



Dan Bucks
Director

Montana Department of Revenue



Brian Schweitzer
Governor

March 9, 2011

Sent Via Electronic Transmission

Mr. Steve Cordi, Chair
Multistate Tax Commission
444 North Capitol Street, Suite 425
Washington, DC 20001

Re: Mobile Workforce Proposal

Dear Steve:

I am submitting these written comments concerning the mobile workforce proposal that has returned to the Executive Committee following some additional work by the Uniformity Committee. I am not certain that I will be able to participate in the March 10, 2011, Executive Committee meeting due to the need to testify on tax legislation pending before our legislature at the time of the meeting.

This item returns to the Executive Committee after being referred back to the Uniformity Committee to address concerns of the State of Montana with the proposal. We had raised three concerns as follows:

1. The proposal for a physical presence *de minimis* for individual income taxes (but not for withholding tax purposes) is bad tax policy and creates an increased risk of federal preemption.
2. The withholding tax portion of the proposal invites tax evasion through the manipulation of employment periods for employees among jointly controlled, affiliated companies.
3. The withholding tax portion of the proposal also creates the potential for broader evasion and non-compliance due to the absence of any reporting mechanisms sufficient to ensure employer compliance—and an effective reporting mechanism needs to be added to the proposal.

We indicated to the Uniformity Committee that they did not need to address the first concern because it was a broad policy issue best considered by the Executive Committee. So we raise that issue here for discussion at the meeting by the Executive Committee. **We recommend an amendment removing the physical presence income tax *de minimis* (but not the withholding *de minimis*) from the proposal. As a substitute, we further recommend that the Executive Committee assign to the Technology Committee or to a special subcommittee of the Executive Committee the development of a web-based service that assists taxpayers working in multiple states in determining their state tax filing responsibilities.**

The Uniformity Committee addressed the second concern fully and adopted an amendment, suggested by Montana, requiring aggregation of employment among related parties. We thank the Uniformity Committee for this change. **We fully support the amendment adopted by the Uniformity Committee on the related parties issue.**

Finally, the Uniformity Committee failed to consider adequately the need to develop and add to the withholding portion of the proposal a reporting and enforcement mechanism to ensure employer compliance. In fact, the Income Tax Subcommittee of the Uniformity Committee actually rejected on December 7, 2010, a motion to work on developing a reporting and enforcement mechanism—effectively declining to work on one of three topics assigned to it by the Executive Committee. **Since the Uniformity Committee has declined to work on a reporting and enforcement mechanism to ensure employer compliance, we ask here that Executive Committee create a special subcommittee to develop such a mechanism.**

Discussion of Recommendation to Delete the Individual Income Tax *De Minimis* and Substitute a National Information Service to Assist Taxpayers

The twenty working days physical presence *de minimis* for income taxes is bad public policy because:

1. It is regressive in its impact on taxpayers. High-income non-residents will be exempted on larger amounts of income earned in a host state than lower income workers in that state.
2. It is unnecessary for an individual taxpayer to determine whether they need to file and pay taxes in any given state and, thus, offers meager improvements in taxpayer simplification. Indeed, taxpayer convenience and simplification can be better served by alternate means.
3. In the absence of a reporting and enforcement provision for the employer withholding portion of the proposal, the income tax *de minimis* provision is an invitation to widespread non-compliance and is practically unenforceable. Even if a reporting and enforcement mechanism is added, the income tax *de minimis* adds administrative complexity and costs to state income tax administration.
4. It is unlikely to be enacted into law to any significant degree by state legislatures because it is a radical departure from the income based thresholds now nearly universally favored in state law.
5. Because it is unlikely to be adopted by states to any significant degree, it will likely hasten congressional preemption in this area under pressure from advocates for preemption arguing that “states have failed to adopt the MTC uniformity measure.”
6. Once a physical presence preemption is adopted for individual income taxes, it will set a precedent that will make it easier for advocates opposed to state sovereignty in taxation to advance a federal law imposing a physical presence *de minimis* for state business activity taxes.

A better and more meaningful approach to taxpayer convenience and simplification would be for the Multistate Tax Commission to implement with the states a national, web-based taxpayer service with information and calculators that enable persons who work in multiple states to determine where they need to file returns. Such a system can provide real and meaningful assistance to citizens as compared to the proposed physical presence *de minimis* which is unlikely to ever be adopted by a large number of states in the foreseeable future.

In contrast to the individual income tax *de minimis*, the twenty working days standard for withholding tax purposes offers meaningful administrative simplification for employers tracking withholding for tens, hundreds and even thousands of workers traveling among the states. In the withholding context, the standard is not a standard of taxability, but is simply a mechanism for administrative convenience. As such, the risk of its being used as a precedent for federal jurisdictional preemption is much less than when used as a standard of taxability for individual income taxpayers.

For these reasons, we recommend deleting the individual income tax *de minimis* portion (but not the employer withholding portion) of the proposal and authorizing the MTC, instead, to begin exploring a national taxpayer information service to assist citizens with determining their income tax filing responsibilities.

Discussion of Recommendation for a Reporting and Enforcement System to Ensure Employer Compliance with Withholding

As the withholding proposal currently stands, it is nearly unenforceable for employers and employees in any practical, cost-effective sense for these reasons:

1. The proposal disconnects the state withholding system from the federal reporting and withholding system for the first time. There is no comparable national reporting system for "working days in a state" to provide for employer and employee accountability for withholding and paying taxes to states. Because the federal reporting system will not be relevant to state enforcement of the new standard for withholding by multistate employers, it leaves the states awash at sea with no anchor mechanism for enforcing the "twenty working days in a state" standard for employer withholding.
2. As extensive IRS research clearly indicates, compliance falls dramatically when there is no reporting system that holds taxpayers accountable.
3. Substantial Montana research and experience in several areas of income tax compliance indicates that out-of-state taxpayer non-compliance typically runs at rate of approximately 65% when reporting or withholding systems are inadequate.
4. In the absence of any tracking and reporting system for the number of days that employees spend in a state, employers will be able to freely avoid registering for and withholding income taxes even if they have employees in a state for more than 20 days in the state. States will not be able to readily detect when an employer sends employees into a state for more than 20 days and needs to register and withhold.
5. As reported in TaxExpress on December 6, 2010, even under the current federal/state system where detection is highly likely, a nine-state temporary service firm already avoided employment taxes fraudulently for an extended period. This example reminds us that the impulse to evade taxes is a given. We should not enable that impulse. This proposal absent a uniform reporting and enforcement system will dramatically increase the potential for withholding non-compliance by employers and income tax non-compliance by individuals.
6. In the instances where states would somehow manage to detect possible cases of non-compliance under the proposal as now written, the public sector cost of seeking compliance will be higher and less cost-effective than with an adequate reporting and enforcement system. States will be left with making decisions on costly, case-by-case administrative enforcement procedures not knowing fully whether the cases are of sufficient value to pursue.
7. Importantly, the proposal without a reporting and enforcement mechanism will also generate increased non-compliance with corporate and other business taxes. A common method to determine compliance with business taxes is to cross-match employer withholding tax registrations with corporate and business tax filings. When employers fail to register for and file withholding taxes, they can effectively stop filing corporate or business taxes as well. So the absence of a tracking and reporting system for employee time in a state will create increased non-compliance for both withholding and corporate or other business taxes.

8. A reporting and enforcement mechanism needs to be uniform among the states to reduce the cost of compliance for the private sector and to enable states to establish effective and efficient exchange of information systems concerning “working days in a state” data. The absence of a reporting and enforcement system within the proposal itself makes such administrative uniformity much less feasible and less likely to occur. Indeed, if individual states attempt to develop their own reporting and enforcement systems separate from each other, some business groups will likely lobby against the establishment of such systems on the grounds that differing approaches among the states make them undesirable and overly burdensome to implement.

The Uniformity Committee has declined to work on adding a reporting and enforcement system that will help ensure effective employer compliance with state wage withholding—and in turn, with corporate and business taxes. The Income Tax Subcommittee of the Uniformity Committee turned down a sample Montana proposal on this subject in November 2010. However, the rejection of one specific proposal did not fully dispose of the issue and did not relieve the Uniformity Committee of the responsibility assigned to it by the Executive Committee to address the need for some type of adequate reporting and enforcement mechanism. Having rejected one approach, the Uniformity Committee should have undertaken steps to address the need through developing another proposal to fill that need.

Accordingly, I addressed the Income Tax Subcommittee by teleconference on December 7, 2010, detailing much of what is outlined above on the need for such a system and urging them to develop an alternative approach. I spoke to the subcommittee for about ten minutes, and at the close of my remarks, the subcommittee did not ask me any questions or engage in any discussion or deliberation of these concerns. It took a break for fifteen minutes. I thought that after the break, they would return and engage the issues I raised. The subcommittee did not. Instead, they began discussion for about 30 to 35 minutes of an issue raised by another state with regard to the wording of a single preposition. I do not recall precisely, but I think the discussion was over whether a preposition should be “of” or “in.” As that discussion wound down, my schedule was pressed by a need to attend a meeting in our Governor’s office. So, not having any substantive response to our concerns, I made a motion that the “Income Tax Subcommittee develop a reporting and enforcement mechanism within the mobile workforce proposal adequate to ensure effective employer compliance with the withholding standard.” The motion did not receive any real discussion by the subcommittee. MTC Counsel did clarify through a question that I was not asking the subcommittee to reconsider its earlier action rejecting the sample Montana proposal, but that I was instead asking the subcommittee to develop its own proposal. Following that clarification, the motion failed by a large margin with only Montana and Missouri voting for it. Thus, the subcommittee rejected working on the need for an enforcement and reporting mechanism even though the Executive Committee assigned that work to the Uniformity Committee.

The failure of the Uniformity Committee to address the need for a reporting and enforcement mechanism leaves a gaping hole in the proposal that renders it practically unworkable. We ask the Executive Committee to remedy this problem by appointing a special subcommittee to develop a reporting and enforcement mechanism adequate to ensure effective employer compliance with the withholding standard.

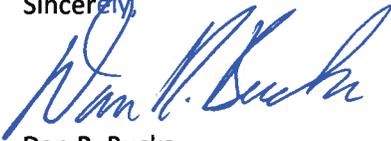
Again, I apologize for likely not being able to participate in the March 10 Executive Committee meeting due to a legislative hearing that requires my attendance. We know that the Executive Committee

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will give careful thought and consideration with regard to any and all recommendations from the member states.

Thank you.

Sincerely,

A handwritten signature in blue ink, appearing to read "Dan R. Bucks". The signature is fluid and cursive, with a large initial "D" and "B".

Dan R. Bucks
Montana Director of Revenue