

House Revenue Committee

February 6, 2017

## HB 2274 – Market-based Sourcing; Definition of Sales

### Summary

HB 2274 adopts two uniform proposals developed by the Multistate Tax Commission (MTC) relating to income apportionment of multi-state corporations. The first proposal modifies the definition of sales, and the second proposal changes the approach for calculating the sales factor numerator for all sales other than sales of tangible personal property (e.g., services and intangibles). Both MTC uniform proposals are amendments to the Uniform Division of Income for Tax Purposes Act (UDITPA). Oregon is a member of the MTC and adopted the UDITPA provisions in 1965; those provisions are codified in ORS chapter 314.

Sales is currently defined in ORS 314.610 as all gross receipts of the taxpayer not allocated under ORS 314.615 to 314.645. HB 2274 adopts the uniform proposal to place a transactional test limitation on the definition of sales that excludes functional test income. The transactional test limitation includes only those items of income arising from transactions and activity in the regular course of the taxpayer's trade or business in the definition of sales. The MTC model regulations have excluded certain functional test income from the definition of sales since 1973 and have adopted further functional test exclusions in model regulations since. Oregon adopted two specific functional test exclusions from the definition of sales in ORS 314.665; one relating to gross receipts arising from the sale, exchange, redemption or holding of intangible assets, including but not limited to securities, unless those receipts are derived from the taxpayer's primary business activity; and the other relating to gross receipts arising from an incidental or occasional sale of a fixed asset or assets used in the regular course of the taxpayer's trade or business if a substantial amount of the gross receipts of the taxpayer arise from an incidental or occasional sale or sales of fixed assets used in the regular course of the taxpayer's trade or business. The uniform proposal would exclude all functional test income from the definition of sales.

The uniform proposal relating to the definition of sales in UDITPA also includes a technical, clarifying amendment. In the process of developing this uniform proposal, the MTC noted that the term "sale(s)" carries a different meaning in different provisions of UDITPA. In some provisions it refers to a type of transaction distinct from other types of transactions like leases, licenses, or rentals. For example, the reference to "sales of tangible personal property" does not include leases of tangible personal property; it's a specific reference to the transaction of a sale. In other provisions, "sale(s)" refers to receipts rather than transactions, and is intended broadly to include receipts from leases, licenses, and other transactions, in addition to receipts from sales transactions. For example, the definition of "sales" in ORS 314.610 and the reference to the

“sales factor” in ORS 314.665 both refer broadly to receipts from leases, licenses, rentals, sales, or any other transaction. In ORS 314.665(4), “[s]ales, other than sales of tangible personal property,” the term “sales” is used in both senses. The uniform proposal amends the UDITPA provisions to clarify the use in the broader sense by replacing sales with receipts. For example, under this proposal ORS 314.665(4) is amended to, “[r]eceipts, other than sales of tangible personal property,” and the sales factor is amended to the receipts factor.

The second uniform proposal HB 2274 adopts is a change to the approach for calculating the sales factor numerator for all sales other than sales of tangible personal property (e.g., services and intangibles). This uniform proposal was the primary focus of the MTC’s amendments to the UDITPA provisions. This provision relating to the calculation of the sales factor numerator for all sales other than sales of tangible personal property (e.g., services and intangibles) was identified early in the MTC process as the UDITPA provision most critically in need of change. The proposal replaces the income-producing activity/costs of performance sourcing method with a market-based approach for assigning sales other than the sales of tangible personal property (e.g., services and intangibles) to the sales factor numerator.

ORS 314.665(4) currently requires use of the income-producing activity/costs of performance method. It states, “[s]ales, other than sales of tangible personal property, are in this state if (a) the income-producing activity is performed in this state; or (b) the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.” HB 2274 adopts the MTC’s proposed market sourcing statute for sales other than tangible personal property that covers four specific areas:

- (1) the sale, rental, lease or license of real property,
- (2) the rental, lease or license of tangible personal property,
- (3) the sale of a service, and
- (4) the sale, rental, lease or license of intangible property.

## **Comments**

As stated earlier, the MTC identified the income-producing activity/costs of performance sourcing rule (promulgated in 1957) as the UDITPA provision most critically in need of change. The MTC documented four specific problems with the provision:<sup>i</sup>

- 1) Identifying a taxpayer’s “income-producing activity” and determining whether particular types of costs should or should not be included in the costs of performing that activity can be difficult and contentious.

## Legislative Testimony

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2) The “all or nothing” aspect of assigning receipts to the state with the greatest costs of performance can produce arbitrary results where income-producing activity is taking place fairly evenly in the states.

3) The income-producing activity/costs of performance sourcing rule doesn’t do what a sales factor is supposed to do – it doesn’t reflect the taxpayer’s market. At the time of adoption in 1957, place of performance may have been a reasonable proxy for market location, but this is no longer the case as globalization and advances in computer and communications technology now allow many services to be provided remotely.

4) The income-producing activity/costs of performance sourcing rule tends to source receipts to the production states where the costs of performance are incurred. This result duplicates the function of the property and payroll factors which is counter-productive for states that have adopted a more heavily weighted sales factor as a means of encouraging economic development.

For more information about this testimony, contact Jeff Henderson 503-947-2124.

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<sup>i</sup> Shirley Sicilian, MTC; Multistate Tax Compact Article IV Recommended Amendments; May 3, 2012