2015

Modernizing the State Corporate Income Tax: Market-Based Apportionment for Content Providers

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MARKET-BASED APPORTIONMENT FOR CONTENT PROVIDERS

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EXECUTIVE SUMMARY

This Issue Paper discusses how technology has overtaken the traditional ways the states tax the income of "content providers" that operate broadcast and cable networks, sell advertising, and produce content such as movies and television programs. This content is licensed at wholesale to distributors and along with the advertising, is watched by customers of these distributors on their televisions, smart phones, tablets, gaming consoles, and computers—either in their homes or on the move.

The so-called "model" for taxing multistate businesses like content providers--the Uniform Division of Income for Tax Purposes Act (UDITPA)--was developed in 1957 and has been adopted in whole or in part by most states. Obviously, a tax system built on a 1957 foundation cannot begin to cope with today's highly technological and digital world. Without the benefit of a model that can accommodate the 21st century, the states have been left on their own to try to modernize their laws. The result has been constant change and flux.

This Paper endorses a new approach to the income taxation of content providers, one unaffected by, rather than becoming antiquated by, tomorrow's technology. The approach assigns receipts of content providers based on the commercial domicile of their customers—an approach that will not be overtaken by technology and one that introduces stability, predictability, and certainty into the tax system and reduces litigation. Moreover, the rule captures the location of the customers and the true market of the content providers.

The rule is free from the conceptual and administrative defects that plague other approaches, such as an audience factor or a population factor. Assigning sales based on the customer's commercial domicile would free policy makers from the need for constant tinkering with the tax law every time a technological innovation led to a new way of doing business for a content provider. This rule has already been adopted by some states.

ABOUT THE AUTHOR

Richard D. Pomp is the Alva P. Loiselle Professor of Law at the University of Connecticut and an Adjunct Professor of Law at New York University Law School in the LL.M. Program in Taxation. He is a summa cum laude graduate of the University of Michigan and a magna cum laude graduate of Harvard Law School. He has taught at Harvard, Columbia, Texas, and Boston College. In addition, he has been a Distinguished Professor in Residence, Chulalongkorn Law School, Bangkok, Thailand, and a Visiting Scholar at the University of Tokyo Law School and at Harvard Law School.

Professor Pomp has served as an expert witness in courts throughout the country for both corporations and the states. He has also represented law firms, corporations, accounting firms, and state tax administrations. He has participated in various capacities in Supreme Court litigation.

Professor Pomp has served as a consultant to cities, states, the Multistate Tax Commission, the Navajo Nation, the U.S. Congress, the U.S. Treasury, the Department of Justice, the IRS, the United Nations, the IMF, the World Bank, and numerous foreign countries, including the People's Republic of China, the Republic of China, Indonesia, the Gambia, Zambia, Mexico, the Philippines, Pakistan, India, and Vietnam. He is the former Director of the New York Tax Study Commission. Under his tenure, New York restructured its personal and corporate income taxes, and created an independent tax court.

Professor Pomp's casebook, State and Local Taxation, has been used in more than 100 schools, state tax administrations, and major accounting firms for their internal training. Portions of the casebook have been translated into Chinese, Dutch, German, Japanese, Spanish, and Vietnamese. He is also the author of more than 90 articles, numerous chapters in books, and various monographs. His writings have also appeared in the New York Times, the Wall Street Journal, and the Financial Times.

In addition to the local and regional media, Professor Pomp has been interviewed by NPR, Bloomberg Radio, The New York Times, The Wall Street Journal, The Washington Post, the Christian Science Monitor, the Los Angeles Times, the Minneapolis Star Tribune, the Sacramento Bee, The Baltimore Sun, Law360, Reuters, and The International Herald Tribune. He has been described as "the most knowledgeable person on state corporate income taxation in the country" (28 State Tax Notes 353).

In 2013, he served as the Hearing Officer for the Multistate Tax Commission on its Proposed Amendments to Article IV of the Multistate Tax Compact.

In 2007, Professor Pomp received the NYU Institute on State and Local Taxation Award for Outstanding Achievement in State and Local Taxation. He was selected by State Tax Notes for its "All Decade State Tax Team" in 2010. In 2011, he received the Bureau of National Affairs Distinguished Service in State and Local Tax Law. Tax Analysts appointed him the 2013 State Tax Person of the Year. The Council on State Taxation selected him for the 2014 Paul Frankel Award.

Richard D. Pomp

I. INTRODUCTION

The law is typically reactive, addressing yesterday's problems. In an area of slow moving change and developments, this commonplace approach is acceptable. But in a field of rapid technological innovation, yesterday's problems have nothing to do with today's. Yesterday's science fiction fantasies are today's realities.

This paper discusses how technology has overtaken the traditional ways the states tax the income of companies like NBCUniversal, CBS, Disney, Time Warner, Fox and Viacom. These companies operate cable and broadcast networks, sell advertising and produce content such as movies and television programs. This content is licensed at wholesale to distributors and along with the advertising, is watched by customers of these distributors on their televisions, smart phones, tablets, gaming consoles, and computers—either in their homes or on the move. For ease of presentation, these companies are referred to as "content providers."

The content and advertising is distributed through five types of distributors: TV station affiliates (e.g., the local Fox, NBC, CBS, or ABC station);[1] national cable system operators (e.g., Comcast, Charter Communications, Time Warner Cable, Cox Communications);[2] satellite television (e.g., Dish TV, DirecTV);[3] telecom distributors (e.g., AT&T, Verizon); and Internet distributors (e.g., Netflix, Hulu, Vudu, Amazon, RIM, Google, Yahoo, Apple).[4]

With limited exceptions, the content providers do not own or control any of these distributors. With the exception of Comcast's ownership of NBCUniversal, the content providers are not owned or controlled by any of the distributors.

The so-called "model" for taxing multistate businesses, including content providers--the Uniform Division of Income for Tax Purposes Act (UDITPA)--was developed in 1957 and has been adopted in whole or in part by most states. UDITPA was adopted when there were only 48 states, before the widespread use of color televisions, the existence of satellite television, computers, videos, laptops, tablets, DVDs and smart phones. Hula Hoops, not Hulu, were the country's obsession when this so-called "model" tax act was enacted. Amazingly, UDITPA has never been amended.[5]

Obviously, a tax system built on a 1957 foundation cannot begin to cope with today's highly technological and digital world. Without the benefit of a model that can accommodate the 21st century, the states have been left on their own to try to modernize their laws. The result has been constant change and flux and the lack of consistency among the states, which sacrifices fundamental goals of a sound tax system. The law generally, and tax law specifically, should provide certainty and stability, allowing businesses to invest confidently and state legislatures to predict their annual revenue so they can plan their spending. Tax rules should not be overtaken and rendered obsolete by new ways of doing business, especially in an area marked by rapid technological innovation.

Taxpayers and state governments should not have to resort to costly and distracting litigation to fit new business practices into outdated statutes. Nor should legislatures be constantly asked to shift their attention and resources to amending their tax statutes to keep up with new practices. Constant change creates an unfavorable business climate and discourages investment. By contrast, tax rules that can accommodate unpredictable technological developments are to be welcomed by taxpayers and state governments.

This Paper endorses a new approach to the income taxation of content providers, one unaffected by, rather than becoming antiquated by, tomorrow's technology. The goal is to provide an approach that will provide certainty, stability, and predictability, consistent with the guiding principles of a state corporate income tax.

To appreciate the issues involved in the state taxation of content providers, the difficulties that have arisen, and a solution to the problem, Section II below provides a brief introduction to the structure of a state corporate income tax.[6] Particular emphasis is on the sales factor, which is at the heart of this Paper and poses the greatest challenge for content providers. Traditional ways of calculating the sales factor are inadequate. Section III provides a solution to the sales factor: assigning receipts based on the state of the commercial domicile of a content provider's customer, an approach that has already been adopted by Florida, Illinois, Michigan, North Carolina and Oregon.

II. THE STRUCTURE OF A STATE CORPORATE INCOME TAX

A. Overview

Almost all the states have a corporate income tax in order to raise revenue from those doing business within their borders. These states face a common challenge: how much of the profits of a multistate business are they entitled to tax?

To use a metaphor, the overall profits of a multistate corporation can be viewed as constituting the size of a pizza pie. The challenge for a state is to determine the slice of the pizza that it can appropriately tax.

Every state follows the UDITPA approach, which determines a state's "slice" through the use of a formula. This method is known as formulary apportionment because a formula is used to apportion the pie, that is, to determine a state's slice.

UDITPA sets forth the following formula:[7]

Income Taxable by a State[8] = Corporation's Total Business Income × 1/3 (Sales Factor[9] + Payroll Factor[10] + Property Factor[11]).

A corporation determines its tax in State A by first calculating its total business income under State A law.[12] This amount represents a corporation's preapportionment tax base—the size of the pizza pie.

The corporation then calculates its apportionment percentage under the formula. Next, the corporation multiplies its total business income by the apportionment percentage. The result is the amount of the business income of the corporation that is apportioned to State A. The final step is to apply the state's rate schedule to determine the corporation's tax liability and to reduce that amount by any available credits.

The use of property and payroll in the formula reflects the capital and labor that contribute to the generation of income. The sales factor makes the formula politically attractive to states in which the corporation's customers are located. The sales factor is commonly described as reflecting the corporation's market, that is, where its customers are located.

The UDITPA formula has the virtue of using factors (property, payroll and sales) that are readily known to the taxpayer and that can be verified by a tax administration. Consequently, an advantage of the formula is that it divides income, which cannot be easily assigned geographically, using factors that can be located geographically, in a politically acceptable manner.

Around the 1970's, some states started to deviate from the UDITPA evenly-weighted, three-factor formula in order to encourage economic development. A few states started to double weight the sales factor with many more doing so over the next few decades.[13] Most recently, states have adopted a formula using only a sales factor.[14] The use of only a sales factor places a premium on how it is calculated because any defects or weaknesses will be magnified and not offset by the property and payroll factors.

B. Calculating the Sales Factor

The heart of this Paper concerns calculating the sales factor. As the UDITPA formula above indicates, the more sales that are assigned to a state, the larger the numerator of the sales factor and consequently, the more income that will be apportioned to that state. This is especially true in states using only a sales factor.

UDITPA provides two different approaches to calculating the sales factor: one for the receipts from the sale of tangible personal property and one for all other activities, which includes those provided by content providers.

1. Receipts from the Sale of Tangible Personal Property

Nearly every state employs the destination principle set forth in UDITPA for determining whether a sale of tangible property will be included in its receipts factor.[15] Under the destination principle, tangible personal property shipped or delivered to customers in the taxing state will be included in the numerator of that state's receipts factor. In the case of a sale by a manufacturer to a distributor, this rule assigns all the receipts to where the goods were delivered. That result recognizes that the distributor is the customer of the manufacturer. The manufacturer would not assign any of its sales to the states in which the distributor sold the goods because the customers of the distributor are not the customers of the manufacturer.[16] Put differently, there is no "look through" rule whereby the sale by the manufacturer is assigned to the state of the distributor's customer. Yet some states would advocate a "look through" rule for content providers through an audience factor, discussed below.[17]

2. Receipts from all other Transactions

In the case of all other receipts, that is, receipts from other than the sale of tangible personal property, such as advertising services and the licensing of intangible personal property, UDITPA provides that when the income-producing activity is performed in more than one state, as would be true in the case of content providers, the receipts are included in the numerator of the state in which a greater proportion of the income-producing activity is performed, as measured by "costs of performance."[18]

The costs of performance rule is "all-or-nothing." That is, if 3% of the costs of performance are incurred in each of 32 states and 4% are incurred in another state, the entire gross receipts will be assigned to that latter state.

Under UDITPA's "all or nothing" approach, gross receipts can be assigned to a state in which the taxpayer has no customers (or can be assigned to a state different from the one in which it has all of its customers). For example, consider a corporation that produces all of its services in State A and has only customers in State B. Under UDITPA, all of the gross receipts would be assigned to State A, even though the taxpayer has no customers there. None would be assigned to State B, where all of its customers are located.

The "all or nothing" feature of UDITPA's costs of performance has proven controversial.[19] Other criticism is that costs of performance are likely to overlap with the property and payroll factors producing a rule that is too heavily biased to the place of production and one that ignores the location of the taxpayer's customers. These features can interfere with attempts at attracting businesses to locate or expand in a state. For example, a corporation moving its operations to a state might find that all of its income becomes taxable in that state, even though all of its customers are located elsewhere.

Criticism of UDITPA's treatment of gross receipts from the sale of services or the licensing of intangible personal property has increased over time. Compared with 1957 when UDITPA was adopted, many more interstate service providers exist today. Moreover, interstate providers of intangible property have also become commonplace because of the Internet and the digital economy.

Because of the dissatisfaction with the costs of performance rule, some states have distorted the concept to reach a destination or market-based approach, such as the use of an audience factor, the location of subscribers, or the billing address of the end user. Other states have adopted a more transparent approach, replacing costs of performance with an explicit statute adopting a destination or market-based approach. Still other states have interpreted ambiguous statutes in problematic ways to reach market-based results.[20]

One of the rationales for these market-based approaches, even when not justified or supported by a statute, is to use a "destination" rule for the receipts from intangible property and advertising because such a rule would mirror the destination rule for tangible personal property. Ironically, however, although there is no "look through" rule for tangible personal property, these market-based approaches adopt one for the receipts from the licensing of intangible personal property and the receipts from advertising. These "look through" approaches focus on the viewers of the intangible property or advertising and consider those persons to be the content providers' market, even though the providers actually license their content to a distributor and not to the viewer. In addition to this conceptual defect, some of these market-based approaches are difficult to apply and can be manipulated by taxpayers.[21]

C. Alternative Apportionment

Even in 1957 when UDITPA was adopted, it was clear that its rules could not anticipate or adequately address all situations. "One size could not fit all." Accordingly, UDITPA Section 18 sets forth what is commonly known as alternative or equitable apportionment. This constitutionally mandated, exculpatory provision, having a statutory counterpart even in states not adopting UDITPA, provides that if the allocation and apportionment provisions do not fairly represent the extent of a taxpayer's business activity in a state, the taxpayer may petition for, or the tax administrator may require, any other method that will result in a reasonable and equitable allocation and apportionment of the taxpayer's income. Section 18 acts as a safety valve, allowing tax administrators and taxpayers to smooth over the rough edges of the apportionment and allocation provisions when applied to a particular transaction.[22]

Section 18 implicitly recognizes that the UDITPA apportionment formula is a pragmatic political compromise that shares the tax base among the states where labor and capital exist and the states where customers are located. A Nobel Prize winning economist described the UDITPA formula as: "[t]his simple but arbitrary and capricious formula has all the earmarks of having been concocted by a committee of lawyers who had forgotten anything they ever were taught about statistics or economics."[23] There is nothing sacrosanct about the sales factor or the formula; the goal is to adopt a politically acceptable approach that can be reasonably administered and one that provides certainty, predictability, and stability.

III. BASIC PRINCIPLES OF APPORTIONMENT APPLIED TO CONTENT PROVIDERS: A SOLUTION TO THE SALES FACTOR

The content providers generate income in two different ways. One way is through advertising. The content providers are paid by national advertisers. The payments are for the content providers to include the advertising as part of the programs and movies that they wholesale to their distributors, such as local broadcast stations, cable systems, telecom distributors, satellite TV, and Internet distributors.[24]

It is important to clearly identify the customers of the content providers in the case of advertising. The customers of the content providers are the advertisers. This is the group that pays the content providers and that generates their advertising income.

The advertisers sell their own goods and services to their customers, which might be distributors, retailers, or end users. In no event, however, will these customers have any legal relationship with the content providers.

(In legal terms, no privity of contract exists between the content providers and the customers of the advertisers.) For example, if a product advertised on a program produced by a content provider is defective, the purchaser of the product would not deal with the content provider. Indeed, the content providers are even unaware of the identity or location of the customers that buy their advertisers' products.

The second of the two sources of revenue for the content providers is the licensing of the programs or movies they produce. The content providers can be viewed as manufacturers of property—intangible property such as programs and movies. Their customers or "market" are the distributors to whom the content is wholesaled. The distributors are the group that pay the content providers and that generate their licensing income.

No legal relationship exists between the content providers and the customers of these distributors. For example, if a content provider licenses a program or movie to DirecTV or Netflix, the viewer of that content is DirecTV's or Netflix's customer, not the content provider's customer. If a content provider wholesales a program to a national cable operator, the viewer of that content is the customer of the local cable system affiliate.[25] If a problem develops with the viewing of the program, the viewer deals with the cable distributor, not the content provider. The viewers are likely unaware of who developed the content that they are viewing. And the content provider is likely unaware of the identity of the customers of its distributors, the home or billing addresses they used when they subscribed to a distributor's programming package, or where the customers are physically located when they view the program or movie.

With respect to the revenue received from licensing their programs and movies, the content providers are best analogized to manufacturers. Instead of manufacturing tangible personal property that is wholesaled to distributors, they manufacture intangible intellectual property that is wholesaled to distributors. The only reason why the destination principle of UDITPA does not apply is that the product that is manufactured is intangible rather than tangible.

Because content providers manufacture intangible property and/or provide advertising services, they are excluded from UDITPA's destination principle and instead are covered by its controversial "all or nothing" costs of performance rule. To avoid that rule, some states adopted an audience factor to assign the receipts of content providers. The earliest states adopted an audience method in the 1980's and some other states followed suit. No legislature, however, has adopted an audience factor since 2004, perhaps because the approach suffers from both conceptual and, more recently, administrative problems.[26]

Nonetheless, the Massachusetts Department of Revenue has recently resurrected an audience factor through a regulation. The Massachusetts Legislature provides that sales other than the sale of tangible personal property are in that State and thus included in the numerator of the Massachusetts sales factor, if "the corporation's market for the sale is in the commonwealth."[27] The statute further provides that "a corporation's market for the sale" is considered to be in Massachusetts "in the case of a service, if and to the extent the service is delivered to a location in the commonwealth."[28]

Under the auspices of this statute, the Department of Revenue recently adopted a regulation providing that "in the case of the direct or indirect delivery of advertising on behalf of a customer to the customer's intended audience by electronic means, the service is delivered in Massachusetts to the extent that the audience for such advertising is in Massachusetts."[29] Accordingly, the regulation adopts a "look through rule," presumably in an attempt to capture the location of the viewers. The regulation further provides that "[i]f the taxpayer cannot determine the state or states where the services are actually delivered to the end users . . . but has sufficient information regarding the place of delivery from which it can reasonably approximate the state or states where the services are delivered, it shall reasonably approximate such state or states."[30]

Conceptually, this regulation is defective because it conflates the advertiser's market with that of the content providers. The audience factor attempts to calculate the percentage of viewers by state, but these viewers are not the customers of the content providers. Moreover, this look through rule is exactly opposite the rule for sales of tangible personal property made to distributors. In that case, the sale would be assigned to the place of delivery to the distributor and not where the distributor resells the property as is true under a look through rule like an audience factor.

The audience factor is defective for administrative reasons as well. A content provider licensing its intellectual property to Hulu, Vudu, RIM, Amazon, Google, Yahoo, Apple, Netflix, DirecTV, or Dish TV, for example, will have no idea about either the billing address of its licensees' customers, or where such content might be viewed by these customers.[31] Passengers on Southwest Airline flights view movies distributed by Dish TV. The content providers have no idea over which states the viewers are located when they watch a movie. Anyone on Amtrak between Boston and Washington can observe riders watching a movie over the Internet while they pass through six states, or watching one that they downloaded over the Internet before starting.[32] Even the distributors themselves do not know where their viewers are located in these cases—and if they did, the information would not have to be shared with the content providers and might well be viewed as proprietary.

Even if it could be administered--which it cannot--an audience factor is conceptually defective because it focuses not on the customers and market of the content providers, but rather on the customers of their customers. In other words, the viewers are not customers of the content providers—they are the customers of: the local broadcast affiliates; the local cable affiliates; the Internet distributors like Hulu, Vudu, RIM, Amazon, Google, Yahoo, Apple, or Netflix; or satellite distributors like Dish TV or DirecTV. An audience factor would also have to take into account the international customers of the satellite distributors and the Internet distributors, which constitute a growing market.[33]

For similar reasons, a population factor is also defective on both conceptual and pragmatic grounds. A population factor would assign receipts of a content provider using the relative population of a state. If a state has three percent of the country's population, for example, three percent of the receipts of a content provider would be assigned to the numerator of that state's sales factor.

Conceptually, this approach suffers from the same defect as the audience factor. Even if one assumes that the viewers of the movies and programs produced by the content providers are uniformly distributed by relative population, this approach focuses not on the customers of the content providers, but rather on the customers of their customers. The viewers are not the customers of the content providers.

But the assumption that the viewers are distributed by relative population of the states is wrong in many situations. Movies and shows, with their related advertising, are directed at different racial or ethnic groups, gender groups, age groups, religious groups, political groups, geographical groups, sports fans, music fans and the like. These demographic targets do not necessarily mirror a state's relative population.[34]

To complicate matters further, companies like Hulu, Amazon, Google, Yahoo, Apple, Netflix, DirecTV, or Dish TV have international customers, which are an expanding market.[35] A state's relative population of the United States would ignore the non-U.S. viewers, thus overstating a particular state's share of viewers. Taken together, the conceptual and pragmatic defects are fatal to using relative U.S. population for purposes of attributing the receipts of the content providers and raise constitutional questions.

The goal of the sales factor should be to assign the receipts of a content provider based on the location of its customers, which represents its market. The sales factor should rely on information that is directly knowable by the content provider and that can be verified by a tax administrator. Receipts should be attributed to a state without undue difficulty and should not be easily manipulated by taxpayers.

A more reasonable and compelling approach that satisfies these criteria is to use the state of the customer's commercial domicile, the principal place from which the trade or business of the customer is directed or managed.[36] Consequently, it is the place where the customer exercises control over the programs and movies provided by the content provider and where decisions about advertising would typically be made.

The commercial domicile is the counterpart of the destination rule used for tangible personal property. Just the way control and possession over tangible personal property take place in the destination state, control and possession over the programs or movies provided by the content providers are likely to occur at their customers' commercial domiciles, as will decisions about advertising.

The state of the customer's commercial domicile also satisfies other criteria for an acceptable sales factor. It would be only by chance if the customer's state of commercial domicile overlapped in any significant degree with the state of the content provider's payroll or property, thereby avoiding a perceived defect with the costs of performance rule.

The commercial domicile of any publicly traded corporation can be easily determined through annual reports or schedules filed with the Securities and Exchange Commission. Indeed, even without resort to these documents, the commercial domiciles of major advertisers or distributors are generally known in state tax circles.

The commercial domicile is a brick and mortar location, often involving hundreds of thousands of square feet and thousands of employees. Changing a commercial domicile is a very serious and costly matter. No customer of a content provider will purposely change its commercial domicile at the request of a content provider. Consequently, the commercial domicile of a customer cannot be easily manipulated by a content provider.[37]

Assigning receipts based on the state of the commercial domicile of a content provider's customer provides stability, predictability, and certainty. Commercial domiciles rarely change. The brick and mortar location of a commercial domicile is independent of technological developments, changes in the business model of content providers, or innovations in the Internet. It is free of all of the defects that infect the current approaches.

Depending on the state, the commercial domicile rule could be implemented through legislation or under existing law by regulation or through equitable apportionment provisions.

Unlike UDITPA's costs of performance rule, which is likely to assign all of the receipts to a particular state, a commercial domicile rule will assign the receipts from each of the content provider's customers to different states. For example, some of the Fortune 500 and their states of commercial domicile include Office Depot (Florida), Eli Lilly (Indiana), McDonalds (Illinois), Principal Financial Group (Iowa), Staples (Massachusetts) and Lowes (North Carolina). Assigning receipts based on the customer's state of commercial domicile will apportion the business income of a content provider to more states than will UDITPA's costs of performance rule.

IV. CONCLUSION

Assigning the sales and receipts of a content provider based on the state of the commercial domicile of its customer would modernize the apportionment formula, consistent with the principles of corporate income taxation.

The use of a commercial domicile rule would bring stability, predictability, and certainty into the income taxation of content providers, enhancing a state's business climate and providing a reliable source of revenue.

The rule would be easily implemented by taxpayers, cannot be easily manipulated, and is easily verifiable by tax administrators. It would capture the actual location of the customers, which constitute the market of the content providers.

The rule is free from the conceptual and administrative defects that plague other approaches, such as an audience factor or a population factor. Assigning sales based on the customer's commercial domicile would greatly reduce litigation and would free a policy maker from the need for constant tinkering with the tax law every time a technological innovation leads to a new way of doing business for a content provider. This approach has already been adopted by some states.

FOOTNOTES

1. The four national broadcast networks (NBC, ABC, Fox, and CBS) own some local TV stations, but most local stations are not owned by these four. The local TV stations are sometimes referred to in the industry as "affiliates" and the agreements between them and the national broadcast networks are referred to as "affiliation agreements." The term "affiliate," however, is not intended to denote common ownership or control between the networks and the local TV stations.

2. National cable operators typically have numerous local cable systems, operating as affiliates under franchises granted by the localities in which they do business. National cable operators receive content with embedded advertising from the content providers, and provide that as part of a bundled package to their local cable systems which, in turn, sell packages directly to subscribers throughout the country. These subscribers are the actual viewers of the content and advertising wholesaled to the national cable operators by the content providers.

3. Satellite television operators sell packages to subscribers throughout the world.

4. The Internet distributors allow viewers to purchase content, rent it, or stream it live. Many of the viewers of the Internet distributors are also cable customers (notwithstanding that some cable customers can also watch programs remotely).

5. In 2007, the Uniform Law Commission (ULC), the successor to the group that adopted UDITPA, started a project to revise it. Two reporters to the project were appointed, one of whom is the author of this Paper. In 2009, after considerable public controversy, the ULC abandoned its efforts. In the same year, the Multistate Tax Commission (MTC) stepped into the breach and started a project to suggest revisions to five areas of UDITPA. The author of this Paper served as the Hearing Officer to the MTC. See Report of the Hearing Officer, Multistate Tax Compact Article IV, Proposed Amendments, published by Tax Analysts. On July 30, 2014, the Executive Committee of the MTC approved a number of changes to the language of UDITPA. Suggested revisions by the MTC have no legal status; they must be adopted by a legislature to become that state's law.

6. For a fuller discussion, see Richard D. Pomp, State and Local Taxation, 7th ed., 2011, Ch. 10.

7. Sections 9-17, UDITPA. For a fuller discussion, see Pomp, supra note 6.

8. Income taxable by a state is the amount of the corporation's total business income that is apportioned to the taxing state.

9. The sales factor is the ratio between a corporation's sales in the taxing state divided by its sales everywhere.

10. The payroll factor is the ratio between a corporation's payroll in the taxing state divided by its payroll everywhere.

11. The property factor is the ratio between a corporation's property in the taxing state divided by its property everywhere.

12. UDITPA has special rules for nonbusiness income, which are not relevant to this Paper. For a discussion of those rules, see Pomp, supra note 6.

13. Compared with an evenly-weighted three-factor formula, a double-weighted sales factor results in increased tax on some corporations and decreased tax on others and has no effect on corporations that conduct all of their activities in the state. The tax effect depends on the mathematical relationship between the sales factor and the property and payroll factors. More specifically, corporations whose sales factors are less than the average of their property and payroll factors benefit from a double-weighted sales factor; other interstate corporations are disadvantaged. The former describes, for example, corporations with the bulk of their property and payroll in a state that sell outside that state.

14. Compared with a double-weighted sales factor, a single sales factor provides even greater tax benefit to corporations that are primarily producing inside the taxing state and selling outside that state.

15. Section 16, UDITPA.

16. In idiosyncratic situations involving the peculiar structure of a particular industry, the "distributor" may be an agent of the manufacturer, in which case a sale by the manufacturer might be assigned to the ultimate customer. This situation has nothing to do with content providers.

17. The Executive Committee of the MTC is suggesting a "look through" rule in the case of marketing intangibles. See Report of the Hearing Officer, supra note 5, at 51-54.

18. Section 17, UDITPA.

19. Criticism of the "all or nothing" approach has led some states to attribute receipts to a state in proportion to the costs of performance incurred in that state. To illustrate, consider the situation in the text where a multistate service provider has 4% of its costs of performance in State A and 3% of its costs of performance in each of 32 other states. Under a proportionate costs of performance rule, the taxpayer would assign 4% of its gross receipts to State A and 3% to each of the 32 other states. For other suggestions about changing UDITPA's costs of performance rule, see Report of the Hearing Officer, supra note 5, at 66-69.

20. For a rarefied discussion of the differences among the use of a license, the licensing of an intangible, and the sale of intellectual property, see TGS-NOPEC Geophysical Co. v. Combs, 340 S.W.3d 432 (Tex.2011).

21. See Report of the Hearing Officer, supra note 5, at 46-54.

22. For a fuller discussion, see Report of the Hearing Officer, supra note 5, at 14-28.

23. William Vickrey, The Corporate Income Tax in the U.S. Tax System, 73 Tax Notes 597, 602 (1996).

24. The national broadcast and cable networks like Fox, CBS, CNN, MSNBC and ESPN deal with national advertisers; local businesses that wish to advertise deal with the local broadcast affiliates and not the content providers. Similarly, local businesses deal with the local affiliates of the national cable operators and not with the content providers.

25. See supra note 2.

26. California and New York, the first states to adopt an audience method, continue to be the headquarters of all of the major content providers. Because the principal business operations of the providers were in California and New York, those two states adopted the audience method as an economic incentive to encourage the industry to maintain and grow their businesses there. This method mitigated the harsh effects of California's all or nothing costs of performance rule or of New York's proportional costs of performance rule.

27. Chapter 63, Section 38(f), as amended by St. 2013, c. 46, s. 37 (effective 2014).

28. Id.

29. 830 CMR 63.38.1(9)(d)4.c.ii(C).

30. Id.

31. The well-known Nielsen ratings do not cover Internet distribution or satellite distribution but only cable operators and local television stations. Even in that case, the ratings are not refined enough for easy use as an audience factor. Nielsen ratings are based on geographic areas that are not coterminous with the boundaries of states (or of the District of Columbia). For example, the ratings for the Boston area include parts of New Hampshire and Vermont. The ratings for the District of Columbia area cover five states and the Philadelphia area covers three states.

32. It is estimated that nearly a majority of the U.S. population will watch full episodes of television programs digitally every month in 2014. U.S. Digital Viewers, eMarketer, April 16, 2014. U.S. advertising revenues from television content grows larger every year because of content viewed on the Internet. U.S. Internet Ad Revenue Surpasses Broadcast, Associated Press, April 10, 2014.

33. See infra note 35.

34. See Report of the Hearing Officer, supra note 5, at 53.

35. According to Netflix's 2013 Form 10-K, it has more than 44 million streaming members in over 40 countries enjoying more than one billion hours of TV shows and movies per month. While some of this is content Netflix created itself, most is acquired from content providers. Id. at 1, 18, 48. DirecTV has 17.6 million subscribers in Latin America. DirecTV 2013 Form 10-K, p. 13.

36. UDITPA defines "commercial domicile" to mean the principal place from which the trade or business of the taxpayer is directed or managed. Section 1(b), UDITPA.

37. The concept of a commercial domicile is a long-standing feature of both corporate and tax law, which has not been abused. The states should be able to deal with any possible manipulation of the concept.