MULTISTATE TAX COMMISSION

Working together since 1967 to preserve federalism and tax fairness

To: Executive Committee

From: Joe Huddleston, Executive Director

Date: July 22, 2010

Subject: 2010 Annual Report of the Executive Director

This report is a summary of the Commission's organizational and staff activities for the period July 1, 2009 through June 30, 2010.

I. Programs & Activities

A. Joint Audit Program

The audit division completed 6 income tax audits and parts of 7 other income tax audits as of June 30, 2010. The audit division also completed 12 sales and parts of 1 other sales tax audits as of June 30, 2010. There are currently 21 income and 32 sales tax audits in progress. Proposed assessments for fiscal year end June 30, 2010 from these audits total $134,044,909.

There were several income tax cases that were delayed by the taxpayers due to staff turnover in their tax departments.

The following chart summarizes hourly data for *completed* audits for fiscal year end June 30, 2010:

	Income & Franchise	**Sales & Use**	**Total**
Total Audits	6	12	18
Total States Audited	152	147	299
Total Hours	10,445	10,772	21,217
Average Hours per State	69	73	71

Aside from the meetings of the Audit Committee, states in numerous audits have met with staff via teleconferences to discuss particular audits in progress and issues specific to those audits.

Hawaii withdrew from the program due to budget issues.

Work on revising the MTC Income and Sales Tax Audit Manuals is nearly finished, and public drafts will posted to the website for comment by the Commission's annual meeting.

Audit division staff provided instruction at two statistical and one income tax training classes during fiscal year end June 30, 2010.

B. National Nexus Program

This fiscal year, the Voluntary Disclosure Program open files for 87 new applicants, executed 440 contracts with states with an average value of $144,084, and collected $63,396,870 of cash revenue on behalf of member states (this does not include after-collected interest, which is usually substantial, nor the value of future tax payments). This is an overall (all states and all tax types) return on investment of $72 for each $1 paid in National Nexus Program fees.

The chart below shows the back taxes collected in recent fiscal years, including the current one:

	Dollar Amount	Executed Agreements	New VDA Applicants	Average Agreement Value	Program Fees	Return on Investment
FY 2006	$6,085,684	376	78	$16,185.33	$812,973	$7.49
FY 2007	$12,799,098	351	75	$36,464.67	$876,983	$14.59
FY 2008	$17,468,156	515	72	$33,918.75	$875,485	$19.95
FY 2009	$31,964,967	375	83	$85,239.91	$892,996	$35.80
FY 2010	$63,396,870	440	87	$144,083.80	$881,325	$71.93

Income and franchise taxes compose 90.2 percent of the back taxes collected; sales and use taxes compose 9.8 percent. The preponderance of income and franchise tax is unusual and is due to the heavy contribution of a single, income-tax taxpayer to FY 2010 results. The same situation prevailed in FY 2009 as well due to this taxpayer.

Nexus Program staff continues to work to improve the Commission's voluntary disclosure software in an environment of limited resources. Staff is also working with its vendor to make improvements and corrections to the present version. Staff believes that the Commission is second only to New York in implementation of an online application. Staff is using the software to track disclosures (approximately one thousand potential state contracts at any given time) and manage work flow more efficiently.

Nexus staff is working with a subcommittee of the Nexus Committee to further develop general conceptual outlines of phase II of this project, which involves giving states and taxpayers access to the software so that they may perform some functions themselves, and facilitating anonymous electronic communication between states and taxpayers. The second portion remains an unfunded concept for now.

Nexus Program staff facilitate and coordinate with the Nexus Committee; at each meeting staff made reports to the committee about activities of the National Nexus Program and general matters concerning nexus law and enforcement, including a presentation from a member state attorney on nexus litigation. Staff sought and received advice and direction from the committee, and committee members exchanged information among themselves in roundtable discussions.

Nexus Program staff continues to work with the Nexus Committee to bring the draft voluntary disclosure guidelines to implementation. Similar to an audit manual, when implemented this document will provide guidance to Commission staff and taxpayers regarding state voluntary disclosure policies. The Nexus Committee plans to complete this work and present a final version to the Executive Committee for consideration at its December 2010 meeting.

Nexus Program staff have researched four industries (several companies each) and three business entities with respect to nexus this fiscal year and presented reports to the Nexus Committee. Some states have indicated that they will follow up with regard to these entities.

Nexus division staff provided instruction at three nexus training courses during this period.

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. The legal division provides individual state support by reviewing and commenting on states' draft statutes, regulations and legal briefs. The division also provides legal support for the Commission's audit division, training division, and general administration.

<u>Uniformity Work</u>

The legal division staffed twelve projects for the Uniformity Committee during fiscal year 2010:

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

- *Amendments to Compact Art. IV and UDITPA* (under development at Uniformity Committee)

- *Amendments to Model Combined Reporting Statute Water's-Edge Tax Haven Provision* (under development at Uniformity Committee)

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

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

- *Model Sales & Use Tax Notice and Reporting Statute* (under development at Uniformity Committee)

- *Model Mobile Workforce Withholding and Individual Income Tax Statute* (referred back to Uniformity Committee after public hearing)

- *Model Add-back Statute to Address Captive REITs* (under consideration by Executive Committee for public hearing)

- *Model Statute on the Tax Collection Responsibilities of Accommodations Intermediaries* (referred back to Executive Committee after failure to pass bylaw 7 survey)

- *Repeal of Guideline on Applicability of Sales and/or Use Tax to Computer Software* (under consideration by the Commission)
- *Amendments to MTC Model Regulation Regarding Section 18* (under consideration by the Commission)

- *Principles Governing State Transactional Taxation of Telecommunications, Vendor -Vendee* (under consideration by the Commission)

Litigation Committee Work

The legal division supported the Litigation Committee by organizing and making presentations for the July 2009 and March 2010 meetings. In addition, the legal division organized a joint Litigation Committee–Audit Committee roundtable discussion during the March meetings. And we organized three state tax attorney teleconferences.

Legal Assistance to States

The legal division consulted with individual states regarding significant on-going litigation, draft legislation, and draft regulations. We also undertook the following *amicus curiae* briefs this fiscal year:

- *Franchise Tax Board of the State of California v. Gilbert P. Hyatt*, Nevada Supreme Court (pending)

- *Blue Bell Creameries, L.P. v. Chumley*, Petition for Review to Tennessee Supreme Court (review granted)

- *DirecTV, et al., v. Levin*, Ohio Supreme Court (pending)

- *Levin v. Commerce Energy*, U.S. Supreme Court (decision in favor of the state)

- *Norfolk Southern Railway v. Alabama Department of Revenue*, U.S. Supreme Court (request received)

Commission Support

During this fiscal year, the legal division provided support for the Commission's general administration by addressing open meetings issues, records requests, researching and making recommendations for record retention policies, and filing corporate registrations and reports. The division provided legal assistance to the Commission's audit division on a number of challenging audit related procedural and substantive issues. legal division taught MTC nexus training in Topeka, Kansas; Landsdown, Virginia; and Salem, Oregon. The division monitored and reported on the activities of the Streamlined Sales and Use Tax Governing Board and its Committees. In addition, the division contributed to state consideration of bills before Congress, including the VoIP, Mobile Workforce, Streamlined Sales Tax, and others.

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 work with other MTC staff, state revenue agency personnel, and industry representatives to develop a model apportionment statute.

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 —

- Completed production of the summer 2009 issue.
- Wrote one article with former intern, Ann Boyd Watts ("Did FIN 48 Increase Tax Compliance Among Non-Filers?") for the summer 2009 issue.
- Completed production of the winter 2010 issue.
- Wrote with former policy research intern, Benjamin Devlen, "COMING SOON: International Financial Reporting Standards" for the winter 2010 issue.
- Wrote article, "Changes in State Corporate Income Tax Apportionment Formulas and Changes in State Corporate Income Tax Bases" for the winter 2010 issue; this article was also published in the February 22, 2010, issue of *State Tax Notes*.
- Completed production of the spring 2010 issue.
- Wrote with former policy research intern, Benjamin Devlen, "COMING SOON: International Financial Reporting Standards" for the winter 2010 issue.
- Wrote article, "Changes in State Corporate Income Tax Apportionment Formulas and Changes in State Corporate Income Tax Bases" for the winter 2010 issue; this article was also published in the February 22, 2010, issue of *State Tax Notes*.
- Working on an article with Shan Chen, Policy Research summer intern on State and Local Fiscal Conditions for the summer 2010 issue.

Other Activities —

- Worked with Census Bureau personnel (Governments Division) on improving quarterly estimates of state & local taxes, revising definitions of state & local taxes initially imposed on businesses, and contents of 2012 Census of Governments.
- Organized meeting of Tax Economists Forum on State Fiscal Conditions.
- Organizing session at FTA Revenue Estimating Conference in Sun Valley, Idaho, on incidence of state and local taxes initially imposed on business, September 2010.
- Monitoring of state adoption of MTC model statutes, regulations, and guidelines.

E. Training

Training staff supported the following training activities:

- *Computer Assisted Audit Techniques Using Excel and Basic Random Sampling* September 14-18 in Mitchell, South Dakota, for 19 students from the South Dakota Department of Revenue and Regulation. This was a combined session for two separate courses

- *Nexus School*
  October 19-20 in Topeka, Kansas, for 14 students (10 from Kansas and one each from Alaska, Missouri, Nebraska, and Utah)

- *Statistical Sampling for Sales and Use Tax Audits*
  October 19-22, in Chicago, Illinois, for 10 participants from Illinois, Maryland, Office of the Revenue Commissioners of Ireland, and the private sector.

- *Nexus School*
  December 7-8 in Lansdowne, Virginia, for 11 students from the District of Columbia.

- *Corporate Income Tax*
  May 17-19, 2010 in Montgomery, Alabama, for 39 students (32 from Alabama, 2 from Mississippi, and 5 from Montana)

- *Nexus School*
  June 28-29, 2010 in Portland, Oregon, for 21 students (19 from Oregon, 1 from Alaska, and 1 from Idaho)

The following courses are currently scheduled:

- *Nexus School*
  October 26-27, 2010 in Helena, Montana (tentative)

- *Statistical Sampling for Sales and Use Tax Audits*
  March 2011 in Chicago, Illinois (tentative)

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

The director of training also prepared a summary of federal estate tax proposals being considered in Congress on behalf of the Policy Research division and prepared a background paper on investment banks for the November 23rd meeting of the Financial Institutions Apportionment Work Group in support of that uniformity project.

Training staff organized the July 28 Annual Meeting Conference sessions to be held in Hood River, Oregon.

The training director has submitted the renewal application for registration as a CPE sponsor with the National Association of State Boards of Accountancy (NASBA).

The training director has supported staff-level discussions of IRS Notice 2010-9 regarding uncertain tax positions and the FCC Broadband plan, and wrote an article on Federal Communications Commission Broadband Plan for a future issue of the *MTC*

Review. He attended the Attended IRS Research Conference, June 29-30, 2010 in Washington, D.C.

II. Administration

On October 29, 2009, final amounts held by ICMA-RC (prior custodian of the MTC Retirement Plan and MTC Deferred Compensation Plan assets) for the benefit of the participants in the MTC Retirement Plan and MTC Deferred Compensation Plan were liquidated. All these participant accounts were in a stable value fund (the ICMC-RC Plus fund) which, due to fund restrictions, were not able to be liquidated until this October. Following liquidation, all funds were wired to Daily Access (the current custodian of the MTC Retirement Plan and MTC Deferred Compensation Plan assets). The funds have been credited to the appropriate participant accounts at Daily Access based on participant information provided by ICMA-RC.

On December 14, 2009, Executive Director Joe Huddleston was awarded the honorary degree of Doctor of Laws by University of South Carolina, the highest honor the University can bestow. He was cited for his considerable leadership and commitment to the pursuit of efficient and effective government and commerce through sound public policies; for his dedication and devotion to the concept of equitable and simplified taxation; and for his dedication to the communities in which he has lived as well as to his alma mater, the University of South Carolina.

Shan Chen was hired as a summer Policy Research intern in June 2010.

III. Presentations

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

<u>JULY</u>

- IPT Annual Conference, San Francisco, California (Huddleston)
- NYU Advanced State & Local Taxation Conference, New York, New York (Huddleston)

<u>AUGUST</u>

- TEI Corporate Income Tax Training, Indianapolis, Indiana (Fort)

<u>SEPTEMBER</u>

- American Bar Association Tax Section Meeting, Chicago, Illinois (Sicilian)
- Paul J. Hartman State & Local Tax Forum, Nashville, Tennessee (Fort)

- Eastern States Legislative Fiscal Officers Association Annual Meeting, Annapolis, Maryland (Huddleston)
- FTA Revenue Estimating Conference, Des Moines, Iowa (Dubin)

OCTOBER
- Regional SALT Forum, New Hampshire Society of CPAs, Manchester, New Hampshire (Sicilian)
- COST Annual Meeting, Las Vegas, Nevada (Huddleston)
- National Association of State Tax Bar Associations, Washington, D.C. (Huddleston)

NOVEMBER
- Michigan Association of CPAs Michigan Tax Conference, Novi, Michigan (Huddleston)
- California Tax Policy Institute, San Diego, California (Sicilian)
- University of New Mexico Law School Tax Law Club, Albuquerque, New Mexico (Fort)
- NTA Annual Conference on Taxation, Denver, Colorado (Dubin)

DECEMBER
- New York University Institute on State and Local Taxation, New York, New York (Fort)

JANUARY
- National Conf. of State Legislators, Atlanta, Georgia (via teleconference) (Sicilian)
- ABA Tax Section Meeting, San Antonio, Texas (Huddleston)
- 19th Annual Ohio State Tax Conference, Columbus, Ohio (Matson)

FEBRUARY
- Paper presented to Louisiana Multiparish Tax Commission on State and Local Government Fiscal Conditions, Baton Rouge, Lousianna (Dubin)
- Tax Council Policy Institute 11th Annual Tax Symposium, Washington, D.C. (Huddleston)

MARCH
- Paper presented to Census Bureau staff on Improving State and Local Revenue Statistical Data, Suitland, Maryland (Dubin)

APRIL
- J. Nelson Young Tax Institute, Chapel Hill, North Carolina (Huddleston)

MAY
- BNA Seminar, *State Nexus Policy Trends: Analyzing BNA's 2010 Survey of State Tax Departments* (via Internet) (Shimkin)

- AICPA State and Local Taxation Committee Meeting, Houston, Texas (via teleconference) (Sicilian)
- American Bar Association, State and Local Taxation Section Meeting, Washington, D.C. (Sicilian)
- Maryland Business Tax Reform Commission Meeting, Annapolis, Maryland (Huddleston)
- Georgetown Advanced State and Local Tax Institute, Washington, D.C. (Matson, Sicilian)
- D.C. Bar Tax Section State and Local Subcommittee Luncheon, Washington, D.C. (Huddleston)

JUNE

- Federation of Tax Administrators Annual Meeting, Atlanta, Georgia (Huddleston, Matson, Sicilian)
- IPT Corporate Income Tax Advanced Training, Indianapolis, Indiana (Sicilian)
- Annual Multistate Tax Institute, Milwaukee, Wisconsin (Huddleston)
- Chief Minister's International Lecture, Douglas, Isle of Man (Huddleston)
- COST Mid-Atlantic Regional State Tax Seminar, McLean, Virginia (Shimkin)