MTC Factor Presence Nexus Model

• Bright-line Nexus Test:
  • Substantial nexus is established if any of the following thresholds is exceeded during the tax period:
    • (a) a dollar amount of $50,000 of property; or
    • (b) a dollar amount of $50,000 of payroll; or
    • (c) a dollar amount of $500,000 of sales; or
    • (d) twenty-five percent of total property, total payroll or total sales.

• Approved October 17, 2002.
Background

• Concept from Professor Charles E. McLure, Jr., Senior Fellow, Hoover Institute, Stanford University

• December 2000 *National Tax Journal*, “Implementing State Corporate Income Taxes in the Digital Age”
McClure, *Implementing State Corporate Income Taxes in the Digital Age*

- In the international sphere residence countries accord to source countries priority in the taxation of corporate income earned by multinational corporations, exercising only a residual right to revenue not taken by the source country.

- Residence countries use two techniques to accord priority to source countries, exemption of foreign–source income and credits for foreign taxes levied on income earned abroad. This two–tiered system would make no sense in the context of state income taxes, since the state of residence is essentially meaningless and subject to manipulation.
MTC “Factor Presence” Nexus Standard

• Provides for adjustment of factors for inflation when consumer price index has changed by more than 5% since last adjustment.

• Defines “property” consistent with “property factor” definition in apportionment formula provisions in Sections 10-12 of Article IV, UDITPA.

• Defines “payroll” consistent with “payroll factor” definition in apportionment formula provisions in Sections 13-14 of Article IV, UDITPA.
MTC “Factor Presence” Nexus Standard - “Sales” Definition

• Destination sourcing for sales of TPP

• Sales, leases of real property, leases of TPP sourced to property location

• Sourcing to address of purchaser for sales of services, intangibles, digital products
MTC “Factor Presence” Nexus Standard - Pass-through Entities

• Pass-through entities determine factor threshold amounts at entity level.

• Owners are subject to tax on their income portion earned in the state.
MTC “Factor Presence” Nexus Standard - Commonly Owned Enterprises

• Entities within a “commonly owned enterprise” and part of unitary business grouping aggregate property, payroll, and sales.

• If any of the factor presence nexus thresholds are exceeded, each entity within unitary business grouping is deemed to have nexus.

• “Commonly owned enterprise”—group of entities under common control through parent owning over 50% of voting power or ownership interests.
MTC “Factor Presence” Nexus Standard Subject to P.L 86-272

• P.L. 86-272 preempts MTC “factor presence” nexus standard.

• When protection applies, sales to customers are “thrown back” to sending state.

• If Congress repeals P.L. 86-272, then “factor presence” nexus standard would apply to sales of TPP.
Objections to MTC’s Project

• COST: relied on *Quill* to argue that for a business to have substantial nexus with a state it *must have a physical presence in the state*

• Because the proposal allows states to use only sales as a factor in determining nexus, it would effectively create an “economic nexus standard”

• Conflicts with the provisions of Pub. L. No. 86-272 (factor presence standard could not supersede it, but would create economic nexus only for the sales of intangibles and services)
# Factor-Presence States

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<tr>
<th>States</th>
<th>Variation from MTC Model</th>
<th>Sourcing</th>
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<tr>
<td>Alabama (Ala. Code §40-18-31.2)</td>
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<td>market-based</td>
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<tr>
<td>California (Cal. Rev. &amp; Tax Code §§23101(b) and (d))</td>
<td>indexed for inflation</td>
<td>market-based</td>
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<td>Colorado (Colo. Code Regs. §39-22-301.1)</td>
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<tr>
<td>Connecticut (Conn. Gen. Stat. §12-216a)</td>
<td>only a sales factor threshold</td>
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<td>Michigan (Mich. Comp. Laws §206.621(1))</td>
<td>only a sales factor threshold ($350,000 instead of $500,000); also requires active solicitation of sales</td>
<td>market-based</td>
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<tr>
<td>New York (N.Y. Tax Law §209.1)</td>
<td>only a sales factor threshold ($1 million)</td>
<td>market-based</td>
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<tr>
<td>Ohio</td>
<td></td>
<td>Special rules apply.</td>
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<tr>
<td>Tennessee (Tenn. Code §67-4-702)</td>
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<td>market-based</td>
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Litigation

- **L.L. Bean v. Levin**
  - (Ohio Bd. Tax App. 3/6/14) (settled on appeal, 11/20/14)

- **Crutchfield Inc. v. Testa**
  - November 17, 2016,
  - Supreme Court of Ohio
    - Out-of-state company with no physical presence in Ohio but $500K in Ohio gross receipts was subject to the CAT
    - The burdens imposed by the CAT on interstate commerce were not excessive in relation to the legitimate interest of Ohio in imposing the tax on receipts of both in-state and out-of-state taxpayers.
    - With respect to *Quill*, the Court indicated that the physical presence requirement for purposes of use tax purposes does not extend to the CAT, which is a business privilege tax.
Potential Int’l Issues for Consideration

• Sourcing rules
  • Most states that have enacted economic factor-presence nexus statutes refer a taxpayer to the state's sales factor sourcing rules

• Look-through rules
  • A number of state market-based sourcing regulations include examples sourcing receipts to a state under “look-through”