

Multistate Tax Commission

Report of Activities

(Preliminary Version)

for the

Year Ending June 30, 1995



*States Working Together Since 1967...
To Protect Federalism and Tax Fairness*

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Executive Director's Report for the Year Ending June 30, 1995

States created the Commission to help preserve federalism and promote tax fairness. With respect to these purposes, States confront an exciting period of change and challenge. Driven by information technology, local and global economies are being linked in complex ways across traditional political boundaries. International trade agreements and the deregulation of industries are extending the reach of market competition. Business organizations and relationships are being transformed from traditional hierarchies to networks of "virtual enterprises" responding flexibly to market conditions. Capital investment—and jobs—are becoming more mobile, and global job competition is restraining and even reducing the value of wages in real terms. Consequently, global market competition translates at the State and local level into competition for jobs. That competition, in turn, increasingly affects the political environment in which State and local tax policy is made. The political environment creates significant challenges for efforts to update the structure and bases of State taxes to keep pace with the nature of the modern economy.

Meanwhile, the balance of responsibilities and authority within the federal system is shifting—and not necessarily in a consistent manner. A broad consensus is developing between Congress and State officials to transfer increasing responsibility for domestic programs and expenditures from the federal government to the States. However, except for critical efforts being made by the Commission and partner State organizations, no similar, comprehensive attention is being given to whether or not States will possess sufficient authority and capacity to finance the responsibilities being transferred.

Federal limits on the jurisdiction of States to tax remain rooted in 19th century business conditions and are becoming increasingly outmoded every day. Although moderated significantly by protections for States secured by the Commission and its partners, international trade agreements that extend market competition also create a new forum and set of standards that can potentially limit State taxing authority. The federal government continues to undermine State tax bases through its failed methods of accounting for international income. The penchant for Congress to preempt State and local taxes selectively for purposes of granting special interest tax breaks remains strong. An historic debate is now emerging over the shape of the federal tax system, and while the proposals will affect State and local taxes significantly, that impact is largely being ignored by national policy makers at this stage. Although there are some countervailing trends—such as the U.S. Supreme Court's support for the unitary business principle and for applying the structure of traditional sales taxes to services—it is hard to escape the conclusion that State taxing authority is in danger of falling behind the governmental responsibilities being shifted to States and localities.

So these are exciting and even critical times for State and local tax policy, and the Member States of the Multistate Tax Commission have used the Commission as a vital means of addressing the key challenges they face in taxing a proper share of national and global commerce. States are increasing their participation in the Commission, and the Commission is being recognized in national and even international forums as a leading voice for preserving federalism and promoting tax fairness. Organizations representing taxpayers have chosen to forge new working relationships with the Commission. The Commission has strengthened its uniform policy development work, and it continues to maintain compliance programs that offer both States and taxpayers the benefits of efficient and consistent tax administration.

Growing State Participation in the Commission

From 1988 through 1995, the number of States (including the District of Columbia) participating in the Commission has increased from thirty to forty. In 1994-95, North Carolina became the fifteenth Associate Member of the Commission. Kentucky joined the MTC Joint Audit Program this year, bringing to twenty the total number of States now participating in the Audit Program. Also this year, seven States have committed to participating in the new Joint Property Tax Auditing Program developed with the Western States Association of Tax Administrators and coordinated through the Commission. Montana, Oregon, Idaho and Utah also are working through the Commission to develop a regional cooperative auditing project for business taxes.

Expanding Relationships with Taxpayer Organizations

Both the Tax Executives Institute (TEI) and the Committee on State Taxation (COST) decided in the course of this year to develop formal liaison relationships with the Commission. TEI met with the MTC Executive Committee in April, 1995, and COST is similarly scheduled to meet in July. During the course of the year, a COST subcommittee provided advice to the Commission on the development of new alternative dispute resolution services. The movement toward working relationships with these two taxpayer organizations is a welcome development that should enhance mutual understanding between the multistate taxpayer community, the Commission and the States.

Preserving Federalism

The Commission played a leadership role over the last two years in securing protections for federalism in the context of the new Uruguay Round Trade Agreements. Of all recent efforts of the Commission, this undertaking may be among those with the most significant long-term impact on the preservation of federalism. In July, 1994, the

Commission, joined by other State organizations, concluded an agreement with the U.S. Trade Representative's Office on the federalism protections to be included in the implementing legislation for the Uruguay Round Agreements. These protections included a prohibition against World Trade Organization (WTO) rulings involving State and local being brought into U.S. courts through private actions. They also included assurances that the federal government would involve States in defending against any challenges of State and local laws in the WTO, as well as guarantees that States would receive information about such challenges. Further, the provisions require the federal officials to notify Congress before bringing suit against States for not implementing WTO standards or rulings. Beyond the implementing legislation, these provisions were accompanied by "reservations" from the General Agreement on Trade in Services (GATS) that substantially exclude a broad range of State and local tax issues from consideration through WTO disputes.

The Commission and the States could not have succeeded in this effort without the active leadership on this issue of North Dakota Senator Kent Conrad, and the support of its partners in the effort, the Federation of Tax Administrators, the National Association of Attorneys General and the National Conference of State Legislatures.

Federal legislation revising the regulation of the interstate banking industry and the telecommunications industry demanded considerable Commission attention during the year. Congress enacted interstate banking legislation that included the Commission's recommendations to prevent the bill from indirectly preempting State taxation. Still pending and unresolved at year end was the fate of a similar provision sought in major telecommunications regulatory legislation.

Full Accountability of Income in Relation to Where It Is Earned

The Commission approved in November, 1994, one of its most significant income apportionment proposals in its history: the apportionment of income from financial institutions. The Uniform Division of Income for Tax Purposes Act (UDITPA) specifically excludes from its scope the financial institutions. However, the advent of interstate banking required that income apportionment be extended to this industry. The Commission's project was noteworthy as well because it was undertaken with broad involvement of the industry.

In the arena of global income taxation, the year began just after the Supreme Court's ruling in the *Barclays* confirming the constitutionality of worldwide combined reporting applied to a unitary, foreign based multinational. That State victory capped over two decades of effort by the States and the Commission supporting the concept of worldwide combined reporting as the appropriate method of dividing the income of an integrated, global enterprise. The Commission continues to support that concept by encouraging the federal government to substitute formula apportionment for the failed

"arms length" method of adjusting transfer prices within integrated companies. In December, 1994, the Commission assisted North Dakota Sen. Byron Dorgan (a former Chair of the Commission) in conducting a seminar comprehensively reviewing the state of economic research relative to international division of income issues. In May, 1994, the Commission also participated with Sen. Dorgan and Nevada Sen. Harry Reid in a press conference highlighting the extent of the international transfer pricing problem.

Advancing Modern Principles of Nexus

Updating nexus standards to reflect the modern, technologically-driven economy has been a continuing emphasis of the Commission over several years. One component of these efforts has been to develop uniform policies interpreting current federal and constitutional law on the jurisdiction of States to tax out of state businesses. The purpose of these of policies is provide clear guidance to tax officials, taxpayers, appeals board and courts on this key component of tax practice. The Commission approved in July, 1994, an updated version of P.L. 86-272 guidelines for determining corporate income tax nexus. It also continued work, through the Uniformity Committee, on a guideline interpreting the constitutional standards of nexus for sales and use tax purposes.

In terms of evolving case on the subject, the Commission filed an amicus brief in two important court cases arising in New York—the *Orvis* and *Vermont Information Processing* cases. The New York Court of Appeals adopted the Commission's basic interpretation of the *National Bellas Hess* and *Quill* standards for sales and use tax nexus.

The Commission's National Nexus Program, with support from the Joint Audit Program, continues to encourage compliance by the multistate businesses with nexus requirements. The program has, over its five years, secured compliance that will generate \$70 for every dollar invested in the program. Taxpayers benefit, as well, because the program offers an efficient means for them to resolve nexus issues with several States at one time.

Improving Tax Administration

The Joint Audit Program continues set high standards for efficiency in auditing. The program now completes audits using only 70 staff hours per audit per State—less than half the hours required just six years ago. The Audit Program is also cost-effective, consistently producing between \$12 and \$13 for each dollar supporting the program, and with \$7 to \$8 more in pending assessments to be resolved.

The Commission is expanding its services to States through a new alternative dispute mediation process for multistate tax disputes. In addition, it also expanding training services to the States.

The Commission itself continues to be financially sound and prepared to assist States in meeting the challenges of contemporary multistate tax administration.

Further details on the Commission's work this past year are provided in the remainder of this report. Prior to considering those details, a few words on the challenges ahead for the States are in order.

Articulating a Vision of Multistate Taxation

The changes in the nature of the economy and in federal tax and expenditure policies are creating a need for a clear vision of State tax policy. States can make a choice between formulating tax policies based on the trends and pressures of the moment or on constant principles for sound tax policies. The temptation to respond to short-term events can lead the States into an uncertain fiscal future, because the pace and unpredictability of change can leave States with tax policies choices based on circumstances and assumptions that no longer exist and that can afoul of constitutional standards. In particular, tax policies based on a short-term pursuit of jobs or incentives for favored, in-state industries can cumulatively result in tax policies that generate, on a national basis, less than full accountability of income and transactions. Further, the U.S. Supreme Court has viewed with some skepticism tax policies designed by States to favor their in-state economic activity over interstate activity.

The alternative course is to fashion tax policies that provide a solid foundation for a free market economy. Such policies attempt to create a level playing field for market competition by providing as much as possible for equal treatment of similarly situated taxpayers or transactions. In a multistate tax context, creating a level playing field between multistate and in-state taxpayers requires as much interstate uniformity or consistency as possible in the rules for dividing and allocating taxable values and determining nexus. Further, consistency in major features of tax bases also contributes to a level playing field by, on the one hand, reducing unnecessary administrative costs for interstate taxpayers or, on the other hand, providing interstate taxpayers with opportunities to less than fully account for income and transactions. Uniformity is a key to promoting tax fairness.

This approach of fostering uniformity in the features of taxes affecting multistate taxpayers also has the benefit of strengthening States in relation to the federal government. Uniformity in multistate taxation creates strength in numbers because States then have a community of interest in defending their tax policies against unjustified limitations. Uniformity also commands, through clarity and consistency, greater respect from the federal government than an inconsistent set of State tax

policies. Finally, uniformity can substantively resolves complaints by industries of excessive administrative costs or duplicative tax burdens. So uniformity is also a means to preserving federalism.

The case for greater uniformity in multistate tax practices is more sophisticated and more difficult to communicate than policies that speak to the fashions of the moment. Yet that case needs to be made. The greatest challenge to the Commission and its Member States may well be to find its voice—to articulate forcefully the case for long-term and durable tax policies embodying greater uniformity in State tax practices and providing a sound foundation for free market competition.

A Description of Current Activities to Pursue Commission Goals

Goal A: Improving State Tax Policy and Administration Affecting National and Global Commerce.

Uniformity Activities

The Uniformity Committee, through the work of its two subcommittees, the Income and Franchise Tax Subcommittee and the Sales and Use Tax Subcommittee, seeks to develop uniform statutes and regulations that will improve the administration and policy development of state taxation in the context of interstate and international commerce. In furtherance of this Goal, the Income and Franchise Tax Subcommittee has completed within the past year a proposed amendment of the existing MTC apportionment and allocation regulations that define business/nonbusiness income and is currently drafting a uniform definition of a unitary business. The Sales and Use Tax Subcommittee is developing a uniform nexus guideline for sales and use taxation and a specimen uniform transactional tax for selective electronic services.

Business Income Regulation. The Uniformity Committee has approved, and the Executive Committee has referred to public hearing, a proposed revision of the MTC's existing regulation on the classification of apportionable, or business, income in light of the United States Supreme Court's decision in *Allied-Signal*.¹ Adoption of the proposed business income regulation offers the prospect of establishing a universal and better understood concept of business income principles, including clarification of the functional and transactional tests that exist in UDITPA's definition of business income. The proposal emphasizes that the business income concept is neutral in operation and that uniform approach in classifying apportionable income is central to allowing States to tax income that is derived from the conduct of the unitary business in the context of multijurisdictional commerce.

Unitary Business Definition. The Income and Franchise Tax Subcommittee continues its efforts to develop a final draft of the Unitary Business definition. In its current working form, the proposal adopts the three tests accepted in various cases by the United States Supreme Court: the contribution/dependency test; the three unities test, and the three-factor (centralization of management, functional integration and economies of scale)

test. A uniform unitary business definition will provide much needed guidance to both taxpayers and the courts in determining under what circumstances the application of formulary apportionment is appropriate.

Revision of UDITPA. Several members have suggested consideration of possible adoption of changes in certain provisions of the Multistate Tax Compact and its incorporation of UDITPA to resolve nagging issues that cannot be adequately addressed through state rule-making. Changes involving the Compact or UDITPA necessarily implicate state legislatures and that reality has prompted an investigation of the implications of possibly seeking amendment of the Compact or UDITPA.

Sales and Use Tax Projects. The Sales and Use Tax Nexus Guideline project seeks to establish principles and rules that will be mutually beneficial to affected industry and state tax administrators in light of the United States Supreme Court's decision in *Quill*. As States have worked with the bright line safe harbor of *Quill*, it has become more and more apparent that States must develop clear and understandable sales and use tax nexus standards that will minimize the incidence of post-transactional assessments. Similarly, development of a specimen uniform state law to deal with state transactional taxation of selective electronic services will well advise state tax administrators and industry of matters that need to be factored into possible state taxation of a developing segment of the economy that is becoming increasingly important.

Policy Research Activities

The MTC Research staff has published a complete, up-to-date compilation of all MTC uniformity recommendations, including writings on the importance of uniformity to preserving federalism and tax fairness. MTC staff has responded to numerous taxpayer and tax agency requests for information regarding current Commission activities, with particular interest during FY95 being shown several Commission efforts. The "Phase II" PL 86-272 Statement of Information, the "substantial nexus/minimum contacts nexus guideline" and the financial institutions apportionment proposal were of widespread interest to the business community and other states.

Audit Activities

The Audit Director has supported Goal A by serving as a member of the FTA/MTC/Industry EDI Task Force. The Task Force created several working

groups on which the Audit Director, the Chicago Field Audit Supervisor and one sales tax auditor serve.

Goal B: Advancing Modern Principles Of Nexus

Uniformity Activities

The advancement of both computer technology and telecommunications has given rise to a new way of doing business. Recognizing that companies no longer need actual physical presence in a State in order to do business, the Sales and Use Tax Subcommittee is attempting to develop a uniform sales and use tax nexus guideline that reflects this modern business approach. First publicly revealed during the MTC's November 1994 Dialogue Day, the current draft of the proposed Sales and Use Tax Nexus Guideline has generated a substantial amount public reaction. The possibility that nexus in a State may be established through telephone lines and computer connections seems to have concerned businesses that currently take profitable advantage of these new modes of doing business without taking on any of the burdens of collecting sales and use tax due on their goods sold to in-state customers. The effort to develop the guideline already has been aided by the courts in cases such as the United States Supreme Court's decision in *Jefferson Lines*, South Carolina's *Geoffrey* decision and the most recent New York high court's *Orvis* and *Vermont Information* decision. Modern principles of nexus reflect modern principles of conducting business.

On the income tax side, more States have adopted the MTC's Statement on P.L. 86-272, increasing uniformity among the States in determining federal statutory nexus for corporate income tax purposes.

Policy Research Activities

In July, 1994, the MTC circulated the "Phase II" "Statement of Information of Multistate Tax Commission and Signatory States Under Public Law 86-272" to corporate income tax states and invited adoption. MTC staff has prepared and now maintains an up-to-date memorandum detailing which states have adopted the "Phase II" Statement and has distributed it to numerous private tax practitioners and tax publications. A follow-up survey of states that have adopted earlier versions of the guideline was conducted to determine their intentions with regard to adoption of "Phase II." An issue of the MULTISTATE TAX COMMISSION REVIEW was published which contained the Phase II P.L. 86-272 Statement of Information and an article by former National Nexus Program

Director Alice Davis entitled "How Much Is Too Little? Defining *De Minimis* Substantial Nexus."

The Policy Research staff has prepared a written submission for the record before a subcommittee of U.S. House of Representatives' Small Business Committee regarding the mail order use tax issue. In addition, it prepared the Commission's submission to the Chair of the Federal Trade Commission supporting the efforts of Senator Bumpers and other Senators to have the FTC investigate whether direct marketers' non-disclosure of consumers' use tax obligations constitutes a misleading advertising practice. Research was conducted on the FTC policy on misleading advertising practices and the potential use of current FTC rulemaking on deceptive telephone marketing as a vehicle for mandatory use tax disclosure.

Nexus Activities

The Multistate Tax Commission filed *Amicus Curiae* briefs of with the New York State Court of Appeals (New York's highest court) in *Vermont Information Processing, Inc. v. Commissioner*, DOL No. 93162808 and *Orvis Co., Inc. v. Commissioner*, DOL No. 93162532. In each of these cases the principal question facing the Court was whether a limited number of in-state visits by a mail order retailer's representative creates "substantial nexus" under the Commerce Clause warranting the imposition of use tax collection responsibilities.

In June, the New York State Court of Appeals issued an opinion consistent with the MTC's amicus briefs, that in-state visits of an out-of-state vendor's representatives creates substantial nexus under the Commerce Clause. In so holding, the Court unanimously overruled the lower court's holding that *Quill* increased the amount of in-state physical presence required to create nexus to "substantial physical presence." The lower court had held that 12 visits by Orvis employees to Orvis customers and 30 to 40 visits by Vermont employees over a three-year audit period did not satisfy the "substantial nexus" requirement of the Commerce Clause under *Quill*.

The Court held that the lower court's "substantial physical presence" test would destroy the bright line rule preserved by the U.S. Supreme Court in *Quill*. Such a standard would "require a 'case-by case evaluation of the actual burden imposed on the individual vendor involving a weighing of factors such as

number of local visits, size of local sales offices, intensity of direct solicitation, etc." Presumably any other nexus test requiring a weighing of these factors will similarly be struck down by the New York Court of Appeals as violative of the *Quill* bright line rule. The Court found that a facts and circumstances based test undermines the principal justification for the *Quill* decision -- "the need to provide certainty in the application of the standard." The Court, citing *National Geographic Soc'y v. California Bd. of Equalization*, 430 U.S. 551 (1977), ruled that the in-state physical presence of a vendor "must be demonstrably more than a slightest presence." Such presence may be manifested by "the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf."

MTC staff views the *Orvis* and *Vermont Information* decision as consistent with the MTC's *amicus* brief and a positive step towards the development of clear, fair nexus standards.

The MTC's National Nexus Program works to increase compliance by multistate businesses with state tax registration and filing laws; establish national cooperation on nexus projects and activities; promote fair, consistent enforcement of nexus standards; and educate taxpayers concerning their enforcement responsibilities. The Nexus Program fulfills these purposes through four activities: 1) Clearinghouse Database, 2) Voluntary Settlements, 3) Nexus Investigations, and 4) Education, Information, and Other Compliance Activities. This last year, the fourth year of program operation, has been a year of change and increased activity for the program.

New Program Director. After four years of hard work and dedicated service, Alice Davis stepped down as Director in September 1994. In January, 1995, June Summers took over as the new Director of the National Nexus Program. Ms. Summers is an attorney formerly associated with the San Francisco law firm of Heller, Ehrman, White & McAullife. Ms. Summers brings extensive experience in some of the most advanced issues in the field of state and local tax including nexus, unitary apportionment, and the treatment of intangibles in property taxation.

New Fiscal Year. In November 1994, the Nexus Committee voted to change the Nexus Program's fiscal year from a November 30 year end to a June 30 year end. This new fiscal year conforms to the Commission fiscal year end

and will ease program reporting.

Clearinghouse Database. The central clearinghouse database allows the member states to exchange information on potential nexus-creating activities of companies involved in multistate commerce. The purpose of the information exchange is to provide states with leads for audit selection. Through the database, states report information they gather through their own audits about company-reported activity in other states. The States exchange information on income tax audits, sales tax audits and business/nonbusiness tax information. During FY95, states reported information on approximately 400 companies bringing the total number of companies included in the database to 3026.

Voluntary Settlements. The Nexus Program's voluntary settlement project allows companies to voluntarily come forward on an anonymous basis and offer to resolve potential past year liabilities with member states. The Nexus Program processes the settlements for the states and the states determine the applicable policies regarding terms of the settlement, based on the facts presented by each taxpayer.

The Nexus Program staff have been actively working to increase public awareness of the voluntary settlement program. The Director and Assistant Counsel published an in-depth article explaining the details of the Voluntary Settlement Program in the American Bar Association Section of Tax Litigation's publication, *Tax Alert*. The Program Director and Assistant Counsel have made presentations to several taxpayer groups regarding the Nexus program. This increased public awareness has produced excellent results.

Nineteen new settlement proposals have been initiated with the National Nexus Program since January 1995. In July, 1994, the Nexus Committee approved a written statement of policies to be utilized by the Nexus Program in the administration of the voluntary settlement program. The Nexus Program concluded its first settlement arising under the new nexus settlement policies in November 1994. In accordance with the new nexus settlement policies, the Executive Committee approved settlement negotiations for a direct marketing company under audit by MTC. This settlement brought approximately \$4.5 million in revenues to the states participating in the settlement. As part of this settlement, this company is will remit \$5-6 million in revenue annually to the signatory states for the next seven years. An audit of this company is being

finalized.

The Nexus Program is processing approximately 38 settlements that are in various stages of completion, including one settlement with a Canadian company that will be the Program's first international agreement. During the Nexus Program's short fiscal year from December, 1994 through June, 1995, the nexus staff sent 171 settlement agreements to the member states. It is anticipated that these settlements will generate over \$6 million in sales and income taxes over the life of these agreements. To date, the Nexus staff have sent over 450 settlement to the states which will generate over \$23 million in revenues for the participating states.

Nexus Investigations. The Nexus Investigation project researches and identifies companies that may have compliance problems in a number of Program member states. As part of the investigation, companies are asked to voluntarily complete a multistate nexus questionnaire. The Nexus staff then sends reports to the states concerning the companies' activities and request the states to report whether the companies are registered. If a company appears to have a compliance problem in a number of states, and if it is suitable, the Nexus Program may request the states to authorize a joint nexus audit. If a sufficient number of states authorized such an audit, the Nexus Program will refer the case to the Audit Program to conduct the formal nexus audit.

During FY95, 120 companies were either investigated or reported to the states for investigation. To date, the nexus investigation project has resulted in settlement agreements that will generate over \$84 million to the program member states.

The Nexus Committee has referred eight nexus investigations to audit this fiscal year. In two cases, the taxpayer is refusing to cooperate with the audit. These cases may lead to a test case on the Commission's power to compel taxpayer disclosure of information. Thus far, this audit activity has yielded assessments and remittances in excess of \$1 million for the FY95.

Education, Information, and Other Compliance Activities.

The Nexus staff provides legal support to its member states' audit and legal personnel to support states' efforts to enforce and advocate nexus standards. The Nexus legal staff responded to requests for assistance from ten of its member states during the last fiscal year. The Nexus Program is in the process of developing a training program for the member states. The Nexus staff also, among other presentations, accomplished the following educational activities during the last fiscal year:

Published one issue of the National Nexus Program Bulletin: *Defining De Minimis Substantial Nexus For Sales And Use Taxes* (Sept. 1994).

Published two News and Views Articles discussing the nexus implications of the *Orvis Co., Inc.* and the *Vermont Information Processing, Inc.* cases pending before the New York State Court of Appeals (New York's highest court).

Conducted training programs on nexus program and constitutional standards for nexus in the states of Colorado, Utah, and Maine.

Assisted in drafting and negotiating federal legislation that would define the state and local sales tax collection obligations of certain satellite companies.

Responded to 80 taxpayer requests for registration and filing information.

Goal C: Encouraging Full Accountability in State Corporate Income Taxation

Uniformity Activities

Besides developing uniform definitions of business income and of unitary business, the Income and Franchise Tax Subcommittee is addressing several issues to encourage full accountability:

- the inclusion of income from outer-jurisdictional property in the property factor of the apportionment formula (one of the November 1994 Dialogue Day topics).

- the inclusion of outer-jurisdictional property in the property factor of broadcasters particularly, an issue which currently is under consideration as part of an MTC public hearing to consider revision to the existing broadcasting regulations;
- the breadth of application of existing MTC regulation IV.18.(b).(2) that values for property factor purposes property of another that is used at no rental or nominal rental, an issue about which the MTC Staff have surveyed the States; and,
- on a more discrete issue, inclusion in the sales factor of net gain from the sale or disposition of certain intangibles, that is also the subject of a public hearing to amend MTC Reg.IV.18.(c).(Special Rules: Sales Factor).

Also, the Income and Franchise Tax Subcommittee has reviewed an initial draft of a proposal to impose evidence-exclusion sanctions on taxpayers who fail to respond adequately to requests for information during the audit process. States' ability to account fully for all income of multistate businesses requires that States have complete access to all relevant tax information. This proposal seeks to give States better access to pertinent tax information taxpayers are reluctant to disclose to auditors. The members directed the MTC staff to conduct a survey about state tax agency administrative discovery practices and the prospects for adoption of the proposed provision. The results of the survey were reported at the July 1995 meeting.

The crown-jewel of the uniformity accomplishments this year has been the Commission's adoption of the Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions ("Financial Institutions Apportionment Formula") during a Special Commission meeting held November 17, 1994. The adoption of the banking formula was the climax of a nearly ten year, and some claim a fifteen year, process involving many Committee members, staff members, and industry representatives. The success of this proposal reflects the cooperative efforts of both the public and private sectors to produce a workable formula to the exceedingly difficult issue of dividing the net income of financial institutions among States in which the institution conducts its business.

Policy Research Activities

MTC staff organized a seminar on the federal revenue impact of transfer pricing abuse which the MTC cosponsored with North Dakota Senator (and

former MTC Chair) Byron Dorgan. The seminar was attended by 30 persons, including Treasury, Commerce, and OMB staff and a number of academic researchers and private attorneys. Additional follow-up activities are ongoing.

MTC staff has provided additional support to Goal C through the following activities:

- Reviewed and prepared comments for the U.S. General Accounting Office concerning a draft of a forthcoming GAO report on issues raised by federal consideration of worldwide formula apportionment.
- Prepared "talking points" document for use by Senator Dorgan's office in responding to criticisms of global formula apportionment contained in draft of forthcoming Organization for Economic Cooperation and Development report on transfer pricing and multinational corporations.
- Addressed the Federation of Tax Administrators' Revenue Estimating Conference on the transfer pricing issue.
- Researched share of international trade comprised of related party trade to support MTC transfer pricing/formula apportionment advocacy activities.
- Reviewed and edited the final technical corrections in MTC Financial Institutions Apportionment Formula and published the final recommended formula in the October 1994 MULTISTATE TAX COMMISSION REVIEW. Staff has also responded to numerous inquiries from state legislative and tax agency staffs in an effort to insure their awareness and consideration of the MTC proposal.
- Developed and analyzed results of survey of state interest in initiating efforts to amend UDITPA.

Audit Activities

The MTC Audit Program completed 5 income tax audit during the last quarter. This brings the total income tax completions for fiscal year 1995 to 9. Attached is a schedule reflecting the average hours per completed audit for the prior twelve month period.

Goal D: Encouraging the Efficient and Effective Operation of Sales/Use Taxes on a Destination Priority Basis

Uniformity Activities

The Sales and Use Tax Subcommittee's work has been boosted recently by the United States Supreme Court's decision in *Jefferson Lines*. The decision dismisses the argument that the price of a ticket providing for interstate transportation must be apportioned to each State through which travel is made and allows the State in which the purchase is made to tax the full amount of the sales price.

Now that the Court has decided *Jefferson Lines*, the principles that should govern the taxability of interstate services by the States seem clearer. The Sales and Use Tax Subcommittee can move forward on the pending proposal on state Transactional Taxation of Selective Electronic Services. At this stage, the proposal that takes the form of a specimen tax on credit bureaus and a consumer on-line service would establish a reasonable method for taxing electronic services.

Lastly, in response to suggestions that a uniform act may ease the collection of sales and use taxes, MTC staff have surveyed the States on the wisdom of developing a uniform Sales and Use Tax Act. At present, there is an insufficient amount of State support for this activity.

Policy Research Activities

The MTC research staff conducted the following activities in support of Goal D:

- Researched recent developments regarding computer on-line payment mechanisms and developed Annual Meeting presentation on the implication of these systems for state tax administration.
- Prepared paper for Executive Committee on policy options to enhance use tax collections involving mandatory disclosure to consumers by direct marketers of consumers' use tax liability, mandatory disclosure to tax agencies of consumer purchases, and related strategies.

Administration Activities

The Administrative staff of the Commission seeks to improve the Commission's internal operations and to conduct same in a cost-effective manner. In support of this effort, the Administrative staff:

- Continued the search for better health insurance. Few companies are willing to provide the MTC with a quote at the moment given the health status of our group.
- Began investing in Treasury Bills via the "Treasury Direct" method. By not dealing with an intermediate financial institution (a bank, a trust company, etc.), the Commission gets a higher effective interest rate.
- Arranging with our DC office landlord to redesign and reconstruct some existing office space in D.C. Among other things this will allow us to add a Computer Specialist.
- Investigating the implementation of an ADP Payroll tax service. This service will provide two labor saving items: [1] wire deposit of the various withheld income taxes, thus eliminating the need for check writing, check signing, and form completion; and [2] production of various quarterly and year-end payroll related tax returns, thus providing time for the MTC accountant to do other things and/or take on other tasks.
- Sold directly to individuals (non-MTC personnel) and organizations, or otherwise disposed of obsolete / no longer used equipment (much of it computers and computer peripherals) and furniture.

The Commission continues to have an annual financial audit conducted by Linton, Shafer & Company, P.A.

Audit Activities

The MTC Audit Program completed 8 sales tax audit during the last

quarter. This brings the total sales tax completions for fiscal year 1995 to 15. Attached is a schedule reflecting the average hours per completed audit for the prior twelve month period.

Goal E: Encouraging Consistent, Efficient and Effective Property Tax Administration

Uniformity Activities

Generally, the Uniformity Committee's proposals have not addressed property tax administration.

Audit Activities

The Director of Audit was trained and successfully completed a course in centrally-assessed property taxation and will attend a Joint Property Tax Auditing meeting in September hosted by WSATA.

Goal F: Preserving the Ability of States to Tax Interstate Commerce Equitably

Uniformity Activities

In the face of the continuing viability of the Commerce Clause holding of *National Bellas Hess*, members of the Committee have suggested ways of encouraging in-state registration of out-of-state vendors selling to in-state customers. Specifically, Michigan has proposed linking in-state registration to the grant of state procurement contracts by state and local agencies to out-of-state businesses. The MTC staff has conducted preliminary research on the possible constitutional issues arising out of the idea and the Committee is expected to discuss Michigan's proposal at the annual meeting. In addition, the draft Nexus Guideline (see Goal B) seeks to establish out-of-state vendor obligations to collect in-state sales and use taxes.

With regard to achieving this goal, the unitary business and business income definitions are aimed at developing a reasonable method of determining

how to tax equitably the income of interstate and multinational businesses.

Policy Research Activities

In support of achieving this goal, the MTC research staff has:

- Reviewed and prepared preliminary analysis of the potential impact on state tax policy and administration of the major federal tax overhaul plans that have been advanced by congressional leaders and 1996 presidential candidates.
- Organized one meeting and three teleconferences of the renewed Property Tax Fairness Project.
- Prepared survey of the states on the potential fiscal impact of extending the 4-R Act to other utility industries. This survey is currently "in the field."
- Prepared report to the Property Tax Fairness Project on passage of the federal "unfunded mandates" legislation containing protection against preemption of state and local taxes and outlining steps for states to take to be able to utilize it as a weapon against extension of 4-R Act to other industries.
- Reviewed existing MTC information base regarding impact of 4-R Act on states and engaged consultant to conduct future research for Project.

Goal G: Preserving and Strengthening the Commission as an Instrument of Interstate Cooperation.

Uniformity Activities

The Committee has been exploring various areas to improve cooperation among the States in state taxation. Uniformity Committee members are participating in a joint MTC-FTA-Industry Task Force on Electronic Data Interchange (EDI), the partial goal of which is to draft a uniform record keeping regulation for electronic records, including records generated through EDI.

One of the Dialogue Day topics in November 1994 revolved around the questionable constitutionality of state tax incentives used to try to lure businesses into a State. The discussion addressed whether these incentives generally are discriminatory and practically, whether they have any effect on business

decisions to locate in a particular State. The question of what solution the Committee may be able to develop to discourage the utilization of tax incentives and to minimize States engaging in destructive competition for economic development remains to be explored.

Towards strengthening the Commission, the Uniformity Committee is doing its part by committing to improve further the uniformity process. To help uniformity efforts remain fresh and timely, the Committee has determined to:

- study the need for technical adjustments to adopted uniformity provisions, particularly the financial institutions and publishing regulations;
- utilize Tax Exchange and conduct interim teleconferences as a means to continue communication and discussion about proposals and emerging issues;
- distribute meeting minutes shortly after each meeting so that members may know what is expected at subsequent meetings and will have maximum opportunity to prepare for the next meeting;
- possibly allot more time to the meetings of the subcommittees so that the members may sufficiently review proposals and discuss issues;
- commit to a continuous re-evaluation of uniformity projects to ensure that time is spent on issues the States are committed to address;
- work in conjunction with the California FTB's in-house task forces on issues similar to those being addressed by the Committee.

In addition, the Committee has been contacted for possible participation in the ongoing State-Federal-Industry project to develop a uniform wage code. The MITRE Corporation, the contractor then working under the Federal STAWRS (Simplified Tax And Wage Reporting System) project, is attempting to develop a harmonized wage code that would establish common rules for the collection and administration of both federal and state income taxes, social security/medicare taxes and federal and state unemployment taxes. The MITRE Corporation seeks the Committee's input on the harmonized wage code, because of the Committee's expertise gathered from successfully developing and promoting

uniform state tax provisions.

Policy Research Activities

In its efforts to advance this goal, the Commission research staff:

- Assisted in publication of MTC Key State Personnel Directory and converted Key State Personnel mailing list database to Windows database.
- Updated MTC "Activities Report" publication, the principal general distribution publication providing overview of current MTC activities; and prepared description of MTC for forthcoming "Encyclopedia of Tax Policy."
- Prepared variety of written materials used to support efforts to recruit new Full and Associate Members of MTC.

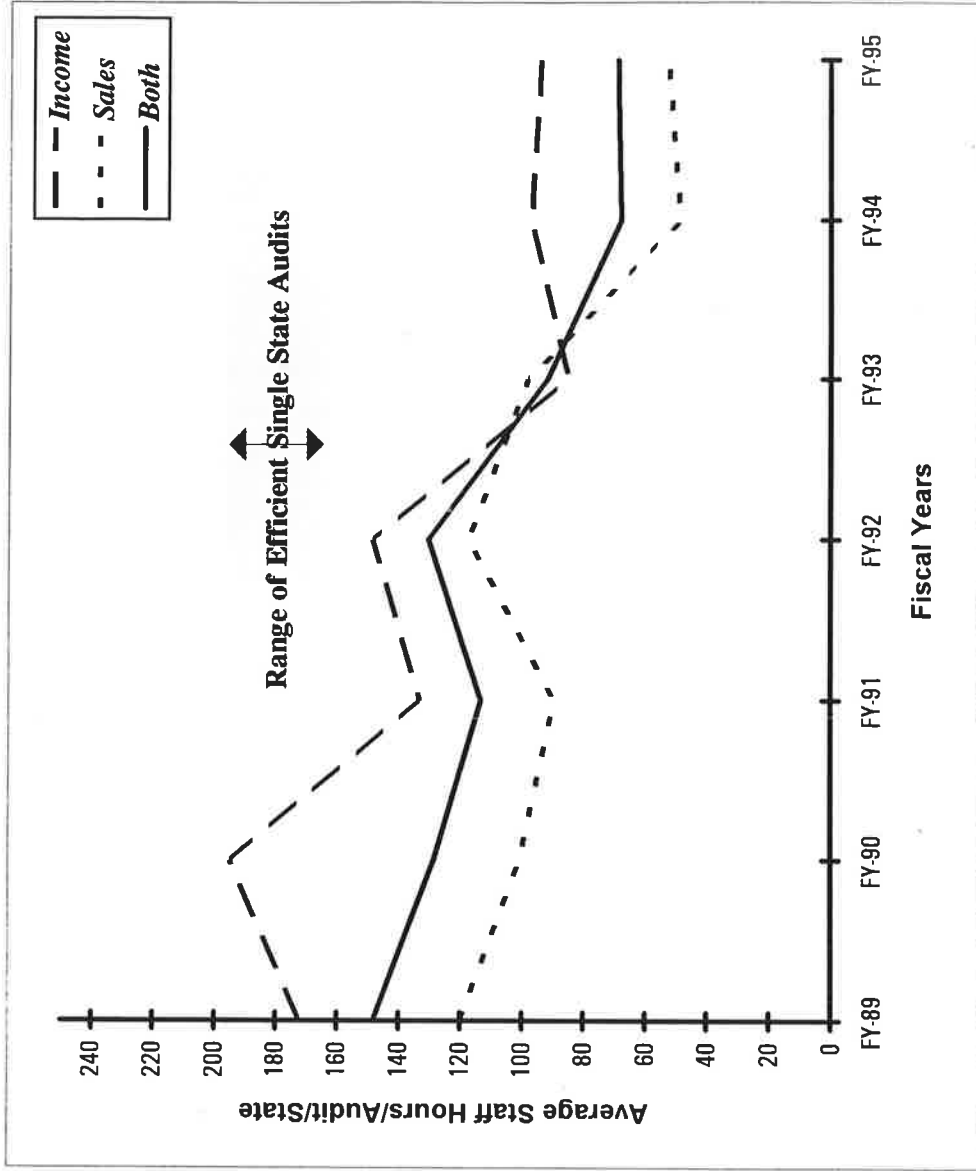
¹*Allied-Signal*, while rejecting the concept of full apportionability, reaffirmed in a manner that was more acceptable to the States unitary-based apportionment. In effect, *Allied-Signal* is now the core of the Commission's activities in refuting the strained interpretations of the U.S. Supreme Court's decisions in *ASARCO* and *Woolworth*. *ASARCO* and *Woolworth* have historically played unwarranted havoc on the ability of non-domicilliary States to apportion so-called investment income that is attributable to the operation of the same unitary business that is being conducted in the taxing State.

CONSOLIDATED STATISTICS ON MTC AUDIT PROGRAM



Trends in Time Spent on MTC Joint Audits

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



Range of time spent on efficient single state audits is derived from discussions in the MTC Audit Committee

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
Income Tax							
Total Audits	12	4	9	7	12	9	9
Total States Audited	120	37	95	75	132	93	99
Total Hours	20679	7211	12646	11148	11208	9016	9284
Avg. Hours per State	172	195	133	149	85	97	94
Sales Tax							
Total Audits	9	9	8	9	14	13	15
Total States Audited	103	88	79	104	146	140	152
Total Hours	12393	8866	7069	12209	14323	6818	8009
Avg. Hours per State	120	101	89	117	98	49	53
Both Taxes							
Total Audits	21	13	17	16	26	22	24
Total States Audited	223	125	174	179	278	233	251
Total Hours	33072	16077	19715	23357	25531	15834	17293
Avg. Hours per State	148	129	113	130	92	68	69

Multistate Tax Commission

Audit History Report for FY 84 - FY 95 (Twelve Years)

	Audit Fees	# of Audits Total	Proposed Assessments		Amount Assessed		Amount Collected		Pending Assessments		Amount Collected + Pending Assessments
			Total	Total	Total	Total	Total	Total			
ALABAMA	\$51,300	5	\$53,689	\$25,122	\$0	\$53,689	\$53,689				
ALASKA	\$108,000	20	\$113,459	\$138,708	\$144,726	\$9,214	\$153,940				
ARKANSAS	\$404,617	182	\$10,635,066	\$7,629,371	\$6,806,938	\$3,374,123	\$10,181,061				
CALIFORNIA	\$1,127,732	36	\$73,368,681	\$50,204,207	\$37,837,896	\$38,132,019	\$75,969,915				
COLORADO	\$832,201	111	\$7,172,032	\$5,570,250	\$4,980,887	\$2,217,343	\$7,198,230				
CONNECTICUT	\$0	2	\$0	\$0	\$0	\$0	\$0				
DC	\$397,580	174	\$9,748,092	\$5,502,992	\$8,650,313	\$1,130,632	\$9,780,945				
FLORIDA	\$0	2	\$0	\$0	\$0	\$0	\$0				
HAWAII	\$897,696	176	\$11,666,920	\$5,678,086	\$5,978,912	\$2,997,806	\$8,976,718				
IDAHO	\$1,017,464	203	\$5,858,304	\$5,148,256	\$4,143,300	\$1,941,064	\$6,084,364				
IOWA	\$0	23	\$0	\$0	\$0	\$0	\$0				
KANSAS	\$1,047,523	193	\$41,296,451	\$36,333,436	\$39,182,696	\$15,604,088	\$54,786,784				
KENTUCKY	\$23,748	1	\$18,625	\$0	\$0	\$18,625	\$18,625				
MAINE	\$531,774	62	\$3,692,894	\$1,405,203	\$836,433	\$2,267,073	\$3,103,506				
MARYLAND	\$0	3	\$0	\$0	\$0	\$0	\$0				
MICHIGAN	\$671,083	51	\$3,748,714	\$1,804,479	\$2,631,459	\$2,150,854	\$4,782,313				
MINNESOTA	\$994,255	134	\$25,029,611	\$21,439,358	\$22,307,307	\$4,026,225	\$26,333,532				
MISSOURI	\$61,000	31	\$1,766,653	\$1,187,832	\$707,956	\$92,997	\$800,953				
MONTANA	\$786,742	82	\$3,630,464	\$3,721,411	\$3,078,084	\$1,095,720	\$4,173,804				
NEBRASKA	\$723,830	91	\$7,841,606	\$5,877,736	\$2,321,102	\$6,056,297	\$8,377,399				
NEW JERSEY	\$531,774	22	\$12,813,782	\$7,331,385	\$10,241,992	\$4,495,315	\$14,737,307				
NEW MEXICO	\$1,049,255	187	\$23,645,877	\$21,917,542	\$6,744,720	\$14,769,171	\$21,513,891				
NORTH DAKOTA	\$910,649	179	\$6,425,417	\$3,993,664	\$3,792,509	\$2,423,342	\$6,215,851				
OHIO	\$0	2	\$0	\$0	\$0	\$0	\$0				
OREGON	\$799,842	67	\$6,728,508	\$6,744,139	\$9,609,343	\$300,864	\$9,910,207				
SOUTH CAROLINA	\$0	1	\$0	\$0	\$0	\$0	\$0				
SOUTH DAKOTA	\$184,744	78	\$582,370	\$436,771	\$678,237	\$89,576	\$767,813				
TEXAS	\$458,392	17	\$15,750,532	\$1,890,668	\$2,903,661	\$12,058,359	\$14,962,020				
UTAH	\$1,059,655	199	\$17,991,563	\$10,782,236	\$11,373,309	\$4,962,406	\$16,335,715				
WASHINGTON	\$741,083	66	\$12,285,133	\$10,964,296	\$4,905,927	\$7,203,288	\$12,109,215				
WEST VIRGINIA	\$42,000	23	\$1,539,232	\$148,013	\$148,013	\$334,146	\$482,159				
TOTAL-S	\$15,453,939	2423	\$303,403,675	\$215,875,161	\$190,005,720	\$127,804,236	\$317,809,956				

FY94 includes \$25,065 in Nexus pro-

contracts revenue for Audit program.

Multistate Tax Commission

Audit History Report for FY 95

	Audit Fees		# of Audits		Proposed Assessments		Amount Assessed		Amount Collected		Pending Assessments		Amount Collected + Pending Assessments	
			Total		Total		Total	Total	Total	Total	Total	Total	Total	Total
ALABAMA	\$41,300		4		\$28,567	\$0	\$0	\$0	\$0	\$28,567	\$28,567	\$28,567	\$28,567	\$28,567
ARKANSAS	\$92,000		21		\$2,288,744	\$1,694,012	\$1,694,012	\$240,792	\$2,065,103	\$2,065,103	\$2,065,103	\$2,065,103	\$2,065,103	\$2,305,895
CALIFORNIA	\$40,000		0		\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
COLORADO	\$70,800		5		\$221,601	\$279,109	\$279,109	\$0	\$279,109	\$279,109	\$279,109	\$279,109	\$279,109	\$279,109
DC	\$92,000		15		\$768,480	\$0	\$0	\$0	\$768,480	\$768,480	\$768,480	\$768,480	\$768,480	\$768,480
HAWAII	\$113,000		19		\$2,301,540	\$1,083,715	\$1,083,715	\$81,207	\$2,140,235	\$2,140,235	\$2,140,235	\$2,140,235	\$2,221,442	\$2,221,442
IDAHO	\$106,200		22		\$1,325,768	\$1,106,955	\$1,106,955	\$149,531	\$1,185,539	\$1,185,539	\$1,185,539	\$1,185,539	\$1,335,070	\$1,335,070
KANSAS	\$118,000		0		\$5,917,170	\$2,272,771	\$2,272,771	\$281,533	\$5,654,218	\$5,654,218	\$5,654,218	\$5,654,218	\$5,935,751	\$5,935,751
KENTUCKY	\$23,748		1		\$18,625	\$0	\$0	\$0	\$18,625	\$18,625	\$18,625	\$18,625	\$18,625	\$18,625
MAINE	\$135,700		21		\$2,177,042	\$958,960	\$958,960	\$87,495	\$1,419,229	\$1,419,229	\$1,419,229	\$1,419,229	\$1,506,724	\$1,506,724
MICHIGAN	\$70,800		4		\$378,425	\$0	\$0	\$0	\$1,057,846	\$1,057,846	\$1,057,846	\$1,057,846	\$1,057,846	\$1,057,846
MINNESOTA	\$118,000		11		-\$44,399	\$0	\$0	\$0	-\$44,400	-\$44,400	-\$44,400	-\$44,400	-\$44,400	-\$44,400
MONTANA	\$63,700		8		\$173,190	\$36,533	\$36,533	\$6,575	\$139,582	\$139,582	\$139,582	\$139,582	\$146,157	\$146,157
NEBRASKA	\$81,420		7		\$1,286,156	\$0	\$0	\$0	\$1,286,156	\$1,286,156	\$1,286,156	\$1,286,156	\$1,286,156	\$1,286,156
NEW JERSEY	\$135,700		5		\$40,501	\$0	\$0	\$0	\$40,501	\$40,501	\$40,501	\$40,501	\$40,501	\$40,501
NEW MEXICO	\$118,000		15		\$1,269,371	\$1,231,267	\$1,231,267	\$164,650	\$1,101,622	\$1,101,622	\$1,101,622	\$1,101,622	\$1,266,272	\$1,266,272
NORTH DAKOTA	\$106,200		20		\$1,789,350	\$786,711	\$786,711	\$101,945	\$1,688,645	\$1,688,645	\$1,688,645	\$1,688,645	\$1,790,590	\$1,790,590
OREGON	\$70,800		2		\$46,043	\$0	\$0	\$0	\$46,043	\$46,043	\$46,043	\$46,043	\$46,043	\$46,043
SOUTH DAKOTA	\$0		4		\$74,491	\$0	\$0	\$0	\$74,491	\$74,491	\$74,491	\$74,491	\$74,491	\$74,491
UTAH	\$118,000		22		\$3,347,909	\$2,400,766	\$2,400,766	\$231,875	\$3,131,692	\$3,131,692	\$3,131,692	\$3,131,692	\$3,363,567	\$3,363,567
WASHINGTON	\$70,800		9		\$7,301,154	\$6,943,200	\$6,943,200	\$855,434	\$6,485,925	\$6,485,925	\$6,485,925	\$6,485,925	\$7,341,359	\$7,341,359
TOTALS	\$1,786,168		235		\$30,709,728	\$18,793,999	\$18,793,999	\$2,201,037	\$28,567,208	\$28,567,208	\$28,567,208	\$28,567,208	\$30,768,245	\$30,768,245

