MULTISTATE TAX COMMISSION

Working together since 1967 to preserve federalism and tax fairness

To: Executive Committee
From: Joe Huddleston
Date: July 28, 2009
Subject: 2007-2008 Annual Report of the Executive Director

This report is a summary of the Commission's organizational and staff activities for the period July 1, 2008, through June 30, 2009.

I. Commission Membership

Wyoming has withdrawn from sovereignty membership. Changes in Joint Audit and National Nexus Program membership are described in their respective sections of this report.

II. Programs & Activities

A. Joint Audit Program

The audit division completed 2 income tax audits and parts of 8 other income tax audits for 2008-2009. The audit division also completed 10 sales and parts of 3 other sales tax audits during the same period. There are currently 22 income and 33 sales tax audits in progress. The audit program generated proposed assessments of $39,432,308 for income tax cases and $6,862,182 for sales tax cases. The following chart summarizes hourly data for *completed* audits during this fiscal year:

	Income & Franchise	**Sales & Use**	**Total**
Total Audits	3	10	13
Total States Audited	79	120	199
Total Hours	6,440	7,265	13,705
Average Hours per State	81	61	69

The states in several audits, along with Commission audit and legal staff, met via numerous teleconferences to discuss particular audits in progress.

Minnesota has withdrawn from the Joint Audit Program. Tennessee has joined the Joint Audit Program for both sales & use tax and income & franchise tax audits.

The audit division continues the process of revamping the Commission's Audit Manuals. There are two separate groups comprised of the Commission's Deputy Director, Audit Director, Audit Supervisors and auditors working to complete the manuals. A second draft of the income tax manual was distributed for review to the Audit Committee as well as to certain individuals in industry for comment in May; the final draft will be available for public review and comment by September 1st. A second draft of the sales tax manual will be ready for distribution to the Audit Committee and select soon individuals in industry by September 1st also; a final draft will be made available for public review and comment before December 1st.

Audit division staff provided instruction at two statistical training classes and two combined reporting schools during this period.

B. National Nexus Program

During 2009-2009, the National Nexus Program:

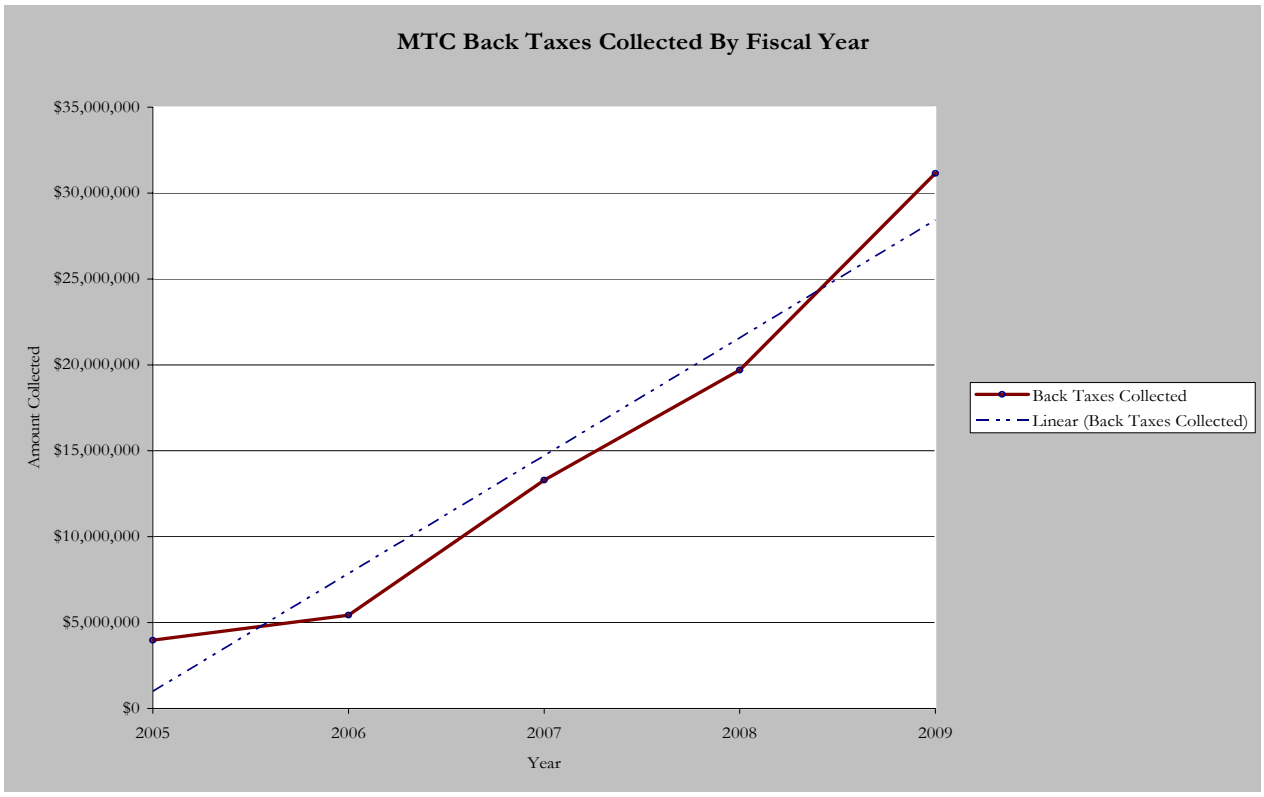
- Executed contracts with 69 taxpayers (69 Files), which resulted in 345 separate contracts with states (345 Cases).

- Opened 83 new voluntary disclosure Files, representing 815 Cases. Please note that some opened Files are closed without an executed contract or are closed with less than the initially estimated number of contracts executed. In other words, if history is a guide, roughly half the 815 opened Cases will result in executed contracts

- Collected back tax of $33.85 million.

It is important to also note that most of this year's revenue came from a single group of affiliated taxpayers. Because this taxpayer chose to disclose through the Commission to a relatively small number of states, this year's revenue is concentrated in those states. States whose FY2009 voluntary disclosure revenue exceeds $2 million are: Arkansas ($2.92 million), Iowa ($4.97 million), and New Jersey ($17.64 million). This affiliated group of taxpayers continues to negotiate with other states through the Commission, so there will likely be similar revenue in other states in the coming fiscal year.

The chart below shows revenue collected with respect to fiscal years 2005-2009. Only back tax* actually collected is included. Interest on back tax collected is billed by the state directly to the taxpayer at the conclusion of the disclosure and is not included. The revenue reflected in these charts takes no account of future amounts collected as the result of having a new taxpayer.



* Insignificant amounts of penalty, interest, registration fee, etc. may be included if actually collected with respect to back periods.

Rhode Island and Wyoming have withdrawn from the National Nexus Program.

Nexus staff continues to work with the Nexus Committee to develop guidelines for voluntary disclosure procedure. This is an effort to provide guidance to Nexus staff, make voluntary disclosure more transparent to taxpayers, and increase efficiency through uniformity.

Staff worked closely with the Technology Committee on a project to improve the program's voluntary disclosure management software, which will improve efficiency, reduce processing time, and thereby make the program more attractive to taxpayers. This project is completed, and taxpayer or their representatives are now able to apply for the Voluntary Disclosure Program online.

The Nexus Program conducted five nexus schools during the year. The next scheduled school will be in Loudoun County, Virginia, in December.

The Commission has trained a back up instructor for the Nexus School to ensure seamless substitution in the event a regular instructor is unexpectedly unavailable. The Commission will likely train an additional back up instructor during the next fiscal year.

Nexus staff has updated a portion of the Nexus School materials and printed revised booklets for use by students in the Little Rock and subsequent schools. Staff will continue to update materials as appropriate and distribute revised versions in future schools.

C. Legal

The Legal Division staffs two standing committees: Uniformity and Litigation. The Division also holds bi-monthly government tax attorney teleconferences; files amicus briefs in state and federal courts; participates as speakers at conferences, symposiums and institutes; and teaches MTC training courses. Upon request, the legal staff provides direct state support by reviewing and commenting on states' own draft statutes, regulations and legal briefs. They also provide legal support for the MTC's audit division, training division, and general administration.

Legal Division staffed ten uniformity projects this fiscal year:

- *Amendments to Compact Art. IV and UDITPA* (under development at Executive Committee and, until recently, at the Uniform Law Commission)

- *Model Statute Clarifying the Tax Collection Responsibilities of Accommodations Intermediaries* (currently in the public hearing process)

- *Amendments to MTC Model Financial Institutions Apportionment Rule* (under development by a Uniformity Subcommittee Work Group)

- *Amendments to MTC Model Regulation Regarding Section 18* (under development at the Uniformity Committee)

- *Model Statutes for Telecommunications Transaction Tax Administration* (under development at Uniformity Committee)

- *Non-Corporate Income Taxpayers* (under development at Uniformity Committee)

- *Review MTC Model Sales & Use Tax Related Statutes and Regulations in light of Streamlined Sales Tax Agreement* (under review at Uniformity Committee)

- *Amendments to MTC Model Add-back Statute to Address REITs* (under development at Uniformity Committee)

- *Review of MTC Model Combined Reporting Statute Tax Haven Provisions* (under review at Uniformity Committee)

- *Model Withholding Statute for Employees Engaged in Multistate Activity* (under development at Uniformity Committee)

Legal Division supported the Litigation Committee during this period by organizing presentations and case summaries for the July 2008 and March 2009 meetings. They also held a short meeting, October 2008 in Nashville, Tennessee, concurrently with the Hartman Conference. Staff made several presentations at these meetings. In addition, legal staff hosted four bi-monthly teleconferences for government tax attorneys, in September, November, February, and May. These teleconferences generally involve two presentations on topics of current interest to the states and allow time for discussion. All government tax attorneys are invited to attend.

The following four *amicus curiae* briefs have been filed this fiscal year:

- *Commissioner of Revenue v. Comcast*, Massachusetts Supreme Judicial Court (decided in favor of taxpayer)

- *Ohio Grocers Association, et al. v. Wilkins*, Ohio Supreme Court (decision pending)

- *Polar Tankers, Inc. v. City of Valdez, Alaska*, United States Supreme Court (apportionment argument not addressed)

- *Franchise Tax Board of the State of California v. Gilbert P. Hyatt*, Nevada Supreme Court (brief submitted; awaiting reply brief)

Legal Division has also drafted a memorandum to be offered to the California Board of Equalization in a case involving Article III of the Compact.

Legal Division provided input to several states on issues in various legal contexts, including review of draft briefs, regulations, and legislation. They monitored and reported on the activities of the Streamlined Sales and Use Tax Governing Board and its Committees. For the third year, the MTC and FTA legal staff co-hosted an evening meeting and dinner for state tax attorneys attending the Georgetown Law Center's Advanced State and Local Tax Institute and Symposium. Legal staff continues to provide assistance to the audit division on several matters, including challenges to the Commission's authority to audit on behalf of sovereignty and associate-member states. They provided legal assistance regarding general Commission administration, including open records requests, required registrations and reporting, and assistance for the Commission's alternative dispute resolution process. In addition, they contributed to review and mark-up of bills before Congress, including the VoIP bill, the BATSA bill, and the Mobil Workforce bill.

Legal division staff provided instruction at four nexus schools and two combined reporting schools during the year.

D. Policy Research

MTC Project on Revising Model Statute on Apportioning Income of Financial Institutions — The policy research director and interns, Cameron Snow and Ann Boyd Watts, developed a database of industries, other than financial services industries, that have substantial income from interest, and fees for services similar to services provided by financial services. The policy research director continues to provide support for this project.

Administration of Telecommunications Transaction Taxes — The policy research director is assisting the Sales & Use Tax Subcommittee of the Uniformity Committee with their project of developing models of centralizing administration of local telecommunications transactions taxes.

Multistate Tax Commission Review —

Policy Research oversaw production of the summer 2008 issue of the *Review*. Dr. Dubin wrote one article with former Policy Research Inter Cameron Snow ("Musings from the BAT Cave" for Summer 2008 issue of MTC Review. This article also appeared in the November 12, 2008 issue of State Tax Notes. This issue also an article by Professor David Wildasin of the University of Kentucky and one article by Harold Jennings and Robert Schauer of the MTC Joint Audit Program staff.

Policy Research oversaw production of the summer 2009 issue of the *Review*. This issue includes an article written by Dr. Dubin with former Research Intern, Ann Boyd Watts ("Did FIN 48 Increase Tax Compliance among Non-Filers?") for next issue of MTC Review. It also includes an article written by outside attorneys on benefits of working with MTC's Alternative Dispute Resolution.

Dr. Dubin is writing an article with current research intern, Ben Devlen, on the transition from General Accounting Principles (GAAP) to International Financial Reporting Standards (IFRS) which will be featured in the next issue of the *Review*.

Other Activities —

- Organized, session on Taxes and Education for National Tax Association' Annual Meeting in Philadelphia, PA. Will act as discussant for two other papers in different sessions.

- Presented short paper on Federal Intervention in State Taxation at FTA Revenue Estimating and Research Directors annual meeting in Portland, Maine, on September 2008.

- Organizing joint NTA-FTA session at FTA Revenue Estimating Conference in Des Moines, Iowa, in September 2009.

- Worked with Census Bureau personnel (Governments Division) on improving quarterly estimates of state/local taxes; and, revising definitions of state/local taxes initially imposed on businesses.

- Organized meeting of Tax Economists Forum on State Fiscal Conditions

- Working with staff of state revenue agencies (Washington, Utah, Minnesota, and Tennessee) to devise methodology to estimate tax gap from remote, non-electronic business to business commerce and from remote, non-electronic business to consumer commerce.

- Recruited and hired a research intern, Ben Devlen, for summer 2009.

- Assisted in planning and preparation of the Annual Meeting Conference in Kansas City in July.

- Monitoring states' adoption of MTC model statutes, regulations, and guidelines.

E. Training

The following MTC courses were offered during the 2008-2009 fiscal year; these courses reached 274 state and local government tax personnel, and four private sector participants (other training events supported by the Commission reached over 130 additional personnel):

- Nexus School
  September 15-16, 2008 in Omaha, Nebraska for 28 students
  October 21-22, 2008 in Boise, Idaho for 28 students
  December 16-17, 2008 in Olympia, Washington for 45 students
  February 9-10, 2009 in Baton Rouge, Louisiana for 18 students
  May 18-19, 2009 in Little Rock, Arkansas for 27 students

- Corporate Income Tax
  December 8-9, 2008 in Boston Massachusetts for 50 students (Part 1 only)
  April 20-23, 2009 in Charleston, West Virginia for 41 students in Part 1 and 16 student in Part 2

- Statistical Sampling for Sales and Use Tax Audits
  July 14-17, 2008 in Cheyenne, Wyoming for 31 students
  March 2-5, 2009 in Topeka, Kansas for 10 students

The Commission staff also supported the 2008 FTA-MTC Audit and Computer Technology Workshop in Albuquerque for 68 participants on October 6-8, 2008.

The tuition schedule for 2009-2010 remains at the level established for 2007-2008. Tuition for private sector participants in the Statistical Sampling and other courses is now set at 75% above the level for Compact and Sovereignty members.

Online registration is now being used for all MTC courses and most MTC in-person meetings. Payment is being handled separately from online registration.

The training staff has ongoing contact with state personnel to ensure state training needs are being monitored and met.

NASBA Certification and Continuation Education Credit — The Commission has renewed its registration with the National Association of State Boards of Accountancy (NASBA) as a CPE sponsor.

Private Sector Participation — We had three private sector participants at the April 2008 Statistical Sampling for Sales and Use Tax Audits course in Denver, and we continue to promote this course to the private sector. At the April 2009 Corporate Income Tax course in West Virginia, we had three private sector participants in Part 1 (Principles of Allocation and Apportionment) of the course.

F. Other Activities

Staff met with delegations from the States of Jersey and the Bailiwick of Guernsey during the fiscal year regarding the tax haven provision in the Commission's model combined reporting statute. In May, the Executive Committee directed the Uniformity Committee to review the Commission's model statute on combined reporting in light of the changes by the Organization for Economic Cooperation and Development to its tax haven list and listing process.

Staff met with representatives from IRS Governmental Liaison & Disclosure and Office of Safeguards to discuss further implementation of the MOU between the Commission and 23 Joint Audit Program member states in respect of access to federal taxpayer information. Audit data has been shared with the IRS under the terms of the MOUs. Staff, with guidance from the IRS, continues to work toward achieving actual exchange of federal data from the states allowing for assessment of how best to use it on behalf of audit program states.

II. Administration

A. Personnel & Benefits

- Terry Daehn joined the Chicago office of the MTC as an auditor on October 16, 2008.

- Ki Yun joined the Chicago office of the MTC as an auditor on November 3, 2008.

- Ann Boyd Watts, a doctoral student at the University of Tennessee at Knoxville, worked as a policy research intern from September 2 to November 7.

- The executive assistant position filled by Sheila Hudson was eliminated in June due to the reduction of fees resulting from some states leaving the Joint Audit and National Nexus Programs.

- Benjamin Devlen, a Florida State University graduate from its Business & Accounting program, is working with the Policy Research division this summer for six weeks studying the effects of the transition from GAAP to IFRS.

Health Insurance — Effective September 1, 2008, the Commission changed its group health insurance plan from a partially self-funded plan with Guardian to a fully premium paid group health insurance plan with CareFirst (BlueCross/BlueShield).

Retirement Plans — In December, the Commission's retirement and deferred compensation plans changed from ICMA-RC as broker, record-keeper, and custodian to Aintree Capital, Daily Access Corporation, and Reliance Trust Company, respectively.

B. Facilities

The physical build out and renovation of the Commission's D.C. office related to acquiring an additional 565 sq ft. of contiguous space was completed.

The lease for the office in Houston expired September 30, 2008, and was not renewed.

Minor construction to prepare the server room in the headquarters office to meet the physical security requirements for handling FTI in accordance with IRS Publication 1075 has been completed.

III. Outside Programs

The following are the programs, conferences, and other events of outside organizations at which members of the staff represented the Commission during the year:

<u>JULY</u>

- SEATA Annual Conference, Williamsburg, Virginia (Huddleston)
- NYU Advanced State & Local Taxation Conference, New York, New York (Huddleston)
- TEI State and Local Tax School, Indianapolis, Indiana (Fort)

AUGUST
- MSATA Annual Conference, Madison, Wisconsin (Huddleston)

SEPTEMBER
- WSATA Annual Conference, Whitefish, Montana (Huddleston)
- TEI, California Regional Chapters Meeting, Redwood City, California (Sicilian)
- Taxpayers' Federation of Illinois State & Local Tax Conference, Springfield, Illinois (Huddleston)
- BNA-Sutherland Multistate Tax Roundtable, Washington, D.C. (Sicilian)
- NESTOA Annual Conference, Newport, Rhode Island (Huddleston)
- FTA Revenue Estimating Conference, Portland, Maine (Dubin)

OCTOBER
- IPT, Advanced State Income Tax School, Atlanta, Georgia (Sicilian)
- COST Annual Meeting, Orlando, Florida (Fort)
- National Association of State Tax Bar Associations, San Francisco, California (Huddleston)
- Pennsylvania Institute of CPAs Multistate Tax Conference, Malvern, Pennsylvania (Dubin)
- Paul J. Hartman State & Local Tax Forum, Nashville, Tennessee (Huddleston, Matson, Fort)

NOVEMBER
- Michigan Association of CPAs Michigan Tax Conference, Detroit, Michigan (Huddleston)
- IPT Income Tax Symposium, Denver, Colorado (Huddleston)
- California Tax Policy Conference, San Francisco, California (Huddleston)
- NTA 101st Annual Conference on Taxation, Philadelphia, Pennsylvania (Dubin)

DECEMBER
- NYU 27th Institute on State & Local Taxation, New York, New York (Huddleston)
- Taxation Section of Maryland State Bar Assoc. and the Graduate Tax Program at University of Baltimore's Second Symposium on State and Local Tax Policy: Expanding the Tax Base –Policy, Legality and Practicality, Baltimore, Maryland (Laskin)

JANUARY
- NYU Tax Lunch Group Meeting, New York , New York (Huddleston)
- 18th Annual Ohio Tax Conference, Columbus, Ohio (Huddleston)

FEBRUARY
- Tax Council Policy Institute 10th Annual Tax Symposium, Washington, D.C. (Huddleston)

MARCH

- ABA/IPT Advanced Income Sales & Use Tax Seminar, Washington, D.C. (Huddleston)
- AFT Tax Auditors Meeting, Madison, Wisconsin (Huddleston)
- Uniform Law Commission UDITPA Study Committee, Chicago, Illinois (Huddleston, Sicilian)

APRIL

- New Mexico Tax Research Institute, Santa Fe, New Mexico (Fort)

MAY

- Georgetown SALT Symposium, Washington, D.C. (Huddleston, Shimkin, Sicilian)
- National Tax Association Spring Seminar, Washington, D.C. (Dubin)
- Conference of Southern County Associations, Ashville, North Carolina (Huddleston)
- FTA Annual Conference, Denver, Colorado (Huddleston, Matson, Sicilian)

JUNE

- IPT Advanced Income Tax School, Williamsburg, Virginia (Huddleston)
- Annual Multistate Tax Institute, Brookfield, Illinois (Huddleston)
- New Jersey Society of Certified Public Accountants, Trenton, New Jersey (Shimkin)
- SEATA Annual Conference, Biloxi, Mississippi (Huddleston)