

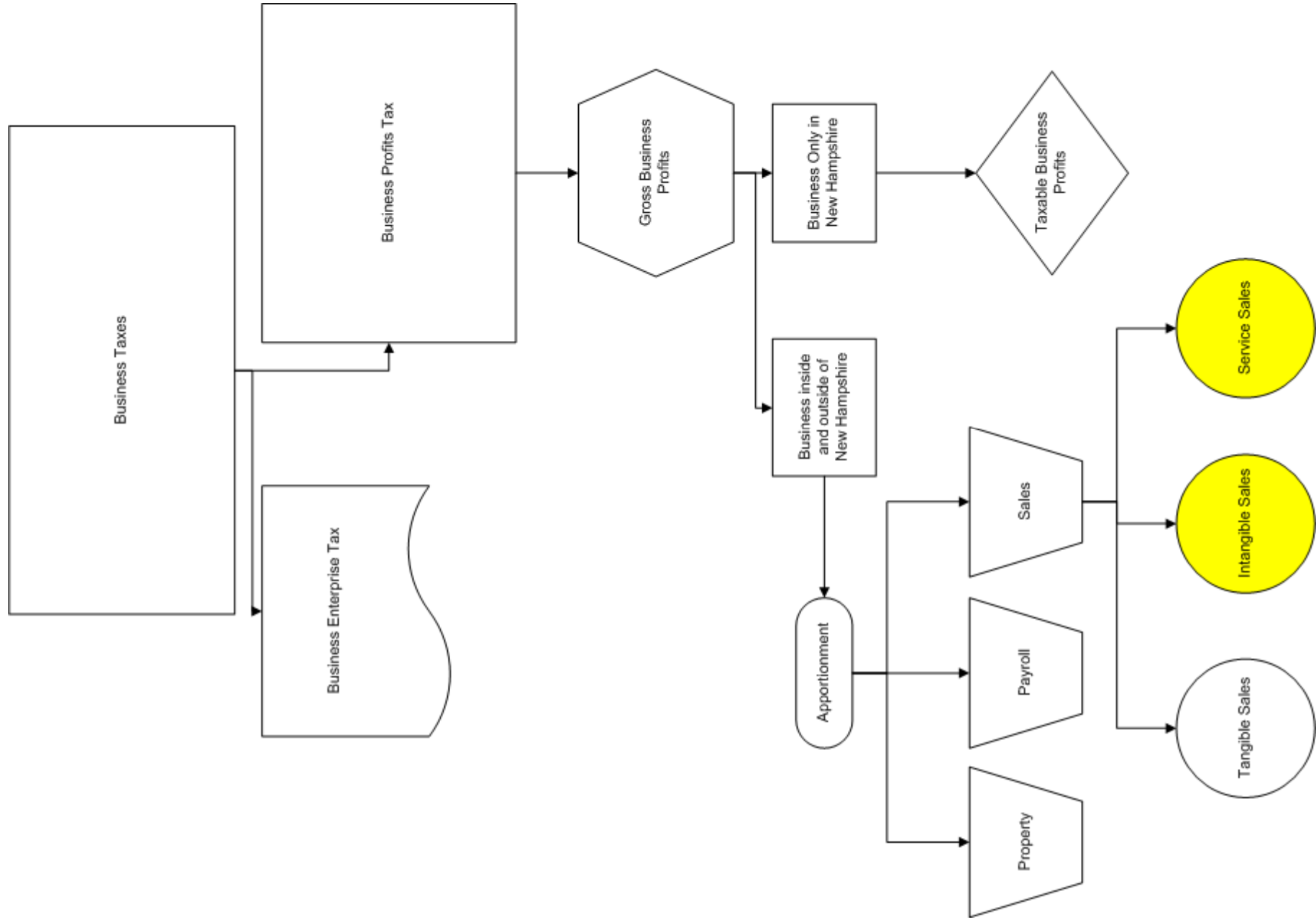


# SOURCING OF SALES APPORTIONMENT FACTOR OF THE NH BUSINESS PROFITS TAX

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Income from Services and Intangibles

New Hampshire Department of Revenue Administration  
Presentation to the  
House Ways & Means Committee  
January 14, 2014



# New Hampshire Apportionment

## Business Profits Tax RSA 77-A:3

A business organization which derives gross business profits from business activity both within and without this state, and which is subject to a net income tax, a franchise tax measured by net income, or a capital stock tax in another state or is subject to the jurisdiction of another state to impose a net income tax or capital stock tax upon it, whether or not such tax is actually imposed, shall apportion its gross business profits so as to allocate to this state a fair and equitable proportion of such business profits.

# New Hampshire Apportionment

New Hampshire uses apportionment to determine the portion of the profit of a company that is taxable to New Hampshire.

Numerator		Denominator	Double Weight		Factor
NH Sales	/	Everywhere Sales	X2	=	Sales Factor
NH Payroll	/	Everywhere Payroll		=	Payroll Factor
NH Property	/	Everywhere Property		=	Property Factor
				+	All Factors
				/4	= NH Apportionment

# Sales Factor

New Hampshire – Cost of Performance method of sourcing of service and intangible sales

- Tangible sales are not sourced using Cost of Performance, they are sourced based on delivery
- Tangible items can be touched or have a physical presence, intangible products or services cannot
- The remainder of this presentation pertains only to the sales factor and the sourcing of service and intangible sales

# Sales Factor Sourcing for NH

## Cost of Performance Method (COP)

- Sourced based on the state with the plurality of income producing activity
- Frequently referred to as “all or nothing”
- Rev 304.04(g) allows for deviation from “all or nothing” based on specific facts in the case of personal services
- Twenty-eight (28) states use COP, nine (9) of those states use Proportionate Share COP instead of “all or nothing”

# Sales Factor Sourcing for NH

- COP sourced on Income-producing activity (Rev 301.16)
  - Income-producing activity: The activities performed by the organization to obtain gain or profit
  - May not be the same location as the customer location
    - 40% of the income-producing activity may be in NH, but 80% of sales may be to out of state customers
    - Methodology: If the work is being done in NH, then it should be in the NH sales factor
- For all examples the following facts are used:

State	Income Producing Activity in State	Sales to State
A	40%	20%
B	30%	40%
C	30%	40%

# Cost of Performance Example

- Service Company has nexus in States A, B, and C
- States A, B, and C source sales of services in accordance with the COP approach
  - 40% of the company's income producing activity occurs in State A,
  - 30% in State B, and
  - 30% in State C
- Under a COP approach all sales are sourced to State A, because a greater proportion of the income producing activity occurs there than in any other state
- Under this scenario, 100% of sales factor would be apportioned for corporate taxes
- This was the situation among the New England states until Maine (2007), and now Massachusetts (2014), went to Market Based Sourcing



# Sales Factor Sourcing for Other States

- Recent Moves Towards Market Based Sourcing
  - Only affects the sales factor for services and intangibles
  - 19 states have adopted a form of Market Based Sourcing
  - Maine in 2007 and Massachusetts in 2014
  - Basic concept: The sales are sourced to where the customer is, rather than where the work is performed

# Market Based Sourcing

- Regulations and rules are not universal
  - Examples include the location of the ultimate customer, location of initial customer, the state where the service or intangible is used, state where benefit is received, etc.
- Typically requires more detailed regulations than COP
  - Can be difficult to determine customer location, where the benefit is received, or have visibility to determine the ultimate customer
  - In business-to-business transactions who is the customer?
    - The receiving business?
    - Or the ultimate customers of the receiving business?

# Market Based Sourcing Example

- Service Company has nexus (does business) in States A, B, and C
- States A, B, and C source sales of services using a Market Based approach
  - 20% of company's sales are to customers in State A,
  - 40% of sales are to customers in State B,
  - 40% are to customers in State C
- Under a Market Based approach the respective sales into each state (A, B, and C) are attributable to each state for apportionment purposes
- Under this scenario, 100% of the sales factor would be apportioned for corporate taxes

# COP and Market Based Sourcing Meet

## How does it affect NH and NH Businesses?

- The changes in other states should not affect NH state revenues or the application of NH law
- The impact will be realized by NH businesses that do business in Market Based States
  - It will not affect businesses that sell tangible products
  - It will affect businesses that have service and intangible sales and have nexus in Market Based Sourcing States (like ME and MA)
- The change does not affect their NH liability, but does affect their total tax liability
- The Commerce Clause requires that the income be fairly apportioned
  - If a states statute is applied in all states the taxpayer would not be taxed on more than 100% of its income

# COP and Market Based Sourcing Meet

## Example (Competing COP and Market Based States):

- Service Company has nexus in States A, B, and C
- State A sources sales of services in accordance with the COP approach, States B and C source sales of services using a Market Based approach
  - 40% of the company's income producing activity occurs in State A, 30% in State B, and 30% in State C
  - 20% of sales are made to customers in State A, while 40% of sales are made to customers in State B and 40% of sales are made to customers in State C
- Under competing sourcing rules, each state applies its respective apportionment formula
  - State A claims 100% of sales based on cost of performance,
  - State B claims 40% of sales based on its Market Based approach, and
  - State C claims 40% of sales based on its Market Based approach
- The company is now subject to state taxes based on 180% of its intangible sales factor
  - Because not all Market Based states have the same statute, causing variations in apportionment
  - Differences in double or single weighting of the sales factor may also cause variations

# Alternatives for New Hampshire

## •No Action

- The changes in other states statutes should not affect NH revenues or the application of NH law, but may affect NH businesses
- The impact will be realized by NH businesses doing business in Market Based States
- It will not affect businesses that sell tangible products
- It will affect businesses that sell intangibles and services and have nexus in a Market Based Sourcing State
- The change in MA statute affects a businesses MA tax liability not the NH liability, but may affect overall total tax liability

## •Legislative Action

- Legislative Study
- Statutory change to become Market Based Sourcing State
- Statutory change to Proportionate Share Cost of Performance
- A credit for taxes paid

# Alternatives for New Hampshire (Cont.)

## Legislative Study

- House Bill 1209 (2012), establishing a committee to study administration of the Business Profits Tax and the Business Enterprise Tax
  - House and Senate Study Committee
    - 3 House members and 3 Senate members
    - Included a review of “the apportionment of business profits taxation based on costs of performance.”
  - Passed in the House (OTP)
  - Passed in the Senate (OTP/A)
    - Senate removed the 3 Senate members
  - The House non-concurred with the Senate amendment
    - Bill did not pass
- This effort could be resurrected as it related to apportionment

## Alternatives for New Hampshire (Cont.)

### Statutory Change to Become a Market Based state

- Biggest risk: Unknown fiscal impact to state revenues
  - Would the out-of-state companies' sales to NH be greater than the NH companies with sales elsewhere?
- This should be researched extensively
- This type of statutory change may require other changes, such as a throw-out rule (if the company does not have nexus in a state, it does not include those sales in the denominator)
- COP can penalize in-state companies investing resources in the state – Market Based Sourcing would not
  - If the company locates in NH, then its greatest amount of income producing activity may be in NH



## Alternatives for New Hampshire (Cont.)

### Statutory Change to Proportionate Share COP

- Nine (9) states currently use this methodology
- Biggest risk: Unknown fiscal impact to state revenues
- This should be researched extensively
- This type of statutory change would require other changes, such as more specialized apportionment rules
- Would decrease the penalty on companies investing resources within New Hampshire
- Would not be the same as Market Based Sourcing, as the sales factor would still be based on the location of the income producing activity
  - May or may not be the same as the customer location

State	Income Producing Activity in State	Sales to State
A	40%	20%
B	30%	40%
C	30%	40%

## Alternatives for New Hampshire (Cont.)

### A Credit for Taxes Paid

- Has been suggested publicly by business representatives
- What would the credit be?
  - The change to Market Based Sourcing is a change to the sales factor only. It is possible that the taxpayer already had payroll and property apportionment to a Market Based state, and had previously paid tax to that state.
- The credit would have to be for any state that has Market Based Sourcing (19 States)
- There would be no reciprocal benefit; only a loss of revenue
- Would give tax relief to NH businesses

# Additional Information about Market Based Sourcing and Cost of Performance

- Multistate Tax Commission, Report of the Hearing Officer, Proposed Amendments to Multistate Tax Compact Article IV, October 25, 2013, pages 54 – 96
  - [http://www.mtc.gov/uploadedFiles/Multistate Tax Commission/Proposed\\_Amendments\\_to\\_Multistate\\_Tax\\_Compact\\_Article\\_IV/October\\_25\\_2013\\_Report\\_of\\_the\\_Hearing\\_Officer.pdf](http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Proposed_Amendments_to_Multistate_Tax_Compact_Article_IV/October_25_2013_Report_of_the_Hearing_Officer.pdf)
- AICPA, The Tax Advisor, November 1, 2012
  - [http://www.aicpa.org/publications/taxadviser/2012/november/pages/schadewald\\_nov2012.aspx](http://www.aicpa.org/publications/taxadviser/2012/november/pages/schadewald_nov2012.aspx)



# QUESTIONS?

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