



To: Executive Committee, Multistate Tax 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 to Executive Committee

Date: May 8, 2014

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. Patricia Calore, Michigan Department of the Treasury, chairs a work group to monitor developments regarding the Marketplace Fairness Act and to recommend possible state implementation strategies for the Act should it be enacted into law. Richard Cram, Kansas Department of Revenue, chairs a work group to draft a remote seller sales tax nexus model statute. Mr. Cram also chairs a membership/ industry work group to address private litigation involving transaction tax under- and over collection. All committee, subcommittee, work group and drafting group meetings and teleconferences are public and public participation is encouraged.

Through April 2014, the committee and subcommittees have met twice in person, during the December 2013 meeting in New Orleans, LA. The committee and subcommittees also met in Denver, CO in March 2014. Drafting groups and work groups have met regularly by teleconference.

Projects by Status

Currently before the Commission:

None.

Currently before the Executive Committee:

1. Report of the Uniformity Committee on the Hearing Officer's Report on UDITPA related amendments for corporate income tax apportionment
 - Sales Factor Sourcing for Services and Intangibles
 - Definition of "Sales"
 - Factor Weighting
 - Definition of Business Income
 - Section 18 Distortion Relief
2. Report of the Uniformity Committee on proposed Model Uniform Financial Institutions Apportionment Rule Amendment

Under Development or Consideration at the Uniformity Committee and Subcommittees:

Income & Franchise Tax

1. Possible Project on Cloud Computing
2. Possible Project on Electricity
3. Strategic Planning

Sales & Use Tax

1. Model Remote Seller Nexus Statute
2. Model Provisions Concerning Class Action and False Claims
3. Marketplace Fairness Act

Project Summaries

Before the Commission

None at this time.

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 – sales factor numerator sourcing for services and intangibles, definition of “sales,” definition of “business income,” factor weighting, clarification of section 18 distortion relief – and to report back if the scope of review should be changed. The income & franchise tax uniformity subcommittee began its effort in December, 2009, with a series of educational presentations from guest experts Professor Richard Pomp, Mr. Prentiss Willson, Professor Michael McIntyre, and Professor Charles McClure. The Subcommittee then formed a drafting group, and after two years of intensive work, began making its recommended amendments for each of these five provisions. The executive committee began considering whether to approve these recommendations for public hearing in December, 2011. It 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 28, 2013, with Professor Richard Pomp serving as hearing officer. The hearing officer’s report, with recommended changes, was issued October 25, 2013. The Executive Committee received the hearing officer’s report at its December 2013 meeting and directed the Uniformity Committee to review the report and report back to the Executive Committee. The Uniformity Committee has completed its review and will report back to the Executive Committee at its meeting in May 2014.

2. Financial Institutions Apportionment, Amendment. Early in this project, the subcommittee’s work group, which includes representatives from several states and the banking industry, identified revisions that are needed to the current MTC financial institutions model. The revisions include, among other things, clarifying the property factor rule for sourcing loans (currently based on SINAA – solicitation, investigation, negotiation, approval and administration); creating new receipts factor rules for sourcing ATM fees, merchant discounts, and trust account fees; and revising 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 for making these improvements, 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 then began work on the property factor and the use of SINAA for sourcing of loans. At its July 2013 meeting, the subcommittee directed the workgroup to move forward with the approach of the property factor being real and tangible personal property and eliminating any aspect of SINAA from the property factor. In December 2013, the subcommittee completed its work on the property factor. The Uniformity Committee approved the draft model at its meeting in December 2013 and voted to submit it to the

Executive Committee for approval and submission to public hearing during the Executive Committee's May 2014 meeting.

3. 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 U.S. Court of Appeals for the 10th Circuit issued its opinion in *Direct Marketing Association v. Brohl*, D.C. No. 10-cv-01546-REB-CBS (10th Circuit). That opinion was issued on August 20, 2013 and held that the federal Tax Injunction Act barred the Court from hearing the case. DMA sought rehearing en banc, which was denied on October 1, 2013. DMA then filed a petition for certiorari in the U.S. Supreme Court on March 5, 2014. As of May 2, 2014, the petition is pending decision by the Court. DMA also filed a separate action in the District Court for the City and County of Denver, which essentially tracks the issues in the federal action. On February 18, 2014, the state district court granted DMA's motion for preliminary injunction, staying the enforcement of the statute pending trial.

Under Development or Consideration at the Uniformity Committee

Income & Franchise Tax Uniformity Subcommittee

1. Strategic Planning. 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.

At its July 2012 meeting, 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 was to get a better understanding of the current process and possible improvements. At its March 2013 meeting, the subcommittee reviewed proposed improvements to the uniformity process web pages and recommended that those changes be made. The strategic planning committee then asked the uniformity committee for recommendations on another project to undertake. The subcommittee suggested that it look into why uniformity recommendations are not more widely adopted. The strategic planning committee approved that proposal in July 2013. A

uniformity work group was assigned to collect background information, analyze the information, and propose possible solutions. The team has surveyed states to identify the current rate of adoption for 11 models. The next step is to interview agency staff to understand why those models were or were not adopted in the states. At the December, 2013, meeting, the strategic planning work group outlined its plans to contact states regarding their adoption of uniformity provisions. The work group has now completed those interviews and compiled a list of the factors that influenced the states' decisions to adopt or not adopt certain MTC models. The work group discussed these findings with the Income & Franchise Tax Subcommittee in Denver on March 12. The work group has reached two tentative conclusions. First, political considerations are often the primary factor affecting whether MTC models are adopted by states. Second, it seems that MTC models are sometimes developed despite the fact that many states will not act on them (either the model doesn't apply to the state or the state already has addressed the issue). The work group met on April 30, 2014, and decided to recommend that the Uniformity Committee consider a project to design a front-end information and survey process so that projects that are approved for drafting have a higher potential for adoption by the states.

2. Possible Cloud Computing Project. At the March, 2014 subcommittee meeting, a member of the subcommittee suggested that the MTC investigate potential income and franchise tax issues inherent in the cloud computing industry. The subcommittee voted to do so. A memorandum outlining the issues will be presented to the subcommittee in July, 2014.

3. Possible Trust Taxation Project. At the March, 2014 subcommittee meeting, Lila Disque, MTC Counsel, made a presentation on the emerging use of trusts as tax shelters analogous to the foreign subsidiaries used by large domestic corporations. The subcommittee voted to have MTC staff prepare a memo outlining the possible scope of a project to explore trust residency and other issues that might benefit from uniform law, and expressing the sense of the committee that this is an appropriate project to pursue. The memo will be presented for consideration at the subcommittee's July, 2014, meeting.

4. Possible Project to Develop Regulation for Sourcing Electricity Sales. At its March 2014 meeting, the subcommittee heard a presentation by Bruce Fort, MTC Counsel, and Ken Beier, MTC Training Director, regarding a staff proposal to develop a model apportionment rule for sourcing sales of electricity by utilities, traders and wholesalers. Currently, the great majority of state revenue departments have responded to surveys stating they consider electricity to be tangible personal property sourced based on destination. A smaller number of states consider electricity to be a service, and some states consider electricity to be intangible property. Several recent court cases have cast doubt on the states' treatment of the sale of electricity under the rules applicable to tangible personal property, holding that such sales should be "sourced" according to cost of performance rules. Even with a "market-based" sourcing rule, the unique properties of electricity can lead to difficulties in determining where a stream of electricity is delivered and whether the taxpayer is subject to tax in intermediate "grid" locations. Wholesaling and trading activities add additional complexity to the industry. The subcommittee heard a brief description of a model apportionment proposal developed by the Northeastern States Tax Administrators' Organization in the early 2000's. Only one state has followed that proposal; and only one other state has promulgated rules for apportioning interstate sales of electricity.

After discussion, the subcommittee voted to continue to study the proposed project before determining if development of a model apportionment regulation or statute would be appropriate. The subcommittee instructed staff to present additional materials at its July 2014 in-person meeting.

1. Sales and Use Tax Associate Nexus Model Statute. A first draft of a proposed 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 remote seller nexus statute. A work group was formed that reviewed nexus research, developed a policy checklist, and identified state legislation that could serve as a template for the model. The workgroup met several times in 2013. At the subcommittee’s meetings in March, July and December 2013, the subcommittee reviewed the drafts prepared by the workgroup and returned them with suggested amendments. At its March, 2014 meeting, the subcommittee reviewed the draft prepared by the workgroup and sent it back to the workgroup for further revisions. The workgroup met once since March, 2014, and will present a draft of the model nexus statute for the subcommittee’s consideration in July, 2014.

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 issues arising from class actions for alleged 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 actions for alleged under collection of tax. The project now encompasses exploring ways to protect retailers from 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 was reviewed by the subcommittee at its July 2013 meeting. An industry-state work group was formed. The workgroup focused on nuisance lawsuits, and in April 2014 the subcommittee considered a resolution endorsing the ABA Model Transactional Tax Overpayment Act. The subcommittee referred the resolution back to staff for further drafting. When the draft is approved by the subcommittee, the work group will focus on issues arising from class actions for alleged under collection of transaction tax.

3. Marketplace Fairness Act. In its current form, the Marketplace Fairness Act provides states with minimal guidance concerning implementation of the Act, including the form and substance of notice requirements, etc. The subcommittee voted to begin work on model language that non-streamlined states can use to implement the act. As of the current date, the work group has performed a thorough review of the MFA and is prepared to draft model language. However, based on hearings held by the Judiciary Committee on March 12, 2014, it is all but certain the MFA will undergo significant changes in the House. Given that fact, the work group notified the subcommittee that it would be best to put the project on hold pending further action from Congress. The work group has reached a point where the project can be easily recommenced when there is progress in the House. The group will meet again by teleconference on June 18, 2014, for a progress update.