July 6, 2015

Hon. Craig M. Burns
Commissioner
Virginia Department of Taxation
600 East Main Street, 23rd Floor
Richmond, VA 23219

Dear Commissioner Burns:

Thank you for the opportunity to submit these comments to the Virginia Department of Taxation's working group studying the desirability of the market-based sourcing approach to sales factor apportionment for sales of services and intangible property. As an introduction, PRA Group is a publicly traded company that is a global leader in acquiring defaulted consumer receivables. PRA Group returns capital to global banks and other creditors to help expand financial services for consumers. Its activities improve the balance sheets and cash flow of financial institutions, supports the functioning of credit markets and helps keep borrowing costs low for all consumers. The company employs approximately 4,000 people worldwide with 10 major locations in the United States and an expansive network of locations in Canada, the United Kingdom, Scandinavia and continental Europe.

Our global headquarters is located in Norfolk, and we employ more than 1,500 Virginia residents in Norfolk and Hampton. Although our greatest capital investment and highest payroll is in Virginia, we operate major facilities with the potential to expand in the market-based sourcing states of Alabama, California, Illinois, Pennsylvania, and Tennessee. We also have significant operations in Kansas and Texas, members of the Multistate Tax Commission ("MTC"). We have invested heavily in Virginia, not only in property and payroll, but through our commitment to civic and charitable causes, and the quality of life our employees enjoy. We hope to continue our commitment to our Virginia communities for many years.

The Trend Toward Market-Based Sourcing

The Uniform Law Commission ("ULC") promulgated the Uniform Division of Income for Tax Purposes Act ("UDITPA") in 1957. UDITPA established the rule that sales of services and intangible property are sourced to the state where the greatest "cost of performance" ("COP") is incurred. The COP rule has been considered outdated in some quarters for many years. Efforts to source revenue to a taxpayer's market gained greater acceptance over time as states recognized inequities in the "all or nothing" approach to COP (the current rule in Virginia) and the general belief that market-based sourcing better reflected the notion that those who benefit from exploiting a state's market should bear a tax burden in that market. Moreover, the COP method penalizes those most heavily invested in Virginia; Virginia real estate investments are subject to the property tax, payroll is taxed as Virginia income tax and ultimately generates sales tax receipts when consumers pay for goods and services.

The movement toward market-based sourcing has accelerated over the last few years. What began as a few states opting for a market-based approach to sourcing has now become a nationwide trend. Currently, there are 20 out of 47 states with corporate income or franchise tax that are using a type of market-based sourcing[1] with two additional states, Tennessee[2] and Missouri[3], recently having adopted legislation to begin market-based sourcing by 2016.

The MTC adopted model regulations for implementing market-based sourcing in July, 2014.[4] The MTC's position has the potential to add another ten states to the market-based sourcing trend. If the MTC model language is adopted by its members, 32 of the 47 states with corporate income or franchise tax requirements will rely on market-based sourcing. It is likely that Virginia will ultimately adopt market-based sourcing, but to keep Virginia's businesses competitive and safeguard the Commonwealth's long-term revenue stream, it would be better to do so sooner rather than later.

Disadvantages and Inequities of the COP Rule

Applying the COP rule to multistate companies that also have business activity in market-based states can subject those companies to double taxation. For example, our company has customers in every state. If it conducts business in and derives revenue from customers in a state that applies market-based sourcing, it will owe income tax to Virginia because of the large payroll and property in the Commonwealth and the operation of the "all or nothing" approach to COP. It will also likely pay taxes in the market-based state based on the revenue it derives from customers in that state. Conversely, a direct competitor in a market-based state that derives revenue from customers in Virginia would pay no tax to its home state based on that state's reliance on market-based sourcing and pay no tax to Virginia based on Virginia's reliance on the COP rule.

It is certainly not sound or fair tax policy to subject Virginia corporations to double taxation, with the resulting benefit to out of state competitors. In that regard, the COP rule penalizes some companies, like PRA Group, that choose to locate headquarters and major investments in the Commonwealth. Nor is it fair for out of state companies that enjoy the same access to customers and revenue in Virginia to pay no income tax at all.

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[1] Sicilian, Shirley. (2015). "Market-Based Sourcing on Cusp of Becoming General Rule." *Journal of Multistate Taxation and Incentives*.

[2] Tennessee Legislature. 2015 House Bill 644. Retrieved from http://wapp.capitol.tn.gov/apps/BillInfo/Default.aspx?BillNumber=%20HB0644&GA=109

[3] Missouri Legislature. 2015 Senate Bill 19. Retrieved from http://www.senate.mo.gov/15info/BTS_Web/Bill.aspx?SessionType=R&BillID=45

[4]Multistate Tax Commission. "Section 17 Model Market-SourcingRegulations." Retrieved from http://www.mtc.gov/Uniformity/Project-Teams/Section-17-Model-Market-Sourcing-Regulations

Virginia's economic competitiveness would also likely benefit from a switch to market-based sourcing. In November 2010, Virginia's Joint Legislative Audit and Review Commission ("JLARC") produced a report to the Governor and the General Assembly entitled "Review of Virginia's Corporate Income Tax System." This report highlighted the fact that "adopting market-based sourcing could enhance economic favorability."[5] Additionally, the report notes that the "adoption of market-based sourcing could provide an incentive for providers of intangible goods and services to stay in Virginia, while increasing the State's appeal as a place to expand or relocate."[6]

The peripheral competitive and economic advantages of eliminating the double taxation resulting from the COP rule should not be overlooked. If businesses have an incentive to stay in or locate to Virginia, the risks of a brain drain are reduced. It would be in Virginia's interest to attract high quality, high paying service businesses, those whose employees typically pay higher personal income and property taxes and spend more for goods and services. It is not difficult to understand how the ill effects of double taxation carry largely unmeasured opportunity costs to the Commonwealth.

Suggested Best Practices for the Market-Based Sourcing Study

The most important considerations for conduct of the study are that the process be unbiased and transparent and that the methodology employed to forecast revenue projections and economic impact to the Commonwealth be as well informed as possible. The best report would be one that most accurately predicts the fiscal and economic impacts that would result from the various scenarios under consideration. It is important that the assumptions as to enforcement and other variables underlying the methodology be based on sound reasoning and be neither too optimistic nor too pessimistic.

To that end, we suggest that the Department of Taxation should share its intended methodology and the assumptions it intends to rely on with interested parties at the earliest practical time and allow comments to be shared. That said, we offer the following initial thoughts:

1. We believe it is important to complete an estimate that limits the application of Public Law 86-272 to tangible personal property which is the only class of sales protected by federal law. Virginia's extension of Public Law 86-272 to the solicitation of services and intangible goods is based on a departmental policy and is not legislatively mandated. Accordingly, the restriction of Public Law86-272 to tangible personal property only requires a reversal of departmental policy and no legislation is required.

2. We endorse the approach taken by JLARC to pull data from the Economic Census and the IRS Statistics of Income to construct an estimate of adopting market-based sourcing combined with ending the extension of Public Law 86-272 protections to

[5] Commonwealth of Virginia Joint Legislative Audit and Review Commission (JLARC). "Review of Virginia's Corporate Income Tax System". Page 92. Retrieved from http://jlarc.virginia.gov/reports/Rpt408.pdf
[6] Ibid.

corporations soliciting the sales of intangible goods and services. A study based solely on the tax returns filed in Virginia would be too narrow. We also endorse the JLARC collaboration with the University of Virginia Weldon Cooper Center for Public Service to produce the dynamic forecasting.

3. Page 92 of the JLARC study contains the following statement: "Currently, California, Georgia, Illinois, and Maryland are Virginia's only competitors that use (or will soon implement) market-based sourcing for intangible goods and services. However, these states represent over 20% of the U.S. population and, most likely, consumer base."[7] Since this statement was written, Massachusetts, New York, Pennsylvania and Tennessee have enacted market-based sourcing. We would like that statement updated to include those additional states.

We also suggest the Department should convene another meeting of interested parties for that purpose and to invite other input that could strengthen the accuracy and completeness of the study.

Thank you for the opportunity to participate in the working group and to provide these comments to you on behalf of PRA Group. We appreciate your willingness to consider our views and look forward to contributing to a successful completion of the study.

As always, please feel free to call if we can be of service.

Sincerely,

Donald W. Redmond
Vice President
Government Relations

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[7] Ibid.