Report of Activities

FY 1997-98

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Report of the Executive Committee and Executive Director

Multistate Tax Commission
August 1998

W. Val Oveson, Chairman
Dan R. Bucks, Executive Director

For issues of multistate taxation, the current times are ones of both challenge and opportunity. The economic and technological environment in which state tax systems operate is changing rapidly. The challenges and opportunities for States and business are linked together: we need to find new ways of making state taxes work smoothly with the flow of commerce and to apply fairly to all its participants. In this context, the purposes of the Multistate Tax Compact—tax fairness, uniformity, taxpayer convenience and compliance, and the prevention of double taxation—are as critical as at any time in the history of the Commission.

In operations terms, 1997-97 was a year characterized by membership growth and public outreach. The Commission welcomed the State of Maine as the 21st Compact Member, Florida as the 1st Sovereignty Member, Kentucky and Oklahoma as the 16th and 17th Associate Members, and Rhodes Island as the 4th Project Member. A total of forty-three jurisdictions—forty-two States plus the District of Columbia—participate in the Multistate Tax Commission. The total number of jurisdictions participating in the Commission has grown from thirty to forty-three in only ten years.

The past year is also one in which the Commission has reached out to taxpayer groups and other organizations to seek advice and cooperation on a range of multistate tax issues. These efforts included:

- Supporting the work of the Commission's Sales Tax Simplification Advisory Committee comprised of private sector representatives and approving their plan to seek improvements ins ales tax administration that will improve the efficiency and convenience of tax administration from a taxpayer perspective,
- Conducting several uniformity projects with industry groups, including the American Institute of Certified Public Accountants (AICPA), the Association of Fund Raisers and Direct Sellers, and the funeral industry,
- Supporting and participating with other state and local government organizations and the private sector the National Tax Association Communications and Electronic Commerce Project which is addressing issues of state taxation of electronic commerce,
- Consulting with the private sector on major issues in multistate taxation through Public Participation Working Groups on sales tax nexus and corporate income apportionment issues,

- Working with the wireless telephone industry on potential federal legislation for the uniform transactional tax treatment of phone calls made outside of service areas,
- Continuing to work as a partner with Federation of Tax Administrators (FTA) and private sector representatives on the FTA Electronic Business Process Project to respond to tax administrative issues created by expanding business use of advanced technology, and
- Conducting liaison meetings with a variety of groups representing taxpayers and tax practitioners.

In addition, the Commission also was able to establish links with tax officials of other nations through participation, in cooperation with the U.S. Treasury, in meetings of the Organzation of Economic Cooperation and Development. These meetings focused on international issues of consumption taxation of electronic commerce—issues that parallel directly those involving state sales taxation of the same commerce.

Executive Committee Activities

In January, 1998, the Executive Committee elected Mary Bryson of Montana as Treasurer (succeeding Janette Lohman of Missouri) and Douglas Roberts of Michigan to serve as a member of the Executive Committee.

As required by the MTC Bylaws, the Executive Committee has met four times since the 1997 Annual Meeting. It met on October 30-31, 1997, in Washington DC; on January 15-16, 1998, in San Antonio, Texas, on May 14-15, 1998, in Boise, Idaho and August 5, 1998, in Dana Point, California. The Executive Committee, at each meeting, has reviewed the full range of activities undertaken by the Commission and has provided guidance as needed to those efforts. Actions taken at these meetings are recorded in minutes on file in the Commission's headquarters. Pursuant to the Compact, it has prepared a budget with membership assessments and program fees for FY 99.

Federal Relations

The Executive Committee directly supervises the federal relations activities of the Commission. The Commission was successful—working with other state government organizations—in securing enactment of a reciprocal refund offset provision in the legislation restructuring the IRS. The Commission also monitored and advised the States on other provisions of the IRS restructuring legislation that affected state taxation. The Commission was also successful in securing a provision that protects state taxation from unintended preemption in legislation now pending in the House of Representatives that would deregulate electric utilities.

Several items of legislation have emerged in Congress dealing with State-tribal relations. The Commission has been active in advising Congress on the need to encourage States and tribes to work together in resolving issues concerning the coordination of taxation.

The Commission has monitored and provided information to States on a variety of other items of federal legislation affecting state taxation. These issues include: bankruptcy reform, federal tax restructuring, “fast track” trade legislation and electronic commerce taxation. The Commission has not articulated a position to Congress on these issues during this year.

The Commission has monitored international negotiations of a “Multilateral Agreement on Investment.” The Commission has articulated its concerns with regard to the impact of international dispute processes on the integrity of state tax appeals process and the potential that this agreement could create inequities in the treatment of foreign and domestic taxpayers.

The Commission continues it long-standing concern with the tax provisions of the 4-R Act that create inequities in property taxation and provide special access by railroads to federal courts. With the participation of several interested States, the Commission has renewed its Property Tax Fairness Project to advise Congress on the need to amend the 4-R Act and to refrain in its expansion to other industries.

Automation and Database Design Efforts

In terms of its administration, the Commission is undertaking a major effort to develop a database design to provide a foundation for its future software developments in auditing, exchange of information, research for uniformity, and communications with States and the public. If done well, several of these programs—such as in computer assisted auditing—will be adapted to use by individual States as well as the Commission.

The activities of the Commission during the past year are described in greater detail in the remaining pages of this report.

Report of the Treasurer

Multistate Tax Commission
August 1998

The Report of the Treasurer is identical to the Treasurer's Report for the August 5, 1998 Executive Committee meeting. Please refer to the Executive Committee meeting *Tab D* under *Session I* for this agenda item.

Report of the Public Participation Working Group on Sales Tax Nexus

Multistate Tax Commission
August 1998

Dan Bucks, MTC Executive Director

The current draft of the gudieline, the *State Participant Revised* Public Participation Working Group Draft of the Constitutional Nexus Guideline for Application of a State's Sales and Use Tax to an Out-of-State Business (Draft 01/98), Reflecting Business Commentary, has been provided as part of the Executive Committee August 5, 1998, meeting materials at *Tab J* under *Session I*.

Report of the Public Participation Working Group on Corporate Income Tax Issues

Multistate Tax Commission
August 1998

Unitary Business. The Interim Report of the Public Participation Working Group on the Definition of a Unitary Business has been provided as part of the Executive Committee August 5, 1998, meeting materials at *Tab J* under *Session I*.

Business/Nonbusiness Income. The Final Report of the Public Participation Working Group on the Business/ Nonbusiness Income Principle Portion has been provided as part of the Executive Committee August 5, 1998, meeting materials at *Tab J* under *Session I*.

Report of the Alternative Dispute Resolution Advisory Committee

Multistate Tax Commission
August 1998

The ADR Advisory Committee Report has been provided as part of the Executive Committee August 5, 1998 meeting materials at *Tab G* under *Session I*.

Report of the Sales Tax Simplification Committee

To:	MTC Executive Committee
From:	Sales Tax Simplification Planning Committee: Wayne Eggert, Planning Committee Chair (NTA) Doug Joseph (AICPA) Frank Davis (TEI) B. J. Denton (COST) Wilma Murphree (IPT)
Date:	May 14, 1998
Subject:	Report of the Sales Tax Simplification Planning Committee

By cover of this memorandum, the Sales Tax Simplification Planning Committee presents to the Multistate Tax Commission Executive Committee, its work product of the first phase of the MTC's Sales Tax Simplification Project.

The Planning Committee members understood that they were charged with the task of making recommendations on ways to simplify the sales tax and proposing a plan for the implementation of the recommendations. The Planning Committee members enthusiastically embraced the process from their very first meeting in Chicago in July 1997. Through a series of teleconferences and meetings, the Planning Committee has completed an extension list of areas of sales tax administration in which the Planning Committee believes there is an immediate need for simplification and/or uniformity. See Attachment 1. The Planning Committee received input from constituents of their various organizations and sought feedback from interested parties through presentations in various forums, including the MTC Business-Government Dialogue session in October 1997. The final list of simplification ideas started out as a long wish list and has been narrowed down to the more important and more realistically achievable sales tax simplification ideas. The list of ideas has been divided into several broad categories: Compliance Simplification, Policy Simplification, Audits and Appeals and Education and Communication. The Planning Committee members found that most of their ideas fell within one of these four categories.

Once the list of ideas was finalized, the Planning Committee moved its attention to developing an implementation plan. The members propose a two-prong approach: a state-specific focus to achieve sales tax simplification in individual states that present specific difficulties; and a uniformity focus aimed at achieving simplification through the adoption of uniform procedures among all of the states. The Planning Committee determined that a state-specific focus may be the more direct means of addressing local sales tax administration concerns. Attachment 2 to this memorandum sets forth those simplification ideas that the Planning Committee believes lend themselves to action in particular states. Five-member state-specific subcommittees would be created and would be comprised of key state government representatives, local government representatives and business representatives. Planning Committee members have started soliciting participation from the business community through the publications of their respective organizations. With the approval of the MTC Executive Committee, the Planning Committee hopes to continue these efforts and to expand their solicitation efforts to state and local representatives. With respect to the uniformity prong of the proposed plan, the Planning Committee members, along with a larger group that would include state government representatives, would focus its attention on achieving changes in the administration of the sales tax among all of the States.

In addition, the Planning Committee proposes a recognition program for sales tax simplification efforts by others. This would allow for the endorsement of other projects aimed at simplifying the sales tax while minimizing the possibility of duplication of work in this area. The Planning Committee can remain abreast of the work of other organizations and of the states and localities and perhaps lend support where the need arises. Attachment 3 to this memorandum provides a detailed description of the proposal.

The Planning Committee encourages the MTC Executive Committee to authorize continued work on the Sales Tax Simplification Project. The business community is interested in achieving significant changes in sales tax administration and the work completed as part of this project is an important step in the right direction.

MTC SALES TAX SIMPLIFICATION PLANNING COMMITTEE
LIST OF SIMPLIFICATION IDEAS WITH EXPLANATIONS

COMPLIANCE SIMPLIFICATION

EXEMPTION PROCESSING

Each state has a web site that contains a list of all exempt customers and their respective registration numbers; includes Direct Pay Permit holders; once established eliminate the need for all businesses from having non-profit exemption certificates and eases verification of status of exemption in each state.

Acceptance by all states of uniform multijurisdiction exemption certificates. List of states that do not currently accept (*e.g.*, IN, LA, MA, NJ, NM, NY, VA).

Uniform date of expiration of exemption from time of issuance: First preference is to have no expiration date; however if state has a 5 year recertification process and advises taxpayers of businesses that fail to requalify that seems appropriate as well.

TAX RETURNS

Home Rule Issues
Uniform returns for all jurisdictions within a state including format, descriptions, information requested and placement of information.

Eliminate home rule jurisdiction reporting such that the state would administer all county, city and special district reporting by utilization of one return covering both state and sub-state reporting.

Require all jurisdictions within the state to use the same taxable base and exemptions as the state.

General
Eliminate returns by type (categories e.g., rentals, consumer use) so that only one return is necessary for the reporting jurisdiction.

Eliminate returns and reconcile payments periodically; payments made monthly or quarterly with annual reconciliation to jurisdiction reporting requirements. [MTC #6]

Filing less frequently (annually, quarterly) with minimum threshold.

Allow consolidated returns for affiliated corporations so that sales tax for all affiliated corporations could be filed on one return under one account number in each state.

Allow for agents of company to file tax returns.

OTHER COMPLIANCE ACTIVITY

Allow meaningful vendor discounts without maximums for a reporting period or for annual reporting or exclusions by type of industry.

Provide multiple registration process at national level that includes forms provision as well as an ability to file one stream of information and selection of all or selected states. [MTC #15, 24]

Uniform registration requirements (until above multiple registration is achieved) by having the same stream of information required for each state. For example, availability on a web site of the multi-jurisdiction form and select states in which registration is desired and each state will receive e-mail of registration information for assignment of account #.

Tax application at national level; statewide rates only; rates at state level or zip code only. Allow varying flexibility of revenue raising depending upon which of the aforementioned is chosen yet provide simplification via tax boundaries that taxpayers have ready access to such as state boundaries or zip code boundaries.

Limit tax changes to annual; certain date per year; require 3 month notification. Notification and limits to tax rate changes provide simplification of tax systems and equally important reduce vendor customer interaction surrounding taxes on bills.

Reduce instances of non-taxable t.p.p. (retail exemptions) and reduced or special rate treatment for selected products or invoice amounts.

Standard situs for taxable t.p.p transactions (*e.g.*, destination origination)

POLICY SIMPLIFICATION

All states should adopt a uniform cost basis for self manufactured goods.

States should all allow bad debt deductions and adopt a uniform methodology such as monthly deduction of bad debt write-offs. The process in some states is too complex to be practical (*e.g.*, Massachusetts).

The MTC should lead the states to develop a uniform sales tax code. The uniform sales tax code would also include a section of uniform exemptions.

All states should adopt provisiions to allow companies to obtain direct pay permits. The states should adopt uniform rules and procedures in connection with direct payment permits.

States are encouraged to consider the adoption of uniform requirements concerning the definition of services, discounts and trade-ins. The uniform treatment should include uniform taxability of discounts and trade-ins. This process has already begun with respect to procurement cards and procedures for the collection and remittance of sales and use tax on fundraising sales.

The MTC should conduct a study to determine what laws states currently have in common and then encourage other states to adopt these common statutes.

States should allow taxpayers to enter into agreements with the states to use effective tax rates for the remittance of use tax based on uniform sampling techniques and/or prior audit results.

States should allow taxpayers on a national level to actively participate in future state policy developments through a Policy Development Process Forum. For example, the efforts that have been made to date on prepaid calling cards, procurement cards and FDI standards. Another possibility is adoption of error disclosure standards that are similar to federal guidelines outlined in Revenue Procedure 94-69.

The Simplification Committee encourages existing efforts to develop nexus standards that are uniform for tax collection and remittance purposes. This will not only assist companies in understanding the nexus consequences of their activities in multiple states, but will also assist state auditors with their nexus determinations. A *de minimis* threshold for sales tax nexus should be established that is adopted by all states to prevent taxpayer confusion and simplify compliance.

The situs of sales taxes for services should uniform throughout the U.S.

Interstate shipments of goods should receive uniform sales tax treatment (*e.g.*, “first use” should be defined consistently in all states).

States should adopt definitions and treatment of drop shipments.

AUDITS AND APPEALS

Auditor Training Develop a training program which would provide educational opportunities in audit fundamentals. Potential topics would include sample selection, statistical sampling, research methods, documentation standards, *etc.*

Computer Assisted Auditing Develop standards for the application of computer assisted audit methodologies which will produce reliable audit results for both assessments and refunds. These methodologies should be able to effectively process varying types of records such as standard electronic transactional records, P-card transactions, EDI transactions, ERS transactions, etc. This process should produce a statistically valid result. (*See statistically sound uniform sampling methodologies below.*)

Audit Procedures for Procurement Cards Develop a uniform process for the audit of procurement card transactions which could be adopted by every tax jurisdiction. This process would also specify minimum documentation standard to effectively demonstrate tax compliance for these transactions.

Uniform Statute of Limitations Develop a uniform statute of limitations statute which every tax jurisdiction would have the opportunity to adopt. This would include a uniform methodology for the state and the taxpayer to agree to the waiver of the statute of limitations. The uniform statute of limitation would apply equally to assessments and refunds.

Uniform Dispute Resolution and Appeals Process Develop a uniform dispute resolution and appeals process which each tax jurisdiction could adopt. This process should be independent of both the taxpayer and the tax agency charged with the administration of the tax. It should provide for uniform filing deadlines, documentation standard, *etc*.

Managed Audits Develop a standardized program of managed audits in which the taxpayer and jurisdictional auditor agree on the process which will be used to determine the audit liability or refund, the audit will be actually conducted by representatives of the taxpayers and then the results will be reviewed by the jurisdictional auditor for final assessment or refund.

Statistically Sound Uniform Sampling Methodologies Develop a uniform statistically valid sampling process which can be used in sales and use tax audits to determine additional tax due from a taxpayer or tax to be refunded to the taxpayer. This process would include a methodology to produce statistically sound stratifications of populations, sample sizes, isolated transaction handling, and projection methods.

Shifting of Burden of Proof for Negligence Penalties from Taxpayer to the States Develop a uniform standard of evidence which would be required to support the application of negligence penalties. The burden of proof for the production of this evidence would rest with the taxing jurisdiction.

Penalties Based Upon Facts and Circumstances Rather than Imposed out of Routine Develop a uniform statute for adoption by the tax jurisdictions, which would only allow for the imposition of penalties based on the facts and circumstances surrounding the underpayment of tax rather than the automatic application of penalties in which an underpayment exists.

Uniform Refund Claim Process Develop a process for the uniform treatment of refund claims to be adopted by tax jurisdictions. This process would include a standard for who is eligible to file refund claims, filing deadlines, documentation standards, standardized forms, response deadlines, etc.

EDUCATION AND COMMUNICATION

Encourage and expand existing taxpayer information sessions among the states and provide easy access to taxpayer information and updates via modern forms of communication such as Tax Bulletin Boards for each state.

Establish State simplification steering committees

MTC SALES TAX SIMPLIFICATION PLANNING COMMITTEE
STATE SALES TAX SIMPLIFICATION ACTION PLAN

LIST OF SIMPLIFICATION IDEAS WHICH APPEAR TO LEND THEMSELVES TO ACTION BY PARTICULAR STATES
12/31/97

COMPLIANCE SIMPLIFICATION

EXEMPTION PROCESSING

Each state has a web site that contains a list of all exempt customers and their respective registration numbers; includes Direct Pay Permit holders; once established eliminate the need for all businesses from having non-profit exemption certificates and eases verification of status of exemption in each state.
STATUS: NOT AWARE OF ANY STATE THAT HAS THIS CAPABILITY AS OF 12/31/97

Acceptance by all states of uniform multijurisdiction exemption certificates. List of states that do not currently accept (*e.g.*, IN, LA, MA, NJ, NM, NY, VA).
STATUS: NEW MEXICO HAS BY FAR THE MOST BURDENSOME PROCESS TYPICALLY NECESSITATING MULTI-DEPARTMENT INVOLVEMENT. THEY HAVE 17 TYPES OF CERTIFICATE AND EACH CERTIFICATE ISSUED MUST HAVE A UNIQUE CERTIFICATE #.
OTHER STATES THAT DO NOT CURRENTLY ACCEPT MULTIJURISDICTION CERTIFICATES: IN, LA, MA, NM, NY, NC, VA, WY; NOTE: THE LIST SEEMS TO VARY BY TAXPAYER EXPERIENCE BUT MOST STATES DO ACCEPT A MULTIJURISDICTION FORM WHICH HAS BEEN A REAL PLUS IN THE BUYER/VENDOR PROCESS

Uniform date of expiration of exemption from time of issuance: First preference is to have no expiration date; however if state has a 5 year recertification process and advises taxpayers of businesses that fail to requalify that seems appropriate as well.
STATUS: STATES WTH NO RENEWAL REQUIREMENTS (PREFERRED APPROACH): AL, AZ, AR, CA, CO DC, GA, HA, ID, KS, KY, LA, ME, MA, MN, MS, NJ, NY, NC, ND, OH, OK, SC, TN, TX, UT, VA, WI, WY

TAX RETURNS

Home Rule Issues
Eliminate home rule jurisdiction reporting such that the state would administer all county, city and special district reporting by utilization of one return covering both state and sub-state reporting.
STATUS: THIS IS CURRENTLY THE MOST BURDENSOME ASPECT OF COMPLIANCE FOR MULTISTATE TAXPAYERS –"60% OF OUR RESOURCES ARE DEVOTED TO HOME RULE COMPLIANCE" WAS ONE ANECDOTAL COMMENT IN DATA GATHERING HOME RULE REPORTING CURRENTLY EXISTS IN : AL, AZ, CO, LA, IL (CHGO), ID, MN (DULUTH), MS(TUPELO)

General
Eliminate returns by type (categories e.g., rentals, consumer use) so that only one return is necessary for the reporting jurisdiction.
STATUS: MULTIPLE RETURNS EXIST IN: AL, IA, KS, MS, OK, VA; MI-PREPAYMENT BY TYPE

Eliminate returns and reconcile payments periodically; payments made monthly or quarterly with annual reconciliation to jurisdiction reporting requirements.
STATUS: NOT AWARE OF ANY STATE THAT HAS ACCOMPLISHED THIS AS OF 12/31/97

Filing less frequently (annually, quarterly) with minimum threshold.
STATUS: NOT AWARE OF ANY STATE THAT HAS ACCOMPLISHED THIS AS OF 12/31/97

Allow consolidated returns for affiliated corporations so that sales tax for all affiliated corporations could be filed on one return under one account number in each state.
STATUS: MATRIX PENDING

Allow for agents of company to file tax returns.
STATUS: MATRIX PENDING

OTHER COMPLIANCE ACTIVITY

Allow meaningful vendor discounts without maximums for a reporting period or for annual reporting or exclusions by type of industry.
STATUS: 17 STATES HAVE MEANINGFUL DISCOUNTS; 11 STATES HAVE MAXIMUMS THAT ELIMINATE VALUE OF DISCOUNT; 18 STATES WITH NO DISCOUNT (SEE ATTACHED VENDOR DISCOUNT PROFILE)

Tax application at national level; statewide rates only; rates at state level or zip code only. Allow varying flexibility of revenue raising depending upon which of the aforementioned is chosen yet provide simplification via tax boundaries that taxpayers have ready access to such as state boundaries or zip code boundaries.
STATUS: STATES WITH LOCAL JURISDICTION TAXES HAVE NOT MOVED TO ACCEPTANCE OF ZIP CODE OR STATE LEVEL REPORTING

Limit tax changes to annual; certain date per year; require 3 month notification. Notification and limits to tax rate changes provide simplification of tax systems and equally important reduce vendor customer interaction surrounding taxes on bills.
STATUS: NOT AWARE OF ANY STATE THAT HAS ACCOMPLISHED THIS AS OF 12/31/97

Reduce instances of non-taxable t.p.p. (retail exemptions) and reduced or special rate treatment for selected products or invoice amounts.
STATUS: AR, NC, ND, TN HAVE MAX TAX AT INVOICE LEVELS

Standard situs for taxable t.p.p transactions (*e.g.*, destination origination)
STATUS: IL, KA, MS, MO, NM, SC, TN, REQUIRE CONTRACT ACCEPTANCE SITUS FOR INTERSTATE ACTIVITY

POLICY SIMPLIFICATION

States should all allow bad debt deductions and adopt a uniform methodology such as monthly deduction of bad debt write-offs. The process in some states is too complex to be practical (*e.g.*, Massachusetts).
STATUS: DC, PA, SC, WV, DO NOT ALLOW BAD DEDUCTIONS! SOME STATES DO NOT ALLOW THE TYPICAL REQUIREMENT OF BAD DEBTS WRITTEN OFF AND DEDUCTIBLE FOR INCOME TAX PURPOSES AND REPORTED EACH MONTH ON TAX RETURN; ANNUAL SPECIAL REPORT: LA, MA, SD; MO (APPLY FOR CREDIT); NJ, NY REFUND PROCESS.

All states should adopt provisiions to allow companies to obtain direct pay permits. The states should adopt uniform rules and procedures in connection with direct payment permits.
STATUS: MATRIX PENDING

States should allow taxpayers to enter into agreements with the states to use effective tax rates for the remittance of use tax based on uniform sampling techniques and/or prior audit results.
STATUS: MATRIX PENDING

AUDITS AND APPEALS

Auditor Training Develop a training program which would provide educational opportunities in audit fundamentals. Potential topics would include sample selection, statistical sampling, research methods, documentation standards, *etc.*
STATUS: MATRIX PENDING

EDUCATION AND COMMUNICATION

Encourage and expand existing taxpayer information sessions among the states and provide easy access to taxpayer information and updates via modern forms of communication such as Tax Bulletin Boards for each state.
STATUS: MATRIX PENDING

SALES TAX SIMPLICATION RECOGNITION PROGRAM

JANUARY 1998

	SALES TAX SIMPLICATION PARTNER	SIMPLICATION EXCELLENCE AWARD	SIMPLIFICATION OUTSTANDING PARTNER
ELIGIBILITY	All state and local tax jurisdictions	Members of Taxpayer Community	All state and local tax jurisdictions
CYCLE	As submitted	As submitted	Annual
CRITERIA	Quick formal way of recognizing a state or local jurisdiction for introduction of a change to simplify the sales tax process	Quick formal way of recognizing a taxpayer for support of a change to simplify the sales tax process	Annual selection of the three best Sales Tax Simplification Partner nominees
AWARD	Acknowledgment or lunch for no more than 3 sales tax dept. team members given by business nominee and recognition letter by Committee	Recognition letter by Committee and acknowledgment by state personnel involved with change	Recognition by each participating tax association (AICPA, COST, IPT, NTA, TEI) and in publications covering sales tax matters
HOW DOES THIS PROGRAM WORK	Any business sends a letter to the Sales Tax Simplification Committee nominating a state or local sales tax process change that simplifies taxpayer activity in that jurisdiction. All such nominees will be announced quarterly in various sales tax publications	Any jurisdiction representative or business group sends a letter to the Sales Tax Simplification Committee nominating a business for support of a state or local sales tax process change that simplifies taxpayer activity in that jurisdiction. All such nominees will be announced quarterly in various sales tax publications	Sales Tax Simplification Committee selects annual nominee from all Sales Tax Simplification Partner nominees

Report of the Uniformity Committee

Multistate Tax Commission
August 1998

Ted Spangler, Chair, Uniformity Committee

The Uniformity Committee is charged with perhaps the most challenging task in addressing multistate tax administration: developing uniform sales tax and income tax proposals acceptable to both businesses and State tax agencies that have a reasonable likelihood of adoption by a significant number of States. Acknowledging the magnitude of its charge the Uniformity Committee decided a year ago to re-evaluate its uniformity process with the intention of achieving greater success in the future. The Uniformity Committee recognizes that in its work it must remain faithful to the core purposes of the Multistate Tax Compact:

- To promote uniformity or compatibility in significant components of tax systems;
- To facilitate the proper determination of State and local tax liability of multistate taxpayers, including equitable apportionment of tax bases and settlement of apportionment disputes;
- To facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration; and
- To avoid duplicative taxation.

With these principles in mind, the Uniformity Committee has continued its work on several joint projects with members of the business community and has re-focused its attention on developing a solution to existing and potential sales tax priority problems that would reduce the chances of duplicative taxation of multistate and multinational businesses. Of course, the Committee has followed the Public Participation Working Groups that are reviewing the draft sales and use tax nexus guideline and the draft definitions of a unitary business and business/ nonbusiness income, all proposals that initially were drafted by the Uniformity Committee. Below we provide a review of the Uniformity Committee's specific projects.

<u>Sales and Use Tax</u>

Joint Project with Association of Fund Raisers and Direct Sellers. Last year the AFRDS approached the Uniformity Committee with the need for uniformity among the States in the administration of the sales taxation of fund raising transactions conducted by nonprofit/not-for-profit, religious, educational and other similar organizations. The Sales and Use Tax Subcommittee worked with the AFRDS to outline the scope of the joint work as follows:

- The establishment of a clearinghouse of information about State laws and procedures related to the transactional taxation of fund raising products and activities;

- The drafting of proposed uniform procedures for the reporting and payment of transactional taxes on fund raising products and activities of nonprofit/not-for-profit organizations in those States where transactional taxes apply, including procedures for the collection and payment of sales/use taxes by fund raising product manufacturers, distributors and sellers;
- The drafting of a proposed uniform method of determining the tax base for calculating transactional taxes due on fund raising products and activities.

Initial draft proposals are expected to be reviewed during the August 1998 Sales/Use Tax Subcommittee. A more detailed description of the clearinghouse is expected to be discussed as well.

State Tax Priority Issues. The Uniformity Committee received a clear directive from the Executive Committee to revive the issue of sales tax priority and to develop a uniform proposal that would resolve the existence and potential for duplicative sales and use taxation. The Sales and Use Tax Subcommittee has directed the conduct of a survey of States regarding their approaches to various circumstances raising the potential for multiple sales and use taxation. The full results of the survey will be reviewed and the direction of the project will be discussed during Subcommittee's August 1998 meeting.

Sales and Use Tax Nexus Guideline. The Uniformity Committee presumably will have the opportunity to comment on the recommendations, if any, of the PPWG now reviewing the Sales and Use Tax Nexus Guideline before they are forwarded to the Executive Committee.

<u>Income and Franchise Tax</u>

Proposed Definition of Gross Receipts. The Uniformity Committee completed a draft proposed definition of the term "gross receipts", the operative term used in the definition of sales under UDITPA. Following Executive Committee referral of the matter to the public hearing process, a hearing in this matter was held Friday, May 8, 1998, in Washington, D.C. The Hearing Officers' report is expected to be completed on or before November 2, 1998.

Property Factor Treatment of Outerjurisdictional Property. The Income/Franchise Tax Subcommittee continues its work on this project aimed at developing a uniform rule for the property factor treatment of items that are not located in any jurisdiction, like satellites and undersea cables. The Subcommittee members recently decided to pursue a "throw-out" approach under the MTC Regulations for Section 18 of UDITPA. This project has been the subject of much debate among the Subcommittee members as they have struggled with attempting to draft a reasonably acceptable solution to this issue.

Joint Work with AICPA on Corporate Income Tax Administrative Uniformity. This is another continuing joint project with the business community that is responding to a variety of issues related to administration of the State corporate income taxes. The initial subject of this project is the development of a draft uniform statute for reporting federal adjustments to the States and a uniform federal adjustment reporting form. The Income and Franchise Tax Subcommittee has been working on the development of the proposed reporting statute, while AICPA representatives have taken the lead on preparing a draft uniform reporting form for federal adjustments. Reporting federal adjustments was identified as one of the areas addressed in the AICPA's Report on Corporate State Tax Administrative Uniformity for which the Uniformity Committee and the AICPA may be able draft a reasonably acceptable uniform proposal.

Telecommunications Apportionment Formula. This topic was one of the Business-Government Dialogue sessions in October 1997 and addressed by the reviewing and analysis of the then proposed draft telecommunications apportionment regulation developed by the California Franchise Tax Board. Instead of moving forward with drafting a proposal after the CA-FTB withdrew its draft proposal, the Uniformity Committee recommended to the Executive Committee that this matter be referred to the MTC Staff for the conduct of a study to determine the actual need and/or desire for a telecommunications apportionment formula. The Executive Committee approved the conduct of the study as recommended.

Joint Project with SCI Management Corp.—Death-Care Providers. The Uniformity Committee agreed to work with this organization on a uniformity project to bring all States into conformity with the federal rules on treatment of funeral trusts for income tax purposes. SCI sought the assistance of the Uniformity Committee in streamlining the State tax administration of funeral trusts. Generally, these trusts are required to be created to hold monies paid for pre-need contracts executed between customers and funeral homes and cemeteries that cover expenses for funeral services and merchandise for the customers at the time of death. For federal purposes, funeral trusts were considered to be grantor trusts, the earnings of which are subject to tax in the name of the pre-need customer. Consequently, death care providers were required to send each customer the annual earnings of the trust and the customers were required to pay tax on the trust earnings. In response to complaints from the death care providers' mostly elderly customers, Congress recently enacted IRC §685 allowing qualified funeral trusts (less that $7,000 of principal) to be treated as non-grantor trusts and allowing the trustee to file a composite return reporting and paying tax on the earnings of all of the qualified trusts administered by the trustee, in lieu of informational reports to each customer. Staff forwarded a survey to the States to determine their preferences on what should be done in this circumstance.

<u>1997 Business-Government Dialogue</u>

Last October, the Uniformity Committee hosted its eighth annual dialogue day session in a different manner to accommodate the meeting of the income tax and sales tax nexus guideline Public Participation Working Groups (PPWGs). Over the course of two days, the dialogue sessions included discussions with the MTC's Sales Tax Simplification Planning Committee and a panel discussion on the then draft CA-FTB telecommunications apportionment regulation, as well as the PPWG discussions on the draft sales and use tax nexus guideline and the draft definitions of a unitary business and of business and nonbusiness income.

In conclusion, we would like to express appreciation to several Uniformity Committee members who have accepted leadership roles as the Subcommittees continue their work. We thank Claire Hesselholt with the Washington Department of Revenue for continuing to ably serve as Chair of the Sales and Use Tax Subcommittee. We also thank Marshall Stranburg with the Florida Department of Revenue for his current temporary leadership of the Income and Franchise Tax Subcommittee. Additionally, we thank Lynn Chenoweth with the Montana Department of Revenue and Brian Toman with the California Franchise Tax Board, respectively, for their leadership, albeit brief, of the Income and Franchise Tax Subcommittee, while we congratulate each on career accomplishments that have required each to resign as Subcommittee Chair. We also thank the Uniformity Committee co-Chair, Mona Shoemate with the Texas Comptroller of Public Accounts, for taking on tasks and filling in as Chair of the Uniformity Committee whenever needed.

Current Uniformity Projects

The following tables list the uniformity recommendations to the States currently under development by the Multistate Tax Commission under authority of Article VI. and Article VII. of the Multistate Tax Compact. Readers may wish to consult the attached description of the uniformity recommendation development process for a more complete understanding of the status of proposals at the various steps of the uniformity process. This information also is available at the MTC website at www.mtc.gov.

The Commission welcomes public participation in its uniformity recommendation development process.

Uniformity Proposals Pending Before the Commission

(Step 8)

None

Hearing Officer Recommendations Under Consideration by the Executive Committee

(Step 7)

None

Uniformity Proposals in the Public Hearing Process

(Step 6)

Project	Status/Anticipated Completion Date of Hearing Officer Report
Proposed addition of definition of "gross receipts" to MTC Reg. IV.2.(a)	Hearing held May 8, 1998; public comment period open until July 6, 1998. Report anticipated November 1998.

Public Participation Working Group Recommendations Under Review

(Step 5)

None

Uniformity Proposals Under Study/Development by Public Participation Working Groups

(Step 4)

Project	Product	Earliest Working Group Completion
Proposed amendments to MTC allocation and apportionment regulation definitions and examples of business and non-business income and Uniform definition of a unitary business post-*Allied Signal*	Model Regulations	Spring 1998
Constitutional Nexus Guideline for Application of a State's Sales and Use Tax to an Out-of-State Business	Model Regulation or Guideline	Spring 1998

Uniformity Proposals Under Development by the Uniformity Committee

(Steps 1-3)

Sales/Use Taxes

Project	Product	Earliest Committee Completion
Tax Priority	Model Legislation	Not established
Taxation of Fund-Raising Transactions (Joint Project with Assn. of Fund Raisers and Direct Sellers)	Model Regulation or Legislation	Not established

Income/Franchise Taxes

Project	Product	Earliest Committee Completion
Uniform treatment in the property factor of "outerjurisdictional property"	Model Regulation	Not established
Corporate Income Tax Administrative Uniformity (Joint Project with the AICPA)	Model Regulation or Legislation	Not established
Uniform State Tax Administration of Funeral Trusts (Joint Project with SCI Management Corp.)	Model Regulation or Legislation	Not Established

Report of the Litigation Committee and on MTC Legal Activities

Multistate Tax Commission
August 1998

Frank Katz, Chair, Litigation Committee
Paull Mines, General Counsel, MTC

We are pleased to report to tender to you the 1997-1998 Annual Report of the Litigation Committee of the Multistate Tax Commission. We additionally report on the legal activities of the Multistate Tax Commission for its fiscal year 1997-1998.

Litigation Committee

The Litigation Committee continues to fulfill its role of reporting U.S. Supreme Court developments to, and providing an informational and educational forum for, attorneys representing State tax agencies. The growing number of States that are represented at the Committee's meetings evidences the continuing need for the Committee's activities. The Committee held two meetings this past year, March 1998 and the meeting in conjunction with Annual Meeting.

Over the past year, the United States Supreme Court has issued a number of opinions that are very important to the administration of State and local taxes. The 1997-1998 term of the Court may be called the "Year of Indian Law," because the Court has issued several decisions implicating state taxation as it relates to Indians: *Yankton Sioux Tribe* v. *South Dakota*, holding a federal act divesting the Tribe's interest in all unallotted lands in 1894 indicated congressional intent to diminish the reservation, resulting in the State's acquisition of primary jurisdiction over the open lands; *Alaska* v. *Native Village of Venetie Tribal Government* holding Alaskan Indian tribe's lands were not "Indian country" within the meaning of 18 U.S.C. §1151(b) and the tribe lacked the power to impose taxes on non-tribal members, because the Alaskan Native Claims Settlement Act disestablished the reservation and resulting in the Tribe holding its land in fee simple; *Yukon Flats School District* v. *Native Village of Venetie* holding a tribe lacked the authority to impose a tax on nontribal members engaged in construction activities on the land that was no longer reservation land under the Alaskan Native Claims Settlement Act; *Montana* v. *Crow Tribe* rejecting disgorgement of taxes illegally collected by a State from a third-party to the Tribe's whose rights were violated; *Kiowa Tribe of Oklahoma* v. *Manufacturing Technologies, Inc.*, holding that a breach of contract suit may not be maintained against a Tribe in the absence of a waiver of sovereign immunity in the contract or a clear statutory by Congress; *Cass County, Minnesota*, v. *Leech Lake Band of Chippewa Indians* holding that State and local governments may impose *ad valorem* taxes on reservation land that was made alienable by Congress and sold to non-Indians, but was later repurchased by the Tribe, because is "when Congress makes reservation lands freely alienable, it is unmistakably clear that Congress intends that land to be taxable by [S]tate and local governments, unless a contrary intent is 'clearly manifested.'".. The tribes lands were disestablished as reservations by of 1971, and were owned by the tribe in fee simple. The Indian phenomenon continues into the 1998-1999 term with the Court having granted review in *Arizona Department of Revenue* v. *Blaze Construction Corporation* raising whether a State may impose a vendor sales tax on a BIA contractor that is constructing a road on the reservation.

In addition to the Indian law cases the Court has also established a violation of the Privileges and Immunities Clause in *Lunding* v. *New York Tax Appeals Tribunal* where New York's individual income system denied nonresidents a state income tax deduction for alimony paid, but allowed the deduction for residents. The Court also reiterated *Reich* v. *Collins* in *Newsweek, Inc.* v. *Florida Department of Revenue* striking down a denial of a constitutional refund claim on the basis of the taxpayer's failure to use an existing pre-deprivation remedy where the taxing State indicated a post-deprivation refund remedy was generally available.

Additionally, most of the Committee members have participated the MTC's Informational and Training Session for State Attorneys during which participants study fundamental state tax principles and analyze how those principles may or may not apply to recent State tax cases.

Accompanying this Report for your information and review are the agendas for the March 1998 and August 1998 meetings.

Legal Activities of Commission

Formal Court Appearances: At the beginning of this fiscal year, the Commission filed in the U.S. Supreme Court an *amicus curiae* brief support of the State of Montana's petition for a writ of certiorari before in *Montana* v. *Crow Tribe of Indians*. Montana was successful in securing review and went on with an additional *amicus curiae* brief filed on hebehalf of the Commission (prepared by the State and Local Legal Center) to prevail in this important case. In ruling that the Crow Tribe lacked a right to secure a disgorgement of taxes illegally paid, the U.S. Supreme Court usefully noted that generally third parties are not permitted to recover taxes paid by another. The issue of third parties using *Crow Tribe* to justify direct actions against a State for illegally collected taxes was the Commission's greatest concern that has been answered in a satisfactory way by the Court.

At the end of this fiscal year we filed an *amicus curiae* brief in support of the State of North Carolina's attempt to treat patent infringement damages secured by Polaroid against Kodak as apportionable income. *Polaroid Corporation* v. *Offerman*. This case that challenges the application of two independent tests for business (apportionable) income is still pending before the North Carolina Supreme Court.

Promoting Uniformity: The Legal Division primarily staffs the Uniformity Committee and as a result participates broadly in the uniformity efforts of the Commission. The uniformity efforts of the Commission do not end with the Uniformity Committee, however. One area where the Legal Division has participated in the promotion of uniformity, which is another way of saying seeking reform of state and local taxes as they apply to multijurisdictional commerce, is in electronic commerce. The Legal Division is an active participant in the NTA Communications and Electronic Commerce Project that is seeking a uniform approach to state and local taxation of electronic and other remote commerce. Additionally, the Legal Division has participated with several officers of the Commission in establishing contacts with foreign tax officials with a view to promoting awareness of the need for and development of approaches that will harmonize consumption taxation of electronic commerce in a manner that does not interrupt that commerce but is largely transparent to it.

Another area of uniformity in which the Legal Division actively participates is the ongoing Public Participation Working Groups. Although the PPWGs have not achieved any consensus with business on issues that are highly charged, *i.e.*, definition of business income, definition of unitary business, and determining the limits of sales and use tax nexus for remote sellers, the PPWGs have been successful in promoting state/business dialogue that facilitates a better appreciation of the other's position.

The Legal Division has also worked with the wireless industry group in attempting to develop a taxing approach that can make transactional taxation of telecommunications that is not geared to a fixed base of operation more practical and clearly understood. This cooperation seeks non-intrusive federal legislation that while limiting impractical state transactional taxation of wireless communication would also empower States to impose transactional taxation of wireless communication in a more practical mode than would otherwise be unavailable in the absence of federal legislation.

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 assumption of our federal system of government: both the States and the Federal Government each have separate spheres of responsibility and a resulting need to raise revenue to discharge that responsbility. Legislation that has been monitored with some activity to preserve federalism during the past year includes State/tribal tax issues and electricity deregulation. The Commission successfully argued for the inclusion of a state tax savings clause in the pending electricity deregulation bill, H.R. 655.

The Legal Division also remains vigilant against any attempt by the Federal Communications Commission to assert regulatory jurisdiction over state taxation of telecommunications in derogation of the state tax savings clause that was a part of the Telecommunications Act of 1996. Assertion of federal regulatory jurisdiction over state taxes would place unelected federal officials in a superintending role with respect to the States without the States ever benefiting from the political process that is the recognized part of the constitutional guaranty of federalism. In addition, establishment of a separate state tax appeal system for telecommunications companies would be detrimental to the interests of other companies that would not enjoy a similar right of separate justice—separate justice is never equal justice.

Updating State Tax Systems: The Legal Division committed substantial resources to the negotiation of a sales and use tax nexus settlement with the direct marketing industry. This effort came close to realizing its goal, when literally in the 24th hour, the direct marketing industry following laborious negotiations pulled from the table and rejected any further efforts to revive the initiative to settle the nexus wars.

The Legal Division principally staffs the effort to develop a simplified sales and use tax, the MTC Simplified Sales and Use Tax Project. This special project that is a joint effort of the States and business has identified many areas where a change in approach would make compliance with the diverse sales and use taxes of the several States more friendly and practical for multijurisdictional commerce. At this time, the Project is promoting the establishment of State specific efforts in all the States that employ sales and use taxes. When the specific projects of the individual States are formed, sales tax simplification effort will involve both national issues and state specific issues.

The Legal Division also participates as the MTC liaison representative with the Electronic Business Processes Work Group of the State/Industry Task Force on Electronic Data Interchange. This effort seeks to bring state tax administration to the point of utilizing and recognizing modern business processes that employ electronic data interchange and like processes.

Communication about State Efforts to Change State Tax Systems to Meeting Changing Economic Conditions: Personnel from the Legal Division are a principal source of spokespersons from the MTC staff to communicate about the activities of the Commission with third parties, including business leagues, professional associations, governmental associations, educational symposiums, and publications.

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, as a separately organized state instrumentality. These issues include the full gamut of what one would suspect for any organization, *e.g.*, leases, contracts, personnel matters. Most recently the cancellation of the Commission's disability insurance policy required a substantial expenditure of time to select an appropriate replacement policy.

The Legal Division has assisted the management of the Commission in reaching conclusions about implementing appropriate risk management initiatives.

Training the state personnel: The Legal Division supplies training to States as need and demand requires. Training this year has occurred in areas of the unitary business principle, a principle that universally applies to all States regardless of whether they employ combined reporting, alternative dispute resolution, and nexus.

Support of Other Functions of Commission: The Legal Division provides legal support to other functions of the Commission, including the Joint Audit Program and the National Nexus Program. Representative issues include the application of appropriate apportionment methods to information services and telecommunications and audit process issues.

Technical Support of States: The Legal Division similarly provides technical support to the States in issues affecting State taxation of multijurisdictional commerce. recent issues include apportionability of litigation awards, Eleventh Amendment restrictions against 4-R Act cases and bankruptcy proceedings brought against States, and proper treatment of dividends and other payments received from foreign affiliates.

Report on Activities of ADR Program

Multistate Tax Commission
August 1998

The Multistate Tax Commission ADR Program continues to evolve, however slowly. The Program now has 6 qualified arbitrators and 5 qualified mediators. As of the present time, the Commission continues to receive inquiries about the availability of the Program from various parties but has yet to proceed to a formal ADR proceeding. There has been some success in the Program flowing from these inquiries, however. The success has occurred, because once the States learn of the availability of the Program and commit to participate in an ADR proceeding, enough motivation exists to prompt the States to settle the dispute among themselves without the necessity of an actual proceeding.

The ADR Advisory Committee has recommended that the Commission promote knowledge of the ADR Program, because, among other things, it is the single venue that has the potential to resolve all sides of a dispute involving two or more States. In addition, there is recognition on the Advisory Committee that the ADR Program should not be viewed as being limited to post-assessment disputes. Indeed, some inquiries have been received asking whether the Program can be used to reach a common understanding among the States where a single issue is repeated across the country without any assessment having first been issued. The ADR Program has also been identified as a possible approach to resolving on a prospective basis nexus issues for taxpayers that want a quick and uniform resolution of nexus issues, including the nexus consequences of changing business operations. These examples illustrate the potential of the Program that to date has simply not yet caught the attention of the taxpayer community or the States.

Given that the States are also experiencing the possibilities of ADR for the first time and are not necessarily enthusiastic about resolving matters through an unproven approach, the Commission has spent some time promoting the ADR Program to the States. Among other things the Commission successfully solicited the States to appoint ADR contact persons. Following these appointments, the Commission has conducted two training sessions of State designated ADR contact persons, one session in the West and the other in the East, so that these contacts will feel more comfortable promoting the possibility of ADR within their own agencies.

The Commission has placed a description of its ADR Program on its webpage and this action has increased awareness of the availability of the Program.

A matter of some continuing tension for the ADR Program is whether qualified neutrals should be a subject matter qualified. While the Commission has lessened the experience needed to qualify as a mediator or arbitrator, there continues to be some reservation on the Advisory Committee as to whether these liberalizations have gone far enough.

In conclusion, the MTC ADR Program remains a meritorious effort for the Commission to be of service to the multistate taxpayer community and the States. Continued efforts must be made to apprise the natural consistency of this Program of its availability.

Report of the Nexus Program

Multistate Tax Commission
August 1998

H. Beau Baez, III, Counsel, Nexus Program

Under the provisions of Article I § 3 to the Multistate Tax Compact, the National Nexus Program continues to provide methods for taxpayers to register with the States in a cost effective manner. During the last fiscal year Nexus Program staff received requests to process over 200 voluntary disclosure agreements representing $500,000 in back taxes and $10,000,000 in future collections to the States. To further help voluntary tax compliance, Nexus Staff has written an article explaining the voluntary disclosure process. This article has been published in at least five state CPA society publications over the last year, in a national bar association publication, and furthers the goals established under Article VI § 3(c) of the Multistate Tax Compact.

In addition to providing a cost efficient program for taxpayers, the Nexus Program is also cost efficient for the States. First, under Article VI § 3(d) of the Multistate Tax Compact, Nexus Program staff members answer many questions that would otherwise get directed to many States. Second, in the voluntary disclosure context the Nexus Program gets taxpayers to use a Nexus Program drafted contract with the States, thereby saving the States from having to examine taxpayer written contracts on a case-by-case basis. *See* Multistate Tax Compact Article VI § 3(c).

During the past year Nexus Program staff held five nexus schools in the States. Also, Nexus Program staff has been working to prepare an advanced nexus school during fiscal year 1999.

June Summers Haas resigned in January of 1998 from her position as Nexus Director. Mr. Sheldon Laskin accepted the position of Nexus Director and commenced his work with the Nexus Program on July 13, 1998.

Report of the Audit Committee and Audit Program

Multistate Tax Commission
August 1998

Kim C. Ferrell, Chair, 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 fiscal year 6/98. The report also reflects various accomplishments of the MTC Audit Program for the last ten years.

MTC AUDIT COMMITTEE 6/98

The MTC Audit Committee met three times during the fiscal year. During the Annual Meeting, the Audit Committee selected 6 income tax audits and 29 sales tax audits for the MTC Audit Program's inventory. The Audit Committee approved a revised method of reporting completed income tax cases. This new method brings the MTC Audit Program's method of counting completed cases in alignment with all the states in the Audit Program.

During the March meeting, the Audit Committee met an additional day and held a round table discussion concerning audit activities in each of the states. The Audit Committee also heard presentations from Illinois regarding audit sampling and from Louisiana regarding restructuring audit divisions in state governments.

The Audit Committee also 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.

MTC AUDIT PROGRAM 6/98

PRODUCTIVITY

The audit staff completed 10 sales tax audits and 9 income tax audits during fiscal year 6/98. The Audit Division had a goal to complete 13 sales tax and 11 income tax audits this fiscal year. The Audit Division fell three audits short of the sales tax goal One audit was delayed due to negotiations with the taxpayer's attorneys. The second audit was delayed because the taxpayer's representative had a heart attack during February and the auditor assigned the case left the Commission in May. The third audit was delayed because the taxpayer would not permit the audit to commence until May

The first income tax audit was delayed due to ongoing discussions with the taxpayer's attorney regarding apportionment of the sales factor for its subsidiary. The second income tax audit was delayed due to ongoing negotiations with the taxpayer's attorney. The accompanying chart details the average hours for the past 12 months.

Currently 29 sales tax and 21 income tax audits are in progress. Two of the audits in progress were assigned from the National Nexus Program.

STAFFING

We hired a new income tax auditor for the New York Office. Larry Shinder began his employment with the MTC on October 13, 1997. Larry has previous experience with private industry. Satvinder Singh, a sales tax auditor resigned in May. Rachel Stephens, a former employee, was rehired to replace Satvinder. Mark Voyda, an income tax auditor in Chicago, was dismissed from employment in June. Recruitment for Mark's replacement will begin in August.

AUTOMATION

We have 6 sales tax audits where the taxpayer has supplied us with electronic records and we are attempting to use ACL software to convert the tapes to our software. We are also pursuing electronic records in every audit that is commencing. Harold Jennings is asking each taxpayer for access to the company's electronic records. We are experiencing some success in this area although there are still problems that arise. We believe substantial progress has been made in this area.

Harold Jennings and Sam Moon are participating in the 15-week training program in computer assisted auditing sponsored by the University of North Texas. They have completed 7 weeks of this training and each has reported that the training has exceeded all expectations. Harold feels confident that he will be able to work on taxpayer's mainframe computers once this training is completed. Sixteen state auditors are also enrolled for this training. This training will be used to reorganize the sales tax portion of the MTC Audit Program. Harold Jennings gave a presentation to the Audit Committee on this new restructuring at the March Committee meeting. We plan to give a comprehensive report to the Audit Committee either in the November or March meeting of the Audit Committee. We believe that this reorganization will enable the MTC Audit Program to better serve the states in the program.

TRAINING

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

PILOT REGIONAL AUDIT PROJECT

There are four states participating in this pilot program. All of the states have completed their audits. One of the states indicated that it might not want to continue in the project. The other three states will decide whether to extend the project.

PROPERTY TAX AUDIT PROGRAM

The first audit in this project was scheduled to begin in early November 1996. The taxpayer contacted was reluctant to be audited by six states and questioned the state's authority to conduct an audit under the MTC umbrella. Rene Blocker responded to the taxpayer's initial concerns. However, the taxpayer has still not agreed to allow the audit to commence. Paull Mines has been in contact with the taxpayer on a continuing basis. Hopefully some agreement will be reached in the near future.

MTC AUDIT PROGRAM 6/89-6/98

Audit Program Membership

The number of states in the Audit Program increased significantly during the last ten years. In fiscal year 6/89 there were 18 states in the Audit Program. During this time California, South Dakota and Texas dropped out of the program. California and Texas were participating in only one or two audits a year. These states have significant field office staffs across the country. South Dakota participated in most audits but there were insignificant tax changes in the audit to remain in the program.

During this same period, the MTC Executive Director with assistance from the MTC Audit Director made numerous contacts to solicit participation with states not in the program. This resulted in 6 additional states joining the Audit program. These states were Alabama, Kentucky, Maine, Maryland, Missouri and New Jersey. Several other states have expressed an interest in the program and periodic discussions continue to encourage membership.

Composition of Audit Staff

The current number of professional audit staff positions remains at the 17, which was the same number in fiscal 6/89. However, only two members of the current staff were on the staff in 6/89. The makeup of the audit staff has changed dramatically over the last ten years, which now more appropriately reflects the general work place environment. In fiscal year 6/89 the audit staff employed one female and one minority. The current audit staff has 5 women and 8 minorities employed. This was accomplished through the direction of the MTC Executive Director who employed a three-member panel hiring system for all professional employees.

Audit Productivity

During the last ten years the MTC Audit Program completed 90 joint income tax audits and 114 joint sales tax audits. This translates to 1026 separate state income tax audits and 1157 separate sales tax audits. As you can see from the accompanying charts, the number of completed audits per years have increased over the last 6 years.

The average number of hours needed to complete the state audits has significantly improved over the years. From 6/89 – 6/92 the average hours to complete all types of audits was well over 100 hours. The average hours have decreased over the last 6 years to about 80 hours per state audit. This compares very favorably to what the member states have reported to the MTC Audit director. This points out one of the benefits to both the states in the audit and also to taxpayers. The taxpayers have to devote less time to a joint audit compared to the time needed for the same number of individual state audits.

MTC Automation

Ten years ago the MTC Audit Staff just began to use computers in auditing. Most of the staff still used paper, pencils and calculators to conduct audits. Currently, the entire audit staff uses the latest in laptop computers and software. The MTC Audit program consistently attempts to keep current technology and to that end two staff members are attending a 15 training course that will enable the staff to access taxpayer’s mainframe computers to obtain electronic records.

The Audit Program hopes to improve the templates currently in use by the staff. The management staff of the Audit program believes that use of data base software will enable the staff to improve the productivity. The staff will utilize the services of outside consultants to revamp the audit templates. The management of the Audit Program believes that statistical sampling will be the norm in the future for sales tax audits. Thus, plans are underway to train the sales tax staff in statistical sampling.

Training

During the last 5 years, the Audit Director has been involved in providing various training for state tax personnel. The Audit Director has participated in 12 Nexus Schools, which trained about 450 state tax personnel. The Audit Director also assisted in 3 Unitary/Business Income schools that trained about 100 state tax personnel. The Audit director also responded to 2 requests to assist two states in state specific training. About 70 auditors were instructed during these two sessions.

There appears to be a need in many states for training in computer assisted auditing, ACL software training and statistical sampling. The MTC will survey the states in the future to determine if there is any other area of training that may be needed. Once the two audit staff members complete the 15-week training, the management of the MTC Audit Program will make recommendations to the MTC Executive Director on q reorganization plan. It is hoped that with the reorganization, additional training may be offered to the states in the above areas.

Future

The MTC Audit Program has made significant progress over the last 10 years. If someone had used a crystal ball 10 years ago, I do not think anyone could have predicted where we would be in 6/98. The MTC management staff may not be able to predict where it will be in the next 10 years but we want to remain flexible to meet all future demands that may be placed upon it. We will constantly remain open to changes that will help the program remain successful.

TRENDS IN PRODUCTIVITY
MTC JOINT AUDIT PROGRAM

Audit Hour Analysis

Last Four Quarters

	9/97	12/97	3/98	6/98	Total
Income Tax Total Audits	1	2	1	5	9
Total States Audited	15	25	13	67	120
Total Hours	1423	2679	534	5376	10,012
Average Hours Per State	**95**	**107**	**41**	**80**	**83**
Sales Tax Total Audits	4	0	1	5	10
Total States Audited	39	0	7	51	97
Total Hours	3032	0	1160	3529	7721
Average Hours Per State	**78**	**0**	**166**	**69**	**80**
Total Both Taxes Total Audits	5	2	2	10	19
Total States Audited	54	25	20	118	217
Total Hours	4455	2679	1694	8905	17,733
Average Hours Per State	**83**	**107**	**85**	**75**	**82**

TRENDS IN PRODUCTIVITY
MTC JOINT AUDIT PROGRAM

Audit Hour Analysis

6/89 - 6/98

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

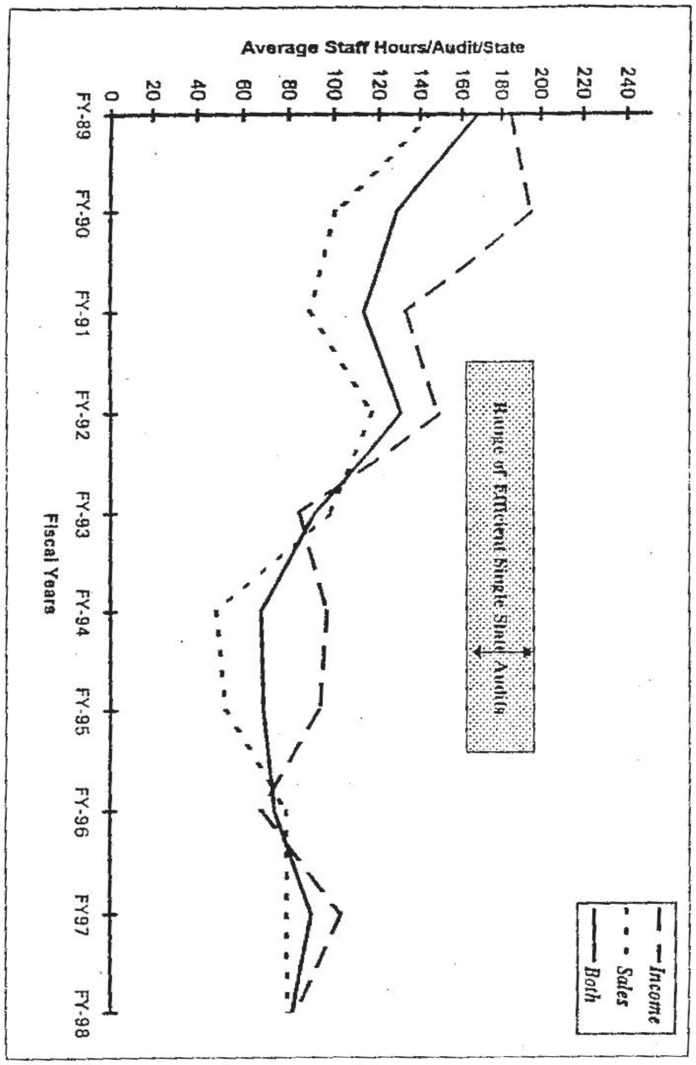
Trends in Productivity of MTC Joint Audit Program

Audit Hour Analysis

Type of Taxes		FY-89	FY-90	FY-91	FY-92	FY-93	FY-94	FY-95	FY-96	FY-97	FY-98
Income Tax	Total Audits	12	4	9	7	12	9	9	9	10	8
	Total States Audited	112	37	95	75	132	93	99	111	118	120
	Total Hours	20679	7211	12640	11140	11208	9016	8284	7548	12249	10012
	Avg. Hours per State	185	195	133	149	85	97	84	68	104	83
Sales Tax	Total Audits	8	9	8	9	14	13	15	13	14	10
	Total States Audited	85	88	79	104	148	140	152	123	143	97
	Total Hours	12393	8868	7089	12209	14323	6818	8009	9746	11349	7721
	Avg. Hours per State	146	101	89	117	98	49	53	79	79	80
Both Taxes	Total Audits	21	13	17	16	26	22	24	22	24	18
	Total States Audited	197	125	174	179	278	233	251	234	261	217
	Total Hours	33072	16077	19715	23357	25531	15834	17293	17294	23598	17733
	Avg. Hours per State	168	129	113	130	92	68	69	74	90	82

Trends in Time Spent on MTC Joint Audits

Comparison with Typical Range of Time Spent on Audits by Single States



STATES IN AUDIT PROGRAM

States in Audit Program 6/89	States in Audit Program 6/98
	Alabama
Arkansas	Arkansas
California	
Colorado	Colorado
District of Columbia	District of Columbia
Hawaii	Hawaii
Idaho	Idaho
Kansas	Kansas
	Kentucky
	Maine
	Maryland
Michigan	Michigan
Minnesota	Minnesota
	Missouri
Montana	Montana
Nebraska	Nebraska
	New Jersey
New Mexico	New Mexico
North Dakota	North Dakota
Oregon	Oregon
South Dakota	
Texas	
Utah	Utah
Washington	Washington

COMPOSITION OF AUDIT STAFF

	F/Y 6/89	F/Y 6/98
Total Professional Audit Staff	17	17
Professional Women on Staff	1	5
Professional Minorities on Staff	1	8

TRAINING PROVIDED

Type of Training	Number of Classes	Total Trained
Nexus Schools	12	450
Unitary/Business Income	3	100
State Specific Training	2	70

COMPACT MEMBER STATES' REPRESENTATIVES
FY 1997-98

STATES	REPRESENTATIVES
ALABAMA	H.E. Gene Monroe, Jr., Commissioner ***Alternate:*** George E. Mingledorff III, Assistant Commissioner
ALASKA	Wilson L. Condon, Commissioner ***Alternate:*** Deborah Vogt, Deputy Commissioner
ARKANSAS	Timothy J. Leathers, Deputy Director ***Alternate:*** John H. Theis, Asst. Commissioner of Revenue
CALIFORNIA, FTB	Gerald H. Goldberg, Executive Officer
CALIFORNIA, SBE	E. Les Sorensen, Jr., Executive Director
COLORADO	Renny Fagan, Executive Director ***Alternate:*** John Martin Vecchiarelli, Division Director
DISTRICT OF COLUMBIA	Natwar M. Gandhi, Deputy Chief Financial Officer ***Alternate:*** Steve P.B. Kranz, Chief Counsel
HAWAII	Ray K. Kamikawa, Director of Taxation ***Alternate:*** Richard Chiogioji, Tax Audit Technical Coordinator
IDAHO	R. Michael Southcombe, Chairman ***Alternate:*** Phil Aldape, Division Administrator
KANSAS	John LaFaver, Secretary of Revenue ***Alternate:*** Shirley Klenda Sicilian, Director
MAINE	Brian H. Mahany, Executive Director ***Alternate:*** Errol E. Dearborn, Director
MICHIGAN	Douglas Roberts, State Treasurer ***Alternate:*** Bernard D. Copping, Commissioner of Revenue
MINNESOTA	James L. Girard, Commissioner ***Alternate:*** Jennifer L. Engh, Assistant Commissioner
MISSOURI	Quentin Wilson, Director ***Alternate:*** Carol Russell Fischer, Director

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SOVEREIGNTY MEMBER STATE REPRESENTATIVE
FY 1997-98

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ASSOCIATE MEMBER STATES' REPRESENTATIVES
FY 1997-98

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NEW JERSEY	Robert K. Thompson, Acting Director
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OHIO	Roger W. Tracy, Commissioner ***Alternates:*** Tom Ruebel, Problem Resolution Officer James J. Lawrence, Chief Counsel
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STATES	REPRESENTATIVES
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TENNESSEE	Ruth E. Johnson, Commissioner ***Alternate:*** Michael L. Cole, Deputy Commissioner
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