ONE HUNDRED SECOND LEGISLATURE - SECOND SESSION - 2012
COMMITTEE STATEMENT
LB872

Hearing Date: Friday January 27, 2012
Committee On: Revenue
Introducer: Hadley
One Liner: Change provisions relating to apportionment of income between states

Roll Call Vote - Final Committee Action:
Advanced to General File with amendment(s)

Vote Results:

Aye:	7	Senators Brasch, Cornett, Fischer, Hadley, Louden, Pirsch, Schumacher
Nay:		
Absent:		
Present Not Voting:	1	Senator Adams

Proponents:	**Representing:**
Sen. Galen Hadley	Introducer
Scott Gubbels	NE Intangibles and Services Assoc.
Jerry Dembowski	First Data Corporation
Douglas Durham	NE Global Investment Co.
Cory Watton	Home Instead Senior Care
David Graff	HUDL
Bruce Bohrer	Lincoln Chamber of Commerce

Opponents:	**Representing:**
Beth Canuteson	AT&T

Neutral:	**Representing:**
Nick Nieman	Greater Omaha Chamber of Commerce
Justin Brady	NE Cable Assoc.
Curt Bromm	Verizon
Eric Carstnenson	NE Telecommunications Assoc.

Summary of purpose and/or changes:
LB 872 would change the method of sourcing income of multistate corporations from sales of services and intangible property for purposes of apportioning such income among the 50 States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision of a foreign country. [LB 872, secs. 1 and 2.]

LB 872 would be operative for all taxable years beginning or deemed to begin on or after January 1, 2013, under the Internal Revenue Code of 1986, as amended, and it would repeal the current version of the statutes that it proposes to amend. [LB 872, secs. 3 and 4.]

SOURCING RULES UNDER CURRENT LAW AND AS PROPOSED BY LB 872

Current Nebraska Law: Multistate Corporate Income Sourcing Rules

Under current Nebraska law, income from sales, "other than sales of tangible personal property" (e.g., income from sales of services-such as legal, accounting, and brokerage services-and income derived from intangible property-such as royalties from the use of trademarks and copyrights), are sourced to Nebraska rather than another State if:

(a) The income producing activity is performed in this state; or
(b) The income producing activity is performed both in and outside this state and a greater proportion of the income producing activity is performed in this state than in any other state, based on cost of performance. [Neb. Rev. Stat. sec. 77-2734.04(3).]

LB 872 would change that method of sourcing such income of multistate corporations for purposes of Nebraska's "sales-only" apportionment formula, and it would redefine "sale" and define 15 new terms and phrases.

LB 872 Proposal: Multistate Corporate Income Sourcing Rules

LB 872 provides methods for sourcing 10 specific types of corporate income (e.g., income from services and income from derived from intangible property) and it provides a "catch-all" method for sourcing types of income that cannot be classified as one of the 10 specific types of income listed in section 2 of the bill:

1. Sales of Services: "Sales of services are in this state if the sales are derived from buyers within this state." LB 872, sec. 2, elaborates on that by listing six situations in which sales of services are derived from buyers within Nebraska (e.g., the service relates to real property located in Nebraska).

2. Sales of an Application Service: "Sales of an application service are within this state if the buyers use the application service in this state." LB 872, sec. 2, elaborates by listing two situations in which the application service is used in Nebraska. It also provides a rule for apportioning such income "[i]f the buyer is a business entity and uses the application service within and without this state" and also provides a rule governing situations in which "the location of a sale cannot be determined".

3. Sales of Intangible Property: "Sales of intangible property are sales in this state if the buyer uses the intangible property at a location in this state." LB 872, sec. 2, also provides a rule for apportioning such income "[i]f the buyer uses the intangible property within and without this state and also provides a rule governing situations in which "the location of a sale cannot be determined".

4. Investment Income and Other Amounts Received from Transactions in Intangible Assets Held in Connection with a Treasury Function: Such income is "in this state to the extent that it is included in taxable income and the investment, management, and record-keeping activities associated with the corporate investments occur in this state".

5. Gross Interest, Fees, Points, Charges, Penalties from Loans, Net Gains from the Sale of Loans, and Loan Servicing Fees Derived from Loans Owned by the Taxpayer or Another Person Secured by Real Property or Tangible Personal Property: Such income is "in this state if the property securing the loan is located in this state." "If the real or tangible personal property securing the loan is located within and without this state, the gross interest, fees, points, charges, penalties from loans, net gains from the sale of loans, and loan servicing fees derived from loans owned by the taxpayer or another person . . . re based upon the ratio of the annual average amortized loan balance of a loan secured by the real property or tangible personal property located without this state".

6. Gross Interest, Fees, Points, Charges, Penalties from Loans, Net Gains from the Sale of Loans, and Loan Servicing Fees Derived from Loans Owned by the Taxpayer or Another Person Not Secured by Real Property or Tangible Personal Property: Such income is "in this state if the borrower is located in this state."

7. Gross Interest, Fees, Points, Charges, and Penalties from Credit Card Receivables and gross Receipts from Annual Fees and Other Fees Charged to Credit Card Holders: Such income is "in this state if the billing address of the credit

card holder is in this state".

8. Net Gains, But Not Less Than Zero, from the Sale of Credit Card Receivables: Such income is "in this state if the billing address of the credit card holder is in this state".

9. The Taxpayer's Credit Card Issuer's Reimbursement Fees: Such income is "in this state if the billing address of the credit card holder is in this state".

10. Gross Receipts from Merchant Discount: Such income is "in this state if the merchant's trade or business is located in this state." LB 872, sec. 2, also provides a rule for apportioning such income "[i]f the merchant's trade or business is located within and without this state" (i.e., "only receipts from merchant discounts on sales made" in Nebraska "are included in this state") and also provides a rule governing situations in which "the location of a sale cannot be determined" (i.e., "the merchant discount on the sale is in this state if the merchant's billing address is in this state"). LB 872, sec. 2, also states that such gross receipts "are computed net of any credit card holder charge backs, but may not be reduced by any interchange transaction fees or by any issuer's reimbursement fees paid to another for charges made by its credit card holders".

11. Sales Other Than Sale of Tangible Personal Property Not Specifically Listed Above: Such income "must be sourced so as to fairly represent the extent of the taxpayer's business activity in this state. If the buyer is an individual, the sale or use is deemed to have occurred in this state if the buyer's billing address is in this state. If the buyer is a business entity, the sale or use is deemed to have occurred in this state from which the order was placed in the regular course of the customer's business. If that place cannot be determined, the sale is considered received at the customer's billing address."

[LB 872, sec. 2, amending Neb. Rev. Stat. sec. 77-2734.14(3), by striking current subsection (3) [the "place of performance of services" income sourcing rule] and replacing it with new subsection (3) [the proposed "market-based" income sourcing rules.]

DEFINITIONS OF KEY TERMS AND PHRASES CONCERNING SOURCING RULES

Current Nebraska Law: Definitions of Key Terms Concerning the Sourcing Rules

Neb. Rev. Stat. sec. 77-2734.04 defines 13 key terms or phrases related to sourcing multistate corporate income for purposes of Nebraska's "sales-only" apportionment formula, including:

"Commercial domicile" (i.e., "the principal place from which the trade or business of the taxpayer is directed or managed").
"Corporation" (i.e., "all corporations and all other entities that are taxed as corporations under the Internal Revenue Code").
Observation: An S Corporation is not taxed as a corporation under the Internal Revenue Code. However, Neb. Rev. Stat. sec. 77-2734.01(b) makes an S Corporation subject to Nebraska's multistate income sourcing rules.
"Subject to the Internal Revenue Code" (i.e., "a corporation that meets the requirements of section 243 of the Internal Revenue Code in order for its distributions to qualify for the dividends-received deduction").
"Corporate taxpayer" (i.e., "any corporation [other than an S corporation or a financial institution as defined in Neb. Rev. Stat. sec. 77-3801] that is not part of a unitary business or the part of a unitary business, whether it is one or more corporations, that is doing business in this state").
Caveat: Neb. Rev. Stat. sec. 77-2734.01(b) makes an S Corporation subject to Nebraska's multistate income sourcing rules. Neb. Rev. Stat. sec. 77-2734.01(b) states that "If the small business corporation or limited liability company is not a member of a unitary group and is subject to tax in another state, it shall apportion its income under sections 77-2734.05 and 77-2734.15." That includes section 77-2734.14(3), which would be amended by LB 872, sec. 2, to switch to the "market-based" sourcing rules. Neb. Rev. Stat. sec. 77-2734.01(c) also states that "If the small business corporation or limited liability company is not subject to tax in another state, all of its income is derived from or connected with Nebraska sources."

"Unitary business" (i.e., "a business that is conducted as a single economic unit by one or more corporations with common ownership and . . . [includes] all activities in different lines of business that contribute to the single economic unit").
"Sale" (i.e., "all gross receipts of the taxpayer").
"Single economic unit" (i.e., "a business in which there is a sharing or exchange of value between the parts of the unit").
"Unitary group" (i.e., "the group of corporations that are conducting a unitary business").
"Doing business in this state" (i.e., "the exercise of the corporation's franchise in this state or the conduct of operations in this state that exceed the limitations provided in 15 U.S.C. 381 on a state imposing an income tax"). (15 U.S.C. 381 is commonly referred to as P.L. 86-272.).

LB 872 Proposal: Would Define 15 New Terms Defined and Redefine the Word "Sale" for Purposes of the Proposed "Market-based" Sourcing Rules

LB 872, sec. 1, would amend Neb. Rev. Stat. sec. 77-2734.04 by redefining the term "sale" and by adding definitions for 15 new terms or phrases:

1. "Annual average amortized loan balance" means "the total of the ending monthly values in the tax year divided by the number of 7 months in the tax year".
2. "Application service" means "computer-based services provided to customers over a network for a fee without selling, renting, leasing, licensing, or otherwise transferring computer software, including, but not limited to, software as a service, platform as a service, or infrastructure as a service".
3. "Billing address" means "the location indicated in the books and records of the taxpayer as the address of record where the bill relating to the customer's account is mailed".
4. "Borrower located in this state" means "(a) A borrower who is engaged in a trade or business in this state; or (b) A borrower whose billing address is in this state, but is not engaged in a trade or business in this state".
5. "Buyer" "includes a buyer, licensee, user, or person providing consideration for the use of an item or service".
6. "Credit card" means "a credit card, debit card, 15 purchase card, charge card, and travel or entertainment card".
7. "Credit card issuer's reimbursement fee" means "Credit card issuer's reimbursement fee means the fee that a taxpayer receives in exchange for funding and incurring the risk associated with a credit or debit card transaction".
8. "Intangible property" "includes, but is not limited to, patents, copyrights, trademarks, trade names, service names, franchises, licenses, royalties, processes, techniques, formulas, and technical know-how".
9. "Loan" means "any extension of credit resulting from direct negotiations between the taxpayer and its customer or the purchase, in whole or in part, of an extension of credit from another person. Loan includes participations, syndications, and leases treated as loans for federal income tax purposes. Loan does not include properties treated as loans under section 595 of the Internal Revenue Code prior to its repeal by Public Law l04-188, futures or forward contracts, options, notional principal contracts such as swaps, credit card receivables, including purchased credit card relationships, noninterest bearing balances due from depository institutions, cash items in the process of collection, federal funds sold, securities purchased under agreements to resell, assets held in a trading account, securities, interests in a real estate mortgage investment conduit or other mortgage-backed or asset-backed security, and other similar items".
10. "Loan secured by real property" means "a loan or other obligation which, at the time the original loan or obligation was incurred or during the current taxable year, was secured by real property. A loan secured by real property includes an installment sales contract for real property".
11. "Loan secured by tangible personal property" means "a loan or other obligation which, at the time the original loan or obligation was incurred or during the current taxable year, was secured by tangible personal property. A loan secured by tangible personal property includes an installment sales contract for tangible personal property".
12. "Loan servicing fee" includes "fees or charges (a) for originating and processing loan applications, including, but not limited to, prepaid interest and loan discounts, (b) for collecting, tracking, and accounting for loan payments received, and (c) gross receipts from the sale of loan servicing rights".
13. "Merchant discount" means "the fee or negotiated discount that is charged to a merchant for accepting a credit card as payment for merchandise or services that are sold to the credit card holder".
14. "Participation" means "an extension of credit in which an undivided ownership interest is held on a pro rata basis in a single loan or pool of loans and related collateral".
15. "Treasury function" "is the pooling, management, and investment of intangible assets to satisfy the cash-flow needs

of the trade or business, including, but not limited to, providing liquidity for a taxpayer's business cycle, providing a reserve for business contingencies, or business acquisitions. A taxpayer principally engaged in the trade or business of purchasing and selling intangible assets of the type typically held in a taxpayer's treasury function, such as a registered broker-dealer, is not performing a treasury function with respect to income so produced".
"Sale" is redefined to mean "all gross receipts of the taxpayer, except: (a) Income from discharge of indebtedness; or (b) Amounts received from hedging transactions involving intangible assets".

[LB 872, sec. 1, amending Neb. Rev. Stat. sec. 77-2734.04.]

Explanation of amendments:
The Revenue Committee amendment (AM 2317) is a white copy amendment of LB 872 that retains substantially all of the provisions of the LB 872, as introduced, except as explain below.

First, AM 2317 delays the operative date of LB 872 by one year, making it operative January 1, 2014, rather than January 1, 2013. This change is meant to affect the fiscal impact of the bill. [AM2317, sec. 3, to LB 872.]

Second, AM 2317 defines a new term "communications company" by adding new subsection (7) to section 77-2734.04 and it also adds new subsection (4) to section 77-2734.14 which provides that:

sales, other sales of tangible personal property, of a communications company are in this state if: (a) The income-producing activity is performed in this state; or (b) the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

New subsection (4) also indicates that the rational basis for providing a different sourcing rule for a communications company is to continue the tax policy of Nebraska that "enhances the deployment of broadband in rural and underserved areas" of Nebraska.

[AM2317, secs. 1 and 2, to LB 872, amending Neb. Rev. Stat. secs. 77-2734.04 (definitions) and 77-2734.14 by adding new subsection (4) (emphasis added).]

Third, AM 2317 redefines "intangible property" to mean:

all personal property which is not tangible personal property and includes, but is not limited to, patents, copyrights, trademarks, trade names, service names, franchises, licenses, royalties, processes, techniques, formulas, and technical know-how but excludes money.

[AM 2317, sec. 1, to LB 872, amending Neb. Rev. Stat. secs. 77-2734.04(14) (definitions)

Fourth, AM 2317 eliminates the definition of "merchant discount" set forth in subsection (19) of LB 872, as introduced. [AM 2317, sec. 1, to LB 872.]

Fifth, AM 2317 redefines "sales" by adding new subparagraph (c), so that sales means all gross receipts of the taxpayer except: (a) income from discharge of indebtedness; (b) amounts received from hedging transactions involving intangible assets; or "(c) Net gains from marketable securities held for investment".

Sixth, AM 2317 rewrites the market-based sourcing rules for sales of services and intangible personal property set forth in new subsection (3) of section 77-2734.14 by:

(a) Stating that the market-based sourcing rules do not apply to a communications company;

(b) Eliminating language in the introduced version of LB 872 which provides that sales of a service are derived from a buyer within Nebraska if: "(iii) The service relates to tangible personal property delivered directly or indirectly to customers in this state" or "(vi) The service is provided to a location within this state"; and

(c) Adding language stating that, for services described in new subsection (3), if the buyer uses the service within and without this state, calculated using any reasonable method, the sales are apportioned between the use in Nebraska in proportion to the use of the service in Nebraska and the other states.

Seventh, for purposes of clarification, AM 2317 rewrites new subparagraph (d) of section 77-2734.14(3) as follows:

(d) Interest, dividends, investment income, and other net gains from transactions in intangible assets held in connection with a treasury function, other than net gains from the sale or redemption of marketable securities, are in this state to the extent that it is included in taxable income and to the extent the investment, management, and record-keeping activities associated with corporate investments occur in this state. . . .

Eighth, AM 2317 adds language to new subparagraph (f) which states that the location of a borrower in Nebraska is "presumed to be the borrower's billing address."

Ninth, AM 2317 rewrites subparagraphs (i) and (j) of section 77-2734.14(3) as follows:

(i) Gross receipts from the lease, rental, or licensing of tangible personal property are in this state to the extent the property is located in this state;

(j) Gross receipts from the sale, lease, rental, or licensing of real property are in this state if the real property is located in this state. . . .

Tenth, AM 2317 adds a rule of construction for purposes of subparagraph (k). Subparagraph (k) is the (i.e., the catch-all provision which requires sales "other than sales of tangible personal property not specifically addressed in subsection (3)-to be sourced so as to fairly represent the extent of the taxpayer's business activity in Nebraska--which states:

This requirement will be considered met in the following situations: (i) If the buyer is an individual, a sale is deemed to have occurred at the buyer's billing address; and (ii) if the buyer is not an individual and the sale is from an order placed in the regular course of the customer's business, the sale is deemed to have occurred in the state from which the order was placed and, if that place cannot be readily determined, the sale is deemed to have occurred at the customer's billing address.

Finally, AM 2317 makes a number of grammatical changes or corrections throughout the introduced version of LB 872, including, for example, redefining "application service" by using two sentences instead of one.

Abbie Cornett, Chairperson