

Report of Activities



FY 1998-99

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Multistate Tax Commission Report of Activities Fiscal Year 1998-99

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Report of the Executive Committee and Executive Director

Multistate Tax Commission

July 1999

R. Michael Southcombe, Chairman

Dan R. Bucks, Executive Director

For issues of multistate taxation, these times are ones of both challenge and opportunity. The economic and technological environment in which state tax systems operate is changing rapidly. Masked by the fortune of unusual economic prosperity, the underlying structure of state and local taxes has become increasingly obsolete over the last quarter century in relation to the nature of the economy. That structural obsolescence will become increasingly clear when economic trends are less favorable than at present. It is with regard to interstate and international commerce that state and local taxes have become especially outdated. States, with the understanding and participation of the business community, need to find new ways of making state taxes work smoothly with the flow of commerce and to apply those taxes 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 terms of membership, Mississippi became the 19th Associate Member of the Commission. Louisiana (an Associate Member) and Oregon (a Compact Member) both joined the National Nexus Program this year, bringing the number of states in this program to 39. At present, there are a total of 44 states participating in the Commission, compared to 30 states eleven years ago.

The Commission continues to reach out to taxpayer groups and other organizations to seek advice and cooperation on a range of multistate tax issues. These efforts include:

- Supporting the work of the Commission's Sales Tax Simplification Committee comprised of private sector representatives and approving their plan to seek improvements in sales 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 Fundraisers and Direct Sellers, and the funeral industry;
- Supporting and participating with other state and local government organizations and the private sector in the National Tax Association Communications and Electronic Commerce Tax Project which is addressing issues of state taxation of electronic commerce;

- Consulting with the private sector on major issues in multistate income taxation through the PPWG-Uniformity Committee Liaison Group on Unitary Business;
- Continuing work with the wireless telephone industry on potential federal legislation for the uniform transactional tax treatment of phone calls made outside of service areas; and
- Continuing to work as a partner with the Federation of Tax Administrators (FTA) and private sector representatives on the FTA-led Electronic Business Processes Project to respond to tax administrative issues created by expanding business use of advanced technology.

Executive Committee Activities

In November 1998, the Executive Committee elected Quentin Wilson of Missouri to serve as Treasurer, succeeding Mary Bryson of Montana.

As required by the MTC Bylaws, the Executive Committee met four times during the 1998-99 fiscal year. The Executive Committee met on August 5, 1998, in Dana Point, California; on November 18, 1998, in Washington, D.C.; on January 14-15, 1999, in San Diego, California; and on May 6-7, 1999 in Santa Fe, New Mexico. At each meeting, the Executive Committee 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 office. Pursuant to the Compact, it has prepared a budget with membership assessments, audit reimbursements and program or project fees for the 1999-00 fiscal year.

Future of the Sales Tax

The past year can be viewed as the "year of the sales tax." During this year, the Commission has placed a priority on working to streamline the sales tax so that it works more efficiently in the context of national and global commerce. The following are a sample of the sales tax efforts that have occupied the Commission in the past year:

- Executive Committee members have served as key state representatives in the NTA Communications and Electronic Commerce Tax Project. Whether a final report will be issued by that group, however, remains to be seen. In spite of this uncertainty, the project has afforded states and businesses a full opportunity to consider together significant sales tax issues.

- Executive Committee members have taken a more active role in the work of the Sales Tax Simplification Project by joining the business representatives as the project moves into implementation of national sales tax simplifications. The Simplification Committee has established several task forces initially to tackle three selected areas, *i.e.*, exemption processing, situsing and refund claims processing.
- The Uniformity Committee is addressing an increasing range of sales tax uniformity issues, including the fundamental issue of how to prevent double taxation by establishing rules for determining which state's tax should take priority when two or more states may tax the same transaction.

In addition, three Commission States, Idaho, Utah, and Washington, have taken the lead on establishing a regional sales tax pilot project the goal of which is to identify, design, and implement innovative means of creating a simpler sales tax system. These states have been successful in integrating interested regional multistate business representatives into the project. The project has the potential to become a model for other states as they seek to resolve the problems currently associated with the administration of the sales tax.

As remote sales on which vendors do not choose to collect sales and use taxes promise to rise and as the issues of the cost of sales and use tax administration continue to be of concern to interstate businesses, the issues of improving the equity and efficiency of sales and use taxes will likely continue to demand significant attention from the Commission and its Member States for years to come.

Corporate Tax Apportionment

The issue of how to divide fairly and equitably the income of a multi-jurisdictional enterprise among the states in which it earns income remains a topic of continuing concern to the Commission and the business community. Among several corporate income topics the Commission addressed, the Commission gave continuing attention to two fundamental issues in this area:

- The definition of a unitary business; and
- The classification of income as apportionable business income or allocable non-business income.

These two issues affect the division of income for more taxpayers than any other unresolved issues with regard to the corporate income tax.

The definition of a unitary business was the subject of a process of consultation between private sector and State representatives. That consultation produced at the end of this year a near-final report on a proposed definition with alternative approaches on key issues. That report and its alternatives will now be the subject of continuing work by the Uniformity Committee.

The classification of income as apportionable business income or allocable non-business income is the subject of extensive litigation in several States. Accordingly, the Commission gave increased attention to this litigation and filed *amicus curiae* briefs in three important cases — the *Polaroid* and the *Union Carbide* cases in North Carolina and the *Hoechst-Celanese* case in California. The Commission anticipates giving continuing attention to these cases in the future.

Beyond these fundamental issues, the Commission also is in the process of addressing a number of other corporate income topics: the definition of gross receipts, the treatment of outer-jurisdictional property in apportionment formulas, the treatment of funeral trusts, and in cooperation with the AICPA, the streamlining of administrative requirements for corporate income taxes.

Conclusion

Rapid economic and technological change will continue to challenge the existing structure and operation of state and local taxes. Issues of multistate taxation will multiply. The need for states to work together to resolve these issues will increase. In this context, the Commission's purposes and efforts will be increasingly more vital. The challenge to the Commission is to assist the states in addressing a broadening area of issues that require resolution in a shorter period of time. Indeed, these are interesting times in the field of multistate taxation.

Report of the Treasurer

Multistate Tax Commission
July 1999

The Report of the Treasurer is identical to the Treasurer's Report for the July 28, 1999, Executive Committee meeting. Please refer to the Executive Committee meeting *Tab E* under *Session I* for this agenda item.

Report of the Alternative Dispute Resolution Advisory Committee

Multistate Tax Commission

July 1999

The ADR Advisory Committee Report has been provided as part of the materials for the July 28, 1999, Executive Director's Report at *Tab F* under *Session I*.

Report of the Sales Tax Simplification Committee

Multistate Tax Commission

July 1999

Wayne Eggert, Chair, MTC Sales Tax Simplification Committee

Overview

The implementation phase of the MTC Sales Tax Simplification Project commenced this year with the establishment of state-specific simplification subcommittees, charged with working towards developing solutions to identified sales tax problems that currently exist or that may arise in the future. Each state's subcommittee consists of at least one state representative and one business representative. Several subcommittees include state legislative representatives as well. The former Sales Tax Simplification Planning Committee (comprised of industry representatives from AICPA, COST, IPT, NTA, and TEI) provided each subcommittee with an extensive list of its ideas for simplifying the sales tax in the various states as a suggested starting point. The subcommittees will operate relatively independently, but are expected to provide periodic reports of their progress to the central Steering Committee. It is the intention to incorporate all forty-six states (including the District of Columbia) that levy a sales tax into this Project. The twenty-three subcommittees established to date are:

STATE	STATE REPRESENTATIVES	BUSINESS REPRESENTATIVES
AL	Mike Mason	Bruce Ely (CH), Todd Brown
AK	Beth Carson, Ed Hicks	Jim Sears, Barbara Miller, Jerry Orr, Saxton, Davis, Haubein
CA (BOE)	Dennis Fox	Dan Thomson (CH), Joe McAulife, Katherine Correa
CO	Joyce Chavarria	Lorraine Dunn, Clifford Turner
CT	Scot R. Anderson	Lynn Kopnicki (CH), Kathleen Buzbee, Lawrence Briand
FL	Jeff Kielbasa, Jim Evers	Tom Findley, John Bussey, D. Roberts
IL	Bill Lundeen	Rich Tittle
IA	Gerry Bair	Alexa Heffernan, Dwayne Vanderkol
KY	Charlotte Quarles	David Wilkerson
MD	Stephen Cordi, Linda Tanton	Bill Van Antwerp
MA	Bob Mood	Scott Walter, Paul Caccamo
MI	Dale Vettel	Pat Fitzgarald (CH), Steve Skiba
MS	Randy Ladner	Craig Beaty
MO	Quentin Wilson	Blankenship, Hilger, Higgins, Clancey, Cudney, Stricker
NE	Tom Gillaspie, Don Ellingson	Scott Becker, Judi Lopez
NJ	Denise Lambert	Keith Brann (CH), Daniels, Kowalski
NC	Charles Collins, Sabra Faires	Gil Kayton, Kathy Long
OK	Tony Mastin, Jim Kinnamon	Debbie Ann Jones
PA	Merrill Jacobson	Donna Daday, James Conant, Thomas Roche, David Werner
RI	John Nugent, Peter McVay	Mark Barnabe
SC	Jerry Knight	Elise Lippe
TX	Mona Shoemate	Ann Glasco, Leo Sierra, Don Larsen, Todd McElroy, Linda Fontaine
WY	Joyce Stewart, Donna Campbell	Michael Walden-Newman

While the state-specific subcommittees moved forward with their work, the focus of the Planning Committee shifted to multistate sales tax simplification. The project participation was expanded to include state tax agency staff members, who along with the business representatives now comprise the Steering Committee. These current members are:

NAME	STATE/ORGANIZATION
Wayne Eggert, Committee Chair	National Tax Association
Frank Davis	Tax Executives Institute
Bruce Johnson	Utah Tax Commission
Fred Kiga	Washington Department of Revenue
Norman Lobins	American Institute of Certified Public Accountants
Wilma Murphree	Institute for Professionals in Taxation
Jerry Orr	Committee on State Taxation
Mona Shoemate	Texas Comptroller's Office
Mike Southcombe	Idaho State Tax Commission
Quentin Wilson	Missouri Department of Revenue

During its first meeting on May 19, 1999, the Steering Committee reviewed the list of ideas for simplifying the sales tax developed by the former Planning Committee to be advanced for implementation. One uniformity issue from three of the broad categories, i.e. compliance simplification, policy simplification, and audit and appeals, was selected:

1. Exemption processing, which includes:
 - Each state constructing a website that contains a list of all exempt customers and their respective registration numbers;
 - Acceptance by all states of uniform multi-jurisdictional exemption certificates; and
 - A uniform date of expiration of exemption from the time of issuance.
2. Uniform sales tax situs for taxable tangible personal property and services; and
3. Uniform refund claim process.

These three ideas were selected only as a starting point. The Steering Committee intends to implement many of the more complex simplification issues over the long run, derived from the aforementioned three broad categories and endorsed by the Planning Committee.

Strategy

The Steering Committee resolved that the optimal way to address these issues was to devise three separate task forces, to be comprised of a mix of government and business community members, which will research and develop a feasible method for the implementation of the uniformity ideas. Each task force will be comprised of between four and six members (to be divided between government and the business community), in addition to the inclusion of a task force chairperson(s). Jerry Orr and Mona Shoemate will co-chair the *Exemption Processing Task Force*; Wilma Murphree will chair the *Situs Task Force*; and Norman Lobins will chair the *Refund Claim Process Task Force*. These task forces are authorized to utilize the staff of the Multistate Tax Commission and the Federation of Tax Administrators and will include the participation of the MTC Uniformity Committee. When each task force has resolved that a “best practice” has been conceived, the task force will present the proposal before the Steering Committee for endorsement. Members of the Steering Committee will also regularly reach out to each of the states to monitor the progress of their state-specific subcommittees.

Each state subcommittee will generate reports on a regular basis, the overall tone of which should enunciate the positive and focus on the progress that is being made. Positive reinforcement of the benefits of simplification and a continuous forward momentum are critical to this process and to the success of the project in its entirety. Generally, states were assigned to Steering Committee members roughly by region. The Steering Committee members and the states they will monitor are:

NAME	STATE
Frank Davis	DC, MD, NC, SC, VA
Wayne Eggert	AL, MA, NJ, PA, RI
Bruce Johnson	AZ, CO, NM, UT, WY
Fred Kiga	CN, ID, ME, VT, WA, WI
Norman Lobins	IN, KY, MI, MN, OH, WV
Wilma Murphree	HI, LA, NV, OK
Jerry Orr	AR, CA, FL, GA, MS
Mona Shoemate	ND, NY, SD, TN, TX
Quentin Wilson	IA, IL, KS, MO, NE

Report of the Uniformity Committee

Multistate Tax Commission

July 1999

Ted Spangler, Chair, MTC Uniformity Committee
Mona Shoemate, Vice-Chair, MTC 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. Below we provide a review of the Uniformity Committee's specific projects.

• SALES AND USE TAX •

Joint Project with Association of Fund Raisers and Direct Sellers

This project is now entering into Phase II, which is the development of a clearinghouse database, accessible by the general public, on state practices in taxing fundraising transactions. This information will be provided for information purposes only; individuals with questions about a specific state practice would be directed to the state revenue agency. A survey was distributed to determine the willingness of the states to participate in the clearinghouse project, the response of which has been very positive. While compilation of the survey results is pending, MTC staff is working with AFRDS to design a format for displaying and presenting information on the World Wide Web. Additionally, the hearing process has begun for the *Proposed Provision for the Collection of Tax on Fundraising Transactions*, completed through the joint efforts of the Uniformity Committee and the AFRDS.

State Tax Priority Issues

In March 1998, MTC staff sent an initial survey to the states to gather responses to a variety of scenarios involving transactions that implicated sales and use tax priority issues. Based on survey responses, MTC staff developed proposed rules and alternate rules to determine sales and use tax priority issues among states. States were resurveyed in November 1998, to determine which proposed rules and alternate rules would be acceptable as parts of a new, uniform system to determine transactional tax priority. Because of the magnitude and the difficulty of the project, this process continues. The Subcommittee has engaged in much discussion of the proposed priority rules and alternate rules, resulting in some broad areas of agreement; there are a number of areas that still require resolution, however. It is anticipated that the Subcommittee will continue discussions at the July 1999 meeting.

• INCOME AND FRANCHISE TAX •

Proposed Definition of Gross Receipts

A public hearing was held on the proposed definition of gross receipts on May 8, 1998, and a Hearing Officer's Report was released the following November. Based on written and oral comments, Hearing Officers recommended that the proposed definition be subjected to an informal dialogue between government and industry participants to discuss outstanding issues and areas of disagreement. The comments and suggestions received by the Hearing Officers during this process resulted in the development of a revised definition of gross receipts, which will be the subject of a second public hearing scheduled for July 8, 1999. Completion of the Hearing Officers' final report is expected by December 1999.

Property Factor Treatment of Outer-Jurisdictional Property

The Income/Franchise Tax Subcommittee completed its work on the development of a uniform rule for property factor treatment of outer-jurisdictional property (*i.e.*, property not located in any jurisdiction, such as satellites and undersea cable), deciding to adopt a "throw-out" approach under the MTC Regulations for Section 18 of UDITPA. The draft definition has been referred by the Executive Committee to public hearing, for which a date has not yet been determined.

Joint Work with AICPA on Corporate Income Tax Administrative Uniformity

The Income and Franchise Tax Subcommittee continues its work on the development of a uniform statute for reporting federal adjustments to states. The work of this project is being jointly coordinated with the AICPA, whose representatives are taking the lead on drafting of a uniform state form for reporting federal adjustments. The Committee hopes to both complete the draft proposal and the draft form in the near future. Thereafter, the Committee will make a decision about selecting another area of corporate income tax administration to continue this joint project.

Telecommunications Apportionment Formula

As directed by the MTC Executive Committee, MTC staff conducted a study among the states to determine the actual need and/or desire for a telecommunications apportionment formula. However, the California FTB decided to revisit this issue, and plans for development of an apportionment proposal have been put on hold pending the outcome of the FTB's new draft proposal.

Joint Project with SCI Management Corp. — Death-Care Providers

The purpose of this project is to streamline the state tax administration of funeral trusts by bringing state rules into conformity with the 1997 federal rules on the treatment of funeral trusts for income tax purposes. A survey of the states indicated that since most jurisdictions incorporate federal law into their own tax codes, conformity with the new federal rules was not an issue. However, states did identify one issue for resolution — determining the residence of a

funeral trust for purposes of state income tax. At the direction of the Uniformity Committee, MTC staff prepared a proposed rule stating that the residency of a funeral trust is determined by the residency of the grantor at the time the trust is founded. Industry response has been to change the residency of the trust to the location of the funeral home/cemetery because many trust grantors either no longer live in the jurisdiction where the trust was created, or move after creation of the trust. Work will continue on this joint project.

Nexus Issues for Financial Institutions

During the course of the year, the Uniformity Committee contemplated whether the time was ripe for addressing the outstanding nexus issue left open in the development of the MTC Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions. However, the Committee would take on the project only if industry representatives expressed an interest. An informal discussion with the industry revealed that the industry does not wish to pursue developing nexus rules for financial institutions at this time.

Throwback Affidavits

This new project is charged with developing an affidavit requiring taxpayers to affirm under oath that they are taxable in other states to avoid a state's throwback rule. Copies of such affidavits will be sent to those states where the taxpayer has indicated taxability. Further discussion of the project will occur at the July 1999 meeting.

Draft Unitary Business Definition

The PPWG Uniformity Liaison Group, which is crafting a definition of unitary business, continues its work discussing the merits of the contribution/dependency tests, the three unities tests, and the *Mobil factors* test. Progress in the last year has been somewhat slow, due to lack of participation and industry concerns regarding the speed of the process. The Uniformity Committee will review at the July 1999 meeting a report on the Group's work.

Pass-Through Entities

This project addresses the nuts and bolts of tax reporting by pass-through entities. Questions to be addressed include whether a clearinghouse of information for pass-through reporting should be created.

• **1998 BUSINESS-GOVERNMENT DIALOGUE** •

No Business/Dialogue Day session was held in 1998 due to a meeting of the NTA Communications and Electronic Commerce Tax Project.

• **CONCLUSION** •

In conclusion, we would like to express our 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 temporary leadership of the Income and Franchise Tax Subcommittee, and Jennifer Hayes with the Kentucky Revenue Cabinet for graciously accepting permanent leadership of the subcommittee. We also thank the Uniformity Committee Vice-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.

Finally, on behalf of all members of the Committee, I commend the MTC staff, especially René Blocker and Roxanne Bland, for their professionalism and tireless efforts in support of the Committee's full range of activities. It is the Staff that makes the Committee's work possible.

Current Uniformity Projects

A primary purpose of the MTC is to encourage uniformity in state tax policies with respect to interstate and international commerce. Current and recently completed uniformity projects undertaken by the Member States through the MTC are summarized in the following series of tables:

UNIFORMITY PROPOSALS RECENTLY ADOPTED BY THE COMMISSION	
Proposal	Date of Adoption
<u>Income or Franchise Taxes</u>	
Regulation apportioning broadcasting industry income	August 31, 1990 <i>Amended April 25, 1996</i>
Model S-Corporation Income Tax Act (“MoSCITA”) with six possible modifications	August 2, 1991
Regulation apportioning publishing industry income	July 30, 1993
Post-Wrigley revision of “Statement of Information Concerning Practices of MTC and Signatory States Under P.L. 86-272”	July 29, 1994
Statute apportioning income of financial institutions	November 17, 1994
Reg. IV.18.(c), clarifying that net gains from sale of intangible assets are treated as receipt for sales factor purposes	August 8, 1997
<u>Sales/Use and Other Transactional Taxes</u>	
Uniform Principles Governing State Transactional Taxation of Telecommunications	July 30, 1993
<u>Administration</u>	
Uniform Protest Period Statute	August 31, 1990
Model Recordkeeping and Retention Regulation	January 15, 1998

UNIFORMITY PROPOSALS AWAITING COMMISSION ACTION	
Proposal	Anticipated Commission Action
None	--

UNIFORMITY PROPOSALS REFERRED TO PUBLIC HEARING		
Proposal	Anticipated Completion Hearing Officer Report	Earliest Action by Commission
Definition of "gross receipts" in the sales factor	A second public hearing was held July 1999; a report is expected by December 1999.	July 2000
Uniform treatment in the property factor of "outer-jurisdictional property"	Hearing to be scheduled	July 2000
Taxation of fund-raising transactions (Joint project with Assn. of Fund Raisers and Direct Sellers)	Hearing to be scheduled	July 2000

UNIFORMITY PROPOSALS UNDER REVIEW BY PUBLIC PARTICIPATION WORKING GROUPS		
Proposal	Working Group Completion Target	Earliest Action by Commission
Definitions of Unitary Businesses	Not yet established	Not yet established

**PROPOSALS
BEING DEVELOPED BY THE UNIFORMITY COMMITTEE**

Proposal	Committee Completion Target	Earliest Action by Commission
<u>Sales/Use/Transaction Taxes</u>		
Tax priority	Not yet established	Not yet established
Database of states' provisions re: fund raising transactions (Joint project with AFRDS — Phase II)	Not yet established	Not yet established
<u>Income/Franchise Taxes</u>		
Corporate income tax administrative uniformity (Joint project with the AICPA)	Not yet established	Not yet established
Uniform State Tax Treatment of Funeral Trusts	Not yet established	Not yet established

Report of the Litigation Committee and Report on MTC Legal Activities

Multistate Tax Commission

July 1999

David Woodgerd, Chair, MTC Litigation Committee

Paull Mines, General Counsel, MTC

We are pleased to tender the 1998-1999 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 1998-1999 fiscal year.

• 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 1999, and the meeting in conjunction with the 1998 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 1998-1999 term of the Court saw the release of a number of decisions that has, to an extent not yet fully determined, altered the balance of power between the state and federal governments. In *Alden v. Maine*, the Court ruled that Congress, under its Article I powers, cannot abrogate the sovereign immunity of states from private suits in its own courts where the state has not affirmatively waived its immunity. In *College Savings Bank v. Florida Prepaid Postsecondary Educ. Expense Bd.*, the Court affirmed the holding of the 3rd Circuit that the petitioner could not sue a state entity in federal court for violations of the Trademark Remedy Clarification Act on grounds that the state had not waived, and Congress, pursuant to its 14th Amendment powers, had not properly abrogated the state's sovereign immunity. Similarly, in *Florida Prepaid Postsecondary Educ. Expense Bd. v. College Savings Bank*, the Court ruled that the express congressional abrogation of states' 11th Amendment sovereign immunity under the Patent and Plant Variety Protection Remedy Clarification Act was invalid because the legislation was not shown to have been enacted to enforce the guarantees of the Due Process Clause of the 14th Amendment.

The Court also rendered decisions in a number of other cases held over from the 1997-1998 term. In *South Central Bell Telephone Co. v. Alabama*, the Court rejected the argument that the 11th Amendment barred Court jurisdiction over the matter, citing *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco* as confirming the long-standing and uniform practice of the Court to review state-court decisions on federal matters. It further ruled that the Due Process Clause of the 14th Amendment invalidates the decision of the Alabama Supreme Court to the extent that the decision was based on grounds of *res judicata*. Finally, the Court found that the state franchise tax on foreign corporations impermissibly discriminates against interstate

commerce, as it gives an advantage to domestic over foreign corporations, which cannot be justified on grounds that the tax is complementary since the relevant tax burdens are not roughly approximate. In *Jefferson County, Alabama v. Acker*, the Court ruled that federal judges are federal officers and are entitled to remove state court civil actions to federal district court under federal officer removal statute. The Court further ruled that the Tax Injunction Act did not deprive the federal district court of jurisdiction to hear the matter, because the Act does not contemplate suits to collect taxes. Finally, the County's tax is a non-discriminatory tax on the compensation of federal judges, which is permitted by the Public Salary Act, and the doctrine of intergovernmental tax immunity does not apply. In *Arizona Department of Revenue v. Blaze Construction Corporation*, the Court held that the State's transaction privilege tax was not preempted by federal law as applied to a non-tribal contractor building roads on an Indian reservation under contract with the Bureau of Indian Affairs.

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.

• LEGAL ACTIVITIES OF COMMISSION •

Formal Court Appearances

During the mid-fiscal year, the Commission filed in the California Court of Appeals an *amicus curiae* brief in support of the California Franchise Tax Board in *Hoechst-Celanese Corporation v. Franchise Tax Board*. This case, like the one described below, involves the appropriateness of including the proceeds of a pension reversion in the State's apportionable tax base, rather than allocating the income to the taxpayer's corporate domicile. The lower court determined that pension reversion income constitutes business income under the functional test for determining business income, and that apportionment was therefore appropriate.

At the end of this fiscal year we filed an *amicus curiae* brief in support of the State of North Carolina's attempt to include funds obtained through a pension reversion within the State's apportionable tax base (*Union Carbide Corporation v. Offerman*). This case, also challenging the inclusion of income derived from a pension reversion as apportionable business income is still pending before the North Carolina Supreme Court.

The Commission also filed an *amicus curiae* brief in support of the State of Oregon in *Sherwin-Williams Company v. Oregon Department of Revenue*. The Oregon Tax Court determined that the return of principal on working capital should have been included in the denominator of the sales factor when determining the taxpayer's apportionable income.

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 multi-jurisdictional commerce, is in electronic commerce. The Legal Division staff have actively participated in the NTA Communications and Electronic Commerce Tax 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 Uniformity Liaison Public Participation Working Group on Unitary Business (principally staffed by MTC Special Counsel). The Liaison Group is an outgrowth of the PPWG process. During the fiscal year, the Liaison Group held numerous teleconferences with government and business participation during which participants examined the three extant methods of determining a unitary business, i.e., the dependency/ contribution test, the three-unities test, and the so-called *Mobil factors* test. This process is still extant, and much discussion is expected during this meeting and in the coming months.

The Legal Division continues to work with the wireless telecommunications industry group in attempting to develop an approach to transactional taxation of telecommunications that is not geared to a fixed base of operations. 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 responsibility. Legislation that has been monitored with some activity to preserve federalism during the past year includes electricity deregulation, bankruptcy reform, and federal tax restructuring.

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 expect for any organization, *e.g.*, leases, contracts, and personnel matters.

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 multi-jurisdictional commerce. Recent issues include apportionability of litigation awards, 11th 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 of the Nexus Committee and Nexus Program

Multistate Tax Commission

July 1999

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, 1998 through June 30, 1999.

Voluntary Disclosures

The National Nexus Program opened twenty-two new voluntary disclosure cases between August 1, 1998 and June 28, 1999. These cases represent 214 separate contracts worth an estimated \$6,154,075 in back taxes and \$2,342,762 in future multistate collections. As of this date, the Nexus Program is transferring the voluntary disclosure database from Improv to Access. The Voluntary Disclosure Program was recently commended at a CCH State Tax Roundtable.

Voluntary Disclosure Marketing

The voluntary disclosure program remains popular among tax professionals. A number of tax professionals have brought repeat clients through the program. NNP staff continues to work to seize opportunities to market the voluntary disclosure program to tax professionals and potential taxpayers. Staff periodically distributes promotional material without charge at professional conferences of tax professionals.

NNP staff speaks frequently at professional gatherings about the voluntary disclosure program. During the past year, staff has addressed the following organizations:

- New York CPA Society;
- Cornell Tax Roundtable;
- Federation of Tax Administrators Compliance Workshop;
- SEATA Annual Conference;
- Direct Sellers Association;
- Maryland State Bar, State Tax Section;
- University of Virginia Tax Roundtable;
- University of Richmond State and Local Tax Institute; and
- Virginia Bar Association Tax Practitioners' Roundtable.

The Maryland State Bar Association has published the NNP Voluntary Disclosure brochure on its website, at <http://www.msba.org/Sectionscommittees/Taxation/voluntarydisclosures.htm>. Staff hopes to persuade other bar associations and accounting organizations to do the same. Staff is also

exploring the possibility of supplying state revenue departments with a link to the brochure on the MTC's website.

Nexus Research Reports

During the past year, NNP staff initiated 152 nexus research reports, the results of which are being made available to the states for cross-referencing with their registration records.

Nexus School

During the past year, staff conducted nexus schools in Boston, Massachusetts, Boise, Idaho, Birmingham, Alabama, and St. Louis, Missouri. Upcoming schools will be held in Portland, Maine, Atlanta, Georgia, and Albuquerque, New Mexico.

SUT Uniform Registration

An effort to establish a uniform, multistate Sales and Use Tax Registration Form, for the convenience of business and the states began in February. An initial evaluation of the current registration procedures of each of the states was conducted, in which a questionnaire was sent to the states requesting them to verify the information gathered by NNP staff and to provide additional details of their registration process. The survey was sent to all member states (including those that do not have a sales tax) on April 1st, with a requested response date of May 15th. Twenty-eight states have responded to date. Those responses will be analyzed and the result will be distributed back to the states for comment. In particular, staff will be looking for elements of the registration process that are common to many states.

Access Databases

As part of an effort to automate data entry and analysis in the nexus program, staff is working on three database projects, each in Microsoft Access. In February, staff began a database for the SUT Uniform Registration Project. Secondly, in April, staff created a database for Nexus Research Reports, which currently contains data on the companies that have been investigated in the past year. Eventually prior year data will be added. Finally, staff has created a new database for the Voluntary Disclosure program and moved existing data into the new database. All of these databases are in continued development.

Nexus List Serve

The NNP List Serve is published monthly, on topics of interest to nexus researchers in the states. There are currently 33 subscribers to the list. Interested nexus researchers should contact Susan Ribe at sribe@mtc.gov.

Clearinghouse Database

On July 7, 1999, TRW began work on correcting the problems the NNP has had with the Clearinghouse Database. The project should be completed in 12-to-14 weeks, after which the NNP will shortly resume providing reports to the member states.

“Nexus Update”

Staff recently published an issue of the *Nexus Update*, which provides the member states with brief descriptions of recent nexus cases, legislation, regulations, rulings, and other pertinent nexus developments during the previous year.

Report of the Audit Committee and Audit Program

Multistate Tax Commission

July 1999

Kim C. Ferrell, 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 1998-99 fiscal year.

• AUDIT COMMITTEE •

The MTC Audit Committee met three times during the fiscal year. During the Annual Meeting, the Audit Committee selected 10 income tax audits and 11 sales tax audits for the MTC Audit Program's inventory.

During the November 1998 meeting, representatives from PDI made a presentation about the computer-assisted audit training they provide. This is a 15-week course held in Texas. Several states have sent auditors to the course during the last year and several additional states expressed an interest in sending auditors to future courses.

During the March 1999 meeting, the Audit Committee members attended one of two all-day discussions. One group heard presentations from five different states regarding their automation efforts in sales tax auditing; the other group spent the day in discussions regarding nexus activities in the states. The Audit Committee also approved a revised waiver form to be used by the MTC Audit program.

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 as well.

• AUDIT PROGRAM •

Productivity

The Audit Staff completed 6 complete and 2 partial income tax audits and 16 sales tax audits during this fiscal year. One of the sales tax audits completed was a nexus audit referred from the Nexus Program. There are currently 24 sales tax audits and 20 income tax audits in progress. The staff is projecting that 16 sales tax audits and 12 income tax audits will be completed during the 1999-00 fiscal year.

Staffing

The 1998-99 fiscal year proved to be a year of significant turnover in the MTC Audit Division. Several auditors resigned from the Commission to accept positions with other state tax agencies and with the private sector. The Commission has successfully recruited for four of these positions, however one position remains vacant. Interviews for this vacancy are expected to be conducted in August.

Automation

The Audit Division is pursuing electronic records in every sales tax 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 and although there are still problems that arise, we believe substantial progress has been made in this area.

Harold Jennings and Sam Moon completed the 15-week training program in computer-assisted auditing sponsored by the University of North Texas. Sixteen state auditors also completed this training, which will be used to reorganize the sales tax portion of the MTC Audit Program. Harold Jennings met with Joe Randall, Forrest Bush, and Tom Atchley on October 29, 1998, and discussed possible training needs and other potential uses of this training. The MTC Audit Director distributed a survey asking the states what audit and training needs they may have. A discussion was held during the MTC Audit Committee Meeting on March 18, 1999.

The MTC staff is preparing a plan to offer computer-assisted auditing services to the states. A report will be given during the Audit Committee Meeting in July, with a recommendation to the Executive Committee to follow.

Training

The Director of Audit participated in four nexus training seminars this year. Harold Jennings, Sales Tax Field Audit Supervisor, has begun to develop training programs for sampling in the sales tax area.

• **PILOT REGIONAL AUDIT PROJECT** •

The four states in this program met on October 29, 1998, and on November 17, 1998, wherein the results of the first four completed audits were discussed. The states selected eight additional audits that will be conducted by the states. A supplemental training session for the state auditors who will conduct these audits was given in April 1999, in Helena, Montana. The states are scheduling the audits to begin this fall.

Audit Hour Analysis

Last Four Quarters

AUDIT TYPE	MONTH/QUARTER				TOTAL
	9/98	12/98	3/99	6/99	
INCOME TAX					
Total Audits	0	1	0.5	5.5	7
Total States Audited	0	21	50	115	186
Total Hours	0	1,420	1,300	7,340	10,060
Average Hours Per State	0	68	26	63	55
SALES TAX					
Sales Tax Total Audits	0	3	3	10	16
Total States Audited	1	47	33	103	184
Total Hours	40	1,167	1,114	5,117	7,438
Average Hours Per State	40	25	34	50	40
TOTAL BOTH TAXES					
Total Audits	0	4	3.5	15.5	23
Total States Audited	1	68	83	218	370
Total Hours	40	2,587	2,414	12,457	17,498
Average Hours Per State	40	38	29	58	48

Trends in Productivity

MTC Joint Audit Program

Audit Hour Analysis 6/89 - 6/99

AUDIT TYPE	6/89	6/90	6/91	6/92	6/93	6/94	6/95	6/96	6/97	6/98	6/99
Income Tax											
Total Audits	12	4	9	7	12	9	9	9	10	9	7
Total States Audited	112	37	95	75	132	93	99	111	152	120	186
Total Hours	20,679	7,211	12,646	11,148	11,208	9,016	9,284	7,548	12,249	10,012	10,060
Average Hours Per State	184	195	133	148	85	97	94	68	81	83	55
Sales Tax											
Total Audits	9	9	8	9	14	13	15	13	14	10	16
Total States Audited	85	88	79	104	146	140	152	123	143	97	184
Total Hours	12,393	8,866	7,069	12,209	14,323	6,818	8,009	9,746	11,349	7,721	7,438
Average Hours Per State	146	101	89	117	98	49	53	79	79	80	40
Total Both Taxes											
Total Audits	21	13	17	16	26	22	24	22	24	19	23
Total States Audited	197	125	174	179	278	233	251	234	295	217	370
Total Hours	33,072	16,077	19,715	23,357	25,531	15,834	17,293	17,294	23,598	17,733	17,498
Average Hours Per State	168	129	113	130	92	68	69	74	80	82	48

**COMPACT MEMBER STATES
REPRESENTATIVES
FY 1998-99**

STATE	REPRESENTATIVES
Alabama	James P. Hayes, Jr., Commissioner <i>Alternate: George E. Mingledorff III, Asst. Commissioner</i>
Alaska	Wilson L. Condon, Commissioner <i>Alternate: Larry E. Meyers, Director</i> <i>Alternate: Deborah Vogt, Deputy Commissioner</i>
Arkansas	Timothy J. Leathers, Acting Director <i>Alternate: John H. Theis, Asst. Commissioner of Revenue</i>
California, FTB	Gerald H. Goldberg, Executive Officer <i>Alternate: E. Les Sorensen, Jr., Executive Director</i>
California, SBE	E. Les Sorensen, Jr., Executive Director
Colorado	Fred Fisher, Executive Director <i>Alternate: John Martin Vecchiarelli, Director</i>
District of Columbia	Natwar M. Gandhi, Deputy Chief Financial Officer <i>Alternate: Stephen P.B. Kranz, Chief Counsel</i>
Hawaii	Ray K. Kamikawa, Director of Taxation <i>Alternate: Grant Tanimoto, Rules Officer</i>
Idaho	R. Michael Southcombe, Chairman <i>Alternate: Phil Aldape, Division Administrator</i>
Kansas	Karla Pierce, Secretary of Revenue <i>Alternate: Shirley Klenda Sicilian, Director</i>
Maine	Anthony J. Neves, Executive Director <i>Alternate: Errol E. Dearborn, Director</i>
Michigan	Mark Murray, State Treasurer <i>Alternate: Bernard D. Copping, Commissioner of Revenue</i>
Minnesota	Matthew Smith, Commissioner <i>Alternate: Jack Mansun, Assistant to the Commissioner</i>

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FY 1998-99**

STATE	REPRESENTATIVES
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Montana	Mary Bryson, Director <i>Alternate: Don Hoffman, Process Lead</i>
New Mexico	John J. Chavez, Cabinet Secretary <i>Alternate: R. Cameron Hull, Deputy Director</i>
North Dakota	Rick Clayburgh, State Tax Commissioner <i>Alternate: Robert W. Wirtz, Chief Legal Counsel</i>
Oregon	Elizabeth Harchenko, Director <i>Alternate: John C. Scott, Administrator</i> <i>Alternate: Stan McClain</i>
South Dakota	Gary R. Viken, Secretary <i>Alternate: Kelly Thompson, Special Projects Director</i>
Texas	Carole Keeton Rylander, Comptroller
Utah	Richard B. McKeown, Chairman <i>Alternate: Joe B. Pacheco, Commissioner</i> <i>Alternate: Rodney G. Marrelli, Executive Director</i>
Washington	Frederick C. Kiga, Director <i>Alternate: William N. Rice, Deputy Director</i>

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Connecticut	Gene Gavin, Commissioner <i>Alternate: Richard D. Nicholson, General Counsel</i>
Georgia	T. Jerry Jackson, Commissioner
Illinois	Glen L. Bower, Director <i>Alternate: William T. Lundeen, Chief Counsel</i>
Kentucky	Sarah Jane (Susie) Schaaf, Secretary <i>Alternate: Jennifer C. Hays, Director</i>
Louisiana	Brett Crawford, Secretary <i>Alternate: Mr. Alva C. Smith, Asst. Secretary, Group</i>
Maryland	William Donald Schaefer <i>Alternate: Stephen M. Cordi, Deputy Comptroller</i>
Massachusetts	Frederick A. Laskey, Commissioner
Mississippi	Ed Buelow, Jr., Chairman and Commissioner
New Hampshire	Stanley R. Arnold, Commissioner <i>Alternate: Maurice P. Gilbert, Director of Audit</i>
New Jersey	Robert K. Thompson, Director <i>Alternate: Richard W. Schrader, Asst. Director</i>
North Carolina	Muriel K. Offerman, Secretary of Revenue <i>Alternate: Sabra J. Faires, Asst. Secretary</i>
Ohio	Thomas M. Zaino, Commissioner <i>Alternate: Tom Ruebel, Administrator</i> <i>Alternate: James J. Lawrence</i>
Oklahoma	Robert E. Anderson, Chairman <i>Alternate: Larry Shropshire, Administrator</i>
Pennsylvania	Robert A. Judge Sr., Secretary of Revenue <i>Alternate: Larry P. Williams, Deputy Secretary for Taxation</i>
South Carolina	Elizabeth Carpentier, Director

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FY 1998-99**

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Tennessee	Ruth E. Johnson, Commissioner <i>Alternate: Michael L. Cole, Deputy Commissioner</i>
West Virginia	Joseph M. Palmer, State Tax Commissioner <i>Alternate: Dale W. Steager, General Counsel</i>
Wisconsin	Cate Zeuske, Secretary of Revenue <i>Alternate: Kathleen D. Heuer, Deputy Secretary</i>

**PROJECT MEMBER STATES
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