

The Show-Me State Shows How It's Done: Missouri Is a Model MTC State

by David Kennedy, Michael Herbert, and Bryan Mayster

David Kennedy is a CPA and director in PricewaterhouseCoopers LLP's St. Louis office. He specializes in Missouri and multistate tax issues. Michael Herbert is a partner and Bryan Mayster is a managing director in PwC's State and Local Tax practice. Herbert, who is based in San Francisco, assisted in filing the claims at issue in *Gillette v. Franchise Tax Board* before the California court, helped develop the issue for litigation, and worked with counsel on the case.

Unless you've been lost in the Meramec Caverns¹ for the last two years hunting for stolen loot Jesse James may have left behind, you've heard about the *Gillette*² case. The California Court of Appeals held in *Gillette* that the Multistate Tax Compact is a valid interstate compact and that California is bound by its provisions, including the election to use the equally weighted apportionment formula instead of the state's double-weighted statutory formula. The California Supreme Court granted a petition for review in this matter.

Similar cases have been brought in Michigan,³ Oregon,⁴ and Texas.⁵ In response to this challenge, California,⁶ the District of Columbia,⁷ Minnesota,⁸ Oregon,⁹ South Dakota,¹⁰ and Utah¹¹ have passed legislation to repeal their membership in the compact.

¹Available at <http://www.americascave.com/>.

²No. A130803, Cal. 1st App. (2012).

³*IBM Corp. v. Dep't of Treasury*, No. 306618, (Mich. App. Ct. 2012); *Anheuser-Busch Inc. v. Mich. Dep't of Treasury*, No. 11-85-MT (Mich. Ct. Cl. 2013).

⁴*Health Net Inc. v. Ore. Dept. of Rev.*, No. TC 5127.

⁵*Graphic Packaging Corp. v. Combs, District Court of Travis County, Tex.*, No. D-1-GN-12-003038 (filed Sept. 27, 2012).

⁶SB 1015.

⁷Budget Support Emergency Act of 2013.

⁸HF 677.

⁹SB 307.

¹⁰SB 239.

¹¹SB 247.

pact.¹² These withdrawals have resulted in a number of issues, including the effect on the joint audit program under Article VIII of the compact.¹³

The compact is at the heart of all these developments. Drafted by the National Association of Tax Administrators, the Federation of Tax Administrators, and various state attorneys general in response to possible federal intervention in state income taxation, the compact became effective in 1967 upon its adoption by seven states. Since then, it has undergone many changes and faced many challenges.¹⁴

When considering the time, effort, and resources states have spent auditing and litigating taxpayers that have made the election, the most recent challenges to the compact, as well as the implications of enacting legislation to repeal membership, one wonders whether these states would not have been better off following Missouri's example in 1967 by making the compact apportionment election available to all taxpayers.

Missouri Chooses Membership In the Compact

Missouri was presented with the first complete draft of the Multistate Tax Compact in January 1967,¹⁵ and it enacted the compact as Missouri Revised Statute section 32.200, effective October 13, 1967.¹⁶ Missouri was confirmed as a full compact member at the first legal meeting of the Multistate Tax Commission three days later, a status it has maintained ever since.

When Missouri enacted the compact provisions, it already had its own single-sales-factor statutory

¹²Some states have chosen to reenact the compact without articles III and IV, the election and Uniform Division of Income for Tax Purposes Act provisions, respectively.

¹³See Michael Herbert and Bryan Mayster, "The Impact of Multistate Tax Compact Withdrawals on the Joint Audit Program," *SALT Alert*.

¹⁴See, e.g., *United States Steel Corp. v. Multistate Tax Commission*, 434 U.S. 452 (1978).

¹⁵See First Annual Report Multistate Tax Commission for the Period Ending December 31, 1968 (Jan. 28, 1969).

¹⁶Mo. Rev. Stat. section 32.200.

apportionment method.¹⁷ Upon enacting the compact, however, the state immediately understood that taxpayers have the option of using the apportionment formula provided in Article IV of the compact or the state's statutory formula. Thus, Missouri recognized from the outset that compact membership meant that taxpayers are afforded the choice promised to them when the compact was created.¹⁸ That Missouri has let this statute and the election stand through many gubernatorial, legislative, and administrative changes is a testament to how strongly the state believes in the compact.

Missouri adopted regulations under the compact in December 1975. They became effective January 9, 1976.¹⁹ Following its administrative policies and procedures, Missouri has amended the regulations several times, with the most recent amendment effective January 30, 1987.

There are several notable differences between Missouri's regulations and the MTC's model regulations, which have been revised many times since 1987. One notable difference is treatment of financial institutions. Financial institution taxpayers are not allowed to apportion income under the MTC three-factor method in Missouri.²⁰ Also, the state has not adopted the change to the model regulation that allows third-party costs to be included in the base for determining the costs of performance under the income-producing activity sourcing method.²¹

Missouri Apportionment Formulas

In its first set of income tax statutes, Missouri subjected domestic corporations incorporated in the state to tax on all income regardless of the source. Foreign corporations not incorporated in Missouri, on the other hand, were taxed on income earned from sources within the state. To correct this inconsistent treatment and better align its taxing regime with the general premise that corporations may be taxed only on income earned from sources within the state, this statutory approach was amended in 1927. The amendment clarified that all corporations were subject to tax on income from transactions wholly within Missouri and on a portion of those transactions conducted partly in Missouri and partly outside the

state.²² From this humble beginning, Missouri's business transacted single-factor apportionment method was born.

The single-factor statute, as it is commonly called, was originally enacted in 1927 as section 10117. Missouri recodified its statutes in 1997. As a result, the single-factor statute was recodified as section 143.451 of the Revised Statutes of Missouri and became effective for tax years beginning on or after January 1, 1998.²³ RSMo section 143.451 contains sourcing language similar to the language in the original 1927 statute. The statute provides definitions for determining how to apportion income from transactions that occur partially in Missouri and partially in another state or states.

RSMo section 143.451.2(2)(b) defines the single factor. The single factor is equal to the percentage of sales or business transacted wholly in Missouri plus half of the sales or business transacted partly within and partly without Missouri divided by total sales or business transacted. The method for determining when sales of tangible personal property are wholly within, partly within and partly without, or wholly without Missouri is contained in subsection .2(3) of the statute.²⁴ For guidance on how to classify receipts from business transactions from other than the sale of tangible personal property, taxpayers look to the rulings of the Missouri Administrative Hearing Commission and Missouri Supreme Court. To date, Missouri has not adopted any regulations clarifying the single-factor statute.

On July 12, Missouri enacted a law that provides taxpayers with an additional single-sales-factor apportionment election.²⁵ Under this election, sales of tangible personal property are included in the numerator if the purchaser's destination point is in Missouri, but not included in the numerator if the destination point is outside the state. The law became effective August 28, 2013, but it is silent as to the first tax year this election will be available. Missouri issued a proposed rule on September 18, stating that the new apportionment method is available for any original return filed on or after the August 28 effective date regardless of the tax year for which the original return is being filed. The proposed rule could become final at the end of a 30-day comment period.²⁶

¹⁷Mo. Rev. Stat. section 10117 (as codified in 1967), section 143.451.2 (1997).

¹⁸See Herbert and Mayster, "The Multistate Tax Compact – A Promise Forgotten," *State Tax Notes*, Nov. 19, 2012, p. 597.

¹⁹Mo. Reg. 12 CSR 10-2.075.

²⁰Multistate Tax Commission Allocation and Apportionment Regulations as revised through July 29, 2010. "The Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions was adopted November 17, 1994." Missouri has not adopted this recommendation into its own laws and procedures.

²¹MTC Reg. IV.17(2) and Mo. Reg. 12 CSR 10-2.075(56).

²²See *Union Electric Co. v. Coale*, 146 S.W.2d 631 (Mo. 1940), for a discussion of the early evolution of the sourcing of income statutes.

²³Mo. Rev. Stat. section 143.451.

²⁴Note that this was recodified as section 143.451.2(2)(c) in HB 128 (Mo. 2013).

²⁵HB 128 (Mo. 2013).

²⁶New Apportionment Method, 12 CSR 10-2.052 (proposed Sept. 2013).

MO-1120

10. Missouri Taxable Income — If all Missouri income, repeat Line 9. If not, complete Schedule MO-MS and enter apportionment method chosen and the applicable % Multiply Line 9 by the percentage

MO-MS

APPORTIONMENT ELECTION

* Missouri Statutes provide seven methods of determining Missouri taxable income from Missouri sources.

Check only ONE of the seven boxes and enter the method number and the percentage calculated on Form MO-1120, Line 10.

Method One — MULTISTATE ALLOCATION AND THREE FACTOR APPORTIONMENT — Multistate Tax Compact — Section 32.200, RSMo — (COMPLETE PART 2)

Method Two — BUSINESS TRANSACTION SINGLE FACTOR APPORTIONMENT — Section 143.451.2(2), RSMo — (COMPLETE PART 1)

Making the MTC Election

Article III of the compact provides that a taxpayer may elect to use a member state's apportionment rules or the MTC three-factor apportionment method. The mechanism for making the election to use either the Missouri single-factor apportionment method or the MTC three-factor method has been in place for many years. To make the election, a taxpayer simply has to check the box for "Method One — Multistate Allocation and Three-Factor Apportionment" or the box for "Method Two — Business Transaction Single Factor Apportionment." Also, the taxpayer must indicate the method number in a box on page 1 of Form MO-1120.²⁷ It's that simple. (See examples above.) There are no separate election forms or additional statements required.²⁸

In contrast, California has never provided a choice to taxpayers on its forms or instructions. The absence of such an election calls into question California's assertion of a "doctrine of elections," since without a choice there is plainly no election to be made.

The apportionment election is an annual election made on an originally filed return including exten-

sion. The election is binding for that tax year.²⁹ An annual election allows taxpayers to proactively manage their Missouri income tax liabilities, providing an economic benefit to doing business in Missouri for both in-state and out-of-state taxpayers. This annual election is consistent with the benefits of compact membership outlined in the "Third Annual Report of the MTC."³⁰

Conclusion

Missouri's simple yet effective apportionment election method is a model other MTC member states could — and perhaps should — follow. Allowing the election aligns with the compact's original purpose, provides economic benefit to taxpayers, and reduces the need for states to use resources and strain budgets in order to argue and fight taxpayers. Missouri has made the MTC work for the benefit of all. If only the other compact members had looked at how Missouri does it and made a simple request: "Show me." ★

²⁷The Missouri Department of Revenue has updated its Form MO-MS to include the new single-factor apportionment method.

²⁸See Form MO-1120, Line 10.

²⁹It should be noted that that there are actually eight methods in Missouri with five for special industries. The five other methods are not relevant to this discussion and, as a result, are not included in the reproduction of the top section of Schedule MO-MS above.

³⁰While simple in concept, the analysis a taxpayer must perform to determine which apportionment method is appropriate may be complex. This determination is a topic beyond the scope of this article.