INTERVIEW

Douglas L. Lindholm

By Jasper L. Cummings, Jr. and Alan J.J. Swirski*

Douglas L. Lindholm is President and Executive Director of the Council On State Taxation (COST). He previously served as Counsel, State Tax Policy for the General Electric Company and worked in the Washington National Tax Services Office of Price Waterhouse LLP.

Q Please describe the history and activities of COST.

A This is COST's 42nd year—we were originally formed as the Committee on State Taxation in 1969 as part of the Council of State Chambers of Commerce, and today we count nearly 600 of the nation's largest corporations as our members. Our mission is to preserve and promote equitable and non-discriminatory state and local taxation of multijurisdictional entities. As our name implies, we've played a central role in nearly every state tax issue affecting multistate corporate taxpayers during our 42-year history. The circumstances that led to the formation of COST had their origins well before then, however, and a little historical context on the development of the legal framework that informs state taxation as we know it today is appropriate. Back in the 1950s, most commerce was local, and most companies paid state income taxes to their headquarters state only. A typical manufacturer of tangible property would manufacture in one location and send salespeople (drummers) to other states to sell its products. The notion of the need for uniformity in state taxation was starting to percolate in legal circles, however, and in 1957 the National Conference of Commissioners on Uniform State Laws (drafters of the Uniform Commercial Code) promulgated the Uniform Division of Income for Tax Purposes Act (UDITPA), although few states adopted it. In 1959, the Supreme Court ruled in *Northwestern States Portland Cement* (358 U.S. 450 (1959)) that states could constitutionally impose an income tax on those out-of-state manufacturers based solely on the presence of traveling salespeople. Companies were thus faced with the prospect of filing income tax returns in every state where they sent salespeople. In response to that case (and denial of *cert.* in two others) business groups petitioned Congress for relief. Within six months, Congress passed Public Law 86-272, which prevented states from imposing income tax on a corporation if the only presence in the state was an employee or agent who solicited orders for tangible personal property.

During debate on the legislation, the states were aghast at the liberties Congress was taking with regard to the states' perceived sovereign right to determine their tax structures. To placate the states, Congress included in the bill a commission—dubbed the Willis Commission after its Chair Rep. Edmund Willis—to study and make recommendations on how to fix the lack of uniformity in state and local taxation of multistate corporations. For nearly five years the Willis Commission convened hearings throughout the country, heard testimony from numerous experts, and ultimately issued its report in 1965. Among the more significant recommendations was the suggestion that the U.S. Treasury Department should administer and collect all state corporate income taxes, and redistribute the revenues to the states based on an agreed-upon factor, such as population. To forestall such a perceived inequity, the states in 1965 established the Multistate Tax Commission (MTC)—with UDITPA as the centerpiece of a Multistate Tax Compact—as a way to foster voluntary uniformity in state taxation. For the next three or four years, state tax commissioners and the business community met as part of an ad hoc committee to seek a uniform apportionment method that could be supported by both groups. Those efforts ultimately fell apart for two primary reasons: the MTC's multistate corporate audit program, and the MTC's failure to secure congressional approval of the Multistate Tax Compact.

In 1969, a group of roughly 100 companies formed a coalition to support litigation against the MTC, challenging its right to conduct multistate audits, and indeed, its very existence under the Compact Clause of the U.S. Constitution. That small group of companies became known as the Committee on State Taxation, or COST, and was initially organized under the auspices of the Council of State Chambers of Commerce. The case challenging the MTC (*U.S. Steel Corp. v. Multistate Tax Commission*, 434 U.S. 452 (1978)) made its way to the Supreme Court in 1978, where the MTC's status and approach was vindicated. That case, however, set the tone for many years to follow of the adversarial relationship between COST and the MTC, some of which remains today, although certain joint projects have been undertaken with some success. In 1992 COST became separately incorporated, and in 2002 we changed our name to the Council On State Taxation. We operate under I.R.C. section 501(c)(6) as a non-profit organization.

Over the years, the COST Board made efforts to work jointly on projects with

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the MTC, but several large unresolved issues have always been in dispute: the proper standard for determining nexus, the unitary question, taxation of certain foreign source income, and the forced collection of tax on remote sales. None of these questions have yet been resolved to the satisfaction of either states or multistate taxpayers, and they largely define the relationship of the two organizations to this day.

COST today has two primary roles—advocacy and education. From a legal perspective, our primary role is to file amicus curiae briefs on state tax issues before state supreme courts and at the U.S. Supreme Court on behalf of our members, thereby providing the larger perspective of the multistate business community. COST is also very active in pursuing legislative and regulatory solutions for issues facing our members. And although a great deal of our time is spent reacting to initiatives seeking to impose unfair burdens on multistate companies, much of it is spent on efforts to improve the tax climate for corporate taxpayers, focusing on certainty, predictability, and ease of administration. As an example, we've recently been working with the ABA Tax Section on efforts to enact independent tribunals in states where such a forum is unavailable (nearly half the states). Our work has recently been successful in Texas, North Carolina, and Mississippi, and joint efforts are currently underway in Alabama, Georgia, Illinois, and Oklahoma.

COST's second role is to offer to our members a fairly substantive educational program. We offer basic, intermediate, and advanced instruction at our state and local tax (SALT) schools, plus three or four annual conferences focused on current developments and networking opportunities. Many of the instructors at our schools and conferences are drawn from the ABA's state and local tax committee. We also sponsor 20 to 30 regional meetings per year across the country for our members, with a mix of local and national speakers. Finally, we prepare a number of authoritative and well-respected studies on discrete state tax issues, partnering with leading economists from academia and the private sector. We've prepared studies on combined reporting, competitiveness of state tax systems, gross receipts taxes, sales taxes on business inputs, property tax administration, and unclaimed property administration. The capstone of this effort is our annual Business Tax Burden Study, prepared by economists at Ernst & Young, which is widely consulted by legislators, legislative staff, and other policymakers in the state tax arena.

Q What do you view as the most important trends in state taxation for multistate corporations today?

A lmost every trend in the state tax arena today stems from the natural tension between the parochial interests of state and local policymakers and the need to consistently ensure the free flow of interstate commerce. Every state legislator and state tax administrator is elected or appointed to look after the specific interests of their state or local jurisdiction. Often these interests are not consistent or cognizant of the need for a national common market, and much of the litigation we see arises under the Commerce Clause of the U.S. Constitution. For example, the question of what the nexus standard is for state corporate income taxes is one of those issues, and is probably the most pressing issue companies face today. It is also quite common for state legislators, seeking to raise revenues without political costs, to try to export part of the state tax burden to out-of-state companies—often in a discriminatory manner. Taxation of foreign income is another such issue, and determining whether certain income is business income (apportionable) or nonbusiness income (allocable to a specific jurisdiction) is yet another. Also, the collection of sales tax on remote sales—another aspect of the nexus question—has been the topic of a lot of litigation and legislation recently.

Q Are those Internet sales?

A Remote sales can be either Internet sales or catalog sales—*i.e.*, any interstate sale that takes place when the company selling the product has no physical presence in the state in which the sale is made. The Supreme Court has found that in the sales tax context, no physical presence means no nexus (i.e., jurisdiction to tax), but that question remains unresolved for corporate income and other business activity taxes. For sales taxes, the nexus question is evolving into what constitutes a "physical presence" under the Supreme Court's 1992 ruling (*Quill v. North Dakota*), and is now focusing more on the nature and quality of affiliate or agency relationships with third parties in the taxing state.

Q What about uniformity in state tax laws? Are states making any effort to impose uniform laws in order to minimize burdens on multistate companies?

A I mentioned earlier that the Multistate Tax Commission was formed to foster uniformity in state tax laws. The second reason for its formation, however, was to forestall any further federal intervention in the state tax arena after enactment of Public Law 86-272. Unfortunately, those two goals tend to be self-defeating: the MTC develops and submits model statutes and regulations for consideration by its member states. Adoption of those uniform proposals, however, is on a completely voluntary basis, and because dollars (revenues) are involved, state legislatures feel no compunction against modifying or amending such proposals for their own ends. Thus the need for uniformity often takes a back seat to states' parochial interests. When one considers that the MTC only has 21 full member states to begin with, their ambition of achieving any type of voluntary uniformity is quite elusive. The business community there-

fore has come to the conclusion that the only way to achieve true uniformity in state tax laws is to seek federal legislative relief through Congress, which has plenary authority to deal with interstate commerce under the Commerce Clause. Of course, as noted, that approach is in direct conflict with the MTC's second reason for its existence—preventing such federal intervention. As a result, COST and the MTC are often at loggerheads on the uniformity question. A further complication arises because state tax issues have no real constituency before Congress. State tax issues are often so complex that congressional staffers and their bosses tend to consult their home state tax commissioners for advice on federal legislative proposals dealing with state taxes, yet as I noted earlier, the state tax commissioner's job is to focus on the specific interests of the state he or she serves, and not necessarily on the benefits of ensuring the free flow of commerce in a common market.

Q One of COST's activities you mentioned is filing amicus briefs in state tax cases. What kind of cases does COST typically weigh in on?

A Most of the cases we file in are consistent with the issues that we've been discussing. One of the advantages of COST is that the issues we see are typically of first impression, arising out of state audit assessments. We often follow developing issues through audits, administrative appeals, multiple levels of court challenges, and finally legislation, if necessary. Over the past year we've filed more than a dozen amicus briefs before state supreme courts as well as the U.S. Supreme Court. Some of the issues we've filed on recently are retroactive legislation; forced combination standards; a California case subjecting intangibles to property taxation; whether the MTC should allow a three-factor apportionment election; the appropriate judicial deference to a non-independent tribunal; the constitutionality of a "throwout" rule; and the constitutionality of an economic presence nexus standard. As states have become more aggressive, this is clearly an advocacy function we're devoting more and more resources toward. At the beginning of the decade, we would typically file only five or six amicus briefs per year.

Q Your organization is made up of over 600 multistate corporations. Most if not all of them have in-house state tax experts. What do you see as the role of and opportunities for independent counsel in the state tax area?

A I think there are tremendous opportunities for independent outside counsel in the state tax arena. Most of our firms hire outside counsel regularly, for both multistate issues and state specific issues, and for the state tax impact on several practice areas including litigation, planning, compliance, and transactional work. There are numerous instances where companies actually would like to see more litigation because two problems tend to recur: first, litigation is often pursued in a state without appropriate consideration of its impact on other states, and second, because some of the state tax dollars tend to be small, companies will tend to settle those cases instead of pursuing the principle at the heart of the litigation. And in many cases if a company settles an issue based on an assessment of dollars at risk, it tends to embolden the state in its efforts to pursue the same issue against other taxpayers.

Q How would you rank state and local taxation among the factors that influence a multistate corporation's decisions on where to locate a business unit in a state? Has COST done any surveys on the question?

A When a company makes a decision to expand or relocate, it typically undertakes a two-step process. The first step is usually a static phase, where the company weighs all the costs of expanding and/or relocating in a number of jurisdictions. Those costs include infrastructure costs, personnel costs, access to markets, access to communications, availability of trained labor, etc., and the tax burden calculation is just one of those static costs. The taxpayer will then narrow it down to the top few locations where total costs are relatively equal. The finalist jurisdictions will be notified that they are under consideration as a finalist in the relocation decision, and are given the opportunity to seal the deal, which is typically done through targeted tax incentives or other tax considerations. So although in the initial phase the business tax burden is just one of several factors considered as part of the overall costs, in the final dynamic phase tax considerations can be the deciding factor. In my view, states should approach this process in much the same way a business would, by considering two factors: First, "clawbacks" of incentives should be a part of the package for nonperformance, say, on promises to bring a certain amount of jobs or investment to the state in return for the incentives; and second, states should be careful not to give too much of an advantage to new companies coming in, to the detriment of companies already in the state that might as a result seek to expand elsewhere in the future.

Q What sorts of competitive tax tools do states use?

A Perhaps the most effective tool available to states is to apportion corporate income for tax purposes based on a single sales factor instead of using the traditional three-factor formula of property, payroll, and sales. Apportioning income by sales allows states to effectively export their tax burden while at the same time it encourages—or at least avoids penalizing—in-state investments of capital (property) and labor (payroll). As a result, there's a distinct trend today of states moving toward single sales factor apportionment. While this may benefit state parochial interests, however, it raises some troubling questions about uniformity and the long-term burdens and viability of our state corporate income tax system. States are essentially using an apportionment concept—which

in theory is designed to equally spread income tax burdens among states—as an economic development tool which by its very nature seeks to differentiate one state from other states. It also begs the question of whether measuring a corporation's tax presence in a state by sales alone might ultimately be distortive under the Commerce Clause and therefore subject to constitutional challenge in certain fact patterns. As more and more states apportion using a single factor, I think this is an area where we may eventually see more frequent litigation.

Q What do you foresee in terms of federal legislation on state tax issues of national impact, such as taxation of interstate commerce, taxation of Internet sales, and the like?

A Let's talk about three issues—the first one is the as-yet-unanswered nexus question: what type of presence must a company have in a state before that state can compel it to pay state corporate income taxes? We have the largest, strongest, and most advanced economy in the world, yet companies operating here still do not know what the nexus standard is for corporate income and other business activity taxes. That lack of certainty and predictability in our state tax system is somewhat embarrassing, and we need to resolve that issue. The Supreme Court has clearly signaled that this is an issue that Congress is better suited to resolve, and legislation is pending before Congress on the issue. The legislation is called BATSA—the Business Activity Tax Simplification Act, and it would impose a single uniform nexus standard for all states based on physical presence, which is similar to the international standard.

The nexus question is also still an issue for sales tax, but on a different level. As I mentioned earlier, in 1992 in the *Quill* case the Supreme Court held that a state can only compel a remote seller to collect sales taxes on sales into a state if that seller has an actual physical presence in the state. The holding, based on the Commerce Clause, recognized that compliance with the existing system created undue burdens on interstate commerce. Over the last decade, COST and the business community have been supportive of state efforts to streamline state sales tax systems in an effort to reduce the burden on remote sellers enough to allow states to compel collection of sales tax on remote sales. Several pieces of legislation are now pending before Congress that would allow states to impose a collection duty if minimum simplification requirements are met. The primary legislative vehicle is called the Main Street Fairness Act, and is sponsored by Senator Durbin in the Senate and Representative Conyers in the House.

The third issue I'd like to talk about is a classic case where federal intervention is necessary from a practical standpoint. It is called the Mobile Workforce State Income Tax Simplification Act, and it is sponsored by Representatives Howard Coble from North Carolina and Hank Johnson from Georgia. Under our existing system, if employees travel for work to another state, in roughly half of the states they incur an income tax liability as of the first day they visit, and their company incurs a corresponding requirement to withhold taxes for that state from the employee's wages. The remaining states have a hodgepodge of rules, some based on days, some based on dollars. It's a very difficult set of rules to comply with. And with the current emphasis under Sarbanes–Oxley on complete compliance with all aspects of federal and state tax laws, it is putting pressure on companies to comply for thousands of traveling employees as best they can. The legislation would impose a simple 30-day threshold before state rules kick in for both employee liability and for employer withholding. Until the 30-day threshold is reached, the employer withholding and employee liability continue in the state of residency.

Q Now when you ask Congress to take a position in resolving some of these thorny areas, do you run into the fact that they have local representation themselves and every Congressman is from a district whose tax office may oppose the bill?

A We have, although I must say, given the amount of federal legislation dealing with state taxes, awareness of the problem on a national scale has gotten much better. Frankly, part of our mission is to help educate legislators about the systemic impact of disparate state actions on our economy. And because Congress has plenary authority over interstate commerce, most policymakers recognize that responsibility. We have been working on some of these issues for ten to fifteen years. The education process is often long and cumbersome, but we hope it will eventually pay dividends by improving our state tax system.

Q Do you see rising interest among your members in unclaimed property audits, and how does that affect the tax function?

A Unclaimed property is becoming a great concern for large companies because certain states are pursuing it as a major revenue source. Responsibility for unclaimed property compliance often falls within corporate tax departments because they are familiar with state audit procedures. Within the last decade or so, states have contracted with third party contingent fee auditors to pursue unclaimed property, and they've been very aggressive—using a combination of statistical sampling, no statute of limitations, and no appeal procedures for escheat challenges to levy very large assessments. Delaware, in particular, has become very aggressive because so many companies are incorporated in the state. I believe unclaimed property collections are the third largest general fund revenue source for the state of Delaware—which means, of course, that very little of what they get in the door is ever returned to the rightful owner,

raising the question of whether the "property" escheated was actually ever unclaimed in the first place. We have been pursuing corrective legislation in Delaware to ameliorate some of these perceived injustices, including a bill last year that provides an appeal mechanism for unclaimed property claims.

Q Do you see states reacting to increased pressure for revenues by making harsher rulings on their favorite tax subjects—out-of-state corporations—and what ought to be done about it?

A There is no question that states are being more aggressive against out-of-state corporations, in both legal rulings and in audits. The difficulty, of course, is that the more a state seeks to export its tax burden by targeting out-of-state corporations, the more likely it is to result in double taxation. Fortunately, most judges still take a dim view of double or multiple taxation under the Commerce Clause. Part of the problem, in my view, is that judges not well-trained in the finer points of multistate tax law tend to give the fiscal impact of their decision more weight than is appropriate. Fortunately, more and more states are realizing that establishing an independent tax tribunal with judges trained in state tax law is a best practice from a business climate and economic development perspective. As I mentioned earlier, within the last few years a number of states—including Texas, Mississippi, and North Carolina—have enacted independent tax tribunals and a number of additional states (Alabama, Georgia, Illinois, and Oklahoma) are giving the issue serious consideration in their respective legislatures.

Q How does COST interact with the states from an advocacy perspective?

A We closely monitor and participate in the work product of both the Federation of Tax Administrators (FTA) and the Multistate Tax Commission. The FTA typically focuses on procedural issues such as E-filing, electronic payment protocols, and electronic recordkeeping requirements. The MTC tends to focus more on policy oriented issues. And although we often disagree with the direction and substance of much of the MTC's proposed statutes and regulations, on occasion we are able to agree on a solution beneficial to both states and taxpayers. We also evaluate state statutory and procedural frameworks using three "Scorecards"—one deals with procedural issues and state tax appeal systems, one evaluates the statutory framework surrounding unclaimed property, and the third evaluates state administrative procedures for property taxes. All three are available on our website, at www.cost.org. These Scorecards have generally been very effective because they let state legislators see how they compare with neighboring states and specify changes necessary to improve the state's business climate.

Q Do you interact with other private organizations?

A COST was formed originally as the Committee on State Taxation under the Council of State Chambers of Commerce, a group consisting of the chief executive of each state chamber. It is a group we remain in close contact with today because they act as our primary partners in every state where we pursue legislative or regulatory advocacy. We value that relationship highly, and our organization and the Chambers have a natural symbiosis in working together on state tax issues affecting large corporations. And it works well because of the significant overlap in our membership as compared to the membership of state chambers of commerce.

Q Was there a time when you became more independent of the Chambers?

A From the start we had always been fairly independent of the Council of State Chambers because our issues were entirely multistate-tax-related and the Chamber executives had to deal with the entire panoply of business issues before state legislatures. Despite the different focus, we typically held meetings in the same location. Eventually our attendance started to dwarf the Council's (they had only 50 members), and in 1992 we officially incorporated as a different entity, a 501(c)(6) non-profit organization. It wasn't until 2002 that we officially changed our name from Committee on State Taxation to Council On State Taxation. ■