REPORT TO STEERING COMMITTEE

COMPLIANCE TEAM 5-7-12 Meeting

Participating: Lennie Collins, Rick de Bano, Larry Shinder, Cathy Felix, Tom Shimkin, Steve Cordi, Elizabeth Harchenko

Meeting Objective: Respond to assignments from Steering Committee; prioritize list of possible strategies and begin to develop pilot project to increase number of audits done each year by MTC.

Topics Discussed

Ranking of strategies – the team members gave their ratings of the list of possible strategies in two ways. First: high, moderate or low impact on taxpayer compliance. Second: Hard or easy to implement.

The team rankings were consolidated and the strategies were placed in one of six priority "buckets" based on the two rating categories. (Results are set out at the end of this report.)

Project assignment – The team generally agreed that simply trying to increase the number of audits could have unintended consequences of reducing the quality of audit work. A significant issue to be addressed is taxpayer cooperation. A lot of time is lost as auditors or states attempt to get information from tax managers. Team members recognized that many tax departments have been downsized and that requests for information are often ignored. Discussion touched on audit process efficiencies and technology as ways to allow existing staff to be more efficient. The team explored other ways that the value of the audit program could be enhanced without sacrificing work quality. The group discussed Wisconsin's new penalty for failure to respond to a request for documents, and how that might be of value to MTC auditors.

The team discussed whether and how to involve MTC auditors in nominating or selecting audit candidates.

The team also discussed whether and how to enable MTC auditors to quickly conclude audits that don't appear productive, and whether and how to allow MTC auditors to add subsequent years for audits that have significant issues. The group recognized that current policies don't allow much flexibility and that those policies would have to be changed or exceptions created. Specific policies are: MTC does not do follow up audits on taxpayers (either due to an appearance of "targeting" or limit on number of different taxpayers that can be audited); MTC does not allow auditors to select audits (appearance of "targeting" specific taxpayers). There was also discussion about differing audit philosophies among the states. Some want the last dollar to be identified and billed. Others want to touch more taxpayers. Also, there are differences between the combined reporting states and the separate entity states concerning which audit issues are material. These philosophical issues would have to be addressed in the design of a project.

The team saw some potential value in allowing MTC auditors to propose adding a fourth or fifth year to an audit to deal with significant issues more efficiently. While an audit is underway, taxpayers are continuing to file and typically continue with the same treatment of state issues until the audit report is issued and the states assess additional tax. Adding one or two years for key issues with which the MTC auditor is already familiar would allow for greater efficiency for the states and taxpayer. There were concerns about the details of such a project, but the team seemed to think that this idea has sufficient potential to continue to work on it.

The team also recognized that the MTC Audit Committee will have to be involved in discussion about a project of this type.

Additional concerns – no one on the team has sales tax audit knowledge. Since the project focus was the audit program, the folks with nexus background may want to step back and have the committee invite more people with audit background to join the team.

Guidance Requested

The team needs direction from the Steering Committee on three questions. First – is the team free to change the project description? Rather than focus on increasing the number of audits, can the team focus on how to increase the return to the states from the audit resource we currently have?

Second – does the steering committee have a strong view about the purpose of the audit program? Dollars versus number of taxpayers touched? Is the team free to set aside the current policy about follow up audits in designing a project?

Third – is it time to adjust composition of the team to focus on the audit program?

<u>Priority Buckets for Compliance Strategies</u> 5-7-12 Compliance Team ratings

High Impact - Easy to do

- ~~When taxpayers file voluntary disclosures – identify industry issues for audit program.~~*

High Impact - Hard to do

- Technology: make electronic work papers and back up documents available to the states and to auditors; improve the secure e-mail system.
- Develop training on issues that are new to states that have just changed their laws to move to combined reporting (example – tax havens).
- Find more ways to engage non-active states in compliance programs.
- Continue to look for the best balance between seeking engagement and trust from industry and getting things done.
- Prepare audit manuals for complex and emerging audit issues, such as bank/brokerage, entertainment industry, NOLs, interest on U.S. obligations.
- Training: MTC offer specialized training on complex industry groups such as banks and brokerage or entertainment industry.

Moderate Impact - Easy to do

- Increase frequency and quantity of information sharing between the states and MTC staff during audits.
- ~~Look for synergies that could come from sharing information between audit/nexus programs.~~*
- Audit selection: include input from audit staff; assess cost/benefit and materiality of potential adjustments for all participating states.

Moderate Impact - Moderate Effort

- Consider providing a manual to taxpayers for added guidance, for example how to handle NOLs correctly.
- Develop audit procedures checklist to share with taxpayers at the beginning of an audit. (Being done by Audit Committee now.)

Moderate Impact - Hard to do

- Create an electronic case management system to monitor audit status
- Allow MTC staff to develop a trouble shooting role, rather than being a "go between" for states and taxpayers.
- Develop a uniform form for taxpayer disclosure of ATATs for state specific issues.
- Develop feedback mechanisms for states to apply lessons learned from audits as they develop regulations and audit standards and procedures.
- Identify skill sets and knowledge base needed to replace MTC and state auditors a they retire.
- Continue to assist states in improving the effectiveness of their own audit programs.

Low Impact - Easy to do

Create standards for audits in which an MTC auditor should do second cycle.

Low Impact - Moderate Effort

Reorganize and increase information in the audit package reported back to the states

* Stricken by Steering Committee on May 9, 2012, as violative of confidentiality of voluntary disclosure program.