MULTISTATE TAX COMMISSION

Working Together Since 1967 to Preserve Federalism and Tax Fairness

Uniformity Committee Report to Executive Committee

Fiscal Year 2010 – First Quarter

The Uniformity Committee is chaired by Ted Spangler, Idaho. The Committee structure includes two standing Subcommittees: the Income & Franchise Tax Uniformity Subcommittee, chaired by Wood Miller, Missouri; and the Sales & Use Tax Uniformity Subcommittee, chaired by Richard Cram, Kansas. In addition, the Subcommittees have appointed Work Groups, Drafting Groups, and Study Groups, as needed. Lennie Collins, North Carolina chairs the Work Group for the Financial Institutions Apportionment project. The Committee, together with its Subcommittees and Groups, worked on the following projects during the first quarter of fiscal year 2010.

Summary

- Sales & Use Tax Uniformity

  1. Accommodations Intermediaries
  2. Transactional Taxation of Telecommunications, Vendor-Vendee, Repeal
  3. Administration of Telecommunications Transaction Tax
  4. Computer Software

- Income & Franchise Tax Uniformity

  1. Section 18 model regulation amendments
  2. Compact Art. IV Revisions
  3. Withholding for Multistate Employees
  4. Entities with Affiliates that are Not Subject to Corporate Income Tax
  5. Financial Institutions
  6. Add-back Statute for Captive REIT Payments
  7. Considering Review of 3 Model Combined Reporting Water's-Edge Provisions

Description

- Sales & Use Tax Uniformity

1. ***Accommodations Intermediaries.*** Public Hearing held July 21. Comments were filed by Martin Morris, FTA and Walter Hellerstein, in addition to industry

representatives Richard Leavy of Mayer, Brown on behalf of Orbitz, and Jonathan Perkel, Travelocity. The Hearing Officer's report and recommendations will be provided to Executive Committee at December meeting. The model is for states that take the position lodging tax must be collected on the price intermediary charges its customer, which includes the intermediary's mark-up, rather than merely on the "wholesale" or "discount" price intermediary pays to the hotel. The model does not impose lodging tax, but addresses collection and remittance requirements: the intermediary is required to collect tax on full amount received from its customer, remit tax on mark-up directly to the state/ locality, and remit tax on "discount" price to the hotel (hotel would then remit to state/ locality).

2. ***Transactional Taxation of Telecommunications – Vendor and Vendee Versions.*** Executive Committee will consider in December whether to send this proposed repeal to public hearing. This MTC Model, titled "Uniform Principles Governing State Transactional Taxation of Telecommunications — Vendor and Vendee Versions," was promulgated in 1993. It is inconsistent with the regulatory structure adopted under the federal Telecommunications Act of 1996 and with the SST Agreement. The Uniformity Committee proposes it be repealed.

3. ***Administration of Telecommunications Transaction Tax.*** This project has three goals. First, develop "best practices" models for centralize administration of local telecommunications transaction taxes under 3 alternative state structures (state taxes distributed to locals, local taxes administered by state, or local taxes administered by centralized local authority). Second, adopt model telecommunications definitions and sourcing rules along the lines of those currently contained in SSUTA. And third, adopt model administrative procedures that would provide protections from class-action lawsuits as contained in SSUTA. We have recognized a need to work closely with SST organization on developing our centralized administration models, in order to make sure we meet requirements of any federal legislation.

4. ***Computer Software.*** This MTC model, titled "Guideline Regarding Applicability of Sales and/or Use Tax to Sales of Computer Software," was promulgated in 1988. It is inconsistent with the SST Agreement and less than 3 states have adopted it. The Uniformity Committee is considering a proposal that it be repealed.

<u>Income & Franchise Tax Uniformity</u>

1. ***Section 18 Model Reg. (Distortion Relief).*** The Uniformity voted to recommend this draft model favorably to Executive Committee for public hearing. In December, Executive Committee will determine whether to send the proposal to public hearing. Proposed amendments would eliminate some restrictions for both taxpayers and states. Specifically, the amendments would delete the language limiting section 18 relief to "unusual fact situations (which ordinarily will be unique and non-recurring)." It would retain the language limiting relief to "limited and specific cases" that produce "incongruous results."

2. ***Amendments to Compact Art. IV.*** Executive Committee directed Uniformity to begin this project after the ULC effort ended. We'll begin with an educational phase in

December. Have invited Rick Pomp, Prentiss Willson, Mike McIntyre, Charlie McLure to assist in that education. Looking at 5 provisions: (1) Sales factor sourcing for services and intangibles - to better reflect market, (2) definition of sales - to exclude churning (and consider excluding receipts from other transactions that are not sales to customers), (3) definition of business income - to consider clarifying that there are two tests and including gain on liquidation, (4) three factor equal weighting - to reflect movement toward more heavily weighted sales, (5) distortion relief - to acknowledge ability for special regulations.

3. ***Uniform Withholding for Multistate Employees.*** This is a priority project to develop a uniform state withholding threshold for non-resident employees. A work group held 3 teleconferences in August to develop a policy checklist. The Subcommittee then held 3 teleconferences in September, October and November to give Staff direction on the first draft, which the Subcommittee will review at the December meeting. The Committee wants a draft that (1) sets a de minimus threshold for both employer withholding responsibility and employee individual income tax filing responsibility; (2) addresses state, but not local withholding; (3) includes a reciprocity provision (though it would not supersede existing reciprocity agreements); (4) sets a threshold based on time in the state; (5) includes exceptions for professional entertainers, professional sports players, and certain other individuals intended to include high-income individuals.

4. ***Entities with Affiliates Not Subject to Corporate Income Tax.*** The purpose of this project is to address tax avoidance issues that may arise when an entity that is not subject to corporate income tax is affiliated with an entity that is (such as asset stuffing of captive insurance companies) or with a pass through entity (such as a pass-through to an insurance company). The State of Massachusetts requested MTC consider the pass-through issue after it attempted to address that issue legislatively, The Massachusetts approach would eliminate the pass-through exemption where income would pass-through to an entity that is not subject to income tax.

5. ***Financial Institutions.*** A joint industry/state work group identified problems with the current MTC financial institutions model and is drafting amendments to address them. The amendments include clarifications to the property factor rule for sourcing loans (based on SINAA – solicitation, investigation, negotiation, approval and administration); new rules for sourcing ATM fees, merchant discounts, and trust account fees; and revisions to the rule that requires use of COP for sourcing any receipts not otherwise specified.

6. ***Model Add-back Statute for REITs.*** This model is an add-back that would cover rental payments made to captive REITs. The MTC's model REIT statute works well for combined filing states in that it captures the REIT income at the entity level before it is sent outside the combined group as a taxable dividend. (REITs are not included in the federal consolidated return.) But the model captive REIT statute may have a loophole in separate entity states: a multistate taxpayer could transfer its real estate holdings in combined filing states only to a captive REIT, while retaining its real estate ownership in separate filing states. The taxpayer would still enjoy a pre-apportioned deduction for rent payments made in those combined states, but its

captive REIT would have no nexus or factors in the separate entity states, rendering the Model REIT Statute's tax imposition on the REIT ineffective in the SE states.

7. ***Considering Review of 3 Model Combined Reporting Water's-Edge Provisions.*** The MTC model statute requires world-wide combination but allows a water's edge election. The election limits the combined group to domestic, and some foreign, unitary affiliates. At the request of the Executive Committee, the Uniformity committee is discussing whether to reconsider 3 of the water's-edge foreign affiliate inclusions:
   - Tax Havens: Unitary foreign affiliates "doing business in a tax-haven…" are included in the combined group. A "tax-haven" is any jurisdiction that, during the tax year, is (1) identified as a tax-haven by the OECD, or (2) meets the description of a tax-haven developed by the OECD. In April 2009, the OECD expanded and restructured its tax haven list.
   - 20% Deductible Income – OFII Request: If a unitary foreign affiliate earn more than 20% of its income from sales of intangible property or services deductible as expenses against the business income of other combined group members, that income (and related factors) is included in combined income.
   - US Source Income – OFII Request: If a unitary foreign affiliate has US Source Income (under the federal code, w/o regard to federal tax treaties), that income (and related factors) is included in combined income.