ECONOMIC ANALYSIS

Political Reality Blocks Radical Reform in North Carolina

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In November 2010 Republicans made history when they seized control of North Carolina's legislature for the first time in more than a century. Two years later they increased their majority to 31 seats in the House and 16 seats in the Senate. They also took the governor's mansion, with Pat McCrory, the former popular mayor of heavily Democratic Charlotte, cruising to victory over incumbent Lt. Gov. Walter Dalton.

At the top of the governor's to-do list was job creation. When McCrory took office in January, North Carolina's unemployment rate was 9.5 percent, while the national average was 7.9 percent. The most prominent component of his economic strategy was tax reform. Like so many other Republican governors — particularly those in Louisiana, Nebraska, and Kansas — McCrory wanted to reduce income and corporate taxes and replace the lost revenue with a higher sales tax. North Carolina had a top individual rate of 7.75 percent and a corporate rate of 6.9 percent, higher than any of its four bordering states, as shown in Table 1.

In his February 18 State of the State address, McCrory told lawmakers that tax reform must be revenue neutral and that he wished to "close loopholes for special interests to make our system more fair and transparent." Beyond those broad guidelines, the new governor was content to let his audience fill in the details. Senate Republicans were particularly enthusiastic. Spearheading the effort were Senate Leader Phil Berger (R), considered by many to be a candidate for U.S. Senate in 2014, and Finance Committee Chair Bob Rucho (R).

Initially the senators floated a plan that included complete elimination of the personal income tax, the corporate tax, and the estate tax. The loss of revenue was covered by a vast expansion of the sales tax base and an increase in the rate from 6.75 percent to 8.05 percent. The plan received high praise from conservative groups like the American Legislative Exchange Council and North Carolina's Civitas Institute. Democrats strongly objected to shifting the tax burden down the income scale, a theme they would repeat throughout the legislative session.

North Carolina's individual and corporate tax rates were higher than any of its four bordering states.

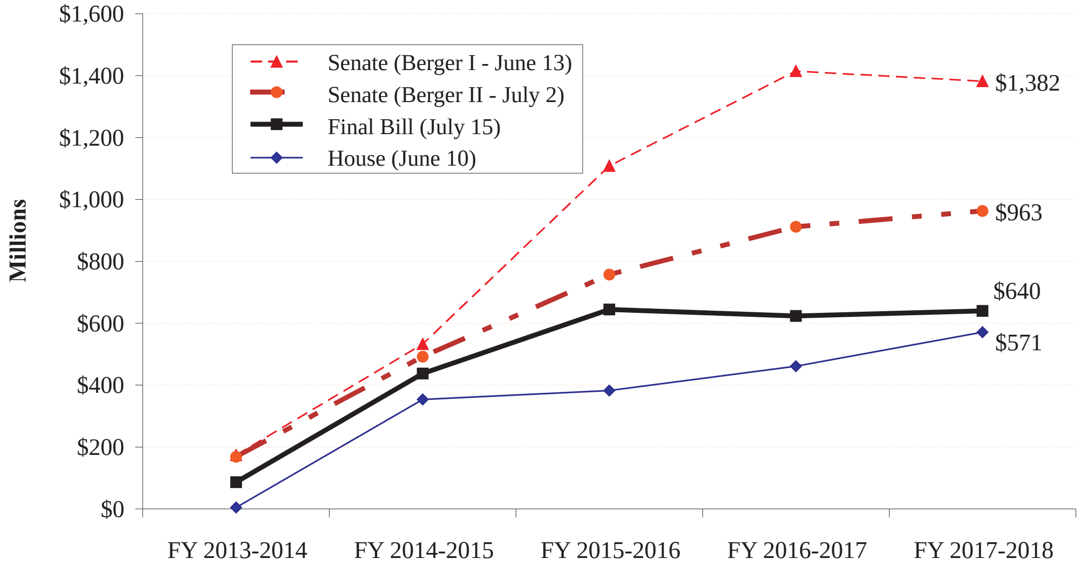
After months of meetings and presentations exploring all aspects of reform, Berger and Rucho offered a new plan. It did not include repeal of the individual and corporate income taxes, but it was still a bold departure from current law. They proposed replacing current income tax rates of 6, 7, and 7.75 percent with a flat rate of 4.5 percent. The corporate tax rate would fall from 6.9 percent to 6 percent, and the state would adopt single-sales-factor apportionment. To pay for that, there would still be an ambitious expansion of the sales tax base to include most services, groceries, and prescription drugs, but the sales tax rate would be reduced from 6.75 percent to 6.5 percent. In response to questions

Table 1.
Comparison of Tax Rates in North Carolina and Neighboring States

Individual Income Tax		Corporation Tax	
State	**Top Rate**	**State**	**Top Rate**
North Carolina (2013)	7.75%	North Carolina (2013)	6.9%
South Carolina	7%	Tennessee	6.5%
Georgia	6%	Georgia	6%
Virginia	6%	Virginia	6%
North Carolina (2015)	5.75%	North Carolina (2015)	5%
Tennessee	*	South Carolina	5%

Source: Tax Foundation. Rates as of January 1 unless otherwise indicated.
*Tennessee has a 6 percent income tax that applies to only some interest and dividends.

Figure 1.
Annual Revenue Losses From Various Tax Reform Plans



Source: North Carolina General Assembly, Fiscal Research Division.

about the regressivity of sales taxes, Rucho said, "The best way to fight poverty is with a job."

At a May 7 press briefing on the new plan, Berger said that to enact true tax reform, lawmakers would need to demonstrate courage and stand up to special interests that want to preserve the status quo. "Our current system cannot be fixed by nibbling around the edges," he said.

In the meantime, a more moderate Senate plan had been introduced by Democrat and former Finance Committee Chair Dan Clodfelter and his former Republican co-chair, Fletcher Hartsell. The major difference between their plan and the Berger-Rucho plan was a more modest reduction in tax rates (individual to 5.9 percent and corporate to 5.95 percent) and the sales tax base would be expanded only to services, such as auto repairs, associated with goods already subject to the tax.

The House adopted a moderate approach. On June 4 the Finance Committee approved a bill sponsored by Rep. David Lewis (R) to reduce the individual rate to 5.9 percent and the corporate rate to 5.4 percent. The Lewis plan included a limited expansion of the sales tax base. A major revenue raiser in the bill was repeal of the $50,000 deduction on active business income that had just come into effect in 2012. The estimated revenue loss over five years was approximately $1.8 billion. (The revenue estimates for that and subsequent versions of the legislation are shown in Figure 1.)

Under the leadership of Speaker Thom Tillis (R), also a likely candidate for U.S. Senate, the full House approved the plan June 10 by a vote of 75 to 37. But the Senate's work was far from complete.

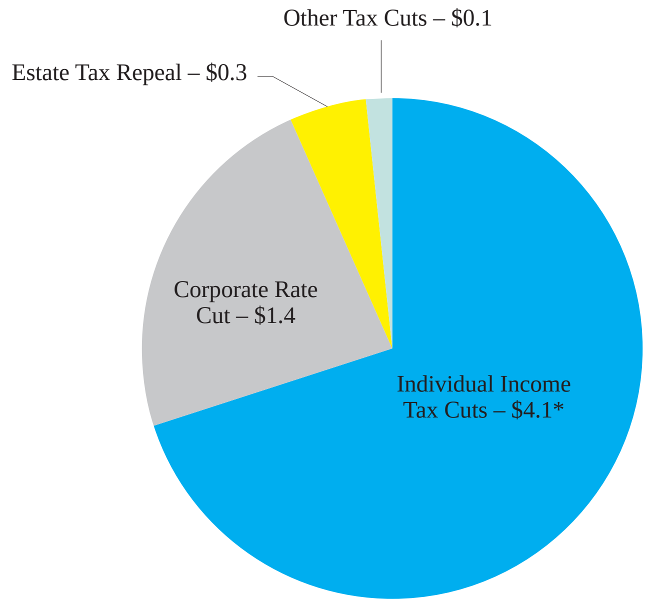
Conversion and Resignation

Just as the Senate Finance Committee was about to begin deliberations on its plan, Berger dramatically changed his approach to tax reform. He was besieged by lobbyists, out of step with fellow Republicans in the House, and not getting any encouragement from the governor. Even the president of the conservative John Locke Foundation in Raleigh voiced displeasure, commenting that the Senate tax plan picked "unnecessary fights with dozens of industry groups who dislike the idea of becoming unpaid tax collectors for government."[1] On June 11 Berger told Rucho he would no longer support the plan they had been pushing for months and would instead move for the Senate to adopt a less aggressive approach to tax reform.

Rucho not only declined to go along with Berger, he resigned as chair of the Finance Committee. In his June 13 letter to Berger, Rucho wrote: "It is a huge disappointment that the Governor and the Speaker of the House did not provide the leadership or have the political backbone to fight the special-interest groups who favor loopholes over a fair tax system." Berger refused to accept Rucho's resignation, and Rucho remained chair. Nevertheless, for a

[1]*See* "Plan Would Broaden N.C. Sales Tax Base," *Winston-Salem Journal*, May 13, 2013.

Figure 2.
Tax Cuts in North Carolina's Tax Reform
(in billions, total of $5.8 billion over five years)



Source: North Carolina General Assembly, Fiscal Research Division, "Fiscal Note on Final Agreement" (undated).
*Individual cuts offset by some base broadeners.

month Rucho did not preside and sat with rank-and-file members at committee meetings.

Although the Berger plan provided for elimination of the corporate tax by 2017, it was otherwise less of a departure from current law than the plan he originally supported. Gone were many of the more controversial features, including full sales taxation of groceries and prescription drugs. Also, far fewer services were subject to tax.

> ***Berger said that to enact true tax reform, lawmakers would need to demonstrate courage and stand up to special interests that want to preserve the status quo.***

The Finance Committee approved the new plan June 13. In a preliminary vote the following day, the full Senate approved it 30 to 17, with Rucho joining the Democrats voting against the bill. Although Berger had scaled back many radical features of his original plan, it was still a far cry from anything the House or the governor could accept. Among its more troublesome features was the end of the income tax exemption for Social Security benefits and a $4.6 billion price tag. Berger postponed a final vote that was scheduled to take place on June 18.

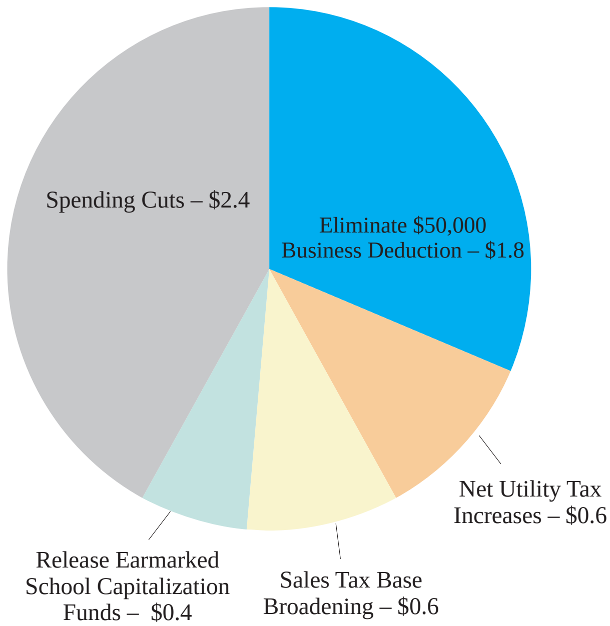
For two weeks the House and Senate tried to hammer out a compromise behind closed doors. But hopes of reaching a deal before the end of the fiscal year on June 30 were not realized. Berger was able only to get the Senate to agree to a plan that moved closer to the House position. On July 3 the Senate voted 29 to 14 to approve a revised bill that cut taxes by $3.3 billion over five years. The major difference between that and the prior version was an individual rate of 5.75 percent instead of 5.4 percent. Again, Rucho and all Democrats voted against the bill.

After passage of the Senate bill, McCrory became more active in negotiations. The governor, who initially favored revenue-neutral tax reform, was on record as favoring the less costly House version. His leverage was limited, however, because Republicans in the House and Senate had veto-proof majorities.

Finally, on the afternoon of July 15, Berger and Tillis announced they had a deal. The individual rate would be 5.8 percent in 2014 and 5.75 percent beginning in 2015. The corporate rate would be 6 percent in 2014 and 5 percent thereafter. Also, if total actual revenue exceeded specific targets, the corporate rate would drop to 4 percent in 2016 and 3 percent in 2017. The five-year revenue cost of the bill was $2.4 billion.

On June 17 the House approved the final bill on a 77-36 vote, followed by the Senate on a 32-17 vote. All Republicans voted yes. And except for three members of the House, all Democrats voted no. The bill became

Figure 3.
Sources of Funds to Pay for Tax Cuts
(in billions, total of $5.8 billion over five years)



Source: North Carolina General Assembly, Fiscal Research Division, "Fiscal Note on Final Agreement," (undated).

law when the governor signed it July 23. Most provisions of the new law come into effect January 1, 2014, except for repeal of the estate tax, which was retroactively effective as of January 1, 2013. Figures 2 and 3 summarize the revenue effects.

Individual Tax Reshuffle

In addition to flattening the individual rate structure of 6, 7, and 7.75 percent to 5.8 percent in 2014 and 5.75 percent in 2015, the major changes to the individual income tax are:

- repeal of the $50,000 deduction for active small business income;
- an increase in the standard deduction to $15,000 for married couples and $7,500 for individual filers;
- an increase in the child credit from $100 to $125 for families with incomes below $40,000;
- repeal of personal exemptions;
- repeal of the exemption for private and some government pension income;
- repeal of the non-itemizer credit for charitable contributions;
- repeal of the child care credit;
- repeal of most other tax credits; and
- limitation of $20,000 on combined deductions for mortgage interest and property taxes.

To no one's surprise, the last provision drew fierce opposition from real estate agents. At various points in the process, the cap was set at $15,000 and $25,000. In an incident that included a dramatic vote against leadership, the limitation was almost dropped from the House bill.

During Finance Committee deliberations in the House on June 6, Rep. Julia Howard, a senior Republican and a real estate agent, succeeded in passing an amendment that eliminated the deduction cap. Lewis and Tillis opposed the amendment because it added $500 million to the five-year revenue total. When the bill came up for subsequent consideration by the Appropriations Committee, the approved amendment was not included. In protest of that heavy-handed breach of procedure, rank-and-file committee members voted against considering the bill. Eventually, leaders were able to put the bill back on track with a limitation on deductions for mortgage interest and property taxes, but the episode clearly displayed how special interest politics in tax reform can foment intraparty discord.

One of the most unpopular proposals in early drafts was the inclusion of Social Security benefits in the income tax base (as they are taxed under the federal income tax). The outcry against that idea was so fierce, especially among senior Republican voters, that it is doubtful the legislature will reconsider it any time soon.

Big Business vs. Small Business

The elimination of the $50,000 deduction for active business income is a key component of the bill. Despite the Republican Party's close affinity to small business, the provision was included in both the House and Senate versions. Working against the provision were several factors. First, it had not yet been ingrained in the consciousness of business owners — many were unaware of its existence until they filed returns in April 2012. Second, it was widely criticized for providing more than $3,000 of tax relief for partners at law and lobbying firms. And third, its repeal raised a whopping $1.8 billion over five years, making it by far the largest single revenue raiser in the final bill.

Besides the reduction in the rate, the most notable corporate tax provision was a two-year extension of the research credit. Although it was included as part of several earlier bills, single-sales-factor apportionment was not included in the final House, Senate, or conference agreements. Since 1988, North Carolina has been using a three-factor formula to apportion interstate corporate income, in which sales receive a 50 percent weight and payroll and property each receive a 25 percent weight.

Another proposed change that attracted widespread attention but was not included in the final bill was franchise tax simplification. Originally enacted in 1849, the tax has evolved into a complex levy generally equal to 0.15 percent of the highest of three different measures of taxable assets. The tax applies to C and S corporations but not to partnerships and limited liability companies taxed as partnerships. The House bill reduced the franchise tax rate from 0.15 percent to 0.135 percent. Under the Senate bill, the franchise tax rate for C corporations would be cut in half but the minimum charge would be raised from $35 to $1,000. S corporations, limited liability companies, and similar types of unincorporated entities with limited liability protection would be subject to a new business privilege tax of a flat $500. But despite all that, the bill that became law left the franchise tax unchanged.

Sales Tax Reform

Regarding the state sales tax, the final bill is most notable for what it excludes. There is no change in the sales tax rate. Gone are earlier proposals to expand the tax to 130 different types of services. Gone are any notions of subjecting groceries and prescription drugs to full sales tax. (Under current law, a 2 percent sales tax on groceries is collected on behalf of municipalities.) And after an intense lobbying effort by the states' prestigious hospital industry, gone is any binding limitation on sales tax refunds to nonprofits. As former Texas Comptroller Billy Hamilton has made abundantly clear on several occasions, efforts to modernize state sales taxes with any significant expansion of the base to services are almost certainly doomed to failure. (See, for example, "The Perfectly Imperfect Sales Tax," *State Tax Notes,* Aug. 26, 2013, p. 545.)

In the end, North Carolina tax reform enlarged the sales tax base only on products and services provided by entities currently paying sales tax or similar levies. Electricity and natural gas now will be subject to general sales tax, but about one-third of that revenue gain was offset by repeal of existing taxes on utilities. Also added to the sales tax base were meals served at college dining halls and service contracts on products already subject to tax. And as a result of the new law, North Carolina had its last sales tax holiday in August.

Succeeding Where Others Failed

Although the final results were a far cry from original suggestions to entirely replace individual and corporate taxes with increased sales tax revenue, McCrory and North Carolina legislative leaders were far more successful than other states that began 2012 with similar ambitions.[2] What factors explain their success?

Republican control of the legislature and governorship certainly smoothed the path. Despite McCrory's initial plea that tax reform be revenue neutral, Republicans were willing to combine tax reduction with tax reform. With more taxpayers on the winning side, tax reform that cuts taxes is easier to pass than tax reform that pays for itself.

Concerns about redistribution of the tax burden from businesses and high-income taxpayers to low- and middle-income taxpayers no longer were central in formulating new law. If Democrats had some veto power, they probably would have insisted on distributional neutrality, making any significant tax reform exponentially more difficult. Nevertheless, Republicans were not immune to criticisms of regressivity. Unlike earlier versions of the legislation, the final draft ensured nobody paid more income tax.

But other states where Republicans are in control have not achieved tax reform. Perhaps what most helped North Carolina achieve success was its starting point. With higher tax rates than most of its southeastern neighbors, the state's tax system was riper for reform than most.

Agreement on partisan political issues certainly helps smooth the path to tax reform, but ultimately, tax reform lives or dies on the skill of politicians who can maneuver through the minefield of special interest politics. If the North Carolina Senate had stuck to the academically and ideologically pure approach advocated by Rucho, tax reform never would have gotten to the governor's desk. Compromise and willingness to settle for something less than sweeping reform got North Carolina Republicans over the finish line. ✰

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[2]*See* Jennifer Carr, "Tax Reform Failures of 2013," *State Tax Notes*, Aug. 5, 2013, p. 339.

NEWS ANALYSIS

Compact Issues: What's Steve Kranz Got Cooking?

by Amy Hamilton — amy_hamilton@tax.org

Tax Analysts will be publishing articles over the next several months analyzing developments regarding the Multistate Tax Compact, the Multistate Tax Commission, and related litigation and legislation in the states.

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Stephen Kranz of McDermott Will & Emery has a penchant for masterfully advocating on behalf of his corporate clients while also stirring the pot. He's at it again as the author of a memorandum circulating among lawmakers nationwide that discusses legal questions raised by a state's membership in the Multistate Tax Compact, given the California Court of Appeal decision in *Gillette Co. v. Franchise Tax Board*.

Kranz and Diann Smith, also of McDermott Will & Emery, presented the memo in Atlanta at the annual legislative summit of the National Conference of State Legislatures. Their audience was the NCSL Executive Committee Task Force on State and Local Taxation — the same group that has opposed all efforts to revise the Uniform Division of Income for Tax Purposes Act and has questioned the appropriateness of some uniformity projects undertaken by the Multistate Tax Commission.

"States are going to address the ramifications of *Gillette* and its progeny one way or another," Kranz told Tax Analysts. "The right place for that discussion to start is in the legislative community and not at the Multistate Tax Commission."

The memo, prepared on behalf of the State Tax Policy Coalition, one of Kranz's corporate clients, provides background on the compact's creation, the inclusion of UDITPA as the apportionment formula in Article IV, and the Article III election allowing out-of-state taxpayers to choose between apportioning their business income to a member state under the UDITPA rules or a state's own formula. Kranz wrote that the election provision was ignored for many years, but that with compact members recently adopting laws that varied both from UDITPA and from other states' laws, multistate business taxpayers began using the election to opt out of the state-specific rules.

Although the memo doesn't mention it, Kranz and Smith represent some of those same multistate business taxpayers. They have clients in Michigan, Minnesota, and Oregon who are seeking refund claims under the compact election. "The Article III election is really a pivotal point of the compact because it allows for sovereignty but then provides the safety valve for multistate taxpayers who desire uniformity and ease of compliance," Smith said.

Kranz and Smith said they encouraged lawmakers to understand the threat posed by *Gillette* and evaluate what they should do to address it. "We didn't give them an answer," Kranz said. "We didn't say you need to withdraw [from the compact], that that's the right decision for you. We raised the questions, and it's up to them as policymakers to decide what the right course of action is for their given state."

The NCSL task force agreed to transmit the memo to lawmakers in compact member states. That might be particularly noteworthy, given the influence task force members have in their states when it comes to membership in the Multistate Tax Compact. Half of all Multistate Tax Compact legislation enacted this year was sponsored by NCSL task force members: Utah Sen. Wayne A. Harper (R), South Dakota Sen. Deb Peters (R), and Minnesota Sen. Ann Rest (DFL).

Another member of the task force, Utah Sen. Curtis Bramble (R), on August 15 took office as the NCSL's vice president and will become president in 2015. Bramble was one of the designated spokespersons who delivered the message to the Uniform Law Commission that it could face an effort to defund its operations if it proceeded with a project to revise UDITPA. He told Tax Analysts last year that lawmakers were nearing that same point with the MTC. (Prior coverage: *State Tax Notes*, Dec. 17, 2012, p. 871.)

"To have a president of the NCSL who understands state tax and engages in state tax policy discussion not just on behalf of Utah but on behalf of the legislative world is a great thing," Kranz said. "It will be a very positive thing to have him at the helm of the organization."

Pushing Buttons

Kranz's memo, peppered with references to threats to state sovereignty and a state's control over its corporate income tax apportionment rules and definitions, comes at a time when lawmakers guard their single-sales-factor apportionment formulas as a form of cutting-edge tax competition.

In addition to describing the legal theory behind *Gillette* and a compact member state's potential exposure to Article III litigation, Kranz lists two areas that could give rise to spinoff lawsuits. The first is in those states that repeal the compact from their codes and then reenact versions without the Article III election provision or Article IV apportionment formula, he said.

In the memo, Kranz asked how a compact member can avoid application of the Article III election. He warned that the validity of a state's repealing and reenacting a version of the compact without the Article III election may not be upheld if taxpayers prevail in *Gillette*, because the election into the compact's apportionment rules is an all-or-nothing proposition. "The only failsafe method for a Compact Member is to withdraw from the Compact itself," Kranz wrote.

MTC General Counsel Shirley Sicilian recently explained the reasoning behind the repeal/reenact maneuver, saying that once a state is out of the compact, "it can start again with a clean slate" by adopting a modified version. That's partly so because of the flexible suggested enabling statute and partly because the Multistate Tax Compact is a model compact, she said. (Prior coverage: *State Tax Notes*, Aug. 19, 2013, p. 471.)

"I don't understand the concept that this is a model compact," Smith said, adding that, generally, model compacts are created by organizations that are trying to help states enter into binding compacts. It's not that the compact itself is model legislation, she said, adding, "Once it gets passed, it's no longer a model — it's actually a compact."

Kranz asked whether states that have repealed and reenacted modified compacts will continue to be seen as legal members of the original compact. If so, taxpayers would be entitled to the same election allowed by the original compact, he said.

"The modification of the compact will likely lead to Round Two litigation over the same question: Is the compact in its entirety binding?" Kranz said. He added that those cases will arise as taxpayers decide whether to take the election on future tax returns.

In the memo, Kranz wrote that another potential source of litigation could arise from the MTC's adoption of its proposed amendments to Article IV.

'The modification of the compact will likely lead to Round Two litigation over the same question: Is the compact in its entirety binding?' Kranz said.

Kranz wrote that if the MTC adopts the proposed amendments to UDITPA/Article IV, litigation could result over whether taxpayers are entitled to the benefit of the amended compact even if the changes are not adopted by a compact member's state legislature. Put another way, Kranz wrote that subsequent amendments to the compact might be binding to compact members even if a compact member's legislature chooses not to adopt the amendments. He pointed out that compact member states might risk having pending amendments to the compact imposed on them to maintain their membership status.

The memo says that if the Multistate Tax Compact is not binding on member states, many in the taxpaying community believe the MTC lacks the legal authority to conduct audits on behalf of those states that are not members. "Thus, Compact members may be faced with choosing between accepting control over part of their corporate income tax imposition or losing the revenue from the Commission's multistate tax audits," Kranz wrote. (Prior coverage: *State Tax Notes*, July 8, 2013, p. 67.)

There will always be tension between the auditor and the businesses being audited, and there's no doubt that to the extent the MTC is less effective, that would benefit Kranz and Smith's clients.

But Kranz and Smith said their focus is not on the MTC's audit program but on what it means for a state to be a compact member and whether there is an appropriate role for members to develop uniform legislation that affects policy issues.

Nature of the Compact

Kranz and Smith said questions raised by Article III litigation include whether the Multistate Tax Compact is the type of agreement creating a contract among the states and whether the Article III election was intended to be mandatory for compact members. Smith criticized the lack of public discussion at MTC meetings about the nature of the compact as an organizational document.

"To me that really was a question that needed to be addressed before they got into the UDITPA rewrite, before they started down the path of amicus in the *Gillette* litigation," Smith said. "I think it would have been useful for the public and corporate taxpayers to have at least heard those types of issues aired and discussed."

Sicilian has made a distinction between kinds of compacts, saying the Multistate Tax Compact is not the kind of compact the taxpayers in *Gillette* argue it is. Sicilian said the U.S. Supreme Court in *U.S. Steel v. Multistate Tax Commission*, 434 U.S. 452, 473 (1978), found only that the compact did not require congressional approval to be valid, not that it is binding.

Smith agreed that the Court in *U.S. Steel* was silent on whether the Multistate Tax Compact is binding. However, the Court and apparently all parties to the litigation assumed at the time that the compact was binding, "because if it wasn't a binding compact, the compact clause itself never would have come into play," she said.

Sicilian has said that 80 percent of the compact cases cited in the court of appeal briefs in *Gillette* deal with congressionally approved compacts, which the Multistate Tax Compact is not. But Smith countered that the reason 80 percent of the compacts cited in the litigation are congressionally approved is because most state compacts have received federal approval.

Sicilian also has said the remaining cases cited in the briefs deal with compacts that require reciprocal action to be effective, which she said does not apply to the Multistate Tax Compact.

Smith disagreed and pointed to Article X, which states that the Multistate Tax Compact shall enter into force when enacted into law by any seven states. "I think that in itself is sufficient reciprocal action, because it's basically saying it's not binding until seven states agree to be bound by it," she said. "If only four states had passed it, there would be no compact."

In *Gillette*, the California Court of Appeal characterized the compact as binding. It quoted *Seattle Master Builders v. Pacific N.W. Elec. Power*, 786 F.2d 1359 (9th Cir. 1986), which it said summarized the U.S. Supreme Court's primary indicia of a compact: the establishment of a joint organization for regulatory purposes; conditional consent by member states in which each state is not free to modify or repeal its participation unilaterally; and state enactments that require reciprocal action for their effectiveness.

But Sicilian has argued that the Multistate Tax Compact meets none of those requirements. She has said the MTC has no regulatory authority over compact members, that the compact allows a state to repeal and withdraw, and that the compact does not require reciprocal action to be effective. In support, she cited *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978), in which the U.S. Supreme Court accepted as constitutional Iowa's single-sales-factor apportionment formula, even though the three-factor, equal-weighted formula was the recognized benchmark at the time.

But Smith said the U.S. Supreme Court cases that *Seattle Master Builders* relied on make clear that an organization established by a compact for regulatory purposes doesn't need to promulgate binding regulations. Instead, the joint organization can be established for the purpose of helping states coordinate a specific industry, such as licensing, she said.

Smith said it's important to note that *Gillette* differs from some of the compact litigation cited by Sicilian in that a state isn't taking the position that another state has violated the compact. In *Gillette*, a third-party beneficiary — the corporate taxpayer — is asserting that the compact needs to be enforced as written. A compact is a contract, and under standard contract law, if there's an intended third-party beneficiary, the third party has standing to enforce the contract and thus has standing to enforce the compact, Smith said.

MTC's Future

Kranz and Smith said there is an appropriate way for the compact member states to develop uniform legislation. However, they said the MTC should focus more on developing legislative models that would aid taxpayer compliance on administrative matters made complex and burdensome because of tremendous variation across the states, such as on state definitions and filing deadlines associated with the IRS's issuance of a final revenue agent's report for settled federal audits.

"UDITPA is loaded with policy questions and [has] caused a fight for years now whether it should be rewritten or not," Kranz said. "Those are the kinds of issues we don't think the MTC should be tackling."

> ***Kranz and Smith said the MTC will survive* Gillette.**

Kranz and Smith said the MTC will survive *Gillette*. "We have no doubt that the organization will continue if in fact they lose in *Gillette* and their progeny," Kranz said. But he pointed out one upshot of the litigation is that the MTC will have to address the governance structure and organizational issues that he and Smith have been raising since their time at the Council On State Taxation more than a decade ago.

Smith elaborated, saying that as a tax lawyer, the question of how an entity is structured is fundamental, yet difficult to pin down. "What is the Multistate Tax Commission?" she asked. "If they're not a government compact, what are they?"

Kranz said the MTC plays some roles today that it will continue to play, no matter whether it is a governmental or 501(c) organization. "They will evolve if they need to, no question about that," he said. "The litigation will ultimately decide whether they have to evolve or not." ✰