Memorandum

TO: UDITPA Study Committee

FROM: Richard Pomp and Prentiss Willson

DATE: April 29, 2009

SUBJECT: Options Concerning UDITPA

No one disagrees that the Uniform Division of Income for Tax Purposes Act (UDITPA) is deeply flawed. The Uniform Law Commission faces two polar choices: fix it, or repeal it. Leaving it as a "model" statute serves no purpose.

UDITPA has been overtaken by changes in the economy, new methods of doing business, the use of the corporate income tax as a tool of economic development, shifts in judicial doctrine, and the increased sophistication of tax lawyers and tax accountants.

UDITPA's failure to address contemporary needs has resulted in a lack of uniformity in state corporate income taxes. In theory, this lack of uniformity can lead to either the overtaxation or the undertaxation of multistate corporations. Realistically, however, the lack of uniformity results in a loss of state revenue.

UDITPA was enacted in 1957 to deal with what, by 21st century standards, was the rather mundane taxation of manufacturing and mercantile activities. The antiquated structure of UDITPA makes it difficult to repel attacks by tax lawyers and accountants who are using modern weapons and techniques that include: the widespread use of tax minimization strategies; the pressing of formal rules to their limits; the exploitation of weaknesses in state tax structures; the shifting of income and deductions among the states; the identification of and capitalization on gaps in the interfacing of state laws, and the overall lack of harmonization in state laws.

Consequently, the Uniform Law Commission is at a crossroads–either UDITPA is modernized or else it should be withdrawn as a model. If UDITPA is to be updated, we suggest the following set of priorities. These are in the order they appear in UDITPA but the most important are marked with an asterisk:

*Section 1(a) and 1(e) (definition of business income) No one has disputed the need to clean up the existing definition. All seem to agree that it should be broadened to, at a minimum, pick up what the framers of UDITPA intended, namely, that property used in the trade or business should give rise to apportionable income when sold, even in a complete liquidation or other extraordinary transaction. It will be appropriate to consider broader options as well.

*Section 1(g) (definition of gross receipts)

Section 3 (requirement to be an apportioning taxpayer)

Section 4-8 (allocation of nonbusiness items)

*Section 9 (appropriate weighting of the three factors) This is key, but at least one option is to take no position on the appropriate weighting, in light of the widespread variations adopted by the states.

Section 15 (definition of sales)

Section 16 (location of sales of tangible personal property)

*Section 17 (location of sales of other than tangible personal property). This is likely to be the most difficult section to rewrite, but states are moving away from the current UDITPA provision that relies on "costs of performance." The threshold question will be whether to keep (and define more precisely) "costs of performance" or to move to a destination approach.

*Section 18 (authority for alternative apportionment)

In addition to the existing sections of UDITPA, the original list included other issues that might be considered. A pared down list is below (the numbering corresponds to the original numbers in the first posting of UDITPA issues and possible other issues to consider):

3. Partnership issues: There are two possible points here: (i) extend UDITPA to partnership/LLC entities subject to income tax and (ii) determine how corporate entities should be taxed on (business) income from partnerships.

4. Mandatory (or elective, consistent with federal consolidation)combination:

9. Should procedural issues be included?

a. Model tax court
b. Pay to play
c. Are the MTC regulations on Consistency and Uniformity in Reporting workable? Reg. IV.2.(c).
d. Are there statutes of limitations that are unreasonably too short?
e. Should interest rates be equalized?
f. Should federal extensions to file control for state purposes?
g. Are the periods for filing protests too short?
h. Should the due date for corporate income tax returns be at least 30 days beyond the federal due date?