

July 7, 2015

Mr. Mark Haskins, Director of Policy Development
Virginia Department of Taxation
P.O. Box 1115
Richmond, VA 23218-1115
E-Mail: tax-studies@tax.virginia.gov

Re: Comments Regarding Market Based Sourcing in Virginia

Dear Mr. Haskins:

Thank you for providing the opportunity to comment on the potential adoption of Market Based Sourcing in Virginia. We appreciate the Department's efforts to seek input from stakeholders on the feasibility and desirability of such an approach to income apportionment.

By way of background, Raytheon Company is a technology and innovation leader specializing in defense and other government markets throughout the world. We develop technologically advanced and integrated products, and provide services and solutions in our core markets, including our growing cyber and information security business. Our Intelligence, Information and Services business, headquartered in Dulles, Virginia, leads our growing cyber security business.

In response to your request, we would like to offer comments on the process for developing the study on Market Based Sourcing and highlight specific areas of concern related to Market Based Sourcing.

First, we suggest the Department hold additional meetings with stakeholders to discuss technical issues involved in the adoption of Market Based Sourcing. These meetings should include representatives from the defense contracting, advanced manufacturing, and cyber technology industries. While these industries may not be formally classified as service providers, they have significant service revenue and business models that make the sourcing of service receipts to the taxpayer's market a difficult exercise. In the case of Raytheon Company, for example, the services we provide, whether involving cyber security, software development for a ship's radar, or the development and delivery of military training, generate benefits to our customer throughout the world. We rarely offer a service that exclusively benefits a single location. The other above industries may present similar challenges and thus need to be considered in the Department's review.

Second, we request the Department carefully consider the possibility of double taxation due to the lack of conformity of state apportionment statutes. The materials of the June 4th meeting recognized that there are at least four different Market Based Sourcing methods used by other states. In addition, other states continue to apply the cost of performance method to source service revenue. Each of these five methods can produce a different result when sourcing the taxpayer's service receipts. Because of a lack of conformity of state apportionment statutes, multistate companies, such as Raytheon, are subject to a risk of double taxation with the adoption of Market Based Sourcing. The Department should consider the impact of the rules on the multiple stakeholders above to minimize the possibility of double taxation.

Mr. Mark Haskins
July 7, 2015
Page 2

Finally, the Department needs to consider the constitutional requirements of defining Market Based Sourcing in such a way that the resulting apportioned income is fairly related to the service provided by the state – meeting the fourth prong of the Commerce Clause test in *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977). Because the Market Based Sourcing approaches are so new, courts have not considered the constitutional implications of such apportionment methods. Failure to consider the constitutional implications of apportioning income under Market Based Sourcing would subject the state and taxpayers to lengthy and expensive controversies and related uncertainty. As noted above, sourcing the service receipts of taxpayers in certain industries presents a unique challenge. To fairly apportion such income, the Department needs to consider the impact of Market Based Sourcing on the industries mentioned above.

Raytheon Company looks forward to collaborating with the Department and other taxpayers to conduct an in-depth and broad review of the issues involved in a change to Market Based Sourcing. We would be pleased to share our comments on specific areas throughout this process.

Respectfully Submitted,



Mark W. March

Vice President, Taxes

cc. Craig M. Burns, Virginia Tax Commissioner
William J. White, Assistant Commissioner for Tax Policy