MULTISTATE TAX COMMISSION

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The Honorable Jack Evans, Chairman
Committee on Finance and Revenue
Council of the District of Columbia
1350 Pennsylvania Avenue, N.W., Suite 106
Washington, DC 20004

RE: FY 2014 and FY 2015 Oversight Questions for the Multistate Tax Commission

Dear Chairman Evans:

I am pleased to respond on behalf of the Multistate Tax Commission to your committee's FY 2014 and FY 2015 Oversight Questions. For convenience, I repeat the questions, and their grouping, in this letter.

**1. Please explain the District of Columbia's participation in the MTC. Please also identify other city agencies or regional bodies that participate.**

The District of Columbia is a party to the Multistate Tax Compact. D.C.'s Deputy Chief Financial Officer for Tax and Revenue has traditionally been the appointed member of the Commission for D.C. pursuant to D.C. Code § 47-442, because the Commission is composed of the top tax administrator for each party state and D.C. that has adopted the Compact. Thus, the Commission is not only an intergovernmental entity, but also an adjunct of D.C.'s and each member state's tax agency. No other D.C. agency or regional bodies participate with the Commission.

The Commission began in 1967 as a joint effort by states to protect their tax authority in the face of possible federal preemption. It was created by the Multistate Tax Compact, the model version of which I include with this letter (D.C.'s version can be found in D.C. Code § 47-441). The Commission's general operations are funded by appropriations from its member states pursuant to the formula contained in Section 4(b) of Article VI of the Compact (also found in D.C. Code § 47-441.Art.VI.4.(b)). D.C.'s membership assessment for the current fiscal year was $20,272.

The Compact deals primarily with income, sales, and use taxes that affect businesses that operate in more than one state. The purposes of the Compact are:

(1) facilitating the proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes;

(2) promoting uniformity or compatibility in significant components of tax systems;

(3) facilitating taxpayer convenience and compliance and compliance in the filing of tax returns and in other phases of tax administration; and

(4) avoiding duplicative taxation.

The validity of the Commission's existence as an intergovernmental entity created by states via the Compact was challenged and sustained by the Supreme Court of the United States in *United States Steel Corp.* et al. *v. Multistate Tax Commission* et al., 434 U.S. 452 (1978). In addition to the model Compact, I include a copy of the Commission's bylaws and public participation policy for your reference.

## Organization

**2. Please provide a complete, up-to-date organizational chart for each division within the MTC including, either attached or separately, an explanation of the roles and responsibilities for each division and subdivision. Please clearly identify any and all participation of or by DC.**

An up-to-date organizational chart is enclosed with this letter. The Commission works to achieve the goals of preserving federalism and tax fairness through a comprehensive range of activities that includes developing recommended uniform state tax laws with respect to interstate commerce, encouraging compliance with tax laws and consistency in enforcement through its Joint Audit and National Nexus Programs, training and education in complex multistate tax issues, supporting states engaged in major tax litigation through amicus briefs and technical assistance, and advocating state interests in the field of multistate taxation to all three branches of federal government.

I identify the "divisions" of the Commission's staff and briefly explain the roles and responsibilities for each here, along with information regarding D.C.'s participation where appropriate:

*Administration*—The administration division of the Commission staff is responsible for human resources functions, including maintenance of personnel files, dealing with employee group insurance and working with other employee benefits; finance functions, including normal accounting functions such as preparing fees invoices for state, depositing funds, preparing checks, preparing the payroll, and producing monthly financial statements, as well as the preparation of an annual budget; meeting management functions, including hotel selection for committee meetings and conferences as well as working with the hotels on the logistical details of each meeting or event; facilities management functions; and provision of administrative assistant support in the D.C. office.

*Legal Division*—The legal division of the Commission staff, under supervision of the Commission's general counsel, provides individual state support upon request by reviewing and commenting on states' draft statutes, regulations and legal briefs. The division also provides legal support for the Commission's audit division, training division, and general administration. The legal division provides primary staff support for the Uniformity and Litigation committees. Commission lawyers file amicus briefs in state and federal courts; participate as speakers at conferences, symposiums and institutes; and teach at MTC training courses.

*Joint Audit Program*—The Commission's Joint Audit Program, authorized by Art. VIII of the Compact, and, for D.C., by D.C. Code § 47-444, has been active since the late 1970s. The Joint Audit Program completes an average of 10-15 sales and 5-10 income tax audits each year. Participating states pay a fee based on program cost set each year by the Commission's Executive Committee. This fee is in addition to any membership assessment paid by states because of their Compact or sovereignty member status.

Joint Audit Program states pool their resources to select candidates for corporate income, franchise, sales and use, or gross receipts tax audits. The Commission's audit staff performs these audits as though they were part of a state's own audit staff, forwarding their findings and recommendations to each member state based on each state's individual laws and policies. Each state will review the recommendation and make its own determination for assessment and collection.

States maintain control of the program through selection of the audit candidates — they make the decision as to whether or not to participate in a given audit and how to act upon the audit results. The Audit Committee guides the program and ensures that it is responsive to member state needs. It also serves as a forum for exchanging information on multistate audit issues.

A single Commission audit takes the place of separate and duplicative audits by member states, and provides obvious economies of scale to the states. At the same time, it relieves the taxpayer of the burden of multiple ongoing audits. A joint audit is also a good way to achieve uniformity among states with similar laws and regulations in the treatment of income or transactions reviewed in a particular audit.

D.C. is a member of our Joint Audit Program and participates in multistate income and sales and use tax audits of business entities. D.C.'s Joint Audit Program fee for the current fiscal year was $182,925. Over the last five completed fiscal years, D.C. has participated in 58 such audits yielding $13,246,407 in proposed assessments for D.C.

*National Nexus Program*—The Commission's National Nexus Program was founded in December 1990. Currently, 36 states and D.C. belong to the Nexus Program. A principal component of the Nexus Program is the voluntary disclosure program. Businesses can use the voluntary disclosure program to resolve outstanding tax issues in multiple states on an anonymous basis, with Nexus Program staff serving as a single point of contact. The program reduces the compliance burden on states and taxpayers by offering a substantially uniform process and a uniform settlement contract.

The National Nexus Program was created by the Commission in furtherance of the following purposes:

> (1) Fostering increased state tax compliance by business that is engaged in multi-jurisdictional commerce.
>
> (2) Establishing national cooperation in the administration of state tax issues arising in the nexus area, including possible development of a uniform nexus standard which satisfies requisite constitutional standards, the identification of businesses involved in multi-jurisdictional commerce which are not now in compliance with applicable state tax laws, the establishment of a national information network with uniform confidentiality standards, and similar activities.
>
> (3) Facilitating taxpayer compliance through education as to a taxpayer's state tax reporting responsibility when it becomes involved in the systematic development of a market in a specific state and providing cooperative services to multistate taxpayers to reduce compliance burdens and to simplify the compliance process.
>
> (4) Promoting fair, even-handed and consistent state tax enforcement in the nexus area.

The National Nexus Program is funded by an annual assessment to the member states, which is in addition to any dues paid by states related to their compact or sovereignty member status. The Commission's Nexus Committee provides state oversight of the program.

D.C. is a member of the National Nexus Program. D.C.'s National Nexus Program fee for the current fiscal year was $17,350. Over the last five completed fiscal years, 76 multistate voluntary disclosure agreements were processed for the District, generating $1,105,841 in back taxes collected.

*Policy Research*—Under the Multistate Tax Compact, the Commission is granted the authority to "study state and local tax systems and particular types of state and local taxes." Through comprehensive research, seminars, and dialogue sessions with stakeholders, the Commission member states study and analyze current issues affecting state taxation of multistate and multinational companies with the goal of developing viable options that policy makers may consider in developing fair, efficient, and administrable state and local tax systems. Educating and informing taxpayers, policy makers, and other stakeholders is a key objective of the Commission's policy research activities.

Policy research staff edits and contribute articles for publication. In addition, policy research staff participates in the programs of other professional organizations, such as the National Tax Association. More generally, the states, through the Commission, constantly monitor the trends in state tax policy development. The Commission conducts research and analyses on proposed or adopted state legislation, federal legislation impacting state and local taxation, economic and fiscal trends, industry trends and other related topics. Bringing together the states' collective expertise in a number of disciplines helps the Commission develop more broadly supported and comprehensive policy options.

*Training Program*—The Commission's Training Program is designed to increase the effectiveness and efficiency of state tax administration. Courses include constitutional and tax law, sampling, audit, technology, and other courses that enhance the knowledge and practical skills of state personnel. The Commission is registered with the National Association of State Boards of Accountancy (NASBA), as a sponsor of continuing professional education on the National Registry of CPE sponsors.

MTC training is provided via in-person courses and is normally hosted by a state. The D.C. Office of Tax and Revenue hosted the Corporate Income Tax course in 2013, Computer Assisted Audit Techniques in 2014, and the Nexus School in 2009. In addition, Office of Tax and Revenue staff members attended the Statistical Sampling course in 2014. Course fees are set at full cost to the Commission with additional charges for participants from states that do not fully support the operations of the Commission. (D.C. pays the lowest rate since it is a Compact member of the MTC.)

**3. Please include a list of the employees (name and title) for each subdivision.**

The names and titles of our 43 current employees are included on the enclosed organizational chart.

**4. Please provide a narrative explanation of any organizational changes made during the previous year.**

There have been no organizational changes made during the previous year.

**5. Please describe the major functions and responsibilities of each division and subdivision of the MTC.**

These have been described in our response to question 2.

## *Gillette*

**6. What is *Gillette*, and what does *Gillette* mean for the MTC and the compact?**

*Gillette* is the generic name for a line of cases in a number of states that are either members or former members of the Compact. The taxpayers in each of these cases challenge the authority of the states to repeal or otherwise supersede Articles III.1 and IV of the Multistate Tax Compact, without withdrawing entirely from the Compact by repealing it.

At the present time, it is unclear what the cases may ultimately mean to the MTC and the compact because all the cases are still being actively litigated. The California Court of Appeal ruled in favor of the taxpayer in *Gillette*, but California appealed and the case has now been briefed in the California Supreme Court. Oral argument has not yet been set. Pending decision, the California Supreme Court has vacated the decision of the Court of Appeal.

In the *IBM* case, a majority of the Michigan Supreme Court ruled in favor of the taxpayer, but on separate state law grounds entirely independent of the *Gillette* issue. Three justices ruled that Michigan had the authority to repeal Articles III.1 and IV without repealing the entire Compact. Following the Supreme Court decision, the Michigan Court of Claims rejected the taxpayers' *Gillette* argument, on the authority of the three justice opinion in *IBM*.

In Texas, the 353d District Court in Travis County granted the Comptroller of Public Accounts motion for summary judgment on the *Gillette* issue in the *Graphic Packaging* case. The case is currently pending in the Texas Court of Appeals for the Third Judicial District.

*Health Net* is a *Gillette* case that has been briefed and argued in the Oregon Tax Court and is pending decision. *Kimberly Clark* is a *Gillette* case pending in the Minnesota Tax Court. No hearing has been set as yet.

**7. How have other member states responded in light of California's withdrawal from the MTC?**

Most of the member states have reacted to *Gillette* by continuing to participate in Commission activities. Only three states (California, Minnesota, and Michigan) have repealed the Compact in its entirety due to *Gillette* litigation. (South Dakota has also recently repealed the Compact, but South Dakota does not have a corporate income tax, and its decision to withdraw had nothing to do with the Gillette cases. It continues to participate in MTC programs.) Michigan and Minnesota continue to actively participate in Commission activities as sovereignty members. Utah, Oregon, and the District of Columbia repealed the Compact and immediately reenacted it without Articles III and IV. The Commission currently recognizes sixteen members of the Compact, including Utah, Oregon, and the District.

All the states in which *Gillette* claims have been raised continue to vigorously contest those claims in the courts, and to assist each other by joining in amicus briefs in the states in which the issue is being litigated.

**8. How is the MTC responding to the *Gillette* case?**

The MTC has responded to *Gillette* by filing amicus briefs in each state in which the claim has been litigated in the appellate courts, as well as in the Oregon Tax Court in *Health Net*, following the request of each such state for amicus support. The three Michigan Supreme Court justices in *IBM* who rejected the taxpayer's *Gillette* argument heavily relied on the Commission's amicus brief in doing so.

## MTC Programs & Training

**9. How many member states utilize the MTC audit program?**

27 states and the District participate in the program (25 for income or franchise tax audits, 17 for sales and use or gross receipts tax audits, and 1 observing state).

**10. How many member states utilize the MTC nexus program?**

36 states and the District participate in the program.

**11. Please describe your voluntary disclosure program?**

Multistate voluntary disclosure (MVD) is one of several services the National Nexus Program (NNP) provides to the District of Columbia, thirty-six states, and the public. MVD allows the District and non-filers to compromise on nexus and have undiscovered non-filers file pay several years back tax and interest in exchange for bringing them into compliance going forward. Most disclosures are for either income and franchise tax, use tax, or both. The program benefits the District and the public by encouraging non-filers to come forward voluntarily. Because it also serves thirty-six states, it offers non-filers an efficient single point of contact, uniform procedure, uniform contract, and guidance through the process when the District and multiple states are involved. These efficiencies have proven particularly important to smaller states and the District, which non-filers sometimes exclude when they do state-by-state voluntary disclosure agreements because liabilities tend to be lower and the chance of discovery less than in larger jurisdictions.

The NNP simplifies the process for the District by presenting a complete package—all necessary information in a uniform format and pre-vetted to save your staff time. The NNP handles communications with the taxpayers, including time-consuming questions and reminders of due dates. NNP staff is available when requested to make recommendations whether to accept disclosure offers, and to use our relationships with the applicants, who may be disclosing to up to thirty-six other jurisdictions, to troubleshoot problems.

**12. What type of training does the MTC provide member states?**

The Commission training program is designed to increase the effectiveness and efficiency of state tax administration and regularly offers the following courses to states and local government personnel:

- Corporate Income Tax: Principles and Audit Techniques for Allocation and Apportionment
- Computer Assisted Audit Techniques Using Excel
- Statistical Sampling for Sales and Use Tax Audits
- Nexus School

In addition to its formal training program, the Commission provides training for state attorneys in conjunction with meetings of its Litigation Committee and via teleconferences.

**13. What type of support is provided to compact members if they adopt an MTC model statute or regulation?**

The legal staff regularly advises the staff of revenue departments when they have questions on the implementation of a model rule or statute and gives background information on the policy behind that model. States that have recently moved to combined filing, for example, have contacted the Commission for advice on implementing that change and managing the transition.

Legal staff of the commission may also provide support in cases challenging an administrative application of a model statute or regulation by providing advice on litigation strategy or by agreeing to write amicus briefs. Recently, for example, the Commission filed a brief in a Massachusetts Supreme Judicial Court case applying the MTC model apportionment rules for financial institutions. The revenue department prevailed in that case.

## MTC Projects

**14. During the past year, what model legislative initiatives have there been?**

The Commission in July 2014 adopted recommendations for amendments to Article IV of the Multistate Tax Compact (UDITPA). This year at its annual meeting, the Commission will consider further amendments to Article IV as well as amendments to the model apportionment rules for financial institutions. The Commission will also consider a resolution recommending that states consider adoption of an ABA model act on class action lawsuits against sellers alleging over-collection of sales tax. The Uniformity Committee is wrapping up work on model "doing business" (or nexus) statutes for sales and use tax purposes. The Uniformity Committee, through its working groups and subcommittees, is also engaged in drafting model regulations to implement the changes to Article IV adopted by the Commission last year and on a possible model whistle-blower act.

**15. Please describe any information sharing arrangement between member states.**

The MTC does not oversee or administer any information sharing arrangement between member states. The states, with the exception of New Mexico, have entered into a multi-lateral exchange agreement which is maintained by the Federation of Tax Administrators. The MTC is also a party to that agreement. Also, the MTC has the authority, under the Compact and under its audit contracts with audit-member states, to obtain state specific taxpayer information for the purpose of conducting audits of taxpayers. The MTC does not share information obtained under its audit program from any state with any other state.

**16. What are MTC's future initiatives/projects?**

The Commission determines future initiatives and projects through its Executive and other committees, not only through the suggestion of the states represented on these committees, but also as a result of input from other organizations, taxpayers, and practitioners. For example, the Council on State Taxation recently discussed with MTC staff several items for possible consideration by the Uniformity Committee in the area of easing the compliance burden on multistate business taxpayers.

**17. Other than member states, does the MTC solicit involvement by other entities, such as the private sector? If so, how and what is the level of their participation in MTC projects?**

Under the MTC's public participation policy, members of the public, business interests, practitioners, and other groups are welcome to observe or participate in the meetings of Commission bodies (that is, committees and other working groups). The MTC often solicits members of the public with particular expertise to speak to its committees or workgroups. The MTC staff and member state representatives also regularly attend and speak at industry and practitioner conferences and events to provide information about the activities of the Commission and to solicit ideas and feedback.

## MTC Transfer Pricing Project

**18. On October 6 and 7, the Arm's-Length Adjustment Service group met to discuss the MTC's proposed multistate transfer pricing audit program. What progress has been made since that meeting?**

A preliminary design of an Arm's-Length Adjustment Service program was presented to the Commission's Executive Committee at its meeting in December. The Executive Committee decided that this preliminary design could be circulated to the states to solicit commitments for participation in a four-year charter period. This month, the preliminary design was sent to every state, including D.C., that taxes corporate income.

The Advisory Group will be holding a teleconference in early March to work on a draft agreement for participation by interested states. The Executive Committee will be conducting a review of the draft design at its meeting in May, and will be deciding at that time whether to approve the program, after which the full Commission would consider it at its annual meeting in July.

**19. Has an economic consulting firm been hired in relation to the Arm's-Length Adjustment Service program?**

No. The Commission has not decided whether or not to implement this program. The project has thus far been one of designing a potential program, and a decision to implement it or not will be made later this year and will be depend on a number of factors, most notably, the number of states interested in such a program.

**20. If no economic consulting firm has been hired, what is the timeline for selection?**

No economic firm will be hired until after a request for proposals (RFP) is initiated by the program, if such a program is implemented by the Commission. The earliest an RFP would be generated would likely be July.

**21. In the Draft Design for an MTC Arm's-Length Adjustment Service, the first audit in the Arm's-Length Adjustment Service program was projected to commence during 2015. Is the MTC on track to meet this projection?**

There seems to be a misunderstanding with respect to the draft program: There are no Arm's-Length Adjustment Service audits contemplated in the design. The proposed design for the Arm's-Length Adjustment Service entails two broad components for correcting improper income shifting. The first and largest cost involves using advanced economic and technical expertise to produce analyses of taxpayer-provided transfer pricing studies and, where appropriate, recommend alternates to taxpayer positions taken based on those studies. The second component envisions enhancing the ability of states to use this expertise and the resulting analyses effectively in addressing cases of income shifting through related party transactions. Both components are complimentary of existing state audit programs and, for those states that are members, the Commission's Joint Audit Program.

**22. How much revenue is expected to be brought in by the Arm's-Length Adjustment Service program?**

The Advisory Group has produced a high quality design for the service and we are confident it will produce significant results in reducing improper corporate income shifting. Estimates of federal revenue loss from international income shifting suggest that those losses approach $100 billion annually. Based on this federal estimate, state revenue losses would be nearly $20 billion a year. Assuming ten participating states and using conservative estimates, the service is expected to generate over $110 million in revenues in its initial four years of operation—more than 14 times its anticipated budget. If more states participate, the results will be even greater.

**23. How will costs related to the Arm's-Length Adjustment Service program be charged and allocated among the participating jurisdictions?**

The cost of the service for each state will vary depending on how a state uses the service, the number of participating states and on the size of the state in terms of general corporate tax revenues. Assuming ten participating states, the average fees for the service per state will be about $125,000 in the first year and $210,000 annually in the following three years. The actual fees will vary from these average amounts depending on the size of state revenues, likely within a range of approximately $140,000 to $380,000 for the latter three years.

Thank you for this opportunity to provide information about the Commission and its current activities. I will be happy to provide any additional information, but also encourage you and your staff to explore the wealth of information available from our website, www.mtc.gov.

Best Regards,

Joe Huddleston

Joe Huddleston, LL.D.
Executive Director

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cc: Jeff DeWitt, Chief Financial Officer