Multistate Tax Commission Hearing Officer Report – Sales Definition

November 20, 2013

In brief

As part of the Multistate Tax Commission's continuing effort to revise UDITPA provisions, the Hearing Officer issued his report on October 25, 2013. This Insight summarizes the Executive Committee's proposed revisions; commentary made during the March 28, 2013, public hearing; and the Hearing Officer's recommendations regarding revisions to UDITPA's sales definition. [*Report of the Hearing Officer, Multistate Tax Compact Article IV [UDITPA] Proposed Amendments*, Multistate Tax Commission (10/25/13)]

In detail

The Multistate Tax Commission (MTC) is proposing revisions to its model Uniform Division of Income for Tax Purposes Act (UDITPA). The MTC is focusing on the following five areas: (1) sales factor numerator sourcing for sales of services and intangibles, (2) sales definition, (3) factor weighting, (4) business income definition, and (5) equitable apportionment.

In December 2012, the MTC's Executive Committee approved proposed UDITPA revisions for public hearing. These revisions were the subject of a March 28, 2013, public hearing held by the Hearing Officer, University of Connecticut Law School Professor Richard Pomp. On October 25, 2013, the Hearing Officer issued his Report, which provides a background to the amendments, a summary of the proposals' substantive features, a review of public testimony provided at the hearing, and the Hearing Officer's comments, recommendations, and proposals.

The following summarizes the Report's findings regarding the definition of 'sales.' We address the other four areas in separate Insights.

Uniformity Committee recommendations – Sales Definition

The Committee's amendments to the sales definition in addition to the name change from *sales* to *receipts*, specifically excludes receipts from hedging transactions and from the maturity, redemption, sale, exchange, loan or other disposition of cash or securities for taxpayers other than securities dealer. The specific recommendation provides the following:

> ~~Sales~~ <u>Receipts</u> means ~~all~~ gross receipts of the taxpayer <u>that are</u> not allocated under ~~Sections 4 through 8 of this Act~~ <u>paragraphs of this article, and that are received from transactions and activity in the regular course of the taxpayer's trade or business; except that receipts of a taxpayer other than a securities dealer from hedging transactions and from the maturity, redemption, sale, exchange, loan or other disposition of case or securities, shall be excluded.</u>

Hearing officer comments

Comments by Professor Pomp include:

- The proposal elevates the heart of an MTC regulation into the body of the proposed statute. The regulation effectively excludes from the sales factor gross receipts related to transactions satisfying the functional test (e.g., the sale of a machine, equipment, plant, or a business).
- The proposal includes only receipts received from transactions under the transactional test. This raises an inconsistency with UDITPA's definition of sales as including "all gross receipts that are not allocated."
- Interpreting what a taxpayer's 'regular' course of business is could lead to litigation. The concept of 'regular' is inconsistent with the proposed draft on apportionable income (for our Insight into apportionable income changes, click on the link in the *additional reading* section below).
- Exclusion of treasury receipts is supported by the purpose of the sales factor to reflect a taxpayer's market for its product. Unless the taxpayer is a securities dealer, receipts from its treasury function and other financial activities should be excluded. However, the Hearing Officer believes that the proposal "needlessly creates a bad precedent of excluding a class of transactions from the sales factor."
- The Hearing Officer offers two alternatives to the proposed Draft, each of which assumes that receipts from the treasury function and hedging are addressed in the section on market based sourcing of intangible property and therefore do not need to be address in the definition of receipts.
- Alternative One would define receipts as "gross receipts of the taxpayer that are received from, or associated with, transactions or activities generating apportionable business income." The Hearing Officer recognizes that this definition is broader and implements the principle that if income is apportionable, the associated receipts should be included in the sales factor so that the formula is more likely to be fair and reflect a reasonable sense of how income is generated.
- Alternative Two would define receipts to mean "gross receipts of the taxpayer that are received from, or associated with, transactions or activities generating apportionable business income . . . excluding substantial amounts of such gross receipts from an incidental or occasional sale of a fixed asset or other property that was, or is, related to, or part of, the operation of the taxpayer's trade or business."
- Alternative Two would presumably exclude receipts from the typical sale of a business, thus giving such transactions the same treatment as stock, partnership interest, or LLC sales that are excluded from the sales factor.
- The Hearing Officer prefers Alternative Two to the Draft proposed by the Uniformity Committee.

Additional reading

Click on the following links to read our summary of the Multistate Tax Commission Hearing Officer's Report regarding:

- market sourcing
- business income
- factor weighting
- equitable apportionment

The takeaway

The Multistate Tax Commission's effort to amend Article IV of the Multistate Tax Compact remains controversial. While the Hearing Officer's lengthy report offers many detailed recommendations, it nonetheless leaves significant unresolved issues, including important definitional standards. The Hearing Officer anticipates the promulgation of regulations to address many of these ambiguities, leading one to believe this process will continue for quite some time. Added to these uncertainties is the ongoing litigation involving the binding nature of the Article III election to apportion income using an equally weighted three factor formula. It appears, therefore, that taxpayers and state revenue agencies eager to have certainty with regard to corporate income tax apportionment provisions may have to exercise patience while these issues work their way through the various administrative and legal processes.

Let's talk

If you have any questions regarding the MTC's proposed amendments to UDITPA's definition of 'sales,' please contact:

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