MULTISTATE TAX COMMISSION

TO: Model Receipts Sourcing Regulations Review Work Group

FROM: Brian Hamer
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RE: Possible change to the MTC's approach to sourcing transportation receipts

DATE: February 6, 2023

Background

As we have discussed during work group meetings, the MTC currently has in place a model special industry rule which addresses the sourcing of trucking company receipts. It was originally adopted in 1986 and amended in 1989, long before the MTC embraced market-based sourcing principles to source receipts from the sale of services and intangibles.[1]

This rule, which can be found at Special-Trucking-Rule-highlighted.pdf (mtc.gov), applies a three-factor apportionment methodology. The numerator of the sales factor consists of the taxpayer's total revenue "in this state"; the denominator of the sales factor consists of all revenue "derived from transactions and activities in the regular course of the taxpayer's trade or business which produce business income."

The rule further provides that revenue from freight, mail, and express is "attributable to this state" as follows:

1. Intrastate: all receipts from any shipment which both originates and terminates within this state; and

2. Interstate: that portion of the receipts from movements or shipments passing through, into, or out of this state as determined by the ratio which the mobile property miles traveled by such movements or shipments in this state bear to the total mobile property miles traveled by movements or shipments from points of origin to destination.[2]

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[1] Under this special industry rule, "trucking company" means "a motor common carrier, a motor contract carrier, or an express carrier which primarily transports tangible personal property of others by motor vehicle for compensation."

[2] The rule states that revenue from other than hauling, freight, mail, and express is "attributable to this state" in accordance with the MTC's general apportionment rules.

In other words, the current MTC rule utilizes a *mileage ratio* to apportion revenue of trucking companies generated from interstate movements or shipments of freight, mail, and express.

Issues

The MTC embraced market-based sourcing principles when it revised Article IV of the Model Multistate Tax Compact. *See* Art. IV, §17.

In the wake of that decision, the work group is considering whether the mileage approach contained in the trucking company rule should be replaced with an alternative methodology that arguably more closely aligns with market based-sourcing principles. And if so, should such an alternative approach be applied to all transportation services, not just to services provided by a business that falls within the definition of trucking company.

Relevant to this inquiry is the fact that courts in two states, Montana and New Mexico, have rejected the use of the MTC's mileage approach to apportion package delivery services sold by United Parcel Service. *See Montana Dep't of Revenue v. United Parcel Service, Inc.*, 830 P.2d 1259 (1992) (holding that application of the mileage method to UPS in Montana was "inequitable"); *New Mexico Public Dec. No. 19-27 (In the Matter of the Protest of United Parcel Service Inc.)* (holding that application of the mileage method to UPS in New Mexico resulted in a "disproportionate distortion of economic reality"). In addition, the work group has learned that at least one other state has agreed to apply an alternative methodology in the face of a taxpayer challenge. Links to the Montana and New Mexico decisions can be found on the work group's project page, which is located at Model Receipts Sourcing Regulation Review Work Group - MTC.[3]

It should be noted that while the MTC trucking rule applies a mileage ratio, the MTC special industry rule for airlines applies a departures ratio to apportion revenue generated by transporting freight and mail (as well as passengers). *See* Special-Airlines-Rule-highlighted.pdf.[4]

Possible Alternative Model Sourcing Approach

In order to focus this discussion, MTC staff suggests that the work group consider whether to replace the mileage-based sales factor methodology contained in the MTC model trucking company rule with the sales factor methodology that Massachusetts currently applies to transportation and delivery services.

Readers of this memorandum may recall that the MTC's Model General Allocation & Apportionment Regulations (the "Section 17 Regulations"), which were adopted by the Commission in 2017, are based on Massachusetts' market-based general apportionment rules.

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[3] My reference to these two decisions should not be read to suggest that courts would conclude that the application of the mileage approach to package delivery companies in every other state would be legally problematic.

[4] The MTC special industry rule for railroads also applies a mileage approach.

Treatment of trucking companies, however, is an instance where the MTC and Massachusetts currently differ in approach.

Shortly before the MTC adopted its Section 17 Regulations, Massachusetts revised the way it sourced transportation services. Prior to 2015, Massachusetts had in place a special industry sourcing rule for Motor Carriers (830 CMR 63.38.3) which applied a mileage approach. In 2015, the state revised this special industry rule: deleting the mileage approach and inserting in its place a cross reference to new subsection 63.38.1(9)(d)(4)(b) of its general apportionment rules.[5]

As a result of these changes, Massachusetts currently apportions transportation and delivery services as follows:

- Transportation and Delivery Services Provided by Means other than Exclusively by Air—assigned to the state or states of the *departures and arrivals* (in the case of the transportation of people) or *pickups and deliveries* (in the case of the transportation of tangible personal property); and

- Transportation and Delivery Services Provided Exclusively by Air—assigned to the state or states of the aircraft *departures* associated with such services.

See 830 CMR 63.38.1(9)(d)(4)(b)(iii)(B)&(C).

<u>**Final Comments**</u>

When considering whether to incorporate the current Massachusetts methodology into the MTC model sourcing rules, work group members should keep in mind that for any number of reasons some states may decide not to adopt a departures/arrivals sourcing approach or to retain a mileage approach that they may have currently in place. In fact, in the case of transportation services, it seems particularly unlikely that every state would embrace the same approach (which is the case today where states apply different sourcing methodologies). This fact alone, however, should not prevent the MTC from revising its special industry trucking company model if it concludes that there is a compelling reason to do so.

Finally, let me emphasize that the question of whether to revise the current MTC model is for the members of the work group and ultimately the Uniformity Committee and the Commission to decide, not the MTC staff.

[5] The MTC, when drafting its market-based sourcing regulations, did not consider making parallel changes to its trucking company rule, presumably because its focus at the time was revising its general section 17 regulations, which was a huge undertaking in itself.