

NO. CV-24-8

IN THE ARKANSAS SUPREME COURT

**JIM HUDSON, IN HIS OFFICIAL
CAPACITY AS SECRETARY AND
DIRECTOR OF THE ARKANSAS
DEPARTMENT OF FINANCE
AND ADMINISTRATION**

APPELLANT

vs.

MURPHY OIL USA, INC.

APPELLEE

**ON APPEAL FROM THE CIRCUIT COURT OF
UNION COUNTY, ARKANSAS**

HONORABLE SPENCER G. SINGLETON, CIRCUIT JUDGE

**BRIEF OF *AMICUS CURIAE* MULTISTATE TAX COMMISSION IN
SUPPORT OF APPELLANT**

Timothy J. Leathers
Ark. Bar No. 78090
20 Victoria Circle
Maumelle, AR 72113
Telephone: (501) 786-2242
timleathers@timleathers.com

Lila D. Disque
Counsel of record
Chris Barber
Jonathan White
Jennifer Stosberg
Multistate Tax Commission
444 N. Capitol St., NW, Ste. 425
Washington, DC 20001
Telephone: (202) 660-1906
ldisque@mtc.gov

Counsel for *amicus curiae*

TABLE OF CONTENTS

TABLE OF AUTHORITIES.....	3
INTEREST OF THE <i>AMICUS CURIAE</i>	6
ARGUMENT	7
I. UDITPA was a triumph of interstate cooperation in ensuring the fair and consistent apportionment of unitary income among competing jurisdictions, benefitting taxpayers and the states.....	7
II. UDITPA’s concept of business income is broad and reflects the economic realities of the unitary business principle.	10
A. UDITPA’s transactional test and functional test operate in conjunction to define the scope of a unitary business, but either will suffice to establish the nature of income as “business income.”	11
B. The definition of “business income” has come to reflect the fact that when a multistate business has only one unitary business, all income from that unitary business is business income.	13
C. Under the matching principle, expenses that relate to the unitary business should be subject to the same rules of apportionment as income that relates to the unitary business.	18
III. Uniform application of UDITPA is relevant to this case and necessary to achieve an equitable result.	19
A. Arkansas’s version of UDITPA should be interpreted under the rules of construction of uniform laws.....	19
B. Interpreting UDITPA inconsistently with other states would distort taxpayer’s income allocated to Arkansas and create considerable uncertainty for other taxpayers.	22
CONCLUSION	24

TABLE OF AUTHORITIES

A. Cases

<i>Allied-Signal, Inc. v. Director, Div. of Tax'n</i> , 504 U.S. 768 (1992)	15, 16, 17, 18
<i>Amerada Hess Corporation v. Director, Div. of Taxation</i> , 490 U.S. 66 (1989)	18
<i>American Honda Motor, Co. v. Walther</i> , 2020 Ark. 349, 610 S.W.3d 633 (2020)	21
<i>ASARCO, Inc. v. Idaho State Tax Comm.</i> , 458 U.S. 307 (1982)	16, 17
<i>Atl. Richfield Co. v. Dep't of Revenue</i> , 717 P.2d 613 (Or. 1986)	19
<i>Blue Bell Creameries, L.P. v. Roberts</i> , 333 S.W.3d 59 (Tenn. 2011)	16
<i>Container Corp. of America v. Franchise Tax Bd.</i> , 463 U.S. 159 (1983)	8, 15
<i>Dows v. City of Chicago</i> , 11 Wall. 108 (1871).....	9
<i>Estate of Ashman v. Commissioner</i> , 231 F.3d 541 (9th Cir. 2000)	21
<i>Gannett Co., Inc. v. State Tax Assessor</i> , 959 A.2d 741 (Me. 2008).....	21
<i>Gannett Satellite Info. Network, Inc. v. Montana Dep't of Rev.</i> , 201 P.3d 132 (Mont. 2009).....	19

<i>Mobil Oil Corp. v. Comm’r of Taxes of Vt.</i> , 445 U.S. 425 (1980).....	16
<i>Moorman Mfg. Co. v. Bair</i> , 437 U.S. 267 (1978).....	11
<i>Nat. Private Truck Council, Inc. v. Oklahoma Tax Commission</i> , 515 U.S. 582 (1995).....	9
<i>Pledger v. Getty Oil Exploration Company</i> , 309 Ark. 257, 831 S.W.2d 124 (1992)	12
<i>Polaroid Corp. v. Offerman</i> , 507 S.E.2d 284 (N.C. 1998).....	13
<i>Revenue Cabinet v. Rohm & Haas Kentucky, Inc.</i> , 929 S.W.2d 741 (Ky. Ct. App. 1996).....	20
<i>UBS Financial Servs., Inc. v. Levin</i> , 893 N.E.2d 811 (Ohio 2008).....	23

B. Statutes and Rules

7A U.L.A. 91 (1957) (Uniform Division of Income for Tax Purposes Act).....	<i>passim</i>
Ark. Code Ann. § 26-51-719 (Repl. 2020).....	19
Uniform Statute and Rule Construction Act §18(b) (Unif. L. Comm’n 1995).....	19

C. Books and Treatises

Hellerstein, Hellerstein & Appleby, <i>State Taxation</i> (Thomson Reuters/Tax & Accounting, 3rd ed. 2001, with updates through December 2023) (online version accessed on Checkpoint May 16, 2024)	9, 12, 14, 23
---	---------------

D. Miscellaneous

H.R. Rep. No. 952, 89th Cong., 1st Sess., Pt. VI (1965)) 9

Joe Huddleston and Shirley K. Sicilian, *Should UDITPA Be Revisited?*
The State and Local Tax Lawyer. Symposium Edition, 2009/10..... 8, 9, 10

Multistate Tax Commission Adopts Uniformity Recommendations for UDITPA,
2014 STT 148-9..... 13, 15

Multistate Tax Compact *passim*

Pomp Releases MTC Hearing Officer’s Report on UDITPA Reforms,
2013 STT 209-35 13

Uniform Division of Income for Tax Purposes Act, 7A U.L.A. § 1,
Comment (1966), *reprinted in 2 Multistate Corporate Income*
Tax Guide (CCH) par. 8805..... 12

Walter Hellerstein, *The Business-NonBusiness Income Distinction and the*
Case for its Abolition,
92 TAX NOTES 1701 (Sept. 24, 2001) 24

INTEREST OF THE *AMICUS CURIAE*

The Multistate Tax Commission (“MTC” or “Commission”) is an intergovernmental state tax agency working on behalf of states and taxpayers to facilitate the equitable and efficient administration of state tax laws that apply to multistate and multinational enterprises. The Commission is charged with administering the Multistate Tax Compact (“Compact”), to which Arkansas is a party.

At issue in this appeal is whether a taxpayer can allocate one hundred percent of its interest expense to one state—from indebtedness financing a spinoff of the taxpayer’s operations in 24 states—while simultaneously apportioning this same expense to the remaining 23 states as being necessary to the operation of that same unitary business. The MTC has a significant interest in this appeal because it involves, in part, the application of the Uniform Division of Income for Tax Purposes Act (“UDITPA”). UDITPA is a model law used to determine the tax liability of a multistate business. Article IV of the Compact incorporated UDITPA almost word for word, and Article VII charges the Commission with interpretation of UDITPA through promulgation of model uniform regulations. Under that authority, in 2014, the MTC recommended changes to Article IV, UDITPA, in part, to clarify the definition of “business” (or “apportionable”) income.

The MTC has worked to increase uniformity and improve the administration of multistate business taxation by drafting model tax laws and regulations through a

public process that involves taxpayers and tax agency representatives, by providing training and legal advice to state tax agencies, and by conducting joint state audits of multistate businesses. The Commission regularly files amicus briefs to help state and federal courts understand the greater context of the issues before them and the potential impacts on state tax jurisprudence across the country.

The MTC joins with Appellant, the Arkansas Department of Finance and Administration (“DFA”), in urging this Court to reverse the judgment below for the reasons stated in the DFA’s brief. We write separately to express our critical interest in the continued uniform interpretation of this provision, and to provide important context about the value of uniformity.

ARGUMENT*

I. UDITPA was a triumph of interstate cooperation in ensuring the fair and consistent apportionment of unitary income among competing jurisdictions, benefitting taxpayers and the states.

The purpose of UDITPA is to establish a system to fairly and uniformly apportion the income of multistate taxpayers to ensure that they are neither advantaged

* No counsel for any party authored this brief in whole or in part. Only *amicus curiae* MTC and its member states, through the payment of their membership fees, made any monetary contribution to the preparation or submission of this brief.

nor disadvantaged compared to their intrastate competitors. UDITPA hinges on the idea of the unitary business principle—the concept that the income and expense of a unitary business is too integrated to be effectively sourced on an item-by-item basis. The unitary business principle ignores the geographical locations at which separate-but-related business operations or transactions may take place, and instead, focuses on the practical reality that most large businesses generate their net income by operating across state borders. In order to divide the income from unitary businesses, UDITPA relies on formulary apportionment rather than geographic accounting and the related arm’s-length methodology, which the Supreme Court has recognized as vulnerable to manipulation and distortion. *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 181 (1983). Naturally, this formulary apportionment system depends on consistency in reporting and application to achieve its purposes.

UDITPA came about due to the evolution of modern business and a resulting need among states for a consistent method of handling interstate business income. In 1957, the National Conference of Commissioners on Uniform State Laws (the predecessor to what is now known as the Uniform Law Commission (“ULC”)) adopted UDITPA to provide a model formula for apportioning a multistate company’s income tax base among the several taxing jurisdictions in which the company does business. Joe Huddleston and Shirley K. Sicilian, *Should UDITPA Be Revisited?*, *The State and Local Tax Lawyer*. Symposium Edition, 2009/10, at 192. UDITPA

incorporated what was the existing practice in a number of states at the time: a distinction between income arising from the taxpayer's unitary business operated in the taxing state, which is apportioned using a formula, and non-unitary (non-business) income, which is allocated as a whole to the particular state from which that income originated. *Id.* at 194.

UDITPA evolved into an instrument to promote interstate uniformity and preserve state sovereignty. Although a few states—including Arkansas—adopted UDITPA early on, it was largely ignored by the states until persistent lack of uniformity led Congress to seriously consider preemptive legislation. *Id.* See also Hellerstein, Hellerstein & Appleby, *State Taxation* ¶ 9.01 (Thomson Reuters/Tax & Accounting, 3rd ed. 2001, with updates through December 2023) (online version accessed on Checkpoint May 16, 2024). Congress formed the Willis Committee, which performed an extensive study and recommended federal legislation to, among other things, establish a uniform state income tax base (using federal taxable income calculations) and a uniform state apportionment formula. Huddleston and Sicilian, *supra* at 195. (citing H.R. Rep. No. 952, 89th Cong., 1st Sess., Pt. VI, at 1139ff (1965)). The states rallied to head off federal intervention that threatened their taxing powers, a necessary and essential attribute of sovereignty. See, e.g., *Nat. Private Truck Council, Inc. v. Oklahoma Tax Commission*, 515 U.S. 582, 586 (1995), quoting *Dows v. City of Chicago*, 11 Wall. 108, 110 (1871). Many states adopted UDITPA directly

into their statutes, and some adopted it by enacting the Multistate Tax Compact. Huddleston and Sicilian, *supra*.

With state adoption of UDITPA, uniformity in state apportionment statutes increased significantly, and the creation of the Multistate Tax Commission greatly improved the likelihood for uniform interpretation of those statutes through adoption of model regulations. *Id.* at 196.

II. UDITPA’s concept of business income is broad and reflects the economic realities of the unitary business principle.

The broad definition of business income under UDITPA captures the full scope of a unitary business’s economic activities, ensuring that states tax a fair portion of income generated from integrated operations. This approach mirrors the real-life operation of businesses, where income results from a web of interconnected and interdependent transactions and activities undertaken across multiple states.

Soon after states began to adopt UDITPA, state courts were asked to interpret a number of its provisions. One of the most important, and most contested, provisions of UDITPA is the definition of “business income,” which defines the extent of the unitary tax base subject to taxation on an apportioned basis. The importance of the definition led to decades of litigation, particularly in the context of apportionment of capital gains and other types of investment-related income.

The Constitution requires states that impose income-based taxes on a multistate business to use some means to fairly determine the amount of the unitary business’

income attributable to the state. *See generally Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978) (States are given wide latitude in devising reasonable formulas for division of income.). UDITPA accomplishes this by first establishing the amount of each unitary business' "business income." That income is then apportioned among the states that have nexus with the unitary business. The remaining "nonbusiness income" is allocated to the state or states that have a particularized connection to that income sufficient to support taxation.

The result is that states are better able to tax the appropriate share of the income generated by the business's integrated operations within their borders. This method minimizes the opportunity for tax avoidance strategies that could arise if a business were able to isolate its more profitable operations or transactions in low-tax states while attributing those generating losses or less profitable activities to higher-tax states. In essence, the system ensures that the tax burden more accurately corresponds to the economic reality of how the business operates, acknowledging that the different parts of the business contribute to its overall profitability in an integrated manner.

A. UDITPA's transactional test and functional test operate in conjunction to define the scope of a unitary business, but either will suffice to establish the nature of income as "business income."

UDITPA defines "business income" as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition

of the property constitute integral parts of the taxpayer's regular trade or business operations." 7A U.L.A. 91 (1957). "In interpreting the meaning of the "business income" definition under UDITPA, particularly with regard to income from the disposition of business assets, courts have divided over the question of whether the two parts of the definition constitute a conjunctive or disjunctive test for resolving the "business income" issue. Hellerstein, Hellerstein & Appleby, *supra* ¶ 9.05[2].

In most states, including Arkansas, courts held that the definition of business income included both a "transactional" and a "functional" test, and that activities or transactions meeting either test were business income. *See Pledger v. Getty Oil Exploration Co.*, 309 Ark. 257 at 263, 831 S.W.2d 121 at 125 (1992) . Under the transactional test, income arising from transactions and activity in the regular course of the taxpayer's trade or business is business income. The second clause of the business income definition has been termed the "functional test," addressing transactions involving property that is used in (functionally related to) the taxpayer's unitary business. The existence of a separate functional test to include income from capital transactions is explicitly set forth in the official comments to UDITPA and is followed in a model regulation issued by the MTC in 1974. *See Uniform Division of Income for Tax Purposes Act*, 7A U.L.A. § 1, Comment (1966), *reprinted in 2 Multistate Corporate Income Tax Guide* (CCH) par. 8805; Multistate Tax Commission Allocation and Apportionment Regulations Reg. IV.1.(a)(4).

In a minority of jurisdictions, however, courts held that the definition of business income under UDITPA contained only the transactional test, thus excluding many types of capital transactions from the apportionable tax base. But in each instance, the decision was later overturned, or the legislature amended the statute to either explicitly include the functional test as a separate test, or to provide that business income is all income that is constitutionally apportionable. *Polaroid Corp. v. Offerman*, 507 S.E.2d 284, 295 (N.C. 1998). By incorporating a separate “functional” test, UDITPA’s business income definition results in income being apportioned or allocated in a manner more consistent with the full extent of states’ jurisdiction to tax under the Constitution, and in particular, in a manner more consistent with the application of the “unitary business principle” to multistate income.

B. The definition of “business income” has come to reflect the fact that when a multistate business has only one unitary business, all income from that unitary business is business income.

In response to the legislative trend of defining business income simply as “all income apportionable under the Constitution of the United States,” in 2014, the MTC recommended revisions to the definition of business income. *Multistate Tax Commission Adopts Uniformity Recommendations for UDITPA*, 2014 STT 148-9. The revisions adopted a constitutionally-based approach to defining apportionable income (and explicitly substituted the label “apportionable income” for “business income”). *Pomp Releases MTC Hearing Officer’s Report on UDITPA Reforms*, 2013

STT 209-35. Importantly, the MTC’s revision clarified that the functional test is a separate test, sufficient to constitute business income, and effectively put to rest the debate, or whatever is left of it, over the “transactional” versus the “functional” test. *See* Hellerstein, Hellerstein & Appleby, *supra* ¶9.05[1][c]. In part, this trend was a reaction to judicial decisions in a few states holding that income arising from the liquidation of a business cannot be included in business income. *Pomp Releases MTC Hearing Officer’s Report on UDITPA Reforms*, 2013 STT 209-35. The theory behind these decisions was that income cannot be “business income” if there is no longer any business. *Id.* The resulting problem was the mismatch between the allocation of gain from the sale of a unitary asset to a particular state and the previously deducted expenses, such as depreciation, associated with that asset which had been apportioned to multiple states. *Id.*

The MTC’s revision also clarified the scope of the functional test in four ways. First, it expanded the list of activities that describe how property can be integrated into a business, adding “employment” and “development” alongside “acquisition, management, and disposition.”

Second, it replaced “and” with “or” in the list of activities to specify that any one of these activities can integrate property into the business.

Third, it removed the word “regular.” Both the transactional and functional tests previously used “regular,” causing confusion about whether the word limited the

functional test to frequent transactions. Deleting “regular” would eliminate this confusion.

The fourth clarification required that the property be “related to the operation” of the taxpayer’s trade or business, rather than constituting an “integral part.” The term “integral” was open to various interpretations, while the phrase “related to the operation” was clear and aligned with language used by the U.S. Supreme Court to analyze business income. *See Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 (1983); *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992). The definition of “functional test” as finally adopted reads, “...income arising from tangible and intangible property if the acquisition, management, employment, development, or disposition of the property is or was related to the operation of the taxpayer’s trade or business.” Multistate Tax Compact, Art. IV.1(a), 2014 STT 148-9.

The expansions and revisions of the MTC revised model UDITPA discussed above demonstrate the importance of the functional test and the relationship between the entire definition of business income—transactional and functional tests—and the unitary business principle. That relationship being largely coterminous, the interpretation of business income has moved in a consistent direction—toward recognition that when a multistate business has only one unitary business, all income from that unitary business is business income. *See Blue Bell Creameries, L.P. v.*

Roberts, 333 S.W.3d 59, 71 (Tenn. 2011) (holding two entities to be unitary because both derive their income from a single underlying unitary activity). In fact, the U.S. Supreme Court has recognized that “[i]n the abstract, these definitions may be quite compatible with the unitary business principle.” *Allied-Signal*, 504 U.S. at 786.

In *Mobil*, the Court held that dividends arising from the taxpayer’s ownership of a foreign corporation were subject to apportionment, where the taxpayer failed to demonstrate that its foreign operations were not a “part of [its] integrated petroleum enterprise.” *Mobil Oil Corp. v. Comm’r of Taxes of Vt.*, 445 U.S. 425 (1980). In so holding, the Court supported the notion that apportionment may obtain for both operating (“transactional”) income and income arising from capital transactions such as dividend distributions: “So long as dividends from subsidiaries and affiliates reflect profits derived from a functionally integrated enterprise, those dividends are income to the parent earned in a unitary business ... and accordingly it ought not to affect the apportionability of income the parent receives.” *Id.* at 440-441.

In *ASARCO, Inc. v. Idaho State Tax Comm.*, 458 U.S. 307, 330 (1982), the Court noted that there is no constitutional basis for a distinction between dividends, capital gains such as those at issue in that litigation, and other types of income for purposes of apportioning the income of a unitary business. Thus, income from the disposition of unitary assets would meet the “functional” test under UDITPA, regardless of its character as dividends, capital gains, or another type of income.

Accordingly, apportioning the income would be constitutionally permissible because the property sold to generate the income was an integral part of the taxpayer's regular business.

By contrast, where income arises from dispositions of property that was not part of the taxpayer's "functionally integrated enterprise" (i.e., not part of its unitary business), that income cannot constitutionally be taxed as part of the net income subject to formulary apportionment. *See ASARCO, Inc. v. Idaho State Tax Comm.*, 458 U.S. 307 (1982) (capital gains and dividends from non-unitary subsidiaries could not be apportioned); *Allied-Signal, Inc. v. Director, Div. of Tax'n*, 504 U.S. 768 (1992) (income arising from a sale of investment assets which lacked connection to the taxpayer's unitary business conducted in New Jersey could not be subject to apportionment in that state). Income from the disposition of non-unitary assets would likewise not meet the "functional" test under UDITPA, because the property would not have been an "integral part of" the taxpayer's regular business, and would accordingly be subject to allocation.

The language and cases discussed above demonstrate the connection between the definition of business income and the unitary business principle and that the connection between the two depends on the existence and application of the functional test as part of the definition of business income.

C. Under the matching principle, expenses that relate to the unitary business should be subject to the same rules of apportionment as income that relates to the unitary business.

While UDITPA is designed to determine the source of net income of a unitary business—that is, income minus related expenses, UDITPA and its business income test only address the treatment of items of income. UDITPA does not address the specific treatment of related expenses like interest expense. In this absence, a matching principle should apply. Unitary income normally includes all income from a corporation’s unitary business activities but excludes income that “derive[s] from unrelated business activity which constitutes a discrete business enterprise,” *Allied-Signal*, 504 U.S. at 773. A similar rule accordingly applies to the expenses needed to generate unitary business income. Expenses to generate unitary business income cannot be localized but must be borne in proportion to the activities of the unitary business as a whole. For example, in *Amerada Hess Corporation v. Director, Div. of Taxation*, 490 U.S. 66, 67 (1989), the Supreme Court held that New Jersey did not need to provide a credit or deduction for windfall profits taxes levied on out of state oil and gas production where that production was part of the unitary business of the taxpayer conducted within the state.

III. Uniform application of UDITPA is relevant to this case and necessary to achieve an equitable result.

A. Arkansas’s version of UDITPA should be interpreted under the rules of construction of uniform laws.

UDITPA is a uniform state law. It is a recognized rule of construction that a uniform law should be interpreted to achieve its intended purpose. For example, Ark. Code Ann. § 26-51-719 (Repl. 2020) provides that UDITPA “shall be so construed so as to effectuate its general purpose to make uniform the law of those states which enact it.” Similarly, the Uniform Statute and Rule Construction Act §18(b) (Unif. L. Comm’n 1995) provides: “[a] statute that is intended to be uniform with those of other States is construed to effectuate that purpose with respect to the subject of the statute.”

In interpreting UDITPA, courts have followed this rule of construction, looking to UDITPA’s goals when reaching their decisions. For example, in *Gannett Satellite Info. Network, Inc. v. Montana Dep’t of Rev.*, 201 P.3d 132, 139 (Mont. 2009), the court rested its conclusion that UDITPA contains a separate functional test on “extrinsic aids, such as UDITPA’s legislative history, and UDITPA’s goals of promoting uniformity among states in the taxation of corporations.” *See also Atl. Richfield Co. v. Dep’t of Revenue*, 717 P.2d 613 (Or. 1986) (relying on UDITPA’s goal of uniformity and the treatment of the issue by other states to determine whether

intangible drilling and development costs should be included in the property factor); *Revenue Cabinet v. Rohm & Haas Kentucky, Inc.*, 929 S.W.2d 741, 745 (Ky. Ct. App. 1996) (relying on UDITPA’s goal of “ensuring uniformity” and the treatment of the issue of dock sales sourcing by other states).

Applying the rule of construction for uniform state laws to this case, Murphy’s position fails to uphold the intended UDITPA goals of uniformity and fair apportionment among states. Instead, Murphy seeks to treat interest expense inconsistently across jurisdictions and time periods, contrary to the principles of uniformity. In effect, Murphy’s position would result in a two-year nonbusiness characterization of interest—from indebtedness used to finance a spinoff of core operations—while simultaneously characterizing such interest as business expense in other states and in later years in Arkansas.

Furthermore, Murphy cannot point to any other jurisdiction that has concluded that its interest from indebtedness used to spinoff core operations should be characterized as nonbusiness. There is also no indication that Murphy has filed amended returns in other states seeking nonbusiness treatment.

Murphy contends that its filings in other states and how those states have handled the issue is irrelevant. Although the sovereign states may not recognize the same estoppel doctrine that federal courts have applied when there are inconsistencies outside the statute of limitations (*see Estate of Ashman v.*

Commissioner, 231 F.3d 541 (9th Cir. 2000)), however, Murphy’s inconsistency in filings—including its Arkansas filings—remains highly relevant to the case. As noted by the court in *Ashman*, “[t]he law should not be such a[n] idiot that it cannot prevent a taxpayer from changing the historical facts from year to year in order to escape a fair share of the burdens of maintaining our government. Our tax system depends upon self assessment and honesty, rather than upon hiding of the pea or forgetful tergiversation.” 231 F.3d at 544.

Consistency in state interpretations of UDITPA is important to ensuring that the incomes of multistate taxpayers are neither under-taxed nor subject to double taxation; consistency in reporting is equally important to achieving that end. UDITPA is premised on the assumption that taxpayers will apply its terms consistently in their filings across multiple UDITPA jurisdictions, just as the Compact promotes uniformity in state tax systems for the benefit of taxpayers. Accordingly, the court in *Gannett Co., Inc. v. State Tax Assessor*, 959 A.2d 741 (Me. 2008), found that the taxpayer’s cable division was unitary and that the capital gain arising from the sale of the division was apportionable, noting that the taxpayer had previously treated the division as unitary on its returns filed in the state and in other states.

Arkansas also recognizes fair apportionment as a goal of UDITPA. In *American Honda Motor, Co. v. Walther*, 2020 Ark. 349, at 7, 610 S.W.3d 633, 637

(2020), this Court noted that “[t]he UDITPA is designed to fairly apportion among the states in which a corporation does business the fair amount of regular business income earned by the corporation’s activities in each state.” Murphy’s position, however, would allocate to Arkansas one hundred percent of the interest expense from indebtedness used to spinoff core operations—even though Murphy’s spun off operations took place in twenty-four states. At the same time, Murphy would be treating the interest as apportionable in other states and other time periods. As such, Murphy’s position would fail to fairly represent Murphy’s business activity in Arkansas and is counterproductive to the goals of UDITPA.

In contrast, DFA’s position promotes UDITPA’s intended goals of uniformity and fair apportionment. DFA’s construction results in a similar characterization of the interest expense across taxing jurisdictions and across Murphy’s tax years in Arkansas. DFA’s construction also fairly represents Murphy’s business activity in Arkansas by accounting for the multistate nature of its spun off operations. DFA’s position is most aligned with the rule of construction for uniform state laws.

B. Interpreting UDITPA inconsistently with other states would distort taxpayer’s income allocated to Arkansas and create considerable uncertainty for other taxpayers.

This Court’s analysis of the business income definition should be informed by UDITPA’s purpose of preventing distortions of income. In his treatise on state taxation, Professor Hellerstein points out the accounting principles at work in business

income:

Moreover, insofar as the gain from the disposition represents recoupment of expenses deducted from apportionable income while the property was used in the business (e.g., depreciation, advertising, research and development expenses), it lends additional support to adoption of the functional test. It would be incongruous (and, from the state's standpoint, inequitable) for a taxpayer to be able to reduce in-state apportionable income through depreciation or other deductions while the asset is being used in the trade or business and then, when the asset is sold, to avoid "recapture" of that income in the state by treating the income...as "nonbusiness" income allocable to another state.

Hellerstein, Hellerstein & Appleby, *State Taxation* ¶ 9.05[2][e].

As Hellerstein notes, a taxpayer can defer income recognition as it incurs expenses to build its business, deducting expenses related to property used in the unitary business, thus reducing the amount of income subject to apportionment. If the property was sold in the "regular" course of business, those expenses would be "recaptured" when the gain is apportioned to the states where the expenses were previously deducted. But if the gain is allocated, a single state would capture all of the deferred income while the states which had previously allowed expense deductions on an apportioned basis would be unable to recapture the deferred income.

This illustrates the fundamental problem with inconsistent interpretation of uniform statute—especially where, as here, the statute in question relates to apportionment, "[a]ny particular construction ... might cut in favor of a taxpayer in one case but against a taxpayer in the next." *UBS Financial Servs., Inc. v. Levin*, 893

N.E.2d 811 (Ohio 2008). “From the standpoint of sound tax administration, these results are unacceptable. Taxpayers and states alike face considerable uncertainty, and both run the risk of being whipsawed by inconsistent determinations—taxpayers by paying twice on the same income and the states by losing the opportunity to tax all of a taxpayer’s income.” Walter Hellerstein, *The Business-NonBusiness Income Distinction and the Case for its Abolition*, 92 TAX NOTES 1701 (Sept. 24, 2001).

CONCLUSION

For the reasons set forth above, the MTC urges this Court to reverse the judgment of the circuit court and retain the uniform application of UDITPA’s definition of business income.

Respectfully submitted,

Date: May 24, 2024


/s/ Timothy J. Leathers

Timothy J. Leathers
Ark. Bar No. 78090
20 Victoria Circle
Maumelle, AR 72113
Telephone: (501) 786-2242
timleathers@timleathers.com

Lila D. Disque
Chris Barber
Jonathan White
Jennifer Stosberg
Multistate Tax Commission
444 N. Capitol St., NW, Ste. 425
Washington, DC 20001
Telephone: (202) 660-1906
ldisque@mtc.gov


CERTIFICATE OF SERVICE

On May 24, 2024, I electronically filed the foregoing with the Clerk of the Court using the Arkansas Judiciary Electronic Filing System, which will send notification of such filing to all counsel of record in this matter.

By: 
Lila D. Disque

CERTIFICATE OF COMPLIANCE

This brief complies with (1) Administrative Order No. 19’s requirements concerning confidential information, (2) Administrative Order No. 21, Section 9, which states that briefs shall not contain hyperlinks to external papers or websites, and (3) word-count limitations identified in Ark. Sup. Ct. R. 4-6(g). The document consists of 4,370 words.

By: 
Lila D. Disque