

February 14, 2024

Via E-Mail @ bhamer@mtc.gov

Brian Hamer
Counsel, Multistate Tax Commission
444 North Capitol Street NW, Suite 425
Washington, DC 20002

Re: Model Sourcing Regulations – Transportation Companies

Dear Brian:

We appreciate the opportunity to work with the MTC regarding the model sourcing regulations for transportation companies. We write to express our concern regarding the process by which the committee analyzed the need for any changes and is now considering acting on an unseconded motion proposing that a proposed change be drafted to the current mileage rule. The majority of participants in the work group believe that the current mileage rule better reflects the market, is more uniform than a handful of other alternatives currently in place, and has resulted in only a few controversies despite being in place for several decades. Indeed, following several work group meetings and separate discussions among a policy committee, there remains little support for any change to the current model regulation. And several states have voiced opposition to any change - including an affirmative vote not to change the longstanding and widely adopted mileage rule.

In addition, industry participants have raised several concerns regarding the competitive implications of any proposed changes, potential federal preemption issues, increased and challenging compliance costs, the impact on consumer pricing, and perhaps most importantly, that the proposed change to the model rule being considered would create less uniformity, more complexity, and result in more controversies. With regard to this last point on the likelihood of increased controversy, the motion sponsor's suggestion is to include in the draft a mediation process whereby disputes between states and industry could potentially be resolved. Candidly, we find it very concerning that the MTC would consider a uniform rule that would result in less uniformity and potentially create so much controversy that it would need to include a mediation provision. These actions are counter to the MTC's stated mission and values.

The MTC's mission is to achieve "fairness by promoting compliance and consistent tax policy and practice, and to preserve the sovereignty of state and local governments over their tax systems." To that end, the compact states in Article I, that its purpose is to: "*Facilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes; Promote uniformity or compatibility in significant components of tax systems; Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration; [and] Avoid duplicative taxation.*" (emphasis added). The MTC explains its mission statement and compact through a series of values such as collaboration, excellence, and uniformity.

At the start of the working group, it was explained that the purpose of revisiting the rules for transportation companies was because those rules do not conform to the market-based sourcing rules. And that reviewing these rules was necessary to expand uniformity following the MTC's shift from cost-of-performance to market-based sourcing. Over the past fourteen months, we have provided substantive written and oral comments at the working group and study group

meetings. We explained that for transportation companies the MTC moved away from cost-of-performance sourcing decades before the MTC's market-based sourcing regulation was enacted. In addition, we explained – and several states agree – that the mileage rule provides market-based sourcing for the industry because, generally, the market for a service is where the service is performed or the benefit is received. And for package delivery services, the service is performed/benefit received throughout the entirety of the transportation service. As such, the shift from cost-of-performance to market-based sourcing is not relevant to the transportation industry. Indeed, this is no longer a point of contention between member states and stakeholders because now most understand and agree that mileage is representative of the market. Therefore, the mileage rule promotes consistent tax policy among industries because transportation companies use market-based sourcing.

The destination of the property being transported as a proxy for the market for transportation services is incorrect. The destination of a property reflects the market for the *property* not the market for the transportation services. Moreover, the person (shipper) sending the property generally hires the transportation company and pays for the transportation. The shipper is the transportation company's customer not the recipient of the property. Using destination ignores the transportation company's sale to *its* customer.

The current rule also promotes uniformity among the states. The majority of states use a mileage rule and the consensus from each meeting is that a new rule is not needed. In fact, the mileage rule has been in place for over 40 years and there are only a handful of cases addressing the issue of transportation companies' mileage-based sourcing methodology and equitable apportionment. A small number of cases is not a reflection of an industry apportionment regulation in need of a fundamental rewrite; rather, the decisions merely reflect the application of a rule to a specific taxpayer's business in a particular state. In the more recent case, *United Parcel Service Inc. (Ohio) & Affs. v. New Mexico Dep't Rev.*, 535 P.3d 715 (N.M. Ct. App. 2023), the issue was not whether mileage worked. It was whether New Mexico's attempt to include third-party miles (trains carrying UPS's trucks) was distortive. The court held for UPS because New Mexico's application of the rule significantly overstated UPS's business activities in the state, and New Mexico had allowed the alternative formula in multiple prior audits.

In addition, the majority of member states agree that the mileage rule works well, with the exception of a few outlier states (primarily Massachusetts and California). The MTC held a vote in April 2023 where states were asked to vote for mileage or pick-up/drop-off. Four states voted in favor of mileage, two states in favor of pick-up/drop-off, and one state abstained. Proceeding with a motion to draft a new rule ignores the results of the majority vote in favor of the agenda of one or two states. Because Massachusetts implemented the pick-up/drop-off rule back in 2014, the MTC is primarily promoting California's agenda as opposed to representing the interests of all its members.

Several states have raised concerns that pick-up/drop-off sourcing is distortive. There is a fundamental disconnect in some states between whether pick-up/drop-off fairly reflects income earned in the state. Many states have indicated that a pick-up/drop-off standard could create distortion based on companies' levels of activities in the state. We understand that some states with particularly high-density populations stand to benefit from a pick-up/drop-off rule, but many other states will either keep mileage-based apportionment or allege that pick-up/drop-off apportionment is distortive. Drafting a pick-up/drop-off rule would likely result in a lack of uniformity, an increased number of tax disputes, and potentially result in double taxation.

Some states have also claimed that mileage has allowed transportation companies to cherry-pick or shift-income. However, no real-life or hypothetical examples have been provided. Mileage is particularly accurate representation of a transportation company's activity in a particular state because the rivers, roads, railroads, and airports are all built independent of transportation companies. Transportation companies merely use the forms of transportation made available to them.

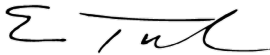
From an industry perspective, each time a proposal has been made to change the existing sourcing regime, it is incumbent upon the industry to spend significant time and resources to determine if they are able to comply with the new regime, the cost of compliance, and whether the regime is fair and equitable. Moreover, when one state asserts that a certain proposal is distortive others argue the same proposal is fair and equitable. This creates an untenable situation for the industry because some states argue that the service is provided solely at the pick-up and drop-off locations, while other states argue that the service is provided throughout the transportation.

Even after the extensive discussions at the workgroup meetings and the deliberation of the multiple proposals and documents that have been shared, there is still significant disagreement among the states. Participants have contributed substantial time and resources and yet the only proposal that received a majority support is maintaining the current regime. A new rule would take substantive time and resources, would detract from uniformity that could benefit everyone, and would squarely contradict the stated interests of the majority of the member states.

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We appreciate the workgroup's efforts thus far to understand the transportation industry. Based on the above we respectfully request that the work group not change the current mileage rule or perhaps pause the process of evaluating the trucking rule and provide time for additional consideration of these issues while the group tackles other priorities. Thank you for your consideration.

Respectfully,



Eric Tresh
Eversheds Sutherland (US) LLP