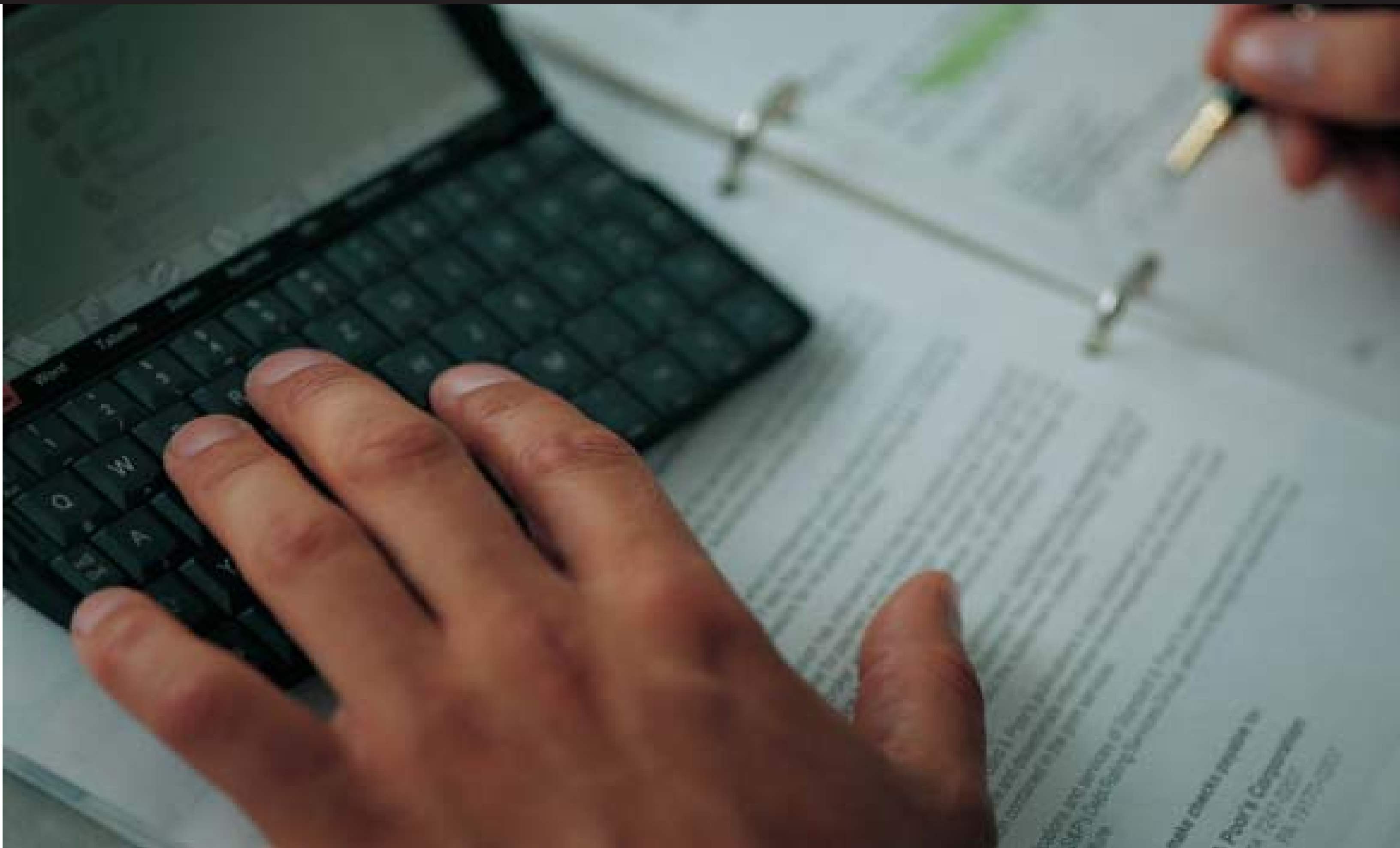
Annual Report for Fiscal Year 2000-01



Contents

History and Purposes

States created the Multistate Tax Commission in 1967 to preserve federalism and promote tax fairness. States control and guide the Commission as the administrative agency of the Multistate Tax Compact—an interstate compact upheld by the U.S. Supreme Court in the 1978 *U.S. Steel* decision.

The authority of States to determine their tax policies is at the very core of State sovereignty, but in the fields of interstate and international commerce that authority is subject to restraint by Congress and the U.S. Supreme Court. In the 1960's—prompted by interstate business complaints that disparate State tax policies created unreasonable burdens for interstate commerce—Congress threatened to assume power over State corporate income, gross receipts and sales and use taxation. Faced with this challenge to federalism, States developed the Multistate Tax Compact to promote greater uniformity, efficiency and equity in the taxation of interstate commerce. ***The Compact and the Commission it established were a success at their very creation, because they forestalled the proposals for broad federal intervention into State taxation.*** The formula of States working together to resolve issues of multistate taxation continues to reduce the degree of federal intervention in the details of State and local tax policy.

The process of States working together through the Commission not only preserves State sovereignty, but also serves to achieve tax fairness. States typically seek to ensure, in the interest of equal taxation, that out-of-state businesses are held to the same standards of tax accountability as local, in-state businesses. However, national and global businesses fear they will be subject to duplicate taxation if different States apply separate and widely different tax rules to interstate commerce. Thus, the Commission assists States in developing and using uniform and effective standards of accountability for national and global businesses so that those businesses will pay their fair share, but not more than their fair share, of a State's taxes. These efforts serve the even larger purpose of supporting a free market economy by helping ensure fair and equal competition among enterprises regardless of type, size or location.

The Commission is a unique entity to help reconcile and ease the tension between Constitutional provisions that, on the one hand, protect State sovereignty and, on the other hand, restrain that sovereignty with regard to interstate and foreign commerce. By assisting States in working together in taxing national and global commerce, the Commission helps preserve state authority in a manner that also ensures fairness and supports our market economy.

Membership and Organization

Forty-five States (including the District of Columbia) participate in the Commission. Twenty-one States are Members of the Commission, two States are Sovereignty Members, nineteen States are Associate Members, and three States are Project Members.

The Member States include: **Alabama, Alaska, Arkansas, California, Colorado, District of Columbia, Hawaii, Idaho, Kansas, Maine, Michigan, Minnesota, Missouri, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah,** and **Washington**. Full Members have enacted the Multistate Tax Compact. These States govern the Commission and typically participate in a wide range of projects and programs.

Florida and **Wyoming** are Sovereignty Members of the Commission. Sovereignty Members join in shaping and supporting the Commission's efforts to preserve state taxing authority and improve multistate tax policy and administration.

Associate Member States include: **Arizona, Connecticut, Georgia, Illinois, Kentucky, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, North Carolina, Ohio, Oklahoma, Pennsylvania, South Carolina, Tennessee, Wisconsin,** and **West Virginia**. Associate Members participate in Commission committees and meetings and often join one or more Commission projects or programs.

Project Member States include: **Iowa, Nebraska,** and **Rhode Island.** These States participate in one or more Commission programs, typically the National Nexus Program or the Joint Audit Program.

In terms of special projects and programs, forty States are members of the National Nexus Program; twenty-two States participate in the Joint Audit Program; ten States in the Deregulation, Industry Change, and Taxation Project; and ten States participated in the most recent phase of the Property Tax Fairness Project.

The Commission is governed by its Members, who are the heads of the tax agencies of the Member States. The Commission Members meet at an Annual Meeting, in July, and at such other times as are necessary. During the year, the Commission is guided by an Executive Committee comprised of seven elected members and *ex officio* past Commission Chairs. Also, each Member State present at an Executive Committee meeting is entitled to vote at Executive Committee meetings. The Commission seeks advice and guidance on its various programs through a set of program committees: Uniformity, Audit, Nexus, Litigation, and Property Tax Fairness.

Activities and Goals

The Commission works to achieve the goals of preserving federalism and tax fairness through a comprehensive range of activities that includes developing recommended uniform state tax policies with respect to interstate commerce, encouraging compliance with tax laws and consistency in enforcement through the Joint Audit and National Nexus Programs, training and education in complex multistate tax issues, supporting States engaged in major and "cutting edge" tax litigation through *amicus* briefs and technical assistance, and advocacy of state interests in the field of multistate taxation to Congress and the Executive Branch. The Commission, in partnership with the Federation of Tax Administrators (FTA), encourages the use of technology to improve and simplify tax administration in the interstate arena. Working with the Western States Association of Tax Administrators (WSATA), the Commission has developed a joint property tax auditing project. The Commission has initiated, to advance uniformity in state taxation, an Alternative Dispute Resolution (ADR) program to respond to cases of alleged duplicate taxation of a taxpayer by two or more States.

The Commission's activities are organized and given focus by a set of goals that define how the Commission interprets its mission. Current Commission goals include the following:

- Preserving the Ability of States to Tax Interstate Commerce Equitably;
- Maintaining Equitable Nexus Standards;
- Encouraging Proper Accountability in State Corporate Income Taxation;
- Encouraging the Efficient and Effective Operation of Sales/Use Taxes;
- Encouraging Consistent, Efficient and Effective Property Tax Administration;
- Improving State Tax Policy and Administration Affecting National and Global Commerce; and
- Preserving and Strengthening the Commission as an Instrument of Interstate Cooperation.

The Commission integrates a variety of activities to further these goals. For example, ***to preserve the ability of States to tax national and global commerce equitably***, the Commission opposes, through its lobbying efforts, unwise Congressional preemption of state taxation of interstate commerce. However, the Commission also works to resolve the issues involved in such cases through the development and promotion of voluntary, uniform measures by the States. In some cases, such as the successful effort to develop a uniform method of apportioning financial institutions' income among States, the existence of a uniformity project eliminated the need for the affected industry to ask Congress to examine the issue.

In further pursuit of preserving state authority to tax commerce equitably, the Commission played a leadership role in exploring the international aspects of state and local issues. The Commission early in its history addressed the international division of income issues. More recently, it secured protections for state taxing authority in the Uruguay Round Trade Agreements. Currently, the Commission has begun a dialogue with European officials to exchange information on methods of applying consumption sales to international sales, including those made by electronic means.

Maintaining equitable nexus standards is another major goal the Commission pursues through multiple means: advocating federal legislation authorizing States to require certain mail-order companies to collect state and local sales taxes, seeking compliance from non-filing businesses through the National Nexus and Audit Programs, and encouraging common nexus practices among the States.

The Commission has a long history of ***promoting the proper accountability of corporate income*** in the interest of leveling the playing field among global, national and local taxpayers. The Commission has successfully opposed proposals for federal restrictions on state apportionment practices, has advocated this goal in the courts in a host of tax cases, has developed an authoritative body of income apportionment rules, and has effectively sought uniform compliance with State corporate income tax laws through the Joint Audit Program. The ADR services established through the Commission also advance this goal.

The goal of ***efficient and equitable sales taxation*** is closely related to the goal of maintaining equitable nexus standards. More recently, as technology and methods of marketing have changed and as the sales of services have risen relative to the sale of goods, the Commission has increasingly developed proposals for uniform sales and use taxation. Chief among these is a uniformity recommendation on the transactional taxation of telecommunications. Moreover, the Commission's work in this area is evolving to focus increasingly on the need to simplify the sales tax to ease the cost of compliance for taxpayers and states alike. As in the case of income taxation, ADR services also promote the Commission's sales tax goal.

The Commission is seeking to ***encourage consistent, efficient and effective property tax administration*** by minimizing federal interference—most notably in the form of the 4-R Act—in property taxation that has distorted and created inequities in State and local property tax systems.

The Commission works to ***improve state tax policy and administration affecting national and global commerce*** through education and training, developing uniform proposals on procedural aspects of state taxation, and encouraging the application of modern technology both to improve interstate cooperation and the operation of state tax systems. The Commission is also developing an expanded series of practical training programs in the field of interstate taxation.

In terms of ***improving its effectiveness in supporting interstate tax cooperation***, the Commission continuously seeks means of increasing both its internal efficiency and its outreach to a growing community of States. For example, the Commission has doubled the efficiency of its joint, multistate audits over a recent five-year period. During the same time period, the Commission developed the National Nexus Program, and now thirty-nine States participate in this highly successful compliance program. In 1989, States asked the Commission to create a Litigation Committee to serve as an educational forum for state tax attorneys working on important interstate commerce cases. States are working through the Commission to conduct regional, cooperative audits. In the mid-eighties, the Commission diversified the membership options available to States, and as a result the number of States participating in the Commission has increased from thirty to forty-five. In 1996, the Commission launched an expanded training program in multistate taxation and a new Alternative Dispute Resolution program for States to use in resolving disputes with taxpayers.

The Commission's major compliance efforts—the Joint Audit Program and the National Nexus Program—serve a variety of objectives including enhancing compliance, promoting consistent application of state laws, and resolving complex issues with the taxpayer community. Thus, the programs are not judged on revenue results alone. However, these programs are highly cost-effective. Over the past twelve years, States have collected $11 for every $1 invested in the Joint Audit Program; over the past nine years, the National Nexus Program has earned States over $80 for every $1 used to operate that Program.

Report of the Executive Committee
to the
Annual Meeting of the Multistate Tax Commission
July 27, 2001

Meetings

The Executive Committee of the Multistate Tax Commission met five times since the Annual Meeting of July 28, 2000. These meetings were held on September 29, 2000 in Denver, Colorado; on November 16 and 17, 2000 in Washington, DC; on January 18 and 19, 2001 in San Diego, California; on May 3 and 4, 2001 in San Antonio, Texas, and on July 25, 2001 in Bismarck, North Dakota. The meeting on September 29, 2000 was a special meeting devoted entirely to strategic planning. The remaining meetings were regular meetings of the Executive Committee. Through these sessions the Executive Committee has provided oversight and direction to the activities of the Commission.

Commission Membership

In the course of the past year, the Executive Committee accepted three states as Sovereignty Members of the Commission as follows:

- The Commonwealth of Kentucky on November 16, 2000,
- The State of New Jersey on May 3, 2001, and
- The State of Louisiana on July 25, 2001.

The addition of these Sovereignty Members—bringing the total of such members to five—represents a welcome and vigorous pace of increased participation by states in the core activities of the Commission devoted to uniformity, legal support, policy research and education, and federal relations.

Executive Committee Membership

The Executive Committee experienced significant change in its membership in the course of the past year following the November 2000 elections. Mary Bryson of Montana concluded her service as MTC Chair on January 1, 2001, because of the completion of her term as Montana Director of Revenue. On that date, MTC Vice-Chair, Quentin Wilson of Missouri, became MTC Chair. On January 5, 2001, Quentin Wilson concluded his service as MTC Chair because of his departure from the position of Missouri Director of Revenue to accept another position with the State of Missouri. Also, in January 2001, Executive Committee Member John Chavez of New Mexico concluded his service on the Executive Committee because of his resignation as New Mexico Secretary of Taxation and Revenue.

At its meeting on January 16, 2001 in San Diego, California, the Executive Committee elected Elizabeth Harchenko of Oregon as Chair, R. Bruce Johnson of Utah as Vice-Chair, and Carol Fischer of Missouri as Treasurer. Elizabeth Harchenko had been serving as Treasurer. Thus, it was necessary to elect a new Treasurer when Ms. Harchenko was elected as MTC Chair.

The Executive Committee did not fill the vacancy on the Executive Committee created by the departure of John Chavez.

Strategic Planning

Strategic planning for the Commission was a major focus of the Executive Committee in the past year. At the special meeting in Denver on September 29, 2000, the Executive Committee arrived at major conclusions concerning future directions for the Commission. Those conclusions are described in a record of that session provided to the membership and maintained in the Commission headquarters office. Among other conclusions, the Executive Committee selected three long-term goals as immediate priorities to guide the Commission's work as follows:

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.

In pursuit to these goals, the Chair, Executive Committee, Standing Committees and/or staff have undertaken a number of actions including, but not limited to the following:

- Development and approval of charters for each of the five Standing Committees of the Commission to provide guidance to those committees;
- Development of a work plan with targeted completion dates for uniformity projects by the Uniformity Committee;
- Implementation of a process of Executive Committee Liaisons to each of the Standing Committees to improve communication and coordination within the Commission;
- Expanded use of upgraded teleconferencing services to provide regular information to the states and to facilitate meetings of committees and task forces;
- Completion of studies to examine and improve the operations of the Joint Audit Program and the National Nexus Program and initial implementation of recommendations from those studies; and
- Inauguration of "Federalism at Risk: A National Inquiry and Dialogue on the Status of State and Local Tax Systems and the Future of Federalism" to evaluate with a broad range of stakeholders the current state of state and local taxation and federalism and to develop potential recommendations for its improvement.

Implementation of Technology Committee
At its meeting on July 28, 2000, the Commission approved the established of a new Standing Committee on Technology. The purposes of this committee are to provide oversight and guidance for the systems efforts of the Commission and to foster greater use of and coordination among the Member States of technology to advance the purposes of the Multistate Tax Compact. The Technology Committee has been successfully launched and has met three times over the past year. In its early work, the Technology Committee has proven to be a vital and effective committee and is exceeding the expectations that accompanied its establishment.

Budget Action
At its meeting on May 3 and 4, 2001, the Executive Committee established revenues for the Commission for FY 2002 in the form of membership assessments, audit reimbursements, and program and project fees. At its meeting on July 25, 2001, the Executive Committee approved an expenditure budget for FY 2002. Also at the May meeting, the Executive Committee transferred $120,000 from the Membership Development appropriated fund to the Future of Multistate Taxation fund to support an inquiry into the status of state and local taxation of interstate commerce and the future of federalism. In July, the Executive Committee appropriated $40,000 to a new Cooperative Audit Study fund to support the development of a plan for expanding cooperative auditing among the states.

The Executive Committee submits to the Commission for ratification its action of May 3, 2001, to establish FY 2002 membership assessments for twenty-one Compact and four Sovereignty Members of the Commission at $1,390,000 to be distributed among those states in accordance with the formula prescribed in Article VI.4.(b) of the Multistate Tax Compact.

Resolution 98-19
The Executive Committee on November 17, 2000, acted to “sunset” Commission Resolution 98-19. This resolution adopted by the Commission in 1998 had suspended the development of a regulation on the definition of business income until circumstances arising from extensive litigation on this topic among the states became sufficiently clear so that uniformity work in this area might be effective. By November 2001, the Uniformity Committee concluded that circumstances were now more favorable for proceeding with work on a uniform definition of business income and recommended the resumption of that work. The Executive Committee approved that recommendation and acted to “sunset” Resolution 98-19.

Additional Actions
The Executive Committee undertook a number of additional actions that are recorded in the minutes of its meetings.

REPORT OF THE AUDIT COMMITTEE AND AUDIT PROGRAM
July 2001
Kim Ferrell, Chair, MTC Audit Committee
Rich Schrader, 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 2000-2001 fiscal year.

*AUDIT COMMITTEE *

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

During the November meeting, the Audit Committee began work on the MTC Audit Committee Charter. The Audit Committee also began work on the goals established by the MTC Executive Committee to improve the MTC Audit Program. The Audit Committee approved the formation of a sub-committee to explore ways to improve the MTC Audit Selection process. Kathleen Stewart former Director of Corporate Franchise Tax division for Minnesota Department of Revenue was hired as a consultant to lead this project. Kathleen surveyed the states in the Audit Program to determine how the individual states selected audits.

During the March meeting, the Audit Committee met an additional ½ day to review the report from Kathleen Stewart on the audit selection process. At this meeting, the Audit Committee received commitments from 5 states (ID, MI, MO, NJ & ND) to serve on the previously formed sub-committee. Members from the 5 states met in Chicago to produce a report on ways to improve the audit selection process for the MTC Audit program. A final report will be reviewed at the MTC Annual Meeting.

Also during the March meeting, the Audit Committee finalized work on the Audit Committee Charter. The final product was forwarded to the MTC Executive Committee for approval. The MTC Audit Director also distributed a survey to the states asking for feedback on ways to improve the audit package. The results of the survey will be discussed at the Annual Meting. The Audit Committee also instructed the MTC Audit Director to prepare a report on the Regional Audit Pilot Program. A discussion of ways to expand the pilot program will be held at the Annual Meeting.

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 14 sales tax audits for the fiscal year end 6/30/01. There are currently 22 sales tax audits in progress one of which is a nexus audit referred from the National Nexus Program. The Audit Staff completed 8 income tax audits during the fiscal year. There are currently 20 income tax audits in progress.

The MTC Audit program has increased the productivity of its audit work by over 55% 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 2001, that number was only 71. 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 had two vacancies at the beginning of the fiscal year. Interviews were held in August and September to fill the vacancies. James Kinsella a former auditor for the state of New York was hired to fill the sales tax position vacancy in the New York Office. Marie Plesko a former auditor for Florida was hired to fill the income tax position vacancy in the Chicago Office. At the close of the fiscal year, the MTC Audit program was fully staffed.

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.

Training

The Director of Audit participated in 4 Nexus training seminars during this fiscal year.

Harold Jennings, MTC Supervisor of Computer Auditing conducted 10 sales tax sampling classes during this fiscal year training approximately 240 state audit personnel. Personnel from the states of Michigan, New Jersey, Washington and Wyoming ably assisted Harold. These classes are very popular and would not have been conducted without this assistance.

Pilot Regional Audit Project

Each of the four sates in this pilot project was assigned two audits. All of the audits were completed during this fiscal year. The states in the program reported the number of hours it took to complete the audits. The average hours were 108 per state audit. This compares very favorably to the number of hours it takes the states to complete a separate state audit. Most states report that a typical state audit of a Fortune 500 company takes from 200 to 300 hours.

Note: Declining numbers on the following charts represent improvement

Audit Hour Analysis

Last Four Quarters

	9/00	12/00	3/01	6/01	Total
Income Tax Total Audits	0	1	1.5	5.5	8
Total States Audited	0	19	28	84	131
Total Hours	0	692	1948	6044	8684
Average Hours Per State	**0**	**36**	**70**	**72**	**66**
Sales Tax Total Audits	2	3	7	2	14
Total States Audited	24	36	77	21	158
Total Hours	925	2448	6494	2033	11,900
Average Hours Per State	**39**	**68**	**84**	**97**	**75**
Total Both Taxes Total Audits	2	4	8.5	7.5	22
Total States Audited	24	55	105	105	289
Total Hours	925	3140	8442	8077	20,584
Average Hours Per State	**39**	**57**	**80**	**77**	**71**

TRENDS IN PRODUCTIVITY

MTC JOINT AUDIT PROGRAM

AUDIT HOUR ANALYSIS

6/89 - 6/01

	6/89	6/90	6/91	6/92	6/93	6/94	6/95	6/96	6/97	6/98	6/99	6/00	6/01
Income Tax Total Audits	12	4	9	7	12	9	9	9	10	9	7	10	8
Total States Audited	112	37	95	75	132	93	99	111	152	120	186	251	131
Total Hours	20679	7211	12646	11148	11208	9016	9284	7548	12249	10012	10060	13133	8684
Average Hours Per State	**184**	**195**	**133**	**148**	**85**	**97**	**94**	**68**	**81**	**83**	**55**	**52**	**66**
Sales Tax Total Audits	9	9	8	9	14	13	15	13	14	10	16	11	14
Total States Audited	85	88	79	104	146	140	152	123	143	97	184	102	158
Total Hours	12393	8866	7069	12209	14323	6818	8009	9746	11349	7721	7438	9062	11900
Average Hours Per State	**146**	**101**	**89**	**117**	**98**	**49**	**53**	**79**	**79**	**80**	**40**	**89**	**75**
Total Both Taxes Total Audits	21	13	17	16	26	22	24	22	24	19	23	21	22
Total States Audited	197	125	174	179	278	233	251	234	295	217	370	353	289
Total Hours	33072	16077	19715	23357	25531	15834	17293	17294	23598	17733	17498	22195	20584
Average Hours Per State	**168**	**129**	**113**	**130**	**92**	**68**	**69**	**74**	**80**	**82**	**48**	**63**	**71**

Report of the Litigation Committee and MTC Legal Activities

We report here on the activities of the Litigation Committee and the legal activities of the Multistate Tax Commission for this first fiscal year of the new millennium 2000-2001.

LITIGATION COMMITTEE

The Litigation Committee met twice this past year, at the annual meeting in Girdwood,, Alaska and in St. Petersburg, Florida, in March. While the Committee continued its informational and educational function, it has begun to focus more on planning, coordination, and policy development. The meetings continue to be well attended, probably having nothing to do with the beauty of Alaska or the warmth and spring training in Florida.

The Supreme Court provided us with meager fodder in the state tax arena this past term. It unanimously upheld state taxation of farm credit associations in *Missouri Director of Revenue v. CoBank ACB* against a challenge that these federal instrumentalities were exempt from state tax. The Court has little trouble in saying that Congress did not intend that these privately owned farm credit associations be exempt from state income taxes in light of the legislative history and the remaining limited tax exemption. Given that Congress almost always specifies the degree of tax exemption when it establishes federal instrumentalities these days, the decision should help protect states from claims under *McCulloch v. Maryland* that federal instrumentalities are exempt from all variety of state tax beyond that expressed by Congress.

The Court also decided in *Atkinson Trading Co. Inc., v. Shirley* that tribes cannot tax non-Indian hotel guests on non-Indian land within a reservation. The decision reduced the pressure on state taxes in this one area from the unfortunate consequence of double taxation by States and Tribes on various reservation activities.

The Litigation Committee discussed at some length a proposed Charter. The discussion focused on the possibilities of broadening the focus of the Committee to include a greater degree of coordination of litigation, including amicus briefs, greater interest in publication of articles reflecting the state tax agency perspective, and greater involvement in policy recommendations to the Executive Committee. Further discussions of the Charter are expected this coming year.

During the Informational and Training Sessions, the Litigation Committee continued to conduct mini-seminars on timely topics. In Girdwood, Bruce Fort from New Mexico presented a lively seminar on how to deal with expert witnesses and Dave Woodgerd from Montana discussed several ethical issues. In St. Petersburg, Florida attorneys discussed the Bank's Use of the Bad Debt Refund on Repossessed Autos, Ben Miller from California and Frank Katz of the MTC discussed the Taxation of Electricity with regard to the sales factor and P.L. 86-272, and Ted Spangler from Idaho, Clark Snelson from Utah, and Paull Mines discussed the nature of state compacts, with an eye towards the Streamlined Sales Tax Project.

Perhaps energized by the discussions of the Litigation Committee Charter and of the broadened role of the Committee, the Roundtable discussion of pending litigation was unusually lively and long. There seemed to be a greater desire to delve more deeply into the status of the pending litigation and to share strategies. The Committee also held its usual discussion of recently decided cases with the appropriate pats on the backs of the victorious attorneys.

LEGAL ACTIVITIES OF THE COMMISSION

Formal Court Appearances

During the past year, the Commission filed an *amicus curia* brief in *Kmart Properties, Inc. v. Taxation and Revenue Department of the State of New Mexico* on the issue of the nexus standard for the imposition of state income tax on a trademark holding company. The case is one of the many state responses to this rampant tax planning device of transferring the trademarks of a major corporation to a shell subsidiary in a tax haven state and then deducting from income earned in all the states the royalty payments made to the wholly owned subsidiary. Many states have disallowed the royalty deduction on the basis that the trademark holding company as a sham. The results of that method of attack have been mixed, often when dealing with the same company, with some courts upholding the deduction, finding other valid business purposes in the arrangement, and other states sustaining the state tax, finding no valid business purpose. New Mexico took the approach that South Carolina had succeeded with in *Geoffrey* of accepting the trademark holding company as a valid company and simply requiring that it pay taxes on its income earned from in-state sources. The departmental hearing officer found that the *Quill* requirement of physical presence for nexus applied to income taxes as well as sales and use taxes, but found that required physical presence with Kmart's acting as representative of Kmart Properties, Inc. (which had only five employees) in policing the use and maintaining the value of the various trademarks licensed exclusive to Kmart. The MTC *amicus* brief argued that long-standing Supreme Court precedent has not required physical presence for income tax nexus and that nothing in *Quill* changed that. Frank Katz of the MTC participated in the oral argument in front of the New Mexico Court of Appeal in July, 2001.

The Commission also filed an *amicus* brief in *Furnitureland South Inc. v. Comptroller of the Treasury* in Maryland's highest court, the Court of Appeal. The declaratory judgment action by the Comptroller raised the question of when a third party transport company that delivered virtually exclusively for Furnitureland and engaged in some ancillary set up activities was sufficiently a representative of Furnitureland to establish use tax collection nexus. Unfortunately, the Maryland court raised *sua sponte* the issue of jurisdiction and concluded that because the Comptroller "failed to invoke and exhaust the prescribed statutory administrative and judicial review remedies for resolution of this tax issue, we shall be unable to reach the merits of the case."

A third *amicus* brief the Commission filed supported Tennessee's petition for certiorari in the U.S. Supreme Court in *J.C. Penney National Bank v. Johnson*. The Tennessee Court of Appeals had applied the *Quill* physical presence requirement to income tax nexus and found no physical presence, even though the Bank had some 22,000 credit cards in Tennessee and had hired a Tennessee lawyer to sue debtors in Tennessee. The petition for certiorari raised the single issue of whether income tax nexus required physical presence. The Court denied certiorari, as it does in most cases.

A fourth *amicus* brief was filed in the Kansas Supreme Court in the *Intercard* case in support of the Kansas Department of Revenue. Seeking reversal of the decision below, the Commission supported Kansas's argument that eleven visits to Kansas by Intercard employees to install the card readers sold to Kinko's stores in Kansas provided substantial nexus justifying the imposition of use tax on the card readers and cards used in the readers. Disappointingly, the Kansas court found this clear physical presence directly relating to sales on which use tax was accesses was insufficient.

In a fifth *amicus* brief filed in the Nevada Supreme Court in the *Hyatt* case, the Commission supported California's motion to dismiss litigation brought by a California taxpayer in Nevada. The taxpayer alleged that California tax personnel committed various torts against him in their effort to audit and collect income tax from him accruing prior to his effective change of residence to Nevada. The Nevada court dismissed this action on California's petition for extraordinary writ.

Previous *amicus* briefing by the Commission bore fruit with two decisions this past year. In *Hoechst Celanese Corp. v. Franchise Tax Board*, the California Supreme Court gave a ringing endorsement of interpretation of business income as having two test, the transactional test and the functional test. The court held that the proceeds from a pension reversion were business income. In *Union Pacific Corp. v. Idaho State Tax Commission*, the Utah Supreme Court also upheld the two test interpretation of business income and further held that the equitable apportionment section of UDITPA applied to the sale of accounts receivable, which the court recognized as double counting.

Promoting Uniformity

The Legal Division continues to staff the Uniformity Committee and participate broadly in the uniformity effort of the Commission. Staff acted as hearing officers for uniformity proposals concerning the residence of funeral trusts, modification of the Public Law 86-272 guidelines and the definition of "gross receipts" under UDITPA. In addition, staff participated in work on uniformity proposals concerning sales and use tax priority, definitions of business income and a unitary business, and composite returns for pass-through entities.

In addition, the Legal Division has participated in the promotion of uniformity by supporting various electronic commerce issues. It actively supported the initiative to establish a streamlined sales and use tax collection system, seen by many as the best answer to the problems presented by the *Quill* decision and threatened congressional preemption.

The Legal Division supported states in implementing the Mobile Telecommunications Sourcing Act, federal legislation that permits States to impose transactional taxes on wireless communications in a more practical manner than before the law was passed. Legal staff worked with States to develop legislation considered by state legislatures.

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 electronic commerce, interstate commerce, bankruptcy reform and federal tax restructuring.

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. Paull Mines and Professors Charles McIntyre and Rick Pomp have completed a primer on state adoption of combined reporting to be published this calendar year in the Louisiana State University Law Review.

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, Legal Division support of the Joint Audit Program has focused on the continued resistance of some taxpayers to cooperate in an examination of their records. The Legal Division has stood ready to apply to the courts for judicial enforcement of its examination powers where taxpayer resistance is not justified. This readiness has so far been successful in persuading taxpayers to comply in face of the realization that judicial enforcement could lead to production of considerably more pertinent evidence than would otherwise be discovered with initial cooperation. The Legal Division has also supported the Joint Audit Program's examination of several nexus issues with the possibility of establishing clear judicial authority for taxpayer examinations under the Due Process Clause, even where Commerce Clause nexus may not be an in indisputable conclusion under current law.

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 11th Amendment restrictions, nexus issues, the test—or tests—for business income, state/tribal issues, the definition of unitary business, the reach of Commerce Clause discrimination claims and the like.

REPORT OF THE NEXUS COMMITTEE &
NATIONAL NEXUS PROGRAM
July 2001
Joseph A. Thomas, Chair, MTC Nexus Committee
Sheldon H. Laskin, Director, MTC National Nexus Program

The following report summarizes the activities of the National Nexus Program for the period July 1, 2000 through June 30, 2001.

Multistate Combined Registration
During the past year, the Executive Committee authorized the formation of a Joint Coordinating Committee to follow up on the previous work of the Nexus Subcommittee on electronic registration, and to implement the MTC's multistate combined registration project. The project will enable a business to simultaneously complete its tax registration online in all those states in which the business intends to operate. Currently, 18 states participate in the work of the committee, either as members or observers. The committee is preparing a policy recommendation for release to interested vendors and expects to receive proposals in the Fall. Sheldon Laskin, NNP Director, staffs the Joint Coordinating Committee.

Clearinghouse Database
The revised clearinghouse database was rolled out to the states in November 2000. Since then, participating states have exchanged tax information twice; the first for the period of January 1 through March 31, 2001 (3d fiscal quarter) and the second for the period of April 1 through June 30, 2001 (4th fiscal quarter). The states of Arkansas, Michigan, Minnesota, Montana, New Jersey and Oregon contributed 6844 income tax and 142 sales tax records for the 3d quarter exchange. The states of Arkansas, Kentucky, Missouri, New Jersey and Ohio contributed 880 income tax and 138 sales tax records for the 4th quarter exchange, with Michigan expected to contribute shortly.

Voluntary Disclosures
The National Nexus Program executed agreements with 28 taxpayers during this period, resulting in 94 separate contracts with member states. These 94 contracts resulted in $1,540,020 in back taxes collected and $588,767 in estimated annual future collections. In addition, during this period the National Nexus Program opened 30 new voluntary disclosure cases, representing 307 separate potential contracts.

Voluntary Disclosure Marketing
NNP Staff continuously promotes the Voluntary Disclosure Program through periodic appearances at tax conferences to speak and to distribute promotional literature. Staff also periodically publishes promotional materials in professional journals. During the

past year, staff has marketed the voluntary disclosure program through the following venues:

- Rothstein, Kass CPAs, Livingston, NJ. Tom Shimkin, Nexus Counsel, has been invited to make this presentation at one of the New York area's largest accounting firms annually for the past three years.
- New Jersey One-Day Tax Seminar, Iselin, NJ
- *Resolving State Tax Liabilities* published in MTC Review, September 2000.

In addition, Tax Analysts has agreed to insert the voluntary disclosure brochure in *State Tax Notes*, free of charge.

Nexus Workplan
The Nexus Committee has prepared a workplan as part of the MTC's strategic planning process. This plan, prepared with the assistance of June Zivley, formerly of the Texas Comptroller of Public Accounts and former Vice Chair of the Nexus Committee, is designed to more closely integrate the compliance programs of the Nexus Committee and of the Nexus member states. Under this plan, the states will take on a greater role in identifying possible compliance subjects and in recommending appropriate actions in bringing those companies into compliance. The Nexus Program will take on an enhanced role in identifying possible compliance subjects for appropriate joint action by the member states as a whole or by individual member states.

Nexus Research Reports
During the previous year, nexus research staff concentrated on studying the practices of specific companies that are most likely to raise compliance issues. Those practices include multi-channel marketing, the expansion of computer kiosks and in-store returns of goods purchased through online subsidiaries of brick and mortar retailers. This research is being used in support of the recommendation of MTC staff to form multistate legal/auditing working groups to develop appropriate compliance strategies to address these issues.

Nexus School
During the previous year, staff conducted nexus schools in Portland, O, Annapolis, MD, Helena, MT and Topeka, KS. Upcoming schools will be held in Tucson, AZ and Charleston, SC.

Streamlined Sales Tax Project
Sheldon Laskin, Director of the NNP, staffed the Registration, Returns Rates and Remittances working group of the Streamlined Sales Tax Project during the past year.

Nexus List Serve
The Nexus List Serve continues to provide pertinent monthly information to nexus researchers in the states. During the past year, subscriptions increased 32% (from 47 to 62). Interested nexus researchers should contact Susan Ribe at sribe@mtc.gov.

The Nexus Program has made past listserve editions available for viewing on the TaxExchange Web site (www.taxexchange.org). Currently these research tips are sent via e-mail to interested state revenue personnel. The listserve was promoted at the FTA Compliance and Nonfiler Workshops and via the first Nexus Gazette released in February.

Publications
NNP staff published a number of articles in the past year on nexus related topics, including,

- S. Laskin, *Furnitureland South: Sua Sponte* Doesn't – or Shouldn't – Mean 'Without Input'. State Tax Notes, June 25, 2001. This was a commentary on the recent decision of the Maryland Court of appeals, which held that the Maryland Comptroller of the Treasury failed to use required statutory procedures in filing its declaratory judgment action in order to determine whether Furnitureland South has sufficient nexus with the State of Maryland to require it to collect use tax.
- B. Baez, *Multistate Update*. This is a regular monthly column in the *Tax Practitioners Journal*. Articles cover a variety of current issues in multistate taxation.
- B. Baez, Voluntary disclosure article: MTC Review, September 2000
- B. Baez, *Understanding 'Substantial Nexus': Errors of Interpretation Fail to Consider the Phrase as a Legal Term of Art; Multistate Tax Report*, June 2001.
- B. Baez, *Nexus Update*; MTC Review, April 2001

Nexus Gazette
The first two issues of the *Nexus Gazette* were published during the year. This is a quarterly publication for users of the Clearinghouse Database that is designed to assist state personnel in using the database, as well as providing useful nexus research tips and general nexus information.

Presentations
In addition to the appearances described under "Voluntary Disclosure Marketing", Sheldon Laskin and Susan Ribe, Nexus Research Assistant, conducted training presentations for employees of the Missouri Department of Revenue and at the FTA Compliance Workshop. Sheldon Laskin made a presentation at WSATA's annual meeting.

REPORT OF THE TECHNOLOGY COMMITTEE
July 2001
Tim Blevins, Chair, MTC Technology Committee

The standing Committee on technology was created by an MTC Resolution on July 28, 2000. The first meeting of the Committee was held November 13, 2000 in Washington, DC. The Committee is comprised of members drawn from both the existing Audit Subcommittee on Technology and other state representatives with expertise in information technology.

What follows is a report of the activities of the Technology Committee of the Multistate Tax Commission for the fiscal year 2000-2001.

MTC Automated Systems Development

As part of Technology Committee Charter, the Committee is charged with and has set forth plans 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. To achieve this goal, the MTC must bring the Commission and its Member States together under one protocol and create an infrastructure that will allow: a) secure email among MTC staff; b) secure email between MTC staff and its Member States; c) secure email among the Member States; and d) secure web access for Member States.

The MTC has envisioned instituting a Public Key Infrastructure (PKI) and has contracted to use VeriSign's products and services in a pilot to test the planned secure communications environment. This Committee is assisting the MTC with the PKI authentication process and criteria.

The first stage of the PKI implementation, Phase I, was implemented this year. Phase I involves testing among MTC staff only. Phase II will involve pilot testing in three states: Idaho, Kansas, and Michigan. Phase III will incorporate all states into the PKI infrastructure.

Multistate Combined Registration Project

The Technology Committee provided assistance in developing an RFI/Policy Statement for the Combined Registration Project and plans to review responses from potential vendors once the RFI/Policy Statement is distributed.

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 under the current system, and to be easily adaptable for users of the Streamlined Sales Tax System.

Mobile Telecommunications Sourcing Database

This Committee has the role of providing support for the joint *MTC/FTA Wireless Database Certification Task Force*. In this role the Committee is evaluating data formats to see if they are feasible to complete the Task Force's purpose.

The technology Committee, working with the FTA, will identify the actions that need to be undertaken to enable the MTC and FTA to certify database standards by the end of 2001.

Coordination with FTA

The Committee also seeks to expand the technology relationship between the MTC and the FTA and enhance communication regarding efforts to prevent their duplication or incompatibility.

Jonathan Lyon of the FTA has participated in Committee discussions. Among the FTA activities discussed were

- Draft Survey to the States Regarding Use of XML
- Discussion of the Federation of Tax Administrators' Surveys
  -Status of States' Electronic Funds Transfer (EFT) Programs
  -Results of Survey on State Acceptance of Credit Cards

Streamlined Sales Tax Project (SSTP) Review

Juli Peterson (MN) identified 6 key technology-related components of the *Streamlined Sales Tax Project*:

- Joint on-line sales and use tax registration (currently under development by the MTC Combined Registration Committee);
- Provision of a database system for tax rate calculation and tax jurisdiction determination purposes;
- Allowance of electronically-filed returns;
- Ability to claim exemptions electronically;
- Development of a uniform product classification scheme; and
- Allowance of EFT payments by both ACH debit and credit mechanisms.

The Technology Committee will continue to closely monitor the development of these components of the SSTP.

Distance Learning
The Committee was also charged with supporting the development 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.

Budgeting Assistance
Finally, The Executive Director expressed his wish to engage the Technology Committee on future budgetary matters. The Technology Committee was asked to lend budgeting assistance to the Executive Director in the future to assist the MTC move in cost-effective ways in allocating their resources for technology related components, infrastructure, and overall plans for the States more efficiently and applying the "least-cost" method of technology.

THE MULTISTATE TAX COMPACT

Entered into force August 4, 1967

Article I. Purposes.

The purposes of this compact are to:

1. Facilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.

2. Promote uniformity or compatibility in significant components of tax systems.

3. Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.

4. Avoid duplicative taxation.

Article II. Definitions.

As used in this compact:

1. "State" means a State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any Territory or Possession of the United States.

2. "Subdivision" means any governmental unit or special district of a State.

3. "Taxpayer" means any corporation, partnership, firm, association, governmental unit or agency or person acting as a business entity in more than one State.

4. "Income tax" means a tax imposed on or measured by net income including any tax imposed on or measured by an amount arrived at by deducting expenses from gross income, one or more forms of which expenses are not specifically and directly related to particular transactions.

5. "Capital stock tax" means a tax measured in any way by the capital of a corporation considered in its entirety.

6. "Gross receipts tax" means a tax, other than a sales tax, which is imposed on or measured by the gross volume of business, in terms of gross receipts or in other terms, and in the determination of which no deduction is allowed which would constitute the tax an income tax.

7. "Sales tax" means a tax imposed with respect to the transfer for a consideration of ownership, possession or custody of tangible personal property or the rendering of services measured by the price of the tangible personal property transferred or services rendered and which is required by State or local law to be separately stated from the sales price by the seller, or which is customarily separately stated from the sales price, but does not include a tax imposed

exclusively on the sale of a specifically identified commodity or article or class of commodities or articles.

8. "Use tax" means a nonrecurring tax, other than a sales tax, which (a) is imposed on or with respect to the exercise or enjoyment of any right or power over tangible personal property incident to the ownership, possession or custody of that property or the leasing of that property from another including any consumption, keeping, retention, or other use of tangible personal property and (b) is complementary to a sales tax.

9. "Tax" means an income tax, capital stock tax, gross receipts tax, sales tax, use tax, and any other tax which has a multistate impact, except that the provisions of Articles III, IV and V of this compact shall apply only to the taxes specifically designated therein and the provisions of Article IX of this compact shall apply only in respect to determinations pursuant to Article IV.

Article III. Elements of Income Tax Laws.

Taxpayer Option, State and Local Taxes.

1. Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes pursuant to the laws of a party State or pursuant to the laws of subdivisions in two or more party States may elect to apportion and allocate his income in the manner provided by the laws of such States or by the laws of such States and subdivisions without reference to this compact, or may elect to apportion and allocate in accordance with Article IV. This election for any tax year may be made in all party States or subdivisions thereof or in any one or more of the party States or subdivisions thereof without reference to the election made in the others. For the purposes of this paragraph, taxes imposed by subdivisions shall be considered separately from State taxes, and the apportionment and allocation also may be applied to the entire tax base. In no instance wherein Article IV is employed for all subdivisions of a State may the sum of all apportionments and allocations to subdivisions within a State be greater than the apportionment and allocation that would be assignable to that State if the apportionment or allocation were being made with respect to a State income tax.

Taxpayer Option, Short Form.

2. Each party State or any subdivision thereof which imposes an income tax shall provide by law that any taxpayer required to file a return whose only activities within the taxing jurisdiction consist of sales and do not include owning or renting real estate or tangible personal property and whose dollar volume of gross sales made during the tax year within the State or subdivision, as the case may be, is not in excess of $100,000 may elect to report and pay any tax due on the basis of a percentage of such volume and shall adopt rates which shall produce a tax which reasonably approximates the tax otherwise due. The Multistate Tax Commission, not more than once in five years, may adjust the $100,000 figure in order to reflect such changes as may occur in the real value of the dollar, and such adjusted figure, upon adoption by the Commission, shall replace the $100,000 figure specifically provided herein. Each party State and subdivision thereof may make the same election available to taxpayers additional to those specified in this paragraph.

Coverage.

3. Nothing in this Article relates to the reporting or payment of any tax other than an income tax.

Article IV. Division of Income.

1. As used in this Article, unless the context otherwise requires:

(a) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(b) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

(c) "Compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

(d) "Financial organization" means any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank, small loan company, sales finance company, investment company, or any type of insurance company.

(e) "Nonbusiness income" means all income other than business income.

(f) "Public utility" means any business entity (1) which owns or operates any plant, equipment, property, franchise, or license for the transmission of communications, transportation of goods or persons, except by pipeline, or the production, transmission, sale, delivery, or furnishing of electricity, water or steam; and (2) whose rates of charges for goods or services have been established or approved by a Federal, State or local government or governmental agency.

(g) "Sales" means all gross receipts of the taxpayer not allocated under paragraphs of this Article.

(h) "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any Territory or Possession of the United States, and any foreign country or political subdivision thereof.

(i) "This State" means the State in which the relevant tax return is filed or, in the case of application of this Article to the apportionment and allocation of income for local tax purposes, the subdivision or local taxing district in which the relevant tax return is filed.

2. Any taxpayer having income from business activity which is taxable both within and without this State, other than activity as a financial organization or public utility or the rendering of purely personal services by an individual, shall allocate and apportion his net income as provided in this Article. If a taxpayer has income from business activity as a public utility but derives the greater percentage of his income from activities subject to this Article, the taxpayer may elect to allocate and apportion his entire net income as provided in this Article.

3. For purposes of allocation and apportionment of income under this Article, a taxpayer is taxable in another State if (1) in that State he is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that State has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the State does or does not do so.

4. Rents and royalties from real or tangible personal property, capital gains, interest, dividends or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in paragraphs 5 through 8 of this Article.

5. (a) Net rents and royalties from real property located in this State are allocable to this State.

(b) Net rents and royalties from tangible personal property are allocable to this State: (1) if and to the extent that the property is utilized in this State, or (2) in their entirety if the taxpayers's commercial domicile is in this State and the taxpayer is not organized under the laws of or taxable in the State in which the property is utilized.

(c) The extent of utilization of tangible personal property in a State is determined by multiplying the rents and royalties by a fraction the numerator of which is the number of days of physical location of the property in the State during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, tangible personal property is utilized in the State in which the property was located at the time the rental or royalty payer obtained possession.

6. (a) Capital gains and losses from sales of real property located in this State are allocable to this State.

(b) Capital gains and losses from sales of tangible personal property are allocable to this State if (1) the property had a situs in this State at the time of the sale, or (2) the taxpayer's commercial domicile is in this State and the taxpayer is not taxable in the State in which the property had a situs.

(c) Capital gains and losses from sales of intangible personal property are allocable to this State if the taxpayer's commercial domicile is in this State.

7. Interest and dividends are allocable to this State if the taxpayer's commercial domicile is in this State.

8. (a) Patent and copyright royalties are allocable to this State: (1) if and to the extent that the patent or copyright is utilized by the payer in this State, or (2) if and to the extent that the patent or copyright is utilized by the payer in a State in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this State.

(b) A patent is utilized in a State to the extent that it is employed in production, fabrication, manufacturing, or other processing in the State or to the extent that a patented product is produced in the State. If the basis of receipts from patent royalties does not permit allocation to States or if the accounting procedures do not reflect States of utilization, the patent is utilized in the State in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized in a State to the extent that printing or other publication originates in the State. If the basis of receipts from copyright royalties does not permit allocation to States or if the accounting procedures do not reflect States of utilization, the copyright is utilized in the State in which the taxpayer's commercial domicile is located.

9. All business income shall be apportioned to this State by multiplying the income by a fraction the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three.

10. The property factor is a fraction the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this State during the tax period and the denominator of which is the average value of all of the taxpayer's real and tangible personal property owned or rented and used during the tax period.

11. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

12. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period; but the tax administrator may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

13. The payroll factor is a fraction the numerator of which is the total amount paid in this State during the tax period by the taxpayer for compensation and the denominator of which is the total compensation paid everywhere during the tax period.

14. Compensation is paid in this State if:

(a) the individual's service is performed entirely within the State;

(b) the individual's service is performed both within and without the State, but the service performed without the State is incidental to the individual's service within the State; or

(c) some of the service is performed in the State and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the State, or (2) the base of operations or the place from which the service is directed or controlled is not in any State in which some part of the service is performed, but the individual's residence is in this State.

15. The sales factor is a fraction the numerator of which is the total sales of the taxpayer in this State during the tax period and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

16. Sales of tangible personal property are in this State if:

(a) the property is delivered or shipped to a purchaser, other than the United States Government, within this State regardless of the f.o.b. point or other conditions of the sale; or

(b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this State and (1) the purchaser is the United States Government or (2) the taxpayer is not taxable in the State of the purchaser.

17. Sales, other than sales of tangible personal property, are in this State if:

(a) the income-producing activity is performed in this State; or

(b) the income-producing activity is performed both in and outside this State and a greater proportion of the income-producing activity is performed in this State than in any other State, based on costs of performance.

18. If the allocation and apportionment provisions of this Article do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting;

(b) the exclusion of any one or more of the factors;

(c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this State; or

(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Article V. Elements of Sales and Use Tax Laws.

Tax Credit.

1. Each purchaser liable for a use tax on tangible personal property shall be entitled to full credit for the combined amount or amounts of legally imposed sales or use taxes paid by him with respect to the same property to another State and any subdivision thereof. The credit shall be applied first against the amount of any use tax due the State, and any unused portion of the credit shall then be applied against the amount of any use tax due a subdivision.

Exemption Certificates. Vendors May Rely.

2. Whenever a vendor receives and accepts in good faith from a purchaser a resale or other exemption certificate or other written evidence of exemption authorized by the appropriate State or subdivision taxing authority, the vendor shall be relieved of liability for a sales or use tax with respect to the transaction.

Article VI. The Commission.

Organization and Management.

1. (a) The Multistate Tax Commission is hereby established. It shall be composed of one "member" from each party State who shall be the head of the State agency charged with the administration of the types of taxes to which this compact applies. If there is more than one such agency, the State shall provide by law for the selection of the Commission member from the heads of the relevant agencies. State law may provide that a member of the Commission be represented by an alternate, but only if there is on file with the Commission written notification of the designation and identity of the alternate. The Attorney General of each party State or his designee, or other counsel if the laws of the party State specifically provide, shall be entitled to attend the meetings of the Commission, but shall not vote. Such Attorneys General, designees, or other counsel shall receive all notices of meetings required under paragraph 1(e) of this Article.

(b) Each party State shall provide by law for the selection of representatives from its subdivisions affected by this compact to consult with the Commission member from that State.

(c) Each member shall be entitled to one vote. The Commission shall not act unless a majority of the members are present, and no action shall be binding unless approved by a majority of the total number of members.

(d) The Commission shall adopt an official seal to be used as it may provide.

(e) The Commission shall hold an annual meeting and such other regular meetings as its bylaws may provide and such special meetings as its Executive Committee may determine. The Commission bylaws shall specify the dates of the annual and any other regular meetings and shall provide for the giving of notice of annual, regular and special meetings. Notices of special meetings shall include the reasons therefor and an agenda of the items to be considered.

(f) The Commission shall elect annually, from among its members, a Chairman, a Vice Chairman and a Treasurer. The Commission shall appoint an Executive Director who shall serve at its pleasure, and it shall fix his duties and compensation. The Executive Director shall be Secretary of the Commission. The Commission shall make provision for the bonding of such of its officers and employees as it may deem appropriate.

(g) Irrespective of the civil service, personnel or other merit system laws of any party State, the Executive Director shall appoint or discharge such personnel as may be necessary for the performance of the functions of the Commission and shall fix their duties and compensation. The Commission bylaws shall provide for personnel policies and programs.

(h) The Commission may borrow, accept or contract for the services of personnel from any State, the United States, or any other governmental entity.

(i) The Commission may accept for any of its purposes and functions any and all donations and grants of money, equipment, supplies, materials and services, conditional or otherwise, from any governmental entity, and may utilize and dispose of the same.

(j) The Commission may establish one or more offices for the transacting of its business.

(k) The Commission shall adopt bylaws for the conduct of its business. The Commission shall publish its bylaws in convenient form and shall file a copy of the bylaws and any amendments thereto with the appropriate agency or officer in each of the party States.

(l) The Commission annually shall make to the Governor and legislature of each party State a report covering its activities for the preceding year. Any donation or grant accepted by the Commission or services borrowed shall be reported in the annual report of the Commission and shall include the nature, amount and conditions, if any, of the donation, gift, grant or services borrowed and the identity of the donor or lender. The Commission may make additional reports as it may deem desirable.

Committees.

2. (a) To assist in the conduct of its business when the full Commission is not meeting, the Commission shall have an Executive Committee of seven members, including the Chairman, Vice Chairman, Treasurer and four other members elected annually by the Commission. The Executive Committee, subject to the provisions of this compact and consistent with the policies of the Commission, shall function as provided in the bylaws of the Commission.

(b) The Commission may establish advisory and technical committees, membership on which may include private persons and public officials, in furthering any of its activities. Such committees may consider any matter of concern to the Commission, including problems of special interest to any party State and problems dealing with particular types of taxes.

(c) The Commission may establish such additional committees as its bylaws may provide.

Powers.

3. In addition to powers conferred elsewhere in this compact, the Commission shall have power to:

(a) Study State and local tax systems and particular types of State and local taxes.

(b) Develop and recommend proposals for an increase in uniformity or compatibility of State and local tax laws with a view toward encouraging the simplification and improvement of State and local tax law and administration.

(c) Compile and publish such information as would, in its judgment, assist the party States in implementation of the compact and taxpayers in complying with State and local tax laws.

(d) Do all things necessary and incidental to the administration of its functions pursuant to this compact.

Finance.

4. (a) The Commission shall submit to the Governor or designated officer or officers of each party State a budget of its estimated expenditures for such period as may be required by the laws of that State for presentation to the legislature thereof.

(b) Each of the Commission's budgets of estimated expenditures shall contain specific recommendations of the amounts to be appropriated by each of the party States. The total amount of appropriations required under any such budget shall be apportioned among the party States as follows: one-tenth in equal shares; and the remainder in proportion to the amount of revenue collected by each party State and its subdivisions from income taxes, capital stock taxes, gross receipts taxes, sales and use taxes. In determining such amounts, the Commission shall employ such available public sources of information as, in its judgment, present the most equitable and accurate comparisons among the party States. Each of the Commission's budgets of estimated expenditures and requests for appropriations shall indicate the sources used in obtaining information employed in applying the formula contained in this paragraph.

(c) The Commission shall not pledge the credit of any party State. The Commission may meet any of its obligations in whole or in part with funds available to it under paragraph 1(i) of this Article; provided that the Commission takes specific action setting aside such funds prior to incurring any obligation to be met in whole or in part in such manner. Except where the Commission makes use of funds available to it under paragraph 1(i), the Commission shall not incur any obligation prior to the allotment of funds by the party States adequate to meet the same.

(d) The Commission shall keep accurate accounts of all receipts and disbursements. The receipts and disbursements of the Commission shall be subject to the audit and accounting procedures established under its bylaws. All receipts and disbursements of funds handled by the Commission shall be audited yearly by a certified or licensed public accountant and the report of the audit shall be included in and become part of the annual report of the Commission.

(e) The accounts of the Commission shall be open at any reasonable time for inspection by duly constituted officers of the party States and by any persons authorized by the Commission.

(f) Nothing contained in this Article shall be construed to prevent Commission compliance with laws relating to audit or inspection of accounts by or on behalf of any government contributing to the support of the Commission.

Article VII. Uniform Regulations and Forms.

1. Whenever any two or more party States or subdivisions of party States have uniform or similar provisions of law relating to an income tax, capital stock tax, gross receipts tax, or sales or use tax, the Commission may adopt uniform regulations for any phase of the administration of such law, including assertion of jurisdiction to tax or prescribing uniform tax forms. The Commission may also act with respect to the provisions of Article IV of this compact.

2. Prior to the adoption of any regulation, the Commission shall:

(a) As provided in its bylaws, hold at least one public hearing on due notice to all affected party States and subdivisions thereof and to all taxpayers and other persons who have made timely request of the Commission for advance notice of its regulation-making proceedings.

(b) Afford all affected party States and subdivisions and interested persons an opportunity to submit relevant written data and views, which shall be considered fully by the Commission.

3. The Commission shall submit any regulations adopted by it to the appropriate officials of all party States and subdivisions to which they might apply. Each such State and subdivision shall consider any such regulation for adoption in accordance with its own laws and procedures.

Article VIII. Interstate Audits.

1. Any party State or subdivision thereof desiring to make or participate in an audit of any accounts, books, papers, records or other documents may request the Commission to perform the audit on its behalf. In responding to the request, the Commission shall have access to and may examine, at any reasonable time, such accounts, books, papers, records, and other documents and any relevant property or stock of merchandise. The Commission may enter into agreements with party States or their subdivisions for assistance in performance of the audit. The Commission shall make charges, to be paid by the State or local government or governments for which it performs the service, for any audits performed by it in order to reimburse itself for the actual costs incurred in making the audit.

2. The Commission may require the attendance of any person within the State where it is conducting an audit or part thereof at a time and place fixed by it within such State for the purpose of giving testimony with respect to any account, book, paper, document, other record, property or stock of merchandise being examined in connection with the audit. If the person is

not within the jurisdiction, he may be required to attend for such purpose at any time and place fixed by the Commission within the State of which he is a resident.

3. The Commission may apply to any court having power to issue compulsory process for orders in aid of its powers and responsibilities pursuant to this Article, and any and all such courts shall have jurisdiction to issue such orders. Failure of any person to obey any such order shall be punishable as contempt of the issuing court. If the party or subject matter on account of which the Commission seeks an order is within the jurisdiction of the court to which application is made, such application may be to a court in the State or subdivision on behalf of which the audit is being made or a court in the State in which the object of the order being sought is situated.

4. The Commission may decline to perform any audit required if it finds that its available personnel or other resources are insufficient for the purpose or that, in the terms requested, the audit is impracticable of satisfactory performance. If the Commission, on the basis of its experience, has reason to believe that an audit of a particular taxpayer, either at a particular time or on a particular schedule, would be of interest to a number of party States or their subdivisions, it may offer to make the audit or audits, the offer to be contingent upon sufficient participation therein as determined by the Commission.

5. Information obtained by any audit pursuant to this Article shall be confidential and available only for tax purposes to party States, their subdivisions or the United States. Availability of information shall be in accordance with the laws of the States or subdivisions on whose account the Commission performs the audit and only through the appropriate agencies or officers of such States or subdivisions. Nothing in this Article shall be construed to require any taxpayer to keep records for any period not otherwise required by law.

6. Other arrangements made or authorized pursuant to law for cooperative audit by or on behalf of the party States or any of their subdivisions are not superseded or invalidated by this Article.

7. In no event shall the Commission make any charge against a taxpayer for an audit.

8. As used in this Article, "tax," in addition to the meaning ascribed to it in Article II, means any tax or license fee imposed in whole or in part for revenue purposes.

Article IX. Arbitration.

1. Whenever the Commission finds a need for settling disputes concerning apportionments and allocations by arbitration, it may adopt a regulation placing this Article in effect, notwithstanding the provisions of Article VII.

2. The Commission shall select and maintain an Arbitration Panel composed of officers and employees of State and local governments and private persons who shall be knowledgeable and experienced in matters of tax law and administration.

3. Whenever a taxpayer who has elected to employ Article IV, or whenever the laws of the party State or subdivision thereof are substantially identical with the relevant provisions of Article IV, the taxpayer, by written notice to the Commission and to each party State or subdivision thereof that would be affected, may secure arbitration of an apportionment or allocation if he is dissatisfied with the final administrative determination of the tax agency of the State or subdivision with respect thereto on the ground that it would subject him to double or multiple taxation by two or more party States or subdivisions thereof. Each party State and subdivision thereof hereby consents to the arbitration as provided herein, and agrees to be bound thereby.

4. The Arbitration Board shall be composed of one person selected by the taxpayer, one by the agency or agencies involved, and one member of the Commission's Arbitration Panel. If the agencies involved are unable to agree on the person to be selected by them, such person shall be selected by lot from the total membership of the Arbitration Panel. The two persons selected for the Board in the manner provided by the foregoing provisions of this paragraph shall jointly select the third member of the Board. If they are unable to agree on the selection, the third member shall be selected by lot from among the total membership of the Arbitration Panel. No member of a Board selected by lot shall be qualified to serve if he is an officer or employee of or is otherwise affiliated with any party to the arbitration proceeding. Residence within the jurisdiction of a party to the arbitration proceeding shall not constitute affiliation within the meaning of this paragraph.

5. The Board may sit in any State or subdivision party to the proceeding, in the State of the taxpayer's incorporation, residence or domicile, in any State in which the taxpayer does business, or in any place that it finds most appropriate for gaining access to evidence relevant to the matter before it.

6. The Board shall give due notice of the times and places of its hearings. The parties shall be entitled to be heard, to present evidence, and to examine and cross-examine witnesses. The Board shall act by majority vote.

7. The Board shall have power to administer oaths, take testimony, subpoena and require the attendance of witnesses and the production of accounts, books, papers, records, and other documents, and issue commissions to take testimony. Subpoenas may be signed by any member of the Board. In case of failure to obey a subpoena, and upon application by the Board, any judge of a court of competent jurisdiction of the State in which the Board is sitting or in which the person to whom the subpoena is directed may be found may make an order requiring compliance with the subpoena, and the court may punish failure to obey the order as a contempt.

8. Unless the parties otherwise agree, the expenses and other costs of the arbitration shall be assessed and allocated among the parties by the Board in such manner as it may determine. The Commission shall fix a schedule of compensation for Arbitration Board members and of other allowable expenses and costs. No officer or employee of a State or local government who serves as a member of a Board shall be entitled to compensation therefor unless he is required on account of his service to forego the regular compensation attaching to his public employment, but any such Board member shall be entitled to expenses.

9. The Board shall determine the disputed apportionment or allocation and any matters necessary thereto. The determinations of the Board shall be final for purposes of making the apportionment or allocation, but for no other purpose.

10. The Board shall file with the Commission and with each tax agency represented in the proceeding: the determination of the Board; the Board's written statement of its reasons therefor; the record of the Board's proceedings; and any other documents required by the arbitration rules of the Commission to be filed.

11. The Commission shall publish the determinations of Boards together with the statements of the reasons therefor.

12. The Commission shall adopt and publish rules of procedure and practice and shall file a copy of such rules and of any amendment thereto with the appropriate agency or officer in each of the party States.

13. Nothing contained herein shall prevent at any time a written compromise of any matter or matters in dispute, if otherwise lawful, by the parties to the arbitration proceedings.

Article X. Entry Into Force and Withdrawal.

1. This compact shall enter into force when enacted into law by any seven States. Thereafter, this compact shall become effective as to any other State upon its enactment thereof. The Commission shall arrange for notification of all party States whenever there is a new enactment of the compact.

2. Any party State may withdraw from this compact by enacting a statute repealing the same. No withdrawal shall affect any liability already incurred by or chargeable to a party State prior to the time of such withdrawal.

3. No proceeding commenced before an Arbitration Board prior to the withdrawal of a State and to which the withdrawing State or any subdivision thereof is a party shall be discontinued or terminated by the withdrawal, nor shall the Board thereby lose jurisdiction over any of the parties to the proceeding necessary to make a binding determination therein.

Article XI. Effect on Other Laws and Jurisdiction.

Nothing in this compact shall be construed to:

(a) Affect the power of any State or subdivision thereof to fix rates of taxation, except that a party State shall be obligated to implement Article III 2 of this compact.

(b) Apply to any tax or fixed fee imposed for the registration of a motor vehicle or any tax on motor fuel, other than sales tax; provided that the definition of "tax" in Article VIII 9 may apply for the purposes of that Article and that the Commission's powers of study and recommendation pursuant to Article VI 3 may apply.

(c) Withdraw or limit the jurisdiction of any State or local court or administrative officer or body with respect to any person, corporation or other entity or subject matter, except to the extent that such jurisdiction is expressly conferred by or pursuant to this compact upon another agency or body.

(d) Supersede or limit the jurisdiction of any court of the United States.

Article XII. Construction and Severability.

This compact shall be liberally construed so as to effectuate the purposes thereof. The provisions of this compact shall be severable and if any phrase, clause, sentence, or provision of this compact is declared to be contrary to the constitution of any State or of the United States or the applicability thereof to any government, agency, person or circumstance is held invalid, the validity of the remainder of this compact and the applicability thereof to any government, agency, person or circumstance shall not be affected thereby. If this compact shall be held contrary to the constitution of any State participating therein, the compact shall remain in full force and effect as to the remaining party States and in full force and effect as to the State affected as to all severable matters.

Multistate Tax Commission
Compact Enactments

Forty-five States (including the District of Columbia) currently participate in the activities of the Multistate Tax Commission. The Commission currently has twenty-one Compact Members, two Sovereignty Members, and nineteen Associate Members. Three additional States are members of special MTC projects.

Compact Members

States attain full membership by enacting the Multistate Tax Compact, an interstate compact among the participating States. Compact Member States are diverse both in size and in the composition of their revenue systems.

Sovereignty Members

States join as Sovereignty Members to help shape and support the Commission's efforts to preserve state taxing authority and improve multistate tax policy and administration. These States receive benefits similar to Compact Membership but do not require enactment of the Compact.

Associate Members

The number of Associate Members has grown in recent years and represents increasing interest in the activities of the Commission. Several of the Associate Members participate in and help finance one or more of the following MTC programs and projects: Joint Audit Program, National Nexus Program, Property Tax Fairness Project, and Deregulation, Industry Change, and Taxation Project.

Project Members

In addition to the Member and Associate Member States, three other States have joined various projects of the Commission.

Compact Membership	Date of Membership
Kansas	August 4, 1967
New Mexico	August 4, 1967
Texas	August 4, 1967
Washington	August 4, 1967
Oregon	September 13, 1967
Missouri	October 13, 1967
Arkansas	January 1, 1968
Idaho	April 10, 1968
Hawaii	May 7, 1968
Colorado	July 1, 1968
Utah	May 13, 1969
Montana	July 1, 1969
North Dakota	July 1, 1969
Alaska	July 1, 1970
Michigan	July 1, 1970
California	January 1, 1976
South Dakota	July 1, 1976
Alabama	October 31, 1977
District of Columbia	July 1, 1980
Minnesota	July 1, 1982
Maine	September 19, 1997

Sovereignty Membership	Date of Membership
Florida	August 6, 1997
Wyoming	April 7, 2000

Associate Membership	Date of Membership
Massachusetts	January 23, 1968
Pennsylvania	January 23, 1968
Arizona	June 7, 1968
Tennessee	June 20, 1969
Louisiana	October 27, 1969
Maryland	July 27, 1970
New Jersey	October 14, 1970
Georgia	June 11, 1971
Ohio	June 11, 1971
New Hampshire	October 27, 1989
Connecticut	August 31, 1990
West Virginia	August 2, 1991
Wisconsin	May 5, 1994
North Carolina	April 28, 1995
Illinois	April 25, 1996
Kentucky	October 31, 1997
Oklahoma	May 14, 1998
Mississippi	November 18, 1998
South Carolina	November 18, 1998

Project Membership	Project Participation
Iowa	National Nexus Program
Nebraska	Joint Audit Program National Nexus Program
Rhode Island	National Nexus Program

MTC Member State Matrix of Participation

State	Compact	Sovereignty	Associate	Project	Audit	Nexus	Deregulation	Non-member
AL	Yes				Yes	Yes	Yes	
AK	Yes					Yes	Yes	
AR	Yes				Yes	Yes		
AZ			Yes			Yes		
CA	Yes					Yes*		
CO	Yes				Yes	Yes	Yes	
CT			Yes			Yes		
DE								Yes
DC	Yes				Yes	Yes		
FL		Yes				Yes		
GA			Yes					
HI	Yes				Yes	Yes		
ID	Yes				Yes	Yes	Yes	
IN								Yes
IL			Yes					
IA				Yes		Yes		
KS	Yes				Yes	Yes		
KY		Yes			Yes	Yes	Yes	
LA		Yes			Yes	Yes		
ME	Yes				Yes	Yes		
MD			Yes			Yes		
MA			Yes			Yes		
MI	Yes				Yes	Yes		
MN	Yes				Yes	Yes		
MS			Yes					
MO	Yes				Yes	Yes	Yes	
MT	Yes				Yes	Yes		
NE				Yes	Yes	Yes		
NV								Yes
NJ		Yes			Yes	Yes		

State	Compact	Sovereignty	Associate	Project	Audit	Nexus	Deregulation	Non-member
NH			Yes			Yes		
NM	Yes				Yes			
NY								Yes
NC			Yes			Yes		
ND	Yes				Yes	Yes		
OH			Yes			Yes		
OK			Yes			Yes		
OR	Yes				Yes	Yes	Yes	
PA			Yes					
RI				Yes		Yes		
SC			Yes			Yes		
SD	Yes					Yes		
TN			Yes			Yes		
TX	Yes					Yes		
UT	Yes				Yes	Yes		
VT								Yes
VA								Yes
WA	Yes				Yes	Yes	Yes	
WV			Yes		Yes	Yes		
WI			Yes		Yes	Yes		
WY		Yes			Yes	Yes		

Multistate Tax Commission Offices

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Chicago, IL 60606-6908
Telephone: 312-913-9150
Fax: 312-913-9151

New York Audit Office
One Blue Hill Plaza
10th Floor
P.O. Box 1524
Pearl River, NY 10968-8524
Telephone: 845-620-3767
Fax: 845-620-1873

Texas Audit Office
15835 Park Ten Place
Suite 104
Houston, TX 77084-5131
Telephone: 281-492-2260
Fax: 281-492-0335

Alabama Audit Office
332 Riverside Drive
Huntsville, AL 35811
Telephone: 256-852-8216
Fax: 256-852-6430

Multistate Tax Commission

Financial Statements and Report of Independent Certified Public Accountants

June 30, 2001 and 2000

MULTISTATE TAX COMMISSION
Table of Contents
June 30, 2001 and 2000

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, 2001 and 2000 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, 2001 and 2000, 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 12, 2001

MULTISTATE TAX COMMISSION
Balance Sheets
June 30,

ASSETS

	2001	2000
Current Assets		
Cash and cash equivalents	$ 2,447,669	$ 1,224,430
U.S. Treasury bills	497,359	1,574,391
Accounts receivable		
Members	161,072	16,514
Special projects	17,601	4,000
Prepaid expenses	41,034	41,689
Total Current Assets	3,164,735	2,861,024
Property and Equipment - at Cost		
Office furniture and equipment	899,840	847,548
Leasehold improvements	84,305	84,305
Less: accumulated depreciation and amortization	(660,380)	(554,911)
Property and Equipment - Net	323,765	376,942
Other Assets		
Expense account advances	8,200	7,550
Deposits	7,629	7,629
Total Other Assets	15,829	15,179
TOTAL ASSETS	$ 3,504,329	$ 3,253,145

LIABILITIES

	2001	2000
Current Liabilities		
Accounts payable	$ 102,197	$ 108,880
Payroll taxes withheld and accrued	31,874	26,810
Accrued salaries and vacation pay	226,584	194,446
Current portion of capital lease obligation	6,165	11,923
Deferred assessments and audit reimbursements	677,474	246,860
Total Current Liabilities	1,044,294	588,919
Long-Term Liabilities		
Capital lease obligation	-	6,165
Total Long-Term Liabilities	-	6,165
TOTAL LIABILITIES	1,044,294	595,084
Commitments and Contingencies - Note 3		
Fund Balances		
Unappropriated	941,045	961,007
Appropriated	926,465	763,324
Restricted	592,525	933,730
Total Fund Balances	2,460,035	2,658,061
TOTAL LIABILITIES AND FUND BALANCES	$ 3,504,329	$ 3,253,145

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,

	2001	2000
Revenue		
Assessments	$ 3,844,009	$ 3,229,116
Interest	159,451	143,216
Other income		
Contract	-	393,185
Training fees	157,972	58,291
Miscellaneous	44,808	36,398
Total Revenue	4,206,240	3,860,206
Expenses		
Accounting	11,300	10,547
Bonds and insurance	14,048	13,721
Conferences	140,531	87,417
Professional services	425,179	341,356
Depreciation and amortization	133,316	116,371
Employee benefits	403,896	346,170
Miscellaneous	12,048	9,689
Office supplies	60,601	43,944
Pension plan and retirement provision	263,582	249,884
Postage	42,793	31,425
Printing and duplicating	48,084	34,631
Publications and electronic resources	63,229	69,124
Recruitment	3,497	5,738
Rent	196,611	197,319
Repairs and maintenance	14,162	10,911
Salaries	2,158,036	2,054,804
Telephone	91,807	75,332
Temporary help	706	29,669
Travel	379,844	337,380
Training	15,240	9,851
Transfer - training and education	(10,779)	-
Allocation of administrative expenses	(184,670)	(165,246)
Total Expenses	$ 4,283,061	$ 3,910,037

(continued)

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

	2001	2000
Excess of Revenue Over (Under) Expenses	$ (76,821)	$ (49,831)
Transfer from Restricted Fund Balance	220,000	-
Transfer to Restricted Fund Balance	-	(57,303)
Transfer to Appropriated Fund Balance	(370,000)	(250,000)
Transfer from Appropriated Fund Balance	206,859	125,325
Total Amount Transferred	56,859	(181,978)
FUND BALANCE-Beginning of Year	961,007	1,192,816
FUND BALANCE-End of Year	$ 941,045	$ 961,007

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,

	Automation Plan	Future of Multistate Taxation Project	Streamlined Sales Tax Project
Fund Balance - June 30,1999	$ 225,945	$ 29,345	$ -
Transfer from Unappropriated Fund Balance	-	-	-
Transfer to Unappropriated Fund Balance	(23,980)	(29,345)	-
Net Amount Transferred (To) From Unappropriated Fund Balance	(23,980)	(29,345)	-
Fund Balance - June 30, 2000	201,965	-	-
Transfer from Unappropriated Fund Balance	-	-	150,000
Transfer to Unappropriated Fund Balance	(45,333)	-	(150,000)
Net Amount Transferred (To) From Unappropriated Fund Balance	(45,333)	-	-
Fund Balance - June 30, 2001	$ 156,632	$ -	$ -

Database Design	Nexus Activities	Membership Development and Relations	Total
$ 303,359	$ 80,000	$ -	$ 638,649
100,000	-	150,000	250,000
(72,000)	-	-	(125,325)
28,000	-	150,000	124,675
331,359	80,000	150,000	763,324
-	220,000	-	370,000
(10,381)	-	(1,145)	(206,859)
(10,381)	220,000	(1,145)	163,141
$ 320,978	$ 300,000	$ 148,855	$ 926,465

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	Unitary Exchange Program	National Nexus Program	Deregulation	Total
Fund Balance - June 30, 1999	$ 34,671	$ 5,092	$ 778,696	$ 170,468	$ 988,927
Revenue	52,500	-	645,063	41,558	739,121
Expenses	2,477	5,092	729,184	114,868	851,621
Excess (Deficiency) of Revenue Over Expenses	50,023	(5,092)	(84,121)	(73,310)	(112,500)
Transfer from Unappropriated Fund Balance	-	-	57,303	-	57,303
Fund Balance - June 30, 2000	84,694	-	751,878	97,158	933,730
Revenue	-	-	667,689	152,037	819,726
Expenses	-	-	793,692	147,239	940,931
Excess (Deficiency) of Revenue Over Expenses	-	-	(126,003)	4,798	(121,205)
Transfer to Unappropriated Fund Balance	-	-	(220,000)	-	(220,000)
Fund Balance - June 30, 2001	$ 84,694	$ -	$ 405,875	$ 101,956	$ 592,525

The accompanying notes are an integral part of these statements.

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

	2001	2000
Increase (Decrease) in Cash and Cash Equivalents		
Cash Flows From Operating Activities		
Excess of revenue over (under) expenses	$ (198,026)	$ (162,331)
Adjustments to reconcile excess of revenue over (under) expenses to net cash provided by (used in) operating activities		
Depreciation and amortization	138,638	120,855
Loss on disposal of property and equipment	3,000	5,540
Changes in assets and liabilities		
Accounts receivable		
Members	(144,558)	(16,515)
Special projects	(13,601)	11,366
Prepaid expenses	655	(7,779)
Noncurrent accounts receivable - other	-	13,500
Expense account advances	(650)	400
Accounts payable	(6,683)	36,397
Payroll taxes withheld and accrued	5,064	3,298
Accrued salaries and vacation pay	32,138	30,080
Deferred assessments and audit reimbursements	430,614	(436,096)
Net Cash Provided by (Used in) Operating Activities	246,591	(401,285)
Cash Flows From Investing Activities		
Purchase of U.S. Treasury bills	(3,922,968)	(1,574,391)
Proceeds from sale of U.S. Treasury bills	5,000,000	-
Purchase of property and equipment	(88,461)	(88,676)
Payments on capital lease	(11,923)	(11,400)
Net Cash Provided by (Used in) Investing Activities	$ 976,648	$ (1,674,467)

(continued)

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

	2001	2000
Net Increase (Decrease) in Cash and Cash Equivalents	$ 1,223,239	$ (2,075,752)
Cash and Cash Equivalents - Beginning of Year	1,224,430	3,300,182
Cash and Cash Equivalents - End of Year	$ 2,447,669	$ 1,224,430
Supplemental Disclosures		
Income taxes paid	$ -	$ -
Interest paid	$ 569	$ 1,092

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

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

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, 2001 and 2000 was $313,163 and $292,942, 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 September 30, 2005. These leases provide for the following minimum annual base rentals exclusive of utility charges and certain escalation charges:

~~Fiscal Year Ended:~~	Minimum Annual Payment
2002	$ 139,106
2003	7,056
2004	7,148
2005	7,277
2006	-

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, 2001 and 2000 was $263,497 and $257,572, respectively.

4. Appropriated Fund Balances

During the year ended June 30, 1990, the Future of Multistate Taxation Project was established whereby contributions received are appropriated for use in supporting the long-range planning and research activities of the Commission.

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 Database Design 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 a database design 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 Streamlined Sales Tax Project fund in the amount of $150,000 during the year ended June 30, 2001. The purpose of this fund is to support the development of the streamlined sales tax system.

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 Unitary Exchange program was established. Contributions are restricted to the development of a clearinghouse for the exchange of information between member states. This program is now ended. The remaining fund balance was refunded to the participating states in the year ending June 30, 2000.

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.

7. Deferred Compensation Plan (continued)

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, 2001, which are presented in the preceding section of this report. The schedule of expenses for the year ended June 30, 2001, 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 12, 2001

MULTISTATE TAX COMMISSION
Schedule of Expenses
For the Year Ended
June 30, 2001

	Unappropriated Funds				
	General Expenses	**Audit Program**	**Administrative Expenses**	**Database Design**	**Streamlined Sales Tax**
Accounting	$ 7,200	$ -	$ 4,100	$ -	$ -
Bonds and insurance	-	-	14,048	-	
Conferences	58,213	10,184	722	-	1,106
Professional services					
Legal and trustee services	520	233	29,763	75,712	-
Legislative	79,642	-	-	-	93,044
Special counsel	46,784	12,381	-	-	47,547
Depreciation and amortization	474	35,502	97,340	-	-
Employee benefits	78,819	222,568	102,509	-	-
Miscellaneous	800	2,335	6,915	-	4
Office supplies	3,273	17,315	27,219	369	-
Pension plan and retirement provision	56,970	152,135	54,477	-	-
Postage	7,613	11,420	11,963	300	19
Printing and duplicating	10,711	2,576	17,255	-	-
Publications and electronic resources	18,583	18,756	25,890	-	-
Recruitment	-	3,497	-	-	-
Rent	38,081	85,886	72,644	-	-
Repairs and maintenance	-	8,612	5,550	-	-
Salaries	477,465	1,216,630	463,941	-	-
Telephone	29,098	36,641	18,719	-	6,323
Temporary help	-	-	706	-	-
Travel	120,257	164,023	32,974	-	1,397
MTC staff training	4,608	1,440	8,632	-	560
Transfer of revenue	-	66,000	-	(66,000)	-
Transfer - training and education	-	(10,779)	-	-	-
Outreach program	-	-	-	-	-
Allocation of administrative expenses	256,273	501,530	(995,367)	-	-
Total Expenses	$ 1,295,384	$ 2,558,885	$ -	$ 10,381	$ 150,000

Training and Education	Membership Development and Relations	Total Unappropriated Funds	Restricted Funds: Deregulation	Restricted Funds: National Nexus Program	Restricted Funds: Total Restricted Funds	Total All Funds
$ -	$ -	$ 11,300	$ -	$ -	$ -	$ 11,300
-	-	14,048	-	-	-	14,048
70,306	-	140,531	71	7,347	7,418	147,949
-	-	106,228	230	10,649	10,879	117,107
-	-	172,686	-	-	-	172,686
38,429	1,124	146,265		-	-	146,265
-	-	133,316	-	5,322	5,322	138,638
-	-	403,896	8,362	71,837	80,199	484,095
1,994	-	12,048	-	305	305	12,353
12,425	-	60,601	457	6,730	7,187	67,788
-	-	263,582	8,519	41,062	49,581	313,163
11,478	-	42,793	15	3,748	3,763	46,556
17,542	-	48,084	134	2,674	2,808	50,892
-	-	63,229	1,000	12,937	13,937	77,166
-	-	3,497	-	-	-	3,497
-	-	196,611	10,631	56,255	66,886	263,497
-	-	14,162	-	722	722	14,884
-	-	2,158,036	73,072	348,534	421,606	2,579,642
1,005	21	91,807	1,573	6,869	8,442	100,249
-	-	706	-	24,790	24,790	25,496
61,193	-	379,844	6,326	29,310	35,636	415,480
-	-	15,240	7,709	7,206	14,915	30,155
-	-	-	-	-	-	-
-	-	(10,779)	-	-	-	(10,779)
-	-	-	-	1,865	1,865	1,865
52,894	-	(184,670)	29,140	155,530	184,670	-
$ 267,266	$ 1,145	$ 4,283,061	$ 147,239	$ 793,692	$ 940,931	$ 5,223,992