



Alternative Apportionment

Policy Position

Position: *The utilization of an alternative apportionment method by a taxpayer or tax administrator should be allowed only in unusual or unique situations where a state's statutory apportionment formula does not fairly represent the extent of a taxpayer's activity in the state. An alternative apportionment statute should include procedural safeguards that impose the burden of proof on the moving party, prohibit the imposition of penalties on a taxpayer that follows the statutory apportionment formula, and require a tax administrator to adopt regulations before imposing alternative apportionment on an industry-wide basis.*

Explanation: In recent years, alternative apportionment (sometimes referred to as “equitable apportionment”) has become a contentious battleground between taxpayers and tax administrators. In part this reflects momentous changes in corporate apportionment formulas as states move away from the traditional evenly weighted three-factor UDITPA apportionment method (property, payroll and sales) to formulas that rely more heavily or entirely on the sales factor. It is also driven by the increased frequency with which results-oriented tax administrators invoke alternative apportionment simply because they believe the statutory apportionment formula does not produce a high enough income tax from a particular taxpayer or industry.

The growth in the use of alternative apportionment highlights the importance of developing reasonable and balanced rules for determining its appropriateness and policing its application in a given case. While a small number of states have adopted rules that provide procedural safeguards for alternative apportionment, most states have no rules or lack clarity in their positions. The inclusion of procedural safeguards in alternative apportionment statutes is an essential underpinning for the legitimacy and fairness of this increasingly important component of state income tax laws.¹

To that end, COST believes the following requirements should be included in any alternative apportionment statute:

- Alternative apportionment may only be utilized by a taxpayer or tax administrator in unusual or unique situations where a state's traditional apportionment formula does not fairly represent the extent of a taxpayer's activity in the state.
- The party seeking to invoke alternative apportionment has the burden of proof that the statutory apportionment formula does not fairly represent the extent of the taxpayer's activity in the state – with the same standard applying to the taxpayer and to the tax administrator.

¹ See generally Report of the Hearing Officer, *Multistate Tax Compact Article IV [UDITPA] Proposed Amendments*, October 25, 2013, Section III B.

- If the tax administrator requires a taxpayer to use an alternative apportionment method, the tax administrator is prohibited from imposing a penalty on a taxpayer that complied with the statutory apportionment method.
- The tax administrator is prohibited from retroactively revoking prior approval of a taxpayer's alternative apportionment method, absent a change in fact or a taxpayer misrepresentation.
- The tax administrator must promulgate a regulation before invoking alternative apportionment for an industry or a transaction or activity of general applicability.

COST has long supported proposals aimed at improving state tax administration by providing more clarity and a level playing field for both taxpayers and state tax administrators. COST views the procedural safeguards on alternative apportionment as consistent with similar administrative rules for which it has previously advocated, including even-handed statutes of limitations for refunds and assessments, equalized interest rates on refunds and assessments, and transparency in guidance and rulings. The inclusion of these procedural safeguards in an alternative apportionment statute will help ensure that this “safety valve” provision is accepted by both taxpayers and tax administrators as fair, balanced and appropriately limited in scope.