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# UPDATE ON MARKET BASED SOURCING (REVENUE LAWS DRAFT #2)

Revenue Laws Committee, 3/8/2016  
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# Goal of Market Based Sourcing

- Provide a North Carolina job creation and investment incentive for all companies with the income and franchise tax apportionment policy.

Here is the incentive:

- Locating a greater percentage of a company's workforce and investment in NC **does not** result in NC taxing a greater percentage of a company's income.
- Legislation enacted last year provides this apportionment policy for most companies, but not for all.

# How Draft #1 and #2 impacts Multistate Service Company

No state can tax all of a multistate company's income (Fed. Law). However, each state has flexibility to choose how it determines the percentage of income to tax.

## Existing NC law for a service company (includes S.L. 2015-241, HB 97)

- % of income taxed = % of company's income producing activity in NC.
- "Income producing activity" equates to employment and capital investment.
- So, the larger the percentage of the company's employment and capital investment in NC, the larger the percentage of the company's income subject to NC tax.

## Draft Legislation

- % of income taxed = % of revenue received from NC market
- So, an increased percentage of employment and capital investment in NC does not result in an increased percentage of the company's income being subject to NC tax.

\*The percentage is called a sales factor. The draft calculates the percentage using a method called "market sourcing."

## How Draft #2 Impacts Banks

Department of Revenue published proposed technical guidelines using the Multistate Tax Commission Apportionment Model (Required S.L. 2015-241). This Model has specific apportionment rules dealing with banks.

### Multistate Tax Commission apportionment of investment income for banks

- % of income taxed = % of investment assets assigned to/managed by NC location
- So, the larger the percentage of a bank's management operations in NC, the larger the percentage of the bank's income subject to NC tax.

### Draft #2 NC apportionment of investment income for banks

- % of income taxed = % of income received from a payer located in NC
- So under Draft #2, an increased percentage of a bank's management operations in NC does not correspond to an increased percentage of a bank's income taxed by NC

The percentage is called a sales factor. The draft calculates the percentage using a method called "market sourcing."

## How Draft #2 impacts Market Based Sourcing Technical Guidelines

- Requires public rulemaking process to establish final Market Based Sourcing Technical Guidelines
- Allows interested parties to have input and file objection; subject to review/approval by Rules Review Commission.

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