

Multistate Tax Commission Approves Certain UDITPA Revisions for Bylaw 7 Survey

May 13, 2014

Overview

On May 8, 2014, the Executive Committee of the Multistate Tax Commission (“MTC”) voted to move forward with certain proposed revisions to Article IV of the Multistate Tax Compact (“Compact”). Article IV incorporates, almost verbatim, the provisions of the Uniform Division of Income for Tax Purposes Act (“UDITPA”), which was promulgated by the Uniform Law Commission (“ULC”) in 1957.¹ A majority of states have adopted one or both of the Compact or UDITPA, which together serve as model law for assigning taxable income of multistate corporations among the state jurisdictions in which they do business.

The latest action by the Executive Committee was to approve to circulate certain of the proposed Article IV revisions for state survey pursuant to MTC Bylaw 7, which requires that “[a]ny recommendation for action submitted by the Executive Committee to the [MTC] relating to uniform or compatible tax laws . . . shall be circulated to the [state Compact] members . . . to determine if the affected members will consider adoption of the recommendation within their respective jurisdictions”² (the “Bylaw 7 Survey”). While 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, taxpayers potentially affected by the ultimate adoption of any of the proposed revisions to Article IV of the Compact may wish to keep a close eye on the MTC’s ongoing efforts in this regard.

In this Alert we summarize the MTC’s latest efforts to revise Article IV, including the next steps in the process and what taxpayers may wish to consider as the MTC moves forward with its revisions.

Uniformity Committee Draft

The MTC’s Uniformity Committee (a program committee that develops uniform approaches to the state transaction and income/franchise taxation of interstate and foreign commerce) began work in July of 2009 on its draft revisions of Article IV, which focused on five specific Article IV provisions: sales factor sourcing for services and intangibles (Art. IV.17), the definition of sales (Art. IV.1(g)), factor weighting (Art. IV.9), the definition of business income (Art. IV.1(a)), and equitable apportionment (Art. IV.18). The Executive Committee approved proposed model amendments in December 2012 for public hearing, which was held in March 2013 and conducted by MTC-appointed hearing officer Richard Pomp.³ The hearing officer released a report in October 2013, providing commentary as well as recommended changes to the proposed model amendments. In December 2013 the Executive Committee sent the hearing officer’s report back to the Uniformity Committee, with direction to limit their review to the hearing officer’s proposals. In March 2014 the Uniformity Committee ultimately decided to send back to the Executive Committee its original five recommendations as originally approved for public comment in December 2012, not incorporating any of the hearing officer’s recommendations.

Voted-on Language

On May 8, the Executive Committee passed motions to release for a Bylaw 7 Survey the proposed model amendments on four of the five Article IV provisions noted above, excluding equitable apportionment (Art. IV.18). Regarding the four provisions, the language to be provided for the survey consists of the following December 2012 Uniformity Committee proposed amendments (except that the definition of sales as set forth in Art. IV.1(g) was modified as noted below):

¹ For additional background on the history of UDITPA and Article IV, as well as the ULC’s original efforts to revise UDITPA, see the MTC’s “The Project to Revise UDITPA” available on the MTC website at: http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Minutes/The%20Project%20to%20Revise%20UDITPA.pdf.

² MTC Bylaw 7(g). Available at: <http://www.mtc.gov/About.aspx?id=2234>.

³ Richard Pomp is Alva P. Loisel Professor of Law at the University of Connecticut.

Sales factor sourcing for services and intangibles (Art. IV.17). Generally provides for market sourcing instead of the existing cost-of-performance provisions contained in Article IV. For services, this would be based on where the service is “delivered.” Utilization of intangibles would be sourced based on “use,” and certain intangible receipts (e.g., hedging/treasury receipts) would be thrown out of the numerator and denominator.

Definition of “sales” (Art. IV.1(g)). Changes the term “sales” to “receipts” and updates the definition to include only those receipts “that are received from transactions and activity in the regular course of the taxpayer’s trade or business.” The definition also specifically excludes receipts from hedging and securities transactions and eliminates the carve-out for securities dealers that had been contained in the December 2012 proposed amendments.

Factor weighting (Art. IV.9). Removes the three-factor apportionment formula requirement and instead provides a suggestion (but not a requirement) that the state use a double-weighted sales factor formula.

Definition of “business income” (Art. IV.1(a)). Provides a broad definition that includes “all income that is apportionable under the Constitution of the United States and is not allocated . . . ,” and retains the existing “transactional” and “functional” tests but makes several substantive changes to the “functional” test.

Art. IV.18 (Equitable Apportionment) Remanded to Uniformity Committee for Additional “Tweaks”

The Executive Committee voted to not immediately move forward with proposed changes to Art. IV.18 (“Section 18”). The original proposed model amendments included a provision that would grant explicit authority under Section 18 to a tax authority to establish apportionment regulations (e.g., industry-wide and transaction-based regulations).⁴ The regulations would be created at the discretion of each tax authority. The Executive Committee voted to support these changes. Additionally, the Executive Committee considered certain changes, originally proposed by the hearing officer, which had been rejected by the Uniformity Committee. Of those changes, the Executive Committee supported in concept the following and remanded the language to the Uniformity Committee to be “tweaked” to alleviate certain statutory interpretation concerns:

- (1) A requirement that the party petitioning for or requiring alternative apportionment bear the burden of proving that: (a) the state’s apportionment provisions do not fairly represent the taxpayer’s activity, and (b) that the alternative method is reasonable;⁵
- (2) A requirement that a taxpayer may not be subject to penalties for reliance on a statutory apportionment provision; and
- (3) A requirement that a taxing authority may not retroactively revoke a previously granted alternative apportionment methodology with respect to transactions and activities that have already occurred, unless there has been a material change in or misrepresentation of facts upon which the taxing authority had reasonably relied.⁶

What’s Next?

As noted previously, Bylaw 7 provides the MTC’s procedures for adopting uniformity recommendations, requiring that Executive Committee recommendations for action involving “uniform or compatible tax laws . . . shall be circulated to the [Compact] members . . . to determine if the affected members will consider adoption of the recommendation within their respective jurisdictions.”⁷ If a majority of Compact member states respond affirmatively to the Bylaw 7 Survey (which is non-binding), the matter will be referred to the full MTC for possible adoption as a uniformity recommendation.⁸ The full MTC, as opposed to its various committees and subcommittees which meet more frequently, meets only once a year and its next meeting is July 30, 2014. While there does not appear to be a defined timeline for a final version of Section 18, it is conceivable that at least the four proposed model amendments included in the Bylaw 7 Survey are expected to be voted on at the July annual

⁴ The Executive Committee rejected the suggestion by the hearing officer that all positions on alternative apportionment with wide application should be published as a regulation.

⁵ This is partly in response to cases in which a taxpayer, petitioning for relief from an alternative apportionment methodology imposed by the state, bore the burden of proof. See *Equifax, Inc. v. Miss. Dep’t of Revenue*, 125 So.3d 36 (2013). The Mississippi legislature subsequently modified its own laws in a manner similar to the Article IV revisions. See our [April 25, 2014 Alert](#).

⁶ This third requirement was adopted by the Executive Committee without modification, however the Executive Committee did not want to move forward with parts of Section 18 piecemeal.

⁷ MTC Bylaw 7(g).

⁸ A full description of the uniformity process may be viewed at the MTC’s website at: <http://www.mtc.gov/Uniformity.aspx?id=448>. Bylaw 7 outlines the specific procedures the MTC must follow for uniformity recommendations.

meeting. Even if the proposal is adopted by the MTC, each state must still decide whether to change its own laws. Additionally, the Compact has never before been amended, and the amendment process as well as its potential impact on existing litigation is unclear.

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, taxpayers potentially affected by the adoption of any of these provisions may wish to keep a close eye on the MTC's ongoing efforts to revise Article IV. Additionally, regardless of the ultimate fate of these proposed revisions within the MTC, states may independently incorporate certain aspects of these concepts in their laws and, in fact, many of these changes reflect ongoing state law trends of which taxpayers should be aware (e.g., a shift to market sourcing of revenue derived from services and intangibles).

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