



## Service Revenue Apportionment - Shift towards Market-Based Sourcing



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Although most states continue to adhere to the cost-of-performance sourcing rule when calculating the sales factor of a multistate taxpayer's apportionment formula, the number of states using a market-based sourcing approach is growing steadily.

Under the cost-of-performance approach, receipts are generally sourced to a state if the income-producing activity is performed entirely in that state or, when the income-producing activity is performed in multiple states, if the income-producing activity is performed more in that state than in any other state, based on costs of performance. Unlike the cost-of-performance approach, the market-based sourcing approach sources receipts to states based on the location of the taxpayer's market for the receipt. Even though this approach is increasingly gaining popularity, its implementation varies greatly among the states and takes into consideration a number of different factors when determining where the taxpayers market is located.

The market-based sourcing approach gained several additional followers in 2014. This method was implemented for the first time in 2014 for taxpayers in the District of Columbia, Massachusetts, Nebraska and Pennsylvania. Market-based sourcing was also adopted, but not implemented, in 2014 by New York, Rhode Island and the Multistate Tax Commission (MTC). Year 2015 also brought about the use of market-based sourcing for taxpayers in New York, Rhode Island and possibly others, but it also saw the introduction of regulations providing additional guidance on the approach by Massachusetts, which adopted its regulations on Jan. 2, and the MTC, which is currently in the process of developing these regulations using those issued by Massachusetts as its starting point.

The following states have enacted Market-Based Sourcing for receipts from services as of August 30, 2015:

### Alabama

Receipts from services are sourced to Alabama to the extent the services are delivered to a location in this state.

### Arizona

For tax years from and after Dec. 31, 2013, through Dec. 31, 2016, Arizona

is phasing in an election to use market-based sourcing of sales of services. Receipts from services are assigned to Arizona if "sales are received by the purchaser in this state".

### **California**

Receipts from the provision of services must be sourced to California using the market-based sourcing methodology. Under the market-based sourcing approach, services are sourced to California to the extent the purchaser of the service received the benefit of the service in the state.

### **District of Columbia**

For tax years beginning after Dec. 31, 2014, receipts from sales of services are sourced in the state if service is delivered to a location in the District.

### **Georgia**

Receipts are attributable to Georgia's marketplace if the taxpayer's overall activities are focused on Georgia customers. In general, the marketplace approach results in sales of service being sourced on a destination basis - *i.e.*, where the customer (the marketplace) is located.

### **Illinois**

Sales of services are sourced to Illinois if the services are received in the state.

### **Iowa**

Gross receipts from the provision of services must be sourced to Iowa if the recipient receives all the benefit of the service in Iowa. To the extent the recipient benefits from the service within and without Iowa, a proportionate amount of the receipt must be included in the numerator.

### **Maine**

Under Maine law, receipts from the provision of services must be attributed to the state where services are received.

### **Maryland**

Income from contracting or service-related activities must be sourced to Maryland if the receipts are derived from individuals or businesses domiciled in Maryland. Customers within Maryland include individuals and business enterprises domiciled within the state.

### **Massachusetts**

For tax years beginning on or after Jan. 1, 2014, sales of services will be sourced to Massachusetts if the services are delivered to Massachusetts. The location to which services are delivered is construed by Massachusetts regulations to be the location of the taxpayer's market for the service provided.

### **Michigan**

Unless otherwise provided, all receipts from the performance of services will be sourced to Michigan if the recipient of the services receives all of the

benefit of the services in the state. If the recipient of the services receives some of the benefit of the services in the state, the receipts are included in the numerator of the apportionment factor in proportion to the extent that the recipient receives benefit of the services in the state.

### **Minnesota**

Under Minnesota law, receipts from the provision of services must be sourced to the state where the services are received.

### **Missouri**

Effective Aug. 28, 2015, sales of services by taxpayers electing to apportion by using a single-factor apportionment formula based on sales are sourced to Missouri to the extent the ultimate beneficiary of the service is located in the state.

### **Nebraska**

Effective for tax years beginning on or after Jan. 1, 2014, sales of services are sourced using a market-based approach. Receipts from performance of services are assigned to Nebraska if the receipts are derived from a buyer within Nebraska.

### **New York**

Beginning Jan. 1, 2015, New York has adopted a market-based sourcing regime for receipts from services. Unless otherwise, services are sourced according to where the benefit of the service was received.

### **Ohio**

Receipts from the provision of services must be sourced to Ohio in proportion to the purchaser's benefit received in Ohio compared to the benefit received everywhere. The physical location where the purchaser ultimately uses or receives the benefit of what was purchased is paramount in determining the proportion of the benefit in Ohio to the benefit everywhere.

### **Oklahoma**

Receipts from the provision of services must be sourced to Oklahoma if the receipts are derived from customers within Oklahoma, or if the receipts are otherwise attributable to Oklahoma's marketplace.

### **Pennsylvania**

For tax years beginning after Dec. 31, 2013, taxpayers must source to Pennsylvania sales of services delivered to a location in the state. Sales of services delivered to a location in and outside of Pennsylvania must be sourced based upon the percentage of "total value" of the service delivered to the Pennsylvania location.

### **Rhode Island**

For tax years beginning on or after Jan. 1, 2015, market-based sourcing will apply only to business entities that are organized as C corporations, and will apply whether or not a C corporation is part of a combined group. Receipts

from the provision of services must be sourced to Rhode Island if the services are delivered to a location in Rhode Island.

### **Tennessee**

Effective for tax years beginning on or after Jan. 1, 2016, receipts from sales, other than sales of tangible personal property, are in Tennessee if the taxpayer's market for the sale is in the state. The taxpayer's market is in Tennessee in the case of sales of a service if and to the extent the service is delivered to a location in the state.

### **Utah**

Receipts from the provision of services must be sourced to Utah if the purchaser of the services received a greater benefit from the service in Utah than in any other state.

### **Wisconsin**

Receipts from the provision of services must be sourced to Wisconsin if the service relates to real or tangible personal property located in the state at the time the service is received or property delivered to customers in the state; is provided to an individual physically present in the state at the time the service is received; or is provided to a person engaged in a trade or business in the state and the service relates to the in-state business.

**Sourcing Rules Adopt to Digital Economy:** As the trend towards a digital economy continues, taxpayers have watched as the states adjust their varying tax schemes to reflect this change. Over the past year, state tax departments have increasingly addressed the issue of how to appropriately source receipts from sales of digital goods or services, including receipts from cloud computing and software as a service transactions- generally, by applying market-based sourcing principles governing receipts from intangibles or services.

Some states, such as Illinois and Florida, have done so by issuing administrative rulings sourcing such receipts based on the location of the customer. Other states, including Massachusetts, Nebraska and New York, have included specific sourcing provisions within their market-based sourcing rules addressing specific digital-related goods or services.

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