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Fifty Years of MTC Uniformity Efforts:

The Not-So-Obvious Lessons

Like uniformity itself, the efforts to achieve uniformity also serve a greater purpose.



Given my role at the Multistate Tax Commission,

I am occasionally asked some version of the following question: Why can't the Commission produce more state tax uniformity? Yes, I sometimes joke, it's a mystery. After all, nothing says fun like drafting model tax regulations by committee. The difficulty is often surpassed only by the tedium. Not to mention the awkwardness of doing this kind of work via conference call.

But, seriously, I would hasten to add, *more* is not necessarily *better* when it comes to state tax uniformity. After all, it is entirely possible for things to be uniformly awful. To be useful, uniformity must serve some greater goal—such as promoting best policy and practice, or at least, increasing ease and efficiency. And while uniformity has benefits, it also has costs—not only the costs of achieving it, but the costs of maintaining it, especially when changing circumstances require innovation and adaptation. Moreover, the investment to achieve uniformity has to be paid upfront—with no guarantee it will produce results. And, so, it entails risk.

The Reason Why We Keep Doing It

Given the obvious difficulties in achieving state tax uniformity, a better question might be: Why don't such efforts simply succumb to the inherent inertia? Clearly, they don't.¹ The Multistate Tax Commission's Uniformity Committee is proof of that. The committee recently marked a half century of uniformity work and is still going strong.²

Why? I personally believe the reason is clear. Like uniformity itself, the *efforts* to achieve uniformity also serve a greater purpose. These efforts, if inclusive, informative, and collaborative, can not only yield greater positive uniformity, but better tax systems generally, better tax administration, and better interstate and taxpayer-administrator relationships.

That said, it is also true that there are lessons from the MTC's experiences over

the last 50 years. And those lessons are the focus of this article.

Yes Virginia, There Is a Process

First, some background on the MTC process. That process can best be described as open and informal. For the more structured among us, it can feel a bit messy. But that messiness serves to foster inclusivity and consensus.

Article VII of the Multistate Tax Compact and the Commission Bylaws provide a general process for the adoption of uniform regulations, including a requirement for public hearing and for a survey of the states.³ But outside of those broad guidelines, the Uniformity Committee determines its own process for the work that it decides to undertake.⁴ And much of that committee process, like state cooperation generally, is voluntary.

In addition, the MTC was created with the authority to:

- *Study* state and local tax systems and particular types of state and local taxes.
- *Develop and recommend proposals* for an increase in uniformity or compatibility of state and local tax laws with a view toward encouraging the simplification and improvement of state and local tax law and administration.
- *Compile and publish such information* as would, in its judgment, assist the party states in implementation of the compact and taxpayers in complying with state and local tax laws.
- Do all things necessary and incidental (for this and other purposes).⁵

These tasks are often done by the MTC through the Uniformity Committee using the same general process used for drafting regulations.

Here is what is most important about the committee's process. All states may participate fully, regardless of their relationship with the Commission.⁶ Furthermore, thanks to the MTC's Public Participation Policy, all deliberations are done publicly.⁷ Notices of meetings and phone calls go out at least 10 days in advance. One can receive email notices by signing up at:



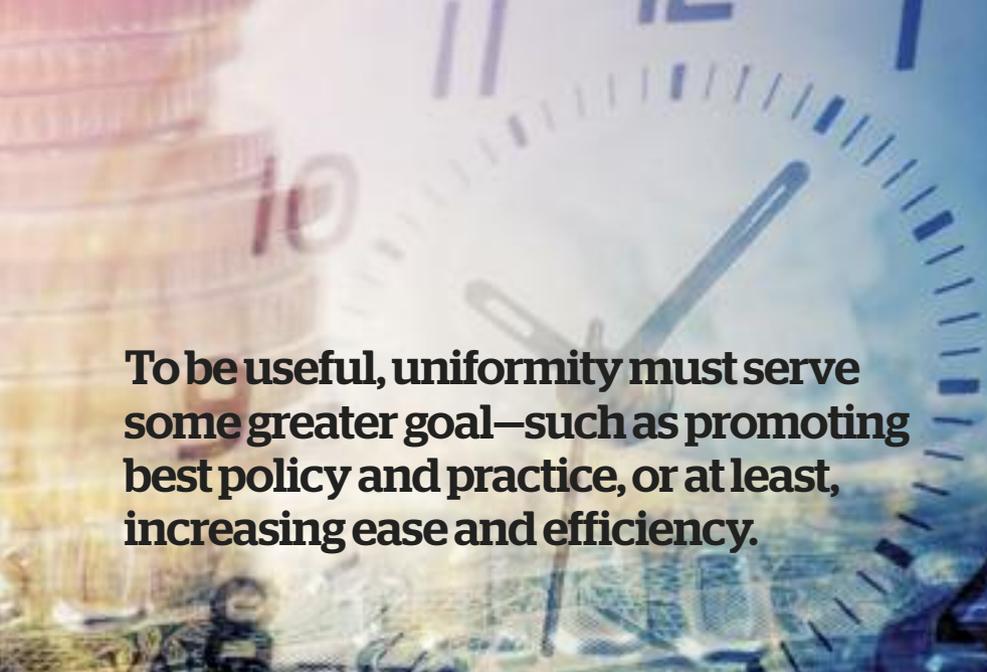
<http://www.mtc.gov/The-Commission/Email-Updates>. Information on those meetings and calls is also on the home page of our website (www.mtc.gov).

Moreover, members of the public are invited and encouraged to take part in committee and work group discussions and to bring forward issues and concerns. Potential uniformity projects can, and often are, proposed by members of the public. And while some decisions come down to a vote of the participating states, most work groups and committee meetings focus on building consensus whenever possible.

In its early years, the MTC uniformity efforts were directed mainly at regulations needed to implement the Uniform Division of Income for Tax Purposes Act (UDITPA).⁸ The MTC currently has about three dozen adopted models (some of which have been amended or added to over the years). Eleven have to do with UDITPA's allocation and apportionment regime—including the model market-based sourcing language adopted as a recommended change to UDITPA, the 100-plus page Model General Allocation and Apportionment Regulations, and the related special industry regulations. Nine models have to do with business income taxes generally—including a combined filing model and a model factor presence statute. Eight have to do with sales and use tax. The remainder have to do with tax administration or miscellaneous tax issues.⁹

The MTC has a small staff that assists with uniformity projects. But much of the work is done by the participants—state tax administrators, taxpayers, practitioners, academics, etc. A particular project may attract the participation of different

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states, groups, or individuals. While much of the work proceeds in a fairly standard way, many projects present unique challenges or take “interesting” turns.

Looking Back

In 2013, as part of the MTC’s strategic planning process, the Uniformity Committee formed a task force to evaluate the uniformity projects undertaken over the prior 10-year period. In 2014, the task force reported the results of the projects in terms of some quantifiable metrics—how much time they took, whether a draft model was eventually adopted by the Commission, and whether that model was then adopted (at least in some form) by the

states. It also reported on interviews conducted with state representatives, asking why their states had not adopted certain models.¹⁰ The results were worrisome.

According to the final task force report, “very few” states had adopted some of the more recent MTC models. Based on interviews with states, the biggest barriers to adoption of those models were: (1) political opposition, or (2) the existence of state law on the particular subject.¹¹ In other words, adoption of a model might depend on finding the issues that policymakers would agree ought to be addressed, but that had not yet been addressed.

The task force also observed that the committee lacked a “structured process to evaluate whether a suggested model

will be adopted by a significant number of states.” Picking good projects was essential, the task force noted, because of the Uniformity Committee’s limited time and resources and the opportunity cost of choosing poorly.

In the years since this report, while the committee has not adopted a *structured* project selection process, it has focused much more on project selection. And an important aspect of that focus is that it is ongoing, so that even after work on a project commences, the committee continues to evaluate the viability and necessity of that project over time, vis-à-vis other possible projects. For example:

- The committee had begun a project to draft a model addressing state tax-related false claims act lawsuits, eliminating any possible authority for such suits, which was taken up in response to a request from the telecommunications industry. But when the American Bar Association drafted a related model, the committee, instead, recommended that the Commission simply endorse that model, which it did.¹²
- In 2014, the committee began a project evaluating the potential for a uniform approach to taxing the income of certain types of trusts, but this project was tabled, in part because the Commission had other pressing issues to address (market-based sourcing, in particular), but also because of the consensus of the committee that achieving uniformity might face political headwinds.

In addition, the committee has focused on other practical mechanisms to get more out of its uniformity efforts—including using the MTC website as an archive for project information and analysis as well as notes and drafts, generally adopting the Uniform Law Commission drafting rules (to reduce the debates over drafting style), better use of technology generally, and leveraging past efforts as well as the efforts of others.

Still, I believe there are lessons from the Uniformity Committee’s five decades of experience that may not be evident from the metrics. None of these lessons are silver bullets guaranteed to make the process foolproof or eliminate inherent difficulties. And, at first glance, these lessons may seem obvious. But I think they reflect my basic premise about why we do it—which is that efforts to achieve state tax unifor-

¹ The Multistate Tax Commission (MTC) is not the only organization that works on state tax uniformity, of course. The Federation of Tax Administrators (FTA) has long spearheaded its own uniformity efforts, especially in the areas of fuel and tobacco taxes. Information on these programs is available on the FTA website: <https://www.tax-admin.org/>. The Streamlined Sales and Use Tax Agreement and its governing board have also made great strides in bringing uniformity to the states’ sales and use tax systems. Information on the Streamlined Sales and Use Tax project is available on the project website: <https://www.streamlinedsalestax.org/>. That effort was highlighted in the recent case of *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2099, 201 L. Ed. 2d 403, 426 (2018). Other groups, including the American Bar Association and the American Society of Certified Public Accountants, as well as the Council On State Taxation, the Tax Executives Institute, the Institute for Professionals in Taxation, and other industry groups also do uniformity work in the state tax field.

² The MTC is the intergovernmental state tax agency formed by the states in 1967. The MTC may be best known by the Fortune 500 for its joint audit program, which focuses on corporate income and sales taxes. Many tax practitioners know the MTC for its nexus program, which provides taxpayers with the opportunity to enter into voluntary disclosure agreements, settling past tax liabilities, with multiple states. But perhaps what the states think of when they think of the MTC is its uniformity process. That process started, in earnest, about 50 years

ago when the MTC began work on its first set of model general allocation and apportionment regulations.

³ The Multistate Tax Compact is available on the MTC website at: <http://www.mtc.gov> and can be seen following the link on this page, <http://www.mtc.gov/The-Commission/Multistate-Tax-Compact>. The Commission Bylaws are available at: <http://www.mtc.gov/The-Commission/Bylaws>.

⁴ See the Uniformity Committee Charter, available at: <http://www.mtc.gov/getattachment/Uniformity/Uniformity-Charter/Uniformity-Committee-Charter-Adopted-November-2018.pdf.aspx>.

⁵ See Multistate Tax Compact, Art. VI, Sec. 3, available at: <http://www.mtc.gov/getattachment/The-Commission/Multistate-Tax-Compact/Original-Model-Multistate-Tax-Compact.pdf.aspx>.

⁶ See Commission Bylaws, *supra* n. 3, Art. 13(c)(2).

⁷ Available at: <http://www.mtc.gov/The-Commission/Public-Participation-Policy>.

⁸ UDITPA was incorporated as Article IV of the Multistate Tax Compact.

⁹ The market-based sourcing and other changes to UDITPA (Multistate Tax Compact, Art. IV) can be found under the “Uniformity” tab on the MTC website at: <http://www.mtc.gov/Uniformity/Article-IV>, and other uniform models are at “Adopted Uniformity Recommendations,” under that same tab, at: <http://www.mtc.gov/Uniformity/Adopted-Uniformity-Recommendations>.

mity are about more than just uniformity—and therein lies the key to success.

Lesson No. 1: To overcome conflicts and sustain uniformity efforts, focus on the benefits that only collective effort can provide.

One critical way of increasing the chance of success of any uniformity effort is to identify interests, on all sides, that would benefit from that collective effort. This may seem self-evident. But, notice, this does not mean one must identify *common* interests. It also does not mean there must be agreement as to the particular uniform *approach*. Those things are not essential—at least not to start. But agreement among the parties that they would be better off engaging in a *collective* approach *is* essential. And once those collective efforts begin, they are often self-sustaining, since participants will not want their investment to be wasted.

The poster child for this lesson is the Hearing Officer Report of Alan Friedman, counsel to the Commission, on the Proposed Formula for Apportionment of the Income of Net Income from Financial Institutions.¹³ In fact, if one is looking for lessons on the topic of federalism, short of the Constitution itself, one could do worse than to consult this report. It is a profile in both what is hard about voluntary interstate cooperation, and what is possible. But beware. The report, with all its exhibits, is over 3,000 pages.

UDITPA, as originally drafted in the 1950s, did not attempt to address financial institutions. And, at that time, the industry was very different, highly regulated and state-bound. But, in the 1970s and 1980s, the states began to realize that they needed to apportion the multistate income of national and regional financial institutions and that UDITPA's bare-bones formula was simply not a good fit. The MTC became the focus of efforts to address this issue and Alan oversaw those efforts.

Alan sought to provide in his report very detailed information and analysis on the proposed model and its potential impacts. But he also sought to fairly present the long and tortuous process of getting all the parties to the table to, at least, consider collaborating on industry-specific rules. Here is a passage from an early part of the report:

In the mid-1980s another effort was launched to develop a uniform apportionment method and the Commission's Uniformity Committee, acting with no di-

rect input from any financial institution, crafted the initial draft. The initial draft was informally circulated to industry representatives, primarily traditional banking institutions, at regional meetings held in Seattle, Chicago, Atlanta, and New York. These meetings were well-attended and proved to be, in the main, quite productive give and take sessions.

But in a footnote to this passage, Alan, a serious attorney with a sense of humor, also adds the following: "As could be anticipated, the meeting with the representatives of the New York institutions was 'highly spirited' (a polite gloss is used here to describe this initial meeting)." Alan went on to suggest that industry representatives there all but yelled: "The states are nothing but a wild pack of hyenas chasing the defenseless banks through the forest!!!" and then he noted that, "the meeting went downhill from there."¹⁴ As the report described it, even various states had opposing interests.

So how did anything productive ever come from such an inauspicious, confrontational beginning? The answer is that Alan and others committed to a process aimed at demonstrating to the various parties that their interests, though conflicting, would nevertheless benefit from collective effort, rather than having everyone retreat to their corners, or go it alone.

According to the report, after the failed start described above, a few states began developing their own, divergent methods for taxing out-of-state financial institutions. This prompted the industry to view the idea of uniform rules more favorably. Re-engagement by industry then allowed the MTC, along with the Federation of Tax Administrators, to reconsider an ap-



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proach that had been discarded but held the potential of being acceptable to a greater number of states, as well as to industry. A specific working group was formed which included both state and industry representatives, thus establishing a formal body through which more intentional interaction could take place.

But still, the issues were complex. So the states agreed to sponsor an educational workshop for state representatives to educate them on the industry and also help states decide that the consensus approach in this complex area made sense. A state subgroup was then formed to work out conflicting state interests (primarily between the financial center and market states). Another subgroup was set up with state and industry members to study specific technical issues (presumably sparing this subgroup the internecine battles engaged in on the state side).

And yet, it was divergent state interests that posed a threat to a consensus solution. But then, according to the report, a disrupter suggested an outside-the-box, five-factor formula, rather than UDITPA's traditional three-factor formula. While that alternative formula was not adopted, it did cause the states to begin thinking more creatively about how to reach a compromise, uncovering new ways to reach that compromise. The participants were also encouraged to, and did, exchange ideas and analysis between meetings and calls; further, the information exchanged was captured for use in the decision-making process. Eventually, a uniform framework began to emerge, piece by piece, along with the support for that framework. This process ultimately resulted in



a uniform set of apportionment rules, adopted by the MTC in 1994, and also adopted by a number of states.

But the story doesn't end there. Thirteen years later, further changes within the industry, and experience with the 1994 model, necessitated changes to that original model, which the MTC Uniformity Committee once again undertook. This time, although the work proved challenging, states and industry groups did not need to be convinced that it was worth the effort. The amendments to the model were adopted by the Commission in 2015.¹⁵

As I mentioned earlier, one of the costs of uniformity efforts is the cost of maintaining uniformity when some change in circumstances requires innovation or adaptation. It appears this has been one

of the greatest impediments to states adopting amendments to the financial industry apportionment rules—although it is too soon to say that states will not move in that direction eventually. This problem of modifying an existing uniform approach has no clear solution and deserves more attention in the future.

The lesson from all this is that while it takes common ground to provide a foundation for uniformity efforts, that common ground can exist even where there are conflicts and even though the right solution is unclear. Common ground simply requires a shared belief among the affected parties that they will derive some benefit from *collective effort*. That benefit might be a uniform solution adopted by every state. But there are many other benefits that can be realized, including mutual education of opposing sides, a means of spurring creativity or compromise on subordinate issues, or just a way to harness collective resources to analyze alternative approaches. This project, and others, have also allowed industry and state agency representatives to get to know each other better and discuss their concerns in a way that no other process provides.

In short, collective effort is powerful. So how should it be used? That brings us to the second lesson.

Lesson No. 2: When choosing between small problems and big ones, remember that bigger problems can produce bigger payoffs. This lesson might not be as obvious. You might think that, given the inherent diffi-

culty of uniformity efforts generally, it would make sense to pick smaller, more manageable problems to tackle. Not so. If the problem is that simple, states can simply copy what works—and they often do. There are countless examples of how states have gravitated toward the same, or very similar, rules for similar issues, without the need for any particular collective effort.

More importantly, there is a certain amount of fixed cost in any uniformity effort—even the most straightforward—including opportunity cost.¹⁶ The only way to ensure that this cost is justified is to pick a big enough problem to make it worthwhile. The bigger the problem, the more it calls for creative, collective effort, and the more likely that kind of effort will be useful. And, if efforts focused on a big problem generate a workable solution, one is likely to see uniformity dividends, that is, states adopting the *same* proven solution. But one also has to be prepared. Tackling a big problem is more of a journey than a destination.

The biggest state tax problem of the last 50 years was the physical presence nexus standard imposed by *Bellas Hess* and *Quill*.¹⁷ That standard kept states from collecting sales and use taxes otherwise due and created a significant competitive disadvantage for traditional bricks-and-mortar retailers. In March 2010, the MTC Uniformity Committee decided to undertake two new projects to help address this problem.

The first was a sales and use tax nexus, or “doing business,” statute incorporating something New York had tried, called “affiliate nexus.”¹⁸ The second was a notice and reporting statute, similar to a prototype enacted by Colorado, requiring remote sellers to provide information on in-state sales.¹⁹ Both of these statutes were unique and controversial. Both were immediately challenged by taxpayers in New York and Colorado, claiming that they violated *Quill*. This delayed the approval of the models that were drafted by the MTC Uniformity Committee.

But, the controversy also brought attention to both ideas. So, by the time the legal challenges rose through the appellate courts, there was substantial multi-state support behind them. Ultimately, the constitutional challenge to Colorado's notice and information reporting statute was resolved in favor of Colorado. This outcome was predicted by Shirley Sicilian, the hearing officer who, in her report on the

¹⁰ See the archives on the work of this task force at: <http://www.mtc.gov/Uniformity/Uniformity-Committee-and-Subcommittees/Uniformity-Strategic-Planning-Project-Team>.

¹¹ See Report on Uniformity Committee Project Team on Barriers to Adoption of Uniformity Measures, April 30, 2014, available at: [http://www.mtc.gov/uploaded-Files/Multistate_Tax_Commission/Committees/Executive_Committee/Scheduled_Events/Final%20Report%20-%20Uniformity%20Project%204-30-14\(1\).pdf](http://www.mtc.gov/uploaded-Files/Multistate_Tax_Commission/Committees/Executive_Committee/Scheduled_Events/Final%20Report%20-%20Uniformity%20Project%204-30-14(1).pdf).

¹² See Multistate Tax Commission Resolution No. 2015-02, Resolution Recommending to States the ABA Model Transactional Tax Overpayment Act, available at: <http://www.mtc.gov/getattachment/The-Commission/Policy-Statements-Resolutions/2015-Draft-Resolutions/Resolution-2015-02-ABA.pdf.aspx>.

¹³ See the Hearing Officer Report of Alan Friedman at: http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/FormulaforApportionmentofNetIncomeFinInst.pdf. Friedman, *supra* n. 13, p. 2.

¹⁵ See the project page for the work group on amending the financial institutions apportionment rule at: <http://www.mtc.gov/Uniformity/Project-Teams/Model-Uniform-Financial-Institutions-Apportionment>.

¹⁶ See, for example, the model Audit Sampling Authorization Statute and Accompanying Regulation, a simple proj-

ect undertaken to set out statutory authority for the use of statistical sampling in audits which generated some controversy requiring a substantial reworking of the model after the public hearing, as recounted in the hearing officer report at: http://www.mtc.gov/uploaded-Files/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/Adopted_Recommendations/By_Category/UniformitySAMPLINGHORPTFINAL.pdf.

¹⁷ *National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967) and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

¹⁸ See the project page for the Sales and Use Tax Nexus Model Statute work group at: <http://www.mtc.gov/Uniformity/Project-Teams/Sales-Use-Tax-Nexus-Model-Statute-Project>.

¹⁹ See the project page for the Use Tax Information Reporting Model work group at: <http://www.mtc.gov/Uniformity/Project-Teams/Model-SU-Notice-and-Reporting-Statute>.

²⁰ 138 S. Ct. 2080 (2018).

²¹ See the project page for the *Wayfair* Implementation and Marketplace Facilitator work group at: <http://www.mtc.gov/getdoc/d3f9e214-6006-4f76-bca2-7287be89dd06/Wayfair-Implementation-Informational-Project.aspx>.

²² See that report, available at: <http://clio.lib.olemiss.edu/cdm/compoundobject/collection/aicpa/id/308196/rec/11>.

public hearing held on the MTC model, said this in response to those who suggested it was constitutionally defective:

In sum, the Hearing Officer believes that the proposal's notice and reporting requirements are an administratively efficient means of administering and enforcing sales and use tax without discriminating against, or imposing an undue burden upon, interstate commerce. As such, the proposed model helps to eliminate the perception and practical reality that in-state sales are subject to tax while interstate remote sales are not. Thus, the proposal effectively promotes the fundamental objective of the commerce clause, which is to preserve level competition in national markets.

This conclusion was not just a guess. It followed pages of analysis, summarizing the work of committee members and staff who had been considering and debating the constitutional issues for months. But what no one could have predicted is that Justice Kennedy, in responding to a procedural issue in the litigation, would use the opportunity to issue an invitation for the states to bring to the Supreme Court a direct challenge to *Quill*.

While all this was happening, a third idea began to take root in a handful of states and within the online retail community. That idea was for marketplace facilitators to collect and remit the tax on sales through the marketplace, rather than having all the third-party sellers register, collect, and remit tax on those sales. Certain big marketplaces had mounted opposition to this idea, and any progress toward such a solution had stalled—until the states won their challenge to *Quill*'s physical presence standard in *South Dakota v. Wayfair*.²⁰

After *Wayfair*, the MTC Uniformity Committee recognized two things. The first was that *Wayfair* not only superseded the “doing business” model statute and its affiliate nexus provision, but that states would likely no longer be interested in the notice and information reporting model statute. The second was the importance of the emerging marketplace-collection approach. The committee also rightly concluded that states would move rapidly to adopt that approach. Rather than undertaking a full-fledged drafting project to create a model statute, therefore, the committee organized a work group to analyze the alternative approaches, looking for pros and cons and

recommending best practices, in advance of state legislative sessions that would soon commence. That work group had substantial participation by taxpayers, practitioners, and states.

This work group produced a white paper, adopting recommendations for state lawmakers to consider.²¹ And consider them, they did. As of the drafting of this article, most states with a sales tax have either adopted or are likely to adopt a marketplace facilitator collection and remittance provision—generally following recommendations of the white paper—with the general blessing of the public interests that had been active in the work group.

Now, there are probably some stingy souls who would insist that uniformity efforts must be judged by whether they result in a uniform model that all states adopt word-for-word. If that were the standard, then the efforts described above must be judged a failure. But if the success of such uniformity efforts is judged by whether they substantially assist in finding a generally workable solution to an important common problem, then these efforts, along with others, were a resounding success. Of course, critics might also argue that this success was more the product of luck than effort. Perhaps. But even luck is only useful when the payoff is big.

Still, others might argue that what the MTC really did was take advantage of events that were already unfolding. Which brings us to the third lesson.

Lesson No. 3: “Crisis” is just another word for “opportunity.” As the strategic planning study conducted by the Uniformity Committee task force showed, the widespread existence of divergent state rules can, somewhat ironically, act as a significant barrier to adoption of uniform models. So, what does one do if this problem creates resistance to the adoption of needed uniformity? Be opportunistic. Or, to use a common aphorism—don't let a good crisis go to waste.

Take the example of the state rules for reporting federal adjustments. States that conform, in whole or in part, to federal tax law in computing the items that go into the calculation of state taxable income must anticipate that there will be adjustments to those items resulting from federal audits or taxpayer amendments. States, therefore, provide a process for taxpayers to report and pay state taxes (or claim re-



funds) when such federal adjustments occur. For multistate taxpayers, this process can be complicated because state rules and timelines vary considerably.

In 1995, the America Institute of Certified Public Accountants (AICPA) issued a “Report on Corporate State Tax Administrative Uniformity,” highlighting the administrative difficulties faced by multistate businesses that must report to multiple states the effects of any federal adjustments (resulting from an IRS audit or other change to federal tax information affecting state tax liabilities).²² The AICPA also approached the MTC and recommended the adoption of uniform rules for when and how state taxes on federal adjustments would be required to be reported. The MTC Uniformity Committee agreed to consider a draft prepared by the AICPA and continued to work with other groups on the model until it was eventually adopted by the commission in 2003.²³

This Model Uniform Statute for Reporting Federal Tax Adjustments was, however, a prime example of a uniform approach to an issue on which states had already adopted their own rules, and so were resistant to change. That resistance typically comes not just from the degree of comfort each state has with its own approach, but also from the transition costs that result from necessary changes to forms, instructions, regulations, information systems, and agency procedures. Finally, engaging policymakers and interest groups, as required to get any statutory changes enacted, can be difficult when the changes are as prosaic as those aimed at creating administrative ease. And, so, the model languished for over a decade despite a gen-



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eral agreement by many that the divergent state rules imposed administrative costs on taxpayers and might well impede the reporting of state taxes due.

Then, at the end of 2015, Congress passed the Bipartisan Budget Act. That legislation provided for a new, centralized, partnership audit regime. Under that audit regime, the IRS would assess any additional tax on partnership income in one of two ways: either at the partnership level, or by “pushing out” the adjustment to partners who would report the related tax on adjustment-year tax returns. This created a disconnect between the typical state tax notice and reporting rules for federal adjustments.

There was, therefore, no doubt that the states would have to act to amend their statutes to provide for federal adjustments flowing from this new audit regime. Nor was this a small matter since information from the U.S. Treasury Department indicated that these audits might produce significant findings. In 2016, the MTC Uniformity Committee formed a work group to draft a model provision requiring reporting and payment of state tax on federal

partnership audit adjustments. The committee also received a proposal from the “interested parties” (the Council On State Taxation (COST), the Tax Executives Institute (TEI), the ABA SALT section (ABA), the AICPA SALT committee (AICPA), the Professionals in Taxation (IPT), and others) to incorporate these provisions, along with minor revisions, into the 2003 model. The hope was that, since states would have to consider amending their laws anyway, there was an opportunity to get additional uniformity in related areas. Because there was a general agreement that the efforts might, this time, produce results, there was also substantial cooperation among all the participants to reach agreement on a workable approach.²⁴ The Commission adopted the revised model, including the provisions to address partnership adjustments, in 2019.²⁵

While it appears the revised model is finally getting some attention, it’s still too early to judge the results. Plus, state tax writing committees have had their hands full recently handling the changes necessitated by the *Wayfair* decision and federal tax reform. Which only goes to show that what constitutes a “crisis” is relative.

There are, of course, a couple other hurdles here that may affect adoption of the amended model. The first is that the provisions addressing federal partnership audit adjustments necessarily implicate complex matters of federal partnership law, making the issue harder to evaluate. Moreover, the centralized partnership audit regime, and the changes it necessitates at the state level, are untested. The participants who drafted the model statute recognized that this complexity may need to be addressed

through more detailed regulations. Which brings us to the final lesson.

Lesson No. 4: When dealing with a new complex issue, focus on the details. This may also seem a bit too obvious—something like, complex problems call for complex solutions. But that’s not the lesson. Rather, think of it this way. In drafting any state tax rule, a decision must always be made as to the level of detail to include. Statutes typically call for less detail than regulations. Choosing the appropriate level of detail is important, since it can affect how long it takes to produce a particular rule. Even simple regulations may raise debates over the wording of particular provisions. Nevertheless, more details may be necessary if more uniformity is the goal. This is true even if the general expectation is that states, when adopting the model, may do so in the form of a simpler version.

But increasing the level of detail beyond what might normally be included also serves another purpose. Rules that address, in greater detail, the particulars of how an approach will apply to different situations also act as a “proof of concept,” reducing the uncertainty inherent in a new approach generally, and increasing the likelihood that the approach will be adopted. For this reason, it makes sense to err on the side of more detail when drafting model rules addressing any new approach to some tax issue, especially a complex issue.

The example that illustrates this lesson is the MTC’s experience with market-based sourcing. Most state tax practitioners know that, starting a couple decades ago, states began changing the traditional rule set out in UDITPA Section 17. Section 17 provides for the sourcing of receipts from things other than the sale of tangible personal property, e.g., sales of services and intangibles. Section 17, as originally drafted, looked to the location of the “income producing activity” as determined by the “predominant costs of performance.” But states that were adopting market-based sourcing were focusing on the location of the customer, however that might be determined.

Unfortunately, the states were not taking exactly the same approach. In addition, some states were applying market-based sourcing on a case-by-case basis, using UDITPA Section 18’s equitable apportionment authority (*Continued on page 48*)

²³ See the Model Uniform Statute for Reporting Federal Tax Adjustments with Accompanying Model Regulation, available at: http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/ReportingFederalTaxAdj.pdf.

²⁴ See the archive on this project, along with a link to the 2018 Hearing Officer Report on the Proposed Model Uniform Statute for Reporting Adjustments to Federal Taxable Income and Federal Partnership Audit Adjustments at: <http://www.mtc.gov/Uniformity/Project-Teams/Partnership-Informational-Project>.

²⁵ See a copy of the revised model at: [http://www.mtc.gov/getattachment/Uniformity/Adopted-Uniformity-Recommendations/Model-RAR-Statute-with-Drafters-Notes-\(1\).pdf.aspx?lang=en-US](http://www.mtc.gov/getattachment/Uniformity/Adopted-Uniformity-Recommendations/Model-RAR-Statute-with-Drafters-Notes-(1).pdf.aspx?lang=en-US).

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(Continued from page 21) to alter the traditional rule, as it might have been applied in particular circumstances, because of the anomalous results that the traditional rule produced. It was clear that there needed to be an effort to produce a uniform set of rules for how market-based sourcing would be applied in a host of different situations.

The history of this problem—the need to update UDITPA Section 17 and the fight over who should do it—is fully recounted in documents available on the MTC website.²⁶ Those documents contain a whole semester’s worth of post-graduate-level lessons on state tax uniformity efforts that are, unfortunately, beyond the scope of this article. Suffice it to say, by the time the MTC began drafting its proposal on market-based sourcing, as an amendment to the Multistate Tax Compact, Art. IV, there were a number of state statutes adopting market-based sourcing but using somewhat divergent language. Moreover, despite the clear movement of states to market sourcing, many still doubted whether it could be practically, and consistently, implemented—in part,

because it was not clear how those general statutory methods would be applied. But some critics also doubted that market-based sourcing was truly viable.

Those doubts were set out, in detail, in the report of Prof. Richard D. Pomp, the hearing officer for the amendments to UDITPA Article 17. He cautioned the MTC Executive Committee not to dismiss these doubts and emphasized that they were likely to be addressed only through the adoption of specific regulations, showing exactly how market-based sourcing would be implemented, and identifying areas where the results of using different state methods might need to be reconciled.²⁷

As it happened, the method adopted by the MTC as part of its recommended changes to Article 17’s sourcing of receipts from services (sometimes called the “delivery approach”), as well as the method for sourcing receipts from intangibles, was almost identical to an approach used by Massachusetts. So it was no surprise that the MTC Uniformity Committee would look to the proposed regulations drafted by Massachusetts as a starting point for its own model regulations. Still, it was necessary to first survey state law

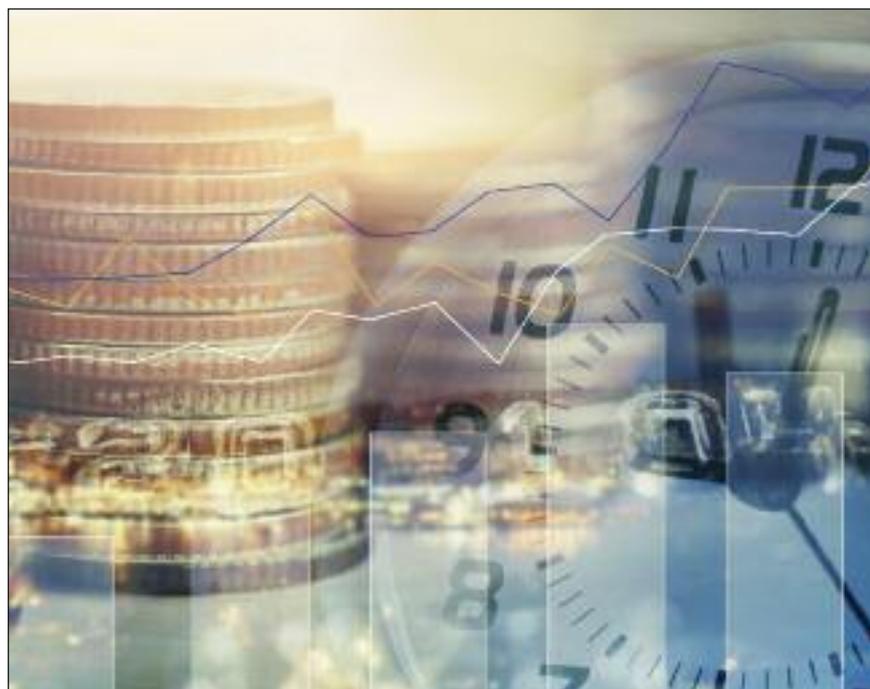
and evaluate what states were doing to implement market-based sourcing in various scenarios. The work group that was responsible for this project also created its own issue checklist to guide its evaluation of the proposed rules.

Only after laying this groundwork did they begin a rigorous analysis of the Massachusetts regulations, proceeding to review those regulations in detail, and making modifications based on work group and committee discussions. Over a period of two years, participants in this effort walked through approximately 50 pages of regulations, including numerous specific examples, parsing provisions and questioning the results. They not only debated whether the rules were realistic and workable, but also considered how the rules might differ from those of states that had adopted a somewhat different approach—including, in particular, California’s “benefits-received” approach.²⁸

I confess that when I make the joke that “nothing says fun like drafting state tax rules by committee,” I’m thinking of this project, in particular. We spent hours debating questions such as how attorney services should be sourced (to where the court is, or where the client is, or where the subject matter of the service is, etc.). Of course, this is the downside to increasing the level of detail—one can lose sight of the forest for the trees. But while grappling with the application of market-based sourcing to specific detailed circumstances was often difficult, once we were done, there were fewer doubts that it was doable.

The Real Reason Why We Keep Doing It

A half-century of experience reveals that MTC uniformity efforts persist for a reason: Misery loves company. Again, just joking. Sort of. In my experience, whenever state policymakers encounter a particular tax issue for the first time, or confront a needed change to their state’s tax system, one of the first things they ask is—what do other states do about this? The unspoken part of this question is—are we the only ones that have this issue? Knowing that others face similar problems or issues can be a comfort. And it’s a small step from commiserating with each other about common problems, to helping each other solve them. ■



²⁶ See the archive on this subject, available at: <http://www.mtc.gov/Uniformity/Article-IV>.

²⁷ Hearing Officer Report on Recommended Amendments to Compact Article IV [UDITPA], p. 96, available at: http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Pomp%20final%20final3.pdf.

²⁸ See the archive for this work group as well as the work group which drafted regulations to implement recommended changes to Section 1 of UDITPA at: <http://www.mtc.gov/Uniformity/Project-Teams/Section-17-Model-Market-Sourcing-Regulations>.