To: MTC Strategic Planning Steering Committee
From: Elizabeth Harchenko
Date: April 5, 2012
Re: Summary of Compliance Work Team Meeting

Background

The Compliance Work Team met by teleconference on March 26. The discussion was lively and detailed. The summary provided in this memo touches the highlights only – the group covered a LOT of ground. Also, the MTC Audit Committee has done a bit of planning since the environmental scan meetings in July. The Audit Committee approved a set of recommendations in October 2011. I have folded those recommendations into this report as additional project opportunities to be considered for further planning work.

Steering Committee Action Needed

At your next meeting, on April 18, we will discuss this information and I will ask you to decide on one or two project ideas to send back to the Compliance team so that they can develop specific measures, identify how to develop the baseline data, and to flesh out the project plan. There is a lot of material here, and I hope that you will have time to consider it, and perhaps discuss it with your own agency compliance staff before our next teleconference.

Compliance Goal - Our goal is to develop strategies to **effectively** address new compliance challenges. Achievement of the MTC's compliance goals will be reflected by:

- Greater voluntary compliance by taxpayers with state and local tax laws.
- Earlier identification of compliance challenges by the states and MTC staff.
- Prompt development of strategies to address new compliance challenges by the states and MTC staff.

[**Note**: I recommend that you add the word "effectively" to the goal as indicated in red above.]

Summary of Compliance Team Discussion

Preliminary discussion touched on a number of concerns:

- Compliance is affected by the effectiveness of state audit work as well as MTC work
- Compliance is affected by taxpayer attitude and behavior
- "Gray areas" will continue to evolve. "Gray areas" include:
    o Issues where the states' rules are unclear or inconsistent
    o Issues where the law is not fully developed or is changing
    o Issues where the law and facts are complex
    o Issues that arise from new business practices or models
    o Issues where there is substantial disagreement between states and taxpayers on the legal standard to be applied, or how a particular standard applies to a given set of facts
- Training and skill development for both MTC and State auditors is critical
- Information exchange and communication need improvement
- Taxpayer education is needed for some issues: nexus standards, NOL rules
- Tension between Voluntary Disclosure program and enforcement work
- State engagement in the audit and nexus programs affects the strength of both

I asked the team to identify any other high level outcomes that would indicate that we are moving in the right direction on this goal. No additional high level outcomes were identified.

We moved to a discussion of possible measures of effectiveness in achieving our goal.
The examples I gave the team were:
- total days to complete an audit;
- hours per state spent on audits;
- Number of taxpayers using voluntary compliance services.

Other possible measures identified by the Compliance team were:
- Percent of audits with repeat findings on the same issues in later years (whether conducted by the states or by the MTC)
- Increase in penetration of the nexus program in the taxpayer community (number of taxpayers participating each year)
- Continuing filing compliance by taxpayers who voluntarily disclosed through MTC
- Assessment dollars
- numbers of audits performed
- numbers of returns filed
- number of states participating in each audit
- Reduce the time from identification of an issue, development of a solution, and implementing the solution
- Number of material issues per audit (fewer would indicate greater compliance)
- Number of new audit candidates identified by the states

Finally, we talked about possible strategies for achieving the goal. In your planning work, you had identified the following possible strategies for the compliance goal:
- Review and evaluate effectiveness of voluntary compliance programs and enforcement programs in order to strengthen these programs.
- Identify potential synergies of compliance strategies.
- Promote voluntary compliance programs differently and to a broader audience.
- Consider deeper research and analysis of enforcement program results (quantitative and qualitative) to enhance our use of what we learn.
- Consider how technology can help enhance effectiveness and efficiency of compliance programs.
- Evaluate communication practices for opportunities to better support compliance programs.
- Evaluate training and education programs.

In addition to the strategies identified by the Steering Committee, the Compliance team suggested:

- Technology: make electronic work papers and back up documents available to the states and to auditors; improve the secure e-mail system (Also recommended by Audit Committee)
- Create an electronic case management system to monitor audit status (Audit Committee)
- Communication – increase frequency and quantity of information sharing between the states and MTC staff during audits

- Allow MTC staff to develop a trouble shooting role, rather than being a "go between" for states and taxpayers.
- Develop a uniform form for taxpayer disclosure of ATATs for state specific issues.
- Develop training on issues that are new to states that have just changed their laws to move to combined reporting (example – tax havens).
- Look for synergies between audit/nexus programs.
- When taxpayers file voluntary disclosures – identify industry issues for audit program.
- Find more ways to engage non-active states in compliance programs.
- Continue to look for the best balance between seeking engagement and trust from industry and getting things done
- Revise standards for audit selection to include input from audit staff; assessment of cost/benefit and materiality of potential adjustments for all potentially participating states; standards for audits in which MTC auditor should do second cycle. (Also recommended by Audit Committee)
- Prepare audit manuals for complex and emerging audit issues, such as bank/brokerage, entertainment industry, net operating losses, interest on U.S. obligations.
- Consider providing a manual to taxpayers for added guidance, for example how to handle NOLs correctly.
- Develop audit procedures checklist to share with taxpayers at the beginning of an audit (Audit Committee)
- Reorganize and increase information in the audit package reported back to the states
- Develop feedback mechanisms for states to apply lessons learned from audits as they develop regulations and audit standards and procedures.
- Training: MTC offer specialized training on complex industry groups such as banks and brokerage or entertainment industry.
- Identify skill sets and knowledge base needed to replace MTC and state auditors a they retire.
- Continue to assist states in improving the effectiveness of their own audit programs