1-1-2019

The Transformation of the State Corporate Income Tax into a Market-Based Levy

Walter Hellerstein
Distinguished Research Professor & Francis Shackelford Distinguished Professor in Taxation Law Emeritus *University of Georgia School of Law*, wallyh@uga.edu

The Transformation of the State Corporate Income Tax into a Market-Based Levy

WALTER HELLERSTEIN

This article traces the developments which have transformed the state corporate income tax into a market-based levy and provides an overview of the current "state of play" regarding the apportionment of income for state corporate income tax purposes.

"Income," the U.S. Supreme Court told us a century ago, "may be defined as the gain derived from capital, from labor, or from both combined."[1] Although the Court subsequently modified its narrow view of the definition of income confined to the product of capital and labor or both combined,[2] and has explicitly recognized the importance of sales as a factor that contributes to the generation of income,[3] the Court has never abandoned the view that capital and labor reflect fundamental "sources of income." Accordingly, while one can argue interminably about the factors that produce income and where such factors are located—as the current debate in the global tax community manifestly reveals[4]—one cannot seriously deny as a matter of established legal doctrine (reflecting established economic principles) that capital and labor contribute to the production of income.

For many years, the state corporate income tax embodied these fundamental understandings in determining the states in which a multistate corporation's income was earned with the location of a corporation's capital[5] and labor serving as essential factors in establishing the geographic source of a corporation's income, or, perhaps more precisely, the states to which the taxing rights over such income were assigned. But this is no longer the case. In recent years, the states have increasingly attributed income to states based on the corporation's "market" for its goods, services, and intangibles without regard to the location of the cor-

WALTER HELLERSTEIN is the Francis Shackelford Professor of Taxation and Distinguished Research Professor Emeritus at the University of Georgia School of Law, co-author of the treatise State Taxation (Thomson Reuters/WG&L), and a member of the Editorial Board of THE JOURNAL OF TAXATION.

poration's capital or labor that produced whatever was sold in that market.

The change is attributable to two developments, one that began roughly four decades ago (the states' redefinition of the factors that should be used in attributing income to the state) and the other of more recent vintage (the redefinition of the receipts factor for sales of services and intangibles). This article traces these developments, which have transformed the state corporate income tax into a market-based levy, and provides an overview of the current "state of play" regarding the apportionment of income for state corporate income tax purposes.[6] Although the article makes passing reference to the significant policy issues that are implicated by these recent developments—issues that the author and many others have addressed (and are continuing to address) elsewhere[7]—my more modest objective here is simply to provide an overview of the changing landscape of state corporate income taxation for those who do not labor in the weeds of the state tax terrain.

The Rise and Fall of the Equally Weighted Three-Factor Formula for Apportioning Corporate Income

We begin with a historical overview.

Historical Overview: 1911-1978

When states began to adopt corporate income taxes in the early part of the 20th century,[8] they typically sought to identify the "source" of the taxpayer's income in attributing it to a particular state.[9] Based on the then-prevailing concepts of the source of income,[10] states often adopted single-factor property formulas for attributing income to the state. Indeed, the first three U.S. Supreme Court cases addressing constitutional challenges to the apportionment of corporate income involved single-factor property formulas.[11]

The single-factor property formula was not well suited to the division of net income among the states. Moreover, during the period that states increased their use of the net income base in taxing corporations, the rationale underlying the states' fiscal claim to a portion of the tax base began to shift from the traditional concept of "source" of income to a growing recognition that the benefits and protection afforded a multistate business—and the public costs of furnishing services, facilities, and resources to the business—should also be considered in apportioning income for tax purposes.

Consequently, although many of the early state corporate income tax statutes employed single-factor property and other single-factor formulas for apportioning taxpayers' income,[12] the states gradually abandoned these traditional formulas for more sophisticated and refined methods of dividing the corporate net income tax base. During the 20th century, a broad consensus developed over the country that, for most manufacturing and mercantile businesses, the so-called Massachusetts formula, which averaged the ratios of property, payroll, and sales or gross receipts within the state to the totals throughout the business, ordinarily produced an equitable and workable division of corporate net income among the states. To be sure, this consensus took decades to accomplish, and there were influential advocates of very different formulas.[13] Nevertheless, by 1978 43 of the 45 states (as well as the District of Columbia) that imposed corporate net income taxes used an equally weighted three-factor formula of property, payroll, and sales.[14]

The U.S. Supreme Court has recognized both the widespread acceptance of and the underlying justifications for the three-factor formula for apportioning corporate income. "[N]ot only has the three-factor formula met our approval, but it has become . . . something of a benchmark against which other apportionment formulas are judged."[15] The Court has further observed that "[t]he three-factor formula . . . has gained wide approval precisely because payroll, property, and sales appear in combination to reflect a very large share of the activ-

NOTES

1 Eisner v. Macomber, 252 U.S. 189, 207 (1920) (quoting Stratton's Independence, Ltd. v. Howbert, 231 U.S. 399, 415 (1913) and Doyle v. Mitchell Bros. Co., 247 U.S. 179, 185 (1918)).

2 Under the Sixteenth Amendment, it is now plain that Congress can tax as income gains other than those derived strictly from capital or labor or both combined. See, e.g., Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 429 (1955) (punitive damages taxable as income).

3 See, e.g., Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 183 (1983) (observing in corporate income tax case that "payroll, property, *and sales* appear in combination to reflect a very large share of the activities by which value is generated" (emphasis supplied)).

4 See, e.g., OECD, *Tax Challenges Arising from Digitalisation—Interim Report 2018*: *Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project (2018); European Commission, *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence*, COM(2018) 147 final.

5 As reflected in the location of its real and tangible personal property. See Uniform Division of Income for Tax Purposes Act (UDITPA) § 10.

6 In undertaking this task, the author draws freely from Hellerstein, Hellerstein, and Swain, *State Taxation*, Third Edition (Thomson Reuters/WG&L 2019 Rev.) (hereinafter Hellerstein, *State Taxation Treatise*).

7 See, e.g., Hellerstein, "A US Subnational Perspective on the 'Logic' of Taxing Income on a 'Market' Basis," 72 Bull. for Int'l Tax'n 293 (2018); Shanske, "A New Theory of the State Corporate Income Tax: The State Corporate Income Tax as a Retail Sales Tax Complement," 66 Tax. L. Rev. 305 (2013).

8 In 1911, Wisconsin inaugurated the modern era of state income taxation by enacting a personal and corporate income tax. See Brownlee, *Progressivism and Economic Growth: The Wisconsin Income Tax, 1911-1929* (1974).

9 "Most students of state taxation have assumed that the search for reasonable division-of-income rules necessarily resolves itself into a search for the 'sources' of income." Special Subcomm. on State Taxation of Interstate Commerce of the House Comm. on the Judiciary, "State Taxation of Interstate Commerce," H.R. Rep. No. 1480, 88th Cong., 2d Sess. (1964); H.R. Reps. Nos. 565 and 952, 89th Cong. (1965) [paginated 1–1255, A1–A752], vol. I, p.158. This four-volume report is generally (and hereafter) referred to as the Willis Committee Report, and it will be cited as __ Willis Comm. Rep. __, with the volume number preceding and the page number succeeding the citation.

10 See text accompanying notes 1-5 *supra*.

11 Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920); Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission, 266 U.S. 271 (1924); Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931).

12 As of 1929, the states employed eleven different formulas for apportioning corporate income. The most common of these were the single-factor property formula and the single-factor sales formula. States also employed single-factor formulas based on cost of production and costs of sales. See 1 Willis Comm. Rep., *supra* note 9, at 119.

13 In 1964, the Willis Committee recommended the abandonment of the sales or gross receipts factor and proposed a two-factor formula of property and payroll, largely because of the burdens and costs of compliance and administration associated with the sales factor of the three-factor formula. See 4 Willis Comm. Rep., *supra* note 9, at 1144 et seq.

14 Moorman Mfg. Co. v. Bair, 437 U.S. 267, 283 (1978) (Powell, J., dissenting).

15 Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 170 (1983).

ities by which value is generated."[16] The Court has also noted that "[t]he standard three-factor formula can be justified as a rough, practical approximation of the distribution of either a corporation's sources of income or the social costs which it generates."[17]

The *Moorman* Case

Despite the legislative and judicial consensus that had emerged over the appropriateness of the equally weighted three-factor formula for apportioning corporate income, we now know, with the benefit of hindsight, that 1978 was the high water mark for state income tax apportionment uniformity based on that formula. In that year, the U.S. Supreme Court sustained the constitutionality of Iowa's single-factor sales formula for apportioning corporate income in *Moorman Manufacturing Co. v. Bair*.[18] The Court made it clear that the dormant Commerce Clause did not require uniform division-of-income rules, because it was to Congress—not the Court—"that the Constitution has committed such policy decisions."[19] Since 1978, the states have increasingly abandoned the equally weighted three-factor formula for formulas that give greater—if not exclusive—weight to the sales factor[20] for reasons that have little to do with sound state tax policy and everything to do with state "economic development" policy.[21]

Indeed, in what may be viewed as the *coup de grace* for the equally

NOTES

16 Id. at 183.

17 General Motors Corp. v. District of Columbia, 380 U.S. 553, 561 (1965).

18 437 U.S. 267 (1978).

19 Id. at 280.

20 See Exhibit 1 *infra*.

21 According greater (or exclusive) weight to the sales factor is designed to encourage taxpayers to locate in the state because their in-state capital and labor will count relatively less (or not at all) in determining their in-state income and their sales will count only insofar as they have a market within the state. The extent to which these changes actually influence economic development in a state, especially in light of other states' adopting similar formulas, remains an open and controversial question. See, e.g., Edmiston, "Strategic Apportionment of the State Corporate Income Tax: An Applied General Equilibrium Analysis," 55 Nat'l Tax J. 239 (2002); Wheeler, "Apportionment Formula Change's Effect on Georgia Corporate Tax Liability," State Tax Notes, 09/27/2010, p. 829.

EXHIBIT 1

State Income Tax Apportionment Formulas[1]

STATE	FORMULA
Alabama	Three-factor formula with double-weighted sales factor.
Alaska	Evenly weighted three-factor formula.
Arizona	Three-factor formula with double-weighted sales factor or optional single-factor sales formula.
Arkansas	Three-factor formula with double-weighted sales factor.
California	Single-factor sales formula.
Colorado	Single-factor sales formula.
Connecticut	Single-factor gross receipts formula.
Delaware	Three-factor formula with triple-weighted sales factor. Single-factor sales formula to be phased-in as of 01/01/2020.
District of Columbia	Single-factor sales formula.
Florida	Three-factor formula with double-weighted sales factor.
Georgia	Single-factor sales formula.
Hawaii	Evenly weighted three-factor formula.
Idaho	Three-factor formula with double-weighted sales factor.
Illinois	Single-factor sales formula.
Indiana	Single-factor sales formula.
Iowa	Single-factor sales formula.
Kansas	Evenly weighted three-factor formula.
Kentucky	Single-factor sales formula.
Louisiana	Single-factor sales formula.
Maine	Single-factor sales formula.
Maryland	Prior to 01/01/2018, three-factor formula with double-weighted sales factor. Thereafter, a single-factor sales formula is being phased in over a five-year period.
Massachusetts	Three-factor formula with double-weighted sales factor.
Michigan	Single-factor sales formula.
Minnesota	Single-factor sales formula.
Mississippi	No general apportionment formula. Single-factor sales formula for taxpayers that are not required to use a designated apportionment formula based on specific type or line of in-state business activity.
Missouri	Beginning 01/01/2020, singe-factor sales formula. Previously, evenly weighted three-factor formula or optional single-factor sales formula for corporations other than certain public utilities and transportation companies.
Montana	Evenly weighted three-factor formula.
Nebraska	Single-factor sales formula.
Nevada	N/A, because state does not tax general business corporation income.
New Hampshire	Three-factor formula with double-weighted sales factor.
New Jersey	Single-factor sales formula.
New Mexico	Single-factor sales formula.
New York	Single-factor receipts formula.
North Carolina	Single-factor sales formula.
North Dakota	Single-factor sales formula.

EXHIBIT 1

State Income Tax Apportionment Formulas[1] *(Continued)*

STATE	FORMULA
Ohio	N/A, because state does not have a general corporate income tax. For purposes of its commercial activity tax, the state has specific rules describing how gross receipts are sitused to the state.
Oklahoma	Evenly weighted three-factor formula; corporations meeting investment criteria may double-weight the sales factor.
Oregon	Single-factor sales formula.
Pennsylvania	Single-factor sales formula.
Rhode Island	Single-factor sales formula.
South Carolina	Single-factor sales formula.
South Dakota	N/A, because state does have a general corporate income tax.
Tennessee	Three-factor formula with triple-weighted sales factor.
Texas	Although Texas does not have a general corporate income tax, it applies a single-factor gross receipts formula to its business margins tax.
Utah	Single-factor sales formula
Vermont	Three-factor formula with double-weighted sales factor.
Virginia	Three-factor formula with double-weighted sales factor.
Washington	N/A, because state does not have a general corporate income tax.
West Virginia	Three-factor formula with double-weighted sales factor.
Wisconsin	Single-factor sales formula.
Wyoming	N/A, because state does not have a general corporate income tax.

[1] Exhibit 1 is based on Federation of Tax Administrators, "State Apportionment of Corporate Income," available at https://www.taxadmin.org/assets/docs/ Research/Rates/apport.pdf (January 2019), as updated from other publicly available sources to reflect more recent developments.

weighted three-factor formula, if not for uniformity itself as a genuine objective of state income tax policymakers, in 2014 the Multistate Tax Commission (MTC) abandoned its support for a mandatory equally weighted three-factor formula and instead endorsed a formula that permits the state to define its own formula weighting, although with a suggestion that states adopt a double-weighted receipts factor.[22] To take seriously the MTC's characterization of its decision to leave factor-weighting to the individual states' discretion as one of its "*uniformity* recommendations"[23] for revisions to the Uniform Division of Income for Tax Purposes Act (UDITPA), as embodied in Article IV of the Multistate Tax Compact, requires the suspension of disbelief.

The states' 40-year "exodus" from their virtually universal embrace of the equally weighted three-factor formula of property, payroll, and sales towards the "promised land" of formulas relying more heavily if not exclusively on sales has been as pervasive as it has been continuous. Today only five of the 44 states (and the District of Columbia) with corporate income taxes rely primarily on the equally weighted three-factor formula to apportion corporate income, with nearly 90% of these jurisdictions employing formulas that look exclusively or more heavily to sales in apportioning such income, as the accompanying Exhibit 1 reveals.

The Revision of the Sales Factor for Receipts from Services and Intangibles to Reflect the Taxpayer's Market

An overview of the sales factor follows.

Overview of the Sales or Receipts Factor

The gross receipts or sales factor, as originally developed in the context of an economy dominated by manufacturing and mercantile companies, was designed to attribute a portion of the income tax base to the states in which the taxpayer markets its goods.[24] To implement that goal, states almost invariably employed (and still employ) a destination test to assign sales of tangible personal property in their apportionment formulas.[25] By attributing income to states in which goods are used or consumed in the context of the widespread adoption of the equally weighted three-factor formula of property, payroll, and sales,[26] the destination-based sales factor serves as a counterbalance to the property and payroll factors that tend to attribute income to states in which goods are produced. In this respect, the sales factor may be justified as much by political as by economic considerations, giving a "slice" of the corporate income tax "pie" to the market states, a position that may be questioned by those who reject the view that "merely" furnishing a "market" for a taxpayer's goods creates a legitimate claim to a portion of the taxpayer's in-

NOTES

[22] The MTC recommendation reads as follows: "All apportionable income shall be apportioned to this State by multiplying the income by a fraction, [State should define its factor weighting fraction here. Recommended definition: 'the numerator of which is the property factor plus the payroll factor plus two times the receipts factor, and the denominator of which is four.']" The "uniformity" recommendation was subsequently incorporated into the MTC's broader "uniformity" recommendation for a "Model Compact Article IV. Division of Income. [UDITPA]" (July 29, 2015), available at www.mtc.gov.

[23] See www.mtc.gov (emphasis supplied).

[24] Hellerstein, *State Taxation Treatise*, *supra* note 6, ¶ 8.06[3].

[25] Id. ¶ 8.06[3][a]; UDITPA § 16. There are exceptions in many states for sales to the United States Government or to a purchaser in a state where the taxpayer is not taxable, in which case the sale or receipts are assigned to the state of origin under the so-called "throwback" rule. Id.; see Hellerstein, *State Taxation Treatise*, *supra* note 6, ¶ 9.18[1][c].

[26] As noted above, this description of the state corporate tax universe began to change dramatically beginning in 1978.

come generated by the sale of such goods.[27]

In contrast to the near universal assignment of receipts from sales of tangible personal property to the "market" state for income tax apportionment purposes, the states historically have taken a more diverse approach to assigning receipts from sales of services and intangible property. Prior to the approval of UDITPA by the National Conference of Commissioners on Uniform State Laws in 1957, most states assigned receipts from services to the state in which the services were performed; they assigned rents to the state in which the property was located; and they assigned patent and copyright royalties to the state in which the patent or copyright was used.[28] With the promulgation of UDITPA, many states adopted UDITPA's general rule for "sales, other than sales of tangible personal property,"[29] which attributes receipts to the state in which the income-producing activity is performed.[30] If the income-producing activity is performed in more than one state, UDITPA assigns the receipts to the state in which "a greater proportion of the income-producing activity is performed . . . , based on costs of performance." [31]

Over the years, however, there was increasing dissatisfaction with the UDITPA and similar rules for attributing receipts from services and intangibles for sales factor purposes. Not only did the all-or-nothing rule often ignore significant income-producing activity in many states, but the rule also creates difficult issues over what constitutes the relevant income-producing activity and where that income-producing activity occurs.[32] Moreover, the rule can be quite awkward in its application to receipts from intangibles.[33] Finally, and most importantly, the rule often fails to reflect the "market" for the taxpayer's services or other income-producing activities, which was the underlying purpose of the sales factor as originally conceived.[34] Instead, the rule tends to replicate the property and payroll factors. As a consequence, in recent years there has been a dramatic movement by the states to embrace market-based rules for attributing receipts from services and intangibles to the numerator of their sales factors. In the balance of this article, we summarize these developments.[35]

States' Adoption of the Market-State Approach for Receipts from Services

A growing number of states have modified their sales factor rules for receipts from services to attribute those receipts to the state of the taxpayer's market. In addition, the MTC has recommended that states adopt a market-state approach for receipts from services (as well as other receipts from sales other than sales of tangible personal property to replace UDITPA's "income-producing activity"/"costs of performance" approach). Before describing individual states' provisions adopting a market-state approach to the attribution of receipts from services, we describe the MTC's recommended approach, even though it is not the "law" in any state until a state adopts the MTC language. Nevertheless, the MTC's proposed statute constitutes an important model for the states and many states have adopted the MTC proposal either literally or in substance.

Multistate Tax Commission. In 2014, the MTC adopted, as a "uniformity" recommendation to the states, a revision to Section 17 of UDITPA ("sales, other than sales of tangible personal property"), incorporated in Article IV of the Multistate Tax Compact.[36] The recommended revision to Section 17 of UDITPA reads, in pertinent part,[37] as follows:

> (a) Receipts, other than receipts [from the sale of tangible personal property], are in this state if the taxpayer's market for the sales is in this state. The taxpayer's market for sales is in this state: . . .
>
> (3) in the case of sale of a service, if and to the extent the service is delivered to a location in this state.[38]

While the MTC has fully embraced the market-state approach for sourcing receipts from services (as well as other receipts not derived from the sale of tangible personal property), the provision itself is relatively skeletal in defining the market, particularly with respect to services. The MTC was well aware of this issue and, at the same time that it adopted the proposed revision to Section 17, it also approved a "Sec. 17 Model Market-Sourcing Regulations" project to "draft model regulations to implement changes to the sourcing of sales other than sales of tangible property under Article IV, Section 17 of the Multistate Tax Compact [UDITPA] that were adopted by the Commission in July 2014."[39]

The MTC's Uniformity Committee instructed the work group charged with

NOTES

27 See Hellerstein, *State Taxation Treatise, supra* note 6, ¶ 8.06[3]; 1 Willis Comm. Rep., *supra* note 9, at 180. This is, of course, a question that lies at the heart of debate over taxation of income in the digital economy. See, e.g., Schoen, "Ten Questions About Why and How to Tax the Digitalized Economy," 72 Bulletin for Int'l Tax'n 278 (2018); Hellerstein, "A US Subnational Perspective on the 'Logic' of Taxing Income on a 'Market' Basis, *supra* note 7.

28 See 1 Willis Comm. Rep., *supra* note 9, at 188.

29 UDITPA § 17.

30 Id.

31 Id.

32 The application of these rules and the case law it has spawned are considered in excruciating detail in Hellerstein, *State Taxation Treatise, supra* note 6, ¶ 9.18[3][b].

33 See id. ¶ ¶ 9.18[4][a], 9.18[4][b].

34 See generally id. ¶ 9.18[3][a] (providing detailed critique of these rules).

35 For a more detailed consideration of these developments, see Hellerstein, *State Taxation Treatise, supra* note 6, ¶ ¶ 9.18[3][c], 9.18[4][c].

36 See www.mtc.gov. The Section 17 "uniformity" recommendation was subsequently incorporated into the MTC's broader "uniformity" recommendation for a "Model Compact Article IV. Division of Income. [UDITPA]" (07/29/2015), available at www.mtc.gov.

37 The MTC's proposed revision of Section 17 of UDITPA applies not only to receipts from services but also to many other types of receipts (other than those from sales of tangible personal property), including receipts from intangible property, which we discuss below.

38 Multistate Tax Commission, "Model Compact Article IV. Division of Income. [UDITPA]" (07/29/2015) (Section 17), available at www.mtc.gov. The statute further provides: "(b) If the state or states of assignment under subsection (a) cannot be determined, the state or states of assignment shall be reasonably approximated. (c) If the taxpayer is not taxable in a state to which a receipt is assigned under subsection (a) or (b), or if the state of assignment cannot be determined under subsection (a) or reasonably approximated under subsection (b), such receipt shall be excluded from the denominator of the receipts factor. (d) [The tax administrator may prescribe regulations as necessary or appropriate to carry out the purposes of this section.]." Id.

39 See http://www.mtc.gov/Uniformity/Project-Teams/Section-17-Model-Market-Sourcing-Regulations.

40 See http://www.mtc.gov/getattachment/Uniformity/Project-Teams/Section-17-Model-Market-Sourcing-Regulations/Sec-1-17-Draft-Regulations-as-of-7-

designing the market-based sourcing regulations to use as its starting point the detailed market-based sourcing rules that were proposed (and have since been adopted) in Massachusetts effective 2015.[40] In this connection, the MTC compiled an invaluable compendium of "State Market Sourcing Rules," setting forth the states' statutory and regulatory provisions addressed to market-state sourcing.[41] In February 2017, after several years of extensive work and consultation, the MTC adopted amendments to its Model General Allocation and Apportionment Regulations, including regulations implementing the market-based sourcing provisions of the proposed revisions to Section 17 of UDITPA.[42]

Alabama. Effective 2011, Alabama adopted a market-based rule for sourcing sales other than sales of tangible personal property.[43] Although Alabama's legislation predates the MTC's recommended changes to UDITPA, it is virtually identical to the MTC's proposal.[44] The Alabama statute provides that sales, other than sales of tangible personal property, are in the state if "the taxpayer's market for the sale is in this state."[45] With respect to services, the market is in the state "if and to the extent the service is delivered to a location in this state."[46] Detailed implementing regulations, along with instructive examples, provide guidance as to whether, and the extent to which, services rendered to individual and unrelated business customers are considered to be delivered to a location within the state.[47]

Arizona. Effective 2014, Arizona offers "multistate service providers"[48] an election to assign sales by reference to the taxpayer's market rather than on the basis of UDITPA's "income-producing activity"/"costs of performance" test.[49] A multistate service provider is a taxpayer that derives more than 85% of its sales from services to purchasers who receive the benefit of the services outside of Arizona.[50] Sales are assigned to the state in which the purchaser "received the benefit of the service."[51] If this state cannot be "readily determined," the services are considered to be received at the customer's home or, in the case of a business, the office of the customer from which the services were ordered in the regular course of the customer's trade or business.[52] If the ordering location cannot be determined, the services are considered to be received at the home or office of the customer to which the services were billed.

California. Effective 2013, California assigns sales from services to the state "to the extent the purchaser of the service received the benefit of the service in this state."[53] Under implementing regulations, the benefit of a service is presumably received by *individuals* at the customer's billing address; if this presumption is overcome then the location of receipt is determined according to the contract between the taxpayer and the customer or the taxpayer's books and records; if this alternative is unavailable, the location of receipt is determined by a reasonable approximation of the customer's activities.[54] The benefit of a service is presumably received by *businesses* at the locations determined by the contract between the taxpayer and the customer or by the taxpayer's books and records, but if the presumption is overcome, then the locations are determined in the following order (depending on availability): (a) a reasonable approximation of the customer's activities; (b) the location from which the customer placed the order; (c) the customer's billing address.[55]

Colorado. Effective 2019, Colorado assigns receipts other than receipts from sales of tangible personal property to the state "if the taxpayer's market for the sales is in Colorado."[56] A taxpayer's market for sales of services is in Colorado "to the extent the service is delivered to a location in Colorado."[57]

Connecticut. Effective 2016, Connecticut assigns receipts from services to the state under its gross receipts formula "if the market for services is in this state."[58] The taxpayer's market for the services is in the state "if and to the extent the service is used at a location in this state."[59]

District of Columbia. Effective 2015, the District of Columbia's newly adopted single-factor sales formula, provides that "[s]ales, other than sales of tangible personal property, are in the District if the taxpayer's market for the sales is in the District."[60] The market for a service is in the District "if and to the extent the service is delivered to a location in the District."[61] If the state or states of assignment cannot be determined under this rule, "the state or states of assignment shall be reasonably approximated."[62] If the taxpayer is not taxable in the state to which the sale is assigned under the foregoing rules, or if a state of assignment cannot be determined or approximated, the sale shall be excluded from the denominator of

NOTES

28-16-with-8-10-16-modifications.pdf.aspx; 830 Mass. Code Regs. § 63.38.1(9)(d) (Westlaw 2019).

41 See MTC, "State Market Sourcing Rules," available at http://www.mtc.gov/getattachment/Uniformity/Project-Teams/Section-17-Model-Market-Sourcing-Regulations/State-Market-Sourcing-Rules-11-17-2014.pdf.aspx. Presumably, these will be updated from time to time and will be available on the MTC's website, www.mtc.gov, under /Uniformity/Project-Teams/Section-17-Model-Market-Sourcing-Regulations.

42 See Multistate Tax Commission, Model General Allocation and Apportionment Regulations with Amendments Submitted for Adoption by the Commission February 24, 2017, available at www.mtc.gov. For a useful discussion of the MTC regulations, see Schadewald, "Multistate Tax Commission's Market-Sourcing Regulations: Will They Promote Uniformity?," 95 Taxes 23 (2017).

43 Act 2011-616 (HB 34), codified at Ala. Code § 40-27-1 (Section 17) (Westlaw 2019).

44 See note 38 *supra* and accompanying text.

45 Ala. Code § 40-27-1 (Section 17) (Westlaw 2019); see also Ala. Admin. Code r. 810-27-1-.17(1) (Westlaw 2019).

46 Ala. Code § 40-27-1 (Section 17(a)(3)) (Westlaw 2019); see also Ala. Admin. Code r. 810-27-1-.17(2) (Westlaw 2019).

47 Ala. Admin. Code r. 810-27-1-.17 (Westlaw 2019). The regulations are discussed in Hellerstein, *State Taxation Treatise, supra* note 6, ¶ ¶ 9.18[3][c][ii].

48 Ariz. Rev. Stat. § 43-1147(B) (Westlaw 2019).

49 Id. § 43-1147.

50 Id. § 43-1147(E)(3).

51 Id. § 43-1147(E)(2).

52 Id. § 43-1147(E)(4).

53 Cal. Rev. & Tax. Code § 25136(1) (Westlaw 2019).

54 Cal. Code Regs. tit. 18, § 25136-2(c)(1) (Westlaw 2019). For a thoughtful analysis of the California regulations, see Schiefelbein, "Market Sourcing for Services: Comparing California and Oregon Regs," State Tax Notes, 01/14/2019, p. 121.

55 Cal. Code Regs. tit. 18, § 25136-2(c)(2) (Westlaw 2019).

56 Colo. Rev. Stat. § 39-22-303.6(6) (Westlaw 2019).

57 Id. § 39-22-303.6(6)(a).

58 Conn. Gen. Stat. § 12-218(b)(2) (Westlaw 2019).

59 Id.

60 D.C. Code § 47-1810.02(g)(3)(A) (Westlaw 2019).

61 Id. § 47-1810.02(g)(3)(A)(iii).

62 Id. § 47-1810.02(g)(3)(B).

the sales factor,[63] i.e., it is "thrown out" of the formula.[64]

Georgia. Georgia has adopted a market-state sales factor for gross receipts of taxpayers whose income is principally derived from activities other than the manufacture, sale, and production of tangible personal property. For such taxpayers "[g]ross receipts are in this state if the receipts are derived from customers within this state or if the receipts are otherwise attributable to the state's marketplace."[65] The Georgia regulations governing receipts from services[66] attribute service receipts based on where the recipient of the service receives the benefit of the service. If the service recipient receives only "some of the benefit of the service in Georgia, the gross receipts are included in the numerator of the apportionment factor in proportion to the extent the recipient receives benefit of the service in Georgia."[67]

Interestingly, the Georgia regulations speak to the effort that a taxpayer must make to comply with the market-state approach:

> The taxpayer must expend a reasonable amount of effort to obtain the information to determine the amount that is attributable to this state's marketplace. If the information is not available, the taxpayer may use other reasonable methods to determine the amount attributable to this state's marketplace. Such other methods are subject to review, adjustment, or change by the Commissioner.[68]

Illinois. Illinois provides that receipts from services are assigned to the state "if the services are received in this State."[69] Services provided to a "corporation, partnership, or trust" are assigned to a state only if the entity has a "fixed place of business"[70] in the state. If the state where the services are received "is not readily determinable" or is one where the business entity does not have a "fixed place of business," the services are deemed to be received "at the location of the office of the customer from which the services were ordered in the regular course of the customer's trade or business."[71] If the ordering office "cannot be determined," the services are then sourced to the billing address.[72] If the taxpayer is not taxable in the state in which the services are received under any of the foregoing rules, the sale is excluded from both the numerator and the denominator of the sales factor[73] (i.e., a "throwout rule").[74]

Iowa. In Iowa gross receipts from services are included in the numerator of the sales factor "in the proportion which the recipient of the service receives benefit of the service in this state."[75] The regulations make it clear that the location of the service provider does not control the determination of where the recipient of the service receives the benefit of the service. For example, receipts for engineering services attributable to a building site in Iowa are included in the numerator of the Iowa gross receipts factor, even if the service provider performs some or all of its services outside Iowa.[76] Similarly, the location of the customer does not control the determination of where the customer receives the benefit of the service. For example, receipts for surveying work done on a tract of land in Iowa are attributed to Iowa even though the customer, the recipient of the services, may be located in Texas.[77]

Moreover, unlike UDITPA's traditional rule for assigning receipts from services based on where the income producing activity was performed, which usually results in an all-or-nothing attribution of receipts to particular states, Iowa requires receipts to be attributed to Iowa in proportion to the benefits received in Iowa. The regulation provides:

> If the recipient of the service receives some of the benefit of the service in Iowa with respect to a specific contract or item of income, the gross receipts are includable in the numerator of the apportionment factor in proportion to the extent the recipient receives benefit of the service in Iowa.[78]

Kentucky. Effective 2018, Kentucky adopted the MTC's proposed revision of UDITPA and with it the market-state approach for attributing receipts other than receipts from the sale of tangible personal property.[79]

Louisiana. Effective 2016, the Louisiana apportionment statute provides that "[s]ales other than sales of tangible personal property are to be sourced to this state if the taxpayer's market for the sale is in this state."[80] In the case of the sale of a service, the market is in the state "if and to the extent the service is delivered to a location in the state."[81] The statute provides for three different sets of sourcing rules depending on whether the taxpayer's customer is a natural person, an unrelated entity, or a related entity. When the customer

NOTES

63 Id. § 47-1810.02(g)(3)(C).

64 See generally Hellerstein, *State Taxation Treatise, supra* note 6, ¶ 9.18[1][c] for a discussion of the throwout rule.

65 Ga. Code Ann. § 48-7-31(d)(2)(A)(i) (Westlaw 2019). This statute is arguably unconstitutional because it is "internally inconsistent." See Hellerstein, *State Taxation Treatise, supra* note 6, ¶ ¶ 4.16[1] (explicating "internal consistency" test); see also W. Hellerstein, "Is 'Internal Consistency' Dead?: Reflections on an Evolving Commerce Clause Restraint on State Taxation," 61 Tax L. Rev. 1 (2007). "In other words, if all jurisdictions adopted this rule then many taxpayers would be subject to multiple taxation, because receipts could be derived from 'customers within' State A but be 'otherwise attributable to [State B's] marketplace.'" Swain, "Reforming the State Corporate Income Tax: A Market State Approach to the Sourcing of Service Receipts," 83 Tul. L. Rev. 285, 322 n.161 (2008).

66 Ga. Comp. R. & Regs. 560-7-7-.03(5)(c)(6)(ii) (Westlaw 2019).

67 Id.

68 Id. 560-7-7-.03(5)(c)(6)(ix). The Georgia regulations are discussed in more detail in Hellerstein, *State Taxation Treatise, supra* note 6, ¶ 9.18[3][c][viii].

69 35 Ill. Comp. Stat. § 5/304(a)(3)(C-5)(iv) (Westlaw 2019).

70 Id.

71 Id.

72 Id. Note that this rule essentially throws back services provided to customers without a fixed place of business in a state to the state in which the customer has a fixed place of business. Without uniformity, this statute presents a risk of multiple taxation. For example, if a service is provided in Maine to a business that has no fixed place of business in Maine, Maine would attribute the receipts to Maine while Illinois would throw back the receipts to the customer's fixed place of business in, say, Champaign-Urbana, Illinois. See text accompanying notes 88-93 *infra* (discussing Maine rule).

73 Id.

74 See generally Hellerstein, *State Taxation Treatise, supra* note 6, ¶ 9.18[1][c] for a discussion of the throwout rule.

75 Iowa Admin. Code r. 701-54.6(1)(422) (Westlaw 2019).

76 Id. r. 701-54.6(1)(b)(422), r. 701-54.6(1)(c)(422).

77 Id. r. 701-54.6(1)(a)(422).

78 Id. r. 701-54.6(1)(422).

79 Ky. Rev. Stat. Ann. § 141.120 (Westlaw 2019). The MTC's proposed revision of UDITPA is discussed at text accompanying notes 36-42 *supra* and notes 166-168 *infra*.

80 La. Rev. Stat. § 47:287.95(L) (Westlaw 2019).

81 Id. § 47:287.95(L)(1)(c).

82 Id. § 47:287.95(L)(2)(a).

is a natural person, and the service is a "direct personal service," the sales are sourced "to the state where the customer received the direct personal service."[82] For other services delivered to natural persons, the sales are sourced to the customer's billing address.[83] When the customer is an unrelated entity, the sales are sourced to the state (or states) to which "the service being provided has a substantial connection to a specific geographic location"[84] in the state. If the service does not have a substantial connection to a specific geographic location, the sales are sourced to the taxpayer's commercial domicile.[85] When the customer is a related entity, the tax administrator is directed to "promulgate rules . . . concerning the sourcing of the sales of services . . . ."[86] When the standard provisions "fail[ ] to clearly reflect the taxpayer's market in this state," the statute also provides for "the use of other criteria and methodologies that will reasonably approximate the taxpayer's market in this state."[87]

Maine. Maine provides that receipts from the performance of services are "attributed to the state where the services are received."[88] Like other states,[89] Maine has an ordering rule for determining where the services are received "[i]f the state where the services are received is not readily determinable."[90] In these circumstances, in the case of individuals, the services are deemed to be received at the home of the customer; in the case of businesses, the services are deemed to be received at the office of the customer from which the services were ordered in the regular course of the customer's trade or business.[91] If the business's ordering location cannot be determined, the services are deemed to be received at the home or office of the customer to which the services are billed.[92] Maine has a special rule for services purchased by the federal government, which is the same as UDITPA's rule for assigning receipts from services.[93]

Maryland. Maryland's market-based approach is embodied in regulations that attribute receipts from services to the state if they are "derived from customers within this State."[94] The regulations then consider various categories of services, including general categories such as services provided to individual customers, services provided to business enterprises, and services related to real property, as well as industry-specific categories, such as brokerage services, services provided to regulated investment companies, and broadcast and print media.[95] A service provided to an individual is attributed to the individual's domicile.[96] Services provided to business enterprises are also attributed according to domicile, but domicile is given a peculiar meaning in the context of these regulations. The domicile of a service customer "is the state in which is located the office or place of business that provided the *principal impetus* for the sale."[97] If an office or place of business "cannot be identified as providing the principal impetus for the sale, then the domicile shall be the state in which the headquarters or principal place of business management of the customer is located."[98]

Services provided to real property constitute a separate category. "If a person provides a service relating to construction or improvement to real property, then whether the customer is a customer within this State will be determined by the situs of the property."[99] Other states reach the same conclusion without providing a separate category for services provided to real property but rather by focusing on where the "benefit is received." Regardless of where the owner of the real property may be located, the benefit of the service is normally deemed to be received where the real property is located.[100]

Massachusetts. Effective 2014, the Massachusetts sales factor provides that "[s]ales, other than sales of tangible personal property, are in the commonwealth if the corporation's market for the sale is in the commonwealth."[101] The corporation's market for a sale of services is in the commonwealth "if and to the extent the service is delivered to a location in the commonwealth."[102] The Massachusetts Department of Revenue has adopted a detailed set of regulations implementing the market-state sourcing statute,[103] and the MTC used the Massachusetts regulations as its starting point for drafting its own model market-state sourcing regulations.[104]

Michigan. The Michigan Business Tax (effective 2008 through 2011),[105] which contained several components, including the business income tax,[106] was replaced by a more traditional corporate income tax, effective 2012.[107] However, the provisions governing the single-factor sales formula for apportionment of business income under the pre- and post-2012 taxes were essentially the same.[108]

NOTES

83 Id. § 47:287.95(L)(2)(b).

84 Id. § 47:287.95(L)(3)(a).

85 Id. § 47:287.95(L)(3)(b).

86 Id. § 47:287.95(L)(3)(d).

87 Id. § § 47:287.95(L)(2)(c), 47:287.95(L)(3)(c).

88 Me. Rev. Stat. Ann. tit. 36, § 5211(16-A) (Westlaw 2019).

89 For example, Illinois (discussed above) and Minnesota (discussed below).

90 Me. Rev. Stat. Ann. tit. 36, § 5211(16-A)(A) (Westlaw 2019); see also 801 Code Me. R. (18-125 CMR 801) § 801.06(F) (Westlaw 2019).

91 Me. Rev. Stat. Ann. tit. 36, § 5211(16-A)(A) (Westlaw 2019).

92 The Maine rules are similar to the Illinois rules (discussed above) and the Minnesota rules (discussed below), except, importantly, there is no requirement that a business customer have an in-state fixed place of business in order for receipts provided to that customer to be attributed to the state.

93 Accordingly, receipts from services purchased by the federal government "are attributable to this State if a greater proportion of the income-producing activity is performed in this State than in any other state based on costs of performance." Me. Rev. Stat. Ann. tit. 36, § 5211(16-A)(A) (Westlaw 2019).

94 Md. Code Regs. 03.04.03.08(C)(3)(c) (Westlaw 2019).

95 Id. 03.04.03.08(C)(D). Special industry apportionment formulas are considered in detail in Hellerstein, *State Taxation Treatise, supra* note 6, Chapter 10.

96 Md. Code Regs. 03.04.03.08(D) (Westlaw 2019).

97 Id. 03.04.03.08(D)(2)(b)(iii) (emphasis supplied).

98 Id. 03.04.03.08(D)(2)(b)(iii).

99 Id. 03.04.03.08(D)(3).

100 See, e.g., text accompanying notes 75-77 *supra* (discussing the Iowa regulations). The Maryland regulations are discussed in more detail in Hellerstein, *State Taxation Treatise, supra* note 6, ¶ 9.18[3][c][xiv].

101 Mass. Gen. Laws ch. 63, § 38(f) (Westlaw 2019).

102 Id. § 38(f)(3).

103 See 830 Mass. Code Regs. § 63.38.1(9)(d) (Westlaw 2019).

104 See text accompanying notes 39-42 *supra* (discussing MTC model regulations).

105 Mich. Comp. Laws Ann. § 208.1101 (Westlaw 2019).

106 See generally McIntyre and Pomp, "A Policy Analysis of Michigan's Mislabeled Gross Receipts Tax," 53 Wayne L. Rev. 1275 (2008).

107 Mich. Comp. Laws Ann. § § 206.601 et seq. (Westlaw 2019).

108 Compare Mich. Comp. Laws Ann. § 208.1305 (Westlaw 2019) (Michigan Business Tax) with Mich. Comp. Laws § 206.665 (Westlaw 2019) (Michigan corporate income tax).

With regard to receipts from services, Michigan adopted a market-state approach. All receipts from the performance of services are included in the numerator of the apportionment factor if the recipient of the services receives all of the benefit of the services in the state.[109] If the recipient of the services receives some of the benefit of the services in Michigan, the receipts are included in the numerator of the apportionment factor in proportion to the extent that the recipient receives the benefit of the services in Michigan.[110]

Minnesota. In Minnesota, "[r]eceipts from the performance of services must be attributed to the state where the services are received."[111] If the customer is a corporation, partnership, or trust, the receipts may be attributed only to a state where the customer has a fixed place of doing business. If the state where the services are received is not readily determinable or if it is a state where the corporation, partnership, or trust receiving such services does not have a fixed place of doing business, then the services are deemed to be received at the location of the office of the customer from which the services were ordered. If the ordering office cannot be determined, the services are deemed to be received at the office of the customer to which the services are billed. The Minnesota rules closely resemble the Illinois rules described above.[112]

Missouri. Effective 2020, Missouri substantially adopted the MTC's proposed market-state approach for attributing receipts other than receipts from the sale of tangible personal property.[113]

Montana. Effective 2018, Montana adopted the MTC's proposed revision of UDITPA and with it the market-state approach for attributing receipts other than receipts from the sale of tangible personal property.[114]

Nebraska. For tax years beginning in 2014, Nebraska adopted a market-state approach for attributing sales from services to replace its UDITPA-based "income-producing activity"/"costs of performance" approach under its single-factor sales apportionment formula.[115] Sales of a service are in Nebraska if they are "derived from a buyer within this state."[116] Sales of a service are "derived from a buyer within" Nebraska if the service, "when rendered," (a) relates to real property located in Nebraska; (b) relates to tangible personal property located in Nebraska at the time the service is received; (c) is provided to an individual physically present in Nebraska at the time the service is received; or (d) is provided to a buyer engaged in a trade or business in Nebraska and relates to "that part of the trade or business then operated in" Nebraska.[117]

Cloud computing services. Nebraska adopted a special rule for attributing sales of cloud computing services, which it calls "application services," in the state.[118]

New Jersey. Effective July 1, 2018, New Jersey adopted a market state approach to sourcing receipts from services.[119] Receipts from sales of services are generally attributable to the state "if the benefit of the service is received at a location in this State."[120] If the benefit of the service is received both at a location within and without the state, the receipts are allocated to the state "based on the percentage of the total value of the benefit of the service received at a location in this State or a reasonable approximation to the total value of the benefit of the service received in all locations both within and outside this State."[121] If the benefit of the service attributable to a state cannot be determined under the foregoing criteria, the benefit of the service for business customers is deemed to be received at the customer's billing address and for other customers at the location from which the services were ordered in the customer's regular course of operations,[122] or, if that address cannot be determined, at the customer's billing address.[123]

New York. In conjunction with the major overhaul of its corporate income tax regime (effective 2015), which incorporates New York's earlier adoption of a single-factor sales formula, New York adopted a market-state approach to sourcing receipts from services for sales factor purposes.[124] In addition to providing specific and detailed sourcing rules for receipts from particular

NOTES

109 Mich. Comp. Laws Ann. § 206.665(2) (Westlaw 2019).

110 Id. The Department of Treasury issued guidelines to explain where the benefits of services are received for purposes of the sales factor. Revenue Admin. Bull. 2015-20, Michigan Dep't of Treasury, 10/16/2015, available at www.checkpoint.thomsonreuters.com.

111 Minn. Stat. Ann. § 290.191(Subd. 5(j)) (Westlaw 2019).

112 See text accompanying notes 69-74 *supra*.

113 Mo. Ann. Stat. § 143.455(12) (Westlaw 2019). The MTC's proposed revision of UDITPA to reflect a market-state approach for attributing receipts from services is discussed at text accompanying notes 36-42 *supra*. Prior to 2020, Missouri provided taxpayers with an election to file under UDITPA or under its so-called source-of-income test, id. § 143.451.2(2)(b), which employed a single-factor formula that attributed sales other than sales of tangible personal property to the state "if the taxpayer's market for the sales is in this state." Id. § 143.451.2(3)(e).

114 Mont. Code Ann. § § 15-1-601 (Westlaw 2019) (adopting MTC's recommendation for revisions to the language of the Multistate Tax Compact). The MTC's proposed revision of UDITPA is discussed at text accompanying notes 36-42 *supra* and notes 166-168 *infra*.

115 Neb. Rev. Stat. § § 77-2734.04, 77-2734.14 (Westlaw 2019).

116 Id. § 77-2734.14(3)(a).

117 Id. For purposes of the last category of services, if the buyer uses the service within and without the state, calculated using any reasonable method, the sales are apportioned between the in-state and out-of-state use. The "income-producing activity"/"costs of performance" approach continues to apply to "sales, other than sales of tangible personal property, of a communications company" in order "[t]o continue the tax policy . . . which enhances the deployment of broadband in underserved areas of this state." Id. § 77-2734.14(4).

118 Id. § 77-2734.14(3)(b). These rules are discussed in Hellerstein, *State Taxation Treatise, supra* note 6, ¶ 9.18[3][f].

119 N.J. Rev. Stat. § 54:10A-6(4) (Westlaw 2019).

120 Id.

121 Id.

122 Id.

123 Id.

124 N.Y. Tax Law § 210-A (Westlaw 2019).

125 Id. § 210-A.4.

126 Id. § 210-A.5.

127 Id. § 210-A.6.

128 Id. § 210-A.7.

129 Id. § 210-A.8.

130 Id. § 210-A.9.

131 Id. § 210-A.10.

132 Id. § 210-A.10(b).

133 Draft Reg. Sec. 4-2.3, Receipts from the Sale of, License to Use, and Granting of Remote Access to Digital Products (Tax Law, Sec. 210-A(4)), available at https://www.tax.ny.gov/bus/ct/pending/draft_Digital_Products_10-19-16.pdf.

134 Draft Reg. Sec. 4-2.15, Receipts from Other Services and Other Business Activities (Tax Law, Sec. 210-A(10)), available at https://www.tax.ny.gov/bus/ct/pending/draft_Services_and_Other_Business_Receipts_10-19-16.pdf.

135 N.C. Sess. Laws 2016-94 (HB 1030) § 38.4 (Westlaw 2019) (historical enacted legislation (session laws)).

types of services or industries including digital products,[125] financial transactions,[126] railroad and trucking businesses,[127] aviation services,[128] advertising,[129] and pipeline transmission or transportation of gas,[130] New York adopted a general rule for other service receipts, which are attributed to New York "if the location of the customer is within the state."[131] The determination of whether a customer is located in New York requires application of the following hierarchy of criteria:

> (1) The benefit is received in this state;
>
> (2) Delivery destination;
>
> (3) The apportionment fraction for such receipts within the state determined pursuant to this subdivision for the preceding taxable year; or
>
> (4) The apportionment fraction in the current taxable year determined pursuant to this subdivision for those receipts that can be sourced using the hierarchy of sourcing methods in subparagraphs one and two of this paragraph.[132]

In October 2016, the New York Department of Taxation and Finance issued revised draft regulations for sourcing receipts from sales of digital products[133] and from other services and business activities.[134]

North Carolina. In 2016, North Carolina adopted legislation with proposed statutory changes reflecting market-state sourcing principles.[135] The proposed statutory change provides that "[r]eceipts are in this State if the taxpayer's market for the receipts is in this State."[136] As applied to the sale of a service, receipts are assigned to the state "if and to the extent the service is delivered to a location in this State."[137] The legislation also provides that "on or before January 20, 2017, the Department of Revenue shall adopt . . . rules regarding the implementation of market-based sourcing principles as if the proposed statutory changes … was [*sic*] law."[138] As of early 2019, however, these changes have not been incorporated into the North Carolina statute.[139]

Oklahoma. Although the Oklahoma statute says simply that the "sales factor is a fraction, the numerator of which is the total sales or gross revenue of the taxpayer in this state during the tax period,"[140] and says nothing explicitly about sales of services, an implementing regulation attributes receipts from the performance of services to the Oklahoma numerator "if the receipts are derived from customers within this state or if the receipts are otherwise attributable to this state's marketplace."[141] A "customer within Oklahoma" is a business customer that "maintains a regular place of business in Oklahoma" or a nonbusiness customer "whose billing address is in Oklahoma."[142]

Oregon. Effective 2018, when Oregon's single-factor sales formula became effective,[143] Oregon in substance adopted the MTC's proposed market-state approach for attributing receipts other than receipts from the sale of tangible personal property for sales factor purposes.[144]

Pennsylvania. Effective 2014, Pennsylvania adopted a market-state approach for attributing sales from services for its single-factor formula, which became effective in 2013.[145] The "market" is determined by the state to which the service is "delivered," and, if delivered both to a location within and without the state, it is attributable to Pennsylvania "based upon the percentage of total value of the service delivered to a location in this State."[146] When the delivery location cannot be determined, the sales are assigned based on an individual (nonbusiness) customer's billing address,[147] and on the location from which a business customer ordered the services in the customer's regular course of operations, or the customer's billing address if the ordering location cannot be determined.[148]

Rhode Island. In conjunction with its adoption (effective 2015) of a single-factor sales formula to replace its traditional three-factor formula,[149] Rhode Island also adopted a market-state approach to state attribution of receipts from the sale of services. Services are assigned to the state "where the recipient of the service receives all of the benefit of the service."[150] If the recipient of the service receives some of the benefit of the service in the state, the receipts are attributable to the state "in proportion to the extent the recipient receives benefit of the service in this state."[151]

Tennessee. Effective July 1, 2016, Tennessee adopted a market-state approach for attributing "[s]ales, other than sales of tangible personal property" to the state under the double-weighted sales factor of its three-factor formula.[152] For services, the market is in the state "if and to the extent the service is delivered to a location in this state."[153] If the assignment cannot be determined under the general rule, the state of assignment "shall be reasonably approximated."[154] If the state of assignment cannot be determined, then the sale is excluded altogether ("thrown out") of the sales factor.[155]

NOTES

136 Id. § 38.4.(c) (proposed N.C. Gen. Stat. § 105-130.4(*l*)).

137 Id. (proposed N.C. Gen. Stat. § 105-130.4(*l*)(4)).

138 Id. § 38.4(a).

139 See N.C. Gen. Stat. § 105-130.4(*l*)(3) (Westlaw 2019) (receipts from the sales of services are in the state if "the income-producing activities are in this State"); "Sales Factor," North Carolina Dep't of Revenue, available at https://www.ncdor.gov/ taxes/corporate-income-franchise-tax/sales-factor.

140 Okla. Stat. tit. 68, § 2358(A)(5)(c) (Westlaw 2019).

141 Okla. Admin. Code § 710:50-17-71(1)(A) (Westlaw 2019).

142 Id.

143 Or. Rev. Stat. § 314.650 (Westlaw 2019).

144 Id. § § 314.605–314.675. The MTC's approach is discussed at text accompanying notes 36-42 *supra* and notes 166-168 *infra*. For a thoughtful analysis of the Oregon market-state sales factor regulations, see Schiefelbein, "Market Sourcing for Services: Comparing California and Oregon Regs," State Tax Notes, 01/14/2019, p. 121.

145 72 Pa. Cons. Stat. § 7401(3)2(a)(9) (Westlaw 2019). But see Sollie et al., "Pennsylvania's New Market Sourcing: Narrower Than You May Think," State Tax Notes, 04/13/2015, p. 125.

146 72 Pa. Stat. § 7401(3)2(a)(16.1)(C)(I) (Westlaw 2019).

147 Id. § 7401(3)2(a)(16.1)(C)(II).

148 Id. § 7401(3)2(a)(16.1)(C)(III).

149 R.I. Gen. Laws § 44-11-14(b) (Westlaw 2019).

150 Id. § 44-11-14(b)(1)(ii).

151 Id.

152 Tenn. Code Ann. § 67-4-2012 (Westlaw 2019).

153 Id. § 67-4-2012(i)(1)(C).

154 Id. § 67-4-2012(i)(2).

155 Id. § 67-4-2012(i)(3). For certain "qualified" taxpayers, namely members of a group of taxpayers, who, among other things, are engaged in the sale of telecommunications services and incur a specified level of expenditures in the state or make a specified level of taxable sales in the state, receipts from sales other than sales of tangible personal property are determined by averaging the taxpayer's receipts determined under the market-state approach and the "income producing activity"/"costs of performance" approach. Id. § 67-4-2012(j).

Utah. The Utah statute defining the sales factor for services provides that "a receipt from the performance of a service is considered to be in this state if the purchaser of the service receives a greater benefit of the service in this state than in any other state."[156] The statute further authorizes the taxing authority, by rule, to "prescribe the circumstances under which a purchaser of a service receives a greater benefit of the service in this state than in any other state."[157] The rules issued pursuant to the foregoing grant of authority provide a detailed set of criteria for determining whether the benefit from performance of a service is in Utah, based on such factors as the nature of the service, where the service is performed, when the service is performed, the location of the customer, etc.[158]

The rules further provide that if the benefit of the service is received in more than one state, "the gross receipts from the service are to be sourced using reasonable and consistent methods of analysis to determine in which state the greater benefit of the service is received."[159] When the state in which the greater benefit of the service is received cannot otherwise readily be determined, the rules prescribe a hierarchy of locations to identify the state to which the services should be attributed, to wit, the office from which the order was placed, the purchaser's billing address, and, if neither of the foregoing locations can be determined, Utah.[160] The rules also set forth a number of examples to illustrate their application.

Wisconsin. Wisconsin's sales factor provides that receipts from services are Wisconsin receipts "if the purchaser of the service received the benefit of the service in this state."[161] The benefit of a service is received in the state if

EXHIBIT 2

Receipts from Services[1]

STATE	COST OF PERFORMANCE (Greater Proportion)[2]	COST OF PERFORMANCE (Proportionate)[3]	MARKET-BASED	OTHER
Alabama			X	
Alaska	X			
Arizona[4]	X		X	
Arkansas		X		
California			X	
Colorado			X	
Connecticut			X	
Delaware[5]				X
District of Columbia			X	
Florida	X			
Georgia			X	
Hawaii	X			
Idaho	X			
Illinois			X	X
Indiana	X			
Iowa			X	
Kansas[6]	X	X		
Kentucky			X	
Louisiana			X	
Maine			X	
Maryland			X	
Massachusetts			X	
Michigan			X	
Minnesota			X	
Mississippi[7]				X
Missouri			X	
Montana			X	
Nebraska			X	
Nevada	State does not impose broad-based income tax			
New Hampshire	X			
New Jersey			X	
New Mexico	X			
New York			X	
North Carolina[8]				X
North Dakota[9]	X	X		
Ohio	State does not impose broad-based income tax			
Oklahoma			X	
Oregon			X	
Pennsylvania			X	
Rhode Island			X	
South Carolina[10]				X

NOTES

[156] Utah Code Ann. § 59-7-319(3)(a) (Westlaw 2019).

[157] Id. § 59-7-319(3)(b).

[158] Utah Admin. Code. R. 865-6F-8(10)(g) (Westlaw 2019). The Utah regulations are discussed in more detail in Hellerstein, *State Taxation Treatise, supra* note 6, ¶ 9.18[3][c][xxix].

[159] Utah Admin. Code. R. 865-6F-8(10)(g) (Westlaw 2019). The methods must be supported by the service provider's business records at the time the service was provided.

[160] Id. 865-6F-8(10)(g)(iv).

[161] Wis. Stat. § 71.25(9)(dh)(1) (Westlaw 2019).

EXHIBIT 2

Receipts from Services[1] *(Continued)*

STATE	COST OF PERFORMANCE (Greater Proportion)[2]	COST OF PERFORMANCE (Proportionate)[3]	MARKET-BASED	OTHER
South Dakota	State does not impose broad-based income tax			
Tennessee			X	
Texas	State does not impose broad-based income tax			
Utah			X	
Vermont[11]				X
Virginia	X			
Washington	State does not impose broad-based income tax			
West Virginia	X			
Wisconsin			X	
Wyoming	State does not impose broad-based income tax			

1 This exhibit has been prepared based on information from a variety of sources (including in Hellerstein, Hellerstein, and Swain, State Taxation, Third Edition (Thomson Reuters/WG&L 2019 Rev.) ¶¶ 9.18[3], Thomson Reuters Checkpoint, Bloomberg Tax Survey of State Tax Departments, and Wolters Kluwer Law & Business CCH Multistate Quick Answer Charts). It does not purport to be (and should not be treated as) a substitute for a careful reading of individual states' statutes and regulations.

2 Under UDITPA §17 and similar statutes, the receipts from the services are assigned to the state where "the greater proportion of the income-producing activity is performed . . . than in any other state."

3 Under the proportionate approach, the receipts from the services are assigned to the states where the services are performed on a pro-rata basis.

4 Taxpayers may elect to use market-based approach rather than UDITPA §17.

5 Receipts are attributed to Delaware when the activity that generates the income is performed in Delaware.

6 If a service is performed both within and outside the state, and a greater proportion of the income-producing activity is performed within the state based on costs of performance, then the receipts from the sale of the services are attributed to that state. However, where services are performed partly within and partly without the state, the services performed in each state may constitute a separate income-producing activity; in such cases, the receipts from the performance of services attributable to the state are measured by the ratio that the time spent in performing the services in the state bears to the total time spent in performing the services everywhere.

7 Mississippi provides different apportionment formulas for specific types of businesses. A single-factor sales formula is required if no specific business formula is specified. Receipts from sales of services are generally attributed to the state where the services are performed. "Gross receipts . . . shall be attributed to this state to the extent of such gross receipts which represent services or activities actually performed within this state." 35 Miss. Admin. Code, tit. 35, pt. III, R. 8.06(402.09(3)(d)) (Westlaw 2019).

8 Although North Carolina has enacted legislation with proposed statutory changes reflecting market-state principles, as of early 2019 the preexisting legislation attributing services to the state based on the location of "the income-producing activities" appears to govern the attribution of receipts from services for sales factor purposes. See text accompanying notes 135-139 in the body of the article.

9 The proportionate method may be utilized if the direct costs for each transaction are unknown and thus incompatible with the "greater proportion method."

10 South Carolina attributes receipts from services to the state "if the entire income-producing activity is within this State," and "[i]f the income-producing activity is performed partly within and partly without this State, sales are attributable to this State to the extent the income-producing activity is performed within this State." S.C. Code Ann. §12-6-2295(A)(5) (Westlaw 2019).

11 Vermont attributes receipts to the state based on "[t]he gross sales, or charges for services performed, within this State, expressed as a percentage of such sales or charges whether within or outside this State." Vt. Stat. Ann. tit. 32, §5833(a)(3) (Westlaw 2019).

a. The service relates to real property that is located in this state.

b. The service relates to tangible personal property that is delivered directly or indirectly to customers in this state.

c. The service is provided to an individual who is physically present in this state at the time that the service is received.

d. The service is provided to a person engaged in a trade or business in this state and relates to that person's business in this state.[162]

If the purchaser receives the benefit in more than one state, the Wisconsin receipts are determined "according to the portion of the service received in this state."[163]

In summary, today 28 of the 45 states with corporate income taxes (and the District of Columbia) employ a market-based approach to attribution of receipts from services to the sales factor of their corporate income tax apportionment formulas.[164] Moreover, in light of the powerful trend in recent years of states' adoption of this approach, which the MTC's recommendation to the same effect has only encouraged, the number of states with an "X" in the "market-based" column in the accompanying Exhibit 2 seems destined to increase.

States' Adoption of the Market-State Approach for Receipts from Intangibles

Just as a growing number of states have modified their sales factor rules for receipts from services to attribute those receipts to the state of the taxpayer's market, so they have taken similar action with respect to receipts from intangible property. In addition, as noted in connection with the discussion of receipts from services,[165] the MTC has recommended that states adopt a market-state approach for receipts from all "sales

NOTES

162 Id. § 71.25(9)(dh)(2).

163 Id. § 71.25(9)(dh)(3). The Wisconsin provisions are discussed in more detail in Hellerstein, *State Taxation Treatise, supra* note 6, ¶ 9.18[3][c][xxx].

164 As Exhibit 2 reveals, in a few instances the taxpayer may elect whether to use the market-based approach or an alternative approach (e.g., Arizona and, prior to 2020, Missouri).

165 See text accompanying notes 36-42 *supra*.

other than sales of tangible personal property," which include receipts from intangible property as well as receipts from services. Before describing individual state's provisions adopting a market-state approach to the attribution of receipts from intangibles, we describe the MTC's recommended approach because it constitutes an important model for the states and many states have adopted the MTC proposal either literally or in substance.

Multistate Tax Commission. In 2014, the MTC adopted, as a "uniformity" recommendation to the states, a proposed revision of Section 17 of UDITPA, incorporated in Article IV of the Multistate Compact.[166] The MTC's proposed revision of UDITPA's attribution of receipts from intangible property, which many states have incorporated verbatim or in substance,[167] provides:

> (a) Receipts, other than receipts [from sales of tangible personal property], are in this state if the taxpayer's market for the sales is in this state. The taxpayer's market for sales is in this state: . . .
>
> (4) in the case of intangible property,
>
> (i) that is rented, leased, or licensed, if and to the extent the property is used in this state, provided that intangible property utilized in marketing a good or service to a consumer is "used in this state" if that good or service is purchased by a consumer who is in this state; and
>
> (ii) that is sold, if and to the extent the property is used in this state, provided that:
>
> (A) a contract right, government license, or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area is "used in this state" if the geographic area includes all or part of this state;
>
> (B) receipts from intangible property sales that are contingent on the productivity, use, or disposition of the intangible property shall be treated as receipts from the rental, lease or licensing of such intangible property under subsection (a)(4)(i); and
>
> (C) all other receipts from a sale of intangible property shall be excluded from the numerator and denominator of the receipts factor.[168]

Alabama. Effective 2011, Alabama adopted a market-based rule for sourcing sales other than sales of tangible personal property.[169] The revised statute, which modifies UDITPA, provides that sales, other than sales of tangible personal property, are in the state if "the taxpayer's market for the sale is in this state."[170] In implementing the market-based approach, Alabama adopted provisions that generally look to the "use" of the intangible in attributing receipts from the license or sale of intangibles. Specifically, the statute provides the following criteria to determine whether the "taxpayer's market for a sale is in this state" with respect to receipts associated with intangible property:

> (4) In the case of lease or license of intangible property; or sale or other exchange of intangible property if the receipts from the sale or exchange derive from payments that are contingent on the productivity, use, or disposition of the property, if and to the extent the intangible property is used in this state; provided that intangible property used in marketing a good or service to a consumer is used in this state if the good or service that is marketed using the intangible property is purchased by a consumer who is in this state; and
>
> (5) In the case of sale of intangible property other than that referenced in subdivision (4) above; where the property sold is a contract right, government license, or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area; if and to the extent the intangible property is used in or otherwise associated with this state, provided that any sale of intangible property not otherwise described in this subdivision or subdivision (4) above shall be excluded from the numerator and the denominator of the sales factor.[171]

California. Effective 2013,[172] California generally assigns receipts from intangible property to the state "to the extent the property is used in this state."[173] A detailed regulation provides guidance for determining where intangible property is used.[174]

Colorado. Effective 2019, Colorado assigns receipts other than receipts from sales of tangible personal property to the state "if the taxpayer's market for the sales is in Colorado."[175] In implementing the market-state approach with respect to receipts from intangible property, Colorado effectively adopted the MTC's recommendations,[176] which are described above.[177]

Connecticut. Effective 2016, Connecticut generally embraced a market-based approach to sourcing receipts under its single-factor gross receipts formula and assigned receipts from the rental, lease, or license of intangible property to the state "if and to the extent the property is used in this state."[178]

NOTES

[166] See www.mtc.gov. The Section 17 "uniformity" recommendation was subsequently incorporated into the MTC's broader "uniformity" recommendation for a "Model Compact Article IV. Division of Income. [UDITPA]" (07/29/2015), available at www.mtc.gov.

[167] As the ensuing discussion reveals.

[168] Multistate Tax Commission, "Model Compact Article IV. Division of Income. [UDITPA]" (07/29/2015) (Section 17), available at www.mtc.gov. See also *supra* note 38 setting forth the "default" rules for attribution of receipts when the state or states of assignment cannot be determined under the specific rules.

[169] Ala. Code § 40-27-1 (Section 17) (Westlaw 2019).

[170] Id.; see also Ala. Admin. Code r. 810-27-1-.17(1) (Westlaw 2019).

[171] Ala. Code § 40-27-1 (Section 17) (Westlaw 2019); see also Ala. Admin. Code r. 810-27-1-.17 (Westlaw 2019).

[172] Between 2011 and 2013, California's market-based sales factor applied only to taxpayers who elected a single-factor sales formula. Effective 2013, all taxpayers are required to use the single-factor sales formula, except taxpayers engaged in "qualified business activity" who must use a three-factor formula with a double-weighted sales factor. Cal. Rev. & Tax Code § 25128.7 (Westlaw 2019).

[173] Id. § 25136(a)(2) (Westlaw 2019).

[174] Cal. Code Regs. tit. 18, § 25136-2(d) (Westlaw 2019).

[175] Colo. Rev. Stat. § 39-22-303.6(6) (Westlaw 2019).

[176] Id. § 39-22-303.6(6)(d).

[177] See text accompanying notes 36-42 and 166-168 *supra*.

[178] Conn. Gen. Stat. § 12-218(b)(4) (Westlaw 2019).

[179] Id.

[180] Id. § 12-218(b)(5).

[181] Id. § 12-218(b)(6).

[182] Id. § 12-218(b)(7).

[183] D.C. Code § 47-1810.02(g)(3)(A) (Westlaw 2019).

[184] Id. § 47-1810.02(g)(3)(A)(iv); see text accompanying notes 36-42 and 166-168 *supra* (discussing MTC's recommended language).

Intangible property utilized in marketing a good or service to a consumer "is used in this state if that good or service is purchased by a consumer in this state."[179] In addition, receipts from "interest managed or controlled within the state" are assigned to the state.[180] Receipts from the sale or other disposition of intangible (and other) property are excluded from the calculation of the apportionment fraction if such property is not held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business.[181] Receipts, other than those specifically addressed in the statute, "are assignable to this state to the extent the taxpayer's market for the sales is in this state."[182]

District of Columbia. Effective 2015, the District of Columbia's sales factor, for its newly adopted single-factor sales formula, provides that "[s]ales, other than sales of tangible personal property, are in the District if the taxpayer's market for the sales is in the District."[183] The provisions defining the "taxpayer's market" with respect to sales of intangible property essentially adopt the MTC's proposed language for revision of Section 17 of UDITPA.[184] If the state or states of assignment cannot be determined under this rule, "the state or states of assignment shall be reasonably approximated."[185] If the taxpayer is not taxable in the state in to which the sale is assigned under the foregoing rules, or if a state of assignment cannot be determined or approximated, the sale shall be excluded from the denominator of the sales factor,[186] i.e., it is "thrown out" of the formula.

Georgia. Georgia has adopted a market-state sales factor for gross receipts of taxpayers whose income is principally derived from activities other than the manufacture, sale, and production of tangible personal property. For such taxpayers, "[g]ross receipts are in this state if the receipts are derived from customers within this state or if the receipts are otherwise attributable to the state's marketplace."[187] Unlike other states' market-state statutes and regulations, Georgia does not provide detailed guidance on the attribution of receipts from intangible property. Nevertheless, the regulations do provide that "gross receipts" do not include "[r]eceipts from the sale of assets unless such receipts are from activities which constitute the taxpayer's regular trade or business"; "[a]pportionable interest and dividends unless the taxpayer's regular trade or business involves the loaning and/or investing of money"; and "[g]ross receipts from the management of working capital."[188]

Kentucky. Effective 2018, Kentucky adopted the MTC's proposed revision of UDITPA and with it the market-state approach for attributing receipts other than receipts from the sale of tangible personal property.[189]

Louisiana. Effective 2016, Louisiana adopted a market-state approach for sourcing receipts from intangibles in conjunction with its general embrace of the market-state approach to sourcing receipts for sales factor purposes.[190] The Louisiana statute is substantially the same as the Alabama statute quoted above.[191]

Maine. Maine provides that "receipts from the license, sale or other disposition of patents, copyrights, trademarks or similar items of intangible personal property must be attributed to this State if the intangible property is used in this State by the licensee."[192] If the intangible personal property is used by the licensee in more than one state, then the income must be apportioned "according to the portion of use" in the state.[193] When the federal government is the purchaser or licensee of the intangible personal property, Maine applies UDITPA's traditional "income-producing activity"/"costs of performance" rule for attribution of such receipts.[194]

Massachusetts. In 2014, Massachusetts adopted a market-state approach to the sales factor, providing generally that "[s]ales, other than sales of tangible personal property, are in the commonwealth if the corporation's market for the sale is in the commonwealth."[195] With regard to intangible property, the statute generally looks to the "use" of the intangible in attributing receipts from the license or sale of intangibles. Thus, the statute provides that a "corporation's market for a sale is in the commonwealth and the sale is thus assigned to the commonwealth," if

> (4) in the case of lease or license of intangible property, including a sale or exchange of such property where the receipts from the sale or exchange derive from payments that are contingent on the productivity, use or disposition of the property, if and to the extent the intangible property is used in the commonwealth; and
>
> (5) in the case of the sale of intangible property, other than as provided in clause (4), where the property sold is a contract right, government license or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area, if and to the extent that the intangible property is used in or otherwise associated with the commonwealth.[196]

The Massachusetts Department of Revenue has adopted a detailed set of regulations implementing the market-state sourcing statute,[197] and the MTC used the Massachusetts regulations as its starting point for drafting its own model market-state sourcing regulations. The Massachusetts statute closely resembles the Alabama statute quoted above[198] as well as the Louisiana statute.[199]

NOTES

185 D.C. Code § 47-1810.02(g)(3)(B) (Westlaw 2019).

186 Id. § 47-1810.02(g)(3)(C).

187 Ga. Code Ann. § 48-7-31(d)(2)(A)(i) (Westlaw 2019).

188 Ga. Comp. R. & Regs. 560-7-7-.03(5)(c)(2) (Westlaw 2019).

189 Ky. Rev. Stat. Ann. § 141.120 (Westlaw 2019). The MTC's proposed revision of UDITPA is discussed at text accompanying notes 36-42 and 166-168 *supra*.

190 La. Rev. Stat. § 47:287.95(L)(1) (Westlaw 2019). See text accompanying notes 80-87 *supra* (describing Louisiana's market-state approach to attribution of receipts from services).

191 See text accompanying notes 169-171 *supra*.

192 Me. Rev. Stat. Ann. tit. 36, § 5211(16-A)(B) (Westlaw 2019).

193 Id.

194 Id. Maine has a similar exception to its market-state approach to receipts from the sale of services for sales to the federal government. See text accompanying note 93 *supra*.

195 Mass. Gen. Laws ch. 63, § 38(f) (Westlaw 2019).

196 Id.

197 See 830 Mass. Code Regs. § 63.38.1(9)(d) (Westlaw 2019).

198 See text accompanying notes 169-171 *supra*.

199 See text accompanying notes 190-191 *supra*.

Michigan. With regard to "income received for the use of or for the privilege of using intangible property,"[200] Michigan attributes the receipts "to the state in which the property is used by the purchaser."[201] If the property is used in more than one state, the receipts are "apportioned to this state pro rata according to the portion of use in this state."[202] If the portion of use in Michigan cannot be determined, the receipts are "thrown out" of the apportionment formula.[203] The statute further provides that "[i]ntangible property is used in this state if the purchaser uses the intangible property or the rights to the intangible property in the regular course of its business operations in this state, regardless of the location of the purchaser's customers."[204]

Minnesota. Minnesota attributes receipts from sales of intangible property to "the state in which the property is used by the purchaser."[205] Intangible property is used in Minnesota "if the purchaser used the intangible property in the regular course of its business operations" in the state.[206]

Missouri. Effective 2020, Missouri substantially adopted the MTC's proposed market-state approach for attributing receipts from intangible property.[207]

Montana. Effective 2018, Montana adopted the MTC's proposed revision of UDITPA and with it the market-state

EXHIBIT 3

Receipts from Intangible Property[1]

STATE	COST OF PERFORMANCE (Greater Proportion)[2]	COST OF PERFORMANCE (Proportionate)[3]	MARKET-BASED	OTHER
Alabama			X	
Alaska	X			
Arizona	X			
Arkansas[4]				X
California			X	
Colorado			X	
Connecticut			X	
Delaware[5]				X
District of Columbia			X	
Florida	X			
Georgia			X	
Hawaii	X			
Idaho	X			
Illinois[6]				X
Indiana	X			
Iowa[7]			X	
Kansas	X			
Kentucky			X	
Louisiana			X	
Maine			X	
Maryland[8]				X
Massachusetts			X	
Michigan			X	
Minnesota			X	
Mississippi[9]				X
Missouri			X	
Montana			X	
Nebraska			X	
Nevada	State does not impose broad-based income tax			
New Hampshire	X			
New Jersey[10]				X
New Mexico	X			
New York			X	
North Carolina[11]				X
North Dakota	X			
Ohio	State does not impose broad-based income tax			
Oklahoma[12]				X
Oregon			X	
Pennsylvania	X			
Rhode Island[13]				X
South Carolina[14]				X
South Dakota	State does not impose broad-based income tax			
Tennessee			X	
Texas	State does not impose broad-based income tax			
Utah			X	
Vermont	X			

NOTES

[200] Mich. Comp. Laws Ann. § 206.665(1)(e) (Westlaw 2019). Such property includes "patents, know-how, formulas, designs, processes, patterns, copyrights, trade names, service names, franchises, licenses, contracts, customer lists, custom computer software, or similar items." Id.

[201] Id.

[202] Id.

[203] Id.

[204] Id.

[205] Minn. Stat. § 290.191(Subd. 5)(i) (Westlaw 2019).

[206] Id.

[207] Mo. Ann. Stat. § 143.455(12) (Westlaw 2019). The MTC's proposed revision of UDITPA to reflect a market-state approach for attributing receipts from intangible property is discussed at text accompanying notes 166-168 *supra*. Prior to 2020, Missouri provided taxpayers with an election to file under UDITPA or under its so-called source-of-income test, id. § 143.451.2(2)(b), which employed a single-factor formula that attributed sales other than sales of tangible personal property to the state "if the taxpayer's market for the sales is in this state." Id. § 143.451.2(3)(e).

EXHIBIT 3

Receipts from Intangible Property[1] ***(Continued)***

STATE	COST OF PERFORMANCE (Greater Proportion)[2]	COST OF PERFORMANCE (Proportionate)[3]	MARKET-BASED	OTHER
Virginia	X			
Washington	State does not impose broad-based income tax			
West Virginia	X			
Wisconsin			X	
Wyoming	State does not impose broad-based income tax			

1 This exhibit has been prepared based on information from a variety of sources (including in Hellerstein, Hellerstein, and Swain, State Taxation, Third Edition (Thomson Reuters/WG&L 2019 Rev.) ¶¶ 9.18[4], Thomson Reuters Checkpoint, Bloomberg Tax Survey of State Tax Departments, and Wolters Kluwer Law & Business CCH Multistate Quick Answer Charts). It does not purport to be (and should not be treated as) a substitute for a careful reading of individual states' statutes and regulations.

2 Under UDITPA §17 and similar statutes, the receipts are assigned to the state where "the greater proportion of the income-producing activity is performed . . . than in any other state."

3 Under the proportionate approach, receipts are assigned to the states where the income-producing activity is performed on a pro-rata basis.

4 Sales of intangible personal property are sourced to Arkansas if the income-producing activity is performed in the state or the income-producing activity is performed both within and without the state, in which event the portion of sales sourced to Arkansas is the percentage used in the formula for apportioning income to Arkansas during the year of the sale.

5 Receipts are attributed to Delaware when the activity that generates the income is performed in Delaware.

6 Illinois attributes receipts from the licensing, sale, or other disposition of a patent, copyright, trademark, or similar item of intangible personal property to the state in which the intangible is utilized (reflecting a market-state approach), but such receipts may be included in the sales factor only when such items exceed 50% of the taxpayer's gross receipts, effectively limiting the rule to a narrow class of taxpayers. 35 Ill. Comp. Stat. §§5/304(a)(3)(B-1), 5/304(a)(3)(B-2) (Westlaw 2019).

7 Royalty income and licensing fees from intangible property are sourced to Iowa to the extent the asset bearing the royalty or license fee is an integral part of some business activity occurring regularly in Iowa. If the asset is not an integral part of some business activity occurring regularly inside or outside of Iowa, but an election has been made to included investment income in the business activity ratio, then the income is sourced to Iowa if Iowa is the taxpayer's state of commercial domicile. Iowa Admin. Code §701-54.2(3)(e) (Westlaw 2019).

8 Gross income from intangible items such as dividends, interest, royalties, and capital gains from the sale of intangible property are included in the numerator based upon the average of the property and payroll factors.

9 Mississippi provides different apportionment formulas for specific types of businesses. A single-factor sales formula is required if no specific business formula is specified, and it has no rules directed specifically at receipts from intangibles. The Mississippi regulation provides that "[g]ross receipts, with respect to a particular item of income, derived from income-producing activity performed within and without this state shall be attributed to this state to the extent of such gross receipts which represent . . . activities actually performed within this state." 35 Miss. Admin. Code, tit. 35, pt. III, R. 8.06(402.09(3)(d)) (Westlaw 2019).

10 Gross receipts from the sale of intangible personal property are sourced to New Jersey if the commercial domicile of the owner of the intangible property is located in the state or if the intangible has been integrated with business carried on in the state.

11 Although North Carolina has enacted legislation with proposed statutory changes reflecting market-state principles, as of early 2019 the preexisting legislation attributing receipts from intangible property to the state if they are "received from sources within this State" appears to govern the attribution of receipts from intangibles for sales factor purposes. See text accompanying notes 218-221 in the body of the article.

12 There are no sourcing rules for receipts from the sale of intangible personal property because the sales are directly allocated to the domiciliary, business, or commercial situs of a nonunitary taxpayer.

13 In contrast to its statutory adoption of a market-state approach to the attribution of receipts of services (see text accompanying notes 149-151 in the body of the article), the attribution of receipts from intangibles would appear to fall under Rhode Island's generic attribution rule for "all other receipts within the state." R.I. Gen. Laws §44-11-14(b)(1)(vi) (Westlaw 2019). Nevertheless, the Rhode Island regulations take an approach that reflects the "market" for the intangibles by focusing on the state in which the intangibles are used as the appropriate criterion for determining the state to which the receipts should be assigned.

14 South Carolina attributes to the state's sales factor "receipts from the use of intangible property in this State including, but not limited to, royalties from patents, copyrights, trademarks, and trade names," as well as "[r]eceipts from the sale of intangible personal property . . . if the property is maintained for sale to customers in the ordinary course of taxpayer's trade or business." S.C. Code Ann. §§12-6-2295(A)(3), 12-6-2295(A)(4) (Westlaw 2019).

approach for attributing receipts from intangible property.[208]

Nebraska. Effective 2014, Nebraska adopted a rule that attributes "sales of intangible property" to the state "if the buyer uses the intangible property at a location in this state."[209] If the buyer uses the intangible property both within and without the state, "the sales are apportioned between this state in proportion to the use of the intangible property in this state and the other states."[210] When the location of a sale cannot be determined, "the sale of intangible property is in this state if the buyer's billing address is in this state."[211]

New York. In conjunction with the major overhaul of its corporate income tax regime (effective 2015), which incorporates New York's earlier adoption of a single-factor sales formula, New York adopted a market-state approach to sourcing receipts from intangibles and for sales factor purposes.[212] In addition to providing specific and detailed sourcing rules for receipts from particular types of services, property, and industries[213] (including royalties from patents, copyrights, and similar intangibles[214]), New York adopted a general rule for "[r]eceipts from other services and other business receipts,"[215] which are attributed to New York "if the location of the customer is within the state."[216] The determination of whether a customer is located in New York requires application of the following hierarchy of criteria:

(1) The benefit is received in this state;

(2) Delivery destination;

NOTES

208 Mont. Code Ann. § 15-1-601 (Westlaw 2019). The MTC's proposed revision of UDITPA to reflect a market-state approach for attributing receipts from intangibles is discussed at text accompanying notes 166-168 *supra*.

209 Neb. Rev. Stat. § 77-2734.14(3)(c) (Westlaw 2019).

210 Id.

211 Id.

212 N.Y Tax Law § 210-A (Westlaw 2019).

213 See text accompanying notes 125-130 *supra*.

214 N.Y. Tax Law § 210-A(3)(b) (Westlaw 2019). For a discussion of the rules for attributing receipts for particular types of intangibles, see Hellerstein, *State Taxation Treatise, supra* note 6, ¶ 9.18[5].

215 N.Y. Tax Law § 210-A.10 (Westlaw 2019).

216 Id.

(3) The apportionment fraction for such receipts within the state determined pursuant to this subdivision for the preceding taxable year; or

(4) The apportionment fraction in the current taxable year determined pursuant to this subdivision for those receipts that can be sourced using the hierarchy of sourcing methods in subparagraphs one and two of this paragraph.[217]

North Carolina. Effective 2017, North Carolina adopted proposed legislation embracing a market-state approach to attribution of receipts generally,[218] including receipts from intangible property.[219] The legislation also directs that "on or before January 20, 2017, the Department of Revenue shall adopt . . . rules regarding the implementation of market-based sourcing principles as if the proposed statutory changes . . . was [*sic*] law."[220] As of early 2019, however, these changes have not been incorporated into the North Carolina statute.[221]

Oregon. Effective 2018, Oregon adopted a market-state approach for sourcing receipts from intangibles that is virtually identical to the approach recommended by the MTC.[222]

Tennessee. Effective July 1, 2016, Tennessee adopted a market-state approach for sourcing receipts from intangibles that is virtually identical to the approach recommended by the MTC.[223]

Utah. In Utah, "a receipt in connection with intangible property is considered to be in this state if the intangible property is used in this state."[224] If the property is used both within and without the state, the receipts are apportioned to the state's sales factor in order to reflect the percentage of use in the state.[225]

Wisconsin. Wisconsin has had a purchaser/licensee-use-based rule for sourcing receipts from intangibles since 2009.[226] The Wisconsin statute provides that, with the exception of receipts from software:

[G]ross royalties and other gross receipts received for the use or license of intangible property, including patents, copyrights, trademarks, trade names, service names, franchises, licenses, plans, specifications, blueprints, processes, techniques, formulas, designs, layouts, patterns, drawings, manuals, technical know-how, contracts, and customer lists, are sales in this state if any of the following applies:

a. The purchaser or licensee uses the intangible property in the operation of a trade or business at a location in this state. . . . [I]f the purchaser or licensee uses the intangible property in the operation of a trade or business in more than one state, the gross royalties and other gross receipts from the use of the intangible property shall be divided between those states having jurisdiction to impose an income tax on the taxpayer in proportion to the use of the intangible property in those states.

b. The purchaser or licensee is billed for the purchase or license of the use of the intangible property at a location in this state.

c. The purchaser or licensee of the use of the intangible property has its commercial domicile in this state.[227]

In summary, today 20 of the 45 states with corporate income taxes (and the District of Columbia) employ a market-based approach to attribution of receipts from intangibles to the sales factor of their corporate income tax apportionment formulas.[228] Moreover, as noted earlier in connection with receipts from services, in light of the powerful trend in recent years of states' adoption of this approach, which the MTC's recommendation to the same effect has only encouraged, the number of states with an "X" in the "market-based" column in the accompanying Exhibit 3 seems destined to increase.

Conclusion

For most tax professionals who do not specialize in state taxation, and even for some that do, it may seem, as of late, that there is little to talk about in the state tax field other than the implications of the U.S. Supreme Court's decision in *South Dakota v. Wayfair, Inc.*,[229] repudiating the requirement that out-of-state sellers without a physical presence in the state cannot be required to collect taxes on their sales to in-state purchasers, or the state tax consequences of federal tax reform.[230] But there are other developments in the state tax field that are worthy of notice. As they used to say at the end of *The Naked City:* "This has been one of them." [231]

NOTES

[217] Id.

[218] N.C. Sess. Laws 2016-94 (HB 1030) § 38.4 (Westlaw 2019) (historical enacted legislation (session laws)).

[219] Id. § 38.4.(c) (Westlaw 2019) (historical enacted legislation (session laws)) (proposed N.C. Gen. Stat. § § 105-130.4(*l*)(5), 105-130.4(*l*)(6)). The proposed legislation closely tracks the MTC proposed revision of UDITPA to reflect a market-state approach for attributing receipts from intangibles. See text accompanying notes 166-168 *supra*.

[220] Id. § 38.4(a) (Westlaw 2019) (historical enacted legislation (session laws)).

[221] See N.C. Gen. Stat. § 105-130.4(*l*)(3)(b) (Westlaw 2019) (receipts from intangible property are attributed to the state if they are "received from sources within this State"); "Sales Factor," North Carolina Dep't of Revenue, available at https://www.ncdor.gov/taxes/corporate-income-franchise-tax/sales-factor.

[222] Or. Rev. Stat. § § 314.665, 314.666 (Westlaw 2019). The MTC's recommended rules are set in text accompanying notes 166-168 *supra*.

[223] Tenn. Code Ann. § 67-4-2012(i) (Westlaw 2019). The MTC's recommended rules are set in text accompanying notes166-168 *supra*.

[224] Utah Code Ann. § 59-7-319(4) (Westlaw 2019).

[225] Id.

[226] Wis. Stat. § 71.25(9)(dj) (Westlaw 2019).

[227] Id. § 71.25(9)(dj)2.

[228] As Exhibit 2 reveals, in a few instances the taxpayer may elect whether to use the market-based approach or an alternative approach (e.g., Arizona and, prior to 2020, Missouri).

[229] 138 S. Ct. 2080 (2018).

[230] Indeed, I may be guilty of having contributed to that impression. See Hellerstein, Swain, and Madison, "Platforms: The Sequel," State Tax Notes, 01/07/2019, p. 7; Hellerstein and Appleby, "Substantive and Enforcement Jurisdiction in a Post-*Wayfair* World," State Tax Notes, 10/22/2018, p. 283; Hellerstein and Sedon, "State Corporate Income Tax Consequences of Federal Tax Reform," Tax Notes, 04/16/2018, p. 347.

[231] For most readers who are not old enough to appreciate the reference, here it is: "*Naked City* is a police drama series . . . which was broadcast from 1958 . . . to 1963 . . . . It was inspired by the 1948 motion picture *The Naked City* and mimics its dramatic 'semi-documentary' format. As in the film, each episode concluded with a narrator intoning the iconic line: 'There are eight million stories in the naked city. This has been one of them.'" "Naked City (TV Series)," https://en.wikipedia.org/wiki/Naked_ City_(TV_series).