



Officers, 2016-2017

Amy Thomas Laub
Chair
Nationwide Insurance Company

Arthur J. Parham, Jr.
Vice Chair
Entergy Services, Inc.

Robert J. Tuinstra, Jr.
Secretary & Treasurer
E.I. DuPont De Nemours
and Company

Theodore H. Ghiz, Jr.
Past Chair
The Coca-Cola Company

John J. Pydyszewski
Past Chair
Johnson & Johnson

Bobby L. Burgner
Past Chair
General Electric Company

Robert F. Montellione
Past Chair
Prudential Financial

Douglas L. Lindholm
President
Council On State Taxation

Directors

Barbara Barton Weiszhaar
HP Inc.

Deborah R. Bierbaum
AT&T

Benjamin Bright
HCA Holdings, Inc.

Paul A. Broman
BP America Inc.

Michael F. Carchia
Capital One Services, LLC

Tony J. Chirico
Medtronic, Inc.

Susan Courson-Smith
Pfizer Inc.

Meredith H. Garwood
Charter Communications

Denise J. Helmen
General Mills

Frank G. Julian
Macy's Inc.

Beth Ann Kendzierski
Apria Healthcare, Inc.

Kurt Lamp
Amazon.Com

Mollie L. Miller
Fresenius Medical Care
North America

Rebecca J. Paulsen
U.S. Bancorp

John H. Paraskevas
Exxon Mobil Corporation

Frances B. Sewell
NextEra Energy, Inc.

Warren D. Townsend
Wal-Mart Stores, Inc.

Frank A. Yanover
GE Capital Americas

David C. Sawyer
Tax Counsel
(202) 484-5226
DSawyer@cost.org

March 9, 2017

Representative Joe Jett
Chair, House Revenue and Taxation Committee
Arkansas House of Representatives
Little Rock, AR 72201

Re: COST Opposes the “Throwout” Provision in H.B. 2100

Dear Chairman Jett and Members of the Committee:

On behalf of the Council On State Taxation (COST), I am writing to oppose the “throwout” provision in H.B. 2100. This legislation would repeal Arkansas’ current cost-of-performance method for sourcing of services and intangibles and adopt market-based sourcing for such sales. Although COST does not take a position regarding cost-of-performance versus market-based sourcing, COST is opposed to the throwout provision in this legislation.

COST is a nonprofit trade association consisting of approximately 600 multistate corporations engaged in interstate and international business. COST’s objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

The “Throwout” Provision Should Be Removed from H.B. 2100

The COST Board of Directors has adopted a formal policy statement against both throwback and throwout provisions.¹ That policy statement position is:

Throwback and throwout laws seek to require companies to pay tax in one state on income that another state has chosen not to tax or is legally unable to tax. A company’s tax liability in one state should not be measured by its tax in another state. Throwback and throwout rules also discourage investment in a state. Such rules must not be adopted and must be repealed where they presently exist.

Section 17(a)(4)(B)(iii)(c) of Section 1 of H.B. 2100, which contains the throwout provision COST opposes, states the following:

If the taxpayer is not taxable in a state to which a receipt is assigned under subsection 17(a) or subsection 17(b) of this article, or if the state of assignment cannot be determined under subsection 17(a) of this article or reasonably approximated under subsection 17(b) of this article, such receipt shall be excluded from the denominator of the receipts factor.

¹ In general, a throwback provision is used for sales of tangible personal property; under throwback, a sale to a “destination” state in which the taxpayer is not taxable is thrown back to the “origin” state’s sales factor numerator. A throwout provision is used with sales of services and/or intangibles; those sales are excluded from both the numerator and denominator of the sales factor.

“Throwout” Provision Contradicts Move to Market-Based Sourcing

Many states have moved to market-based sourcing to export their tax burden. In other words, instead of receipts being sourced to the location where the cost to perform a service occurred (origin location), receipts are sourced to the location of the customer (market location). Thus, in general, the tax liability of a service provider in Arkansas with the majority of its customers located outside of the State will be reduced if the State switches to market-based sourcing. In contrast, there is an increase in tax liability for an out-of-state service business with the majority of its income producing activities outside of Arkansas but its customers in the State. By including a throwout provision in a market-based sourcing statute, sales not taxable in another state or which cannot be assigned are excluded, or “thrown out,” of both the numerator and the denominator. Although COST does not take a position on whether a state should use cost-of-performance sourcing or market-based sourcing, sales that are “thrown out” will likely increase an Arkansas-based business’s sales factor in the State. Accordingly, by including a throwout provision, Arkansas would essentially be undermining the general rationale behind adopting market-based sourcing.

“Throwout” Provision Is Constitutionally Suspect

As noted above, the proposed throwout provision will generally require a business, when calculating its tax in Arkansas, to exclude sales made to customers in another state if the other state chooses not to tax that income or is prohibited from taxing that income by the U.S. Constitution or by a federal law. This goes against good tax policy. A business’s correct measure of tax in a state should be determined without reference to the taxes a business pays in other states. It is also inconsistent with the basic premise of fair apportionment.² Throwout must be limited to survive a constitutional challenge. Two cases in New Jersey that addressed New Jersey’s throwout provision, which was subsequently repealed, held: (1) only receipts where another state lacks the legal authority to impose an income tax can be subject to throwout and (2) to be “internally consistent” for purposes of the U.S. Constitution’s Commerce Clause, the taxing state’s position on what constitutes “substantial nexus” must be used to determine the legal authority to impose a tax, not the other states’ legal positions.³

Conclusion

COST strongly encourages this Committee to recommend that throwout provisions be excluded from any Arkansas market-based sourcing proposal.

Sincerely,



David C. Sawyer

cc: COST Board of Directors
Douglas L. Lindholm, President & Executive Director, COST
Randy Zook, President & CEO, Arkansas State Chamber of Commerce

² See COST’s Policy Statement on Throwback/Throwout, available at: http://cost.org/uploadedFiles/About_COST/Policy_Statement/Throwback-Throwout.pdf, citing Final Report, New Jersey Corporation Business Tax Study Commission, June 29, 2004, pp. 8-9.

³ See *Whirlpool Properties, Inc. v. Director, Div. of Taxation*, 208 N.J. 141 (N.J. 2011) and *Lorillard Licensing Co., LLC v. Director, Div. of Taxation*, Superior Court, App. Div. (Dec. 4, 2015), review denied, N.J. (June 17, 2016). The New Jersey legislature repealed its throwout provision effective July 1, 2010. To be internally consistent, a state’s tax, if theoretically imposed by every other state, would not result in duplicative taxation. See *Comptroller of the Treasury of Maryland v. Wynne*, 135 S. Ct. 1787, 1802 (2015).