

Mr. Dunham,

Here is the memo, late but finished . I hope it is still of some use to you. I spent about, or at least, 50 hours on it. I will be around this summer to pick up a check, or it can be mailed me at 5535 S. Kimbark.

Peter Bornstein

DIVISION OF INCOME FOR TAX PURPOSES: UTILITIES,
CARRIERS AND FINANCIAL INSTITUTIONS

Most of the states have provided special apportionment criteria for at least some utility, usually a public service carrier. This dispensation allowed to some of the utilities operating in the state is usually not accorded to all of the possible enterprises which fit into the definition of utility. For the purpose of this report, it has been inferred that the absence of a special procedure means that the enterprise is treated in the same way as any other interstate business taxed by the state. It should be noted, however, that the validity of this inference is dubious.

Every state has a provision in their taxing statutes which enables the state tax commissioner to grant exceptions when the standard apportionment formula produces unfair or inequitable results. It is believed that the formula used for many utilities is the product of a bargain made between the commissioner and the company which seeks an exception. In most instances this agreement has not been reported to the CCH reporting service from which this research was taken.

A number of the states exempt some or all of their utilities from their income tax, choosing instead a property tax or a gross receipts tax. In a few instances, states with an income tax have no express provisions for any utilities.

The search for exceptions in financial institutions proved fruitless for the most part. Most of the states exempt them from the income tax while a few treat them as any other business. The following states have singled out financial institutions for special apportionment treatment:

1. Louisiana
2. Minnesota
3. Mississippi
4. New York
5. Oklahoma
6. Oregon
7. Pennsylvania
8. Tennessee

In the following states there is some indication that exceptions exist for utilities which have not been reported. It is possible that a letter sent to the states tax commissioner would yield the information.

1. Arizona
2. Colorado
3. Delaware
4. Idaho
5. Minnesota
6. Nebraska
7. New Mexico
8. South Dakota

The states of Florida, Illinois, Nevada, Ohio, Washington, and Wyoming do not have taxes based on net income.

Glossary of Terms:

1. Ratio based on _____: Unless otherwise specified, a ratio based on a factor is a fraction, the numerator of which is a numerical expression of the quantity of that factor found within the taxing state, and the denominator of which is a numerical expression of the totality of that factor. Example: a ratio based on track mileage signifies,

$$\frac{\text{miles of railroad track the company uses in the state}}{\text{total number of miles of track used}}$$

2. Ton miles, barrel miles, etc.: This usually means the number of tons carried per mile traveled, barrels carried per mile, etc.

3. Revenue miles: the number of miles traveled in the production of income

4. Gross operating revenue has been taken to mean the same as gross receipts or gross sales.

5. Many of the terms used in a particular state are never defined in the statute. It is believed that the meaning is common knowledge to those who pay taxes to the state.

Typical Formulae for Apportionment:

Each state which treats some or most of ~~them~~ its utilities differently from other interstate businesses has a distinct method for allocating income to the taxing state. There are, however, certain similar forms for allocation.

1. Many states will allow exceptions based on the fact that the company keeps its books in accordance with a federal regulatory agency. In some cases exceptions are granted solely because the approved form of accounting separates the sources of income by location. In those cases the state will often accept the income as shown by the books as the income taxable to the state.

2. Some states which have adopted the uniform act have made special provisions for public utilities by modifying the three factor formula. Hawaii is an example of a state which has retained a three factor formula, but has changed the factors from the standard property, payroll, and sales. In all other respects it is similar to the uniform act.

3. A second common form is the one factor formula. In these states, the total net income, however defined, is multiplied by an apportionment fraction. The amount obtained from this multiplication represents the net income allocated to the state. Examples of states using this method are, Alaska, Michigan, and Iowa. Often there will be a different factor used for each type of business, ie. railroads by mileage, telephone companies by miles of wire, carriers by ton miles, etc.

4. The fourth variety is created by changing the property factor of the uniform law. The uniform law provides that the property factor is a fraction which represents the proportion of property owned and used in the taxing state to that which is owned and used everywhere. The uniform law allocates property which has no fixed situs by the number of days in the state in which the property was used. Perhaps believing that this expression isn't equitable, some states have abandoned it in favor of a mileage proportion or a proportion based on some other factor than days used. Examples are Oregon and Pennsylvania.

5. The fifth form occurs when the state has worked out a formula of its own. In some ways these will be hybrids of the other typical forms, but in many ~~xxx~~ respects they will be sui generis. In most cases the result is ambiguous and confusing. Examples of states in this last category are Arkansas and Louisiana.

The States:

Alabama:

no apparent provisions for utilities

Alaska: (statute section 43.20.130)

Alaska has special provisions for ocean going ships, aircraft, and automotive vehicles - carriers.

1. Vessels are apportioned by a ration based on days spent in port.
2. Aircraft and automotive vehicles are apportioned on by a ratio based on days during which the services are rendered.
3. In the alternative, under his broad powers to reach equitable results the commissioner can use a ratio based on revenue miles traveled.

Arizona:

no express provisions for exceptions; however, there is a suggestion that the commissioner will use a proportion or ratio based on mileage.

Arkansas: (statute section 84-2003d and 2003e)

Statutory provision covers railroads, express companies, telephone, telegraph, "or other form of public service" - so long as these companies are governed by ICC standard accounting procedures.

The process of allocating income to the state takes two steps. The word "income" comes from the ICC standard method of classification.

Step One -- The net income of a business which operates partially within the state and partially without is determined by the following factors:

- A. wholly intrastate gross operating revenue

Arkansas cont.

- B. gross operating revenue from interstate business multiplied by an equal mileage proportion (ratio based on mileage)
- C. operating expenses of the entire business multiplied by a ratio based on the proportionate average of business carried on in the state.

$$\text{Net operating revenue} = (A+B) - (C)$$

Step Two -- to the net operating revenue the following calculation is performed.

- A. Revenue from misc. operations within the state
- B. revenue from non-operational business within the state
- C. non-operational revenue from sources outside the state multiplied by a ratio based on gross operating revenue
- D. misc. operating expenses within the state
- E. ICC deductions multiplied by a ratio based on gross operating revenue

$$\text{Taxable net income} = (A+B+C + \text{net operating revenue}) - (D+E)$$

California: (statute sections 25101 et al.)

There are only two reported exceptions and they are not statutory.

Airlines - property factor for moveable flight equipment is apportioned by a ratio based on revenue miles

Steamship Companies - property and wage factors are apportioned by a ratio based on days spent in port.

Connecticut:

There are three exceptions, bus companies, airlines and telephone companies. Most utilities pay a gross earnings tax which exempts them from the franchise tax based on net income.

Bus companies - income derived from carrying passengers for hire is apportioned by a ratio based on mileage.

Airlines - Three ratios are averaged:

1. ratio based on aircraft arrivals and departures
2. ratio based on revenue tons
3. ratio based on originating revenue

Telephone companies - ratio based on telephone instruments for hire.

Colorado:

no express provisions reported

Delaware:

There are no special provisions for those utilities not exempt from the income tax. Under the discretionary provision, it appears that the commissioner has allowed a mileage proportion, but no examples are reported.

Georgia: (statute section 93-3116)

The statutes create special provisions for railroads, express companies, telephone, telegraph, or "all other forms of public service".

1. If ICC standard classification is used, the ratio used for apportionment is as follows:

$$\frac{\text{G.O.R. within state} + (\text{G.O.R. interstate} \times \frac{\text{mileage w/i}}{\text{total mileage}})}{\text{Total G.O.R. of all business}}$$

where G.O.R. = gross operating revenue

2. If the ICC classification already provides for division into intra and inter-state revenues, it may be used under the commissioner's supervision.
3. The commissioner also allows other alternatives based on the accounting procedures followed.
4. The state's attorney general has given the opinion that airlines may not use a scheduled miles formula.

Hawaii: (regulation 60-1, Article 84)

Special exceptions are made for ocean and air carriers by modifying the three ratios used.

1. Ocean carriers: apportionment ratio is the average of the three following ratios:
 - a. ratio based on revenue tons handled at ports
 - b. ratio based on originating revenue
 - c. ratio based on voyage days
2. Air carriers: apportionment ratio is the average of three following ratios.
 - a. ratio based on revenue tons handled at airports
 - b. ratio based on originating revenue
 - c. ratio based on flight operating hours

Idaho:

no express provisions reported

Indiana: (statute section 204b and circular IT-9)

Exceptions are allowed, at least to carriers, on the basis of separate accounting procedures or ICC standard classifications. The railroad's accounting system is used as an example of how this can be determined in court.

Secondly they will allow a ratio based on mileage.

The commissioner has indicated that motor truck companies would be apportioned on the basis of the following formula:

$$\text{total adjusted gross income} \times \frac{\text{over the road miles within state}}{\text{total over the road miles}}$$

Iowa: (regulation 22.33 (1)-10)

The special provisions cover transportation, public utilities, and the communications industry. The net income of these companies, except for interest, dividends, rents, and royalties is multiplied by the following ratios.

1. Railroads - ratio based on trackage owned and operated
2. Airlines - ratio based on mileage actually traveled
3. Trucks and Buses - ratio based on mileage actually traveled
4. Oil and Gas pipelines - ratio based on traffic units
traffic units indicates gallons per mile or cubic feet per mile, etc.
5. Telephone and Telegraph - ratio based on used wire mileage

Kansas: (statute section 79-3290)

The statutory exceptions cover only those enterprises which keep their books in accordance with some regulatory agency; the others are apportioned as any other business. The special provision is in two steps.

1. step one -
 net income = G.O.R. within state - operating ratio
 G.O.R. = gross operating revenues multiplied by
 a ratio based on mileage
 operating = not defined
2. step two-
 from net income is subtracted,
 - a. other taxes paid or accrued
 - b. proportion of federal taxes
 - c. proportion of interest
 - d. proportion of losses
3. proviso: if the railroad's classification for operating expenses differs from that of the other utilities, the railroad's classification is controlling

Kentucky: (statute section 141.120)

The statute covers public utilities. The net business income for tax purposes is computed by multiplying the total net income by the arithmetical average of three ratios.

1. ratio based on tangible property - tangible property is defined as the average value of the property held and owned in connection with such business during the year
 - a. railroads -- valuation of rolling stock is based on a mileage proportion
 - b. buses -- valuation is computed by means of a ratio based on passenger miles
 - c. barges and trucks -- valuation is computed by means of a ratio based on ton miles. Upon petition actual miles may be substituted for ton miles.

Kentucky (cont.):

2. ratio based on payroll - interstate payroll is apportioned by a ratio based on time spent.
3. business income - ratio based on the amount of receipts multiplied by a ratio based on mileage. Transportation companies use a ratio based on ton miles for receipts from interstate traffic.

Louisiana: (statute sections 245 and 223, ITR-245)

The statute covers transportation companies, loan businesses, foreign life insurance companies, and "service enterprises". The latter is not defined except that it covers income derived from a service business in which the use of property is not a substantial income producing factor. The definition does include commodities shipped through pipelines.

The tax commissioner of Louisiana has wide powers of discretion in working out alternative forms and ratios, especially for these "service enterprises".

1. Airlines - based on the average of two ratios.
 - a. ratio based on the value of property (excluding aircraft) used in the production of apportionable income.
 - b. ratio based on gross apportionable income
2. Other Transportation companies - ratio based on the average of two ratios.
 - a. ratio based on the value of property. The denominator of the fraction, however, is the value of all property used in the production of apportionable income.
 - b. ratio based on gross apportionable income
3. Service enterprises - ratio based on the average of two ratios.
 - a. ratio based on amount paid for salaries
 - b. ratio based on gross apportionable income
4. Loan business - ratio based on the average of two ratios.
 - a. ratio based on salaries and other compensation
 - b. ratio based on amount of loans made
5. Foreign life insurance companies - ratio based on the reserve fund required to be held by law.

Interstate revenue from transportation is to be prorated subject to the rules and regulations of the commissioner. One factor of this proration is the proportion of service performed in Louisiana.

The value of rolling stock in the property ratio is prorated in the same way using mileage and traffic density as factors. The commissioner has reported some of the rules and regulations for proration of moveable equipment.

1. diesel locomotives - ratio of diesel locomotive miles to total of other locomotive miles
2. other locomotives - ratio based on locomotive miles
3. freight and passenger train cars, buses, trucks, trailers, towboats, tugs, barges, and other floating equipment-- ratio based on mileage.

Louisiana (cont.):

4. work and misc. equipment -
 - a. railroads -- ratio based on track miles
 - b. navigation companies -- ratio based on bank miles
 - c. trucks and buses -- ratio based on route miles
 note: when mileage is determined on navigable streams, one-half of the mileage on streams bordering Louisiana is considered to be Louisiana miles

Commodities through pipelines have the alternative of using a ratio based on the number of units of transportation service performed.

Maryland:

No special provisions. The state has exempted carriers and utilities from their income tax.

Massachusetts: (statute section 52a)

1. Gas, electric, pipelines, etc. - ratio based on the cost of plants, property, and equipment.
2. Railroads and other transportation carriers - ratio based on length of lines.
3. Telegraph companies - ratio based on gross receipts
4. Telephone companies - ratio based on the number of telephones.

Michigan: (statute section 205.553)

1. Transportation companies - ratio based on revenue miles using either,
 - a. ratio based on ton miles, or
 - b. ratio based on passenger miles
2. Transportation companies of both property and passengers - ratio based on the average of the passenger mile ratio and the ton mile ratio. Each ratio is weighted by a ratio based on gross receipts.
3. Oil pipelines - ratio based on barrel miles
4. Gas pipelines - ratio based on 1,000 cubic feet miles.

Minnesota:

There are no special provisions for utilities.

Insurance companies are apportioned by a ratio based on gross premiums collected.

Mississippi:

1. Pipe lines - ratio based on the average of three ratios,
 - a. ratio based on property owned or used
 - b. ratio based on operating labor
 - c. ratio based on traffic miles, barrel miles, etc.
2. Motor carriers - ratio based on the average of two ratios
 - a. ratio based on revenue passenger miles
 - b. ratio based on revenue ton miles, or vehicle miles, or gross receipts.

Mississippi (cont.):

3. Public utilities (including railroads, express companies, telephone and telegraph) - interstate revenue is computed using a ratio based on mileage, or message miles, or ton miles, etc. Interstate revenue is then computed into the basic ratio which is based on gross operating revenue,

$$\frac{\text{gross operating revenue within the state}}{\text{total gross operating revenue} + \text{gross operating rev. within}}$$
4. Airlines - three alternative methods for apportionment
 - a. ratio based on gross revenue (computed separately for each class of traffic)
 - b. ratio based on flight miles
 - c. the following:

$$\frac{\text{ton miles within the state} \times \text{number of miles flown over}}{\text{total ton miles carried} \times \text{total number of miles flown}}$$
 for passenger traffic the same ratio is used, only revenue producing passengers is substituted for ton miles.
5. Insurance companies:- formula to be approved by the commissioner and the governor

Missouri: (statute sections 143.040 to 143.070)

The statute covers interstate transportation companies, railroads, buses, trucks, airlines, as well as telephone and telegraph companies. There are three alternative means of apportionment, and there is wide latitude for combining different methods of apportionment.

1. Mileage - computed in two steps
 - a. income apportionable to the state = intrastate revenue + interstate revenue multiplied by a ratio based on mileage (or wire miles, etc) + misc. sources of income.
 - b. then, deductions are allowed, yielding the net income allocated to the state.
2. Statutory formula (property) - ratio based on the value of property owned and used.
3. Three factor formula - average of ratios based on property, sales, and payroll

note: the last two methods use the ratio by multiplying it with the total net income of the business, yielding the allocated net income.

Montana:

no special provisions. moveable property is allocated to the state on the basis of a ratio based on days used.

Nebraska:

no special provisions, income tax recently passed.

New Hampshire: (statute section 83-B:8)

Statute covers electric or gas operating property for the franchise tax based on net operating income. The commissioner considers two factors giving equal weight to each. Ratio based on:

1. net book value (gross book value is an alternative)
2. total amount of gas and electric energy produced and purchased.

New Jersey:

utilities are exempted

New Mexico: (Statute section 72-15A-34)

The state uses the uniform law, but allows the commissioner to make special apportionment agreement.

New York: (regulations 4.12 and 4.22)

Business Corporation Income Tax, all utilities and financial institutions are exempted, except omnibuses.

Omnibuses and other rolling equipment - property factor may be allocated either by a ratio based on mileage or by one based on time spent. The receipts factor may be allocated in the same way.

Franchise (income) Tax on Banks and Financial Institutions - The apportionment may be based on the accounts kept at each branch or agency. As an alternative, deductions from gross income may be apportioned to the state on the basis of a ratio based on gross income.

North Carolina: (statute section 105-134)

Since 1957, special provisions are made only for railroads, motor carriers, telephone and telegraph companies.

1. Railroads - two alternative methods of apportionment.
 - a. ICC standard classifications, or
 - b. ratio based on railway operating revenue

note: railway operating revenue is the sum of the total intrastate gross operating revenue + each item of railway operating revenue received from interstate business multiplied by a ratio based on mileage.

N.C. defines interstate business so as to exclude any business which goes "into, out of, or through" the state.

2. Telephone companies - apportionment computation is made on the basis of the following factors. The figures for these factors can come from FCC standard accounts.
 - a. gross operating revenue from local services
 - b. gross operating revenue from toll services performed wholly within the state
 - c. proportion of revenue from interstate toll services
 - d. gross operating revenue in N.C. from other services - minus - uncollectable revenue from within the state

North Carolina (cont.):

- e. total gross operating revenue - minus - total uncollectable revenue
 computation - $\frac{a+b+c+d}{e}$
3. Telegraph companies - apportionment ratio is the average of the following three ratios.
 - a. ratio based on property
 - b. ratio based on payroll
 - c. ratio based on gross receipts
 4. Motor carriers - ratio based on actual miles traveled (even when running empty)

North Dakota: (statute section 57-38-13)

North Dakota adopted the uniform law in 1965, but did not include public utilities or financial institutions.

Railroads: moveable property is allocated to the state on the basis of a ratio based on mileage.

Public Service Corporations: allocation is measured by two ratios. (1) ratio based on compensation paid, and (2) a ratio based on gross receipts. For the purpose of allocating interstate gross receipts, they use a ratio based on mileage.

There is no allocation procedure for the net income tax on banks.

Oklahoma: (statute sections 2316, 2306g, and 2327)

The statute covers special provisions for some financial institutions, transportation companies, pipelines, telephone and telegraph.

1. Transportation companies - apportionment is based on three factors and there is an allocation ratio present in each factor. It is assumed that the factors are averaged to reach a final apportionment ratio.
 - a. investment factor - in effect this is a property factor. When the property has no fixed situs it is allocated to the state by a ratio based on miles traveled.
 - b. expenditure factor - in effect this is a compensation factor. Allocation is made by a ratio based on miles traveled.
 - c. gross sales or gross revenue factor - ratio based on mileage, except for railroads which use mileage based on annual reports to the Oklahoma Corporation Commission.
2. Pipeline companies - in the gross sales factor allocation allocation is made by a ratio based on traffic units.
3. Telephone and telegraph - allocation is made by a ratio based on toll line wire miles.
4. Banking institutions - to be determined by the rules and regulations of the commissioner.
5. Life insurance companies - most are exempt, but those which pay the income tax use a "fair and reasonable" standard.

Oregon: (statute section 314.280)

There are special provisions for financial institutions, utilities, and transportation carriers. They use a three factor formula like the ~~the~~ uniform law, except that there are some modifications.

1. Financial organizations - the three ratios used are gross loans, payroll, and gross interest.
2. Insurance companies - the three ratios used are property, payroll, and gross premium receipts.
3. Public utilities - the three ratios used are property, payroll, and sales.
4. Carriers of freight and passengers - the three uniform factors are used, but modified as follows,
 - a. tangible property - property not allocated to one state is allocated by means of a ratio based on revenue miles
 - b. payroll - employees not fixed in one state are allocated by means of a ratio based on revenue miles
 - c. revenues - allocated by means of a ratio based on revenue miles
5. Sea transportation companies - the three uniform factors are used, but modified as follows,
 - a. sales - the numerator of the fraction is multiplied by a ratio based on voyage days
 - b. payroll - that part of the numerator covering ocean going personnel is multiplied by a ratio based on voyage days
 - c. property - that part of the numerator covering ships is multiplied by a ratio based on voyage days

Pennsylvania:

The state has two taxes based on net income, a franchise tax and a property tax. Special provisions for transportation companies and insurance companies are handled by modifying the uniform factors

Transportation companies - a ratio based on mileage covers the following.

- a. property fraction of rolling stock
- b. compensation to interstate employees
- c. gross receipts of interstate business

Insurance or surety companies - they do not use the regular three factor formula; instead they use a ratio based on gross premiums.

Rhode Island:

The only special provision covers the rolling equipment of bus companies. Within the property factor, this rolling equipment is allocated by means of a ratio based on mileage or a ratio based on time spent.

South Carolina: (statute section 65-256.3)

Special provisions cover railroads, motor carriers, telephone companies, pipelines, and airlines.

1. Railroads - ratio based on railway operating revenue. The portion representing interstate revenue is allocated by means of a ratio based on mileage
2. Motor carriers - ratio based on vehicle miles
3. Telephone - ratio based on gross receipts
4. Pipelines - ratio based on revenue unit miles
5. Airlines - ratio based on the average of ratios taken from each class of revenue derived from passengers or freight which is loaded or unloaded

South Dakota:

no special provisions reported

Tennessee: (statute section 67-2709)

Special provisions cover railroads, motor carriers, pipelines, and insurance companies.

1. railroads - ratio based on the average of two ratios
 - a. ratio based on gross receipts
 - b. ratio based on mileage
2. Motor carriers - ratio based on the average of two ratios
 - a. ratio based on gross receipts
 - b. ratio based on franchise miles
3. Pipelines - same as for railroads
4. Insurance companies - ratio based on premiums

Utah:

no special provisions

Vermont:

Utilities, insurance companies and railroads are specifically exempted from the income tax.

Virginia: (statute section 58-131.17)

Special provision exists only for motor carriers. Most other utilities and carriers are exempted.

Motor carriers - ratio based on vehicle miles

West Virginia:

special provisions cover railroads, steamboats, airlines, carriers, telephone, telegraph, and express companies. All are apportioned by a ratio based on mileage, be it ton miles, wire miles, passenger miles, barrel miles, etc.

Wisconsin:

Special provisions cover airlines and interstate motor carriers of property. Most other utilities and financial institutions are exempted from the income tax.

1. Airlines - ratio based on the average of three ratios
 - a. ratio based on arrivals and departures
 - b. ratio based on revenue tons
 - c. ratio based on originating revenue

2. Freight motor carriers - ratio based on the average of three ratios.
 - a. ratio based on gross receipts
 - b. ratio based on ton miles

note: the commissioner has been trying other methods of apportionment, eg. average of revenue miles, payroll and originating revenue.

