



MULTISTATE TAX COMMISSION

To: Commission
From: Joe Huddleston
Date: July 27, 2012
Subject: 2012 Annual Report of the Executive Director

This report is a summary of the Commission's organizational and staff activities for the period July 1, 2011, through June 30, 2012.

I. Programs & Activities

A. Joint Audit Program

The Joint Audit Program completed 4 and parts of 8 income tax audits for fiscal year end 6/12. The program also completed 5 sales tax audits and parts of 8 other audit for the same period. There are 20 income and 32 sales tax audits in progress.

The MTC Audit Program proposed assessments of \$110,878,008 for income tax and \$6,990,376 for sales tax.

The following chart summarizes hourly data for completed audits for fiscal year end June 30, 2012:

	Income & Franchise	Sales & Use	Total
Total Audits	4	5	9
Total States Audited	131	59	190
Total Hours	11,937	5000	16,937
Average Hours per State	91	85	89

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.

Audit division staff provided instruction at two income tax training classes and two sampling classes for fiscal year end June 30, 2012.

Federal Data Sharing Initiative— The one-year Data Sharing Initiative (DSI) is exploring, within the framework of IRS Safeguard policies, the respective MOUs

executed between individual states and the MTC, and the policies, procedures, and practices that guide the MTC's Joint Audit Program activities to determine the effectiveness of pooling state FTI for analysis by MTC to enhance the Joint Audit Program and compliance activities on behalf of our member states. Accomplishment of the DSI test phase objectives by October 31, 2012 will depend, in large part, on the timeliness of the IRS in processing and approving the MTC's Safeguard Procedures Report (SPR) which was submitted for review on July 27, 2012.

The DSI project manager has researched states' needs, access, and use of FTI and federal tax return info, identified types of FTI (in the form of IRS data extracts) to be examined by the DSI, and obtained the agreement of three states to participate in the test phase. The SPR (required for MTC to receive FTI from the states) has been prepared and submitted to the IRS and is now pending review by Safeguards. The project manager and network administrator have implemented safeguard policies, procedures, and equipment at the MTC in accordance with our SPR and IRS Publ. 1075. The project manager has prepared a framework for analysis that the DSI will use in examining FTI.

B. National Nexus Program

Voluntary Disclosure — the number of voluntary disclosure cases has continued its slow but fairly consistent rise over the years. During fiscal year 2012, the National Nexus Program collected \$12,547,433 on behalf of Nexus member states and \$15,246,349 on behalf of all states.¹ The Commission provides multi-state voluntary disclosure service to states not members of the National Nexus Program. Doing so increases the one-stop value of the Commission's program to taxpayers and thereby helps member states by attracting participants. Providing these services is also a way to introduce the multi-state program to non-members who may later choose to join.

During the last decade, collection of back taxes by the program peaked sharply in 2010, mostly due to a single taxpayer representative with taxpayers having significant liability. In 2011, back taxes collected returned to pre-2008 levels, so next we will investigate whether the drop in revenue was due to fewer contracts or lower contract value.

Nexus School — Nexus and legal staff conducted well-attended Nexus Schools in Little Rock (October 2011) and Jefferson City (April 2012). The trainers from the nexus and legal divisions re-wrote most of the curriculum for the Jefferson City school to update citations and shift the presentation format somewhat away from a Socratic, case-law approach and toward one more rules-based (black letter).

¹ The annual collection amounts include only back tax actually collected (cash basis). They may also contain a trivial amount of penalty, interest, and miscellaneous fees if they were collected before conclusion of the voluntary disclosure. It does not include any tax, interest, penalty, or other thing of value collected after the voluntary disclosure process ended. States almost always collect substantial interest on back tax amounts after the end of the voluntary disclosure process, but the Commission does not include these amounts in its reports, nor does it include the value of future tax payments from a newly-compliant taxpayer, which is usually also substantial.

Nexus program staff also contributed to BNA's annual published survey of state nexus policies (and a few other issues).

C. Legal

The legal division staffs two standing committees: Uniformity and Litigation. The division also holds regular state 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 assisting in state litigation and reviewing states' draft statutes, regulations, and legal briefs. The division also provides legal support for the Commission's Joint Audit Program, training events, and general administration.

Uniformity Work

The legal division staffed 17 uniformity matters, including work on three whitepapers, during this period:

- *Model Statutes for Telecommunications Transaction Tax Centralized Administration* (pending consideration for approval by the Commission)
- *Model Statute on the Tax Collection Procedures for Accommodations Intermediaries* (pending consideration for approval by the Commission)
- *Amendments to Compact Art. IV related provisions* (retained by Executive Committee pending consideration for public hearing)
 - Definition of "sales" (Compact Art.IV(1)(g))
 - Sales factor sourcing (Compact Art.IV.17)
 - Factor weighting (Compact Art.IV.9)
 - Definition of "business income" (Compact Art. IV.1(a))
 - Distortion relief (Compact Art. IV.18)
- *Model Sales & Use Tax Notice and Reporting Statute* (retained Executive Committee pending recommendation for consideration for adoption by the Commission triggering bylaw 7 survey)
- *Model Statutes for Associate Nexus Presumption (NY-style "Amazon" Law)* (under development at Uniformity Subcommittee)
- *Amendments to MTC Model Financial Institutions Apportionment* (under development at Uniformity Subcommittee, regular work group input)

- *Partnership or Pass-Through Entity Income Ultimately Realized by an Entity That Is Not Subject to Income Tax* (pending Executive Committee action on hearing officer's report and recommendations, and request for additional Uniformity Committee input)
- *Possible New Project Regarding Interpretation of Art.IV.3 (Taxable in Another State)* (Uniformity Committee chose not to initiate this project)
- *Protection of Telecommunications Providers from Class Action Lawsuits* (under consideration by Uniformity Committee)
- *Telecommunications Definition and Sourcing* (under consideration by Uniformity Committee)
- *Possible New Project Regarding Agency Adjustments to Correct for Distortion* (whitepaper for Uniformity Committee)
- *Cloud Computing Issues* (whitepaper for uniformity committee)
- *Internet Group Coupons* (whitepaper for uniformity committee)

Litigation Committee Work

Legal division supported the Litigation Committee by organizing and making presentations for the July 2011 and March 2012 in-person meetings. In addition, Legal Division organized 8 Information and Training Sessions for State Tax Attorneys, including 6 state tax attorney teleconferences. All meetings were well attended. Attendance for teleconference meetings generally included well over 50 representatives from approximately 35 states.

Legal Assistance to States

The legal division consulted with individual states regarding significant on-going litigation strategy and briefs, draft legislation, and draft regulations. *Amicus curiae* briefs were filed in—

- *The Gillette Company et al. v. California Franchise Tax Board* (California Court of Appeals; filed November 14, 2011; the court found in favor of Gillette)
- *The Gillette Company et al. v. California Franchise Tax Board* (California Court of Appeals; filed February 6, 2012; decision pending)
- *IBM v Dep't of Treasury* (Michigan Court of Appeals; decision pending)

- *Harris Corporation and Consolidated Subsidiaries v. Arizona Dep't of Revenue* (Arizona Court of Appeals; briefing stage)
- *First Data Corporation et al. v. Arizona Dep't of Revenue*, (Arizona Court of Appeals; briefing stage)
- *In the Matter of the Appeal of Cessna Employee Credit Union* (Kansas Supreme Court; pending decision on petition for review)
- *Home Depot USA, Inc. and Affiliates v. Arizona Dep't of Revenue*. (Arizona Court of Appeals; briefing stage)
- *Direct Marketing Association, Inc. v. Brohl* (U.S. Court of Appeals, 10th Circuit; briefing stage)
- *Performance Marketing Association, Inc. v. Hamer* (Illinois Supreme Court; amicus request received)

In addition, the Commission's General Counsel participated in oral argument in *The Gillette Company et al. v. California Franchise Tax Board* before the California Court of Appeals on May 8, 2012.

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 program on a number of challenging audit related procedural and substantive issues. Legal division provided support for MTC training by teaching several classes, including:

- Nexus Training (Little Rock, Arkansas)
- Nexus Training (Jefferson City, Missouri)
- Combined Reporting Training (Madison, Wisconsin)
- Combined Reporting Training (Charleston, West Virginia)
- Pass-Through Entity Training (Internet Seminar)

The division monitored and reported on the activities of the Streamlined Sales and Use Tax Governing Board and its Committees. In addition, the division assisted in communicating the Commission's position on matters before Congress, including BATSA, Digital Goods, VoIP, Mobile Workforce, Tax Reform, and others.

D. Policy Research

BATSA — the policy research director worked with state revenue estimators to develop estimates of revenue impact of H.R. 1439, “The Business Activity Tax Simplification Act of 2011.”

Uniformity Project on Revising Model Statute on Apportioning Income of Financial Institutions — The policy research director continues to work with other MTC staff, state revenue agency personnel, and industry representatives to develop model apportionment statute, and otherwise provide support for this project. Policy research staff helped develop methods for siting loan bundles for property factor in apportionment formula.

Uniformity Project on Recommended Amendments to Compact Art. IV [UDITPA] — Section 9, Factor weighting — The policy research director worked with other MTC staff and the Uniformity Committee on this project.

Multistate Tax Commission Review —

- Article by Elliott Dubin and former Research Intern André Barbé on a comparison of sales taxes and gross receipts taxes
- Article by Elliott Dubin and former Research Intern Yi Feng, with input from Professor Richard Harvey, Villanova University, on Uncertain Tax Positions and State Corporate Income Tax
- Article by Bob Schauer, Harold Jennings, and Elliott Dubin on dealing with troublesome IT personnel.
- Spring 2012 issue in progress, which will also include an article on the effect of imposing sales taxes on remote commerce in Iowa and Virginia.

Other Activities —

- Supports MTC efforts in addressing federal legislation with implications for state and local taxation.
- An article by the policy research director entitled, “State and Local Governments: Cash-Strapped but not Broke,” published by Tax Analysts, *State Tax Notes*, August 8, 2011, pp. 363-371
- Monitor state adoption of MTC model statutes, regulations, and guidelines.
- Elected to advisory board of National Tax Association
- Assisted with organizing National Tax Association’s Spring Symposium with Prof. John Anderson, University of Nebraska at Lincoln, State-Local Tax Program — *Competitiveness: What Does it Mean for State and Local Governments?*
- Organizing session on sales taxes for FTA Revenue Estimating and Research Conference in Providence, Rhode Island, October 21-24, 2012

E. Training

The Training staff supported the following training activities in fiscal year 2012:

Computer Assisted Audit Training Using Excel & Basic Random Sampling (combined course) — August 22-25, 2011, in Albuquerque, New Mexico for 26 students—25 students from New Mexico and 1 from South Carolina

Corporate Income Tax —

September 19-22, 2011, in Madison, Wisconsin for 33 students, 30 from Wisconsin and 3 from South Carolina.

April 10-12, 2012, in Charleston, West Virginia for 34 students from West Virginia and the MTC.

Nexus School —

October 26-27, 2011, in Little Rock, Arkansas for 37 students— 22 from Arkansas and 15 additional students from Alabama, Idaho, Minnesota, Missouri, South Carolina, Virginia, West Virginia, and the MTC

April 25-26, 2012, in Jefferson City, Missouri for 41 students from Missouri, Kansas, New Mexico, Iowa, West Virginia and the MTC

Online Seminar — Pass-Through Entities—Income Tax Implications for the States, May 16, 2012, for 81 participants

Statistical Sampling for Sales and Use Tax Audits —

March 26-29, 2012, in Chicago, Illinois for 17 students from Idaho, Utah, Alaska, Mississippi, Kentucky, Wisconsin, the MTC, and the private sector

May 27-31, 2012 in Denver, Colorado for 31 students, 30 from the Colorado Department of Revenue and 1 from the City of Fort Collins

Cvent Registration System — The Commission has contracted with Cvent to provide online event management services. This will support online registration, event communication and online payment for training and other Commission events. The Cvent was first used for the May online seminar and has been used for training and meeting events since then.

The director of training was the principal coordinator of the July 27th annual meeting conference. He is also coordinating the August 1, 2012, annual meeting conference being held in Grand Rapids, Michigan.

II. Administration

Beginning with the new fiscal year the MTC has changed the bank it uses for its operations from Wachovia (Wells Fargo) to BB&T. This was done in order to reduce the level of bank fees, to provide a better fit in regards to the size of the bank compared to the MTC, and to establish better relationships with banking personnel.

André Barbé, Ph.D. candidate in Economics, Rice University; and, Yi Feng Accounting Major, University of Iowa, successfully completed their internships and are currently back at their respective universities.

Ted Jutras, paralegal in the National Nexus Program, resigned effective September 30, 2011, to take a position with the District of Columbia.

Amber Kirby began employment with the Multistate Tax Commission on October 3, 2011 as an assistant to the Director of the National Nexus Program. Amber will be involved all aspects of the National Nexus Program including the voluntary disclosure program tasks previously performed by Ted Jutras. Amber is a graduate of the Wake Forest School of Law and a member of the New York bar. She is currently enrolled in a dual degree program (Master in Public Policy & Master of Laws) at American University.

Ben Abalos was hired on November 1, 2011 as Project Manager, Data Sharing Initiative, a one-year appointment to initiate then evaluate Commission use of federal tax information on behalf of audit program states signing an MOU with the MTC. Ben is both an attorney and a CPA. Benjamin's previous professional experience includes the Department of the Navy (both active duty and reserve status) and the District of Columbia.

Nicholas Polimeros joined the Commission as an auditor in the New York office on February 6, 2012. Nicholas has worked in the field of taxation for many years including working for the Multistate Tax Commission in the mid-1990s.

William LoCascio began work with Commission as an auditor in the Commission's Chicago office on February 21, 2012. William previously worked for the Florida Department of Revenue for many years.

Lila Disque was hired as a legal intern on April 9, 2012, working with the Commission's legal department. She is continuing her intern work through the summer. Lila has a J.D. from U.C. Davis and completed an LL.M. in tax from Georgetown University Law School this spring.

Two interns are working with the Director of Policy Research this summer: Yi Feng, who attends the University of Iowa, will be on the Commission's staff from July 2

through August 17 (this will be Ms. Feng's second summer working with the Commission); and Matt Wade, who attends Virginia Tech, will be working with the Commission from July 2 through August 10.

III. Correspondence

I sent several letters to Congress this past year opposing preemptive federal legislative proposals, and also submitted hearing statement. The following summarizes this correspondence and submission:

- Letter to members of the U.S. House of Representatives (addressed to Speaker John Boehner and Democratic Leader Nancy Pelosi) RE: *H.R. 1439, Business Activity Tax Simplification Act of 2011*, July 22, 2011.
- Letter to U.S. House of Representatives Committee on the Judiciary (addressed to Chairman Lamar Smith and Ranking Member John Conyers, Jr.), RE: Revenue Impact of H.R. 1439, *Business Activity Tax Simplification Act of 2011*, September 20, 2011.
- Letter to Subcommittee on Courts, Commercial and Administrative Law & Chairman, Committee on the Judiciary (addressed to Chairman Howard Coble and Ranking Member Steve Cohen), RE: H.R. 1864, *Mobile Workforce State Income Tax Simplification Act of 2011*, November 15, 2011.
- Letter to members of the U.S. House of Representatives (addressed to Speaker John Boehner and Democratic Leader Nancy Pelosi) RE: H.R. 1439, *Business Activity Tax Simplification Act of 2011*, March 1, 2012 (also signed by Commission Chair).
- Letter to U.S. Senate Committee on Finance (addressed to Chairman Max Baucus and Ranking Member Orrin G. Hatch) RE: Tax Reform-What It Means for State and Local Tax and Fiscal Policy, April 19, 2012 (also signed by Commission Chair).
- Statement on the Topic of Tax Reform: What it means for State and Local Government Tax and Fiscal Policy, submitted to U.S. Senate Committee on Finance Hearing of April 25, 2012.

IV. Outside Presentations & Events

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:

JULY 2011

- NYU Summer Institute in Taxation, State Taxation II; New York, New York (Huddleston)
- National Association of Publicly Traded Partnerships Annual Meeting; Washington, D.C. (Shimkin)

AUGUST

- NCSL Task Force Meeting; San Antonio, Texas (Huddleston)

SEPTEMBER

- 2011 Annual Meeting of North Eastern State Tax Officials Association; Wilmington, Delaware (Huddleston, Matson)
- Institute for Professionals in Taxation, Sales Tax Symposium; Orlando, Florida (Matson)

OCTOBER

- Georgetown University Law Center SALT Certificate Program Meeting; Washington, D.C. (Huddleston)
- COST 42nd Annual Meeting and Fall Audit Session; New Orleans, Louisiana (Huddleston)
- ABA Section of Taxation 2011 Joint Fall CLE Meeting; Denver, Colorado (Sicilian)
- Hartman State and Local Tax Forum; Nashville, Tennessee (Fort, Matson, Sicilian)
- Pennsylvania Institute of CPAs' Multistate Tax Conference; Malvern, Pennsylvania (Dubin)
- 32nd Annual Conference of the National Association of State Bar Tax Sections; Washington, D.C. (Sicilian)

NOVEMBER

- AICPA Tax Division State & Local Taxation Technical Resource Panel; Washington, D.C. (Sicilian, *via teleconf.*)
- Hartman SALT Tax Forum; Nashville, Tennessee (Fort, Sicilian)
- Georgetown Law School, LL.M. Program Guest Lecture; Washington, D.C. (Sicilian)

DECEMBER

- Strafford Seminars (online presentation), "Sales Tax Affiliate Nexus: Latest Developments" (Sicilian)
- New York University Tax Conference; New York, New York (Huddleston, Fort)

JANUARY

- FTA-MTC Midwinter Commissioners Meeting; Newport Beach, California (Huddleston, Sicilian)

- Tax Analysts and the Kogod Tax Center at American University Roundtable Discussion, Taxes and Small Business; Washington, D.C. (Huddleston)
- 21st Annual Ohio State Tax Conference; Columbus, Ohio (Huddleston)

FEBRUARY

- Deloitte and Florida Bar Tax Section's National Multistate Tax Symposium; Orlando, Florida (Huddleston)
- New York University State & Local Tax Group Luncheon; New York, New York (Huddleston)
- American Enterprise Institute, Global Currency War, Endless Financial Crises: What's Wrong with the International Monetary System?; Washington, D.C. (Huddleston)
- FTA Compliance & Education Workshop; Tampa Bay, Florida (Matson, Abalos)

MARCH

- American Bar Association & Institute for Professionals in Taxation Advanced Income Tax Seminar, *Update on Economic Nexus—It's the Next Best Thing to Being There*; New Orleans, Louisiana (Shimkin)

APRIL

- California State Board of Equalization, Executive Director Candidates Interview Process; Newport Beach, California (Huddleston)
- Georgetown Law School, LL.M. program; Washington, D.C. (Huddleston, Sicilian)

MAY

- Oregon State Bar Association Tax Section event, Salem, Oregon (Sicilian *via teleconf.*)
- American Bar Association, State and Local Taxation Section Meeting, Washington, D.C. (Sicilian)
- BNA online seminar, *Cloudy with a Chance of Nexus: Analyzing Bloomberg BNA's 2012 Survey of State Tax Departments*, Washington, D.C. (Shimkin)
- 2012 9th Annual NMTRI Tax Policy Conference, Albuquerque, New Mexico (Huddleston)

JUNE 2012

- 2nd Annual Connecting Women to Power Conference, Carson, California (Huddleston)
- Federation of Tax Administrators Annual Meeting, Washington, D.C. (Huddleston, Sicilian)
- 2012 Spring Financial Officers and Tax Executives Executive Study Group Meeting, National Restaurant Association, Boston, Massachusetts (Huddleston)

Technology Addendum

The Technology Committee was inactivated by the Executive Committee in June of 2011; during the time this committee is inactive, the Executive Director is responsible for providing this technology update with his reports to the Executive Committee and Commission.

During fiscal year 2012, the Commission's computing assets and information security structures have been appropriately maintained and operational.

New endpoint software was updated on all auditor laptops. (Endpoint is the hard disk encryption system used for MTC laptops and desktops.)

Preparations for data sharing initiative (DSI) project is ongoing, and configuration of DSI related hardware, functionality, and security testing are nearly complete.

A supplemental backup system has been purchased and installed in the D.C., Chicago, and New York offices. This system currently facilitates replication of critical backup data from our D.C. office to our Chicago office, as well as from the Chicago and New York offices back to the D.C. office for disaster recovery.

New email search and archive software was loaded on all auditor laptops. This software works in conjunction with a message archiver that was installed and configured in May.

VOIP (AKA "unified communications" or UC) phones have been installed in select offices in D.C. for testing. Two UC phones will also be sent to select remote users as well.

MTC is working with Quality Assessment Solutions, LLC, regarding a centralized contact and membership management database that will greatly improve our ability to keep member and individual data up to date for communication and publication purposes. Servers to host this web application have been configured, and data has been mined and provided to the vendor to provide a single point service for all MTC related contacts. This application will be available to MTC staff and state personnel as well. This project will be completed this summer.

Upgrades to the Exchange e-mail server are still planned for this summer following the annual meetings and conference.

The network administrator has also been working with National Nexus Program staff to provide technical guidance in creating requirements for a phase upgrade to the voluntary disclosure application system.

The website provides a platform for MTC information, news, and events. The website received a total of 121,110 visitors and 370,463 page views during the year. The MTC website underwent a security update on the server in November 2011 performed by our hosting provider.

We continually make improvements to the Commission’s website to enhance its functionality and ease of use. In May, the Commission implemented its online registration and payment system through a third party service provider, beginning with the Commission’s first online seminar online seminar, *Pass-Through Entities: Income Tax Implications for the States*. We continue to explore the best way to integrate the online registration and payment service with the Commission’s own website, which serves as an important resource and repository for meeting information and documents.

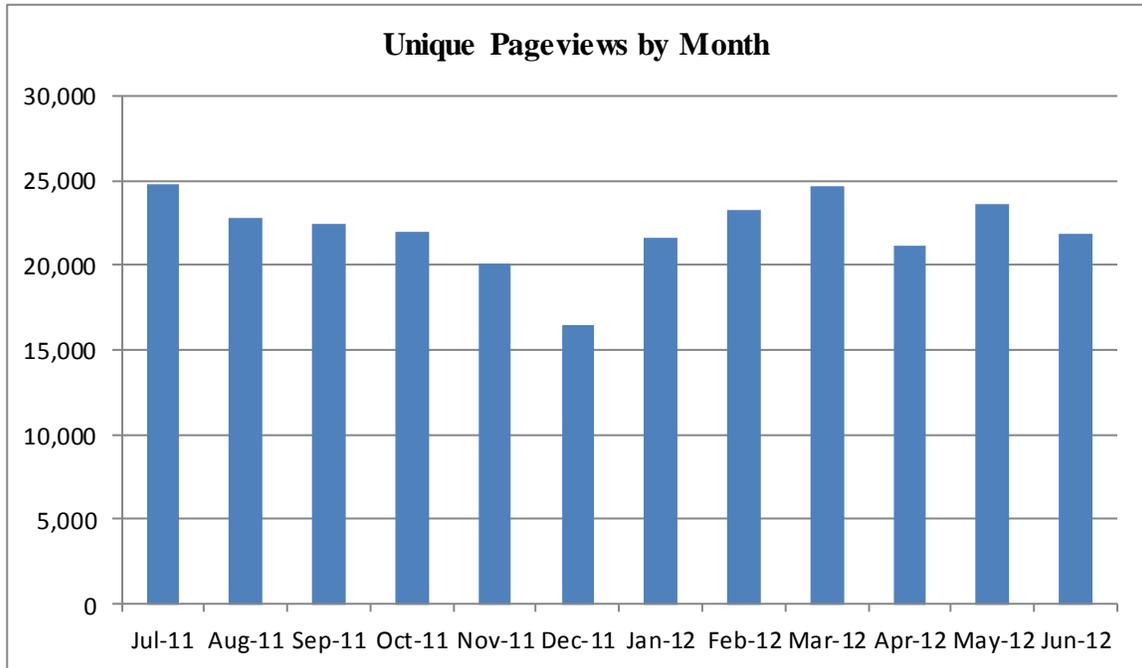
Website Activity at a Glance

	Page Title	Total Page Views	Unique Page Views	Average Time on Page in minutes
1	Homepage	54,725	43,344	0:01:13
2	Sales and Use Certificate	48,998	35,849	0:02:18
3	State Map	17,474	10,695	0:01:57
4	MTC Compact	14,305	8,294	0:00:25
5	About the Nexus Program	9,797	6,956	0:00:44
6	Overview Multi-state Voluntary Disclosure	8,678	6,525	0:01:57
7	FAQ's Sales and Use Certificate	6,275	5,430	0:02:57
8	About MTC	6,234	4,563	0:01:48
9	MTC Training Courses	4,368	2,626	0:00:56
10	Employment Opportunities	4,313	2,570	0:00:59

Interesting Facts —

- The top three states with the most visitors were California (10,601), Texas (9,320), and Illinois (9,172).
- A total of 2,845 visits came from a mobile device.
- A total of 29,963 visits came directly to www.mtc.gov.
- The average visit duration was 2 minutes and 23 seconds.
- An estimated 78,226 unique people visited our website.
- The homepage received 15% of page views following by Sales and Use Certificate at 13% and the MTC State Map at 5% page views.
- 54% of visitors come from search traffic, 21% from referral sites such as *Alabama, Washington State and Iowa Department of Revenue*, and 25% directly with no referral.

- Internet Explorer continues to maintain top web browser with 77% of visits, following by Firefox with 11%, Google Chrome at 7%, and Safari at 4%.



Note: Unique page views are the total number of unique visitors to a given web page during the same session (visit).