

July 8, 2024

Via E-Mail @ bhamer@mtc.gov

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444 North Capitol Street NW, Suite 425
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Re: Model Sourcing Regulations – Ground Transportation and Product Delivery Services

Dear Brian:

We appreciate the MTC's request for additional comments regarding the model sourcing regulations for receipts from ground transportation and product delivery services. We write to express our concerns with the MTC's June 2, 2024 draft rule ("Draft Rule"); the June 24, 2024 meeting to discuss the Draft Rule; and the project generally.

At the Uniformity Committee's August 2022 meeting, the committee agreed to undertake a project and form a work group to review its special industry model receipts (sales) sourcing regulations for income apportionment purposes because of the MTC's change to market-based sourcing. The project's purpose was to review whether these special industry rules were based on the old costs of performance rule or whether they were consistent with market-based sourcing. MTC staff selected the special rule for trucking companies for initial review and stated that its goal was to (i) evaluate the mileage model sourcing regulation to determine if there were any issues with the rule, (ii) whether it was more akin to a costs of performance based rule or a market-based sourcing rule, and (iii) if there was a need to change the rule. In our view, the work group has not met any of these directives.

1. The MTC failed to identify issues with the mileage rule

Since 2022, the MTC held nearly a dozen meetings. These meetings were attended by state representatives and MTC staff who identified only two instances of "issues" with the current 40 year-old model rule. See *Montana Dep't Rev. v. United Parcel Serv.*, 830 P.2d 1259 (Mont. 1992); *United Parcel Service Inc. (Ohio) & Affs. v. New Mexico Dep't Rev.*, 535 P.3d 715 (N.M. Ct. App. 2023). In both of these cases, the issue in dispute was not related to the mileage rule generally or whether it reflected the market for transportation services, the issue was the state's application of the mileage rule. In *UPS v. New Mexico*, a key reason for the distortion was New Mexico's attempt to include third-party miles (trains passing through New Mexico carrying UPS's trailers) in the mileage apportionment formula. The court held for UPS because New Mexico's application of the rule significantly overstated UPS's business activities in the state.

Besides these two cases, neither the MTC nor the few state representatives advocating for a new model rule, have identified any other issues with the mileage rule.

2. State representatives have different views of how best to reflect the "market" for transportation and product delivery services

Throughout the project, state representatives have disagreed regarding whether the current mileage rule accurately reflects the market for transportations services. Some state

representatives believe the mileage rule was adopted to reflect the “market” because the MTC’s costs-of-performance rule did not work for transportation services. Certain MTC staff and a few state representatives expressed a view that there are issues with the mileage rule and proposed several alternatives that they believe better reflect the “market”. Each alternative proposed had its own issues, and in no case was it shown that any alternative proposal did a better (or even good) job of reflecting the market for transportation services.

The disagreement regarding the market seems to stem from a misunderstanding about what transportation services are and how such services are provided. Is the service only the pick-up and drop-off of a package? Is it only the drop-off? Or, is the service the entire transportation – the moment the package is collected until and through the delivery? Industry representatives have continuously made clear that the service their customers contract for is the collection, transportation, and delivery of a package throughout and including each moment the service provider is in possession of the package. And the service includes all aspects of transportation, such as rerouting a package to avoid inclement weather.

Sourcing all receipts to the package recipient’s location does not reflect the market for transportation services. It disregards that the transportation service is provided from the time the package is picked up until it is dropped-off because the service is provided the entire time the package is in the service provider’s possession. Moreover, recipient-based sourcing ignores the transportation company’s customer. Very often the transportation company does not have a contractual relationship with the person to whom the package is delivered. Thus, a destination rule would source revenue to the customer of the transportation company’s customer, creating a quasi-look through form of sourcing revenue.

Selecting the drop-off location does nothing other than source more revenue to highly/densely-populated states. Unsurprisingly, only a few MTC staff and certain members of population-dense states are of the opinion that a recipient-based rule reflects the market. Whereas the majority of the work group’s discussions have concluded that miles accurately reflects the market for transportation services.

Unable to determine any issues with the mileage rule, and the market for package delivery services, the work group ignored the Uniformity Committee’s directive and proposed multiple versions of an *alternative* rule. First, the MTC proposed using the pick-up/drop-off location of the package or individual. And then 30-days later, the MTC moved to the drop-off location only. The MTC has claimed that this change was necessary to ensure the rule applied equitably. It strikes us as arbitrary to move from one rule, which was discussed at length for two years, to a new rule without any discussion or evidence of equitable application.

3. The MTC’s expansion of the rule is not workable

We are also concerned with the MTC’s latest attempt to expand the rule to cover additional types of service providers, such as logistics companies, freight forwarders, and marketplace facilitators. As we noted to the work group, a preliminary issue with including logistic companies, freight forwarders, and marketplace facilitators in this rule is that such service providers may not know the means of transportation services being used. Our understanding is that the MTC sought to be more equitable with its inclusion of some additional service providers that may interact with the industry. Despite this “equitable” approach, the Draft Rule excludes railroads, planes, barges. Essentially, the MTC is singling out certain types of transportation services and providers for undisclosed reasons. To the extent the work group seeks to change the model rules, it would be helpful for all to understand the MTC staff’s reasoning for distinguishing among various types of transportation.

The issues associated with including some types of transportation providers and not others in the Draft Rule is illustrated by a simple example. Assume, a widget maker in Kansas uses a freight forwarder to transport its widgets to New York. Kansas and the states in-between Kansas and New York, including Missouri, Indiana, Ohio, and Pennsylvania, will not receive any

revenue from the company that physically transports the package or the freight forwarder. Instead, New York will receive all of the revenue from both the freight forwarder and the transportation provider. The Draft Rule creates an opportunity for double-dipping and makes arbitrary distinctions between different forms of transportation services and service providers.

4. The Draft Rule conflicts with the MTC's mission to create uniformity

In addition to the substantive issues with the Draft Rule, the Draft Rule undermines the MTC's stated goal to create uniformity and instead contributes to a lack of uniformity. Having a model rule that contains two alternatives is the opposite of uniformity.

Miles has been the model rule for this industry for almost half a century, and adopted by the majority of states. More than half of the states that have participated in the work group stated that their respective state will not depart from a miles rule. In an effort to create an "equitable" rule, the MTC will now have two model rules for trucking companies and different model rules for other transportation service providers? This too is the opposite of uniformity and equity.

5. The Draft Rule creates winners and losers

The MTC seems to acknowledge that there will be winners and losers using either pick-up/drop-off or drop-off only because the MTC included a mediation provision. And particularly, what has been said time and time again, is that having two alternative rules will result in taxation chaos.

We have continued to express our concern with the mediation provision, which the MTC refuses to address. It strikes us as punitive to require a taxpayer who wants to take advantage of mediation to be required to turn over confidential agreements with other states.

6. The work group should clarify the role of state participants

Finally, we request clarification regarding state representatives' participation in the work group. During the June 24, 2024 meeting, representatives from California, who spearheaded the Draft Rule and have continued to push for this rule despite the lack of interest from other state participants, stated that California was not pushing for the Draft Rule in an effort to obtain additional tax revenue. We do not take issue with the representatives' statements or dispute this response. Our issue, however, is that we would like clarification that when a state representative voices an opinion, or votes in favor of a rule, that their intent is to suggest that the state adopt the rule. State representatives that vote with the work group are policy makers within their respective tax and revenue departments. It strikes us as problematic that state representatives would vote for a rule that they would not advocate their own state adopt.

We appreciate the work group's efforts thus far. Based on the above, we respectfully request that the work group put aside the Draft Rule or provide time for additional consideration of these issues while the work group tackles other priorities. Thank you for your consideration.

Respectfully,



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