

The logo for the Texas Sunset Advisory Commission is a semi-circle with a thick black border. Inside the semi-circle, the words "Texas", "Sunset", "Advisory", and "Commission" are stacked vertically in a bold, white, sans-serif font.

**Texas
Sunset
Advisory
Commission**

STAFF EVALUATION

*Office of Multistate
Tax Compact Commissioner for Texas*

A Staff Report
to the
Sunset Advisory Commission

1989

**Office of the Multistate Tax Compact
Commissioner for Texas**

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Background and Focus

Creation and Powers

The Multistate Tax Compact (MTC) is a model law for adoption by states intended to help solve historical problems with interstate taxation. The enabling legislation was drafted by the National Association of Tax Administrators, the National Association of Attorneys General, and the Council of State Governments in 1966 to help multistate taxpayers determine and comply with state and local tax laws, avoid duplicative taxation, encourage uniformity in state and local tax policies, and to advance state interests with respect to federal tax policy.

To be a member, a state must pass the common legislation, or compact. In 1967, upon ratification by seven states, the compact went into effect. Texas ratified the compact in 1967, becoming the eighth member. Pursuit of a few controversial audit issues in the early years prompted business organizations to lobby non-member states against ratification which slowed the momentum of membership. Today, 19, mostly Western, states are members; ten states are associate members. Compact staff believe a renewed momentum is underway for non-member states to adopt the compact.

The need for the compact arose when historical problems with uniformity and discrimination in interstate commerce taxation raised the likelihood of federal intervention. Legislation pending in Congress (the "Willis bill") would have curtailed existing state and local taxing power in an effort to force more uniformity and equality in taxation practices across states.

Because businesses buy and sell goods and services across state lines, a mechanism was needed to help taxpayers and the states apportion a company's tax burden equitably among the states in which it was doing business.

The Multistate Tax Compact (MTC) was drafted to address these problems. To that end, the compact defines member states' responsibilities and rights under the law, defines procedures for the states and businesses to follow to fairly and legally apportion taxes among all eligible states, and establishes a voluntary arbitration mechanism for taxpayers. It is concerned with sales, use and income taxes. The compact does not, however, interfere with a state's autonomy in setting tax rates or policy.

Policy-making Structure

The compact creates a commission to carry out programs and functions. This commission is composed of one representative from each state who, by statute, must be the head of the member state's tax department. The member may designate an alternate to attend meetings in the member's absence. Also, the attorney general from each state may attend all meetings of the commission but may not vote. The full commission meets once a year. An executive committee, composed of seven members elected annually by the commission meets quarterly to handle policy and administration issues. The current Texas representative, State Comptroller Bob Bullock, has served on the executive committee for a number of years.

Administration of the compact is carried out by an executive director and approximately 25 staff headquartered in Washington, D.C. This includes a staff of

17 auditors who work out of offices in Houston, Chicago and New York. There are three program areas in which commission staff are actively involved. First, the MTC works with Congress on behalf of member states. From its inception, the existence of the commission has been successful in stalling congressional efforts to increase federal control over state policy and the commission has been continuously active in working with Congress on a variety of related bills and interests.

Second, the MTC employs a 17-person audit staff to perform audits of national companies on behalf of member states. Through these audits, the commission is able to ensure that the audited company is paying member states the taxes legally due, ease the audit burden of smaller states and, perhaps more importantly for Texas, use the process to test legal principles of taxation.

Third, the MTC employs a legal staff to provide support to the audit and legislative programs and to member states who request assistance. This staff is also active in developing legal arguments to try to overturn court decisions unfavorable to the states or to support state and federal legislative efforts.

Funding and Organization

When Texas became a member in 1967, the Office of the Multistate Tax Compact Commissioner for Texas was created. It is that office which is subject to the Texas Sunset Act.

The Texas statute provides that the governor shall appoint the comptroller as the state's representative to the commission; the comptroller serves in this position for his tenure as comptroller. The comptroller may designate one of his division chiefs as an alternate to conduct the business of the compact in his absence. The Texas statute also creates two advisory committees to meet with the comptroller on matters relating to the compact.

As the comptroller is the representative to the commission, his office provides administration for the Office of the Multistate Tax Compact Commissioner for Texas. Minimal staff time is involved in this function; the office processes travel vouchers for the member or his alternate and pays Texas' annual dues.

Funding for the commission is derived from dues and audit fees from member states; by statute, 40 percent is apportioned among member states and 60 percent is collected in fees for audit services rendered by commission auditors under agreement with member states. Texas' contribution in fiscal year 1987 was \$104,644. Dues are derived from general revenue and are paid out of the comptroller's operating fund (062). Membership dues are listed in the comptroller's annual report to the governor; travel expenses are also recorded in the report aggregated with all other travel expenditures.

Focus of Review

The review of the Office of the Multistate Tax Compact Commissioner for Texas focused on two primary areas. First, consideration was given to whether Texas' participation in the compact should be continued. This assessment concluded that:

- Participation has been valuable to Texas. The state has reaped the rewards of many of the advocacy efforts the commission undertakes on behalf of member states.
- These efforts have returned a significant amount of revenue to the state. For example, from fiscal years 1985-1987, commission efforts yielded at least \$3,144,460 in revenue for Texas; during the same years, dues to the compact from general revenue totaled \$345,330.
- Texas has played a major role in the compact, and it is anticipated that continued influence on the direction of future activities will also benefit Texas.

Second, the elements unique to the Texas statute were examined to determine a) whether current practice follows the statute, b) whether any element of the statute is outdated and should be changed, and c) whether provisions should be added to the statute to improve its operation. The review indicated changes were needed in several areas:

- First, the two committees established to advise the comptroller on matters relating to the compact are not active and serve no function. This authority should be changed to remove these specific committees and to give the comptroller authority to assemble advisory committees as the need arises.
- Second, the statute allows the comptroller to designate an alternate representative to the commission in his absence. The current designation of division chief, however, is too restrictive and should be changed to allow the comptroller to appoint any top associate.
- Third, the statute does not provide for public notice of the annual national commission meetings and notice is not published in the Texas Register.
- Fourth, the statute does not provide for reporting of the functions of the compact as they impact the state of Texas.

In analyzing the merit of continued membership in the compact, no attempt was made to determine whether changes needed to be made to the common language of the compact itself since any such changes would require ratification by all member states. Also, no attempt was made to evaluate particular commission activities or areas of concern except to determine the extent to which Texas benefits from these activities relative to other states. All programs and activities are carried out by staff hired by the commission; the Office of the Multistate Tax Compact Commissioner for Texas does not perform independent programs or functions. Again, any changes in the administration of the compact would require consent of all member states. Analyses of this nature are outside the scope of this review and no recommendations are made in these areas.

The recommendations contained in the report would not result in any significant change in state expenditure on behalf of the compact or related activities.

Findings and Recommendations

ISSUE 1: Texas membership in the Multistate Tax Compact should be continued and the sunset date removed.

BACKGROUND

Texas has been a member of the Multistate Tax Compact (MTC) since its inception in 1967. With ratification of the compact, the legislature created the office of the Multistate Tax Compact Commissioner for Texas. This office has a sunset termination date of September 1, 1989, and unless continued in statute, it will automatically be abolished and Texas' membership in the compact will be withdrawn.

A review of the need for continued membership in the compact indicated the following:

- ▶ Because of the existence and work of the compact, federal legislation to curtail state and local taxing power through uniformity imposed by the federal government has been forestalled.
- ▶ The compact has been beneficial to multistate taxpayers in complying with other state and local taxing laws.
- ▶ The state has benefited financially from the efforts of the commission and its staff in its role as advocate for the states on a number of taxation issues not specifically addressed in the compact itself. These efforts are directed at changing tax policy unfavorable to states. Revenue received as a result of commission initiatives and MTC audits have exceeded membership dues paid by Texas to the compact in recent years as shown below:

<u>Fiscal Year</u>	<u>Dues Paid</u>	<u>Revenue Received</u>
1985	\$ 122,216	\$ 2,000,107
1986	118,470	457,369
1987	104,644	686,984
Total	\$ 345,330	\$ 3,144,460

- ▶ Although withdrawal from the compact would save about \$100,000 in annual dues and audit expenses, there would be a net negative effect on the state due to lost revenues. This amount would vary from \$500,000 to over \$2 million annually in otherwise unrealized tax revenue, based on revenue generated over the past several years.
- ▶ Partly because of its size and partly because of the importance attached to the compact by the comptroller, Texas has been able to influence the commission's agenda. Once primarily concerned with income taxes, the commission is shifting its attention to sales and use tax issues.
- ▶ Specifically, the commission has been in the forefront in two related areas of particular interest to Texas. Both issues have returned significant revenue to the state. The first involves the tax liability of

mail order sales. Mail order companies have traditionally exempted themselves from corporate sales taxes in all states except their home base, relying on the National Bellas Hess Supreme Court case of 1967. The MTC has led an effort to overturn that decision by encouraging member states to change their tax laws and by helping states set legal precedents through court cases upholding the new laws.

- ▶ MTC staff negotiate with these mail order companies on behalf of the member states to pay back taxes in return for lessened liability charges in the future, as the new laws and court cases are expected to require. The comptroller's office estimates that up to 95 percent of the \$3.5 million revenue figure shown above was generated through such Bellas Hess agreements negotiated by commission staff.
- ▶ The second area of particular interest to Texas involves MTC audits of out-of-state companies which reveal a previously unknown presence of a company in Texas, making them subject to Texas sales and use tax laws. This concept is referred to as "nexus" -- or presence -- in Texas. Constitutional law suggests that without proof of a company doing business in a state, that state cannot initiate an audit of an out-of-state company. The commission, however, can provide that proof when information is found during one of their routine audits. The comptroller's auditors can then perform their own audit and collect any taxes due Texas .
- ▶ As with the National Bellas Hess issue, states, including Texas (H.B. 61, 1987), are changing their laws to re-define "presence" to incorporate the concept of "economic presence," thereby bringing mail order transactions--those made as a result of television, radio or print media--under existing sales tax laws. The revenue generated by these audits is not included in the \$3.5 million figure above; the commission, though, estimates the amount of revenue brought into the state from these changes is significant.
- ▶ Federal legislation, and subsequent Supreme Court decisions, are expected to be decisive on these issues in the next few years.
- ▶ If Texas were to end participation in the compact, revenue from these sources would be lost. The revenue gained from the mail order issue is from negotiations by MTC staff on behalf of member states. Not only would commission staff no longer include Texas in these negotiations, their knowledge of Texas tax laws would subside. Likewise, Texas would no longer be a party to MTC audits which alert the comptroller to potential nexus issues.
- ▶ If Texas withdrew participation, other member states would continue to pursue corporate taxes from interstate companies based in Texas, including taxes involving the nexus or mail order sales issues which the commission is actively pursuing. Liability to Texas businesses would not decrease if Texas withdrew; indeed, it may increase as the revenue to the state lost from withdrawal would be sought from local taxpayers.
- ▶ Finally, the compact is a function solely of the comptroller. The comptroller's staff follow established procedures in carrying out duties

related to the compact, and with the amendments to the statute of the remaining recommendations included in this report, further controls will be added to increase accountability and awareness of compact activities by the legislature and governor. Assessments can be made in the future of the value of continued participation and review of compact activities through the sunset process every 12 years is not necessary.

PROBLEM

Texas' participation in the Multistate Tax Compact is beneficial to the state and should be continued. However, the statute authorizing participation will be repealed in 1989 unless amended this next session. Because of the level of oversight for compact activities and expenditures, continued review through the sunset process every 12 years is not necessary.

RECOMMENDATION

The statute should be amended to:

- continue the compact; and,
- eliminate the separate statutory sunset date for the office of the Multistate Tax Compact Commissioner for Texas..

This recommendation would continue Texas' participation in the Multistate Tax Compact in order to continue to benefit from the initiatives of the commission. Removing the sunset date would allow the compact to continue without the requirement for another review in twelve years. Since it is a program wholly within the comptroller's office, funding and activities of the compact will still be subject to all other controls placed upon state agencies..

FISCAL IMPACT

No change in expenditure would occur from the adoption of this recommendation.

ISSUE 2: The Multistate Tax Compact Advisory Committee and the Local Government Council should be abolished.

BACKGROUND

Two advisory committees related to the compact are created in Texas law; the Multistate Tax Compact Advisory Committee and the Local Government Council. These committees are created independent of the common legislation adopted by member states.

The review of the purpose and need for these committees found the following:

- ▶ The statute requires the governor to appoint a Local Government Council composed of representatives of local political subdivisions, which would be affected by decisions of the compact, to consult regularly with the comptroller.
- ▶ The statute also requires the appointment of the Multistate Tax Compact Advisory Committee composed of the comptroller, the alternate, the attorney general, and two members each from the House and the Senate. This committee is required to meet at least three times per year.
- ▶ There are no current appointments to either committee. Staff at the comptroller's office involved with the compact over the past decade believe these committees have never been activated in Texas.
- ▶ The compact requires each state to provide a mechanism for the member to select representatives from subdivisions affected by the compact to consult with the member when needed. It does not, however, require the member to convene and consult any such group. A survey of 13 member states found that ten have local consulting committees established in statute.
- ▶ Although the compact is silent regarding other advisory committees, seven other states also created legislative advisory committees, each having nearly identical composition to each other. Two other states have had advisory committees at one time but have abolished them.
- ▶ The survey also found, however, that the states either do not maintain active committees or they convene their committees only as a formality in order to comply with the statute. No state contacted actively utilizes these committees.

PROBLEM

The statute requires the Texas member to the Multistate Tax Compact to meet regularly with a local consulting committee and an advisory committee. Neither committee exists and, therefore, current practice does not comply with the statute.

RECOMMENDATION

The statute should be amended to:

- abolish the Local Government Council;
- abolish the Multistate Tax Compact Advisory Committee;
- provide the comptroller with the authority to assemble advisory committees to obtain local or state-wide perspectives as needed; and,
- authorize the comptroller to pay expenses of the committee members.

This approach would remove the requirement that the comptroller meet with the advisory committees as they are currently outlined in statute since these committees have not proven to be needed or utilized. However, as topics arise which may require counsel, the comptroller will have the authority to convene committees (from a local or state-wide perspective) to provide the needed expertise.

FISCAL IMPACT

No significant change in expenditure is expected to result from the adoption of this recommendation. The comptroller would pay expenses for any committee activity out of funds available for general compact duties.

ISSUE 3: Designation of the state's alternate representative should be changed.

BACKGROUND

The Multistate Tax Compact allows for state law to designate an alternate to serve in the member's absence, provided that the alternate is registered with the commission. No other restriction is placed upon the selection of the alternate by the compact.

The review found the following:

- ▶ The Texas statute calls for the comptroller to designate one of his division chiefs as his alternate representative to the commission.
- ▶ Throughout Mr. Bullock's tenure as comptroller, one person has served as the alternate; during this time, he has held several different positions at the comptroller's office.
- ▶ By requiring the alternate to be a division chief, the statute limits the flexibility of the comptroller to appoint a colleague, without regard to a particular job title. The most appropriate person to serve may not be a division chief, according to an organizational chart. Likewise, the designated alternate may change positions within the comptroller's office, dropping the division chief title, thereby jeopardizing continuity with the compact.
- ▶ A survey of 13 other member states found that none required the alternate be a division head. One state designates the attorney general; four others have no restrictions. Eight states provide for the alternate to be a "principal deputy or assistant of the member" at the member's agency.

PROBLEM

The designation in statute of the comptroller's alternate as a division chief of the comptroller is unnecessarily restrictive.

RECOMMENDATION

The statute should be amended to:

- allow the comptroller to designate a principal deputy or assistant as his alternate representative to the compact.

This approach would give the comptroller flexibility to appoint his alternate without being restricted to the title of division chief, as the statute now requires. Changing the designation to a principal deputy or assistant gives the comptroller needed flexibility while still ensuring that the alternate is a high-level, qualified employee.

FISCAL IMPACT

No change in expenditure would result from the adoption of this recommendation.

ISSUE 4: The comptroller's office should post notice of commission meetings in the Texas Register.

BACKGROUND

As a state official, the comptroller, who is the Texas representative to the Multistate Tax Compact, is subject to the Texas Open Meetings Act. However, as a body, the total membership of the compact is not subject to the state's open meetings requirements.

The review indicated the following:

- ▶ Although the commission encourages any interested persons to attend, neither the compact nor the Texas statute require the posting for the public of the annual national commission meetings, which are held in different locations around the country.
- ▶ Publication in the Texas Register of the date, time, and location of commission meetings has not occurred.

PROBLEM

Notice of the annual national tax compact commission meetings is not provided the public in Texas.

RECOMMENDATION

The statute should be amended to:

- require the comptroller's office to post notice of national compact meetings with the secretary of state's office for publication in the Texas Register.

This change will provide the public with notice of commission meetings.

FISCAL IMPACT

No change in expenditure would result from the adoption of this recommendation.

ISSUE 5: The comptroller should report on the functions and expenditures relating to Texas' participation in the compact.

BACKGROUND

Annual reports are generally required of most state agencies in Texas to provide information on their functions and expenditures to the legislature, the governor, and the public of Texas.

The review indicated the following:

- ▶ The Multistate Tax Compact requires the commission to submit an annual report of its functions to the governor and legislature of each member state. However, this report does not specifically address the impact of the compact on member states.
- ▶ The comptroller's office currently includes the expenditures for annual dues to the compact in the comptroller's annual report to the governor. However, the comptroller currently does not provide in that report a summary of compact functions and their impact on the state.
- ▶ While the Office of the Multistate Tax Compact Commissioner for Texas does not carry out any independent programs, the comptroller's office has the overall responsibility for maintaining Texas' membership in the compact.

PROBLEM

The legislature, the governor and the public of Texas are not provided information on the functions and impact of Texas' participation in the compact.

RECOMMENDATION

The statute should be amended to:

- require the comptroller to report on the functions and expenditures relating to Texas' participation in the compact; and,
- the report should be included as part of the annual financial report of the comptroller's office.

This report should provide information on compact functions particularly as they relate to the interests of the state.

FISCAL IMPACT

Minimal cost would be involved to incorporate this information into the annual financial report of the comptroller's office.