

# States Trending Toward Single Sales Factor, Panelist Says

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By Andrea Muse

States are moving toward single-sales-factor apportionment because of economic development concerns, according to a tax practitioner.

At a January 26 panel during the American Bar Association Section of Taxation's Virtual 2021 Midyear Tax Meeting, Matthew Boch of Dover Dixon Horne PLLC said that if states have the flexibility to go to single sales factor, "from a policy perspective, it is almost a no-brainer."

Boch added that explaining it to policymakers and legislators who aren't tax professionals can be a challenge, but the fact that most states aren't taxing jobs or investment can be a compelling case to make.

"Bottom line is we're seeing a very strong trend toward single-sales-factor apportionment driven by economic development concerns," Boch said. He added that right now the sense is that the incidence of the tax is landing on out-of-state companies, but he wondered whether, in the long term, businesses will start pricing in the income tax and billing their tax burden through to their customers.

## Market-Based Sourcing

Boch said the case *Sirius XM Radio Inc. v. Hegar* is a classic example of a state trying to reach market-based sourcing by taking a transaction approach to cost of performance. He said it isn't certain whether the Texas Supreme Court will hear the appeal, but it has become more likely after the court recently requested briefing on the merits.

Sirius XM Radio [is asking](#) the state supreme court to review the [Texas Court of Appeals, Third District's ruling](#) that the company's subscription receipts should be sourced for franchise tax purposes based on where the "receipt-producing end-product act" of decrypting the radio signal occurred — where the satellite-enabled radio is located.

Panelist Open Weaver Banks of Eversheds Sutherland (US) LLP said Pennsylvania switched to market-based sourcing from sourcing based on costs of performance in 2014, but the state Department of Revenue was pushing taxpayers to market-based sourcing before its adoption. Banks said taxpayers began challenging the interpretation.

However, Synthes USA HQ Inc. sought a refund for 2011, arguing that its receipts should be

sourced based on customer location because that is where the benefit was received under the DOR's interpretation. According to Banks, [Synthes USA HQ Inc. v. Pennsylvania](#) was interesting because the state attorney general argued that the taxpayer was not entitled to a refund since the state had not adopted market-based sourcing in 2011, but the DOR intervened and argued for the taxpayer's interpretation and against the attorney general. Banks said the Pennsylvania Commonwealth Court [ruled in favor](#) of the taxpayer, which is bad for taxpayers fighting against the use of market-based sourcing before 2014.

Debra Herman of Hodgson Russ LLP said receipts can be sourced a variety of ways under market-based sourcing depending on how "market" is defined, including where customers are located, where services are performed, or where the benefit is received.

Boch said a September 2020 Ohio Supreme Court decision, [Defender Security Co. v. McClain](#), illustrates how hard it can be to determine where the benefit is received with market-based sourcing, adding that this is a fluid area especially when dealing with intangibles.

The state supreme court ruled in *Defender Security* that the gross receipts received by an authorized dealer of security systems from ADT Security Services Inc. for the sale of security monitoring services contracts are situated to the [location where ADT realized](#) the benefit derived from purchasing the intangible contract rights, which was outside the state.

## Mandatory Apportionment Formula

Responding to a question, Boch said he thinks it is unlikely that Congress would ever mandate a uniform apportionment formula for the states to use. "Depending on what the formula was, it might be a good thing or a bad thing, but politically it's hard to see Congress doing that right now." Boch supposed there would also be questions regarding its validity.

Herman agreed, saying she could see a decision by the U.S. Supreme Court before she could see Congress stepping in.

Lynn Gandhi of Foley & Lardner LLP echoed Herman, adding that there has to be a reasonable understanding of alternative apportionment. Gandhi added that while she understands the burden on revenue departments trying to determine the reasonableness of an apportionment method and, perhaps the more difficult part, how to apply it consistently across taxpayers, resolving what are reasonable alternatives might solve a lot of issues.