



**To: Cory Fong, Commission Chair
Members of the Commission**

**From: Wood Miller, Uniformity Committee Chair
Richard Cram, Sales & Use Tax Uniformity Subcommittee Chair
Robynn Wilson, Income & Franchise Tax Uniformity Subcommittee Chair**

Re: Uniformity Committee Report for Fiscal Year 2013

Date: July 16, 2013

The commission develops model state tax laws for states to consider adopting. Proposed model laws may be suggested by our executive committee, a standing committee, a single state, a taxpayer, taxpayer groups, or any other member of the public. Once members have identified a model to develop, initial drafting takes place in our subcommittees. The subcommittees appoint work groups and drafting groups, as needed. Lennie Collins, North Carolina Department of Revenue, chairs a membership/industry work group for the financial institutions apportionment project. All committee, subcommittee, work group and drafting group meetings and teleconferences are public and public participation is encouraged.

Through this fiscal year, the committee and subcommittees have met twice in person; the sales & use tax uniformity subcommittee has met three times by teleconference; and the income & franchise tax uniformity subcommittee has met once by teleconference. Drafting groups and work groups associated with various uniformity projects have met regularly by teleconference.

Projects by Status

Currently before the Commission:

1. Communications Definition and Sourcing (Resolution)

Currently before the Executive Committee:

1. UDITPA related amendments for corporate income tax apportionment
 - o Sales Factor Sourcing for Services and Intangibles
 - o Definition of "Sales"
 - o Factor Weighting
 - o Definition of Business Income
 - o Section 18 Distortion Relief
2. Sales and Use Tax Notice and Reporting
3. Partnership or Pass-Through Entity Income Ultimately Realized by an Entity That Is Not Subject to Income Tax

Under Development or Consideration at the Uniformity Committee and Subcommittees:

Income & Franchise Tax

1. Financial Institutions Apportionment, Amendment
2. Process Improvements
3. Section 482 Authority (ended)

Sales & Use Tax

1. Model Nexus Statute
2. Model Provisions Concerning Class Action and False Claims

Project Summaries

Currently Before the Commission

1. ***Communications Definition and Sourcing (Resolution)*** The telecommunications industry requested this project at the executive committee. The executive committee forwarded the proposal to the uniformity subcommittee. The industry asked the subcommittee to develop uniform rules for communications sourcing, sourcing definitions, and tax base/exemptions definitions. Since the Streamlined Sales and Use Tax Agreement already covers these topics, rather than develop its own set of model rules and definitions (which may vary from Streamlined), the uniformity committee has recommended a commission resolution encouraging states to consider adoption of Streamlined's sourcing rules, definitions, and tax base/exemptions definitions. A draft resolution is now before the resolutions committee for presentation to the Commission.

Currently Before the Executive Committee

1. ***Compact Art.IV [UDITPA] amendments.*** Article IV of the Multistate Tax Compact contains UDITPA virtually word for word. In July 2009, the executive committee directed the uniformity committee to begin drafting model amendments for five of its provisions: **section 17 sales factor numerator sourcing, definition "sales," definition "business income," factor weighting, clarification of section 18 distortion relief,** and instructed the uniformity committee to report back if it recommends the scope of review be changed. In December 2009, Richard Pomp, Prentiss Willson, and Michael McIntyre provided an educational foundation on UDITPA background and apportionment concepts. The uniformity subcommittee, working with a drafting group, recommended amendments for each of these five provisions. The executive committee began its consideration of whether to approve the models for public hearing in December, 2011, and asked for uniformity committee clarifications. Those clarifications were made and the executive committee took the matter up again in May, 2012. After discussion at that meeting, the July 2012 meeting, and the December 2012 meeting, the executive committee approved the proposals for public hearing. Public hearing was held March 27, 2013, with Professor Richard Pomp serving as hearing officer.

2. ***Sales and Use Tax Notice and Reporting.*** At its March, 2010 meetings, the subcommittee initiated two projects related to sales and use tax education and enforcement: (1) a sales and use tax notice and reporting model, and (2) an associate nexus model (the associate nexus model is discussed below). The subcommittee determined it would work first on the sales and use tax notice and reporting model. The resulting proposal requires sellers who are not collecting sales or use tax to notify purchasers of a potential tax liability at the time of sale if the product is to be delivered into the state. Sellers are also required to make annual reports to each such purchaser and an annual report to the state. De minimis exceptions and penalties are provided. The uniformity committee approved a draft in early March, 2011. Later that month, the executive committee approved the draft for public hearing. The hearing was held, and the hearing officer's report and recommendations were presented to the executive committee, which recommended approval of the proposal to the commission. The proposal was not placed on the commission's agenda, however, because it had not passed the bylaw 7 survey at that point. The proposal came back before the executive committee in December, 2011, and clarifications were requested. The uniformity committee made those clarifications and the executive committee took the matter up again in May, 2012. During that meeting, the executive committee voted to retain the proposal pending further discussion after the 10th Circuit has issued its opinion in *Direct Marketing Association v. Brohl*, D.C. No. 10-cv-01546-REB-CBS (10th Circuit).

3. ***Partnership or Pass-Through Entity Income Ultimately Realized by an Entity That Is Not Subject to Income Tax.*** This project addresses tax gap issues that arise when a pass-through entity is

owned by another entity that is not subject to corporate income tax. The subcommittee appointed a drafting group to list issues and options. After considering several alternative approaches and receiving significant input from the insurance industry, the subcommittee chose its preferred approach and directed that a draft be developed. After several meetings and teleconferences, the subcommittee voted to approve a draft in at its in-person meeting in December 2010. In March 2011, the executive committee approved the proposal for public hearing. The hearing was held and a hearing officer's report and recommendations were provided to the executive committee, which discussed the matter in June and continued the discussion to its meeting in July, 2011. At the July, 2011 meeting, the executive committee requested the uniformity committee work with industry on its alternative recommendations or amendments to the current recommendation and report back to the executive committee with a matrix of issues and options. The uniformity committee formulated a matrix and reconsidered several options proposed by its members and the insurance industry representatives over teleconferences and three in-person meetings; and completed its recommendation for the executive committee in July 2012. In December 2012, the executive committee asked for the uniformity committee to draft an addition. That was drafted, and the proposed model before the executive committee again in May, 2012. At that May meeting, the executive committee considered the proposal and directed that the project be concluded by staff preparation of a final project report.

Under Development or Consideration at the Uniformity Committee

Income & Franchise Tax Uniformity Subcommittee

1. *Financial Institutions Apportionment, Amendment.* The subcommittee's work group, which includes representatives from several states and the banking industry, identified problems with the current MTC financial institutions model and proposed conceptual amendments for addressing them. The amendments included clarifications to the property factor rule for sourcing loans (based on SINAA – solicitation, investigation, negotiation, approval and administration); new receipts factor rules for sourcing ATM fees, merchant discounts, and trust account fees; and revisions to the receipts factor rule that requires use of "cost of performance" for sourcing any receipts not otherwise specified. The subcommittee agreed with the work group's conceptual recommendations, and directed the work group to draft amendments accordingly. The work group completed a draft of recommended changes to the receipts factor and certain definitions, which the subcommittee has reviewed, amended, and preliminarily approved. The work group has now begun drafting amendments to the property factor – in particular, it is reviewing the sourcing of loans using the "SINAA" approach. When the property factor provision is complete, the subcommittee will consider the proposal as a whole.

2. *Process Improvements.* The commission's strategic planning committee has identified four strategic goal areas - areas in which MTC must focus in order to achieve its vision. One of these areas relates to the uniformity process:

Uniformity – Our goal is to increase uniformity in tax policy and administrative practices among the states. Achievement of the MTC's uniformity goal will be reflected by:

- Greater adoption of uniformity recommendations by state and local tax jurisdictions.
- Uniformity projects will have the greatest value to the states and stakeholders.
- More multistate tax issues will be referred first to the MTC for recommendation or resolution by the states, taxpayers and the federal government.

The income & franchise tax uniformity subcommittee began considering the current uniformity process: how projects are currently chosen; the current development process and how long it generally takes for each step, from initiation to commission approval; how a project's progress is planned, communicated, and tracked; how the finished product is made accessible to states and the public for consideration; and tools for tracking or recording progress of all current and completed projects. The goal is to get a better understanding of the current process. In the course of this effort, improvements may be identified that could feed into the strategic planning process when that committee is ready to turn its attention our

way; or, depending on what the scope of the suggested improvement is, it may even be reasonable to go ahead and implement. At its March meeting, the subcommittee reviewed proposed improvements to the uniformity process web pages and recommended that those changes be made. The strategic planning committee has now asked the uniformity committee for recommendations on another project to undertake. A workgroup has been established to make preliminary recommendations to the uniformity committee.

3. Section 482 Authority (ended). At its July 2012 meeting, the subcommittee heard a presentation regarding a possible project to draft one or more regulations establishing guidelines for states to use in making adjustments of income and expenses for state tax purposes, either domestically or internationally, under IRC Section 482 and state versions of that statute. The methodologies of such model regulations could be significantly different than federal methodologies, including use of combined reporting or other apportionment based approaches. The subcommittee solicited input from taxpayer groups on the desirability, practicality, or any other thoughts regarding the possible initiation of such a project and the contours any such project might take before proceeding further. After receiving several educational memorandums from staff, hearing from the public, and lively discussion by the subcommittee, the subcommittee determined not to initiate a uniformity project at this time.

Sales & Use Tax Uniformity Subcommittee

1. Nexus Statute. A first draft of a proposal New York style “associate nexus” statute was presented during the uniformity committee teleconference in October, 2011. That draft largely followed so-called “Amazon” legislation first adopted in New York. A second draft was prepared for the July 2012 meeting that also largely followed the New York legislation and included aspects of the similar legislation adopted by California. The subcommittee has benefited considerably from comments and input by representatives from New York and California. The subcommittee held a teleconference in October, 2012 which resulted in a third draft incorporating elements of the MTC affiliate nexus statute. This draft was reviewed and discussed during the December 2012 meeting. During that meeting, the subcommittee voted to expand the project to create a model sales & use tax nexus statute. A work group was formed and has met to review nexus research, develop a policy checklist, and identify state legislation that could serve as a template for the model. That checklist and research will be considered at the July 2013 meeting.

2. Model Provisions Concerning Class Actions and False Claims. This project was originally requested by the telecommunications industry. Industry representatives gave a presentation in July 2012 on the class action difficulties faced from over collection of tax from communications customers. In December, 2012, after hearing input from COST and others, the project was expanded to include all industries, not just communications, and to include a look at false claims acts. So the project now encompasses protecting retailers in general from class action lawsuits in both under and over collection situations. The subcommittee met with the litigation committee in February, 2013, to review a class action model recommended by the American Bar Association. In March, 2013, the subcommittee directed staff to provide an overview of state laws on class action and false claims acts in the state tax context. That research will be reviewed by the subcommittee at its July 2013 meeting.