonizing existing rules 3. Reliability -- in preventing mis-sourcing or manipulation 4. Simplicity -- so that: <ol style="list-style-type: none"> a. Terms used mean the same thing in different contexts; b. The sourcing rules achieve the same result, as often as possible, regardless of how the sale is characterized; c. The records required or relied on are generally available; and d. Sales in similar industries or under similar circumstances are sourced similarly. 5. Adaptability -- to allow a logical progression from general rules to more specific rules. 6. Certainty -- to prevent unexpected issues or questions for tax administrators or traps for taxpayers. 7. Compatibility -- so that the rules used in sourcing sales for other state tax purposes, especially sales and use taxes, are compatible with the rules adopted. 	<p>These ideas have been discussed by both the Uniformity Committee and the work group as possible guides for the work in producing model sourcing rules.</p>

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Guiding Statutory Principles

- Statutory intent to source to market effectuated by subrules
- Built-in flexibility via reasonable approximation
- Throwout where the taxpayer cannot reasonably approximate or is not taxable in the state of assignment

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Road Map: Market Sourcing

- Real property: Sale, Rental, Lease or License
- Tangible personal property: Rental, Lease or License
- Services
 - In-Person Services
 - Professional Services
 - Other Services Delivered
 - To or on Behalf of a Customer by Physical Means
 - To a Customer by Electronic Transmission
 - Through or on behalf of a Customer by Electronic Transmission
- Intangible property:
 - Rental, Lease, or License
 - Sale

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Road Map: Market Sourcing

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Market Sourcing of Real Property

Art. IV. Sec. 17(a)(1)

- in the case of sale, rental, lease or license of real property, if and to the extent the property is located in this state

830 Mass. Code Regs. 63.38.1

- In the case of a sale, rental, lease or license of real property, the sale is in Massachusetts if and to the extent that the property is in Massachusetts

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Road Map: Market Sourcing

- Real property: Sale, Rental, Lease or License
- **Tangible personal property: Rental, Lease or License**
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Market Sourcing of Tangible Personal Property

Art. IV. Sec. 17(a)(2)

- in the case of rental, lease or license of tangible personal property, if and to the extent the property is located in this state

830 Mass. Code Regs. 63.38.1

- In the case of a rental, lease or license of tangible personal property, the sale is in Massachusetts if and to the extent that the property is in Massachusetts.
- If property is mobile property that is located both within and without Massachusetts during the period of the lease or other contract the receipts assigned to Massachusetts shall be the receipts from the contract period multiplied by the fraction used by the taxpayer for property factor purposes...

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Road Map: Market Sourcing

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- Tangible personal property: Rental, Lease or License
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Market Sourcing of Services

Art. IV. Sec. 17(a)(3)

- in the case of sale of a service, if and to the extent the service is delivered to a location in this state



830 Mass. Code Regs. 63.38.1

- The sale of a service is in Massachusetts if and to the extent that the service is delivered at a location in Massachusetts.
- In general, the term "delivered" shall be construed to refer to the location of the taxpayer's market for the service provided and is not to be construed by reference to the location of the property or payroll of the taxpayer as otherwise determined for corporate apportionment purposes...

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Market Sourcing of Services

- MA breaks down "services" into 3 categories:
 - In-Person Services
 - Professional Services
 - Other Services Delivered
 - To or on Behalf of a Customer by Physical Means
 - To a Customer by Electronic Transmission
 - Through or on behalf of a Customer by Electronic Transmission

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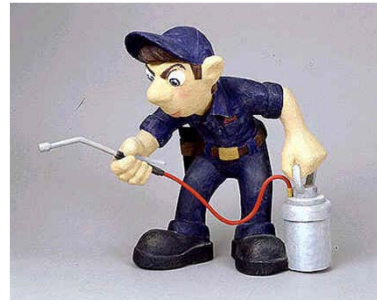
Road Map: Market Sourcing

- Real property: Sale, Rental, Lease or License
- Tangible personal property: Rental, Lease or License
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Market Sourcing of Services: “In-Person” Services

- “In-Person” = Customer or customer's real or tangible property upon which the services are performed is in the same location as the service provider at the time the services are performed
- E.g.: repair services; cleaning services; construction contractor services; pest control; landscape services; child care; hair cutting and salon services; live entertainment and athletic performances; in-person training or lessons
 - includes situations where the services are provided on behalf of the taxpayer by a third-party contractor



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Market Sourcing of Services: “In-Person” Services

Source to MA:

- (A) Where the service is performed with respect to the body of or in the physical presence of the customer in MA
- (B) Where the service is performed with respect to the customer's real estate or tangible personal property at the customer's residence or in the customer's possession in MA
- (C) Where the service is performed with respect to the customer's tangible personal property and the tangible personal property is to be shipped or delivered to the customer in MA



Reasonable Approximation

If the state or states where a service is actually received cannot be determined, but the taxpayer has sufficient information regarding the place of receipt from which it can reasonably approximate the state or states where the service is received, the taxpayer shall reasonably approximate such state or states

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Market Sourcing of Services: “Professional” Services



- Services that require specialized knowledge and in some cases require a professional certification, license or degree.
- *E.g.*, management services, bank and financial services, financial custodial services, investment and brokerage services, fiduciary services, tax preparation, payroll and accounting services, lending and credit card services, legal services, consulting services, video production services, graphic and other design services, engineering services, and architectural services

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Market Sourcing of Services: “Professional” Services

Professional Services Delivered to Business Customers (default)

State where the contract of sale is principally managed by the customer*

* in any instance in which the taxpayer derives more than 5% of its sales of services from a customer, the taxpayer is required to identify the state in which the contract of sale is principally managed by the customer.

If place of customer management is not reasonably determinable, to customer's place of order

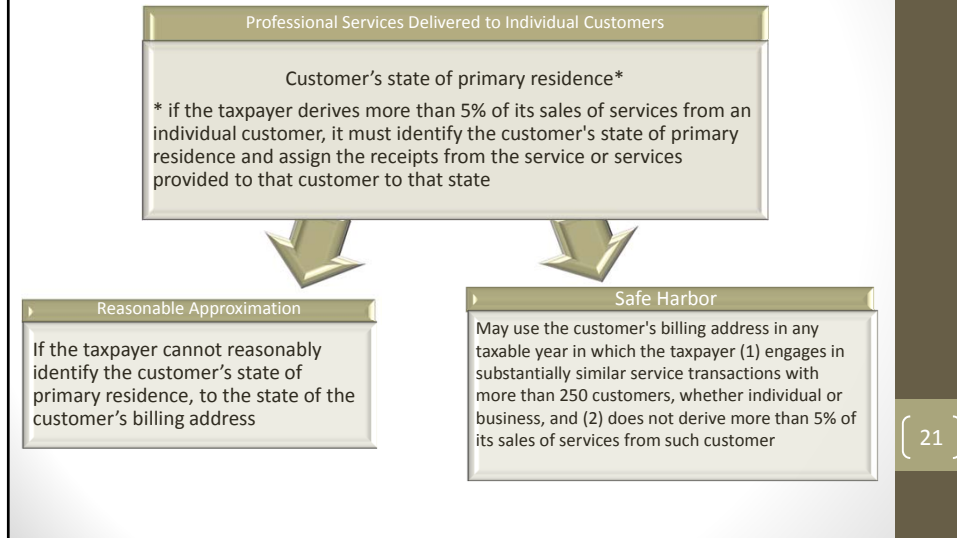
If place of customer order is not reasonably determinable, to customer's billing address

Safe Harbor

May use the customer's billing address in any taxable year in which the taxpayer (1) engages in substantially similar service transactions with more than 250 customers, whether individual or business, and (2) does not derive more than 5% of its sales of services from such customer

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Market Sourcing of Services: “Professional” Services



Special Treatment of Certain Professional Services

- Architectural and engineering services with respect to real or tangible personal property are professional services
- However,
 - (1) the sale of such an architectural service is assigned to a state or states if and to the extent that the services are with respect to real estate improvements located, or expected to be located, in such state or states; and
 - (2) the sale of such an engineering service is assigned to a state or states if and to the extent that the services are with respect to tangible or real property located in such state or states, including real estate improvements located in, or expected to be located in, such state or states.

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Road Map: Market Sourcing

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Market Sourcing of Services: Services Delivered to or on Behalf of a Customer by Physical Means

- **Service delivered "to" a customer** = customer and not a third party is the recipient of the service (*e.g.*, custom software)
- **Service delivered "on behalf of" a customer** = customer contracts for a service but one or more third parties is the recipient of the service (*e.g.*, fulfillment services, delivery of brochures, fliers or other direct mail services; delivery of advertising or advertising-related services to the customer's intended audience in the form of a physical medium)



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Market Sourcing of Services: Services Delivered to or on Behalf of a Customer by Physical Means

Rule of Determination

Taxpayer must first attempt to determine the state or states where such services are delivered, and assign the services there.



Rule of Reasonable Approximation

If taxpayer cannot make a determination, but has sufficient information regarding the place of delivery, taxpayer shall reasonably approximate such state or states.

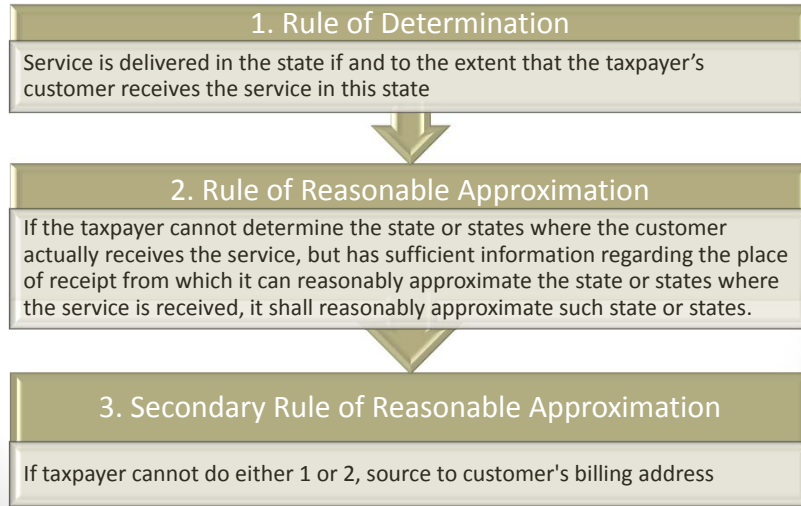
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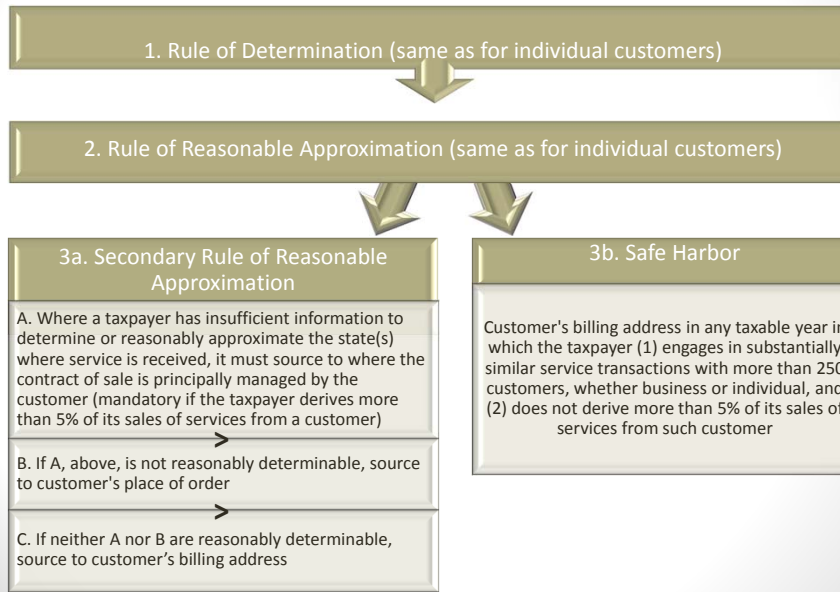
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Market Sourcing of Services Delivered By Electronic Transmission to an Individual Customer



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Market Sourcing of Services Delivered By Electronic Transmission to a Business Customer

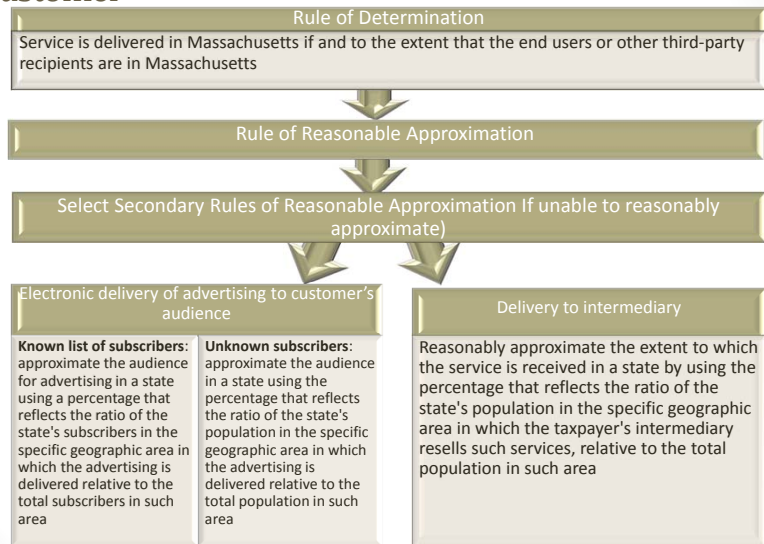


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Road Map: Market Sourcing

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Market Sourcing of Services Delivered Electronically Through or on Behalf of an Individual or Business Customer



Is there potential overlap?



- Yes
 - Drafters of MA regulations considered and addressed; regulations clarify some overlaps
 - Intent is for everything to fit into *a* category; *which* category is generally less important



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 - **Rental, Lease, or License**
 - Sale

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Market Sourcing of licenses and leases of intangible property

Art. IV. Sec. 17(a)(4)(i)

- [The taxpayer’s market for sales is in this state:]
- (4) in the case of intangible property,
 - (i) that is rented, leased, or licensed, if and to the extent the property is used in this state, provided that intangible property utilized in marketing a good or service to a consumer is “used in this state” if that good or service is purchased by a consumer who is in this state

830 Mass. Code Regs. 63.38.1

- The receipts from the license of intangible property are in Massachusetts if and to the extent the intangible is used in Massachusetts.
- In general, the term "use" shall be construed to refer to the location of the taxpayer's market for the use of the intangible property that is being licensed

MA Treatment of Specific Transactions

This transaction:	Is treated for tax purposes as:
License of intangible property that conveys all substantial rights in such property	sale of intangible property
Sale or exchange of intangible property where receipts are contingent on the productivity, use or disposition of the property	license of intangible property (in line w/Art. IV. Sec. 17(a)(4)(ii))
Intangible property licensed as part of the sale or lease of tangible property	sale or lease of tangible property
License of intangible property that resembles sale of electronically-delivered good or service	a service delivered to an individual or business customer or delivered electronically through an individual or business customer
License to a customer who sublicenses intangible property to end users	(in some cases) services delivered electronically to a customer for purposes of resale and subsequent electronic delivery in substantially identical form to end users or other recipients

MA Treatment of Certain Licensing Transactions

- **Marketing intangibles**

General Sourcing

Fees are assigned to MA to the extent they are attributable to the sales of goods and services acquired by purchasers in MA



Approximation

Multiply total fee by percentage that reflects ratio of MA population in geographic area in which licensee makes material use of the property

If license is for right to use intangible at wholesale, multiply total fee by percentage that reflects the ratio of MA population in the geographic area where the items are ultimately marketed

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Licensing of Other Intangibles

- **Production intangibles**

- Rebuttable presumption that use takes place in licensee's commercial domicile or state of primary residence
- If Commissioner can establish actual use of some of the intangibles is in MA, rebuttable presumption that entire use is in MA

- **Mixed intangibles**

- If production intangible and marketing intangible not separately stated in contract, rebuttable presumption that licensing fees were paid entirely for the marketing intangible

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 - Rental, Lease, or License
 - **Sale**

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Market Sourcing of sales of intangible property

Art. IV. Sec. 17(a)(4)(ii)

- [The taxpayer's market for sales is in this state: (4) in the case of intangible property,]
 - (ii) that is sold, if and to the extent the property is used in this state, provided that:
 - (A) a contract right, government license, or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area is "used in this state" if the geographic area includes all or part of this state;
 - (B) receipts from intangible property sales that are contingent on the productivity, use, or disposition of the intangible property shall be treated as receipts from the rental, lease or licensing of such intangible property under subsection (a)(4)(i); and
 - (C) all other receipts from a sale of intangible property shall be excluded from the numerator and denominator of the receipts factor.

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MA Treatment of Certain IP Sales Transactions

- **Contract right or government license that authorizes business activity in specific geographic areas**
 - Assigned to a state if and to extent the intangible is used or otherwise associated with the state
- **Agreement not to compete**
 - Assigned to a state based on the percentage that reflects the state's population in US geographic area specified in the contract relative to the total population in the area

