

MTC's amended model regulations include market sourcing rules for states

Overview

Pursuant to the Multistate Tax Commission (MTC) Uniformity Committee's project for adoption of amendments to its Model General Allocation and Apportionment Regulations which began in 2014, the full MTC formally adopted via teleconference on February 24, 2017, revisions to its model allocation and apportionment regulations (Amended Model General Allocation and Apportionment Regulations) under Multistate Tax Compact (Compact) Article IV,¹ including:

- implementation of Article IV, Section 17 of the Compact's market-based sourcing approach of certain receipts from the sale of services and intangibles (in lieu of the previous cost-of-performance provisions); and
- definitions for "apportionable income" (previously "business income") and "receipts" (previously "sales").²

This Tax Alert highlights some of the recent changes contained within the Amended Model General Allocation and Apportionment Regulations, and provides some taxpayer considerations.

Background and procedural process

At its December 2014 meeting, the MTC Uniformity Committee had voted to use the then recently-promulgated market-based sourcing regulations issued in Massachusetts as the working draft starting point for the MTC's own model regulations to implement Article IV, Section 17 of the Compact's market-based sourcing approach. The underlying "Section 17 work group" then spent over a year reviewing the Massachusetts market-based sourcing regulations and made numerous changes to the working draft of the MTC model regulations. In addition, the MTC Uniformity Committee and Executive Committee made changes to the MTC working draft during 2015 and 2016 before adopting a final version of the proposed amendments to the Section 17 regulations. On October 26, 2016, a "bylaw 7" survey of the states (i.e., a survey in which member states are asked whether they would consider adoption of the proposal as a new addition or amendment to their tax statutes or regulations) was sent to the member states. The proposed amendments to the model allocation and apportionment regulations under Compact Article IV, Sections 1 and 17 were then ultimately approved by the full MTC at the February 24, 2017 teleconference as the final step in this revision and adoption process.³

Highlights from the amended model general allocation and apportionment regulations

The new Section 17 of the Amended Model General Allocation and Apportionment Regulations (New Section 17) reflects a market-based sourcing approach of receipts from the sale of services and intangibles in accordance with similar Compact changes made in 2014, rather than the previous cost-of-performance methodology that generally had sourced such receipts to the state with a preponderance of income-producing activity. New Section 17 attempts to establish uniform rules for:

- determining whether and to what extent the market for a sale other than the sale of tangible personal property is in a state;
- reasonably approximating the state or states of assignment where the state or states cannot be determined;
- excluding receipts from the sale of intangible property from the numerator and denominator of the receipts factor pursuant to Compact Article IV.17(a)(4)(ii)(c); and

¹ See "Resolution Adopting Amendments to the Multistate Tax Commission's Model General Allocation and Apportionment Regulations," Special Meeting of the MTC (February 24, 2017), a copy of which is accessible [here](#).

² MTC Model General Allocation & Apportionment Regulations with Amendments, as formally adopted on February 24, 2017. A copy of the final version is accessible [here](#).

³ See "Resolution Adopting Amendments to the Multistate Tax Commission's Model General Allocation and Apportionment Regulations," Special Meeting of the MTC (February 24, 2017), and summary of the [MTC Uniformity Project: Sections 17 & 1](#) at www.mtc.gov for more details.

External Multistate Tax Alert

- excluding receipts from the denominator of the receipts factor, pursuant to Compact Article IV.17(c) where the state or states of assignment cannot be determined or reasonably approximated, or where the taxpayer is not taxable in the state to which the receipts are assigned as determined under Compact Article IV.3 and applicable regulations.⁴

New Section 17 addresses different categories of receipts with specific rules for sourcing receipts, including distinct subsections on sourcing gross receipts from the "Sale of a Service," including sales delivered electronically through the customer, "License or Lease of Intangible Property," including marketing, production and mixed intangibles, and "Sale of Intangible Property." Other noteworthy items contained in New Section 17 include special rules for sourcing receipts from software transactions and sales or licenses of digital goods or services, as well as a voluntary non-binding mediation option to resolve sourcing issues with state taxing authorities.⁵

Throughout the Amended Model General Allocation and Apportionment Regulations, revisions were also made to conform terminology and particular language to related changes in the language of Article IV of the Compact, including the substitution of the terms "apportionable income" for "business income," "non-apportionable income" for "nonbusiness income," and "receipts" for "sales." The Amended Model General Allocation and Apportionment Regulations include some explicit narrowing of the definition of "receipts," as well as a provision clarifying that while particular receipts may give rise to apportionable income, this does not control whether those receipts are included in the receipts factor.⁶

A word on the Section 18 alternative apportionment regulatory project

Under the MTC's ongoing "Section 18 Regulatory Project," the MTC Uniformity Committee is currently considering issues which had been identified by the Section 1 and 17 workgroups as in need of additional attention. These include proposed amendments to Section 18 of the MTC's model allocation and apportionment regulations related to alternative apportionment that address possible distortion that may be caused by the exclusion of functional receipts from the receipts factor; exceptions to the definition of receipts which now generally excludes receipts from securities and hedging transactions; consideration of factoring receipts; situations where application of general population data may result in distortion; the possible necessity of a de minimis rule; and other special industry rules as necessary. These issues are being considered as a result of the amendments made in 2014 and 2015 to Article IV of the Compact.⁷

Considerations

Although the MTC's actions are not binding on the states and have no effect in a particular state until adopted into law by that state via statute and/or promulgated via administrative regulation within that state, taxpayers potentially affected by the provisions contained within the Amended Model General Allocation and Apportionment Regulations may wish to closely monitor and consult with their tax advisers regarding related legislative and administrative developments of the various states, as well as the pending Multistate Tax Compact litigation in numerous states.

Also note that the states (whether MTC members or not) may independently incorporate certain aspects of the Amended Model General Allocation and Apportionment Regulations into their statutes, regulations, and/or tax administration policy, as many of these changes reflect ongoing state law trends of which taxpayers should be aware such as a shift to market-sourcing of revenue derived from services and intangibles – including sales factor computation guidance on what may constitute an includable receipt, a "reasonable approximation," the proper treatment of related party transactions, and the suitable maintenance of contemporaneous documentation.⁸

⁴ See "Drafter's Notes" included with the MTC Model General Allocation & Apportionment Regulations with Amendments and MTC Model General Allocation & Apportionment Regulations with Amendments, as formally adopted on February 24, 2017, a copy of which is accessible [here](#).

⁵ *Id.*

⁶ *Id.*

⁷ See [MTC Uniformity: Section 18 Regulatory Project](#) at www.mtc.gov for more details.

⁸ Examples of 2017 market-based sourcing legislative proposals incorporating some aspects found within the Compact and/or Amended Model General Allocation and Apportionment Regulations include: Ark. HB 2100, 91st Gen. Ass., 2017 Reg. Sess.; Mont. HB 511, 65th Leg., 2017 Reg. Sess.; N.C. SB 325, 2017 Leg., Reg. Sess.; and Ore. HB 2048, 79th Leg. Ass., 2017 Reg. Sess.

Contacts:

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