Montana adopts market-based sourcing for receipts from sales of non-TPP

Overview

On May 3, 2017, Montana Governor Steve Bullock signed House Bill 511 (H.B. 511).[1] H.B. 511 revises Montana's adopted version of the Multistate Tax Compact as recommended by the Multistate Tax Commission, and generally includes the following modifications to Montana income tax law:

- Implements market-based sourcing for sourcing receipts from sales other than the sale of tangible personal property for apportionment purposes;[2]
- Imposes a receipts factor "throwout" rule;[3] and
- Provides new definitions for "apportionable income" and "receipts."[4]

This Tax Alert summarizes these law changes that are effective for tax years beginning on or after January 1, 2018.

Market-based sourcing

H.B. 511 generally requires corporations and pass-through entities to adopt market-based sourcing for sourcing receipts from sales other than the sale of tangible personal property for apportionment purposes, replacing the current costs of performance method for sourcing such sales.[5] Under this new market-based sourcing approach, receipts from sales other than from the sale of tangible personal property are in Montana if and to the extent the taxpayer's market for sales is in Montana.[6] A taxpayer's "market" for sales generally is in Montana based on the following:

- for the sale of a service, if and to the extent the service is delivered to a location in Montana,[7]
- for the rental, lease, or license of tangible personal property, if and to the extent the property is used in Montana, provided that intangible property utilized in marketing a good or service to a consumer is used in Montana if that good or service is purchased by a consumer who is in Montana,[8] and
- for the sale of intangible property, if and to the extent the property is used in Montana,[9] provided that 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 Montana if the geographic area includes all or part of Montana.[10]

Receipts from intangible property sales that are contingent on productivity, use, or disposition of the intangible property must be treated as receipts from the rental, lease, or licensing of such intangible property,[11] while all other receipts from sales of intangible property must be excluded from both the numerator and denominator of the receipts factor.[12] If the state of assignment cannot be determined by applying these delineated rules, then the state of assignment must be reasonably approximated.[13]

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[1] Laws 2017, 65th Legislature, Regular Session (HB 511; May 3, 2017). A copy of the adopted law is accessible here.
[2] HB 511, MCA §15-1-601.Art.IV.(17)(a).
[3] HB 511, MCA §15-1-601.Art.IV.(17)(c).
[4] HB 511, MCA §15-1-601.Art.IV.(1)(a), MCA §15-1-601.Art.IV.(1)(g).
[5] HB 511, MCA §15-1-601.Art.IV.(17)(a), MCA §15-30-3302(6)(a).
[6] HB 511, MCA §15-1-601.Art.IV.(17)(a).
[7] HB 511, MCA §15-1-601.Art.IV.(17)(a)(iii).
[8] HB 511, MCA §15-1-601.Art.IV.(17)(a)(iv)(A).
[9] HB 511, MCA §15-1-601.Art.IV.(17)(a)(iv)(B).
[10] HB 511, MCA §15-1-601.Art.IV.(17)(a)(iv)(B)(I).
[11] HB 511, MCA §15-1-601.Art.IV.(17)(a)(iv)(B)(II).
[12] HB 511, MCA §15-1-601.Art.IV.(17)(a)(iv)(B)(III).
[13] HB 511, MCA §15-1-601.Art.IV.(17)(b).

Pursuant to Montana's adoption of the receipts factor "throwout rule," if the taxpayer is not taxable in a state to which a receipt is assigned, or if the state of assignment cannot be determined or reasonably approximated under these delineated rules such receipt must be excluded from the denominator of the receipts factor.[14]

Definitional changes: apportionable income & receipts

H.B. 511 additionally repeals the current definition of "business income" and replaces the term with "apportionable income."[15] "Apportionable income" generally is defined to include:

- All income that is apportionable under the U.S. Constitution and is not allocated under the laws of Montana,[16] including:
    - income arising from transactions and activity in the regular course of the taxpayer's trade or business,[17] and
    - income arising from tangible and intangible property if the acquisition, management, employment, development, or disposition of the property is or was related to the operation of the taxpayer's trade or business;[18] and
- Any income that would be allocable to Montana under the U.S. Constitution but that is apportioned rather than allocated pursuant to the laws of Montana.[19]

The new law also repeals the definition of "sales" and replaces the term with "receipts."[20] The definition of "receipts" for receipts factor purposes generally excludes receipts of a taxpayer from hedging transactions and from the maturity, redemption, sale, exchange, loan, or other disposition of cash or securities.[21]

ASC 740 treatment

Pursuant to ASC 740, "Income Taxes," companies are required to account for the effect of a change in income tax law in the period that includes the enactment date of that law change. The income tax law changes discussed in this Tax Alert were enacted on May 3, 2017.

Considerations

While Montana has adopted market-based sourcing for sales other than the sale of tangible personal property for tax years beginning on or after January 1, 2018, Montana has *not* adopted a single sales factor apportionment regime. In this respect, corporations and pass-through entities filing in Montana must continue to apportion their income using an equally-weighted three-factor apportionment formula consisting of property, payroll, and receipts.

Taxpayers with significant market and sales presence in Montana may want to review and consult with their tax advisers regarding the effect of this new law on their tax reporting and compliance obligations, as well as the potential financial statement impact. Note also that because Montana imposes worldwide unitary combined reporting, this new market-based sourcing methodology may impact unitary domestic and foreign affiliates that previously did not have Montana income tax liabilities.

Finally, given the shift from Montana's current costs of performance methodology for sourcing sales other than the sale of tangible personal property to market-based sourcing, many companies may soon transition from having a zero or minimal Montana apportionment factor to having a relatively significant Montana apportionment factor. As a result, businesses currently incurring only minor Montana corporate income tax liabilities may begin incurring significant liabilities with the 2018 tax year.

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[14] HB 511, MCA §15-1-601.Art.IV.(17)(c).
[15] HB 511, MCA §15-1-601.Art.IV.(1)(a).
[16] HB 511, MCA §15-1-601.Art.IV.(1)(a)(i).
[17] HB 511, MCA §15-1-601.Art.IV.(1)(a)(i)(A).
[18] HB 511, MCA §15-1-601.Art.IV.(1)(a)(i)(B).
[19] HB 511, MCA §15-1-601.Art.IV.(1)(a)(ii).
[20] HB 511, MCA §15-1-601.Art.IV.(1)(g).
[21] *Id.*

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