Briefing

European Parliament

How the United States Addresses Harmful Tax Competition

Purpose

The brief provides information on how harmful tax competition is addressed in the United States.

The central piece of conflict resolution is the Multistate Tax Commission (MTC) which is utilized in the U.S. as a voluntary mechanism for addressing harmful tax competition.

Background

The U.S. Constitution enumerates some powers to the federal government, while powers not enumerated are reserved for the states (Article 1, Section 8). Thus the U.S. possesses a multi-layered tax system, with some taxes in the jurisdiction of the federal government and some taxes in the jurisdiction of the individual states. The Interstate Commerce Clause (Article 1, Section 8, Clause 3) allows for some expansion of the federal government's jurisdiction while also ensuring that states do not use tax policies to obstruct interstate commerce.

U.S. case law has established and reaffirmed this Constitutional principle by determining that companies must establish a "substantial nexus" within a state to justify the state's taxing authority. In Quill Corp v. North Dakota the Supreme Court determined that a company doing business in a state only by mail does not constitute "substantial nexus" as the company hosted its operations in Delaware and had no physical presence in North Dakota. This has become an increasingly important issue due to the prevalence of e-commerce as companies such as Amazon.com have been able to sell products in states without establishing a physical presence. The standard for income taxes varies by state, but for sales tax purposes nexus is established if the company owns property in the state or employs workers in the state where the company is doing business. In the Amazon.com case, substantial nexus was established when the company built a distribution center in the state. Amazon.com and similar companies are not obliged by the federal government to collect sales tax without substantial nexus, but in the Quill Corps decision the Supreme Court noted that the U.S. Congress possesses the authority to pass legislation to require sales tax collection of cross-border sales.

Multistate Tax Commission

The U.S. has more than 200 interstate compacts, which are a way to allow states to solve issues through interstate cooperation without Congressional intervention. Such compacts are allowed under Article 1, Section 10 of the U.S. Constitution and must be approved by Congress. Through these arrangements model legislation can be developed and recommended, with existing and future members able to adopt recommendations.

The Multistate Tax Compact was established in 1967 as a way of resolving tax disputes and has become increasingly important due to the prevalence of interstate commerce. The Compact serves to streamline tax administration between participating states by addressing such issues as determining tax liability of companies, promoting compatibility and compliance, and avoiding double taxation. The Compact is governed by the *Multistate Tax Commission,* primarily an

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information-gathering body that makes recommendations to the participating states and conducts audits in accordance to the provisions of the programs described below.

Currently 47 states participate at different levels to MTC. Of those states, 16 are full Compact members, which mean the states have fully enacted the Compact. Sovereignty members (17 states) may provide general support to MSC without implementing recommendations. Associate members may participate in some of the MSC programs or projects. This means that only 3 states-Delaware, Nevada, and Virginia-do not participate at all.

The National Nexus Program was created by MTC to clarify the nexus standard and ensure tax compliance by companies that participate in multijurisdictional business. The program uses cooperative information exchange as a tool for promoting compliance and strives to make compliance more simplified and less burdensome.

The MTC Joint Audit Program is a program by which audits are conducted for the joint benefit of states and citizens. Audit candidates are nominated by the states, assessed and voted on by the Audit Committee, and then the audits are conducted by MTC auditors as if the auditors are part of the state's audit committee staff. States decide whether to participate in audits and how to utilize audit findings. Auditors are selected from the states and must undergo training courses, which are made available to state tax administrators by MTC. The Audit Committee includes member state audit and compliance directors. MTC claims that conducting audits in a cooperative manner is more cost effective than relying on individual state audits.

The MTC Training Program provides services to states that enable tax administrators to gain or improve skills. This is a beneficial program to states because the states possess incentives to improve efficiency and effectiveness of its own tax administrators. It is also a key component of the Joint Audit Program, as the Training Program includes courses that provide auditing expertise.

The decision-making process is facilitated by MTC committees, including an Executive Committee consisting of a Chair, Vice-Chair, Treasurer, and four elected members that meet quarterly. The Executive Committee is elected annually by the member states. MTC has Program Committees that meet regularly including the Uniformity Committee, Litigation Committee, Nexus Committee, Audit Committee, and Technology Committee. MTC has meetings for functional or issue-specific work groups and project teams. MTC also hosts an annual conference, which may coincide with committee meetings and include consideration of recommendations for adoption. MTC committees are responsible to the member states.

MTC hosts forums on state fiscal conditions or tax trends and sends letters to public officials expressing opinions about legislation. MTC has participated in the legal process by filing briefs in court proceedings. For example, MTC recently filed amicus briefs in California, Massachusetts, and Tennessee in cases involving tax administration disputes.

Current Issues

Recently states have shifted to using different apportionment methods for determining tax liability, which effectively lowers the tax liability of companies doing business in the respective state. States may lower effective tax liability for the sake of competitiveness, but it results in Base

Erosion and Profit Shifting. In an effort to address this trend, MTC has proposed a Transfer Price Program, which would conduct audits under the Arm's Length Adjustment Service (ALAS). This would ensure that states are using fair and appropriate apportionment methods to determine tax liability and avoid harmful tax competition. The efforts of the MTC demonstrate the potential benefits of employing this model as a way of addressing harmful tax competition.