

Allocation and Apportionment: Lessons from the U.S. State Tax System

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In this article we look at allocation and apportionment based on the U.S. state tax system.

First, we summarise the limits on the States' powers to tax, the UDITPA and the Multistate Tax Commission. We then consider the right to divide the state income tax base, business vs. non-business income distinction and formulary apportionment. Finally, we look at what may be learned from the U.S. state tax apportionment system.

I. Introduction

A. Limits on the States' Powers to Tax: Nexus

In the United States, a state's ability to impose income tax on a foreign business entity engaged in interstate or international commerce is limited by the Commerce and Due Process Clauses of the U.S. Constitution,¹ and controlled by U.S. Supreme Court interpretations of these Clauses, as well as by Federal statute.² Generally, a state has jurisdiction³ to impose an income tax (or franchise tax based on income) if the activity of a business entity is sufficient to establish nexus with the taxing jurisdiction.⁴ State statutes impute jurisdiction based on factors such as doing business or owning property within the state. Since nexus is separately defined and interpreted by each state's courts the level of contact necessary to create nexus varies among the states even when state jurisdiction statutes are similar.

When more than one state has jurisdiction to impose income tax on a business, a method of fair apportionment of income between the states is needed to mitigate the problem of double taxation.

B. The UDITPA

The Uniform Division of Income for Tax Purposes Act ("UDITPA") is a model act that provides a system for dividing the income of multistate businesses. UDITPA was drafted by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") and approved by the NCCUSL and the House of Delegates of the American Bar Association in July 1957. UDITPA was conceived as a way to promote uniformity among states and to avoid the over- or under-taxation of interstate income. UDITPA provides a method for allocating and apportioning the income of multistate businesses, and was designed for enactment in states that have a net income tax or a tax measured by net income. About half the states have adopted UDITPA and most of the remaining states have substantially similar allocation and appointment statutes, base for the tax and the only remaining question is the amount of the base that should be assigned to the particular taxing jurisdiction.

C. The Multistate Tax Commission

Multistate Tax Commission ("MTC") is a joint agency of state governments created in 1967 through the *Multistate Tax Compact* (the "Compact"), an interstate compact statute enacted by

each Compact Member State. The MTC is comprised of the principal tax administrator of each Compact Member State acting as the representative of the state.⁵

The MTC was established to: (i) improve the fairness, efficiency and effectiveness of state tax systems as they apply to interstate and international commerce; and (ii) preserve state tax sovereignty. The MTC regards greater uniformity in multistate taxation as a way to ensure that interstate commerce is neither under-taxed nor over-taxed and to reduce the potential for the U.S. Congress to pre-empt or unduly limit state taxing authority. To further its purpose of promoting uniformity, preventing double taxation and preserving state sovereignty, the MTC:

- Studies state tax issues and recommends uniform tax laws and regulations that apply to multistate and multinational enterprises;
- Enables taxpayers to resolve common tax issues with several states at once through its *Multistate Alternative Dispute Resolution Program*;
- Actively participates in significant court cases and educates Congress about state tax authority and interests; and
- Encourages proper compliance by businesses with state tax laws through its *Joint Audit Program* and *National Nexus Program*.

Forty-seven states participate in the MTC as Compact Members (21), Sovereignty Members (5), Associate Members (18), and Project Members (3).

1. *Compact Members*

Compact Members are states that enact the Compact and govern the MTC's activities pursuant to the Compact's expressed purposes. Compact Members provide leadership in fostering interstate co-operation on challenging multistate tax issues. They direct the MTC's uniformity, Federal relations, educational and litigation support activities.⁶

2. *Sovereignty Members*

Sovereignty Members join in shaping and supporting the MTC's activities. Benefits are similar to Compact Membership, but do not require enactment of the Compact.⁷

3. *Associate Members*

Associate Members are states that wish to participate in MTC meetings with an eye to considering broader participation in MTC activities.⁸

4. *Project Members*

Project Members are those states that participate in and support specific MTC projects or programmes, but are not otherwise members of the MTC. The MTC currently has four projects that states can join: Joint Audit Program, National Nexus Program, Property Tax Fairness Project, and the Property Tax Audit Program.⁹

D. Definition of Key Terms

These are as follows:

- *Allocation* is a vehicle for the assignment of "non-business income" to a particular taxing jurisdiction.
- *Apportionment* is a means for the assignment of "business income" among the states *via* the use of a formula based on factors such as property, payroll and sales.
- *Business income* is defined by UDITPA as income that arises from transactions and activities in the regular course of the business entity's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the business entity's regular trade or business operations.¹⁰
- *Non-business income* is defined by UDITPA as all income other than business income¹¹ and is generally comprised of passive income, such as dividends, interest, rents, royalties, and certain capital gains. Under the MTC regulations interpreting UDITPA, passive income may be deemed to be business income in instances where the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.¹²

II. The Right to Divide the State Income Tax Base

Under UDITPA, a business entity allocates all of its income to one state unless it is "taxable in another state". If the business entity is taxable in more than one state, the entity must allocate and apportion its income. A business entity is taxable in another state if: (i) in that state the business entity is subject to either a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or (ii) that state has the jurisdiction to subject the business entity to a net income tax, regardless of whether the state does in fact do so.¹³ Under the MTC Regulations interpreting UDITPA, the first prong of the "taxable in another state" test is satisfied when the state imposes one of the specified taxes on the business entity by reason of its business activities in that state.¹⁴ The second prong is satisfied _____¹⁵

III. Business vs. Non-Business Income Distinction

Having established that a business entity has a right to divide its tax base, because it is taxable in more than one state, the business entity's income must be divided among those states possessing the jurisdiction to tax the business entity. With most states, the first step in determining the division of the tax base is to categorise the income as either business or non-business income.¹⁶ A few states do not make this distinction, and usually seek to apportion all of the business entity's net income. However, since the U.S. Supreme Court has stated that a distinction between operational and investment income is constitutionally required,¹⁷ states that fail to make such a distinction are constitutionally suspect.

A. Non-Business Income — Allocated to (a) Specific State(s)

Under UDITPA, non-business income generated by patent and copyright royalties is allocated to a state based on the proportionate utilisation of the property (e.g., production, fabrication, manufacturing or other processing) by the taxpayer.¹⁸ If the business entity is not subject to tax in the state in which the income producing patent or copyright is used, the royalty income is "thrown back" to the business entity's state of commercial domicile.¹⁹ Non-business income from interest, dividends and capital gains and losses from sales of intangible personal property are allocable to the business entity's state of commercial domicile under UDITPA.²⁰

Commercial domicile is defined as the "principal place from which the trade or business of the taxpayer is directed or managed".²¹

With regard to tangible income/producing property, net rents, royalties, and capital gains and losses from sales of real property (when they constitute non-business income) are allocable to the state in which the property is located.²² Non-business income from tangible personal property is allocated to a state based on the proportionate utilisation of the property in that state, but are "thrown back" to the state of commercial domicile if the business entity is not subject to tax in the state in which the property is used.²³

B. Business Income — Apportioned amongst all States in which the Business Entity Operates.

Under UDITPA, business income is apportioned to the states by use of a formula which is meant to reflect the relative amount of business activity conducted in each of the states in which the business entity operates.²⁴ Although state apportionment statutes differ, most states use one of three approaches in deciding whether an item of income is non-business (therefore allocable) or business (and therefore apportionable). These approaches are (i) UDITPA; (ii) the type of income approach; and (iii) the unitary business approach.

1. UDITPA

UDITPA, the most common approach, is interpreted by most states as incorporating two alternative tests for determining whether income is apportionable "business income". The tests are referred to as the "transactional test" and the "functional _____"^{25 26 27} of transaction giving rise to the income and how the transaction relates to the business entity's regular trade or business. Under the "functional test", income is classified as apportionable business income if the acquisition, management, and disposition of the asset that generated the income constitute integral parts of the business entity's regular trade or business.²⁸ The functional test focuses on the relationship of the asset giving rise to the taxable income and the business itself.

2. "Type of Income" Approach

Under the "type of income" approach, used by several states that do not subscribe to UDITPA, all income of a certain type is considered allocable, and all remaining income is treated as apportionable. For example, under Virginia law, dividend income is subject to allocation and all other income is subject to apportionment.²⁹ Following the U.S. Supreme Court decision in *Allied Signal*,³⁰ however, statutes that require income to be apportioned regardless of its relationship to business operations have a questionable application. While Virginia's statutes remain unchanged in light of *Allied Signal*, the Virginia Department of Taxation has administratively avoided unconstitutional apportionment by treating a request to allocate certain investment income as a request for an alternate method of apportionment.³¹ UDITPA permits taxpayers to petition for an alternative to the statutory method of apportionment if the statutory method does not fairly reflect the taxpayer's income in the state.³²

3. "Unitary Business" Approach

Under the "unitary business" approach, developed by the U.S. Supreme Court in the 1980s,³³ a state is allowed to subject the combined worldwide unitary income of an economically integrated group to its statutory apportionment formula.³⁴ A unitary business operates as a single unit,

with each branch contributing to the operation of the business as a whole. The courts have developed three tests to define a unitary business: (i) the three unities tests;³⁵ (ii) the contribution or dependency test;³⁶ and (iii) the factors of profitability tests.³⁷

Apportionment decisions in unitary business cases pre-empt any UDITPA provisions to the extent the decisions are based on constitutional grounds.³⁸ Accordingly, only income from a business entity's unitary business is apportionable business income. If the business entity's activities and properties are part of a unitary business, income from such activity or property is deemed to be derived from the regular course of the business entity's trade or business and is considered to be apportionable business income. Income that is unrelated to the business entity's unitary business is classified as non-business income subject to allocation. While affirming the unitary test for determining whether income is business or non-business, the Court in *Allied Signal* held that the unitary test is not the exclusive test.³⁹

IV. Formulary Apportionment

Under UDITPA and the MTC regulations, business income is apportioned to a given state using a three-factor, equally-weighted formula that compares the ratio of in-state to overall property, payroll and sales, respectively. The apportionment formula for State A (using equally-weighted factors) is computed as follows:

The apportionment formula yields a percentage that determines the portion of the business entity's business income included in its State A taxable income computation. The larger the numerators of the apportionment factors for State A, the more income that will be apportioned to State A.

While most states follow the general approach of UDITPA and the MTC regulations, there are numerous exceptions and differences. The most common modification to the equally-weighted three-factor formula is to double weight the sales factor. This method favours domestic companies that typically have more payroll and property in the state and taxes more heavily out-of-state companies that make sales into the state. Some states modify the UDITPA formula with less than three factors, using either a single-factor or two-factor formula. Differences between the state apportionment formulas can result in a business entity being subject to state income tax on more (or less) than its entire net income, and thus provide incentive for forum shopping.

A. Property Factor

Under UDITPA and the MTC regulations, the property factor consists of the business entity's real and tangible personal property owned or rented and used in the regular course of the business entity's trade or business during the tax period at issue.⁴⁰ Excluded from the property factor are cash, intangible property and property that produces non-business income.

Property is included in the property factor if it is used or capable of use.⁴¹ Property is removed from the factor when "its permanent withdrawal is established by an identifiable event such as its conversion to the production of non-business income, its sale, or the lapse of an extended period of time (normally, five years) during which the property is no longer held for use in the trade or business".⁴²

Owned property is valued at its average original cost, adjusted for additions, improvements, and partial dispositions.⁴³ Generally, the average value of the property owned is determined by averaging the values at the beginning and the end of the tax period.⁴⁴ Rented property is valued at eight times the net annual rental rate, which includes amounts paid in lieu of rents (such as real estate taxes, insurance, or repairs) but not amounts paid as service charges (such as utilities).⁴⁵

Property is assigned to the numerator of the property factor based on its state of location or use. If the property is in transit at year-end, it is included in the numerator of the destination state. Mobile or movable property is included in the numerators of each state in which it is present during the year based on the relative time in each state.⁴⁶ The denominator includes all real and tangible personal property owned and rented by the business entity used in generating business income wherever located.⁴⁷

B. Payroll Factor

Under UDITPA and the MTC regulations, the payroll factor, consists of amounts paid by the business entity in the regular course of its trade or business for compensation during the tax period at issue. Compensation includes: taxable wages, salaries, commissions, and any other form of remuneration paid to employees for personal services.⁴⁸ Compensation does not include amounts paid to independent contractors.

Employers determine which wages to include in their payroll factor based on their method of accounting (cash or accrual).⁴⁹ Payroll capitalised in the cost basis of a self-constructed asset (e.g., a construction worker's salary for a new plant facility) is included in the payroll factor?⁵⁰ Payroll is excluded from both the numerator and the denominator if connected with the production of non-business income.⁵¹

The payroll factor numerator is the total compensation paid by the business entity in the state during the tax period.⁵² Compensation is paid in a state (and included in that state's numerator) if an employee's service is performed entirely within that state.⁵³ If an employee's service is performed both within and without the state, the MTC regulations effectively attribute the employee's entire compensation to a single state, unless the employee's base of operations actually moves from one state to another during the years.⁵⁴ If payroll is properly assigned to a state where the business entity does not have nexus (because its activities are limited to solicitation under P.L. 86-272) the payroll is not "thrown back" to the commercial domicile state.

C. Sales Factor

Under UDITPA, the sales factor is a fraction, the numerator of which is the total sales of the business entity in a state during the tax period, and the denominator of which is the total sales of the business entity everywhere during the tax period.⁵⁵

1. The denominator

The MTC regulations define "sales" to mean all gross receipts not subject to direct allocation.⁵⁶ For purposes of the sales factor, "sales" means all gross receipts derived by a business entity from transactions and activity in the regular course of its trade or business.⁵⁷ Generally, only apportionable business receipts are included in the sales factor.⁵⁸

The sales factor includes: gross sales (less returns and allowances), all interest income, service charges, carrying charges, time-price differential charges incidental to such sales, and Federal and state excise taxes (if such taxes are passed on to the buyer or are included as part of the selling price of the product).⁵⁹ The sales factor includes not just receipts from sales of inventory, but also includes other income such as: (i) fees and commissions received from the performance of services; (ii) rents and lease payments received from renting real or tangible property; (iii) proceeds from the disposition of other tangible and intangible assets (such as the sale of equipment used in a business); and (iv) royalties and other payments received from the sale, assignment or licensing of intangible personal property such as patents and copyrights.⁶⁰

MTC regulations specifically exclude the following receipts from the sales factor under the theory that their inclusion could distort the overall apportionment of income in a given year by giving undue weight to a particular state: (i) substantial gross receipts arising from an incidental or occasional sale of fixed assets used in the regular course of the business entity's trade or business;⁶¹ (ii) insubstantial receipts arising from occasional transactions (unless such exclusion would materially affect the amount of income apportioned to this state);⁶² and (iii) business income from intangible property not readily attributable to a particular income producing activity.⁶³

_____ the state to which property is shipped or delivered, regardless of the F.O.B. point or other conditions of sale.⁶⁴ Property is deemed to have been shipped or delivered to a purchaser within the state if the shipment terminates in the state, even if the purchaser subsequently transfers the property to another state.⁶⁵ Sales to a destination state where the seller is not taxable (e.g., because its activities do not exceed solicitation under P.L. 86-272) are "thrown back" to the numerator of the state from which the goods were shipped.⁶⁶

With respect to drop shipments, the MTC regulations provide that if a seller directs its supplier to deliver the property to a third party, delivery to the third party constitutes a sale in the third party's state.⁶⁷ The MTC regulations apply a "double-throwback" rule with regard to drop shipments.⁶⁸

Under UDITPA, receipts (other than from the sale of tangible personal property) are included in the sales numerator of the state with the greatest proportion of the income producing activity, measured by the cost of performance.⁶⁹ The MTC regulations also provide special rules for the attribution of income from certain transactions, for example: (i) rental receipts are attributed based on the number of days the tangible personal property is used in a state, compared with total use everywhere; and (ii) receipts from personal services are attributable based on performance in the state, and are allocated between states based on actual time of performance when performed in several states.⁷⁰

V. Lessons from the U.S. State Tax Apportionment System

A. One Size Does Not Fit All

UDITPA was adopted when manufacturing and retailers reflected the bulk of interstate commerce. The standard formula is not well suited for much of today's commerce.

1. Relief under UDITPA —Alternative methods

Under UDITPA, business entities whose business activities within a state are not fairly represented by the use of the allocation and apportionment provisions are allowed to petition for (or may be required by a state tax administrator to use) another alternative.⁷¹ Alternative methods may include: separate accounting;⁷² the exclusion of one or more factors; the inclusion of additional factors; or "any other method to effectuate an equitable allocation and apportionment of the taxpayer's income".⁷³

2. *Deviation from UDITPA-Specialised industries: The future of apportionment*

For certain specialised industries, in which the payroll, property and sales factors do not fairly represent where the income is generated, the MTC has adopted regulations to modify the standard UDITPA formula to more accurately reflect income for that industry. While some states continue to apply the standard apportionment formula, others have devised their own specialised apportionment methods for specialised industries (which are not necessarily the same as those proposed by the MTC). In the future, specialised apportionment methods are financial institutions; publishing; and television and radio.⁷⁴

B. Lack of Uniformity Breeds Discontent

Perhaps the most important lesson to be learned from the U.S. state tax system of apportionment is the need for uniformity. In the United States, at least 27 states modify the UDITPA's equally-weighted formula (usually double weighting the sales factor), while some states use only a single factor (sales). The lack of uniformity: (i) makes the task of complying with the various state tax laws more difficult and administratively more expensive for businesses; (ii) can cause some taxpayers to be taxed on more than 100 percent of their net income; and (iii) can cause some net income to escape taxation at the state level altogether.

Specialised industries, for which the standard apportionment factors fail to produce fair apportionment, need uniformity on an industry-by-industry basis. Otherwise, industries may be forced to "forum shop" between the states.

C. Vague Terminology Leads to Litigation

Virtually every state's highest court has heard arguments on what either constitutes "business income" under UDITPA or a "unitary business" under state law or Federal case law. Under the UDITPA provisions, parties routinely argue over whether an activity is in the "regular course" of business or whether a transaction constitutes an "integral part" of a taxpayer's "regular trade or business" operations. Taxpayers also regularly argue over whether the functional test and transactional test are alternative tests or refinements of a single test.

Where general principles are established as guidelines for apportionment, the courts of the various states create case-by-case determinations that often lead to differing interpretations of the general principles among the states.

"Type of income" or industry-specific allocation and apportionment rules that are more clearly defined - such as allocating dividends to the state of the taxpayer's commercial domicile or allocating airline revenue based on fly-over miles - are much less likely to be manipulated or litigated. The more vague the definition, the more value is transferred away from taxing jurisdictions (based on potentially aggressive reporting positions) and toward the lawyers who will litigate the issues.

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Submissions by Authors: The editor of *Tax Planning International Review* invites readers to submit for publication articles that address issues arising from developments in international tax law, either on a national or transnational level. Articles with an appeal to an international audience are most welcome. Prospective authors should contact Melanie Bond, Managing Editor, _____.

¹ The Commerce Clause of the U.S. Constitution provides that "Congress shall have the power . . . (t)o regulate commerce with foreign nations, and among the several states, and with the Indian tribes". U.S. Const. Art. I, § 8, cl. 3. The Due Process Clause of the Constitution provides, in relevant part, that no state shall "deprive any person of life, liberty, or property, without due process of law". U.S. Const. Amend. XIV, § 1. The focus of a Due Process analysis of a state tax is the extent to which apportionment accurately reflects the taxpayer's activity in the taxing state.

² P.L. 86-272, 73 Stat. 555, 15 U.S.C. § 381 (1959). Public Law 86-272 provides a state income tax nexus safe harbor for taxpayers who merely enter a state to solicit sales (sales are completed out-of-state).

³ "Jurisdiction" refers to a state's power or authority to impose tax.

⁴ "Nexus" refers to the presence or amount of activity within a state that is sufficient to subject an individual, corporation, or other entity to state taxation. With respect to income tax, some form of physical presence is usually required (such as having employees in the state making sales).

⁵ See www.mtc.gov.

⁶ _____ Maine, Michigan, Minnesota, Missouri, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah, and Washington.

⁷ Sovereignty Members include: Florida, Kentucky, Louisiana, New Jersey, and Wyoming.

⁸ Associate Members include: Arizona, Connecticut, Georgia, Illinois, Maryland, Massachusetts, Mississippi, New Hampshire, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, South Carolina, Tennessee, Vermont, West Virginia, and Wisconsin.

⁹ Project Members include: Iowa, Nebraska, and Rhode Island.

¹⁰ UDITPA § 1(a)

¹¹ UDITPA § 1(e)

¹² MTC Regs. § IV.1.(a)

¹³ UDITPA § 3

¹⁴ MTC Regs. § IV.3.(b)

¹⁵ MTC Regs. § IV(3).(c)

¹⁶ See e.g., Conn. Gen. Stat. § 12-218 and Conn. Dept. of Rev. Svcs., Special Notice 93(26) (Nov. 18, 1993).

¹⁷ *Allied Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992) (the U.S. Supreme Court struck down as unconstitutional New Jersey's full apportionment statute which required that all income earned by a nondomiciliary corporation be apportioned and that no income was allocable).

18 UDITPA § 8(a)
19 UDITPA § 8(a)(2)
20 UDITPA §§ 6(c), (7)
21 UDITPA § 1(b)
22 UDITPA §§ 5(a), (6)(a)
23 UDITPA §§ 5(b), (6)(b)
24 UDITPA § 9
25 MTC Regs. § IV.1.(a)
26 *Id.* A few state courts (Iowa and Kansas) have interpreted the tests as not being independent, instead holding that the functional test merely operates to limit the transactional test. See *Phillips Petroleum Co. v. Iowa Dept of Revenue and Finance*, 511 N.W.2d 608 (Iowa 1993); *Appeal of Chief Industries, Inc.*, 875 P.2d 278 (Kan. 1994). After these court decisions, however, the legislatures of these states amended their respective tax codes to expressly include the functional test within the definition of business income.
27 UDITPA § 1(a); MTC Regs. §. IV.1.(a).(4)
28 UDITPA § 1(a); MTC Regs. §. IV.1.(a).(5)
29 Va. Code Ann. §§ 58.1-407 and 58.1-408
30 *Allied Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992)
31 See Va. Ruling of Comm'r P.D. 94-178 (June 8, 1994)
32 UDITPA § 18
33 See *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980); *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982); *F.W. Woolworth Co. v. Taxation & Revenue Dept of N.M.*, 458 U.S. 354 (1982). See also 1160 BNA Tax Management Portfolio, *Income Taxes: State Formulary Apportionment Methods*, 1160.01.G.2.
34 Several states have adopted this approach in an effort to maximise income taxable to their states, as well as to prevent erosion of the tax base through intercompany pricing arrangements. See, e.g., *Ramsay, Scarlett & Co. v Comptroller of Treasury*, 490 A.2d 1296 (Md. 1985).
35 Under this test, a unitary business is found where related entities display unity of ownership (more than 50 percent commonly owned), operation (centralised operations, such as management, purchasing, accounting), and use (major policy decisions are made for the entire group by a centralised management and general operations systems are centrally controlled).
36 Under this test, a unitary business is found where the corporation's in-state business contributes to or is dependent upon the corporation's out-of-state business.
37 Under this test, a business is unitary where related entities display functional integration, economies of scale, and centralised management.
38 See *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980); *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982); *F.W. Woolworth Co. v. Taxation & Revenue Dep't of N.M.*, 458 U.S. 354 (1982).
39 *Allied Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992).
40 UDITPA § 10; MTC Regs. § IV.10.(a).
41 MTC Regs. § IV.10.(b). For example, an idle plant facility is included, but a plant under construction and unavailable for use is not.

42 *Id.*

43 UDITPA § 11; MTC Regs. § IV.11(a). Fair market value is not used and depreciation is not taken
into account.

44 UDITPA § 12; MTC Regs. § IV.12 (averaging monthly values may be required in some
circumstances).

45 UDITPA § 11; MTC Regs. § IV.11.(b).

46 MTC Regs. § IV.10.(d).

47 UDITPA § 10.

48 UDITPA § 13; MTC Regs. § IV.13.(a).

49 MTC Regs. §. IV.13.(a).

50 MTC Regs. § IV.13.(a).

51 MTC Regs. § IV.13.(a). For example, the salary of an employee whose only duty is the
management of an investment portfolio, which is not part of the business entity's regular trade or
business, is excluded from the payroll factor.

52 MTC Regs. § IV.13.(c).

53 MTC Regs. §§ IV. 13, 14.

54 See MTC Regs. § IV.14. If an employee's service is performed both within and without the state,
the compensation is deemed to be paid in the state by applying the following hierarchy: (i) if the service
performed without the state is incidental to the employee's service within the state; (ii) if the employee's
base of operation is in the state or if there is no base of operation in any state in which some part of the
service is performed and the service is directed or controlled from within the state; and (iii) if 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 and the employee's residence is in the state.

55 UDITPA § 15.

56 MTC Regs. § IV.15.(a).

57 MTC Regs. § IV.15.(a).

58 See UDITPA, § 4; MTC Regs. § IV.15. Gross receipts allocated (not apportioned) generally
include rents and royalties from real or tangible personal property, capital gains, interest, dividends, and
patent or copyright royalties, to the extent they are non-business income.

59 MTC Regs. § IV.15.(a).

60 UDITPA § 15; MTC Regs. § IV.15.

61 MTC Regs. § IV.18.(c).(1).

62 MTC Regs. § IV.18.(c).(2).

63 MTC Regs. § IV.18.(c).(3).

64 MTC Regs. § IV.16.(a).(2).

65 MTC Regs. § IV.16.(a).(3).

66 MTC Regs. § IV.16.(a).(1).

67 MTC Regs. § IV.16.(a).(4).

68 MTC Regs. § IV.16.(a).(7).

69 UDITPA § 17(a). The "cost of performance" is the direct costs under generally accepted
accounting principles. See MTC Regs. § IV.17.

⁷⁰ MTC Regs. § IV 17.(4).

⁷¹ UDITPA § 18. A state's apportionment statutes are presumed to be equitable. Before granting use of an alternative method, a business entity generally must prove by clear and convincing evidence that application of the state's apportionment statute produces a distorted perception of the business entity's activities in that state, and that this distortion results in an inequitable tax burden.

⁷² "Separate accounting" is a method of attributing the income or loss of a corporation with multistate business activities to a particular state based on actual sales in and expenses directly attributable to that state. This method, once regarded as the most precise measure of Income attributable to business operations within a state, is viewed as expensive and impractical to administer. With the enactment of UDITPA by many states, it has largely been abandoned.

⁷³ UDITPA § 18.

⁷⁴ MTC Regs. § IV.18.