ANNUAL REPORT

Multistate Tax Commission
2003-2004

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Report of the Executive Committee to the Annual Meeting of the Multistate Tax Commission

July 30, 2004

Meetings

The Executive Committee of the Multistate Tax Commission met nine times since the Annual Meeting of August 1, 2003—four times in regular sessions and five times by teleconference. These meetings were held as follows:

- October 16 and 17, 2003 in Washington, DC,
- October 29, 2003 by teleconference,
- January 14 and 15, 2004 in San Diego, California,
- February 5, 2004, by teleconference,
- March 3, 2004 by teleconference,
- April 29 and 30, 2004 in Portland, Oregon,
- July 9, 2004 by teleconference,
- July 12, 2004 by teleconference, and
- July 28, 2004 in Mystic, Connecticut.

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 compliance with state and local taxes and greater uniformity in multistate taxation. The Executive Committee's actions at these meetings are recorded in the minutes of these meetings.

Membership

As elected by the Multistate Tax Commission on August 1, 2003, The Executive Committee membership throughout the year was as follows:

R. Bruce Johnson (UT), Chair
Carol Fischer (MO), Vice-Chair
Rick Clayburgh (ND), Treasurer
Carol Keeton Strayhorn (TX)
Jay Rising (MI)
Will Rice (WA)
Joan Wagnon (KS)
Gerald Goldberg (CA), ex officio
Timothy Leathers (AR), ex officio
Elizabeth Harchenko (OR), ex officio

Highlights

The Executive Committee at each of its in-person meetings conducted oversight of the activities of the Commission's committees, task forces and staff. Care was taken to review the Commission's finances through the quarterly reports of the Treasurer and the conduct and review of an annual financial audit.

The Executive Committee supervised the development of measures for improving the uniformity and compatibility of state tax practices. The Executive Committee shepherded the development of two major uniformity proposals adopted by the Commission in the course of the year:

1. Uniform Reporting Options for Non-resident members of Pass-through Entities, adopted by the Multistate tax Commission on December 18, 2003, and
2. A Revision of the Multistate Tax Commission Allocation and Apportionment Regulation IV.1.(b) Setting Forth Principles for Determining the Existence of as Unitary Business, Adopted by the Commission on January 15, 2004.

The Executive Committee also approved on March 3, 2004—in response to a request from the leadership of the Streamlined Sales Tax Project—the development of a combined registration system required by the Streamlined Agreement at an estimated cost of $195,000 for computer hardware and software consultants plus the use of Commission staff time at an estimated value of approximately $100,000. This system, which provides businesses a one-stop multistate registration service for sales and use tax purposes, furthers two of the Commission's purposes under the Compact: a) taxpayer convenience and compliance and b) uniformity or compatibility in state tax systems.

The Executive Committee devoted considerable effort to supervising the Commission's work in representing the interests of the states in measures pending before Congress. Congress in considering an increase number and range of proposals affecting state and local taxes, including proposals that would preempt state authority in the imposition of business activity taxes, the taxation of Internet access and related services, and the taxation of "Voice over Internet Protocol" telephony. Further, Congress is considering measures that would help curtail abusive tax shelters and that would approve expanded use tax collection authority for state adopting, albeit with a additional requirements, the Streamlined Sales Tax Agreement. These measures would have a substantial impact on state and local taxing authority and the equity and effectiveness of state and local tax systems. The range of proposals before Congress has required considerable efforts by the Commission. These efforts have included two state tax legislative days through which state tax officials have visited their respective members of Congress, one in October 2003 and another in March 2004 (the latter in cooperation with the Federation of Tax Administrators).

To improve equitable compliance by the taxpayers with state and local tax system, the Executive Committee approved the recommendations of the State Tax Compliance Initiative meetings on April 29 and 30 and July 9 and 13. These recommendations address compliance problems for sales and use taxes, corporate income taxes, and pass-through income reporting. Together they comprise a major agenda and blueprint for improving compliance. The Executive Committee has set in motion the implementation phase of this initiative by referring these measures to a variety of committees and task forces and retaining direct supervision of a portion of the recommendations. The implementation phase of this effort is expected to be a major focus of the Executive Committee's work during the coming year.

The Executive Committee undertook additional actions as described in the minutes of its meetings.

Budget Action

The Executive Committee, with the support of a Budget Subcommittee, has continued to balance the need for the Commission's work with the strained fiscal capacity of the states. It adopted the revenue portion of the Commission's budget at its April 29 and 30, 2004 meeting and the expenditure portion of the budget on July 29, 2004. In addition, it has set in motion a process of early budget planning for FY 2006 through its Budget Subcommittee.

The Executive Committee submits to the Commission for ratification its action of April 29, 2004, to establish FY 2004 membership assessments for twenty-one Compact and five Sovereignty Members of the Commission at $1,483,000 distributed among those states in accordance with the formula prescribed in Article VI.4(b) of the Multistate Tax Compact.

Annual Report of the

Litigation Committee and MTC Legal Activities

We report here on the activities of the Litigation Committee and the Legal Division of the Multistate Tax Commission for fiscal year 2003-2004.

Litigation Committee

The Litigation Committee met twice this past year, at the annual meeting in Salt Lake City, UT, and in March, 2004, in San Diego, CA. Marshall Stranburg of FL has assumed the Chair of the Committee. The Committee held its regular informational and training sessions at both venues, holding the following mini-seminars. In Salt Lake City, Marshall Stranburg gave an update on the Streamlined Sales Tax Project, Ted Spangler of ID discussed governance issues and Frank Katz, MTC General Counsel, discussed strategies (the courts vs. Congress) for gaining collection authority over remote sellers. Deborah Mayer from IL presented the developing jurisprudence regarding treatment of IRC §338(h)(10) liquidations as business or nonbusiness income. In San Diego, Teresa Mitchell of MN discussed the potential tax implications of the ***Vonage*** decision concerning VoIP and Marshall Stranburg discussed the definition of a "qualified representative" for purposes of administrative practice. The Committee continued to discuss methods of cooperation among states and a coordinated, strategic approach to litigation.

The Supreme Court decided only one state tax cases this term. In ***Hibbs v. Winn***, the Court ruled that the Tax Injunction Act did not bar an action in U.S. District Court to challenge an Arizona statute which allows an income tax credit for contributions to a "school tuition organization" that provides scholarships to private elementary and secondary schools, including religious schools. The Court reasoned that the third party challenge to the tax credit was not an "assessment, levy or collection of a tax" and that if such litigation were successful, the likely result would be to increase state revenues, not impair them. The Court also noted that various federal courts had entertained lawsuits challenging tax credits for private segregated schools in the past.

In a federal tax case, ***U.S. v. Galletti***, the Court ruled unanimously that the proper tax assessment against a Partnership suffices to extend the statute of limitations to collect the tax in a judicial proceeding from the general partners who are liable for the payment of the Partnership's debts.

The Court decided two federalism cases of tangential interest to tax departments. In ***Tennessee v. Lane***, the Court decided that Congress validly abrogated state sovereign immunity to permit suit under Title II of the Americans with Disabilities Act to sue for access to the courtroom. In ***Tennessee Student Assistance Corp. v. Hood***, the Court avoided the sovereign immunity issue in the context of a bankruptcy court suits against state instrumentalities (here an attempt to avoid paying back a student loan) by deciding that States can be bound by some judicial proceedings—*in rem* actions—even when it is not a party. Because the Bankruptcy Court has jurisdiction over the bankruptcy estate, its rulings are binding on States even when a State is not a party.

Activities of the Legal Division of the Commissioner

Formal Court Appearances

The Commission filed an *Amicus Curiae* brief in the United States Supreme Court in ***AT&T Corp v. Bobby Gene Allen*** in support of the Petition for Certiorari filed by the AT&T Corp. At issue was whether the Oklahoma trial court incorrectly certified a plaintiff class of AT&T customers from 28 states in a class action against AT&T for incorrectly charging rural residents for municipal tax when a number of those states treat such actions as tax refund actions for which administrative remedies must be exhausted. The Court denied the Petition for Certiorari.

The legal division has prepared an amicus curiae brief for filing this month in the New Jersey Court of Appeal in ***Lanco v. Director, Division of Taxation***. The case concerns whether an intangible holding company has sufficient nexus with New Jersey to be liable for income tax on the royalties from licensing the Lane Bryant name to retail stores in New Jersey, even though Lanco has no physical presence there.

Promoting Uniformity

The Legal Division continued to staff the Uniformity Committee and participate broadly in the uniformity effort of the Commission. The projects on which the Committee and the Division have been working are:

- sales and use tax priority for leasing transactions;
- principles for determining a unitary business;
- affiliate nexus;
- combined reporting; and
- telecommunications sales factor apportionment.

Roxanne Bland, MTC Counsel, conducted a public hearing on sales and use tax priority proposal and filed her report with the Executive Committee. MTC General Counsel Frank Katz conducted two public hearings on the uniformity proposal on unitary business and filed his report with the Executive Committee.

In addition, the Legal Division continued its involvement with and support of the Streamlined Sales Tax Project attending meetings in Savannah, GA, Phoenix, AZ, San Diego, CA, and Tampa, FL.

Federal Legislative and Executive Issues

The Legal Division spent a considerable amount of time and effort monitoring proposed federal legislation that has threatened the fundamental assumptions of our federal system and has the potential to significantly deny States the ability to raise revenue in a number of areas. Legislation that has been monitored during the past year includes business activities tax nexus (HR 3220); authorization for SSTP implementing states to require remote sellers to collect use tax; the Internet Tax Freedom Act extension; preemption of state regulation and taxation of VoIP; 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 made presentations to the New Mexico Blue Ribbon Tax Reform Commission in July, to MSATA in August and to the Hartman Seminar in Nashville in October. He participated in presentations on the appropriate nexus standard for business activity taxes at the Ohio Tax Conference in January and the Federation of Tax Administrators Annual Meeting in June. Deputy General Counsel Shirley Sicilian gave a presentation to the Tax Section of the National Association of State Bars in Washington D.C. in October and in January she participated in a presentation on SB 150 to the NCSL in Denver. Counsel Roxanne Bland made a presentation in February to the American Automobile Leasing Association on the pending proposal for priority in imposing sales tax on leasing transactions.

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 and has consulted on personnel issues, leases and contracts.

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 Legal Division drafted a subpoena that the Commission issued to compel the production of records, resulting in the production of documents by the taxpayer. This was the first subpoena the Commission has issued in many years and involved extensive review of the Commission's authority to audit and to compel the production of documents. The adequacy of the production is still being reviewed but an initial view is that more records will be required.

The Legal Division has provided staff support to the State Tax Compliance Initiative Work Groups, working with the work groups on their recommendations and their reports.

Technical Support of States

The Legal Division has from time to time provided technical support to the States on various issues affecting state taxation of multijurisdictional commerce, including the definition of unitary business, apportionment and business/nonbusiness income questions.

Annual Report of the

Audit Committee and Audit Program

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

The following report reflects the activities of the MTC Audit Committee and the Audit Program for 2003-2004 fiscal year.

AUDIT COMMITTEE

The MTC Audit Committee met three times during the fiscal year. During the Annual Meeting in July, 2003 the Audit Committee reviewed the past year MTC audit activity.

During the October, 2003 meeting, Sales Tax Nomination Forms were distributed at this meeting to start the annual selection process. The Audit Committee approved a special income tax audit on a taxpayer who was filing for bankruptcy and had reported huge inter-company royalties. Two taxpayers also attended the meeting to discuss issues in their audits.

During the March meeting, the Audit Committee reviewed the status of all audits in progress. The Committee also provided guidance on several key issues in several audits.

The Audit Committee also met numerous times by teleconference to discuss several audits where cutting edge issues were pertinent.

Lastly, the Audit Committee reviewed the MTC Audit Program's audit activity at each meeting and offered advice on many complex audit issues that were found in various audits.

AUDIT PROGRAM

Productivity

The Audit Staff completed 10 sales tax audits for the fiscal year end 6/30/04. There are currently 18 sales tax audits in progress one of which is a nexus audit referred from the National Nexus Program. The Audit Staff completed 7 income tax audits during this fiscal year. There are currently 21 income tax audits in progress one of which is an audit referred from the National Nexus Program..

The MTC Audit Program has increased the productivity of its audit work by over 66% since 1989, as measured by the number of staff hours per audit per state. In 1989, an MTC audit required 168 hours of staff time per audit per state. In 2004, that number was only 55. That represents improved efficiency for both states and taxpayers, who also benefit when tax auditors spend less time completing an audit.

Please note in interpreting the enclosed charts on productivity that declining numbers represent improvement.

Staffing

The MTC Audit Program hired two income tax auditors this year. One was to replace an auditor who resigned and the other was an increase in staff positions. The Chicago Office moved to a new office in its Chicago building. The amount of office space was reduced to reflect the savings of some auditors telecommuting. This moved saves about $8,000 a year in rental expense.

Automation

The MTC is pursuing electronic records in every audit that is commencing. The MTC Sales Tax Auditors request electronic records when an audit begins. Several taxpayers have been cooperative in supplying the records. However, many taxpayers are still reluctant to supply electronic records. Every effort is made to assure the taxpayer that electronic records will be held in all confidentiality.

Taxpayer Requested Audit

During fiscal year 6/03, a taxpayer came forward and requested a joint audit on its newly acquired subsidiary. The taxpayer saw the benefit in a joint audit to insure that its acquisition was in compliance with its sales and use taxes in all the states. The taxpayer requested that states not in the Audit Program be offered an opportunity to participate in the audit. The audit was opened up to additional states for a fee. This effort proved to be a success as 30 states are participating in the audit. Eleven states that are not part of the Audit Program chose to participate in the audit. The audit was completed in fiscal year 6/04.

Note: Declining numbers on the following charts represent improvement

Audit Hour Analysis - Last Four Quarters

SALES TAX	FISCAL YEAR QUARTER ENDING				
	Sep '03	Dec '03	Mar '04	Jun '04	Total
Total Completed Audits	1	3	2	4	10
Total States Audited	14	52	27	61	154
Total Hours	906	3,267	820	5,950	10,943
Average Hours Per State	65	63	30	97	71

INCOME TAX	FISCAL YEAR QUARTER ENDING				
	Sep '03	Dec '03	Mar '04	Jun '04	Total
Total Completed Audits	1	0	1	5	7
Total States Audited	18	0	90	158	266
Total Hours	1,288	0	1,521	9,203	12,012
Average Hours Per State	72	0	17	58	45

INCOME AND SALES TAXES	FISCAL YEAR QUARTER ENDING				
	Sep '03	Dec '03	Mar '04	Jun '04	Total
Total Completed Audits	2	3	3	9	17
Total States Audited	32	52	117	219	420
Total Hours	2,194	3,267	2,341	15,153	22,955
Average Hours Per State	69	63	20	69	55

Trends in Productivity

Audit Hour Analysis 6/89 - 6/04

SALES TAX	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Total Completed Audits	9	8	9	14	13	15	13	14	10	16	11	14	13	11	10
Total States Audited	88	79	104	146	140	152	123	143	97	184	102	158	159	145	154
Total Hours	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	10,943
Average Hours Per State	**101**	**89**	**117**	**98**	**49**	**53**	**79**	**79**	**80**	**80**	**89**	**75**	**56**	**61**	**71**

INCOME TAX	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Total Completed Audits	4	9	7	12	9	9	9	10	9	7	10	8	7	8	7
Total States Audited	37	95	75	132	93	99	111	152	120	186	251	131	166	165	266
Total Hours	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	12,012
Average Hours Per State	**195**	**133**	**148**	**85**	**97**	**94**	**68**	**81**	**83**	**55**	**52**	**66**	**57**	**64**	**45**

INCOME AND SALES TAXES	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Total Completed Audits	13	17	16	26	22	24	22	24	19	23	21	22	20	19	17
Total States Audited	125	174	179	278	233	251	234	295	217	370	353	289	325	310	420
Total Hours	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	22,955
Average Hours Per State	**129**	**113**	**130**	**92**	**68**	**69**	**74**	**80**	**82**	**48**	**63**	**71**	**56**	**62**	**55**

Annual Report of the

National Nexus Committee & Program

July 2004

Joseph Thomas, MTC Nexus Committee Chair
Sheldon H. Laskin, National Nexus Program Director

This report summarizes the activities of the MTC Nexus Committee and the Nexus Program for the period July 1, 2003 through June 30, 2004.

Nexus Committee

The MTC Nexus Committee met in Salt Lake City, UT, Washington, DC and San Diego, CA during the fiscal year. In addition, the Committee met a number of times by teleconference. During the Annual Meeting in Mystic, CT, the Nexus Committee will review the activities of the Nexus Program during the past year. In addition, the Committee will consider implementing certain recommendations of the Nexus Clearinghouse Database Advisory Committee and the Nexus Task Force.

During the year, the Committee reviewed the results of a sales tax nexus audit of a major retailer and received status updates of an income tax nexus audit of another major retailer.

The Nexus Clearinghouse Database Advisory Committee met by teleconference several times during the year and completed its use tax collection module for major purchases. The module will be submitted to the Nexus Committee at its meeting in Mystic, CT for its implementation recommendations. Jennifer Hays, Chair of the Clearinghouse Database Advisory Committee and Director of Compliance and Taxpayer Assistance of the Kentucky Department of Tax Administration, resigned from state service. Jennifer rendered long and outstanding service to the Commission in general and specifically to the Nexus Committee. Nexus Committee Chair Joseph Thomas appointed Bill Lindsay, Revenue Tax Specialist in the Corporate Nexus Unit of the Minnesota Department of Revenue, as the new Chair of the Clearinghouse Database Advisory Committee.

The MTC Combined Registration Committee met periodically throughout the year. A major change in the development of the combined registration system took place during the year. MTC member states decided in February 2004 that MTC staff, rather than a private vendor, would develop the registration portal, both for SSTP and for the MTC Combined Registration system. Under the direction of MTC IT Director Naresh Verma, the MTC project design team has begun the design work for the project, with the continuous input of the Combined Registration Committee. The project is expected to be implemented by January 2005.

The Nexus Committee formed a Nexus task force this year, to develop a nexus discovery unit information exchange system and to catalog state nexus discovery "best practices". The task force, under the chairmanship of Michael Gorczycki, Assistant Chief of Office Audits for the New Jersey Division of Taxation, met seven times by teleconference during the fiscal year. During these meetings, the task force refined its proposal for a webpage on the MTC Extranet, for the exchange of nexus discovery best practices. The Nexus Committee will consider the implementation of this webpage at its meeting in Mystic, CT.

Nexus Program

Voluntary Disclosures

During FY 2004, the National Nexus Program executed contracts with 87 taxpayers,

	FY2003[1]	FY2004	Percentage Change
Number of taxpayers concluding agreements	68	87/23	28%
Number of executed contracts	604	510/182	-15%
Back taxes collected	$12,958,997	$6,226,701/$732,182	-50%
Estimated future collections	$27,958,997	$52,271,596/$49,126,616	87%
New cases opened	75	73	-2%
Number of potential contracts under new cases	954	806	-15%

resulting in 510 separate agreements with member states. These agreements resulted in $6,226,701 in back taxes collected and $52,271,596 in estimated annual future collections. Also, during the fiscal year, the Nexus Program opened 73 new voluntary disclosure cases, representing 806 separate potential contracts. The following chart compares the results in FY 2003 to those of FY 2004. **Note:** In interpreting these results, please keep in mind that both the FY 2003 and the FY 2004 results include the disclosures processed by the National Nexus Program to facilitate agreements made between the SSTP and a number of companies as an early good faith test of the SSTP's amnesty provisions. The first number in the FY 2004 column is the total listed item for the disclosure program as a whole. The SSTP disclosures contained within that first number are reported as the second number in the column. The percentage increases reported in the last column do not separately break out the SSTP disclosures. A further item is worthy of note. The dollar value of prospective agreements has increased exponentially, while the dollar value of back taxes collected has declined substantially. This seems to indicate that, as more states adopt the SSTP, the states appear to be more willing to accept prospective agreements notwithstanding that the SSTP is not yet in effect.

Voluntary Disclosure Marketing

During FY 2004, three member states distributed 1,739 MTC voluntary disclosure brochures to taxpayers making voluntary disclosures in the states. This is a decrease of 959 brochures compared to last year.

Also during the fiscal year, the Voluntary Disclosure Program's ad on Google was viewed 222,603 times with 1,264 viewers linking to the MTC website by clicking on the ad. Comparable figures for FY 2003 were 21,016 ad viewings and 1,004 linkages to the MTC website. The cost of the ad for the year was $430.62.

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

Nexus Data Exchange

Nexus Discovery Lead set 5 was completed during FY 2004 and lead set 6 was initiated covering a total of 100 companies. Two companies identified in the lead sets have initiated voluntary disclosures during the year as a result of lead set follow-up by MTC staff. Two other companies completed voluntary disclosures during the year. The remaining companies have been referred to the states for follow-up. A March 2004 survey indicated that the states have collected at least $243,023 in taxes as a result of individual state follow up. MTC staff conducted research on sixteen of the lead set 5 companies and has made recommendations to the Nexus Committee regarding appropriate follow up.

Nexus School

During the fiscal year, MTC staff conducted a nexus school in Portland, OR. Another school is scheduled in Ohio in October and Maine in May 2005. Two other states have expressed interest in conducting schools during the current fiscal year.

Presentations

Nexus Program Director Sheldon H. Laskin participated in the Transportation Law Institute, University of Denver College of Law (October 2003), where he spoke on nexus issues applicable to common carriers. Nexus Counsel Tom Shimkin made nexus presentations to a multi-state tax conference of the New Jersey Society of Certified Public Accountants (December 2003) and to the Chicago Tax Club (June 2004).

Publications

Nexus Director Sheldon Laskin was quoted in L. Stansky, *Tax Turf War,*
The National Law Journal (January 26, 2004). The article reported on the Delaware holding company issue.

Staff Developments

Nexus Counsel Beau Baez left the Commission after eight years, to accept a position as an Associate Professor of Law at Liberty University School of Law in Lynchburg, VA. This is a very exciting opportunity for Beau, who will be an inaugural member of the faculty of Liberty University's new law school. The Nexus staff will miss Beau and wishes him well in his new endeavor.

Andy Barnes has joined the staff of the National Nexus Program as a paralegal. Andy has a Master of Arts in English Literature from Rutgers University and will be staffing the voluntary disclosure program.

(Footnotes)

[1] The FY 2003 numbers reported vary slightly from the numbers for the same period reported at the 2003 annual meeting. The variance is because results of the voluntary disclosure program change over time for two principal reasons. One, over time estimated future collections decline as those revenues are collected, which in turn increases tax collected. Second, the number of individual state agreements under a disclosure can increase as the taxpayer reaches agreement with additional states.

Annual Report of the
MTC/Streamlined Combined Registration Committee

Juli Peterson, Chair,
MTC/Streamlined Combined Registration Advisory Committee

During the past year, there was a major change in the development plan for the MTC/Streamlined Combined Registration System. In February 2004, the MTC and the Streamlined Sales Tax Project (SSTP) decided to have the MTC develop both the streamlined and the traditional joint registration systems, rather than engage a private vendor to develop either system. The MTC committed itself to developing the streamlined system by January 2005. The Commission's IT Department engaged a consultant and began design work for both the streamlined and traditional registration systems in the Spring of 2004. Since then, the Committee has met periodically to address design issues in the following areas:

1. Traditional registration system data elements. The Committee has refined a list of registration data elements that are common to all states, and a list of data elements that are specific to some but not all states. Furthermore, the Committee has refined the state-specific data elements to identify which data elements are mandatory and which optional.
2. Schema. Under the design protocols for the traditional registration system, no state is required to change its computer systems in order to participate. However, the streamlined system will require states to be able to accept files in XML format. Therefore, the Committee has asked participating states to indicate whether they would be willing to accept traditional registration files in XML format. Most participating states have indicated that they would.
3. Software architecture. Working with the MTC design team, the Committee continuously refines the software architecture. This is an iterative process that will continue throughout the design phase.

The system will be developed in the Fall, following the completion of the design phase. After a pilot testing period, the system is to be implemented in January 2005.

Multistate Tax Commission

Financial Statements and Report of Independent Certified Public Accountants

June 30, 2004 and 2003

MULTISTATE TAX COMMISSION
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June 30, 2004 and 2003

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, 2004 and 2003 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, 2004 and 2003, 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 2, 2004

MULTISTATE TAX COMMISSION
Balance Sheets
June 30,

ASSETS

		2004		2003
Current Assets				
Cash and cash equivalents	$	1,797,550	$	2,134,592
Accounts receivable				
Members		27,330		6,481
Schools		1,680		16,790
Prepaid expenses		73,524		45,683
Total Current Assets		1,900,084		2,203,546
Property and Equipment - at Cost				
Office furniture and equipment		1,030,289		972,478
Leasehold improvements		87,485		87,485
Less: accumulated depreciation and amortization		(814,542)		(769,793)
Property and Equipment - Net		303,232		290,170
Other Assets				
Expense account advances		8,100		8,200
Deposits		10,861		10,628
Total Other Assets		18,961		18,828
TOTAL ASSETS	$	2,222,277	$	2,512,544

LIABILITIES

	2004	2003
Current Liabilities		
Accounts payable	$ 65,664	$ 67,449
Payroll taxes withheld and accrued	26,307	27,676
Accrued salaries and vacation pay	263,909	242,554
Current portion of capital lease obligation	6,176	5,376
Deferred assessments and audit reimbursements	140,881	89,576
Total Current Liabilities	502,937	432,631
Long-Term Liabilities		
Capital lease obligation	12,847	1,636
Total Long-Term Liabilities	12,847	1,636
TOTAL LIABILITIES	515,784	434,267
Commitments and Contingencies - Note 3		
Fund Balances		
Unappropriated	736,436	866,127
Appropriated	732,594	809,520
Restricted	237,463	402,630
Total Fund Balances	1,706,493	2,078,277
TOTAL LIABILITIES AND FUND BALANCES	$ 2,222,277	$ 2,512,544

The accompanying notes are an integral part of these statements.

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

	2004	2003
Revenue - Unappropriated and Appropriated		
Assessments	$ 4,278,463	$ 4,085,904
Less amounts from restricted funds	(24,000)	-
Interest	21,808	44,125
Other income		
Training fees	38,950	123,320
Miscellaneous	13,222	25,632
Total Revenue	4,328,443	4,278,981
Expenses - Unappropriated and Appropriated		
Accounting	12,903	11,739
Bonds and insurance	18,845	15,621
Conferences	102,603	104,328
Professional services	366,844	349,714
Database services	140,000	61,710
Depreciation and amortization	99,973	123,722
Employee benefits	535,798	449,551
Miscellaneous	11,657	23,194
Office supplies	52,430	44,692
Pension plan and retirement provision	294,174	280,968
Postage	35,510	35,715
Printing and duplicating	33,355	34,724
Publications and electronic resources	26,820	28,692
Recruitment	1,538	1,204
Rent	225,317	220,069
Repairs and maintenance	7,604	7,453
Salaries	2,486,798	2,286,795
Software licenses	60,331	56,241
Subscriptions, publications, dues	28,322	27,007
Telephone	83,102	80,289
Travel	257,197	327,772
Training	9,723	12,001
Transfer - training and education	(2,200)	7,040
Transfer - database services	(150,000)	(61,710)
Allocation of administrative expenses	(179,584)	(174,512)
Total Expenses	$ 4,559,060	$ 4,354,019

(continued)

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

	2004	2003
Excess of Revenue Over (Under) Expenses	$ (230,617)	$ (75,038)
Transfer to Appropriated Fund Balance	-	(157,298)
Transfer from Appropriated Fund Balance	76,926	84,750
Transfer from Restricted Fund Balance	24,000	-
Total Amount Transferred	100,926	(72,548)
FUND BALANCE - Unappropriated - Beginning of Year	866,127	1,013,713
FUND BALANCE - Unappropriated - End of Year	$ 736,436	$ 866,127

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

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

	Cooperative Auditing Study	State Tax Compliance	Federalism At Risk
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
Transfer to State Tax Compliance	(23,918)	23,918	
Transfer to Unappropriated Fund Balance	-	-	(12,410)
Net Amount Transferred (To) From Unappropriated Fund Balance	(23,918)	23,918	(12,410)
Fund Balance - June 30, 2004	$ -	$ 23,918	$ 25,146

Enterprise Automation Project	Nexus Activities	Nexus Education	Membership Development and Relations	Total
$ 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
(21,272)	-	(43,244)	-	(76,926)
(21,272)	-	(43,244)	-	(76,926)
$ 557,004	$ 90,000	$ 7,671	$ 28,855	$ 732,594

The accompanying notes are an integral part of these statements.

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

	4R Project	Nexus Program	Deregulation	Special Audit	Total
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
Revenue	-	733,252	-	100,830	834,082
Expenses	-	837,058	45,450	92,741	975,249
Excess (Deficiency) of Revenue Over Expenses	-	(103,806)	(45,450)	8,089	(141,167)
Transfer to Unappropriated Fund Balance	(24,000)	-	-	-	(24,000)
Fund Balance - June 30, 2004	$ 60,694	$ 162,982	$ 5,698	$ 8,089	$ 237,463

The accompanying notes are an integral part of these statements.

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

	2004	2003
Increase (Decrease) in Cash and Cash Equivalents		
Cash Flows From Operating Activities		
Excess of revenue over (under) expenses	$ (371,784)	$ (196,944)
Adjustments to reconcile excess of revenue over (under) expenses to net cash provided by (used in) operating activities		
Depreciation and amortization	106,442	130,491
Loss on disposal of property and equipment	6,052	-
Changes in assets and liabilities		
Accounts receivable		
Members	(20,849)	(6,481)
Schools	15,110	12,785
Prepaid expenses	(27,841)	(6,437)
Deposits	(233)	-
Expense account advances	100	-
Accounts payable	(1,785)	(149,277)
Payroll taxes withheld and accrued	(1,369)	(8,085)
Accrued salaries and vacation pay	21,355	(28)
Deferred assessments and audit reimbursements	51,305	(293,748)
Net Cash Used in Operating Activities	(223,497)	(517,724)
Cash Flows From Investing Activities		
Purchase of property and equipment	(125,556)	(22,885)
Increase in capital lease	20,000	-
Payments on capital lease	(7,989)	(3,900)
Net Cash Used in Investing Activities	(113,545)	(26,785)
Net Decrease in Cash and Cash Equivalents	(337,042)	(544,509)
Cash and Cash Equivalents - Beginning of Year	2,134,592	2,679,101
Cash and Cash Equivalents - End of Year	$ 1,797,550	$ 2,134,592
Supplemental Disclosures		
Income taxes paid	$ -	$ -
Interest paid	$ 1,906	$ 2,999

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

MULTISTATE TAX COMMISSION
Notes To Financial Statements
June 30, 2004 and 2003

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.

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, 2004 and 2003 was $341,750 and $329,397, 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, 2009. These leases provide for the following minimum annual base rentals exclusive of utility charges and certain escalation charges:

	Minimum
Fiscal Year Ended:	Annual Payment
2005	$ 281,080
2006	281,762
2007	274,090
2008	165,657
2009	42,576

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, 2004 and 2003 was $283,187 and $293,275, respectively.

4. Appropriated Fund Balances

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 $614,298 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 net amount of $20,000 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. At July 1, 2003, the remaining balance in the fund was transferred to the State Tax Compliance fund.

The Commission's executive committee authorized the State Tax Compliance fund in the amount of $23,918 during the year ended June 30, 2004. The purpose of this fund is to support the implementation of the recommendations of the Commission's State Tax Compliance Initiative and the measures to improve state tax compliance by multistate taxpayers as approved by the Executive Committee or Commission.

The Commission's executive committee authorized the Nexus Education fund in the amount of $100,000 during the year ended June 30, 2002. The purpose of this fund is to educate federal and state policymakers and the public concerning issues and standards of Nexus for state taxation of interstate commerce to advance the goal of preserving the ability of states to tax a fair share of such commerce and for preventing the unwarranted restrictions on state jurisdictional authority.

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 of Multistate Tax Commission for the year ended June 30, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule of expenses for the year ended June 30, 2004, 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 2, 2004

MULTISTATE TAX COMMISSION
Schedule of Expenses
For the Year Ended
June 30, 2004

	Unappropriated and Appropriated Funds					
	General Expenses	Audit Program	Administrative Expenses	Enterprise Automation	Federalism At Risk	Training and Education
Accounting	$ 8,500	$ -	$ 4,403	$ -	$ -	$ -
Bonds and insurance	-	-	18,845	-	-	-
Conferences	62,948	6,983	271	-	-	31,401
Professional services	245,379	6,750	33,319	27,687	-	12,847
Database services	-	140,000	-	-	-	-
Depreciation and amortization	-	16,561	83,412	-	-	-
Employee benefits	92,019	293,775	130,659	17,242	-	2,103
Miscellaneous	524	3,256	7,747	-	-	130
Office supplies	3,117	22,771	23,052	717	(35)	2,808
Pension plan and retirement provision	56,035	165,650	63,227	7,574	-	1,688
Postage	3,487	12,783	13,193	-	2,400	3,647
Printing and duplicating	5,755	5,346	8,173	-	10,045	4,036
Publications and electronic resources	3,650	6,596	15,204	-	-	-
Recruitment	-	1,538	-	-	-	-
Rent	37,365	82,693	105,259	-	-	-
Repairs and maintenance	-	3,808	3,796	-	-	-
Salaries	507,362	1,360,934	538,610	65,829	-	14,063
Software licenses	186	5,645	2,277	52,223	-	-
Subcriptions, publications, dues	12,894	11,782	3,531	-	-	115
Telephone	35,827	32,495	14,704	-	-	76
Travel	78,703	148,069	21,179	-	-	9,234
Training	1,955	2,326	4,147	-	-	1,295
Transfer - training and education	-	(2,200)	-	-	-	-
Transfer - database services	-	-	-	(150,000)	-	-
Allocation of administrative expenses	298,005	595,903	(1,095,008)	-	-	21,516
Total Expenses	$ 1,453,711	$ 2,923,464	$ -	$ 21,272	$ 12,410	$ 104,959

		Restricted Funds				
Nexus Education	Total Unappropriated and Appropriated Funds	Deregulation	National Nexus Program	Special Audit	Total Restricted Funds	Total All Funds
$ -	$ 12,903	$ -	$ -	$ -	$ -	$ 12,903
-	18,845	-	-	-	-	18,845
1,000	102,603	1,951	5,522	-	7,473	110,076
40,862	366,844	-	28,700	68,219	96,919	463,763
-	140,000	-	10,000	-	10,000	150,000
-	99,973	-	6,469	-	6,469	106,442
-	535,798	2,820	88,435	-	91,255	627,053
-	11,657	-	799	39	838	12,495
-	52,430	-	3,157	-	3,157	55,587
-	294,174	2,953	43,305	1,318	47,576	341,750
-	35,510	72	4,583	1,253	5,908	41,418
-	33,355	-	526	88	614	33,969
1,370	26,820	-	406	-	406	27,226
-	1,538	-	-	-	-	1,538
-	225,317	-	57,870	-	57,870	283,187
-	7,604	-	-	-	-	7,604
-	2,486,798	24,610	387,870	10,982	423,462	2,910,260
-	60,331	-	217	-	217	60,548
-	28,322	566	12,500	-	13,066	41,388
-	83,102	380	7,376	12	7,768	90,870
12	257,197	2,781	9,701	10,830	23,312	280,509
-	9,723	-	1,115	-	1,115	10,838
-	(2,200)	-	(1,760)	-	(1,760)	(3,960)
-	(150,000)	-	-	-	-	(150,000)
-	(179,584)	9,317	170,267	-	179,584	-
$ 43,244	$ 4,559,061	$ 45,450	$ 837,058	$ 92,741	$ 975,249	$ 5,534,309