ALTERNATIVE APPORTIONMENT
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Most states have some sort of discretionary authority to require a taxpayer to use an alternative apportionment formula.

UDIPTA section 18

Provides for the use of alternative apportionment “[if the allocation and apportionment provisions of this Act do not fairly represent the extent of the taxpayer’s business activity in the state.”
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- Generally permits the use of one or more alternative methods if the apportionment provisions “do not fairly represent” the taxpayer’s business activity in the state.
- No requirement that the taxpayer be attempting to avoid taxes.
- References separate accounting, exclusion/inclusion of one or more factors, or “employment of any other method to effectuate an equitable allocation and apportionment” of taxpayer’s income.
- Generally available to both the taxpayer and the state.
- Sometimes requires special election/procedure “appropriate only in limited and unusual circumstances (which ordinarily will be unique and nonrecurring)”
The drafters of UDITPA contemplated that alternative apportionment would be an unusual remedy and that it would not be invoked routinely.

It was assumed that the statutory formula would usually reach the correct results.
Professor William Pierce, the principal draftsperson of UDITPA, stated that:

“Section 18 permits … some other method … where unreasonable results ensue from the operation of the other provisions of the Act. … Of course, departures from the basic formula should be avoided except where reasonableness requires. Nonetheless, some alternative method must be available to handle the constitutional problems as well as the unusual cases.”

“In many types of service functions, [the section 17 IPA/COP] approach appears adequate. However, there are many unusual fact situations connected with this type of income and probably the general provisions of Section 18 should be utilized for these cases.”

A number of states have determined that alternative apportionment may only be required in unusual cases.

  - “The central question under [the alternative apportionment provision] is not whether some quantitative comparison has produced a large-enough “distortive” figure. Rather, the question is whether there is an unusual fact situation that leads to an unfair reflection of business activity under the standard apportionment formula.”

- See also, e.g., **Union Pac. Corp. v. Idaho State Tax Comm’n, 83 P.3d 116, 120-121 (Idaho 2004); Roger Dean Enterprises, Inc. v. State, Dep’t. of Rev., 387 So.2d 358 (Fla. 1980); Deseret Pharm. Co. v. State Tax Comm’n, 579 P.2d 1322 (Utah 1978)**
Many states have also recognized that alternative apportionment is an exceptional remedy.

  - “The alternative formula is the exception . . . . Merely because the use of an alternative form of computation produces a higher business activity attributable to [the taxing state], is not in and of itself a sufficient reason for deviating from the legislatively mandated formula.”

- See also, e.g., *Deseret Pharm. Co., Inc. v. State Tax Comm’n*, 579 P.2d 1322, 1326 (Utah 1978); *Donald M. Drake Co. v. Dep’t of Rev.*, 500 P.2d 1041, 1044 (Or. 1972).

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The Multistate Tax Commission has changed its view on this. It’s original model regulation IV.18(a) provided:

**Original:** “...only in specific cases where unusual fact situations (which usually will be unique and non-recurring) produce incongruous results...”

- It then changed its mind:

**As Amended:** “...only in limited and specific cases where the apportionment and allocation provisions contained in Article IV produce incongruous results...”
Standards for Application:

- The standard for distortion should be lower than the constitutional “out of all appropriate proportion” standard set forth in *Hans Rees’ Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135 (1931).

- *F.W. Woolworth Co. v. Director, Div. of Taxation*, 213 A.2d 1 (N.J. 1965) (finding that alternative apportionment is available when the level of distortion is not unconstitutional).
Standards for Application:

- However, some states allow for alternative apportionment only when constitutional distortion is present.
  - Mich. Comp. Laws § 206.667(3) (providing for alternative apportionment where “the business activity attributed to the taxpayer in this state is out of all appropriate proportion to the actual business activity transacted in this state and leads to a grossly distorted result or would operate unconstitutionally to tax the extraterritorial activity of the taxpayer.”).
Alternative apportionment may be used more often as more states adopt single-sales-factor (SSF) apportionment.

SSF ignores the contributions of labor and capital to the production of income.

As a result, state revenue departments may become more aggressive (and taxpayers may become more assertive) in arguing that the statutory formula does not reflect where income is earned.
Consistency with spirit of the statutory apportionment formula.

- The legislature has made a judgment about how income should be apportioned to the state. Alternative apportionment methodologies should arguably be consistent with that judgment to the extent possible.

- State revenue departments have not always adhered to this principle.
Discretionary authority has been used in a cost-of-performance state to produce market-based sourcing

- On audit, credit card companies and financial institutions
- Advertising and publishers

The New York State Department of Taxation and Finance is asserting in audits of banks that deposits in the apportionment formula (which is based on deposits, payroll, and receipts) should be sourced to the residences of the depositors even though the statute refers to the place where the deposits are "maintained."
Generally, alternative apportionment is used to more accurately reflect a corporation’s in-state income, but it can be used in other contexts.

In *The McGraw-Hill Companies, Inc.*, TAT(H)10-19(GC) (2014), a New York City administrative law judge held that the Department of Finance’s refusal to allow a publisher to source its receipts in the same manner as other publishers violated the taxpayer’s rights under the First Amendment of the U.S. Constitution.
Discretionary authority has been used to allow for combined returns.

*Media General Commc’ns, Inc. v. Dep’t of Revenue*, 694 S.E.2d 525 (S.C. 2010) (granting a taxpayer’s request for alternative apportionment on a combined basis).
Burden of proof:

- The general rule is that the party seeking to depart from the statutory apportionment formula has the burden of proving that the formula does not accurately reflect the taxpayer’s in-state income.
- This rule generally applies even if the revenue department is seeking alternative apportionment.
Burden of proof.


The Department, as the party seeking to deviate from the standard formula, must satisfy two burdens:

1. standard statutory formula did not fairly represent CarMax West’s in-state business activity; and
2. alternative formula is appropriate, and it is more appropriate than any other competing method.

“It is only logical that a party seeking to override the legislatively determined apportionment method bears the burden of proving that method is not appropriate and an alternative method more accurately reflects the taxpayer’s business activity within the state.”
Burden of proof.

To the contrary, see *Equifax Inc. v. Miss. Dep't of Revenue*, 125 So.3d 36 (Miss. 2013), cert. requested.

- The taxpayer filed using state’s statutory cost-of-performance apportionment method, but the Mississippi DOR applied a “market approach” to the taxpayer under the state’s alternative apportionment provisions.
- The Mississippi Supreme Court held that the taxpayer bears the burden to prove the state’s proffered alternative apportionment method is not reasonable.
Burden of proof.

- The burden of proof should be harder to meet if the statutory formula in question was designed for a specific industry and not for all businesses.
- It can be expected that a formula intended to apply to all businesses will not work for some. One size cannot fit all.

Where the legislature has focused on a particular industry in crafting an apportionment formula, the presumption that it accurately reflects a company’s income should be particularly strong. See, e.g., Appeal of Fluor Corp., No. 93A-0719 (95-SBE-16) (Calif. SBE 1995); Appeal of Quick and Reilly Inc., No. 203953, 2004 WL 542899 (Calif. SBE 2004).
Penalties.

- A taxpayer that follows the statutory formula should not be subject to penalties if the revenue department successfully invokes alternative apportionment. One should not be penalized for obeying the law.

- Nevertheless, the Mississippi Supreme Court in *Equifax Inc. v. Miss. Dep't of Revenue*, 125 So.3d 36 (Miss. 2013), cert. requested, imposed penalties on a taxpayer that followed the statutory formula when the Department of Revenue successfully invoked alternative apportionment.