

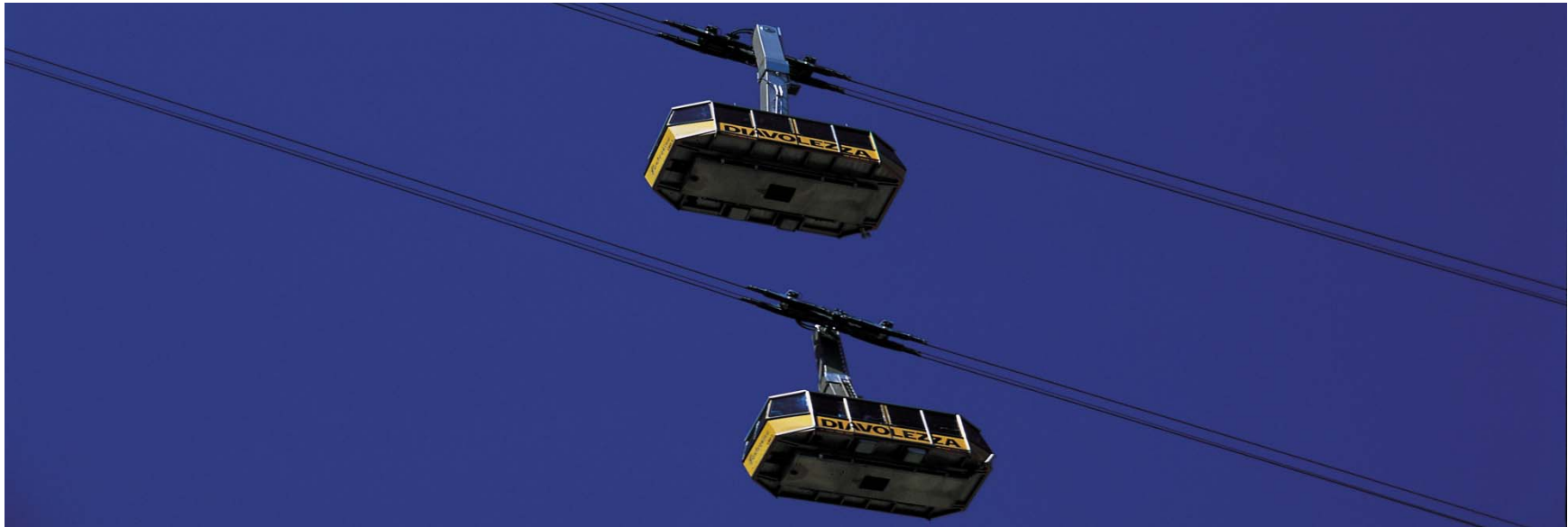
# UDITPA Section 18: The Changing Faces of Alternative Apportionment

July 12, 2009

Presented by:

Kelly W. Smith, PricewaterhouseCoopers LLP

Jay Koren, PricewaterhouseCoopers LLP



This document was not written to be used, and it cannot be used, for purposes of avoiding U.S., state or local tax penalties.

# UDIPTA Section 18: Overview

- Uniform Division of Income for Tax Purposes Act (“UDIPTA”)
  - Governs apportionment of income
  - Adopted in most states (or similar provisions)
  - Purpose is to promote uniformity

# UDIPTA Section 18: Overview

- Section 18 Text

- “If the allocation and apportionment provisions of [UDIPTA] do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
  - (a) separate accounting;
  - (b) the exclusion of any one or more of the factors;
  - (c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this State; or
  - (d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.”

# UDIPTA Section 18: Overview

- MTC Regulation

- “MTC Reg. IV.18.(a) permits a departure from the allocation and apportionment provisions of Article IV only in limited and specific cases. Article IV.18, may be invoked only in specific cases where *unusual fact situations* (which ordinarily will be *unique and nonrecurring*) produce *incongruous results* under the apportionment and allocation provisions contained in Article IV.” (emphasis added)
- Adopted by a number of states

# UDIPTA Section 18: Historic Interpretation

- Historically narrowly interpreted
  - Unique and non-recurring circumstances
  - Statutory formula unconstitutional in application
  - Promotes goal of uniformity

# UDIPTA Section 18: Historic Interpretation

- State courts applied narrow interpretation
  - *Roger Dean Enterprises v. Dep't of Revenue*, 387 So.2d 358 (Fla. 1980)
    - “There is a very strong presumption . . . against the applicability of the relief provisions.”
  - *AT&T v. Huddleston*, 880 S.W.2d 682 (Tenn. 1994)
    - “[T]he variance provision . . . is to be interpreted narrowly in order to carry out the purposes of uniform apportionment under [UDITPA].”

# South Carolina

- *Media General Comm. v. Dep't of Revenue*, 2010 WL 2347037 (SC June 14, 2010)
  - Intangible holding companies (“IHC”) licensed intangibles to affiliated members
  - SC asserted “Geoffrey” nexus over IHCs and required standard separate company filings
  - Taxpayer argued for unitary combined reporting under SC version of UDIPTA Section 18
  - SC Supreme Court upheld unitary combined reporting method



## South Carolina (cont'd)

- *Carmax Auto Superstores West Coast, Inc. v. Dep't of Revenue*, Docket No. 09-ALJ-17-0160-CC (S.C. Admin. Law Ct. April 22, 2010)
  - Auto retailer had “East-West” structure
  - Partnership conducted group’s financing and intangible property licensing
  - SC asserted alternative apportionment to bifurcate income streams
    - Retail income: retail income in SC / retail income everywhere
    - Financing/intangible income: F/I income in SC / F/I income everywhere
  - Court upheld alternative apportionment against taxpayer challenge

# Tennessee

- *Bellsouth Advertising v. Chumley*, 308 S.W.3d 350 (Tenn. App. 2009)
  - Taxpayer printed and distributed The Yellow Pages (advertising services)
  - Near zero sales factor, all costs of performance out of state
  - Variance on audit sourced sales based on customer location
  - Court upheld variance despite non-unique facts
- *See also, AT&T v. Huddleston*, 880 S.W.2d 682 (Tenn. App. 1994)
  - Taxpayer requested variance to use combined reporting
  - Comm'r denied, court upheld denial

# Alabama

- *Plantation Pipeline v. Ala. Dep't of Revenue, Corp.* Case No. 05-948 (Ala. Admin. Law Div. May 23, 2006)
  - Pipeline company transferred employees to partnership
  - Reported payroll factor included “loaned” employees’ wages
  - On audit, DOR eliminated payroll factor
  - ALD held for taxpayer, rejected DOR’s Section 18 variance argument

# Florida

- Fla. Tech. Assistance Adv. No. 08C1-006 (July 25, 2008)
  - Taxpayer apportioned >100% of income across states
  - DOR denied taxpayer's request for alternative apportionment
  - Stated “[a]lternative apportionment is very rare”

## Other States: Minnesota

- HMN Financial, Inc. v. Comm’r of Revenue, 782 N.W.2d 558 (Minn. 2010)
  - Held Comm’r does not have Section 18 authority to disregard tax motivated captive REIT structure
  - Court rejects “results oriented” variance
    - “the Commissioner appears to take issue with the result rather than the methods [taxpayer] used to reach that result.”

## Other States: California

### Treasury Function Receipts

- *Microsoft Corp. v. Franchise Tax Bd.*, 39 Cal.4th 750 (2006)
  - Gross proceeds from marketable securities included in statutory sales factor
  - Court upheld FTB's alternative apportionment to include only net gain
  - Alternative apportionment allowed where gross proceeds distort level of taxpayer's activity in the state
    - Quantitative and/or qualitative standard

## Other States: California (cont'd)

### Treasury Function Receipts

- *General Motors Corp. v. Franchise Tax Bd.*, 39 Cal.4th 773 (2006)
  - SBE rejected FTB's assertion of alternative apportionment formula
    - FTB failed to show inclusion of marketable security redemption gross proceeds in sales factor would cause "distortion" under *Microsoft*
    - "Clear and convincing" evidence standard not met
  - Non-precedential decision

## Other States: California (cont'd)

### Treasury Function Receipts

- *Appeal of Home Depot U.S.A. Inc.*, No. 298683 (SBE Dec. 18, 2008)
  - Marketable security repurchase agreements treated as loans
    - Therefore only interest income was “receipts”
  - Court rejected taxpayer argument that alternative apportionment was limited to correcting unconstitutional distortions
  - Court remanded for determination of whether “distortion” was present



© 2010 PricewaterhouseCoopers LLP. All rights reserved. "PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP, a Delaware limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity.

