MTC Audit Nomination Process – Version 1.0 1-8-13

(NOTE: The same basic steps apply for both income and sales tax audits)

1. Audit Director sends out Audit Nomination Forms to states

- Generally, the sales tax process is conducted annual, and the income tax process is every 18 months. However, if inventory is getting low, the Audit Director may initiate the process as necessary.
- He will start the process with an Audit Committee meeting date in mind so that final review will be timely.
- The Audit Director may tell the states how many audits he needs to fill inventory (example: 10), and how many nominations he would like to receive from each state.

2. States Return Audit Nomination forms with potential Candidates (60-90 days)

- Audit Director will generally ask for submissions within 60 days; usually must send a reminder to several states and wait an additional 30 days.

3. Audit Director distributes a list that summarizes the audit nominations he has received together with another form seeking state specific information about those candidates. (It takes about 7 days to generate this information)
4. States supply information on all audit nominations

- Generally 70% of the states respond within 30-60 days. The Audit Director sends out a reminder and gives remaining states about 20 days to respond.

5. Audit director consolidates all of the information submitted (14-21 days)
6. Audit director sends out the consolidated information together with ballots for the states to indicate which audit nominations they prefer.

- Voting criteria: -1- Priority (the state will participate in an audit of this candidate); -2- the state is likely to participate; -3- the state would not likely participate in an audit of this candidate.

- Typically the states take 30 – 45 days to return their ballots.

- Audit director summarizes the vote results and shares the results with the states.

7. The states discuss the results either on a conference call or at next audit committee meeting – The Audit Director makes a recommendation for a cut off point based on how many audits are needed. He also looks for broad state representation (either a "priority" or "likely to participate" vote) in the audit list he suggests.

8. States approve MTC Audit Inventory after discussion. They usually approve the list as presented.

TO BE CONTINUED…

ISSUES AND CONCERNS WITH CURRENT PROCESS:

Where could time savings be achieved?

Is step 2 information too detailed? Is it the right information to evaluation nominations? Could MTC staff use this data to do an initial screen?

How is the detail from step 2 going to help states to vote? The team may need to get feedback from the states on the usefulness of the information to vote.

For sales tax audits the detailed information requested after nominations may not be the best.

Sales tax: one issue is that each state looks at its own criteria to determine whether the audit will be good for that state. We may need a new way to analyze the overall data. If a taxpayer has only a few physical locations, it may not be a good audit for a large group of states. Is there a way to apply a quality filter before asking the states to vote? If we stay with the same list – other states will sign on because that is all there is. A state may conclude that there may be a hope of nexus or something that will justify participation. States that nominate may be frustrated if the companies they nominate don't get audited due to the small number of states affected.

Guidelines were given to the states after the process was reworked – criteria for a good MTC audit rather than a good state audit. We will need to check whether the new guidelines will work well.

MTC can see the national picture that sometimes the states individually don't see. The inventory nominating cycle gets stretched out when states are asked for more nominations.

**Consider the philosophical views of the states concerning their relationship with the MTC audit program – as an extension of their own audit resources, or as a nexus finder. Small states with lower levels of business activity may see sales tax audits primarily as nexus tools. The group may want to consider whether the process should explicitly offer an initial nexus probe before conducting a complete audit for one of these states.

Some states consider it an extension – to pick up where state can't reach; some states look at MTC as a nexus finder (need to ask the states how they use the audit program). Need to be

clear about criteria, and most valuable use of the time of the auditors. In sales tax audits this is the key issue, if there is a large presence in a lot of states the states want to keep because of use tax issues. Use tax is most significant with manufacturing (self assessed use tax); if records are kept in a central location, that company would be a good MTC audit, particularly national retail.

Rather than trying to find an audit for 10-12 states, where states are participating only because the inventory is fixed, maybe look at smaller audits (6-7 states) to hit the sweet spot more frequently. Audits should be less time consuming and more likely to add value. More audits could be done?

If taxpayer shows minimal presence in half the states, perhaps the auditor could use the "early no change" process that is being developed by the other project team. This could reduce the demands on taxpayers' time. As we move forward, we can look for the intersection between nomination filtering, audit selection and early no change process.

See whether states are willing to share taxpayer populations, and do some filtering to develop an initial list of companies for consideration.

What to do if a state gives a "non-filer" response in the audit process – check for nexus first?

Les has a list of nomination lists that were voted on. He doesn't keep the back up data after a vote has been taken. The team may want to recommend retaining some kind of a list of prior nominees.

This may be an area where a data base would be helpful to keep track of the number of audits by tax type that were nominated by a state and voted in. There are some states that don't appear to put a lot of thought into making nominations of initial candidates. The team recognized that there is turnover in staff, and that the states need to be kept aware of their overall results.

Voting criteria: consider asking why the state is voting the way it is. This could help the selection criteria be refined.