

States weighing considerations for continued Multistate Tax Compact membership

March 8, 2013

In brief

On March 4, 2013, South Dakota Governor Dennis Daugaard was presented with [Senate Bill 239](#), which would repeal all provisions of the Multistate Tax Compact from South Dakota law. Additionally, on February 28, 2013, Utah introduced [Senate Bill 247](#), which would repeal and then re-enact certain Compact provisions.

Michael Herbert examines the trend of states abandoning the Compact. Mr. Herbert is a PwC State and Local Tax Partner in San Francisco and Tax Analysts' 2012 State Tax [Person of the Year](#) for his contributions to the California *Gillette* litigation.

The takeaway

South Dakota does not have an income tax and did not participate in the Multistate Tax Commission's [audit program](#), so it is not surprising the state is seeking to repeal its membership in the Compact. South Dakota estimates its budget savings from repeal to be \$12,000. However, South Dakota is not the only state addressing its membership in the Multistate Tax Compact.

Utah introduced [Senate Bill 247](#), which would repeal Compact provisions from Utah law and temporarily reinstate most provisions of the Compact, but not Article III (allowing taxpayer to elect to apportion under the laws of the state or in

accordance with the Compact provisions) or Article IV (apportionment provisions). The bill's fiscal note, made prior to the amendment temporarily reinstating select provisions of the Compact, provides that complete repeal of the Compact will save the Tax Commission \$245,000 in dues and participation fees. However, depending on the year and whether the state "would impose certain assessments absent the Multistate Tax Compact, enactment of this bill may reduce sales and corporate income tax revenue by as little as \$75,000 and up to \$1.6 million annually." The fiscal note is silent regarding the incremental benefit Utah may experience by removing the

Article III election (assuming that the election would otherwise provide taxpayers with tax savings).

The Chief Sponsor of the legislation, Senator Wayne Harper, is a member of the National Conference of State Legislators' (NCSL) Executive Committee Tax Force on State and Local Taxation. He stated that the main reason for introduction of SB 247 is the *Gillette* case in California ([click here](#) for our summary of the *Gillette* decision).

Evaluating the benefits and detriments of Compact membership

Because of the potential ramifications of a taxpayer win

in *Gillette*, many states will evaluate the benefits and detriments to Compact membership. For example, one of the benefits of Compact membership is participation in interstate audits under Article VIII. However, with the expansion of IRS State information sharing and state-to-state information sharing, states may be considering the incremental value of the Compact audit program.

One issue that may arise from Utah's proposal to repeal the Compact and re-enact only certain provisions is whether the state could then participate in the interstate audit program under Article VIII. Partial enactment of the Compact is not likely to have the effect of rejoining the Compact as a party state as there is no 'acceptance' by the other state legislators, such as occurred when the Compact was created. The audit program under Article VIII of the Compact is only available to 'party states,' and the information derived from these audits is confidential. Taxpayers could challenge information sharing under this provision if the state is not a 'party state.'

State sovereignty over tax matters, potential federal intervention?

As party states to the Compact compete to attract new business, regaining their sovereignty over apportionment (they already have it over the rate, the base, and credits) takes on greater importance, which makes withdrawal from the Compact more attractive. As pointed out in the *Gillette* decision, withdrawal is the only way a party state can avoid

offering the election under Article III. Of course, if many states withdraw from the Compact, we might see the question of federal intervention in state taxation raised again and that is the question that led to the Compact in the first place.

The idea of a Compact was brought forward by then Assistant Attorney General of Michigan, William David Dexter. He argued the *US Steel* case in the US Supreme Court, which upheld the constitutionality of the Compact. This is an interesting part of history as Michigan was a member of three other non-congressionally approved compacts at the time Michigan joined the Compact, including a critical boundary compact with Minnesota and Wisconsin, a Civil Defense compact and a transportation compact. It is hard to imagine that Mr. Dexter would have thought Article III of the Multistate Tax Compact wasn't binding on the states, as reliance on following the provisions of these other interstate agreements would be critical for the safety of Michigan's citizens and Michigan's economy.

Future Commission actions

The Multistate Tax Commission will hold hearings on March 28 and 29 regarding the rewrite of UDITPA. The Commission is undertaking this process in its advisory role. The recommended provisions for review include sales factor numerator sourcing for intangibles, the definition of 'sales,' factor weighting, the definition of 'business income' and distortion relief. Any amendments to UDITPA will not impact the Compact unless all member states agree to

legislatively adopt these changes, which seems highly unlikely. Indeed, for this reason, the NCSL has objected to the Commission developing proposed amendments to UDITPA and, more recently, has asked that any consideration be deferred until *Gillette* is resolved.

Keep learning

For additional reading on Multistate Tax Compact issues across the states, please review any of our following publications:

- [Michigan: Taxpayers may not elect to apportion income based on MTC three-factor formula](#) (11/30/12)
- [FTB files petition for review of Gillette in the California Supreme Court](#) (11/16/12)
- [Alert: Results of November 2012 state tax ballot initiatives](#) (11/7/12)
- [Texas Comptroller issues first post-Gillette denial of MTC apportionment election](#) (10/19/12)
- [California Court of Appeal issues opinion in Gillette rehearing](#) (10/4/12)
- [Oregon provides guidance on MTC apportionment election](#) (10/2/12)
- [California - Taxpayers may elect to apportion income under the Multistate Tax Compact's equally weighted three-factor formula](#) (7/25/12)
- [California repeals MTC election effective immediately](#) (7/2/12)

Let's talk

If you have questions about the Multistate Tax Compact and its impact on taxpayers in member states, please contact one of the following individuals:

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