Overview of State Taxation—The Multistate Tax Commission

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Background & Programs

Multistate Tax Commission

- An intergovernmental state tax agency established in 1967 by states adopting the Multistate Tax Compact
  - A response by states to the Willis Commission report
  - Uniform Division of Income for Tax Purposes Act (UDITPA) adopted in Article IV of the Compact

Multistate Tax Compact

- The purposes of the compact—
  - Facilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.
  - Promote uniformity or compatibility in significant components of tax systems.
  - Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.
  - Avoid duplicative taxation.

What the Commission Is and Isn't

- The Commission is a state intergovernmental agency —
  - The Commission is not a non-profit membership organization, such as the Federation of Tax Administrators.
  - The Commission is not an incorporated organization, such as the Streamlined Sales Tax Governing Board, Inc.
  - The Commission, as a creation of state governments, is not a business.

Core Programs

- **Joint Audit Program**
  - Operates under authority of the Multistate Tax Compact and state contracts; auditors are agents of, and work at the direction of, participating states in conducting an audit (the Commission does not have assessment or collection authority)
  - 28 states participate in the program (25 for income tax audits, 20 for sales & use tax audits, and 1 observing state)
- **National Nexus Program**
  - Created to foster state tax compliance by business that is engaged in multi-jurisdictional commerce, and to promote cooperation and consistent state tax enforcement and administration of issues in the nexus area
  - 36 states participate in the program
  - Offers multi-state voluntary disclosure to help businesses and individuals settle nexus issues efficiently through a single point of contact and uniform process

Core Programs, cont.

- What the Joint Audit Program and National Nexus Program mean to participating states for the last three completed fiscal years—
  - FY2011

Voluntary Disclosure Program back taxes collected: $11,884,837

Joint Audit Program proposed assessments: $96,104,743

  - FY2012

Voluntary Disclosure Program back taxes collected: $15,246,349

Joint Audit Program proposed assessments: $117,868,384

  - FY2013

Voluntary Disclosure Program back taxes collected: $10, 842,380

Joint Audit Program proposed assessments: $47,686,035

Core Programs, cont.

- **Uniformity**
  - The Commission promotes and maintains uniformity in state taxation of interstate business through uniformity projects under the direction of the Uniformity Committee
  - The Uniformity Committee is composed of representatives from participating states
  - The uniformity process is designed to maximize input from states and interested parties at nearly every stage

Other Support

- **Legal Support**
  - Amicus briefs & case consultation
  - Semiannual Litigation Committee meetings
  - State tax attorney teleconferences
- **Training**
  - Schools and programs designed to increase the effectiveness and efficiency of state tax administration with courses that enhance knowledge and practical skills.
- **Policy Research**
  - Staff economist provides technical support for uniformity projects
  - Consultation with states on fiscal & legislative issues
  - Support for addressing federal legislative activity
- **Voluntary Alternative Dispute Resolution Program**
  - Resolve controversies of an interstate nature involving more than one state
  - Mediation, Arbitration, or any Combination

Uniformity Process & Efforts

Uniformity Process

1. Proposal initiated by or assigned to Uniformity Committee
2. Uniformity Committee develops proposal, with input from relevant interest groups
3. Uniformity Committee proposal considered by Executive Committee
4. Public Hearing
5. Hearing Officer Report considered by Executive Committee
6. Bylaw 7 Survey of Affected Commission States
7. Proposal Considered for Adoption by Commission at Annual Business Meeting
8. Adopted Proposal submitted to the States

Uniformity Committee

- The Uniformity Committee consists of representatives from all interested member states (not just Compact states)
- The Uniformity Committee's goals are three-fold—
  - Simplicity, equity, and consistency
  - Greater voluntary compliance through taxpayer education and increased enforcement
  - Fostering greater communication among stakeholders
- To facilitate its work, the Uniformity Committee is divided into two working subcommittees
  - Subcommittee on Income and Franchise Taxes
  - Subcommittee on Sales and Use Taxes

Examples of MTC Model Laws

Exercise Jurisdiction

- Factor Presence Nexus

Tax Base

- Add-back
- Captive REITs
- Mobile Workforce Withholding

Administrative

- Uniform Protest
- RAR Reporting

Apportionment:

- UDITPA Regulations
- Special Apportionment
  - Financial Institutions
  - Telecommunications
  - Airlines, etc.
- Combined Reporting

Sales and Use Tax

- Priority – Leasing; Construction Inventory
- Models for Telecommunications Transaction Tax Centralized Administration
- Models on the Tax Collection Responsibilities of Accommodations Intermediaries

Current Uniformity Projects

- Recommended Amendments to Compact Art. IV (UDITPA), pending results of a bylaw 7 survey—
  - Section 17
  - Section 1(g), Definition of "sales"
  - Section 1(a), Definition of "business income"
  - Section 9, Factor weighting
- Recommended Amendments to Compact Art. IV (UDITPA), being revised by Uniformity Committee at request of Executive Committee—
  - Section 18, Distortion relief
- Amendments to Model Financial Institutions Apportionment Rule—public hearing held, pending a hearing officer's report.

Current Uniformity Projects, Cont.

- Model Sales & Use Tax Notice and Reporting Statute—being held by Executive Committee pending outcome of litigation
- Model Sales & Use Nexus Statute—being worked on at Uniformity Committee
- Model Provisions Concerning Class Actions and False Claims—being worked on at Uniformity Committee

Possible Uniformity Projects

- The Uniformity Committee is considering possible projects in the following areas—
  - Possible Cloud Computing Project
  - Possible Trust Taxation Project
  - Possible Project to Develop Regulation for Sourcing Electricity Sales

Litigation—Amicus Efforts

Alabama Dep't of Revenue v. CSX Transportation Inc.

- Alabama filed petition for writ of certiorari with the U.S. Supreme Court
- The Commission urged the Supreme Court to grant certiorari to resolve a conflict among the circuits as to the correct test for "discrimination" under 49 U.S.C. § 11501(b)(4) of the Railroad Revitalization and Regulatory Reform Act of 1976 ("the 4-R Act").
- The Supreme Court has not yet decided whether to grant certiorari.
- Oral argument is scheduled for December 9, 2014.

Direct Marketing Ass'n v. Brohl

- The Commission supported Colorado's use tax notice and reporting requirement for out-of-state sellers, §39-21-112(3.5) C.R.S. (2010), as commensurate with the burden on in-state sellers and as neither discriminatory nor unduly burdensome within the meaning of the dormant commerce clause.
- On Aug. 20, 2013, the court ruled the Tax Injunction Act deprived it of jurisdiction. The taxpayer has filed a petition for writ of certiorari with the U.S. Supreme Court to review the 10th Circuit's opinion, and has refiled the case in state court.
- Oral argument scheduled for December 8, 2014.

Comptroller of Maryland v. Wynne

- The Commission filed an amicus brief with the U.S. Supreme Court arguing that Maryland should not be required to provide a credit for taxes paid by residents to other states against the tax those residents owe to Maryland —
  - The tax imposed on residents by their home state is imposed with the consent of those residents through their elected representatives and funds the governmental services provided by that state, including schools and other critical programs, on which residents primarily depend.
  - States may also tax the portion of a nonresident's income earned in that state, but the fact that an individual might pay a tax on a portion of their income to another state because the income is earned in that state does not violate the Commerce Clause.
- Oral argument is scheduled for November 12, 2014.

Harris Corporation and Consol. Subsidiaries v. AZ Dep't of Rev.

- Harris Corporation and First Data Corporation cases in the Arizona Ct of Appeals.
- The Commission filed a joint brief to assert that capital transactions may give rise to business income by meeting a stand-alone "functional test" under Sec. 1(a) of UDITPA. (A.R.S. Sec. 43-113-1.)
- The court ruled in favor of the department.

Home Depot USA, Inc. v. AZ Dep't of Rev.

- The Commission supported the AZ tax court's determination that Home Depot and Homer, a Delaware intangible holding company, were part of a vertically-integrated unitary business.
- Given the operational relationship between Homer and Home Depot, they would be considered as engaging in a single unitary business.
- The Court of Appeals affirmed the tax court's ruling.

Gillette Co. et al. v. *Franchise Tax Bd.*

- The preeminent case regarding the nature of the Multistate Tax Compact and whether it's election provision (Article III) binds the states.
- The Commission argues that California law may vary from Compact Articles III.1 and IV because the Compact is an advisory compact, and Articles III.1 and IV of the Compact are more in the nature of a model uniform law.
- Moreover, if the Compact is to be characterized as an interstate contract, California may vary from Articles III.1 and IV because the Compact itself may be and has been interpreted by its member states to allow for variations in its enactment of, and the member states' course of performance shows that they have so interpreted the Compact.
- All briefs are in with the California Supreme Court.

IBM v. Dep't of Treasury

- Michigan's "*Gillette* case" furthest along in the process.
- The Commission filed a brief in support of Michigan addressing the third of four questions posed by the court: "whether the Multistate Tax Compact constitutes a contract that cannot be unilaterally altered or amended by a member state."
- As in *Gillette*, the MTC answered that the Compact is not a contract, and that it may be unilaterally altered or amended. To the extent Michigan's adoption of a mandatory single sales factor apportionment formula implicates the Compact at all, it is not prohibited by the Compact.
- All briefs are in with the Michigan Supreme Court and oral argument has been held.

HealthNet v. Oregon Dep't of Revenue

- Oregon's "Gillette case."
- The Commission addressed the question of whether the Compact adopted by Oregon affords its legislature the flexibility to participate in a nationwide trend toward more heavily weighted sales, consistent with the Compact purposes of preserving state sovereignty and promoting uniformity.
- As in Gillette and IBM, the MTC argues that it does, because the Compact is not a binding interstate compact, the terms of which cannot be unilaterally modified. Rather, it is an advisory compact under which its members have flexibility to vary — directly or indirectly — with respect to the model uniform apportionment provisions contained in Articles III.1 and IV.
- A decision by the Oregon Tax Court is pending.

Performance Marketing Ass'n v. Hamer

- The Commission argued that the lower court erred when it decided that Illinois' "Amazon Tax" (a) discriminated against interstate commerce in violation of the Commerce Clause , and (b) violated the federal Internet Tax Freedom Act's (ITFA) preemption of certain state taxes.
- In addition, the Commission urged narrow construction of the preemption provisions of ITFA.
- On Oct. 18, 2013, the court ruled in favor of the taxpayer, holding that Illinois' statute was expressly preempted by ITFA.

In re *BarnesandNoble.Com*

- The taxpayer in question was an online bookseller whose affiliates operated three brick-and-mortar bookstores in New Mexico under Barnes & Noble trademarks.
- The Commission agreed with the Department that the taxpayer had sufficient nexus with New Mexico for the state to impose its gross receipts tax; a state's jurisdiction to levy a tax on gross receipts realized from certain activities within the state is not limited by the dormant commerce clause to only those taxpayers with a physical presence in the State.
- The New Mexico Supreme Court ruled in favor of the Department.

Bridges v. Thomas

- The Commission urged the Louisiana Supreme court to reverse the First Circuit Court of Appeal's holding that legal effect must be given to the purported registration in Montana of a motor home by a "shell" limited liability company established for the exclusive purpose of avoiding Louisiana's sales tax on motor vehicles purchased in the state.
- The court ruled in favor of the taxpayer on May 7, 2014.

Harris Corporation and Consolidated Subsidiaries v. Arizona Dep't of Rev.

- *Harris Corporation* case consolidated with *First Data Corporation* et al. v. *Arizona Dep't of Rev.* at the Arizona Court of Appeals.
- The Commission filed a joint brief in these cases to assert that capital transactions may give rise to business income by meeting a stand-alone "functional test" under Section 1(a) of UDITPA, codified as A.R.S. § 43-1131-1.
- The court ruled in favor of the department in both cases.

Home Depot USA, Inc. and Affiliates v. Arizona Dep't of Rev.

- The Commission supported the Arizona Tax Court's determination that Home Depot and Homer, a "Delaware Intangibles Holding Company," were part of a vertically-integrated unitary business.
- Given the operational relationship between Homer and Home Depot, they would be considered as engaging in a single unitary business under the Court's definition announced in Container, and under any other recognized articulation of the unitary business concept.
- The Court of Appeals affirmed the Tax Court's ruling.

Tracking Federal Legislation

Federal Legislation

- The Commission opposes any federal legislation that encroaches on states' sovereign tax authority as established in our system of federalism.
- We do recognize, however, that Congress has a constitutional duty to regulate interstate commerce.
- Thus, in addressing any federal legislation, we seek to help Congress maintain the careful balance implicated by states' sovereignty and federal responsibility.

Permanent Internet Tax Freedom Act

- Amends the Internet Tax Freedom Act to make permanent the ban on state and local taxation of Internet access and on multiple or discriminatory taxes on electronic commerce.
- Several bills were introduced, two in the House, two in the Senate.
- H.R. 3086 passed out of House Committee on the Judiciary on June 18, 2014.
- CBO estimates that the direct costs to states and local governments would probably total more than several hundred million dollars annually.

Marketplace Fairness Act

- Authorizes each member state under the Streamlined Sales and Use Tax Agreement (the multistate agreement for the administration and collection of sales and use taxes adopted on November 12, 2002) to require all sellers to collect and remit sales and use taxes with respect to remote sales under provisions of the Agreement.
- Provides same authority to non-SSUTA states if the state adopts and implements minimum simplification requirements relating to the administration of the tax, audits, and streamlined filing.
- Exception for "small-sellers" – sellers with annual gross receipts in total U.S. remote sales not exceeding $1 million.

Mobile Workforce State Income Tax Simplification Act

- Limits state taxation of the wages or other remuneration of any employee who performs duties in more than one state to: (1) the state of the employee's residence; and (2) the state in which the employee is present and performing employment duties for more than 30 days.
- Exempts from the definition of "employee" for purposes of this Act a professional athlete or entertainer or certain public figures
- The MTC adopted a uniformity recommendation for the states on this in 2011, but it uses a 20-day threshold.

Digital Goods and Services Tax Fairness Act

- A bill "to promote neutrality, simplicity, and fairness in the taxation of digital goods and digital services."
- Prohibits a state or local jurisdiction from imposing "multiple or discriminatory" taxes on or with respect to the sale or use of digital goods or services delivered or transferred electronically to a customer.
- The bill would prohibit states from interpreting their laws to apply even-handedly to digital products, even when the products are simply the digital equivalent of other taxable electronic and tangible products.
- Grants jurisdiction to federal district courts to prevent a violation of this Act, without regard to the amount in controversy or the citizenship of the parties.

Business Activity Tax Simplification Act

- BATSA is an "anti-jobs" bill
- BATSA would hurt small business
- BATSA would upset well-established legal and policy principles
- BATSA would unnecessarily intrude upon state taxing authority, flouting the Tenth Amendment
- BATSA would blur the bright line rule
- BATSA would strip states of needed revenue— scored by CBO as the largest unfunded mandate upon the states
- There is an alternative—The Factor Presence Nexus standard adopted by the MTC

Industry-Specific State Tax Preemptions

- Increasingly, industries that have been unsuccessful in reducing their state taxes through litigation or state legislation have turned to Congress for redress by seeking to preempt state tax authority in their specific area of business, even when that business is thriving—
  - Direct Broadcast Satellites
  - Automobile Rentals
  - Hotel Intermediaries
  - Cell Phones
  - Natural Gas Pipelines
- Federalism is best maintained through Congress prompting the states and industry to address areas of concern, and then giving them reasonable time to work out a solution while refraining from pre-empting the states in tax matters traditionally managed by the states.

Looking for More?

- Information on the Commission and its activities can always be found at www.mtc.gov —