Uniformity Income and Franchise Tax Subcommittee Meeting
El Tropicano Riverwalk
110 Lexington Avenue
San Antonio, Texas 78205

November 18, 2008 Meeting Minutes

Present at the Meeting (including via teleconference)

States	
Michael Mason, AL	Frank Hales, UT
Fred Campbell-Craven, CA	Andrew Glancy, WV
Carl Joseph, CA	Craig Griffith, WV
Charles Wilson, District of Columbia	
Richard Cram, KS	**MTC Staff**
Bryan Vargas, KS	Shirley Sicilian
Jennifer Hays, KY	Roxanne Bland
Ted Spangler, ID	Bruce Fort
Randy Tilley, ID	Sheldon Laskin
Reva Tisdale, ID	Diane Simon-Queen
Michael Fatale, MA	
Keith Getschel, MN	**Industry Representatives**
Wood Miller, MO	Todd Lard, COST
Lee Baerlocker, MT	Jim Hall
Gene Walborne, MT	
Rebecca Abbo, NM	
Lennie Collins, NC	
Mary Loftsgard, ND	
Myles Vosberg, ND	
Dee Wald, ND	

I. Welcome and Introductions

Wood Miller, Chair, opened the meeting.

II. Public Comments

There were no comments at this time. Members of the public were invited to make comments during the discussion of specific agenda items as reflected in these minutes.

III. Approval of Minutes from the October 22, 2008 Teleconference

The minutes of the Subcommittee meeting of October 22, 2008 were approved as presented.

IV. Reports and Updates

A. Report on Uniformity Projects in Process

1. Commission Adoption of Model REIT Statute and Model Telecommunications Apportionment Statute

Bruce Fort, MTC Counsel, reported that the Model REIT Statute was adopted by the Commission at its July 2008 meeting. He noted that it has been "more or less" adopted in 2 or 3 states, and that about 14 states have adopted some form of REIT legislation, mainly concerning the double-deduction issue. He also advised that members of the REIT industry may contact states urging adoption of the model statute.

2. Model Amendments to Multistate Tax Compact Art. IV and ULC (NCCUSL) UDITPA Effort

Shirley Sicilian, MTC General Counsel, reported that since the July 2008 meeting, the Uniform Law Commission (ULC) has redesignated the drafting group as a study group, whose charge is, in part, to address and report on whether the project should proceed. The ULC will hold a meeting at the end of January 2009 to discuss the issue. In the meantime, it would be helpful if state legislators contacted the ULC and express their support for the project to update UDITPA. She further reported that NCSL task force on this issue will be meeting on November 20-21, 2008, and one of the items that will be discussed is the project and whether NCSL should contribute to the effort. She also said that an email has been sent to the states listing all members of the NCSL task force and urged states that have a legislative representative on the force to ensure that their representative understands the importance of the project to state tax administration.

3. Federal Issues Affecting State Taxation

Roxanne Bland, MTC Counsel, reported that overall, as long as this current economic crisis persists, there is very little chance that Congress will pass any legislation with a negative fiscal impact upon the states, as states are currently accumulating a total deficit approaching two hundred billion dollars. Regarding BAT, it is certain that the bill's proponents will introduce the proposal in 2009, but unless its supporters can show they have made significant movement in their discussions with states, Congress will probably be reticent to move the bill along. BAT proponents will most likely try to tie BAT with SSTP to blunt the argument regarding revenue loss, but the states' allies realize BAT and SSTP are completely separate matters. The Mobile Workforce bill will almost certainly be introduced, but now that the FTA has new leadership, discussions on these bills may have to start from scratch. Ms. Bland further reported that regarding the election, three of the five minority members of the House Subcommittee on Commercial and

Administrative Law were defeated, and since the subcommittee's party ratio will probably change, it is unlikely that the GOP will replace all three defeated members. In the Senate, Senator Rockefeller (D-WV) will succeed Senator Inouye as Commerce Committee Chair. Senator Inouye (D-HI) is a strong supporter of the states, and Senator Rockefeller has also been very receptive to the concerns of the WV Department of Revenue.

V. Report on Project to Amend MTC Model Financial Institutions Apportionment Rule

Lennie Collins, NC reported that the pace of the project has slowed in part because of the financial crisis. In addition, weekly meetings with the three sub-groups [Receipts Factor, Property Factor, and Definitions] proved too much of a burden so the sub-groups merged and moved to one meeting per month. The project is still in the information-gathering stage.

VI. Project to Amend MTC Model Regulation IV.18

The Chair noted that the results of the workgroup's teleconference, the survey results as well as Mr. Fort's memorandum were included in the materials for this meeting. At the July 2008 meeting, the subcommittee voted to start working on model language amending Section 18, and a survey was sent to the states to determine what states most wanted out of this project. One clear trend is that virtually every state that responded to the survey agreed that Section 18 is too restrictive. The Chair reminded the subcommittee that it is not the language in the statute that is restrictive; it is the regulation that contains significant restrictions. He also noted that this project is focused on one paragraph, namely, that the Section "shall be used in unusual factual circumstances that are unique and nonrecurring." An additional aspect of this project is whether the regulation should make clear that it can be used on a case-by-case basis, even though the issue in question might apply to an entire industry. The idea is not to develop a litmus test to determine when the regulation should be invoked; if there is distortion, a taxpayer (or the state) should have a right to come forward but it should not apply in cases of, for example, tax planning or sales throwback issues. The reason for the latter is that throwback is not an apportionment issue, but of nowhere income. Regarding the burden of proof issue, the goal is to develop procedural language, such as whether the burden rests with the party moving to invoke Section 18, the level of substance pertaining to the burden. In resolving these issues, the Chair noted that in the Oregon case concerning 20th Century Fox, the court cautioned that the formula used should not unduly interfere with uniformity. Other courts have said that when addressing the distortion issue, the statute should be considered as whole lest the formula result in an unfair reflection of a taxpayer's business activity. Of the five proposed models for amending the section, one question that was not addressed was whether examples should be used. The committee decided to use the existing language.

Mr. Fort went through the five proposals for amending the regulation. The first proposal merely restates the statutory language. This means that its interpretation is wide open, i.e., a court can come in and interpret the language on its own. Ted Spangler commented that taking this approach to the project is not the appropriate answer.

The second proposal imposes minimal restrictions on the use of the section. In essence, it restates the statute but provides guidance that the distortion has to be due to the nature of the taxpayer's business, structure, etc. This approach is very broad, but not unlimited. The third proposal restricts use of Section 18 only in limited and specific cases. The fourth proposal limits Section 18 to limited and specific cases where application of the apportionment regulations would produce incongruous results. Jennifer Hays, expressed approval of the concept of incongruous results and the retention of the "limited cases" language. The fifth proposal deletes the parenthetical contained in the original regulation but is still restrictive.

Mr. Spangler noted that one of the concerns driving this project is that states have a number of industry-specific regulations that address specific industries, but the conditions being addressed by Section 18 are not unusual and non-recurring. Under the existing regulation, there must be unusual and recurring circumstances within the specific industry, leaving the state open to claims that it is going beyond what the statute means. Mr. Fort responded that the current regulation attempts to cure that problem by permitting states to develop rules for specific industries, but that the rule has to be applied uniformly. Mr. Spangler said that when states become aware of a new industry problem, they may be limited by their own rule to invoke section 18 because in a new industry, the circumstances are not unusual or nonrecurring. However, the limitation works both ways in that it may preclude a taxpayer from invoking it, too. Mr. Fort noted that states aren't really burdened by Section 18 petitions, pointing out that no state reported such in the survey. Mr. Spangler said that what Mr. Fort may be suggesting is that the existing rule could preclude a proper taxpayer from petitioning for relief. Ms. Sicilian said that the proposals are clear in that they can be applied to specific industries, but that the circumstances do not have to be unique and non-recurring. Carl Joseph, CA noted that his state has addressed this issue by using the term "ordinarily" to get around the non-recurring issue—the point is that the effect is unusual.

Mr. Fort said that the genesis of this project stems from three decisions, two appellate and one administrative. The idea is to look at the statute's intent, not to parse every word. Mr. Joseph noted that decisions like those help justify amending the regulation. Mr. Fort explained that the ALJ interpretation was unusual at the time the regulation was framed in 1965, but not today. The argument is that regulations are not frozen in time; the tax department has an obligation to upgrade its regulations to reflect existing practices. Any of the five proposals on the table would send a signal to the courts that states recognize the problem and are trying to fix it. Fred Campbell-Craven, CA said that it never occurred to him that courts, etc. might be restricting the tax departments' ability to invoke Section 18 because of its language.

Eric Smith, OR, said that his state has had the regulation for about ten years and that the department interprets the regulations broadly. If "unusual" is deleted then "fairly represents" remains. The argument shifts to the meaning of fairly represent. Mr. Spangler asked whether that was the argument anyway; Mr. Smith agreed.

Todd Lard, Council on State Taxation (COST) observed that where either side can invoke the regulation, his membership isn't interested but it may be later during the hearing process. Mr. Spangler noted that when he began working in this field his state was still arguing with the taxpayer that Section 18 could be not invoked even if taxpayer could show that separate accounting gave a more accurate reflection of state income than apportionment. Denying the use of separate accounting was to reinforce the idea that the three factor formula was the general standard, not separate accounting that would limit the use of Section 18; that is, separate accounting can't be used to open the door. Today we are in a considerably different environment; there are numerous court cases holding that apportionment is the constitutional standard, recognizing that separate accounting doesn't accurately reflect activity in the state. It is the new industries where the three factor formula doesn't accurately reflect activity in the state. It's necessary to loosen the Section 18 restrictions, for the benefit of both taxpayers and tax administrators. The rule needs to be written to focus on the proper representation of income-producing activity, regardless of whether it is the industry or the taxpayer that is unique. In his view, this project should focus on one of the less restrictive alternatives.

Mr. Joseph asked what was the difference between fairly represent and incongruous. Mr. Fort responded that fairly represents is much broader that incongruous—it implies something that "shocks the conscience" could instruct the trier of fact that it is something more than just a problem. Mr. Fort said that doing so might raise the bar as to when the regulation could be invoked.

The committee then voted on which option with which it wanted to proceed:

Option 1: 7
Option 2: 9
Option 3: 1
Option 4: 1
Option 5: 5

Mr. Miller said that the drafting committee will work on a draft starting from Option Two.

Mr. Fort turned to the next issue in this project, concerning burden of proof. The question is whether such language should be added. There are three alternatives to consider: the burden is always on the moving parting with a 51% preponderance of the evidence; the burden is met by clear and convincing evidence; and that considering the formula as a whole, the incongruous results do not necessarily foster lack of uniformity. He said that with respect to 20th Century Fox, use of the term "unnecessarily" implies that there is already a lack of uniformity among the states. Mr. Spangler noted that this makes it hard to state a movement towards a new scheme because unless all states move at once, disuniformity will necessarily result. Ms. Sicilian noted that there is case law pointing to an MTC model rule as evidence that states desire uniformity in that direction.

Mr. Joseph asked, as a threshold matter, how unusual is it for a tax agency to write a regulation that includes burden of proof language? Mr. Spangler responded that in his state, the burden rule reflects the case law. Mr. Joseph said that most states have case law governing burden of proof, but regulating burden of proof didn't seem proper. Mr. Fort said that the committee has indicated that burden of proof language would be helpful, though he recognizes that this may run afoul of case law. Mr. Joseph said the issue is a matter of who has the evidence, and it is not the state. The committee discussed the standards for burden of proof; Mr. Joseph said that in drafting language, in the instance where a party has to come forward with the evidence, then they have the burden of proof. Mr. Spangler said perhaps the way to phrase the idea is that whoever wishes to invoke Section 18, that person has to show why. Mr. Joseph suggested that states need to find out what their statutes say about burden of proof then compare it to the proposal—in income tax cases, it's unusual for the state to bear the burden. Mr. Fort said that burden of proof is not necessary for the regulation, but the committee needs to decide whether it wants to work on it. Mr. Smith said that "more fairly represents" is what his state would like to see. Mr. Fort responded that it was a possibility but the point is to make the language better than what is currently there.

Mr. Miller said that the threshold question is whether the committee wants to proceed with drafting burden of proof language. The committee voted 15 to one against proceeding.

Concerning the procedural language to invoke Section 18, Richard Cram, KS, said that as a practical matter, a petition is more likely to get someone's attention that just a return, and so gets the process moving faster. Mr. Campbell-Craven said that the Franchise Tax Board has been doing that for four years as a petition immediately puts the FTB on notice that there's an issue. Mary Loftsgard, ND, said that a petition would help with taxpayer concerns retarding an audit; if the issue isn't raised until 4 or 5 years have passed, the taxpayer wants to know why the department did noting. Mr. Spangler asked whether the intent of the provision is to prevent taxpayers from asserting a request to invoke Section 18 at the 11th hour. Mr. Fort said yes, the language can be interpreted to preclude such things. As a practical matter, the language could actually require a petition because states have a limitations period on amended returns. Mr. Spangler asked does the fact that the petition must be filed contemporaneously with the return preclude a taxpayer from filing a petition before filing the return. Mr. Fort said that a taxpayer can file a pro forma return and request relief. If a state adopts this kind of language, it will cut down on filing last minute petitions. Mr. Joseph said that in CA, taxpayers have to file the petition before filing the return, and that the petition has to be approved. Mr. Spangler asked whether the taxpayer can continue to rely on the approval. Mr. Joseph said yes, but only for a few years; then the taxpayer has to re-petition. Dee Wald, ND asked what happens if the petition is denied. Mr. Joseph said that the taxpayer can ask the FTB to review the denial, which is a public, adversarial proceeding. If the taxpayer loses at this level it may go further, but not many taxpayers want to make their petition public. Mr. Fort said that a lack of total uniformity isn't a killer here; some states may want to be more restrictive while others might want to be more permissive. The point is the prevent last minute filings; it is more of a notice rather than a timing issue. Mr. Spangler asked whether the

statute of limitations runs if there is a proceeding underway for a particular year. Mr. Fort said that it varies from state to state. Reva Tisdale, ID said that she agreed with Ms. Loftsgard that the state should have notice before the return is filed. Ms. Loftsgard asked whether a penalty involved. Mr. Joseph said if there's no penalty, the it's just an erroneous return. Keith Getschel, MN said that his state requires taxpayers to obtain approval before filing; he has never seen an amended return in this context.

Mr. Lard said that this is one of those areas that doesn't impact the taxpayer and the state equally. Two components are involved here; transparency and scope, i.e., from the taxpayer's perspective, it's about the ability to invoke Section 18 when the return changes significantly after audit. There may not have been material for a taxpayer to focus on when filing, but that may change after an audit. COST's concern is precluding a taxpayer from invoking the section at all.

Mr. Miller asked whether the committee thinks the procedural language is a good addition to the proposal. Mr. Smith said that he would like prior approval and asked if there was a groundswell of this type of activity in general. Mr. Fort cautioned that if the agency fails to act, the taxpayer doesn't have a remedy. Mr. Miller said MO law already addresses this issue and doesn't need such language. Mr. Campbell-Craven said that CA is pretty liberal; sometimes the taxpayer's ideas change after audit. The state simply wants notice. Gene Walborne, MT, asked if the committee would have a choice whether to have this language or not. Mr. Fort said that language could be added providing a taxpayer under audit more leeway than one who is not. Mr. Miller suggested that this language can be either enclosed in brackets or struck, i.e., [prior to filing] or [contemporaneously].

The next issue involves whether to preserve the throwback language in Section 18. Mr. Lard said of all the issues discussed by the committee, this is the one COST feels most strongly about. There are times when a taxpayer can't get relief under Section 18 as noted in UDITPA's original comments. If strict application results in distortion, there may be a constitutional issue. Section 18 is a safety valve that resolves the throwback issue. It may result in a dramatic increase in factors from which the taxpayer can't get relief. This is counter to the original interpretation of UDITPA and Section 18.

Mr. Campbell-Craven said that it seems the throwback rule is always going to change the factors; where should the line be drawn—after the point where the level of distortion is unconstitutional. Mr. Lard said yes; the purpose of Section 18 is to avoid the litigation that might otherwise result. Mr. Joseph said that he didn't think that throwback is much of a constitutional issue, but that throwout was. Inherent in this issue of that if the model statutes say that taxability is important because the drafters were trying to reach 100 percent of a taxpayer's income, then it is not unfair to give it to the state from where the item was shipped because that state's contact with the sale gives it a clear ability to tax. The throwback rule is around for reasons unrelated to the market. Mr. Lard said that the draft regulation precludes any argument, meaning that there is no situation where throwback would result in distortion. Mr. Fort said that the question really isn't about Section 18, but asked whether it is something that should be introduced in the regulation.

The language could be broadened to address the throwout rule. Ms. Sicilian said that throwout is used in some of the MTC special apportionment regulations. Mr. Joseph said that throwout should be used where there is really no place—such as property—can be assigned. Even so, these are oddball cases, like outerjurisdictional property.

Mr. Fort asked whether the committee thought it would be better to leave the Section 18 issues to the Uniform Law Commission for a statutory approach, or is there more value in making a fresh regulatory start. He also raised the question of whether the model regulation should include examples. Mr. Miller said that for the drafting group, if anyone has new language to submit, it should be sent to Mr. Fort, Mr. Spangler, Mr. Cram or to himself. Mr. Spangler asked how many states have a policy against using examples in regulations or administrative rules. Two states indicated that they had such a policy. Mr. Spangler said that his state discourages this practice.

Mr. Miller said that the next step is for the workgroup to draft language and bring it before the committee at the next meeting. He also said that if someone not on the workgroup has ideas about language to please bring it forward.

Discussion of IRS ruling.

Mr. Miller then asked if anyone on the committee would like to discuss the new IRS 2008-382 regulation for educational purposes or perhaps as a possible project. He then asked if anyone in the states has reviewed this regulation and can give some background and what it might mean for the states. In MO, it means a possible loss of revenue in that it's a reduction of federal taxable income. Is this a variation on NOL? Mr. Spangler responded that the regulation means that for banks, in the case opf an acquisition, there are limitations on NOLs from the acquired entity that can be used by the acquiring entity. The result is that the acquiring entity can use all of the NOL for subsequent tax years. Academics have questioned IRS authority to take such action, but the reasons are to stabilize the banks and other financial institutions during the economic crisis. At any rate, the regulation means that NOLs can be increased for future years, which reduced the federal AGI, and for states, it means a loss of revenue. For example, if a bank acquires another bank for $5 billion dollars, and the acquired bank has $50 billion in losses, under the old regulation the acquiring bank could only amortize the loss up to the acquired bank's purchase price. Under the new regulation, the acquiring bank can amortize the entire loss—$50 billion. It raises an interesting question, though—if a state has adopted 2008-382, is it bound by the new regulation if the IRS is later found to have acted illegally, as some claim.

The committee then ceased discussion on this issue without taking further action.

VII. Project Regarding Income Earned by Non-Corporate Income Taxpayers Derived from an Ownership Interest in a Partnership or LLC

Sheldon Laskin, MTC Counsel, reviewed the staff memorandum on pass-through entities. There are three possible issues involved. First, if a non-corporate entity (like an

insurance company) owns an interest in a pass-through entity, the pass-through's income flows through to the non-corporate entity, and the income accruing to both entities goes untaxed. The second issue concerns "asset stuffing", i.e., where a corporate income taxpayer transfers income producing assets to an insurance affiliate and takes an income tax deduction for the amounts transferred, in excess of amounts reasonably required to maintain adequate reserves against claims. This could be used as a tax shelter by a taxpayer with a captive insurance affiliate, for example. The third is similar to the "Delaware holding company" issue for intangibles (which has been resolved by many states) but it arises anew if the "holding company" is a non-taxable entity, i.e., the royalty payments made by the operating company to the "holding company" would not be taxable.

There are a number of approaches that might be taken to resolve these issues. A state might: 1) include non-corporate entities into the combined group; 2) phase-out the dividends received deduction in specific circumstances; 3) impose a tax on the non-taxable income of partnerships and limited liability companies if the income "flowed through" to a non-taxable entity that owned, directly or indirectly, at least 50% of the interests in the flow through entity; 4) subject non-premium income earned from transactions with affiliates to tax; and 5) require income taxpaying affiliates to add back deductions for expenses paid to affiliated non-income tax paying companies. All of these approaches are defective in one way or another in addressing the issues involved. Option 4 is the only solution that addresses all three issues, but in the case of insurance companies, for example, all options may subject a domestic insurer to retaliatory taxes in their market states.

The Chair explained that this project was begun in March [2008] and at the July meeting, the committee heard from people in the industry as well as a representative from a state insurance commission. Now the committee has to decide where to go from here. Ms. Sicilian pointed out that two of the solutions represent approaches to situations where an insurance company owns the pass-through. She asked the committee if they believed that there may be further solutions that address the issues presented, and if there are any further issues that should be addressed.

Mr. Joseph asked whether the issue could be looked at in the context of unrelated business taxable income (UBTI). He told the committee that CA has thought about including it in the combined report; this wouldn't be a separate set of rules, but it would exempt a company that had a significant UBTI. Would this work for insurance companies? They would be subject to gross premiums tax, but they'd have unrelated business income because they have to invest their premiums. Michael Fatale, MA thought it was analogous, but his state took a "shorthand" approach. Mr. Joseph said the MA approach seemed to be along the lines that there would be deemed income. Mr. Fatale responded that the question was one of controlling interest. Mr. Joseph said that CA's approach to stuffing works pretty well, but it really relates to how the funds are considered (taxable or non); perhaps they can be deemed dividends or something else. Identifying the activity as being non-insurance related is best, but it's not easy to do that.

The Chair said that several of the solutions identified carry with them the possibility of a retaliatory tax. Mr. Laskin said this was one area where the committee needs more education, how retaliatory taxes might work in this instance since there is no case law.

His hope is that by involving the National Association of Insurance Commissioners (NAIC) and a state commissioner, the committee might be able to figure out how the retaliatory tax issue might play out. Ms. Sicilian said that members of the industry gave a similar presentation to the MTC Executive Committee in January 2007 regarding combined reporting. Ms. Wald suggested whether it would be useful to take each of the solutions listed and analyze them in terms of the retaliatory tax. Mr. Fatale said that the MA solution, if they didn't recognize the company and treated it as a separate entity, then the tax would be imposed on the insurance company. They couldn't see how this would create a retaliatory tax situation, but it's possible that another state might do that, if they did not know what MA had done. Ms. Wald asked if that meant the tax department is at the mercy of the insurance commissioner, no matter what. Ms. Sicilian pointed out that this project is not just about insurance companies, but any entity that is not a corporate income taxpayer.

The committee discussed at length the issues raised, their possible solutions, and how retaliatory taxes might affect the outcome. Mr. Miller said that during the combined reporting project, there was some discussion regarding tying this question into the project or whether there was some other connection. It was decided to leave these issues for a later time, leaving the question of whether this project is going to impact the combined reporting model regulation. Ms. Sicilian said that in combined reporting, the question was how to treat affiliated entities like insurance companies when they are included in the combined group, i.e., does it mean their income is being taxed. Mr. Laskin said the question is how to address these issues; most states that have dealt with them have said they can be combined but they didn't deal with retaliatory taxes. Mr. Fatale said that the MA tax study commission has been assigned to review the issue; Ms. Wald said that ND lost in court on the same question. Ms. Sicilian asked whether combination would address the problems. Mr. Fatale responded if an insurance company is included in the combined group, there shouldn't be a problem with the retaliatory tax just because its income is included in the combination. Mr. Joseph said that in principle, insurance companies can be put into a combined group even though they're not taxpayers, but there is a long-standing practice of excluding them and that would be hard to change.

The Chair asked if the committee would like to further develop an issues list, or would it like to put together a drafting group. In the alternative, if the committee does nothing, these issues will continue to arise. Mr. Joseph said that he thinks there's a difference between the question of combining an insurance company in a report and an insurance company that has a lot of non-insurance income. In that case, states would be better served to look at streams of income that are not derived from insurance. Ms. Sicilian said that the model combined reporting statute didn't require insurance companies to be included, but allows the director to include them on a case by case basis where there is abuse, or by regulation. The question then was whether the Commission wanted to return and take up the issue at a later time. The Chair said that even if the committee doesn't go that far, it still has the project of addressing other non-taxable entities.

Mr. Fatale and Mr. Joseph volunteered to serve in a work group. Mr. Miller said that he'd be interested in a UBTI approach or an exempt entity approach. Mr. Laskin said that if there is another type of entity on which the committee can focus, perhaps that might give the committee insights into the insurance issue. Ms. Sicilian said that in some states, financial institutions aren't subject to the corporate income tax. Mr. Smith said that he would be interested in more than just insurance companies; he'd also like to review REITs, and how these might be brought into a consolidated report. Mr. Walborne said that MT has taken a run at the asset stuffing issue through the deemed dividends approach, and will try again in the upcoming legislative session. Mr. Cram said that KS is working on a combined reporting regulation that will be applicable not just to insurance companies, but other entities too, like financial institutions. Minnesota is a combined reporting state, but they don't combine insurance companies; they are required to a franchise tax which is credited against the gross premiums tax. Ms. Sicilian asked whether MN's approach should be considered. Craig Griffith, WV, said that insurance companies are included in the combined report, and in order to be excluded, the entity has to prove to the state that it is an insurance company. Mr. Fort said that developing a model definition of an insurance company might be a good project.

Mr. Miller said that the committee has identified a number of ideas on how to approach this question, identified resources to gather further information to develop an issues list, and a few suggestions on how to proceed with the project. These will be sorted out and reviewed at the committee's March 2009 meeting.

There being no new business, the meeting was adjourned.

MULTISTATE TAX COMMISSION

PUBLIC NOTICE AND AGENDA

Uniformity Committee Meeting
El Tropicano Riverwalk
110 Lexington Avenue
San Antonio, Texas 78205

Sales and Use Tax Uniformity Subcommittee

Monday, November 17, 2008

1:30 PM –5:00 PM

I. Welcome and Introductions

Richard Cram, Chair of the Subcommittee, called the meeting to order at 1:30 p.m. Central Time. The following individuals attended:

Name	Affiliation	Phone
Michael Fatale	Mass DOR	(617) 626-3259
Brandon Seibel	South Dakota DOR	(605) 773-3311
Lennie Collins	North Carolina DOR	(919) 733-8510
Wood Miller	Missouri DOR	(573) 751-0961
Eric Smith	Oregon DOR	(503) 945-8232
Charles Wilson	District of Columbia OTR	(202) 442-6859
Les Koenig	MTC	(312) 913-9150
Harold Jennings	MTC	(256) 852-8216
Sheldon Laskin	MTC	(410) 484-2790
Donna Donovan	Michigan Dept. Treasury	(517) 373-3223
Ted Spangler	Idaho STC	(208) 334-3538

Richard Cram	Kansas DOR	(785) 296-8042
Todd Lard	COST	(202) 484-5215
Greg Matson	MTC	(202) 624-8699
Joe Huddleston	MTC	(202) 624-8699
Randy Tilley	Idaho STC	(208) 334 -7673
Shirley Sicilian	MTC	(785) 312-9779
Bruce Fort	MTC	(505) 982-8902
Myles Vosberg	North Dakota Tax Dept.	(701) 328-3471
Andrew Glancy	West Virginia Tax Dept.	(304) 558-8552
Bryan Vargas	Kansas DOR	(785) 291-3286
Jennifer Hays	KY Legislature	(502) 564-8100
Roxanne Bland	MTC	(410) 391-3336
Lindey Osborne	TX Comptroller of Public Accounts	(512) 475-0037
John M. Allan	Jones Day	(707) 581-8012
Barry Tobin*	Government Finance Officers Association (GFOA)	
Larry Jones*	United States Conference of Mayors (USCM)	
Lars Etzkorn*	National League of Cities (NLC)	
Jamie Fenwick*	Time/Warner	
Deborah Bierbaum*	ATT	
Jeff Arnold*	National Association of Counties (NACO)	

II. Public Comment Period

There were no comments at this time. Members of the public were invited to make comments during the discussion of specific agenda items as reflected in these minutes.

III. Approval of Minutes

The minutes of the Subcommittee meeting of July 27, 2008 were approved as presented.

IV. Reports and Updates

Roxanne Bland reported that the Commission approved the adoption of the Audit Sampling Model Statute and Regulation at its annual meeting in Santa Fe, New Mexico on July 31, 2008.

Ms. Bland reported that no congressional action is anticipated on any federal bill affecting state taxation for the remainder of this year. It is expected that a federal Streamlined Sales Tax bill will be introduced in January 2009.

V. Telecommunications Transactions Administration Project

Representatives of several local government organizations participated by teleconference to express their concerns about the MTC's telecommunications transactions administration project, in particular, that the MTC was in discussions with industry representatives to simplify the administration of local taxation of communications services. The local organizations indicated that they had been in discussion with industry to address comprehensive reform of state and local taxation of telecommunications services, with the understanding that administration would not be separately addressed but would be considered in the context of comprehensive reform. Following a thorough discussion, Ted Spangler, Chair of the MTC Uniformity Committee, asked the local representatives if they would consider participating in the MTC project. The NACO and GFOA representatives indicated that their organizations would do so. The NATOA and USCM representatives indicated they would advise the Commission whether they will participate following their organizations' January meetings.

VI. Accommodations Intermediaries Project

The subcommittee heard a NACO representative express concern about the draft MTC model statute. NACO was of the view that the definition of "accommodation fee" is confusing. NACO believed that the only statutory clarification required is to ensure that hotel intermediaries collect and remit the full transient occupancy tax due on the full amount charged to the retail customer and not only on the wholesale amount paid to the hotel. Following discussion, Brandon Seibel of South Dakota suggested that the definition of "accommodations fee" state that the "room charge amount shall not be less than the discount room charge." Eric Smith of Oregon suggested that specific examples explaining how the accommodations fee should be calculated be included in the regulation and the subcommittee agreed. After the

Subcommittee explained the model's purpose, NACO suggested that "less than 30 days" be changed to "30 days or less." Wood Miller proposed that both formulations of the 30 day rule be retained, to accommodate states whose statutory law use one or the other formulation in other taxation contexts.

VII. Conformity of MTC Model Statutes and Regulations to Streamlined Sales and Use Tax Agreement

Mr. Spangler suggested that, for each of the items considered, the subcommittee's options were to amend, withdraw or retain the existing MTC definitions in light of their consistency or inconsistency with Streamlined.

1. Applicability of sales and/or use tax to sales of computer software. The subcommittee directed staff to prepare proposed amendments to conform the definition contained in the MTC guideline to the definition in the Streamlined Sales and Use Tax Agreement.
2. Uniform Principles Governing State Transactional Taxation of Telecommunications Services – Vendee and Vendor versions. The subcommittee noted this model is inconsistent with SSUTA and recommended that the work group currently addressing telecommunications transaction tax centralization models consider what, if any, changes should be made to this model.

3. Uniform Statute/Regulation, Sales and Use tax Priority – Construction Inventory. The subcommittee recommended retaining this recommendation as is.

4. Uniform Regulation for Determining Sales and Use Tax Priority for Leasing Transactions. The subcommittee recommended retaining this recommendation as is.

5. Provision for the Collection of Tax on Fundraising Transactions. The subcommittee recommended retaining this recommendation as is.

VIII. New Business

There was no new business to consider.

IX. Adjourn

The subcommittee adjourned at 5 p.m. Central Time.

MULTISTATE TAX COMMISSION

Working Together Since 1967 to Preserve Federalism and Tax Fairness

Multistate Tax Commission
Uniformity Committee Meeting
El Tropicana Riverwalk Hotel
110 Lexington Avenue
San Antonio, Texas 78205

Minutes of Meeting

The following persons attended the Uniformity Committee Meeting, in person or via phone:

Name	Affiliation	Phone
Michael Fatale	Mass DOR	(617) 626-3259
Brandon Seibel	South Dakota DOR	(605) 773-3311
Lennie Collins	North Carolina DOR	(919) 733-8510
Wood Miller	Missouri DOR	(573) 751-0961
Eric Smith	Oregon DOR	(503) 945-8232
Janielle Lipscomb	Oregon DOR	(503) 945-8433
Charles Wilson	District of Columbia OTR	(202) 442-6859
Richard DeBano	Wisconsin DOR	(608) 266-3618
Fred Campbell-Craven	California FTB	(916) 845-3796
Carl Joseph	California FTB	(916) 845-6027
Sheldon Laskin	MTC	(410) 484-2790

Donna Donovan	Michigan Dept. Treasury	(517) 373-3223
Ted Spangler	Idaho STC, Chairman	(208) 334-3538
Richard Cram	Kansas DOR	(785) 296-8042
Michael Mason	Alabama DOR	(334) 242-1175
Christy Vandevender	Alabama DOR	(334) 242-1175
Rebecca Abbo	New Mexico DOR	(505) 841-6361
Todd Lard	COST	(202) 484-5215
Greg Matson	MTC	(202) 624-8699
Joe Huddleston	MTC	(202) 624-8699
Randy Tilley	Idaho STC	(208) 334 -7673
Reva Tisdale	Idaho STC	(208) 334-7585
Shirley Sicilian	MTC	(785) 312-9779
Bruce Fort	MTC	(505) 982-8902
Myles Vosberg	North Dakota Tax Dept.	(701) 328-3471
Andrew Glancy	West Virginia DOR	(304) 558-8552
Craig Griffith	WV DOR	(304) 558-8351
Bryan Vargas	Kansas DOR	(785) 291-3286
Jennifer Hays	KY Legislature	(502) 564-8100
Roxanne Bland	MTC	(410) 391-3336
Lindey Osborne	TX Comptroller of Public Accounts	(512) 475-0037
Mary Loftsgard	North Dakota DOR	(701) 328-2045
Donnita Wald	North Dakota DOR	(701) 328-2777
Myles Vosberg	North Dakota DOR	(701) 328-3471
Eugene Walborn	Montana DOR	(406) 444-0908
Lee Baerlocher	Montana DOR	(406) 444-3587
Keith Getschel	Minn. DOR	(651) 556-6757
Joanne Garvin	Traveler’s Insurance	N/A

Uniformity Committee
November 18, 2008
2:30 P.M. to 5:00 P.M.

I. Welcome and Introductions

Ted Spangler, Committee Chairman, welcomed the attendees.

II. Public Comment

There was no public comment at this time.

III. Approval of Minutes.

The minutes from the meeting of the Uniformity Committee on July 30, 2008 were introduced, followed by the minutes of the October 22, 2008 Uniformity Committee teleconference. There were no comments on either set of minutes. Both were moved and approved.

IV. Executive Director's Report

Joe Huddleston, MTC Executive Director, gave a report to the Committee on federal legislation and the UDITPA redrafting efforts.

Mr. Huddleston spoke mainly on the Business Activities Tax Simplification Act of 2007 (BATSA), HR 5267. The legislation will be introduced again next year, with a majority of the members of the House Judiciary committee as co-sponsors. Industry groups have been meeting with state representatives at the request of House members. A wide gap exists between the positions of the two groups following the latest meeting that November, Mr. Huddleston reported, especially with respect to a physical presence test for nexus.

Mr. Huddleston reported that Streamlined Sales and Use Tax Agreement (SSUTA) legislation will be re-introduced in the coming year, as well as the "Telecommuter's Tax Fairness" bill, HR 1360, and the Mobile Workforce Act, HR 3359, providing employers and employees an immunity from income taxes for workers who spend less than 60 days in a state.

Mr. Huddleston reported that it was likely the BATSA bill would be coupled with the SSUTA legislation in a bid for revenue neutrality, and the states must be prepared to respond to that possibility.

Mr. Huddleston reported on the efforts to re-draft UDITPA through the Uniform Law Commission (ULC). Many states responded to the Executive Committee's pleas to contact their state legislative representatives to urge support for this project. The UDITPA project is proceeding through ULC as a study project for now, and not as a drafting effort. The MTC continues in its own efforts to consider amendments to five sections of the Act.

V. Report from the Sales and Use Tax Subcommittee.

Richard Cram, Chairman of the Sales and Use Tax Uniformity Subcommittee, reported on the Subcommittee's recent activities.

A. Telecommunications Transaction Tax Project. The Subcommittee received oral and written comments from several state and local governmental organizations regarding the Commission's Telecommunications Transactions Tax Administration Project. The National Association of Telecommunications Officers and Advisors (NATOA), the National Association of Counties, National Conference of Mayors and the Government Finance Officers Association reported that they were surprised to learn of the MTC's efforts because those associations felt they had an agreement with representatives of the Telecommunications Industry that centralized administration of taxes would be part of a larger reform effort covering many regulatory areas. Nonetheless, the local government representatives states they wished to cooperate with the Committee's efforts in this project. A request was made to postpone further action on the project until after some of these organizations held meetings in January 2009, to see specifically how those groups might participate. Ted Spangler (Idaho) reported that work would continue on the project unless and until the executive committee asked the subcommittee to put its efforts on hold.

B. Travel Accommodations Intermediaries Project. The subcommittee heard from several representatives of local governments. Some language was proposed to clarify the definition of accommodations fees, and proposals were made to include examples of how the statute would work, perhaps in a model regulation. The project was referred back to the drafting committee for further drafting.

C. Project to Conform MTC Definitions to SSUTA language. Five areas were identified of possible conflict between model MTC regulation definitions and SSUTA definitions. The subcommittee directed MTC staff to update definitions of computer software to conform to SSUTA standards, and the issue of updating telecommunications definitions was referred to the working group for the Telecommunications Transactions Tax project. No changes were recommended for the final three areas, as no actual conflict was seen.

VI. Report from the Income and Franchise Tax Subcommittee.

Wood Miller (Missouri) reported on the recent activities of the subcommittee.

MTC General Counsel Shirley Sicilian and Lenny Collins (North Carolina) reported on the project to amend the Financial Institutions apportionment regulation. The drafting committee is now meeting again as a group after working through distinct issues in separate subgroups.

Mr. Miller briefly described the subcommittee's efforts to amend model regulation IV.18.(a) pertaining to equitable apportionment. There was a general agreement on what the proposed changes to the regulation should entail following a series of votes, and the subcommittee anticipates that it will consider three alternative drafts at its March meeting.

Mr. Miller discussed the project to ensure that income flowing to non-corporate owners of pass-through entities was appropriately captured. A work group has been formed. .

Mr. Miller discussed the possibility of a project to consider the impact of Treasury Notice 2008-83, which purports to waive Section 382 limitations on claiming losses of acquired banks. Ted Spangler (Idaho) suggested that Idaho and some other states would not be affected by the Notice.

No projects were voted out of the subcommittee.

VII. Roundtable Discussion.

Alabama reported that the *VJF Ventures v. Surtees* decision upholding the state's add-back statute will likely be the subject of a *certiorari* petition to the U.S. Supreme Court.

Kansas reported on legislative efforts to amend the statute of limitations on refunds following an adverse decision by their court of appeals. In light of a looming budget deficit, Kansas may not go ahead with plans to phase out the estate tax and franchise taxes.

West Virginia reported that it recently won a lower court decision allowing it to make adjustments to reported federal taxable income (above line 30) for state tax purposes. An appeal is likely. There is also pending hospital refund litigation regarding the definition of a "drug" for tax exemption purposes. The state has a budget surplus of $9 million and is looking to reduce corporate tax rates to 6.5%. The state is also finalizing its combined reporting regulations.

North Dakota reported that their bi-annual legislative session is approaching. The model REIT statute and statistical sampling model legislation will be introduced. Bills to repeal the income tax are also expected to be introduced.

Idaho reported on pending rulemaking which will require electronic filing of many returns. Rule 500 has been adopted setting forth more detailed guidelines for settling

cases in response to a “whistle-blower” case. Idaho is implementing the Gentax audit selection module with high expectations.

Wisconsin reported that the legislature adopted an add-back statute in March which will require add-backs of interest payments and rental payments to captive REITs. Legislation will be introduced this year calling for passage of Streamlined Sales Tax Administration and combined filing.

Kentucky reported that the state expects a $350 million budget shortfall. Cigarette and sales tax increases are the likely means to close the gap. The *Johnson Controls* case is at the state Supreme Court, testing the constitutionality of a retroactive statute preventing refunds based on combined filing for years prior to the 1995 *GTE* case. Kentucky is investigating an add-back statute for REIT rental payments and is looking at amending its current statute to exempt Australian Limited Property Trusts.

California reported that the state supreme court recently denied certiorari in the *Ventas Finance* case, which limited LLC un-apportioned tax refunds to actual damages based on what the taxpayers would have owed under a three-factor apportionment formula. California also reported that the legislature has imposed additional under-reporting penalties going back to the 2003 tax year, with a grant of amnesty allowed for voluntary amendments to returns. The *Hyatt v. FTB* case was also discussed, in which a Nevada jury awarded significant compensatory and punitive damages against the State of California for alleged abuses in the course of a residency audit. Multiple levels of appeal are expected.

Missouri reported that its legislature has repealed limitations on claiming gambling losses. Missouri also reported on a sales tax case entitled *Great Southern Bank*, where a IRC 1031 like-kind exchange was reported as two separate transactions, thus precluding the bank from claiming a credit for property trade-ins (“taken in trade”) on the full value of the acquired property. It was also reported that the state Supreme Court held that where the two year SOL on refund claims expired on a weekend, the taxpayer was required to file before the weekend, not after.

Michigan reported on its herculean efforts to implementing its new business tax by January 1, including new processing systems and new forms. The tax has four separate tax calculations and two nexus standards. (The MTC was thanked for its efforts in assisting in the writing of one of those standards.) Michigan’s mandatory unitary filing system has also raised complex administrative issues. Michigan has also been found to be out of compliance with the Streamlined Sales Tax Administration despite being a founding member. The legislature is expected to bring the state back into compliance.

Montana reported that its expected $800 million surplus is now down to about $250 million. The department’s efforts will be directed towards a statewide re-appraisal of property values. The state may adopt some local option sales tax provisions. No MTC uniformity projects are expected to be introduced in the legislature. The Gentax program for discovery matters and audit evaluation appears to be working very well.

Oregon stated it may raise the minimum amounts for franchise fees, but otherwise, all is expected to be quiet on the western coast.

Minnesota announced that some taxes were approved in a referendum, including a gas tax increase and funding for the arts and for clean water projects. A $4 billion deficit is projected for the state. The state is also in litigation over a foreign operating company that may be deemed a sham, with an ALJ decision expected in several months. A Gentax sales tax module is expected to be rolled out shortly.

North Carolina reported that its sham-transaction Wal-Mart REIT decision is now in the court of appeals with a decision expected in a few months. The issue is whether North Carolina can force a combined return to more accurate reflect income within the state. A combined reporting bill will be introduced in the legislature again this year, while the Department hopes to adopt MTC-model- based regulations on broadcasting, publishing and financial institutions.

South Dakota expects to see legislation including pre-paid wireless service as subject to gross receipts taxation. The state is anxiously following the *Amazon* nexus litigation in New York. It has used local software companies for its programming needs and seems satisfied with the results and prices so far.

The District of Columbia reported that, despite the expected influx of several million inaugural attendees, it is anticipating a severe budget shortfall. No decisions have been reached for how that shortfall will be made up.

Massachusetts reported that a large budget deficit is expected. Combined reporting becomes effective in 2009, with regulations now in the public comment period. The Commonwealth's proposed telecommunications sourcing regulations have proven to be unpopular with certain taxpayers although the state intends to go forward. Mass. Has asked the SSTA governing body to grant an exception to the state for its exemption of clothing under $75 in value. Decisions are due out soon from the Supreme Judicial Court on the *Geoffrey* and *Capital One* nexus cases, and a decision is expected soon in the *Fleet Funding REIT* and *TJX* sham transaction doctrine cases. The MTC was thanked for its amicus brief in the *Capital One* case. A voluntary disclosure agreement program for economic nexus taxpayers, with a five-year look-back, attracted far fewer takers than expected. Sheldon Laskin reported on the Comcast case, in which the MTC filed an amicus brief. At issue is whether tax memoranda prepared by an accountant for an attorney are subject to disclosure or protected by various privileges.

VIII. New Business.

There was no new business before the Committee.

IX. Adjournment.

The Uniformity Committee Meeting was declared adjourned at 4:20 p.m. Central Time.