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(Attachment II.2)



**Resolution in Support of
the National Conference of Commissioners on Uniform State Laws'
Project to Revise the Uniform Division of Income for Tax Purposes Act**

Whereas, the Multistate Tax Commission has initiated a project to develop recommended amendments to Article IV of the Multistate Tax Compact; and

Whereas, Article IV of the Multistate Tax Compact provides the method for apportionment of state corporate income and franchise tax bases and incorporates, virtually word for word, the Uniform Division of Income for Tax Purposes Act (UDITPA); and

Whereas, UDITPA was originally drafted by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 1957; and

Whereas, of the forty-seven states with a corporate income or franchise tax, thirty-six have adopted, in one form or another, all or substantial parts of UDITPA, and the remaining eleven states employ its concepts; and

Whereas, substantial uniformity in apportionment of state tax bases is critical to efficient and fair administration of state taxes, and ultimately to state tax sovereignty; and for fifty years UDITPA, has been the foundation for that uniformity; and

Whereas, American business and economic structures have changed substantially since 1957, and certain UDITPA provisions are now in critical need of targeted modernization; and

Whereas, in recognition of the historic relationship between the Compact and UDITPA, the Commission recommended NCCUSL develop amendments to those provisions of the Act most in need of modernization; and

Whereas, NCCUSL has deemed it appropriate to undertake a revision of UDITPA in its entirety; and

Whereas, NCCUSL has formed a drafting committee to undertake such revisions; now, therefore, be it

RESOLVED, that the Multistate Tax Commission supports the efforts of NCCUSL to revise UDITPA so to bring this cornerstone of the fair and equitable apportionment of income earned in interstate commerce into the 21st century; and be it further

RESOLVED, that the Commission stands ready to assist NCCUSL in its work to revise UDITPA, in whatever manner is appropriate.

Adopted this 31st day of July 2008.

Omar Davis
Chair

Joe Huddleston
Executive Director

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Multistate Tax Commission Policy Statement
02-02 Amended October 17, 2002

02-02 Ensuring the Equity, Integrity and Viability of State Income Tax Systems

2.1 Preamble

The right of a state to tax a fair share of interstate commerce that occurs within its borders is an essential element of sovereignty guaranteed under the U.S. Constitution. The exercise of that right by a state is fundamental to the proper allocation of the costs of governmental services to those who benefit from those services, which includes in-state residents and businesses and out-of-state enterprises engaging in business within the state. Otherwise, in-state residents and businesses will be unfairly burdened by the cost of services attributable to economic activity of out-of-state enterprises.

A primary means by which states tax a share of interstate commerce is by taxing income earned within its borders. To be fair to all taxpayers income should be properly measured and divided among states in reasonable relationship to where the income was earned. Businesses earn income by engaging in activities of supply that meet customer demand. Engaging in either supply or demand activities beyond *de minimis* levels is evidence that the enterprise is doing business within a state, earning income within its borders and benefiting from the opportunities and services provided by that state.

Unfortunately, in recent years the increasing use of business tax sheltering methods has significantly undermined the proper accountability of income reporting by many multistate enterprises that are both willing and able to engage in aggressive tax avoidance. The extensive use of business tax shelters undermines the equity, integrity and viability of state income tax systems. Federal proposals to restrict state authority to impose business activity taxes will serve to legalize and expand tax shelter opportunities for a large segment of multistate businesses and further shift the tax burden unfairly to local citizens and businesses.

The recent rise in business tax sheltering compounds long-standing problems of ensuring proper accountability of income reporting from multinational corporations. In 1990, a congressional subcommittee estimated that the federal government lost \$30 billion annually due to widespread international transfer pricing practices that shift income earned in the United States to tax haven locations. That \$30 billion in lost federal revenue translates into approximately \$6 billion of additional revenue lost at the state level. Federal efforts to solve the transfer pricing and other international income shifting problems have been ineffective.

Widespread international and domestic tax sheltering adversely affects the economy. Earning statements that are inflated by unproven tax shelters mislead investors as to the true value of a corporation's actual business activity. Capital is misallocated away from prudent enterprises that are diligent in their tax reporting obligations and toward corporations that engage in risky tax planning methods. Recent spectacular corporate bankruptcies underscore the fact that some companies that engage in aggressive tax planning methods only postpone the inevitable

day of economic reckoning and, in the process, harm both investors and employees. Beyond the problems of tax equity, improper reporting of income for tax purposes creates significant economic harm.

The Multistate Tax Compact charges the Commission with facilitating “the proper determination of the state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases . . .” The Compact was developed to preserve the sovereign authority of states to tax a fair share of interstate commerce occurring within their borders. Accordingly, the Commission by law and history is committed to advancing the full accountability of income reporting in reasonable relationship to where income is earned. A major portion of the activities of the Commission and its member states is devoted to this purpose. The Commission urges Congress and the Administration to support the states in achieving that purpose and, at a minimum, refrain from any actions that further undermine the equity, integrity and viability of state income tax systems.

2.2 Federal Support for Ensuring Full Accountability of Income Reporting

The Multistate Tax Commission strongly supports efforts by federal and state governments to enact legislation and regulations to insure full accountability in income reporting by individuals and business entities. The federal government asked the states to refrain from the use of worldwide combined reporting on the basis that the states should allow the federal government to handle international division of income issues. In exchange, the states were promised improved federal efforts to solve international income reporting problems and federal assistance in administering their corporate tax systems, including a federally-administered “domestic disclosure spreadsheet” to document the state income tax reporting practices of corporations. While the states honored the federal government’s request to refrain from using worldwide combined reporting, the federal support for the states has not been forthcoming. Moreover, the federal efforts to resolve the international income reporting problems remain inadequate because they are based on an “arms length” method of accounting that simply does not work in either theory or practice in the context of the modern global economy. The federal government should honor its earlier promises to the states of support for corporate income tax administration. The federal government should recognize as well the superiority of formula apportionment over arms length accounting and adopt methods of dividing international income pioneered and effectively applied by the states. Finally, the federal government should continue to upgrade its general efforts to counteract abusive tax shelter activity that undermines both federal and state income tax systems.

Specifically, Congress should undertake the following steps to ensure the proper reporting of income:

- Enact legislation to undertake an orderly process of converting to formula apportionment on a worldwide basis employing the unitary business principle as the correct approach to properly dividing the income of multinational enterprises.
- Enact legislation that eliminates the tax benefits from “corporate inversions” under which U.S. corporations incorporate in off-shore tax havens to escape federal and state corporate income taxes while continuing to operate in the United States. Such

legislation would be a transition measure until the federal government fully converts to a formula apportionment system applied on a worldwide basis.

- Enact legislation requiring multijurisdictional taxpayers to file with the IRS a domestic disclosure spreadsheet. Each spreadsheet would list the taxpayer's liability in each state in which it operates and disclose the method of calculation used to reach the result. The IRS would review the spreadsheets for accuracy and would share information contained on the spreadsheets with the states. The information should be shared under exchange of information agreements that support cooperative work by the states through the Commission or other joint instrumentalities to ensure the proper reporting of income. This measure would strengthen the ability of states to ensure proper corporate income reporting. It would provide a basis for a stronger partnership between the federal government and the states in working to curb abusive tax shelter activity.
- Enact federal legislation to impose effective penalties on taxpayers for failure to properly report income and on investors in and promoters of transactions the primary purpose of which is tax avoidance. Such legislation will encourage the proper reporting of net income for both federal and state income tax purposes. Enact federal legislation that prohibits taxpayers from relying on opinions written by tax advisors who benefit from contingency fee arrangement in which the tax advisor receives a portion of the tax savings from the tax planning methods on which they offer advice. This legislation is necessary and important to help restore integrity to the tax system.
- Study methods of bringing into closer alignment statements of book income and taxable income and then take action to implement the most promising methods. Sophisticated accounting methods are increasingly used to inflate book income and deflate taxable income. Strengthening links between book income and taxable income will help restore integrity to accounting for both.

To improve coordination with the federal government on curtailing international and domestic tax shelter activities, the Commission commits itself to assisting the federal government in developing a system of formula apportionment at the international level. Further, the states should consider the development of a process that parallels the federal process of requiring those who engage in abusive tax shelters to disclose those tax shelters for review in advance of the normal audit process. Such a process would build on the federal process and would focus on domestic tax shelter activities that shift income away from where it was earned to tax haven locations or to being reported nowhere.

2.3 Opposing Federal Efforts to Restrict State Business Tax Authority

The Multistate Tax Commission strongly opposes federal legislation that infringes upon state authority to tax a fair share of interstate commerce. Currently, legislation is pending in Congress that would impose a federal nexus standard of substantial physical presence for imposition of business activity taxes. The U.S. Supreme Court has upheld on numerous occasions that the nexus standard for business activity taxes is not based upon a concept of physical presence, but instead is based on the privilege of engaging in business in the state.

Further, the Court has never ruled that a business must have “substantial physical presence” in a state before it can be subjected to state taxing jurisdiction. In addition, the proposed federal legislation not only would impose a general physical presence standard, it would also create a list of “tax haven activities” that would allow a company to avoid the jurisdiction of a state despite engaging in income-producing activity there.

Nexus standards for the imposition of business activity taxes based on physical presence will legalize and expand the use of abusive tax shelter activities that are already undermining the equity, integrity and viability of state business activity taxes. The list of “tax haven activities” offers a specific blueprint for shifting income away from where it is earned to tax favored locations. The physical presence standard and the list of “tax haven activities” will allow many out-of-state enterprises that earn income from within a state and benefit from the services the state provides to escape paying a fair share of the cost of those services. Imposition of new limits on state business activity taxing authority by requiring an untested level of physical contacts by a taxpayer will inevitably lead to lengthy and expensive litigation to determine the full meaning of such laws. Finally, physical presence nexus standards discourage the flow of investment across state boundaries, and subvert national economic growth and balanced economic development among all geographic regions of the nation.

Instead of undermining the proper operation of state business activity taxes, the Congress should undertake the measures outlined above that would establish a cooperative federal-state framework for ensuring the proper accountability of income.

2.4 Opposing Federal Efforts to Restrict State Individual Income Tax Authority

The Multistate Tax Commission strongly urges Congress to respect the sovereignty of states in exercising their jurisdiction to impose individual income taxes within constitutional limits. The Multistate Tax Commission is prepared to assist states in developing uniform *de minimis* thresholds for withholding obligations on tax due from multistate individual income taxpayers.

2.5 Commitment to Educating Constituencies

One of the most important roles that the Multistate Tax Commission fulfills is that of educating constituencies on issues of taxation. Understanding the underlying principles of state corporate income taxes is a difficult task. The Commission commits itself to providing education and guidance to taxpayers, federal and state government officials and all other interested parties concerning:

- current issues in corporate income tax law,
- suggestions by which these laws can be improved, and
- how current law and other proposals affect state and local tax systems.

To be effective through Annual Meeting 2007.

Factor Presence Nexus Standard for Business Activity Taxes

Approved by the Multistate Tax Commission October 17, 2002

A. (1) Individuals who are residents or domiciliaries of this State and business entities that are organized or commercially domiciled in this State have substantial nexus with this State.

(2) Nonresident individuals and business entities organized outside the State that are doing business in this State have substantial nexus and are subject to [list appropriate business activity taxes for the state, with statutory citations] when in any tax period the property, payroll or sales of the individual or business in the State, as they are defined below in Subsection C, exceeds the thresholds set forth in Subsection B.

B. (1) Substantial nexus is established if any of the following thresholds is exceeded during the tax period:

(a) a dollar amount of \$50,000 of property; or

(b) a dollar amount of \$50,000 of payroll; or

(c) a dollar amount of \$500,000 of sales; or

(d) twenty-five percent of total property, total payroll or total sales.

(2) At the end of each year, the [tax administrator] shall review the cumulative percentage change in the consumer price index. The [tax administrator] shall adjust the thresholds set forth in paragraph (1) if the consumer price index has changed by 5% or more since January 1, 2003, or since the date that the thresholds were last adjusted under this subsection. The thresholds shall be adjusted to reflect that cumulative percentage change in the consumer price index. The adjusted thresholds shall be rounded to the nearest \$1,000. As used in this subsection, "consumer price index" means the Consumer Price Index for All Urban Consumers (CPI-U) available from the Bureau of Labor Statistics of the United States Department of Labor. Any adjustment shall apply to tax periods that begin after the adjustment is made.

C. Property, payroll and sales are defined as follows:

(1) Property counting toward the threshold is the average value of the taxpayer's real property and tangible personal property owned or rented and used in this State during the tax period. Property owned by the taxpayer is valued at its original cost basis. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from sub-rentals. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period; but the tax administrator may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

(2) Payroll counting toward the threshold is the total amount paid by the taxpayer for compensation in this State during the tax period. Compensation means wages, salaries,

commissions and any other form of remuneration paid to employees and defined as gross income under Internal Revenue Code § 61. Compensation is paid in this State if (a) the individual's service is performed entirely within the State; (b) the individual's service is performed both within and without the State, but the service performed without the State is incidental to the individual's service within the State; or (c) some of the service is performed in the State and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the State, or (2) the base of operations or the place from which the service is directed or controlled is not in any State in which some part of the service is performed, but the individual's residence is in this State.

(3) Sales counting toward the threshold include the total dollar value of the taxpayer's gross receipts, including receipts from entities that are part of a commonly owned enterprise as defined in D(2) of which the taxpayer is a member, from

(a) the sale, lease or license of real property located in this State;

(b) the lease or license of tangible personal property located in this State;

(c) the sale of tangible personal property received in this State as indicated by receipt at a business location of the seller in this State or by instructions, known to the seller, for delivery or shipment to a purchaser (or to another at the direction of the purchaser) in this State; and

(d) The sale, lease or license of services, intangibles, and digital products for primary use by a purchaser known to the seller to be in this State. If the seller knows that a service, intangible, or digital product will be used in multiple States because of separate charges levied for, or measured by, the use at different locations, because of other contractual provisions measuring use, or because of other information provided to the seller, the seller shall apportion the receipts according to usage in each State.

(e) If the seller does not know where a service, intangible, or digital product will be used or where a tangible will be received, the receipts shall count toward the threshold of the State indicated by an address for the purchaser that is available from the business records of the seller maintained in the ordinary course of business when such use does not constitute bad faith. If that is not known, then the receipts shall count toward the threshold of the State indicated by an address for the purchaser that is obtained during the consummation of the sale, including the address of the purchaser's payment instrument, if no other address is available, when the use of this address does not constitute bad faith.

(4) Notwithstanding the other provisions of this Subsection C, for a taxpayer subject to the special apportionment methods under [Multistate Tax Commission Regulations IV.18.(d) through (j)], the property, payroll and sales for measuring against the nexus thresholds shall be defined as they are for apportionment purposes under those regulations. Financial institutions subject to an apportioned income or franchise tax shall determine property, payroll and sales for nexus threshold purposes the same as for apportionment purposes under the [MTC Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions]. Pass-through entities, including, but not limited to, partnerships, limited liability companies, S corporations, and trusts, shall determine threshold amounts at the entity level. If property, payroll or sales of an entity in this State exceeds the nexus threshold, members, partners, owners, shareholders or beneficiaries of that pass-through

entity are subject to tax on the portion of income earned in this State and passed through to them.

D. (1) Entities that are part of a commonly owned enterprise shall determine whether they meet the threshold for nexus as follows:

(a) Commonly owned enterprises shall first aggregate the property, payroll and sales of their entities that have a minimum presence in this State of \$5000 of combined property, payroll and sales, including those entities that independently exceed a threshold and separately have nexus. The aggregate number shall be reduced based on detailed disclosure of any intercompany transactions where inclusion would result in one State's double counting assets or revenue. If that aggregation of property, payroll and sales meets any threshold in Subsection B, the enterprise shall file a joint information return as specified by the [tax agency] separately listing the property, payroll and sales in this State of each entity.

(b) Those entities of the commonly owned enterprise that are listed in the joint information return and that are also part of a unitary business grouping conducting business in this State shall then aggregate the property, payroll and sales of each such unitary business grouping on the joint information return. The aggregate number shall be reduced based on detailed disclosure of any intercompany transactions where inclusion would result in one State's double counting assets or revenue. The entities shall base the unitary business groupings on the unitary combined report filed in this State. If no unitary combined report is required in this State, then the taxpayer shall use the unitary business groupings the taxpayer most commonly reports in States that require combined returns.

(c) If the aggregate property, payroll or sales in this State of the entities of any unitary business of the enterprise meets a threshold in Subsection B, then each entity that is part of that unitary business is deemed to have nexus and shall file and pay income or franchise tax as required by law.

(2) "Commonly owned enterprise" means a group of entities under common control either through a common parent that owns, or constructively owns, more than 50 percent of the voting power of the outstanding stock or ownership interests or through five or fewer individuals (individuals, estates or trusts) that own, or constructively own, more than 50 percent of the voting power of the outstanding stock or ownership interests taking into account the ownership interest of each such person only to the extent such ownership is identical with respect to each such entity.

E. A State without jurisdiction to impose tax on or measured by net income on a particular taxpayer because that taxpayer comes within the protection of Public Law 86-272 (15 U.S.C. § 381) does not gain jurisdiction to impose such a tax even if the taxpayer's property, payroll or sales in the State exceeds a threshold in Subsection B. Public Law 86-272 preempts the state's authority to tax and will therefore cause sales of each protected taxpayer to customers in the State to be thrown back to those sending States that require throwback. If Congress repeals the application of Public Law 86-272 to this State, an out-of-state business shall not have substantial nexus in this State unless its property, payroll or sales exceeds a threshold in this provision.

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(Attachment II.3)



**Resolution No. 03-01
State-Tribal Tax Issues**

Whereas, Native American tribal governments under federal law are dependent sovereign nations; and

Whereas, tribal enterprises all over the United States have grown significantly over the last twenty years; and

Whereas, tribal enterprises serve Native American and non-Native Americans alike; and

Whereas, the growth of tribal economies has sometimes resulted in jurisdictional clashes with respect to the proper taxing authority of States and tribal governments, and

Whereas, the courts of the United States have attempted to resolve the jurisdictional friction with mixed results, and

Whereas, many States and Tribes have successfully resolved tax issues through State-Tribal agreements and other arrangements, and

Whereas, States and Tribes have a vital interest in retaining the validity and vitality of the tax agreement negotiation process; now, therefore, be it

RESOLVED, that the Commission encourages States and Tribes to resolve state-tribal tax issues through negotiated agreements, and that if requested, the Commission work with state tax officials and tribal leaders to initiate and foster expanded dialogues between States and Tribes with the aim of resolving state-tribal tax issues; and be it further

RESOLVED, that the Commission encourages that any federal legislation in this area be supportive of state and tribal efforts to resolve longstanding tax issues.

Adopted this 1st day of August 2003, by the Multistate Tax Commission.

Elizabeth Harchenko
Chair

Dan R. Bucks
Executive Director

This Resolution shall expire on August 1, 2008.

Renewed by the Commission on July 31, 2008; this resolution shall expire on July 31, 2013.

Omar Davis
Chair

Joe Huddleston
Executive Director