



**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

**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

**C. 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. Helmken**  
General Mills

**Beth Ann Kendziarski**  
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.

**Nikki E. Dobay**  
Senior Tax Counsel  
(202) 484-5221  
[ndobay@cost.org](mailto:ndobay@cost.org)

April 5, 2017

Montana State Legislature  
Senate Taxation Committee

Via E-mail

**Re: COST Opposes the “Throwout” Provision in H.B. 511**

Dear Chairman Blasdel 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. 511. H.B. 511 among other things would repeal Montana’s 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 verses market-based sourcing, COST is opposed to the throwout provision.

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. 511**

The COST Board of Directors has adopted a formal policy statement against both throwback and throwout provisions.<sup>1</sup> 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.*

Subsection (17)(c) of Section 1, Article IV of H.B. 511, which contains the throwout provision COST opposes, states the following:

<sup>1</sup> COST’s Policy Statements are available at: <http://cost.org/Page.aspx?id=3140>. In general, a throwback provision is used for sales of tangible personal property and a sale to a “destination” state which the taxpayer is not taxable is thrown back to the “origin” state. A throwout provision is used with sales of services and/or intangibles for sales which cannot be sourced to a specific location; those sales are excluded from both the numerator and denominator of the sales factor.

If the taxpayer is not taxable in a state to which a receipt is assigned under subsection (17)(a) or (17)(b), or if the state of assignment cannot be determined under subsections (17)(a) or reasonable approximated under subsection (17)(b), such receipt shall be excluded from the denominator of the receipts 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 Montana 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 business with the majority of its income producing activities outside of Montana 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 Montana based business’s sales factor to the State. Accordingly, by including a throwout provision, Montana would essentially be negating 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 Montana, 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.<sup>2</sup> 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, 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.<sup>3</sup> Thus, based Montana imposes income tax on businesses with no physical presence in the State (*i.e.*, merely having an economic presence in the State) the State will be hard pressed to throw out any sales.<sup>4</sup>

---

<sup>2</sup> See COST’s Policy Statements are available at: <http://cost.org/Page.aspx?id=3140>, citing Final Report, New Jersey Corporation Business Tax Study Commission, June 29, 2004, pp. 8-9.

<sup>3</sup> 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). 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).

<sup>4</sup> See Mont. Cd. Ann. § 15-31-101.

**Conclusion**

COST strongly encourages this Committee to recommend that the throwout provision be excluded from Montana’s market-based sourcing statute.

Sincerely,

A handwritten signature in black ink, appearing to read "Nikki E. Dobay". The signature is fluid and cursive, with a long horizontal stroke at the end.

Nikki E. Dobay

cc: COST Board of Directors  
Douglas L. Lindholm, President & Executive Director, COST