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UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT

The Uniform Division of Income for Tax Purposes Act is designed to meet a critical problem in the application and administration of state income tax laws--a problem which exists at this time because the rules presently applied to determine the amount of income from multistate business activities taxable in the state now vary widely from state to state. The application of these divergent rules results, in some instances, in duplicative, over-lapping taxation of business net income by two or more states and, in other instances, it results in substantial escapement of such income from taxation by any state. The Uniform Act provides a single, equitable standard for determining the portion of a corporation's aggregate net income from multistate business activities which may be subjected to income tax by each of the states in which a corporation carries on such activities. When enacted by all of the states imposing income taxes the Uniform Act will eliminate the evil of such duplicative tax impact as well as undesirable tax escapement. But to attain these goals the Uniform Act must become law in every state which levies a tax on, or measured by, net income from multistate business activities. For this reason legislative approval of the Uniform Act, without change in any of its provisions, by every income tax state is imperative. Anything less than such unanimous enactment will defeat the Act's basic objective of equality throughout the United States in the application of state income tax laws.

Upon its adoption by a state this Uniform Act applies to all corporations and individuals within the taxing state who engage in business activities either in two or more states of the United States or in one or more such states and a foreign country. As to such persons and corporations its purposes are dual in nature.

Stated in its most simple terms, the first purpose is to ensure that no more than one hundred percent of the business net income of any corporation or other taxable entity doing business in more than one state shall be subject to taxation by all of the states, in the aggregate, in which the taxpayer carries on its business.

The second purpose is to ensure that each individual and corporation which does engage in business in more than one state is subject to state income taxation upon one hundred percent, no more and no less, of its net business income from multi-state activities.

The Uniform Act does <u>not</u> itself impose a tax on net income. Whether a state does or does not impose a net income tax is a policy issue to be determined solely by the legislature or the voters of that particular state. When a state has independently made the policy decision to levy and collect a net income tax then, and then only, can the Uniform Act have operation in that state.

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The Uniform Act does not require that every state in which a taxpayer, either individual or corporate, carries on its multi-state business must levy a tax on net business income in order for the provisions of the Act to be operative in states which do impose a tax on net income. To illustrate, assume that taxpayer corporation engages in business in states A, B and C. If all three states levy taxes on or measured by net income the effect of adoption of the Uniform Act by all three states would be, first, to apportion one hundred percent (no more, no less) of the corporation's net business income from its multi-state business activities in all three states among the three states, A, B and C, and to permit each state to impose its net income tax on that portion only of the corporation's net income which is apportioned to the state under the Uniform Act's standard apportionment formula--the identical formula being used in each of the three states. All--no more, no less--of corporation's aggregate multi-state business net income would be taxed under these circumstances by the three states combined.

If State A and State B each levy a net income tax but State C does not impose such a tax, the amount of the corporation's total multi-state business net income apportioned to and taxable by State A and by State B under their respective net income tax laws is exactly the same as it is when all three states levy an income tax. However, the multi-state business net income apportionable to State C by the Uniform Act's apportionment formula is not taxed by State C, because State C does not levy and collect an income tax. Under the Uniform Act neither State A nor State B is permitted to tax any greater amount of the corporation's multi-state business net income even though the income apportioned to State C under the Uniform Act's formula is not actually taxed by State C. In other words, under the Uniform Act all that is required is that all of the business net income from multi-state business operations be subject to income taxation in all of the states in which the multi-state business activities are carried on. It is not necessary that all of these states actually levy and collect a tax upon or measured by net income in order for the apportionment formula of the Uniform Act to apply.

The Uniform Division of Income for Tax Purposes Act was formulated by the National Conference of Commissioners on Uniform State Laws to provide a means through which the states acting in unison can not only eliminate the evils inherent in disparate methods of allocating and apportioning business net income among the several states, but also to forestall Congressional action which could well hamper the states in freely choosing the components of their respective state tax systems. The Act was formulated after long and thorough study of the problems involved and of the alternative solutions available. It was promulgated by the Conference after careful, word by word, consideration of its provisions by commissioners representing every state of the Union.

Those states which do not levy a net income tax should also exert every effort to obtain enactment of the Uniform Act by all of the states that do levy net income taxes. Even though a non-income-tax state

never expects to levy a tax on net income its freedom of action in formulating its own tax structure will undoubtedly be jeopardized if Congress decides to enact legislation with respect to state taxation of multi-state businesses. Also, it should be noted that the use of the Uniform Act's standard apportionment formula by all of the net income tax states should eliminate complaints by its own taxpayers that income earned by such taxpayers in the non-income-tax state is being indirectly used to measure the amount of tax which the taxpayer has to pay to other income tax states in which it carries on its multi-state business operations.

Uniform Division of Income for Tax Purposes Act

Prefatory Note

The Uniform Division of Income for Tax Purposes Act is designed for enactment in those states which levy taxes on or measured by net income.

The need for a uniform method of division of income for tax purposes among the several taxing jurisdictions has been recognized for many years and has long been recommended by the Council of State Governments. There is no other practical means of assuring that a taxpayer is not taxed on more than its net income. At present, the several states have various formulae for determining the amount of income to be taxed, and the differences in the formulae produce inequitable results. The problem has been well analyzed and its historical background outlined in an article appearing in 18 Ohio State Law Journal, page 84.

The Uniform Division of Income for Tax Purposes Act is the result of conferences with the representatives of the Controller's Institute of America, the Council of State Governments and various interested individuals, and promulgated by the National Conference of Commissioners on Uniform State Laws.

UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT

1 Section 1. As used in this Act, unless the context otherwise re-
2 quires:
3 (a) "Business income" means income arising from transactions and
4 activity in the regular course of the taxpayer's trade or business and
5 includes income from tangible and intangible property if the acquisition,
6 management, and disposition of the property constitute integral parts of
7 the taxpayer's regular trade or business operations.
8 (b) "Commercial domicile" means the principal place from which the
9 trade or business of the taxpayer is directed or managed.
10 (c) "Compensation" means wages, salaries, commissions and any other
11 form of remuneration paid to employees for personal services.

COMMENT

This definition is derived from the Model Unemployment Compensation Act which has been adopted in all states.

12 (d) "Financial organization" means any bank, trust company, savings
13 bank, [industrial bank, land bank, safe deposit company], private banker,
14 savings and loan association, credit union, [cooperative bank], invest-
15 ment company, or any type of insurance company.
16 (e) "Non-business income" means all income other than business income.
17 (f) "Public utility" means [any business entity which owns or operates
18 for public use any plant, equipment, property, franchise, or license for

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19 the transmission of communications, transportation of goods or persons,
20 or the production, storage, transmission, sale, delivery, or furnishing
21 of electricity, water, steam, oil, oil products or gas.]

COMMENT

It is expected that "public utility" will be defined to include all taxpayers subject to the control of the state's regulatory bodies on the theory that separate legislation will provide for the apportionment and allocation of the income of such taxpayers.

22 (g) "Sales" means all gross receipts of the taxpayer not allocated
23 under sections 4 through 8 of this Act.
24 (h) "State" means any state of the United States, the District of
25 Columbia, the Commonwealth of Puerto Rico, any territory or possession
26 of the United States, and any foreign country or political subdivision
27 thereof.

1 Section 2. Any taxpayer having income from business activity which is
2 taxable both within and without this state, other than activity as a fi-
3 nancial organization or public utility or the rendering of purely personal
4 services by an individual, shall allocate and apportion his net income as
5 provided in this Act.

1 Section 3. For purposes of allocation and apportionment of income
2 under this Act, a taxpayer is taxable in another state if (1) in that
3 state he is subject to a net income tax, a franchise tax measured by net
4 income, a franchise tax for the privilege of doing business, or a cor-
5 porate stock tax, or (2) that state has jurisdiction to subject the tax-
6 payer to a net income tax regardless of whether, in fact, the state does
7 or does not.

1 Section 4. Rents and royalties from real or tangible personal property,
2 capital gains, interest, dividends, or patent or copyright royalties, to
3 the extent that they constitute non-business income, shall be allocated
4 as provided in sections 5 through 8 of this Act.

1 Section 5. (a) Net rents and royalties from real property located
2 in this state are allocable to this state.
3 (b) Net rents and royalties from tangible personal property are al-
4 locable to this state:
5 (1) if and to the extent that the property is utilized in this
6 state, or

7 (2) in their entirety if the taxpayer's commercial domicile is in
8 this state and the taxpayer is not organized under the laws of or taxable
9 in the state in which the property is utilized.
10 (c) The extent of utilization of tangible personal property in a
11 state is determined by multiplying the rents and royalties by a fraction,
12 the numerator of which is the number of days of physical location of the
13 property in the state during the rental or royalty period in the taxable
14 year and the denominator of which is the number of days of physical loca-
15 tion of the property everywhere during all rental or royalty periods in
16 the taxable year. If the physical location of the property during the
17 rental or royalty period is unknown or unascertainable by the taxpayer
18 tangible personal property is utilized in the state in which the property
19 was located at the time the rental or royalty payer obtained possession.

1 Section 6. (a) Capital gains and losses from sales of real property
2 located in this state are allocable to this state.
3 (b) Capital gains and losses from sales of tangible personal property
4 are allocable to this state if
5 (1) the property had a situs in this state at the time of the sale,
6 or
7 (2) the taxpayer's commercial domicile is in this state and the tax-
8 payer is not taxable in the state in which the property had a situs.
9 (c) Capital gains and losses from sales of intangible personal property
10 are allocable to this state if the taxpayer's commercial domicile is in
11 this state.

1 Section 7. Interest and dividends are allocable to this state if the
2 taxpayer's commercial domicile is in this state.

1 Section 8. (a) Patent and copyright royalties are allocable to this
2 state:
3 (1) if and to the extent that the patent or copyright is utilized
4 by the payer in this state, or
5 (2) if and to the extent that the patent or copyright is utilized
6 by the payer in a state in which the taxpayer is not taxable and the tax-
7 payer's commercial domicile is in this state.
8 (b) A patent is utilized in a state to the extent that it is employed
9 in production, fabrication, manufacturing, or other processing in the
10 state or to the extent that a patented product is produced in the state.
11 If the basis of receipts from patent royalties does not permit allocation
12 to states or if the accounting procedures do not reflect states of utiliza-
13 tion, the patent is utilized in the state in which the taxpayer's com-
14 mercial domicile is located.
15 (c) A copyright is utilized in a state to the extent that printing
16 or other publication originates in the state. If the basis of receipts

from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

Section 9. All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the demominator of which is three.

Section 10. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period.

Section 11. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from sub-rentals.

COMMENT

This section is admittedly arbitrary in using original cost rather than depreciated cost, and in valuing rented property as eight times the annual rental. This approach is justified because the act does not impose a tax, nor prescribe the depreciation allowable in computing the tax, but merely provides a basis for division of the taxable income among the several states. The use of original cost obviates any differences due to varying methods of depreciation, and has the advantage that the basic figure is readily ascertainable from the taxpayer's books. No method of valuing the property would probably be universally acceptable.

Section 12. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the [tax administrator] may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

Section 13. The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the tax period by the taxpayer for compensation, and the denominator of which is the total compensation paid everywhere during the tax period.

Section 14. Compensation is paid in this state if:

(a) the individual's service is performed entirely within the state; or

(b) the individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or

(c) some of the service is performed in the state and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or (2) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

COMMENT

This section is derived from the Model Unemployment Compensation Act. This is the same figure which will be used by taxpayers for unemployment compensation purposes.

Section 15. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

Section 16. Sales of tangible personal property are in this state if:

(a) the property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale; or

(b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (1) the purchaser is the United States government or (2) the taxpayer is not taxable in the state of the purchaser.

COMMENT

Sales to the United States Government are treated separately because they are not necessarily attributable to a market existing in the state to which the goods are originally shipped.

Section 17. Sales, 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.

Section 18. If the allocation and apportionment provisions of this Act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the [tax administrator] may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting;

(b) the exclusion of any one or more of the factors;

(c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

COMMENT

It is anticipated that this act will be made a part of the income tax acts of the several states. For that reason, this section does not spell out the procedure to be followed in the event of a disagreement between the taxpayer and the tax administator. The income tax acts of each state presumably outline the procedure to be followed.

1 Section 19. This Act shall be so construed as to effectuate its
2 general purpose to make uniform the law of those states which enact it.

1 Section 20. This Act may be cited as the Uniform Division of Income
2 for Tax Purposes Act.

1 Section 21. [The following acts and parts of acts are hereby repealed:
2 (a)
3 (b)
4 (c) .]

1 Section 22. This Act shall take effect.....

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STATE TAXATION OF BUSINESSES ENGAGED IN INTERSTATE COMMERCE

The attached resolution, adopted by the General Assembly of the States meeting in Chicago, December 3, 1964, would seem to be addressed to a truism in pointing out that "...an integral aspect of the sovereignty of each of the several states is the power to levy and collect taxes, revenue from which is needed to meet the responsibilities of the states and their local governments;..."

Truism or not, it is a response to a very real threat to the power of the states to levy and collect taxes - a threat of federal legislation imposing standards to be observed by states in taxing businesses engaged in interstate commerce.

The sequence of events which led to the current situation began with two decisions of the Supreme Court - Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959) and Scripto, Inc. v. Carson, 362 U.S. 207 (1960). In the former case it was held that a fairly apportioned net income tax could be levied on an out-of-state corporation engaged in business in the taxing state even though the business activities were exclusively in furtherance of interstate commerce. In the latter case it was held that a state could require an out-of-state corporation having no office or regular employee or salesman traveling within the taxing state to collect sales taxes on goods sold to customers in such state.

Within seven months of the date the Northwestern decision was rendered, Public Law 86-272 was enacted. Initially limited to corporation income taxes, the scope of the legislation was broadened in Public Law 87-17 (1961) to authorize the House Judiciary Committee and the Senate Finance Committee to "make full and complete studies of all matters pertaining to the taxation of interstate commerce by the States, territories, and possessions of the United States, the District of Columbia, and the Commonwealth of Puerto Rico, or any political or taxing subdivision of the foregoing."

By agreement between the two Committees, the House Judiciary Committee assumed responsibility for making the studies and, for the purpose, set up the Special Subcommittee on State Taxation of Interstate Business Income. After several extensions, the Subcommittee now is required to submit its final report by June 30, 1965. An initial, two-volume report, dealing primarily with income taxation was made June 15, 1964. Subsequent reports will deal with other forms of taxation, including sales and use taxes and capital stock taxes, as well as recommendations for action by Congress.

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The resolution attached and similar resolutions of the Governors' Conference, National Association of Attorneys General, National Legislative Conference, National Association of Tax Administrators, National Institute of Municipal Law Officers and Council of State Governments all recommend adoption by states of the "Uniform Division of Income for Tax Purposes Act", developed by the National Conference of Commissioners on Uniform State Laws.

Promulgated in 1957 after four years of study, the uniform act has been adopted by four states. About half of the remaining states having a corporate income tax appear to have laws in substantial conformity with the uniform act. (In all, 38 states, including Michigan, which has a business activities tax, and the District of Columbia, tax corporate income.) To put it another way, 33 states use a property factor, 36 use a receipts or sales factor and 29 use a payroll factor in one form or another - property, sales and payroll being the three factors employed in the uniform act to determine income allocable to business activity within a state. It would appear that the great majority of the corporate income taxing states could adopt the uniform act without substantial modification of their tax structures.

The first step that must be taken by those states which levy corporate income taxes is re-examination of their tax laws. Those which have not already done so are urged to give serious consideration to the "Uniform Division of Income for Tax Purposes Act". Time is of the essence in such re-examination and consideration since there will be strong impetus in the current Congress to enact federal standards. In transmitting the Subcommittee's initial report, its Chairman stated, "I think it will suffice for me to say that the information contained in this report inevitably leads to the conclusion that the prevailing system of State and local income taxation creates, for companies engaged in interstate commerce, serious problems which it would be appropriate for Congress to attempt to resolve." States which fail to act in the 1965 legislative sessions may find that later the limits within which they may act have been reduced drastically.

Unfortunately, with respect to sales and use taxes and other forms of taxation no recommendation for uniform action can be made at this time. The matter has been referred to the National Conference of Commissioners on Uniform State Laws for study. Their recommendations may be anticipated in due course. In the meantime, however, the Subcommittee will make its recommendations.

Every state is urged to keep this matter under surveillance and to take such steps as may be needed to put in order its own tax structure. Opposition by states to the imposition of federal limitations on the power of the states and their political subdivisions to levy and collect taxes must be continued. Taxation must be equitable within classes of taxpayers and among such classes. It is submitted that tax equity will be impossible to maintain if one category of taxpayers - businesses engaged in interstate commerce - is given a preferred standing by federal law.

STATE TAXATION OF MULTI-STATE BUSINESSES

WHEREAS, an integral aspect of the sovereignty of each of the several states is the power to levy and collect taxes, revenue from which is needed to meet the responsibilities of the states and their local governments; and

WHEREAS, such levies should be in accord with formulas adopted by the appropriate taxing authority; and

WHEREAS, with respect to business income, the states are making progress in bringing their tax laws into conformity with the uniform law proposed in 1957 by the National Conference of Commissioners on Uniform State Laws; and

WHEREAS, federal legislation enacted in 1959 and 1961 authorized and directed a study of all matters pertaining to the taxation by states of businesses engaged in doing business in more than one state for the purpose of recommending the imposition of federal standards to be observed by states in taxing such businesses; and

WHEREAS, the great majority of the states and such organizations of state officials as the Governors' Conference, the National Association of Attorneys General, the National Association of Tax Administrators and the National Legislative Conference have registered opposition to the imposition of such federal standards;

NOW, THEREFORE, BE IT RESOLVED by the Seventeenth Biennial General Assembly of the States, meeting in Chicago, on December 3, 1964, that it reaffirm its opposition to any curtailment of state taxing power and to any establishment of federal standards for state income, sales and use, property or other tax; and

BE IT FURTHER RESOLVED that those states which tax business income be urged to bring their laws into substantial conformity with the 1957 uniform act, and the National Conference of Commissioners on Uniform State Laws be urged to study the need for and make recommendations concerning uniformity in sales and use and other fields of taxation.

[Resolution adopted by the Seventeenth Biennial General Assembly of the States, Chicago, Illinois, December 3, 1964.]