

March 6, 2013

Update from the MTC's Winter Committee Meetings: Transfer Pricing and Financial Institution Apportionment

During the Multistate Tax Commission's (MTC) Winter Committee Meetings in St. Louis on March 5, 2013, the Income and Franchise Tax Uniformity Subcommittee (I/F Subcommittee) declined to move forward with a project that would address the ability of states to invoke transfer pricing principles contained in IRC § 482 to "clearly reflect income" and to prevent so-called distortive transactions. No state represented on the I/F Subcommittee voted in favor of moving forward with this uniformity project, although four states abstained.¹ Separately, the I/F Subcommittee voted to essentially restart the Financial Institutions Working Group by instructing it to examine the inclusion of loans in the property apportionment factor.

Potential Transfer Pricing Project

Originating last summer, and reflected in MTC staff memoranda, the rejected section 482 uniformity project would have sought to establish "a possible model that would fill that gap by providing regulatory guidance for applying one existing statutory source of state anti-abuse authority in the context of formulary apportionment." Apparently driven by MTC staff, the background [memorandum](#) on the potential section 482 project is exceptionally – and purposefully – broad in scope. Moreover, the MTC memorandum stated that federal section 482 rules (based on separate, geographic-based accounting) should not apply to the formulary apportionment basis of dividing income among the states.

The Rejected Proposal and Next Steps

The members of the I/F Subcommittee questioned the need for a model section 482 regulation due to numerous state laws (as outlined in the MTC's most recent staff [memorandum](#) on the subject) as well as the inherent complexities of section 482 issues at both the federal and state levels. A representative of the Massachusetts Department of Revenue, for example, also noted that an MTC model section 482 regulation would not be appropriate because these issues do not lend themselves to a "one-size-fits-all" solution.

Despite this positive vote, it seems that the MTC may still pursue applying section 482 at the state level. MTC Executive Director Joe Huddleston noted that section 482-type issues will be raised in the Audit Subcommittee.

Déjà vu All Over Again – MTC to Review Propriety of Property Factor for Financial Institution Apportionment

The MTC's Financial Institutions Working Group has returned to square one in its five-year effort to redesign the financial institution apportionment rules. Since 2007, the group has examined whether the

¹ The I/F Subcommittee representatives who abstained from voting likely did so as a result of pending or potential litigation involving challenges to their respective state's section 482-type powers.

MTC's special financial apportionment regulations, which were adopted in 1994 and applied by many states, are still the best method to apportion income. The Working Group, which consists of states and industry, had decided to not consider the sourcing of loans. Under the existing MTC rules, loans are sourced for property factor purposes based on where the preponderance of substantive contacts relating to a loan has occurred by reference to: solicitation, investigation, negotiation, approval and administration of the loan (the SINAA test). The Working Group examined the viability of the SINAA test over the past five years and decided to leave the SINAA test in place. Nevertheless, a minority of states succeeded in getting the property factor issue before the I/F Subcommittee. In a surprising move, the I/F Subcommittee voted to instruct the Working Group to explore the viability of the SINAA test. The I/F Subcommittee discussed possible options such as altering the SINAA test, removing loans from the property factor, or perhaps eliminating the property factor altogether. The Working Group will convene in the coming weeks to begin exploring these alternatives.



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