ANNUAL REPORT

2002-2003 Annual Report

Multistate Tax Commission

States Working Together Since 1967....To preserve Federalism and Tax Fairness

July 2003

To the Honorable Governors and State Legislators of Member States to the Multistate Tax Commission

One of the principal purposes of the Multistate Tax Commission is to bring greater equity, uniformity and compatibility to the tax laws of the various states of this nation and their political subdivisions as those laws affect multistate and multinational businesses. Additionally, the Commission provides both industry and states an organization within which to discuss and resolve their tax problems. The Commission also assists the States in encouraging multistate and multinational businesses to comply properly with state and local tax laws and, in turn, advocates improvements in laws, rules and practices that make it easier and more convenient for those businesses to comply. Finally and fundamentally, the Commission works to help protect the tax sovereignty and jurisdiction of States under the U.S. Constitution so that the role of the States in our democratic systems of federalism remains vital and strong.

I respectfully submit to you the Annual Report of the Multistate Tax Commission. This report covers the Commission's activities for the fiscal year beginning July 1, 2002 and ending June 30, 2003.

Respectfully submitted,

Dan R. Bucks
Executive Director

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Overview of Actions Taken by Multistate Tax Commission

July 2002 through June 2003

The Multistate Tax Commission works to support the integrity, efficiency and equity of state tax systems and to preserve the sovereign authority of states to tax a fair share of interstate commerce. The Commission meets annually to approve the budget, select the Executive Committee and vote on policy matters that provide guidance for Commission activities in the coming year. The Executive Committee, which meets four times annually, is authorized under the Multistate Tax Compact to act for the Commission during the course of the year. When necessary, the Commission holds special or emergency meetings to take action on important uniformity matters and policy issues. During the 2002-03 fiscal year, the Commission held its annual business meeting on August 2, 2002, in Madison, WI. The Commission also held a special meeting on October 17, 2002.

This year the Commission concluded its *Federalism at Risk* seminar series, the year-long inquiry into the state of state and local taxation and the fiscal relationship between the states and federal government. The final seminar was held on August 1, 2002, during the MTC's annual meeting week in Madison. In February 2003, the Commission issued an Executive Summary and Overview of the *Federalism at Risk* report and subsequently finalized the full report in June 2003. The report sets forth recommendations and policy options for improving major areas of state taxation, including sales and use tax, business activity tax, fiscal federalism and general tax administration.

At its annual business meeting on August 2, 2002, the Commission adopted two comprehensive policy statements—one addressing sales and use taxation and the other addressing state business income taxation. Policy Statement 02-01, *Improving State Sales Taxes to Achieve Fairness and Simplicity*, supports state efforts to require large out-of-state sellers to collect sales and use taxes from their customers and reduce the compliance burden for such collection. Through this policy statement, the Commission reinforces its support for the development and implementation by the states of a simplified sales and use tax system, like the system under development in the Streamlined Sales Tax Project. Among other things, the policy statement also calls on Congress or the U.S. Supreme Court to restore equity among sellers by requiring collection of sales and use taxes by out-of-state sellers that make sales above a threshold level, for those states implementing a variety of simplification measures. Policy Statement 02-01 also expressed opposition to legislation that would link the expansion sales and use tax collection requirements to efforts to restrict state authority to levy business activity taxes.

The second policy statement adopted by the Commission on August 2nd expresses the Commission's continued support of the right of states to impose income taxes on a fair share of the income of multistate businesses doing business within their borders. Policy Statement 02-02 calls for federal support for ensuring full accountability of income; opposed federal efforts to restrict state business activity tax authority; and expresses the Commission's continued commitment to educating taxpayers, state and federal representatives and all other interested parties on issues related to business activity taxation. This policy statement was amended at the Commission's October 17, 2002, special meeting to incorporate a "factor presence" nexus standard for business activity taxes, a standard based on the traditional apportionment formula factors of payroll, property and receipts (sales). The amended policy statement recommends that states adopt this "factor presence" nexus standard and to urge that Congress relieve the restrictions of P.L. 86-272 for those states adopting this nexus standard.

At its August 2nd meeting, the Commission also amended MTC Resolution 01-08, *Resolution Regarding Tax Fairness in the Proposed Federal Extension for the "Internet Tax Freedom Act"* to urge that any extension of the internet access tax moratorium be temporary, continue to preserve the authority for state taxes existing before the original federal moratorium, and clarify ambiguities in the language of the existing federal law. (MTC Policy Statements and Resolutions are available via the MTC website at www.mtc.gov.)

The Commission, as is custom, adopted a number of honorary resolutions recognizing individuals who make significant contributions to the work of the Commission throughout the year.

At its special meeting on October 17, 2002, the Commission amended the MTC Bylaws to add a new Bylaw 15 setting forth procedures for adopting policy statements and resolutions.

Report of the Executive Committee

August 1, 2003

Meetings

The Executive Committee of the Multistate Tax Commission met nine times since the Annual Meeting of August 2, 2002—four times in regular sessions and five times by teleconference. These meetings were held as follows:

- October 11, 2002 by teleconference,
- October 17 and 18 , 2002 in Washington, DC,
- January 16 and 17, 2003 in San Diego, California,
- April 17, 2003 by teleconference,
- April 23 and 24, 2003 in New Orleans, Louisiana,
- May 27, 2003 by teleconference,
- June 13, 2003 by teleconference,
- June 27, 2003 by teleconference, and
- July 30, 2003 in Salt Lake City, Utah.

Through these meetings the Executive Committee has provided oversight and direction to the activities of the Commission and has moved forward the development of recommendations to achieve greater uniformity in multistate taxation. The Executive Committee's actions at these meetings are recorded in the minutes of these meetings.

Membership

The Executive Committee began the year with the following members:

Elizabeth Harchenko (OR), Chair
R. Bruce Johnson (UT), Vice Chair
Carol Fischer (MO), Treasurer
Carol Keeton Strayhorn (TX)
Rick Clayburgh (ND)
Douglas Roberts (MI)
Stephen Richards (KS)
Gerald Goldberg (CA), ex officio
Timothy Leathers (AR), ex officio

With changes of administration in Michigan and Kansas, Douglas Roberts and Stephen Richards concluded their state service in early January 2003. At its January 16 and 17, 2003 meeting, the Executive Committee elected Will Rice of Washington State and Tim Leathers of Arkansas to fill the two vacancies on the Executive Committee for the remainder of the year.

The Loss of Wade Anderson, Paull Mines and Wayne Eggert

The Executive Committee noted with sadness the loss of Wade Anderson, Paull Mines and Wayne Eggert in the past year, each of whom made important and lasting contributions to improving state and local taxation of interstate commerce and to interstate cooperation.

Wade Anderson had represented Texas to the Commission and the Executive Committee since 1969, with a short interlude from the late 1990's through 2002 when he worked in private legal practice. He had returned to the Texas Comptroller's Office in January 2003 and represented Texas at the January 16 and 17, 2003 Executive Committee meeting for what was to be a final time. Wade's contributions to interstate tax cooperation were enormous. An award in his honor to recognize those making outstanding contributions to interstate tax cooperation is being established through the Texas Comptroller's Office, the FTA and MTC and will be awarded jointly by the FTA and MTC.

Paull Mines, MTC General Counsel, and member of the Commission staff since 1989 passed away in August 2002. Paull was extraordinarily dedicated about preserving "our federalism." He was a champion of the right of states to develop and implement tax policy independent of the federal government and of voluntary uniformity among the states as a means of reconciling state sovereignty with the needs of interstate commerce . He brought great talent and intellect to his work and was widely recognized for his scholarly approach to issues. He was also distinguished by a gentle and open manner and by efforts to reach out and develop common understanding with other people, especially those who might disagree with his views. The Executive Committee has begun discussions of establishing an award for scholarly work in by persons in state agencies in memory of Paull.

At its April meeting, the Executive Committee noted as well the passing of Wayne Eggert. Wayne, who had retired as a tax manager for Lucent Technologies, had chaired the Commission's Sales Tax Simplification Planning Committee. The committee's work in the 1990's helped establish a knowledge base and increased support for sales tax simplification that has contributed to the Streamlined Sales Tax Project. Wayne was an early, consistent and strong advocate of sales and use tax simplification. He was especially active in the National Tax Association, which he had served in various capacities, including as its President.

At its meeting on April 23 and 24, 2003, the Executive Committee authorized a State Tax Compliance Initiative to focus on improving state tax compliance in three areas: business income sheltering, sales and use taxes and pass-through entity income reporting. The initiative is being conducted through a Steering Committee comprised of state representatives organized into three work groups organized around the major problem areas assigned to the initiative. The Steering Committee will also coordinate with and rely on the Commission's standing committees to assist with the development of improved methods of compliance.

The Executive Committee also provided guidance to the Commission staff in its preparation, in cooperation with the states, a path-breaking study of the fiscal impact of corporate tax sheltering on the states. The report was released on July 15, 2003, and has received widespread coverage in the press. This report represents a major effort to inform policy-makers and the public of a major problem in state and local taxation of interstate commerce.

The Executive Committee continued to emphasize coordination and communication with the Commission's standing committees and amongst the States as a means of focusing scarce Member State and Commission resource on key issues and activities. Those efforts at coordination have borne fruit especially in the form of an accelerated pace of work on the development of proposals for uniformity in multistate taxation.

Implementing Strategic Goals: Federalism at Risk, State Tax Compliance Initiative and Improved Communications

The Executive Committee continued efforts, begun in the prior year, to guide the work of the Commission toward achieving the goals set in September 2000:

1. More uniform tax treatment—in terms of consistency, equity and simplicity—amongst the states and amongst taxpayers to ensure a level playing field among all forms of commerce.
2. More voluntary compliance with state and local tax laws through effective education, simplification and coordinated enforcement.
3. Increased dialogue among all stakeholders.

The Commission has reached out to policy-makers and a host of stakeholder groups through the Federalism at Risk seminars it sponsored in 2001 and 2002. During the past year the Executive Committee has reviewed, approved and directed the publication of an Executive Summary and Overview and a final Federalism at Risk Report. The final report was approved at a May 27, 2003 teleconference and was issued at the July 30, 2003 Executive Committee meeting. The Federalism at Risk Report evaluates the status of state and local taxation in the modern economy and the evolving nature of state-federal relations. It makes a series of recommendations for policymakers on ways to improve major state and local taxes affecting interstate commerce. Those recommendations emphasize greater uniformity in taxation amongst the states and taxpayers. The report also presents a vision of cooperative federalism in which the federal government and state governments become partners in improving state and local tax systems and harmonizing the needs of the states with the needs of interstate commerce. This report is the most comprehensive assessment of federalism and taxation prepared in over a decade.

Budget Action

With the States undergoing considerable fiscal stress, the Executive Committee has taken special care to develop both an immediate and mid-term Commission budget strategy appropriated to these circumstances. That strategy involves:

- authorizing only modest 1.5% increases two major fees for FY 2004—membership assessments and audit reimbursements, following a year in which both fees had been frozen at the prior year's levels,
- holding constant the Nexus Program fees for FY 2004 at the prior's years level,
- using Commission reserves to help support budgets over the next few years,

- exercising expenditure restraint, and
- projecting the stabilization of those reserves in future years through fee levels in future years sufficient to accomplish that objective.

The Executive Committee established a Budget Committee comprised of four members to work with the Executive Director on the preparation of the FY 2004 budget. The strategy outlined above and the fee recommendations for FY 2004 were the product of this process.

The Executive Committee submits to the Commission for ratification its action of April 24, 2003, to establish FY 2004 membership assessments for twenty-one Compact and five Sovereignty Members of the Commission at $1,440,000 distributed among those states in accordance with the formula prescribed in Article VI.4. (b) of the Multistate Tax Compact.

Report of the Audit Committee and Audit Program

Rich Schrader, Chair
John Feldmann, Vice Chair
Les Koenig, Director, MTC Joint Audit Program

The Audit Committee met on July 29, 2003 in Salt Lake City, Utah. There were 36 members, guests and staff present at the meeting. There were 25 individuals representing 14 Audit Program States plus 7 guests from 5 non-audit participating states present. There were no members of the public present at the meeting. Two additional state members were present via the conference call.

The Audit Committee reviewed the status of all the audits in progress. A lengthy discussion was held on 6 income tax and 2 sales tax audits that had significant issues. One area of significant importance was a discussion on the MTC Financial Regulations and the problems of assigning receivables to the property factor. The Audit Committee expressed its satisfaction with the status of the audits in progress.

Four members of the Audit Committee volunteered to serve on a Task Force to develop a Sales and Use Tax Audit Manual for the SSTP project. Members of the Audit Committee are also serving on a Task Force to recommend standards to the SSTP project on certifying companies that will be responsible to collect and remit sales taxes on behalf of other companies. An initial draft has been presented to the SSTP project.

Audit Hours Analysis
Fiscal Year 2002-2003

SALES TAX	FISCAL YEAR QUARTER ENDING				
	Dec '02	Mar '03	Jun '03	Sep '03	Total
Total Completed Audits	2	1	3	7	13
Total States Audited	23	13	41	82	159
Total Hours	1,571	478	2,140	4,661	8,850
Average Hours Per State	68	37	52	57	56

INCOME TAX	FISCAL YEAR QUARTER ENDING				
	Dec '02	Mar '03	Jun '03	Sep '03	Total
Total Completed Audits	0	1	6	1	8
Total States Audited	0	14	134	18	166
Total Hours	0	1,224	8,583	1,288	11,095
Average Hours Per State	0	87	64	72	67

INCOME AND SALES TAXES	FISCAL YEAR QUARTER ENDING				
	Dec '02	Mar '03	Jun '03	Sep '03	Total
Total Completed Audits	0	4	12	2	18
Total States Audited	0	53	220	32	305
Total Hours	0	3,706	12,381	2,194	18,281
Average Hours Per State	0	70	56	69	60

Trends in Productivity

Fiscal Year 1989-90 through 2002-03

SALES TAX	FISCAL YEAR ENDING														
	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Total Completed Audits	9	9	8	9	14	13	15	13	14	10	16	11	14	13	11
Total States Audited	85	88	79	104	146	140	152	123	143	97	184	102	158	159	145
Total Hours	12,393	8,866	7,069	12,209	14,323	6,818	8,009	9,746	11,349	7,721	7,438	9,062	11,900	8,850	8,792
Average Hours Per State	**146**	**101**	**89**	**117**	**98**	**49**	**53**	**79**	**79**	**80**	**80**	**89**	**75**	**56**	**61**

INCOME TAX	FISCAL YEAR ENDING														
	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Total Completed Audits	12	4	9	7	12	9	9	9	10	9	7	10	8	7	8
Total States Audited	112	37	95	75	132	93	99	111	152	120	186	251	131	166	165
Total Hours	20,679	7,211	12,646	11,148	11,208	9,016	9,284	7,548	12,249	10,012	10,060	13,133	8,684	9,396	10,556
Average Hours Per State	**184**	**195**	**133**	**148**	**85**	**97**	**94**	**68**	**81**	**83**	**55**	**52**	**66**	**57**	**64**

INCOME AND SALES TAXES	FISCAL YEAR ENDING														
	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Total Completed Audits	21	13	17	16	26	22	24	22	24	19	23	21	22	20	19
Total States Audited	197	125	174	179	278	233	251	234	295	217	370	353	289	325	310
Total Hours	33,072	16,077	19,715	23,357	25,531	15,834	17,293	17,294	23,598	17,733	17,498	22,195	20,584	18,246	19,348
Average Hours Per State	**168**	**129**	**113**	**130**	**92**	**68**	**69**	**74**	**80**	**82**	**48**	**63**	**71**	**56**	**62**

Report of the Litigation Committee and MTC Legal Activities

Marshall Stranburg, FL, Chair
Frank Katz, MTC General Counsel

We report here on the activities of the Litigation Committee and the Legal Division of the Multistate Tax Commission for fiscal year 2002-2003.

Litigation Committee

The Litigation Committee met twice this past year, at the annual meeting in Madison, WI, and in Austin, TX, in March. Jack Van Coevering from Michigan continues as the Chair of the Committee and Marshall Stranburg from Florida as the vice-chair. The Committee held its regular informational and training sessions at both venues, holding a number of mini-seminars. In Madison, Dave Gormley, the Ohio Solicitor General presented a very helpful Drafting Guide for Supreme Court Amicus Briefs. Ed Gentle, an Alabama Department of Revenue contract attorney, and Executive Director Dan Bucks spoke of efforts to curb abusive tax shelters. Jack Kopald, an assistant attorney general from Tennessee, and Utah State Tax Commissioner and our own Vice Chairman Bruce Johnson updated the Committee on the Streamlined Sales Tax Project. In Austin, Dawn Miller, Chief Disciplinary Counsel for the Texas Bar gave an informative seminar on Ethics for Public Attorneys. Frank Katz, MTC General Counsel, and Roxanne Bland, MTC Counsel, discussed potential federal nexus legislation. The Committee continues to discuss methods of cooperation among states and a coordinated, strategic approach to litigation

The Supreme Court decided two important cases this term. In ***Franchise Tax Board of California v. Hyatt***, the Court ruled that the Full Faith and Credit Clause does not require Nevada to give full faith and credit to California's statutes providing its tax agency with immunity from intentional torts. The Full Faith and Credit command is "exacting" with respect to a final judgment rendered by a court, but does not compel a state to substitute the statutes of other states for its own statutes dealing with subject matter concerning which it is competent to legislate. The Court upheld its earlier ruling in *Nevada v. Hall*, that a court can lawfully apply either the law of its own state or the contrary law of another, but is not required to apply a another state's sovereign immunity statutes where such application would violate the state's own legitimate public policy. The Commission had submitted an *amicus* brief arguing that *Nevada v. Hall* was incorrect and should be overruled insofar as it held that the Full Faith and Credit Clause does not require that the courts of one state recognize and respect the sovereign immunity of sister states. In the absence of a request from the Petitioner, the Court declined the invitation of the *amici* States to reexamine that ruling.

In ***Fitzgerald v. Racing Association of Central Iowa***, the Court ruled Iowa's imposition of a higher rate of taxation on receipts from racetrack gambling facilities than on receipts from river boat gambling facilities did not violate the federal equal protection clause. The Iowa Supreme Court had found a higher tax rate on gambling facilities at racetracks had no rationale basis because the intention of the legislature in authorizing those facilities was to benefit the race tracks. The U.S. Supreme Court noted "not every provision in a law must share a single objective …the Iowa law, like most laws, might predominately serve one general purpose …while containing subsidiary provisions that seek to achieve other desirable (perhaps even contrary) ends as well, thereby producing a law that balances objectives but still serves the general objective when seen as a whole." The great flexibility of States to determine classifications for taxation was preserved.

Activities of the Legal Division of the Commission

Personnel Changes

The Commission lost it revered General Counsel last August. Paull Mines died a couple of days after his 60th birthday leaving a hole that cannot be filled. Paull had been with the Commission since 1989. Deputy General Counsel Frank Katz was promoted to General Counsel, and the Commission hired Shirley Sicilian of Kansas as the new Deputy General Counsel.

Formal Court Appearances

The Commission filed an *Amicus Curiae* brief in the United States Supreme Court in the *Hyatt* case as noted above.

Promoting Uniformity

The Legal Division continues to staff the Uniformity Committee and participate broadly in the uniformity effort of the Commission. The Division helped bring the Factor Presence Nexus Standard through the hearing process and to final approval by the Commission in October. Staff acted as hearing officers for several other uniformity proposals this past year:

- ☐ sales and use tax priority for leasing transactions;
- ☐ reporting federal adjustments;
- ☐ revision of the allocation and apportionment regulations concerning the definition of business income;
- ☐ reporting options for nonresident members of pass-through entities; and
- ☐ principles for determining the existence of a unitary business.

In addition, the Legal Division continues its involvement with the Streamlined Sales Tax Project as it moves into the governance stage.

Federal Legislative and Executive Issues

The Legal Division with the Commission's Legislative Consultant monitors proposed federal legislation that has the potential to impact the fundamental assumptions of our federal system: both the States and the Federal Government each have separate spheres of responsibility and a resulting need to raise revenue to discharge that responsibility. Legislation that has been monitored during the past year includes business activities tax nexus, authorization for SSTP states to require remote sellers to collect use tax,the Internet Tax Freedom Act extension, and abusive tax shelter monitoring and restriction.

Communications about State Efforts to Change State Tax Systems to Meet Changing Economic Conditions

Personnel from the Legal Division are a source of spokespersons from the MTC to communicate about the activities of the Commission with third parties, including business leagues, professional associations, government associations, educational symposiums and publications. General Counsel Frank Katz participated in a number of presentations on the appropriate nexus standard for business activity taxes. He spoke to the National Tax Association, the FTA Revenue Estimators, MTC Dialogue Day, the CCH Roundtable, the NCSL, the Tax Executives Institute, the Tax Council Policy Institute and to COST. He also made presentations on the Commission's Uniformity Proposal for Pass-through Entities to the Tax Section of the American Bar Association and to the Coalition of Publicly Traded Partnerships. Deputy General Counsel Shirley Sicilian gave a presentation to the Kansas Chamber of Commerce on the Commission's work in general. Counsel Roxanne Bland attended the annual NESTOA meeting in Wilmington, DE.

Administration of the Commission

The Legal Division acts as the legal advisor on issues that arise in the context of the administration of the Commission, a separately organized state instrumentality. These issues include the full gamut of what one would expect for any organization, *e.g.*, leases, contracts, and personnel matters.

Support of Other Functions of the Commission

The Legal Division provides legal support to other functions of the Commission, including the Joint Audit Program and the National Nexus Program. During the past year, the Legal Division has advised the staff of the Joint Audit Program on a number of audits, meeting with several taxpayers in the process. The readiness of the Legal Division to apply to the courts for judicial enforcement of the Commission's powers to compel the production of records helped to persuade taxpayers to comply with reasonable requests of the auditors. The Legal Division has lent considerable staff support to the State Tax Compliance Initiative Work Groups.

Technical Support of States

The Legal Division similarly continues to provide technical support to the States in issues affecting state taxation of multijurisdictional commerce. Recent issues include nexus issues, state/tribal issues, the definition of unitary business, and business income issues.

Report of the Nexus Committee and Nexus Program

Joseph Thomas, Chair
Florentino Barraza, Vice Chair
Sheldon H. Laskin, Director, MTC Nexus Program

This report summarizes the activities of the MTC Nexus Committee and the Nexus Program for the period July 1, 2002 through June 30, 2003.

Nexus Committee

The MTC Nexus Committee met in person three times during the fiscal year. In addition, the Committee met a number of times by teleconference. During the Annual Meeting, the Nexus Committee reviewed the activities of the Nexus Program during the past year. In addition, the Committee considered implementing certain reforms of the Clearinghouse Database and the Nexus Lead Set Exchange Program.

During the year, the Committee reviewed two ongoing nexus audits and made certain recommendations to the Audit Committee regarding those audits.

The Nexus Clearinghouse Database Advisory Committee met by teleconference several times during the year and produced its business plan for an Internet-based MTC clearinghouse database. The business plan was submitted to the MTC Technology Committee for its consideration.

The MTC Combined Registration Committee met periodically throughout the year. At the request of TaxWare, the Committee prepared a list of required sales and use tax data elements to be included in the MTC multistate combined electronic registration system. TaxWare is now considering those data elements in its preparation of a proposal to develop the system.

Voluntary Disclosures

During FY 2003, the National Nexus Program executed agreements with 66 taxpayers, resulting in 566 separate contracts with member states. These 566 contracts resulted in $11,900,000 in back taxes collected and $238,500,000 in estimated annual future collections. In addition, during this period the National Nexus Program opened 73 new voluntary disclosure cases, representing 914 separate potential contracts. The following chart compares the results in FY 2002 to those of FY 2003. **Note:** In interpreting these results, please keep in mind that the FY 2003 results include the disclosures processed by the National Nexus Program to facilitate agreements made between the Streamlined Sales Tax Participating States and a number of "dotcom" companies as an early good faith test of Streamlined's amnesty provisions. The first number in the FY 2003 column is the total listed item for the disclosure program as a whole. The Streamlined disclosures contained within that first number are reported as the second number in the FY 2003 column. For example, in FY 2003 66 taxpayers concluded agreements through the MTC voluntary disclosure program, of which 11 were endorsed by Streamlined. The percentage increases reported in the last column do not separately break out the Streamlined disclosures. A good measure of the growth of the Nexus Program's voluntary disclosure program in the past fiscal year, independent of Streamlined, is the amount of **back taxes collected,** as the Streamlined agreements were prospective only. In addition, the program processed many more cases in FY 2003 due to increased staff efficiencies and the extraordinary dedication of Nexus Program staff to this program.

The MTC has hired an additional part-time administrative assistant, Cherlyn Richardson, to process the increased voluntary disclosure caseload.

The Harvard University John F. Kennedy School of Government named the MTC Voluntary Disclosure Program among the top 100 programs (out of almost 1,000 candidates) in the 16th annual Innovations in American Government Awards competition.

Voluntary Disclosure Marketing

During FY 2003, nexus member states distributed 2,628 MTC voluntary disclosure brochures to taxpayers making voluntary disclosures in the states. This is an increase of 745 brochures (39%) over last year.

From October 7, 2002 to July 2, 2003, the Voluntary Disclosure Program's ad on Google was viewed 21,016 times with 1,004 viewers linking to the MTC website by clicking on the ad.[1] Comparable figures for FY 2002 were 16,239 ad viewings and 147 linkings to the MTC website. The cost of the ad from October 7, 2002 to July 2, 2003 was $184.59.

In addition, MTC staff routinely discusses the voluntary disclosure program and distributes disclosure brochures during appropriate public presentations.

Nexus Data Exchange

Nexus Discovery Lead Sets 2, 3 and 4 were completed during the fiscal year, covering a total of 176 companies. At least four companies have initiated voluntary disclosures as a result of follow-up letters from the MTC. The remaining leads were provided to the states for individual follow-up. A survey of the Nexus member states completed in February 2003 reported that at least $586,000 in taxes had been collected as a result of the lead sets. As of September 2003, the member states will be exchanging two lead sets per year, as per the vote of the Nexus Committee.

Nexus School

During the fiscal year, MTC staff conducted nexus schools in Columbus, OH, Austin, TX, Trenton, NJ and St. Paul, MN.

Multistate Combined Registration

During FY 2003, the MTC Combined Registration Committee compiled a list of data elements that participating states will require for taxpayers to electronically register for sales and use tax. The list has been supplied to TaxWare to assist the vendor in completing its proposal to develop an electronic multistate combined registration system.

Clearinghouse Database

During FY 2003, the member states exchanged 17,627 income tax and 83 sales tax records through the Clearinghouse Database. The Clearinghouse Database Advisory Committee met by teleconference several times during the year. The Committee developed a business plan for an Internet based Clearinghouse Database.

Publications

Nexus Counsel Beau Baez published the quarterly *Multistate Update* column in TaxPro Quarterly Journal during the fiscal year.

Nexus Gazette

The Nexus Program published one issue of the Nexus Gazette during the fiscal year (April 2003). Staff will occasionally publish this two-page update of Nexus Program activities and projects.

	FY 2002	FY2003	Percentage Increase
Number of taxpayers concluding agreements	32	66/11	106%
Number of executed contracts	171	566/308	231%
Back taxes collected	$2,834,751	$11,900,000	420%
Estimated future collections	$953,348	$27.7 million $22.9 million from SSTP endorsed disclosures	24917%
New cases opened	52	73/22	40%
Number of potential contracts under new cases	476	914/407	92%

Presentations

Nexus Program Director Sheldon H. Laskin participated at the CCH State Tax Advisory Board meeting in November 2002, and spoke on business activity tax nexus at the New Jersey Institute of Professionals in Taxation One-Day Tax Seminar in April 2003.

(Footnotes)

[1]Google revised its data-reporting program as of October 7, 2002. Therefore, results are reported from October 7, 2002 to July 2, 2003 instead of the entire fiscal year. Results for the entire year were obviously higher.

Report of the Uniformity Committee

Ted Spangler, Chair
Roxanne Bland, Counsel
August 1, 2003

The Uniformity Committee is charged with developing uniform sales and income tax proposals that are not only acceptable to business and state tax agencies, but also have a reasonable likelihood of adoption by a significant number of States. Since much of the Commissions' policies originate in this Committee, members endeavor to reflect this understanding in their deliberations.

Below is a review of the Uniformity Committee's specific projects for the complete fiscal year 2002-2003.

Sales and Use Tax

Sales and Use Tax Priority Project—Construction Inventory

The proposal for determining sales and use tax priority with respect to the sales and use of construction materials held in inventory was formally adopted by the Commission as a uniformity recommendation to the States in July 2002.

Sales and Use Tax Priority Project—Leasing Transactions

Significant progress has been made towards the completion of this project. The initial draft of the leasing transaction proposal was referred to public hearing in December 2002. After extensive testimony and input from the leasing industry, the Hearing Officer formed a Task Force to consider the proposal and how it could be improved. During the following months, the Task Force developed a proposal that is now nearing completion. It is anticipated that the Hearing Officer will request the Executive Committee to refer the matter back to the Uniformity Committee to review the proposal in light of the substantial changes that have been made in it.

Sales and Use Tax Priority Project—Services

After much discussion, the Sales and Use Tax Subcommittee determined to suspend work on this part of the project pending the completion of the work on sourcing sales of services by the Streamlined Sales Tax Project.

Streamlined Sales Tax Project

The Sales and Use Tax Subcommittee has begun to examine what role it should play in promoting uniformity in state sales and use tax policy once the Streamlined Project is implemented. Areas being explored include working jointly with the State Advisory Council, or narrowing its focus to use tax issues, as these are outside the province of SSTP.

Income and Franchise Tax

Reporting Federal Adjustments to States—Joint Project with AICPA

A public hearing on this uniformity proposal was held December 17, 2002 and is currently the subject of a Bylaw 7 survey. Action by the Commission on this proposal is expected in July 2003.

Uniform Definition of Business/Nonbusiness Income

A public hearing was held on this uniformity proposal on December 17, 2002 in Washington, DC. A hearing officer's report was filed on January 15, 2003. At its meeting held April 23, 2003, the Executive Committee of the Commission authorized the conduct of a Bylaw 7 survey with respect to the adoption of revisions to the Business Income Definition. The Bylaw 7 survey was sent out on June 13, 2003.

Reporting Options for nonresident members of Pass-Through Entities

This proposal was re-referred to the public hearing process by the Executive Committee in October 2002. A public hearing was held on December 17, 2002 in Washington, DC. A second hearing officer's report was filed on January 10, 2003, recommending a revision of the proposal to require withholding of tax from distributions to nonmembers unless they had agreed to be part of a composite return.. The Executive Committee approved a Bylaw 7 survey on the revised proposal at its meeting of January 16, 2003. The survey showed a majority of affected states would consider adopting the proposal. At the April Executive Committee meeting, representatives of Public Traded Partnerships (PTPs) explained why including PTPs in the withholding requirement would cause enormous difficulties for them. The Executive Committee directed the hearing officer to work further on the project.

Definition of a Unitary Business

The Committee's work on developing a definition of a unitary business has been completed. On June 13, 2003, the Executive Committee approved the proposal for public hearing. The current proposal is significantly simpler than its predecessors; particularly notable is the deletion of two of the three "tests" used by States to determine the existence of a unitary business. The "contribution and dependency" test and the "three unities" test have been incorporated in the "Mobil factors" test developed by the U.S. Supreme Court.

New Projects

The Income and Franchise Tax Subcommittee identified three potential new projects:

1. Insurance Deregulation. A joint effort with the National Association of Insurance Commissioners and other interested organizations to examine whether mergers between banks and insurance companies, with special attention paid to the creation of captive insurance companies, have resulted in the shifting of income from banks to insurance companies in efforts to shield bank income from tax.

2. Income Apportionment—Telecommunications. This project had been held in abeyance pending the conclusion of a study conducted by California on the same issue. The study has now been completed.

3. Energy Industry. Develop an apportionment rule for energy companies.

These potential projects will be discussed further and possibly decided upon at the July 2003 meeting.

2002 Business-Government Dialogue Day

The 2002 Business-Government dialogue focused on the concluding Report on the Federalism at Risk series, an initiative sponsored by the Commission to investigate and study current issues of federalism.

Conclusion

I would like to express my appreciation to the several Uniformity Committee members who have given generously of their time and energy to develop the large number of proposals considered by the Committee during this fiscal year. As always, I remain grateful to Jennifer Hays, KY, and Claire Hesselholt, WA, Chairs of the Income and Franchise Tax Subcommittee and the Sales and Use Tax Subcommittee. The committed involvement of state participation on these proposals is testimony to the dynamic and committed leadership of the Commission itself.

Report of the Technology Committee

Tim Blevins, Chair
Joe Randall, Vice Chair
July 2003

The following is a report of the activities of the Technology Committee of the Multistate Tax Commission for the fiscal year 2002-03.

MTC Enterprise Automation Project: Security Architecture

Under its charter, the Technology Committee is charged with and has proceeded to review and evaluate the Commission's automated systems development plans to ensure that they are sound, cost-effective, likely to achieve their objectives, and compatible with Member State systems and operations.

The MTC has the goal of becoming an e-trustworthy entity so that its Member States can conduct secure business transactions over the Internet with the MTC and among themselves. Pursuant to this goal, the MTC has initiated work to allow: a) secure e-mail among MTC staff; b) secure e-mail between MTC staff and its Member States; c) secure e-mail among the Member States; and d) secure web access for Member States.

The MTC has been testing Public Key Infrastructure (PKI) and now uses VeriSign's products and services in a pilot project to test the planned secure communications environment. This Committee is assisting the MTC with the PKI authentication process and criteria, and helping to define the role of PKI in the MTC's security infrastructure and automated systems.

The second stage of the PKI implementation continued with some success. Technological constraints are being resolved on both the MTC internal system and on state systems. Currently, personnel in eight states have PKI certificates for the pilot testing. Policies and procedures are being developed to begin practical use of this technology.

MTC Enterprise Automation Project: Applications

The MTC plans to automate many programs of the Commission by developing, or having developed for it, applications that will improve the operations of the following processes:

- ☐ Contacts, Membership and Online Meeting Registration Administration
- ☐ Audit Selection
- ☐ Online Clearinghouse Database
- ☐ Audit Management (sales tax, initially)

During the past year, business definitions for each application were drafted or refined. A detailed development plan was reviewed and revised with direction from this Committee. The plan provides for the Contacts application to be developed as the first priority, with the other applications following. It is expected that the development of the initial application will encompass much of the foundation of the overall Automated System. This Committee has provided assistance in these efforts and has helped to structure a plan of action for the development of the various applications. The hiring process for an MTC software engineer to conduct (and oversee, in some instances) the programming for the applications, was completed near the end of the fiscal year 2002-03. The new staff member commenced employment on July 21, 2003.

Multistate Combined Registration Project

The Technology Committee provided assistance in communications with potential vendors for the development of the Combined Registration System. The Committee also has monitored this project's adherence to the requirements of the Streamlined Sales Tax Project.

The purpose of the Project is to implement an online tax registration system that will enable multistate taxpayers to register for tax simultaneously in a number of jurisdictions on a "one-stop shopping" basis. The project is intended to both accommodate conventional registration in an online environment, and to fulfill the Streamlined Sales Tax Project requirement of a streamlined, centralized online registration system.

One vendor, TaxWare, has not yet provided the formal proposal. The MTC has provided the vendor a list of common data elements that the states will require under the conventional registration method.

Streamlined Sales Tax Project (SSTP) Technology Requirements

The Streamlined Sales Tax Project will require a certification and systems audit plan to assure the integrity of electronic sales tax collection software for certified service providers (CSP) and certified automated systems (CAS) under the streamlined system tax collection models. This Committee has provided support in evaluating systems audit options, including reviewing existing systems certification and audit models and defining the scope of certification and systems audit requirements under the SSTP. A task force comprised of both Technology Committee and Audit Committee members was created. This task force recently produced a comprehensive draft of systems certification and audit standards and has submitted the draft for review by the SSTP audit work group.

The Technology Committee will continue to closely monitor the development of this and other components of the SSTP.

Distance Learning

The Committee advised in the evaluation of distance learning, such as Internet-based training, for use by the MTC as a supplement to existing training provided to state personnel by the Nexus Program and the Audit Program, and for future MTC training courses. The Committee itself held three (3) videoconferences and produced a reference document to the facilities and procedures available to states for conducting videoconferences. This Committee supports the continuation of MTC staff research into distance learning options, including the possible hiring of a consultant to advise on the potential advantages and disadvantages of various distance learning techniques to MTC training courses.

Budgeting Assistance

The Committee continued its role as advisor on the technology budget of the MTC. The Committee advised staff on the relative costs of various approaches to the automation project development.

Compliance Initiative

The Technology Committee was advised of its expected role in assisting with the technology-related issues that will arise out of the MTC State Tax Compliance Initiative. Aspects that may be addressed by this Committee include electronic exchange of information, database development and automation of systems that assist with tax compliance.

Other Items

The Committee reviewed an MTC Information Systems staff roles and responsibilities document. Also, the Committee has created an Electronic Document Exchange Standards to facilitate the electronic exchange of different type of documents (*e.g.*, word processing documents and spreadsheets) between Member states and MTC staff and among the states.

Report of the Deregulation, Industry Change and Taxation Project

Ken Beier, Project Manager
August 1, 2003

The MTC Deregulation, Industry Change and Taxation Project was established in FY 1999 to provide research and technical assistance to states and support the exchange of information on tax changes arising from industry restructuring. The project has undertaken a range of research and educational efforts, and increased the understanding of industry issues among state tax personnel. Project activities will continue this year (FY 2003-04) with carryover funding from prior years. With the end of a separately funded project after this fiscal year, there is an opportunity for MTC standing committees to incorporate industry-specific issues into their regular work.

Project Retrospective

The MTC Deregulation Project was established with the participation of eleven States (MT, WA, OR, ID, NM, CO, MO, KY, AL, AR, and PA) in FY1999 to provide research and technical assistance to States and support the exchange of information on tax changes arising from industry restructuring. The Deregulation Project manager was hired in August 1999. Eight States (WA, OR, ID, CO, MO, KY, AL, and AR) have continued their support for the project through FY2001-02. Ken Pearson of the Missouri Department of Revenue was appointed Chair of the MTC Deregulation Task Force by MTC Chair Elizabeth Harchenko in October 2002. Project activities continue to be funded during fiscal year 02-03 and 03-04 with carryover funds from prior years.

The initial focus of project was on electric utility restructuring. With the passage of Gramm-Leach-Bliley Act (PL 106-102) in November 1999, it became apparent to the Deregulation Project States and the Executive Committee that the project should broaden its focus to include financial services issues. The project has also, in its communication with the States and educational seminars, included telecommunications issues.

Project Activities

The following activities have been undertaken by the MTC Deregulation Project:

- Deregulation Update—Twenty-three editions of the MTC Deregulation Update have summarized significant legislative, regulatory, industry, and tax events and issues in the electric utility and financial services industries.
- Deregulation Seminars—Four Deregulation Seminars (December 2000 in Denver, Colorado; May 2001 in St. Louis, Missouri; March 2002 in Tucson, Arizona and March 2003 in Austin Texas.) have focused on industry-specific knowledge and state tax issues. These seminars have been repeatedly cited as one of the best contributions of the Deregulation Project to industry-specific knowledge of state tax personnel.
- NESTOA Subcommittee on Income Taxation of Energy Companies—The MTC project manager and other MTC staff participated in meetings of this group during 2000. The subcommittee report was submitted to the Northeast States Tax Officials Association (NESTOA) commissioners and directors in January 2001. This was followed with a fiscal survey of the northeast states. No action has been taken on the proposal.
- NCSL Electric Utility Tax Partnership—The MTC Deregulation Project and several other public and private sector partners are participating in this update of the 1997 National Conference of State Legislatures (NCSL) electric utility taxation study. The project has completed a survey of electric industry taxation in the 50 states and will be completing its report by the end of 2003.
- Survey of Project States on taxation of cable modem and DSL service—The Federal Communications Commission is considering reclassification of broadband communications services

from "telecommunications services" to "information services." Due to concerns about the effect of these changes on state revenues, the MTC Deregulation Project conducted a survey of the application of telecommunications taxes to cable modem and DSL services among the Deregulation Project States. The results were distributed to the Project States in September 2002.

- Technical assistance for state tax policy research and tax audits—The MTC Deregulation Project Manager has responded to requests for technical support on energy tax proposals and an MTC and state income tax audits of utilities.

Recent Industry Events

Deregulation of electric supply at the retail level, after a promising start in the late 1990s, has not expanded since California's negative experience with this approach. Since the California debacle, no additional States have passed legislation that introduces retail competition. In addition, several states have delayed implementation of retail choice programs. Wholesale energy markets have experienced a retrenchment following the Enron bankruptcy, but are expected to recover following the sale and write-down of utility assets by independent energy companies. Federal encouragement of wholesale competition is expected to expand under the Federal Energy Regulatory Commission's single market design proposal.

In the financial services area, Gramm-Leach-Bliley has allowed a wide range of activities—including commercial banking, investment banking, securities, and insurance—to be undertaken by related companies under a holding company structure. However, there has not been the degree of integration of insurance and other financial activities that was expected in the wake of the Citibank-Travelers merger and the subsequent passage of Gramm-Leach-Bliley.

The expansion of authorized activities of industrial loan companies, such as offering checking accounts to businesses and opening branches nationwide, could have a significant effect on the ability of non-financial firms to provide financial services. Proposals to allow these activities have cleared the U.S. House Financial Services Committee, but face major concerns from federal regulators and key members of Congress about federal regulation of industrial loan companies and their parent companies. Industrial loan companies, which operate in Utah, California, Colorado, Nevada and Minnesota, are regulated at the state level.

Continuing a Focus on Industry-Specific Activities

With the end of a separately funded Deregulation Project (at the end of this fiscal year), the MTC standing committees and MTC staff have an opportunity to incorporate industry-specific issues into their regular work. At its March 2003 meeting, the Income Tax Subcommittee of the MTC Uniformity Committee suggested three possible topics for its work: 1) income apportionment for telecommunication companies, 2) taxation of financial and insurance activities, and 3) apportionment rules applicable to the energy industry. At a July 11, 2003 teleconference, Deregulation Project states expressed the most interest in financial and insurance taxation. At this meeting, it was also agreed that the audience for Deregulation Project communications would be broadened to include the Uniformity Committee, and interested participants from other MTC committees and the states.

During the coming year, the Deregulation Project will continue to:

- Monitor federal legislative and regulatory activity affecting the electric utility, financial services and telecommunications industries.
- Monitor state regulatory and tax compliance activity in these industries.
- Increase the awareness of industry-specific issues among state tax personnel by providing updates on industry events and training to the states. Training may occur through a stand-alone seminar or through more narrowly focused training for the Uniformity Committee and other interested state tax personnel.

Multistate Tax Commission

Financial Statements and Report of Independent Certified Public Accountants

June 30, 2003 and 2002

MULTISTATE TAX COMMISSION
Table of Contents
June 30, 2003 and 2002

Report of Independent Certified Public Accountants

Executive Committee
Multistate Tax Commission

We have audited the accompanying balance sheets of Multistate Tax Commission as of June 30, 2003 and 2002 and the related statements of revenue and expenses and changes in fund balance and cash flows for the years then ended. These financial statements are the responsibility of the Commission's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Multistate Tax Commission as of June 30, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

September 9, 2003

MULTISTATE TAX COMMISSION
Balance Sheets
June 30,

ASSETS

		2003		2002
Current Assets				
Cash and cash equivalents	$	2,134,592	$	2,679,101
Accounts receivable				
Members		6,481		-
Schools		16,790		29,575
Prepaid expenses		45,683		39,246
Total Current Assets		2,203,546		2,747,922
Property and Equipment - at Cost				
Office furniture and equipment		972,478		976,284
Leasehold improvements		87,485		87,485
Less: accumulated depreciation and amortization		(769,793)		(665,993)
Property and Equipment - Net		290,170		397,776
Other Assets				
Expense account advances		8,200		8,200
Deposits		10,628		10,628
Total Other Assets		18,828		18,828
TOTAL ASSETS	$	2,512,544	$	3,164,526

LIABILITIES

	2003	2002
Current Liabilities		
Accounts payable	$ 67,449	$ 216,726
Payroll taxes withheld and accrued	27,676	35,761
Accrued salaries and vacation pay	242,554	242,582
Current portion of capital lease obligation	5,376	3,798
Deferred assessments and audit reimbursements	89,576	383,324
Total Current Liabilities	432,631	882,191
Long-Term Liabilities		
Capital lease obligation	1,636	7,114
Total Long-Term Liabilities	1,636	7,114
TOTAL LIABILITIES	434,267	889,305
Commitments and Contingencies - Note 3		
Fund Balances		
Unappropriated	866,127	1,013,713
Appropriated	809,520	736,972
Restricted	402,630	524,536
Total Fund Balances	2,078,277	2,275,221
TOTAL LIABILITIES AND FUND BALANCES	$ 2,512,544	$ 3,164,526

MULTISTATE TAX COMMISSION
Statements of Revenue and Expenses
and Changes in Fund Balance
Unappropriated Funds
For the Years Ended June 30,

	2003	2002
Revenue - Unappropriated and Appropriated		
Assessments	$ 4,085,904	$ 4,026,175
Interest	44,125	70,695
Other income		
Training fees	123,320	108,435
Miscellaneous	25,632	2,241
Total Revenue	4,278,981	4,207,546
Expenses - Unappropriated and Appropriated		
Accounting	11,739	11,540
Bonds and insurance	15,621	14,074
Conferences	104,328	108,157
Professional services	349,714	342,976
Database services	61,710	-
Depreciation and amortization	123,722	122,618
Employee benefits	449,551	425,130
Miscellaneous	23,194	17,844
Office supplies	44,692	60,210
Pension plan and retirement provision	280,968	275,794
Postage	35,715	40,792
Printing and duplicating	34,724	40,220
Publications and electronic resources	28,692	45,852
Recruitment	1,204	929
Rent	220,069	203,759
Repairs and maintenance	7,453	11,409
Salaries	2,286,795	2,276,491
Software licenses	56,241	15,702
Subscriptions, publications, dues	27,007	27,915
Telephone	80,289	96,702
Travel	327,772	349,513
Training	12,001	13,156
Transfer - training and education	7,040	(2,640)
Transfer - database services	(61,710)	-
Allocation of administrative expenses	(174,512)	(173,772)
Total Expenses	$ 4,354,019	$ 4,324,371

(continued)

MULTISTATE TAX COMMISSION
Statements of Revenue and Expenses
and Changes in Fund Balance
Unappropriated Funds
For the Years Ended June 30,

	2003	2002
Excess of Revenue Over (Under) Expenses	$ (75,038)	$ (116,825)
Transfer to Appropriated Fund Balance	(157,298)	(44,770)
Transfer from Appropriated Fund Balance	84,750	234,263
Total Amount Transferred	(72,548)	189,493
FUND BALANCE - Unappropriated - Beginning of Year	1,013,713	941,045
FUND BALANCE - Unappropriated - End of Year	$ 866,127	$ 1,013,713

MULTISTATE TAX COMMISSION
Statements of Changes in Fund Balance
Appropriated Funds
For the Years Ended June 30,

	Automation Plan	Cooperative Auditing Study	Federalism At Risk
Fund Balance - June 30, 2001	$ 156,632	$ -	$ -
Transfer from Unappropriated Fund Balance	-	40,000	124,770
Transfer to Unappropriated Fund Balance	(156,632)	(5,469)	(68,943)
Net Amount Transferred (To) From Unappropriated Fund Balance	(156,632)	34,531	55,827
Fund Balance - June 30, 2002	-	34,531	55,827
Transfer from Unappropriated Fund Balance	-	-	-
Transfer to Unappropriated Fund Balance	-	(10,613)	(18,271)
Net Amount Transferred (To) From Unappropriated Fund Balance	-	(10,613)	(18,271)
Fund Balance - June 30, 2003	$ -	$ 23,918	$ 37,556

Enterprise Automation Project	Nexus Activities	Nexus Education	Membership Development and Relations	Total
$ 320,978	$ 300,000	$ -	$ 148,855	$ 926,465
100,000	(200,000)	100,000	(120,000)	44,770
-	-	(3,219)	-	(234,263)
100,000	(200,000)	96,781	(120,000)	(189,493)
420,978	100,000	96,781	28,855	736,972
157,298	-	-	-	157,298
-	(10,000)	(45,866)	-	(84,750)
157,298	(10,000)	(45,866)	-	72,548
$ 578,276	$ 90,000	$ 50,915	$ 28,855	$ 809,520

MULTISTATE TAX COMMISSION
Statements of Changes in Fund Balance
Restricted Funds
For the Years Ended June 30,

	4R Project	Nexus Program	Deregulation	Total
Fund Balance - June 30, 2001	$ 84,694	$ 405,875	$ 101,956	$ 592,525
Revenue	-	670,150	140,485	810,635
Expenses	-	775,537	103,087	878,624
Excess (Deficiency) of Revenue Over Expenses	-	(105,387)	37,398	(67,989)
Transfer from Unappropriated Fund Balance	-	-	-	-
Fund Balance - June 30, 2002	84,694	300,488	139,354	524,536
Revenue	-	737,070	-	737,070
Expenses	-	770,770	88,206	858,976
Excess (Deficiency) of Revenue Over Expenses	-	(33,700)	(88,206)	(121,906)
Fund Balance - June 30, 2003	$ 84,694	$ 266,788	$ 51,148	$ 402,630

MULTISTATE TAX COMMISSION
Statements of Cash Flows
For the Years Ended June 30,

	2003	2002
Increase (Decrease) in Cash and Cash Equivalents		
Cash Flows From Operating Activities		
Excess of revenue over (under) expenses	$ (196,944)	$ (184,814)
Adjustments to reconcile excess of revenue over (under) expenses to net cash provided by (used in) operating activities		
Depreciation and amortization	130,491	128,177
Loss on disposal of property and equipment	-	37,196
Changes in assets and liabilities		
Accounts receivable		
Members	(6,481)	161,072
Special projects	(4,000)	17,601
Schools	16,785	(29,575)
Prepaid expenses	(6,437)	1,788
Deposits	-	(2,999)
Accounts payable	(149,277)	114,529
Payroll taxes withheld and accrued	(8,085)	3,887
Accrued salaries and vacation pay	(28)	15,998
Deferred assessments and audit reimbursements	(293,748)	(294,150)
Net Cash Used in Operating Activities	(517,724)	(31,290)
Cash Flows From Investing Activities		
Proceeds from sale of U.S. Treasury bills	-	497,359
Purchase of property and equipment	(22,885)	(239,384)
Increase in capital lease	-	13,119
Payments on capital lease	(3,900)	(8,372)
Net Cash Provided by (Used in) Investing Activities	(26,785)	262,722
Net Increase (Decrease) in Cash and Cash Equivalents	(544,509)	231,432
Cash and Cash Equivalents - Beginning of Year	2,679,101	2,447,669
Cash and Cash Equivalents - End of Year	$ 2,134,592	$ 2,679,101
Supplemental Disclosures		
Income taxes paid	$ -	$ -
Interest paid	$ 2,999	$ 3,050

The accompanying notes are an integral part of these financial statements.

MULTISTATE TAX COMMISSION
Notes To Financial Statements
June 30, 2003 and 2002

1. Summary of Significant Accounting Policies

The Multistate Tax Commission (the Commission) was organized in 1967. It was established under the Multistate Tax Compact, which by its terms, became effective August 4, 1967. The basic objective of the 'Compact' and, accordingly, the Commission is to provide solutions and additional facilities for dealing with state taxing problems related to multi-jurisdictional business.

Cash Equivalents

For purposes of the statement of cash flows, the Commission considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents.

Accounts Receivable

Accounts receivable are stated at the amount management expects to collect from outstanding balances. The Commission considers accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts is required. If amounts become uncollectible, they will be charged to operations when that determination is made.

Property and Equipment

All property and equipment is stated at cost and depreciated using straight-line and accelerated methods based upon estimated useful lives as follows:

Leasehold Improvements	5 years
Office Furniture and Equipment	5 to 7 years

Expenditures for maintenance and repairs are charged to the appropriate expense accounts as incurred. Expenditures for renewals or betterments which materially extend the useful lives of assets or increase their productivity are capitalized at cost. The costs and related allowances for depreciation of assets retired or otherwise disposed of are eliminated from the accounts. The resulting gains or losses are included in the determination of excess of revenue over expenses.

Deferred Assessments and Audit Reimbursements

Assessments and audit reimbursements are due from the respective states on July lst of each year and cover the following twelve-month period. Assessments received prior to July 1st for the following year are unearned and considered deferred income until recognized as revenue in the following year.

MULTISTATE TAX COMMISSION
Notes To Financial Statements
June 30, 2003 and 2002

1. Summary of Significant Accounting Policies (Continued)

Income Taxes

In the opinion of legal counsel, the Commission is exempt from Federal income taxes as well as from other Federal taxes as an organization of a group of States or as an instrumentality of those States. Therefore, no provision has been made in the financial statements for Federal income taxes.

2. Pension Plan

Effective June 30, 1986, the Commission adopted a defined contribution plan to be funded at a rate of twelve percent of each participating individual's annual salary. To participate in this plan, employees are required to work more than certain pre-determined hourly and monthly levels throughout the plan year. The total pension expense relating to the defined contribution plan for the years ended June 30, 2003 and 2002 was $329,397 and $323,812, respectively.

3. Commitments

The Commission rents its office facilities in Washington, D.C., Texas, New York, and Illinois under lease agreements with terms expiring on various dates through January 31, 2008. These leases provide for the following minimum annual base rentals exclusive of utility charges and certain escalation charges:

Fiscal Year Ended:	Minimum Annual Payment
2004	$ 281,869
2005	265,142
2006	242,786
2007	233,951
2008	124,305

The leases include certain escalation charges based on various factors including utility, operating expense and property tax increases from a base year. Rent expense, exclusive of utility charges and real estate taxes, for the years ended June 30, 2003 and 2002 was $293,275 and $274,847, respectively.

4. Appropriated Fund Balances

During the year ended June 30, 1996, the Automation Plan was established for the purpose of financing automation improvements. The automation plan would improve audit efficiency through upgraded computers and software, potentially enabling the audit program to undertake computer-assisted audits. The plan would also improve other staff operations through upgraded computers, and upgraded communications among the Commission's offices and the states, and expand training services to states through enhanced computer communications, improved presentation equipment and videoconferencing.

The Commission's executive committee authorized the Enterprise Automation fund in the amount of $73,000 during the year ended June 30, 1997. An additional $357,000 has been authorized in subsequent years. The purpose of this fund is to provide support, through professional services, for developing enterprise-wide applications for managing the Commission information resources in a manner that enhances its operations.

The Commission's executive committee authorized the Nexus Activities fund in the amount of $80,000 during the year ended June 30, 1997. An additional $220,000 has been authorized in subsequent years. The purpose of this fund is to provide support for Commission nexus activities including, a) research and writing on Constitutional nexus issues and b) a reserve for professional services to support work on potential nexus cases in litigation.

The Commission's executive committee authorized the Membership Development and Relations fund in the amount of $150,000 during the year ended June 30, 2000. The purpose of this fund is to support efforts aimed at increasing membership.

The Commission's executive committee authorized the Cooperative Audit Study fund in the amount of $40,000 during the year ended June 30, 2002. The purpose of this fund is to evaluate the expansion of cooperative auditing among states.

5. Restricted Fund Balances

During the year ended June 30, 1988, the 4R Program was established whereby contributions received are restricted to use for supporting education, lobbying and legal expenses related to this property tax project. The purpose of the project is to provide for research activities as well as to seek favorable changes in Federal laws which are related to property tax restrictions of state and local governments.

5. Restricted Fund Balances (Continued)

During the year ended June 30, 1991, the National Nexus program was established. This program, funded by participating states, aims to encourage and secure taxpayer compliance with current state laws through a centralized taxpayer registration information service, a liability resolution process and information sharing among member states. The contributions received from the participating states are restricted for this purpose.

During the year ended June 30, 1999, the Deregulation project was established. This project provides technical assistance to help states adapt their tax policies to the deregulation of major industries, with an initial focus on electric utility deregulation. The contributions received from the participating states are restricted for this purpose.

6. TaxNet Governmental Communications Corporation (TaxNet)

TaxNet is a separate corporation organized as a public charity and instrumentality of the states for the purpose of establishing, maintaining and administering an electronic communications network to allow subscriber access to tax information and communication with governmental tax offices. The corporation is managed by a board of directors, which includes, in accordance with its bylaws, the Chair, Vice Chair and Executive Director of Multistate Tax Commission.

Among other things, the Commission assisted in the formation of TaxNet by contributing legal services. The Commission continues to assist TaxNet by contributing other legal services. Such services have not been reflected separately in the accompanying financial statements, because such amounts are not material.

7. Deferred Compensation Plan

The Commission offers employees a deferred compensation plan in accordance with Internal Revenue Code Section 457. The plan permits employees to defer a portion of their salary until future years. Participation in the plan is optional. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. In accordance with federal law, participants' deferred compensation under the plan is trusteed and thus shielded against the claims of the creditors of the Commission and therefore, not included in these financial statements.

The Commission believes it has no liability for losses under the plan but does have a duty of due care that would be required of an ordinary prudent investor.

Investments are managed by the plan's trustee under twenty seven investment options or a combination thereof. The participants make the choice of the investment option(s).

8. Allocation of Administrative Expenses

The administrative costs of providing the various programs and other activities have been allocated among the programs and supporting services, based on total operating costs.

9. Use of Estimates

In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the reported amounts of revenues and expenses during the reporting period, and disclosures. Actual results could differ from those estimates.

10. Concentration of Credit Risk

The Commission maintains cash balances in excess of $100,000 in a bank in the State of Colorado. The Commission is an eligible account holder under Colorado's "Public Deposit Protection Act of 1975". The purpose of the act is to provide protection of public moneys on deposit in state and national banks in Colorado and beyond that provided by the federal deposit insurance corporation and to ensure prompt payment of deposit liabilities to governmental units in the event of default or insolvency of any such banks.

Report of Independent Certified Public Accountants on Supplementary Information

Executive Committee
Multistate Tax Commission

Our audit was conducted for the purpose of forming an opinion on the basic financial statements for the year ended June 30, 2003, which are presented in the preceding section of this report. The schedule of expenses for the year ended June 30, 2003, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

September 19, 2003

MULTISTATE TAX COMMISSION
Schedule of Expenses
For the Year Ended
June 30, 2003

	Unappropriated and Appropriated Funds					
	General Expenses	Audit Program	Administrative Expenses	Enterprise Automation	Federalism At Risk	Cooperative Auditing Study
Accounting	$ 8,000	$ -	$ 3,739	$ -	$ -	-
Bonds and insurance	-	-	15,621	-	-	-
Conferences	51,215	9,724	525	-	-	-
Professional services	229,654	11,234	27,899	5,469	8,410	9,357
Database services	-	61,710	-	-	-	-
Depreciation and amortization	-	26,395	97,327	-	-	-
Employee benefits	74,054	255,865	114,132	-	-	-
Miscellaneous	1,587	2,243	9,139	-	1,544	-
Office supplies	8,199	10,304	18,228	-	964	-
Pension plan and retirement provision	52,635	161,896	62,230	-	-	-
Postage	4,011	11,126	14,802	-	1,069	210
Printing and duplicating	3,188	4,592	16,097	-	4,651	611
Computer communications	3,285	8,276	16,140	-	160	-
Recruitment	1,204	-	-	-	-	-
Rent	36,231	100,778	83,060	-	-	-
Repairs and maintenance	-	3,199	4,254	-	-	-
Salaries	425,320	1,313,805	512,610	-	-	-
Software licenses	-	-	-	56,241	-	-
Subcriptions, publications, dues	11,326	11,972	3,591	-	-	-
Telephone	32,165	32,935	14,552	-	-	37
Temporary help	-	-	-	-	-	-
Travel	96,573	188,424	17,489	-	1,473	398
MTC staff training	3,515	2,596	5,890	-	-	-
Transfer - training and education	-	(5,280)	-	-	-	-
Transfer - database services	-	-	-	(61,710)	-	-
Allocation of administrative expenses	265,606	558,341	(1,037,325)	-	-	-
Total Expenses	$ 1,307,768	$ 2,770,135	$ -	$ -	$ 18,271	$ 10,613

				Restricted Funds			
Training and Education	Nexus Education	Nexus Activities	Total Unappropriated and Appropriated Funds	Deregulation	National Nexus Program	Total Restricted Funds	Total All Funds
$ -	$ -	$ -	$ 11,739	$ -	$ -	$ -	$ 11,739
-	-	-	15,621	-	-	-	15,621
42,864	-	-	104,328	46	5,131	5,177	109,505
3,225	44,466	10,000	349,714	459	7,331	7,790	357,504
-	-	-	61,710	-	-	-	61,710
-	-	-	123,722	-	6,769	6,769	130,491
5,500	-	-	449,551	5,890	81,675	87,565	537,116
8,681	-	-	23,194	-	324	324	23,518
6,997	-	-	44,692	-	4,468	4,468	49,160
4,207	-	-	280,968	5,565	42,864	48,429	329,397
4,497	-	-	35,715	-	9,424	9,424	45,139
5,585	-	-	34,724	-	2,573	2,573	37,297
31	800	-	28,692	-	(521)	(521)	28,171
-	-	-	1,204	-	-	-	1,204
-	-	-	220,069	12,772	60,434	73,206	293,275
-	-	-	7,453	-	409	409	7,862
35,060	-	-	2,286,795	43,708	359,001	402,709	2,689,504
-	-	-	56,241	-	-	-	56,241
118	-	-	27,007	925	11,117	12,042	39,049
-	600	-	80,289	810	7,126	7,936	88,225
-	-	-	-	-	8,702	8,702	8,702
23,415	-	-	327,772	116	12,062	12,178	339,950
-	-	-	12,001	-	2,324	2,324	14,325
12,320	-	-	7,040	-	(7,040)	(7,040)	-
-	-	-	(61,710)	-	-	-	(61,710)
38,866	-	-	(174,512)	17,915	156,597	174,512	-
$ 191,366	$ 45,866	$ 10,000	$ 4,354,019	$ 88,206	$ 770,770	$ 858,976	$ 5,212,994