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Executive Committee
Uniformity Committee
Multistate Tax Commission

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Re: Proposed Changes to Article IV of the Compact

As most of you may be aware I was employed by the California Franchise Tax Board for over 40 years and participated as part of the Uniformity Committee's working group on Article IV. I am no longer affiliated with the California Franchise Tax Board and do not speak for them. The views set forth in the attachment are mine alone and do not represent the views of the California Franchise Tax Board and were not the result of any consultation with any members of the Board or its staff.

I present these comments for your consideration because of my continuing interest in this area where I have worked for so many years and based upon my experience in administering or defending the implementation of the current UDITPA for over 40 years. Whatever decisions are made by the Executive Committee on these issues please be assured I will continue to support the efforts of the Commission to update Article IV of the Compact and the decisions of the Executive Committee and the member states of the Compact.

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Proposed Amendments to Art. IV. 18

Subsection (b)

The addition of subsection (b) as proposed by the Uniformity Committee should be adopted.

The recommendation of the Hearing Officer to amend subsection (b)(1) to require that the tax administrator publish rules or regulations in the case of a variance should not be adopted. In many circumstances it is only after the filing of tax returns that tax administrators become aware of the need to address particular circumstances. It would be unreasonable to require a tax administrator to anticipate all circumstances on an a priori basis and adopt rules or regulations to implement the authority granted by Section 18 of UDITPA to address issues or circumstances that justify the use of alternative methods. Holding the tax administrator to a requirement to anticipate situations and address them by regulation would be inappropriate.

Many times the alternative approach must be reviewed and approved either through an administrative hearing or a judicial proceeding. Until there is finality it would be inappropriate to require the adoption of a regulation.

As an example, when UDITPA was drafted it was not anticipated that taxpayers would seek to include the receipts from treasury activities in the receipts factor. It was several years later before this issue arose, principally by a single taxpayer, AT&T, and it was almost uniformly dealt with under Section 18. There was widespread acceptance of the result of administrative and judicial proceedings on this question for years. Challenges only arose as a result of a decision, California SBE *Appeal of Merrill Lynch,* to allow such receipts to be included in the sales factor in the context of a taxpayer who was a securities dealer. To require a tax administrator to anticipate this issue would have been unreasonable

Other additions proposed by the Hearing Officer

Comments have been made that these provisions are basically administrative and therefore might not be appropriate to be made part of Article IV. If the Commission accepts that position I would recommend that consideration be given to adopted these proposals outside of Article IV as recommendations for model statutes. Either alternative should accomplish the same result. In either circumstance I would offer the following suggestions for consideration by the Uniformity Committee and the Executive Committee.

Subsection (c)

The recommendation of the Hearing Officer to add a subsection (c) to address the question of the burden of proof and state that it applies to both the taxpayer and the tax administrator is appropriate and follows the practice and judicial decisions of the states collectively.

An additional subsection might be added to state that the adoption of a rule or regulation by the tax administrator after appropriate hearings meets the burden of proof that the standard provisions do not fairly reflect represent the activities of the taxpayer in this state. My suggested language is

> (c)(2) Adoption of a regulation after hearing pursuant to subsection 18(b) shall be presumed to meet the burden of proof as provided for in subsection 18(c)(1).

The Executive Committee suggested that the burden of proof be placed on the taxpayer if the tax administrator applied alternative apportionment as a result of the taxpayer's changing its long standing filing status. I think this would be appropriate where the taxpayer's filing status in prior returns was a variation from the standard UDITPA rules. I was recently involved in the *Vodaphone Americas Holding v. Roberts*, (Tenn June 23, 2014) a case where the taxpayer, a cell phone provider, had assigned sales based on the billing address of its customers for a number of years. The returns had been accepted by the department. The taxpayer filed claims for refund asserting that it should have filed pursuant to Section 17 on the basis of the state with the greatest income producing activity. I testified that the taxpayer's filing position established that the normal UDITPA rules did not fairly reflect its activities in the state and that the alternative of the billing address was a reasonable alternative. If the Uniformity Committee wants to address this issue I would suggest the following language"

> (c)(3) A taxpayer that has filed returns with the state on a method other than provided for in the statute that have been accepted by the state has the burden of proof to show that the method on which it filed does not fairly represent its activities in the state.

In *Vodaphone Amercias Holding v. Roberts* all of the states which the taxpayer presented as having greater income producing activity than in Tennessee had adopted rules or practices that assigned receipts on some basis of the proportion of the income producing activity in the state. As a result application of the greatest income producing activity would have given rise to "nowhere" income. This is an issue that the Uniformity Committee might wish to consider. I make no suggestions as to language.

Subsection (d)

It is my opinion that the recommendation of the Hearing Officer to add subsection (d) should only be adopted if modified. As drafted the Hearing Officer's recommendation allows a taxpayer to avoid penalties whenever it files in compliance with allocation and apportionment provisions of this Article in filing a return.

First, the first clause of Section 18 is "If the allocation and apportionment provisions of this article . . . " The Hearing Officer's recommendation would prohibit the imposition of penalties where the taxpayer ". . . reasonably relied on the allocation and apportionment provisions of this Article in filing a return." My concern is that the term "allocation and apportionment provisions of this article" could be construed to encompass only Sections 1 -17 of the Article and not also include rules or statutes adopted pursuant to Section 18. I recognize that an argument can be made that a taxpayer cannot "reasonably" rely upon provisions that have been overcome by reliance upon statutes, regulations or decisions that have been made upon the authority of Section 18. I think efforts should be made to foreclose this argument.

Second, it is not clear that the proposed language would allow for penalties to be imposed if the tax administrator has rules and regulations adopted pursuant to the authority contemplated by subsection 18(b). The filing of a return which does not comply with rules and regulations adopted pursuant to the authority granted by Section 18 should not be absolved from penalties.

Third, it does not address the circumstance where the tax administrator has required an alternative method that the taxpayer has accepted or which has been sustained by an independent administrative hearing or a final judicial decision, or where the tax administrator has accepted an alternative method of allocating and apportioning income for prior years used by the taxpayer. If a filing position has been found to be acceptable in prior years a taxpayer should not be allowed to be absolved from penalties when it make a change in its filing position without prior approval of the tax administrator or unless it can meet the burden or proof provided for in subsection (c) to adopt a different method of allocating and apportioning its income.

The proposed suggestion is too broad. Once a taxpayer has been put on notice that a section 18 variance should be applied, either by ruling of the tax administrator or an administrative or judicial decision, it should be required to follow those decisions unless the tax administrator affirmatively allows for the use of standard methods in the taxpayer's circumstances. If the taxpayer does not follow known rulings it should be subject to penalty.

My suggested language for a subsection (d) if adopted is

(d) A taxpayer shall not be subject to civil or criminal penalties solely because the tax administrator requires any method to effectuate an equitable allocation and apportion of the taxpayer's income that is

(i) different from methods required by this Article, including methods required pursuant to rules or regulations adopted pursuant to Section 18 of this article; or

(ii) different from methods required or accepted by the tax administrator or by which the taxpayer filed returns for prior years; or

(iii) was pursuant to prior preliminary written approval by the tax administrator.

Subsection (e)

The Hearing Officer proposed language that the tax administrator that has permitted alternative methods of allocation and apportionment not be allowed to revoke permission previously granted to use alternative allocation and apportionment methods with respect to transactions and activities that have already occurred unless there has been a material change in, or a material misrepresentation of the facts by the taxpayer upon which the tax administrator reasonably relied.

I question the need for this provision if proposed language absolving a taxpayer from penalties as provided for in proposed subsection (d) is adopted. If this language is adopted it may be appropriate to provide a definition of "permitted." Does the acceptance of a return with or without audit constitute permission? If the proposal is to be adopted I would suggest requiring that written permission be required. My suggested change in the language is

> (e) A taxpayer that has ~~been permitted~~ received written permission by the tax administrator . . .