PARTICIPANTS:

Moderator:

CHRISTOPHER E. BERGIN
President and Publisher
Tax Analysts

Speakers:

PETER A. BARNES, ESQUIRE
Caplin & Drysdale

JOE HUDDLESTON
Executive Director
Multistate Tax Commission

DIANN SMITH, ESQUIRE
McDermott, Will & Emery, LLP

Other Participants:

LAURA BREECH
State Tax Notes

DAVID BRUNORI

VALERIE DICKERSON
Deloitte Touche

SCOTT DRENKARD
Tax Foundation

HARLEY DUNCAN
KPMG LLP

CHARLES FISCHER
Deloitte Touche

KARL FRIEDMAN

CARA GRIFFITH
Editor in Chief
State Tax Publications
PARTICIPANTS (CONT'D):

DOUG LINDHOLM

MARTY LOBEL

PETER LOWY
Caplin & Drysdale

LYMAN STONE

MARTY SULLIVAN
Tax Analysts

ERIC TODER

JOANN WEINTER
George Washington University

JAMIE YESNOWITZ
Grant Thornton
MR. BERGIN: Good morning, everybody.

How are you? This is an awesome gathering. I'm a little intimidated by the table up here and all of you out there. Thanks to all the TA folks, our special folks who came, because they're special.

Welcome to the latest in Tax Analyst series of discussions in key issues in tax policy and tax administration. In today's debate we'll examine the intersection between US state tax rules and international tax rules.

I'm Chris Bergin, the president of Tax Analysts which is the non-profit publisher of Tax Notes, Tax Notes Today, State Tax Notes, Tax Notes International, and many other fine print and online products on federal, state, and international taxation.

We are in, believe it or not, our 12th year of public discussions on tax policy. If you are new to our discussions let me say it's great to have you here.
Let me take just a moment to explain our process today. I will open things up with some brief remarks to introduce our topic. David Brunori, deputy publisher at Tax Analysts, and I will then kick off the discussion by inviting our distinguished panel of speakers to answer questions addressing various aspects of our topic. After that, we will open up the discussion to all of you, and we encourage all of you to participate.

Actually, we're going to try something new here today. If you have a question or a point just raise your hand as we're discussing, and we will recognize you and let you in, including everybody at the table. I just ask you, because we've got a lot of information to cover today, that you try to keep your comments brief.

We are streaming live video of this event on our website. That explains the camera in the back of the room, so I want to welcome our virtual audience as well. We've now added a Q&A feature on our site that will allow the online
viewers to submit their questions throughout our discussion today. We will be taking those questions up here at the table.

For all media purposes, we are on the record. For that reason, when one of us recognizes you please tell us who you are. It helps with the transcript. For those of you in the audience, once we call on you we will get a handheld mic to you very quickly.

We are also live-tweeting this event at #statetaxlessons as we reach more people beyond this room to social media. We invite our online viewers to send us questions via Twitter. Just tweet at #statetaxlessons -- I believe there are spaces between the words on that -- and we hope to hear from you.

We also will post the webcast and a transcript of today's event by the end of this week on our website, taxanalyst.com.

Following this event, I'm told we will send a brief survey to all of you who are registered for this for your feedback, and we will
be giving away a $50 American Express gift card to one lucky respondent.

Now, on to the subject at hand: The intersection between US state tax rules and international tax rules. The current international tax system is facing some real challenges. While the system has been largely unchanged since the 1920s, there has been a lot of public outcry recently over the ability of multinational corporations to generate significant revenue, yet be subject to a low tax burden.

International governments have been feeling the pressure to change existing rules and, in essence, fix the problem. This is what led to the much-publicized project led by the OECD which focuses on base erosion and profit shifting, also known as BEPS, taking a step back to look at the current international tax system.

It relies on a set of principles and treaties drafted by US and large western European countries during interwar years. Not surprisingly, then, it reflects the economic realities of that
time and does not address what we consider
important issues now. For example, when cross-
border commerce is an exception to normal practice
there is little need for detailed rules addressing
jurisdiction to tax, nexus, or double taxation,
but times have changed.

The OECD's BEPS Project touches on a
number of important international concepts
including jurisdiction to tax, how to allocate
income among different tax jurisdictions,
reporting and sharing of taxpayer information, how
to address double taxation, and how to resolve
disputes. Interestingly though, each of these
issues has been considered at the US state tax
level for nearly a century.

In a special edition of State Tax Notes
and Tax Notes International that you were all
given today -- and if you didn't get it I think we
have plenty of copies -- we attempt to use the
knowledge that has been gleaned by US states as a
means of informing the international tax debate,
and that is the subject of today's conference.
I am pleased to be joined by three tremendous panelists: Peter Barnes, of counsel with Caplin and Drysdale; Diane Smith, counsel with McDermott Will and Emery; and Joe Huddleston, executive director for the Multistate Tax Commission. Thank you all for being here.

We've also invited a number of esteemed people to join the speakers at this table, and while we expect they will participate in discussion, as I said earlier, we encourage everyone in the audience to participate as well.

Peter, could you start by addressing the general rules for determining what is taxable for international tax purposes and specifically what constitutes PE?

MR. BARNES: That's jumping straight into the fire. There's no doubt about it that on the international front in general, nexus for tax is based on physical presence. That's been a struggle for more than just the last couple of years.

When e-commerce started to emerge in the
late 1990s, the international world, uninformed by the States, spent a lot of time, '98 through the early 2000s, looking at whether ecommerce suddenly upended all of the rules on nexus for tax and concluded they didn't. But in general, in order to have nexus to tax in the international world you need to have a physical presence; a fixed place for some period of time in some cases, in other cases a single day.

That's being challenged as we go forward with things like cloud computing and remote monitoring and digital downloads, and the international world's worried about those issues. But the cornerstone has been and continues to be physical presence.

MR. BERGIN: Joe, could you address the definition of nexus and the rules for determining what is taxable at the state level?

MR. HUDDLESTON: Certainly. I want to begin by saying that my initial caveat is always that, while I'm here as the executive director of the Multistate Tax Commission, my comments may or
may not represent the opinions of our member
states or the Multistate Tax Commission. Having
said that let me talk a little bit about nexus.

As much as Peter outlined, the nexus
issues for state tax are long-standing. Certainly
in the 1800s, physical presence was the standard
by which everyone began the discussion; what
created nexus to tax. In fact in the early 1800s,
the US Supreme Court, addressing what criteria
were necessary to create a jurisdictional
authority to tax, looked at many of these
requirements as early as 1819, looking at the
question of physical presence and what causes a
state or allows a state to have jurisdiction to
tax.

Basically they've broken out into two
areas. Early on they looked at physical presence,
as Peter said, in Europe; in other words,
residency. If you were a resident in a
jurisdiction, it was largely thought, and in fact
enforced, that there was sufficient requirement
for that jurisdiction to tax. Based upon some of
the concepts that we'll talk about later having to do with dual sovereignty, that is the separation between the federal government and the state governments, and federalism as we talk about that going forward.

Certainly as we evolved into the 20th century, the views of what created nexus for corporate income tax purposes began to evolve in the United States. It began on the base of looking at activities of railroads and other multistate corporations, and we began to understand that the overall activity was not necessarily tied to a physical presence.

So, this discussion began to take place and continued to evolved through the decades of the 20th century so that where we are currently is that, for our corporate income tax, many of the states will recognize nexus based upon activities that take place within the jurisdiction that where (inaudible) purposely avail themselves of a marketplace. Many states, in fact most states, will take the view today that that creates
physical presence.

   Now, that has been hotly contested for
the last 30 years in fact, but as of today the
purposeful availment concepts of nexus in the
corporate income tax area has been repeatedly
affirmed at the state court levels. The US
Supreme Court has not opined on that issue so far,
but they have repeatedly declined to get into that
area. While it appears to be a fairly
straightforward mechanism of carrying on
activities, obviously it's perhaps much deeper
than it is broad.

   MR. BRUNORI: I think you have a
question right over here.

   MR. BERGIN: Cara?

   MS. GRIFFITH: Cara Griffith with Tax
Analyst. Peter, for you, I'm curious as to
whether services PE mimics at all the state
economic nexus?

   MR. BARNES: It clearly does. Let me
back up just to make sure everybody's on board. A
number of countries, including fully-developed
countries -- Canada, are starting to say, hold on;
if you provide services here, even if you aren't
physically here, that ought to generate a
permanent establishment and give us nexus. And
yes, it does.

There's the same debate, exactly the
same debate, in the international world you have
in the States between the producer states and the
market states; producer countries, market
countries. So, yes, the services PE is an effort
to push the boundary and to say physical presence
is not the only basis on which we're going to tax
you. If you provide services in some fashion, in
some way, at some level, then yes, you are subject
to tax.

There's one important issue to point out
here. If you believe that income generally should
be taxed once, always once but only once, if we
have more nexus, if we have more jurisdictions in
which the income is going to be taxed, there
probably is going to be a reduction in tax in some
jurisdictions -- the home jurisdiction or
somebody.

We need to remember that there's only one pie here, and what we're talking about, I think, is how to split that pie between producer markets and consumer markets, between countries, between states. So as we expand the PE concept, if we go that route, we've got to recognize there's still only one pie here.

MR. BRUNORI: Let me ask Diane a question, and Joe and Peter may want to weigh in as well. When you look at nexus and you look at PE, what specifically are the differences when you look at international permanent establishment rules and state nexus rules? If you can explain what those differences might be?

MS. SMITH: Yeah, David, and everybody else feel free to jump in. This is something, I think, that always comes as a surprise to people that are only operating in the international area when they suddenly discover that they may be subject to state corporate income tax.

One of the primary things to realize is
that because the state corporate income tax jurisdiction in many states does have this economic nexus component, meaning that you don't actually have to have a physical presence, that there's lots of companies that are challenging that. But to the extent that a state says that merely having an economic presence in the state will subject a corporation to that state's corporate income tax.

As we've just seen in the international area, that's not how the US, as the federal government, would subject a foreign entity to the US income tax. Thus, the result is that an entity can not have PE in the US. So for example, they might have a treaty that says PE is not established merely by holding goods for sale in a certain state. But nevertheless, the state -- because that foreign entity has goods actually there, they would have a physical presence and thus be subject to the state tax. That's really the fundamental issue, is that you could have no PE but still have state nexus.
A couple other things to bring out that I think are interesting is that in the PE arena there's much more control for the taxing jurisdictions. Because when you look at how it works in the US, we've got the internal Revenue Code that says basically in the absence of a treaty, if an entity has income effectively connected with a trade or business in the US, then that income is subject to tax in the US. But then the treaties, which establish the permanent establishment concept, they pull back on that further, so they have additional exceptions within that that are negotiated in the international arena.

The states, bless their hearts, are usually in the jurisdictional aspect. They don't have as much control because they're subject to the overall US Constitution, both the due process and the commerce clause. So, the states have this limit that they can't ever exceed, and they're stuck with that.

Now, the states also can pull back on
what their jurisdiction is, and we see that when
they've got their "doing business" definitions in
the statutes. Thus in the same way that in the
international arena they may say, okay, if you're
just storing goods in a jurisdiction, it doesn't
create PE, some states have, for policy reasons,
said, for example, if you've got a fulfillment
center, if you're using a fulfillment center in a
state, you're not doing business, and thus you're
not subject to tax. But that's different than the
commerce clause nexus issue.

One of the things Joe mentioned that I'd
like to talk a little bit about is this concept of
purposeful availment, because I think when you
look at the state nexus issues you've got both the
due process and the commerce clause.

The purposeful availment concept is
clearly a due process clause, so it applies to any
jurisdictional concept. So, even in the
international arena we've seen several cases
recently from the US Supreme Court that, even
outside of the tax area, before a foreign entity
can be subject to any type of jurisdiction here, there has to be some type of purposeful availment. Thus they could not even be subject to tax if there was not some type of purposeful availment of the market in the US.

On the other hand we've got the commerce clause which does not put any type of pressure on the federal government but does for the states. That's where we get this different nexus concept which is the substantial nexus concept.

MR. BRUNORI: Joe, do you agree with that assessment?

MR. HUDDLESTON: I think that's largely accurate. I think that it's important to understand that PE, permanent establishment rules in the EU tend to be much more restrictive than what we see in the States. There's any number of ways that physical presence can be established in the US that would not meet a PE standard in the EU; the emphasis there on the word "permanent".

There's all kinds of different types of nexus activity, as Diann pointed out, that can
create nexus under physical presence standards in the States which might not in the EU or in the OECD countries. So, there is a substantial difference.

What I would encourage you as we make these discussions -- I think it's important to keep in mind that this is really almost not an apples-to-apples discussion. What's going on in the EU and other places around the world is really fundamentally different than what's going on in the States.

MR. BRUNORI: Peter, do you agree with that?

MR. BARNES: I do. Let me respond to one point Diann made and then make one new point. She said something very important that I don't want people to miss.

The international group is not unmindful of the kinds of standards that the States apply, because as Diann said, the basic internal revenue code has engaged in trader business standard. The US only has 60 treaties, so there are a lot of
countries in the world where the engaged in trader
business standard applies. So, the international
groups, I think, are pretty sensitive to that.

The second point I want to make though
is nexus is important, and we ought to talk about
it, and I'm not trying to cut that short. But in
the international world, the fact that you may be
taxable is usually not that big a deal. Fine, you
have nexus. I have a PE. I have a presence.
That's the way I do business. Now, let's get to
the meat of the issue which is how much income is
attributable to PE. Yes, there are taxpayers who
just have this visceral reaction of I don't want
to have any tax compliance obligation in country
X. I don't want nexus there whether it's a state
or otherwise. But in general, I think people are
sophisticated enough to say fine, if I'm taxable
I'm taxable. Now, let's get down to what matters.
What's the income attributable?

MR. BRUNORI: We have a question down --

MR. BERGIN: We got one here first.

Sorry. I'm sorry. We're getting engagement which
is great.

MR. STONE: I'm Lyman Stone from the Tax Foundation, and I had a question about this circumstance where a firm could not have PE in the US but still establish physical presence in a state, and specifically that would seem to me to cause a treaty problem. So, I was wondering is there a case where this has happened and it's been, I guess, not litigated, but argued out in a fairly public fashion between nations?

I have in my head a similar circumstance where tax incentives in Washington came up in a WTO case between the US and the EU. Is there a similar circumstance where a firm had physical presence but not PE, and it was hashed out fairly publicly?

MR. BARNES: The answer, I think, is no because it's so well understood. I understand that you look at it and you say, hold on, you don't have a federal obligation, but you do have a New York obligation. What's going on? But after that initial horror, the answer is that's
absolutely the truth.

The US treaties do not cover the states. States are not covered taxes. That's crystal clear. That's uniform. Now, interestingly -- and this is actually in one of the articles in here -- interestingly -- there are a half dozen U.S. treaties where our treaty partner has covered subnational taxes. So there's a little bit of an imbalance in that the U.S. company is protected in the foreign jurisdiction; the foreign company is not protected here. But the issue is well understood even if people think it's foolish. So I don't think it's controversial other than by foreign investors who say what's up? I'm surprised by this. And the U.S. does not hide this fact. This is not something we put over on other jurisdictions. They know that our subnational taxes are not covered taxes for treaty purposes under the PDR.

MR. HUDDLESTON: Yeah, I think there's a couple of issues there and one is that the PE concepts as we know them in the EU really are not
applicable here and would not be subject to litigation in this country. And the other is there's been a couple of cases through the years, several cases, in fact, looking at whether or not treaty obligations extend past the federal government, the states. And they've been litigated fairly uniformly and outlined in one of my favorite cases, Itel v. Huddleston and Barclays Bank.

MS. SMITH: And there has been a history at least not in the PE and nexus area, but in a worldwide combined area where the U.S. government actually initially did try to get some treaty protections prohibiting states from imposing worldwide combination and that got shot down at the federal level. So there is this history that you can look to to see that it was not popular.

MR. BRUNORI: We have a question down here at the end of the table.

MR. LOWY: So my question was actually answered, but let me follow up on this line right here. So in terms of --
MR. BRUNORI: Can you state your name, please?

MR. LOWY: Yes, Pete Lowy with Caplin & Drysdale. So in terms of enforcement, states actually identify in situations where inbound companies may not have a PE or may not have nexus for federal purposes, but they do for states. How effective are states at identifying those situations?

MR. HUDDELESTON: They're not very effective because for almost all corporate income tax structures, the state governments begin at federal taxable income. So much of the calculations that state governments do as they begin to try to apportion income based upon whatever their apportionment formula is rely on the federal figure. So it's very difficult for states to go above the line and look at the transaction basis of what that number is. And it's rare that states will do that, although at times they do given information they receive from the federal government.
On the end of that question, the implied follow up to that is well, assuming they are able to identify these numbers and they issue an assessment, can they, in fact, enforce that assessment? As a general rule they can because almost nobody does business internationally in a vacuum. They have all manner of transactional types of relationships with the U.S. and with the states that enable the states to be able to enforce an assessment.

MS. SMITH: And, Joe, you probably know more about this than I do, but there's the super-secret -- and I think we're getting into this later -- information exchange that happens between the IRS and the states. When we're talking about PE at the federal level, because it's primarily more of a tax-base issue than a jurisdiction issue, there's a specific tax form that companies that say we don't have a PE but we want to just file a protective form so the statute starts, they can file that at the federal level. I know that there's at least a couple of states
that do get that information that they can follow up on because if it's being filed at the federal level, there's a possibility that they'll have physical presence. I don't know how widespread that is.

MR. BRUNORI: It's not very widespread.

And actually we have a follow-up question later to address that issue, Diann, for the panel. Doug?

MR. LINDHOLM: This is a little bit of a follow-up question as well. Doug Lindholm with COST. I want to explore further Diann's comment about worldwide unitary and then Peter's comment overlays the fact that states are not subject to international treaties. And it begs the question of whether they ought to be subject to international treaties. Does the fact that they are not subject to international treaties impede our nation's ability to speak with one voice? And this issue, as Diann mentioned, first arose in the worldwide combined arena back with the Barclays case in the early nineties when California tried to impose mandatory worldwide combined reporting.
Our foreign trading partners objected vociferously to the extent that the UK threatened retaliatory taxation, something that was completely out of the hands of our federal government. The federal government was forced to step in and sort of mediate a dispute between trading partners and the states. I don't think that was in the best interests of our ability to speak with one voice, and that same issue is coming up again as states try to put statutory definitions of what a foreign tax haven is. And I can't think of why a tax commissioner would be qualified to determine, to make that determination, given the political implications of calling one of our trading partners a tax haven. And I wondered if you guys would like to comment further on that?

MR. BRUNORI: And, Doug, we have a couple of former tax commissioners here. Peter?

MR. BARNES: I'm happy to speak. Look, I cut my teeth as an international tax professional in '82-'83 on the Barclays case, which was the intersection of the international
and the states stuff. Sure, I would love it if the states were bound by the treaties. That's great, but in the real world that we live, let's get past that. There are plenty of other issues that irritate our trading partners in the tax arena a lot more than this one. They don't like it, but they don't like a lot of things that we do. They don't like FACA. They don't like a lot of stuff we're doing.

So it seems to me in terms of just my emotional energy, let's focus on things that we might actually impact. This issue, in my mind, is settled. In a perfect world, perfect world sure, we would speak with one voice, the states would all use the same formula for allocating income. There would be no harmful competition between the states. I mean I've got a lot of lists, items on my wish list. This one's low.

MR. BRUNORI: Go ahead, Joe.

MR. HUDDLESTON: Yeah, let me just comment on that. The issue of tax havens is not one which is exclusive to the United States. This
is an issue which plagues the rest of the world as much as it does here. And as to whether or not tax commissioners and individual states have the capacity to be able to identify a tax haven or make those required judgments, let me just suggest to you that the tax haven problem worldwide is a whole lot like pornography. We all know it when we see it, so we don't need to kid ourselves about that.

MR. BARNES: Well, in the international arena, Tax Notes International will run an article at least every three months in which a foreign party says why is the U.S. doing this because Delaware and Nevada are the worst tax havens in the whole wide world. So I'd do a quick search over the last ten years, that's been a piece in Tax Notes International all the time. So we live in a glass house in this regard. I can argue why Delaware and Nevada are different from Cayman's. I get all that. But I just don't think we're in a very secure position.

MR. BRUNORI: One more question before
we move on to the next topic. Joann?

MS. WEINER: Sure. I'll just -- my

name's Joann Weiner. I'm with GWU and I also
write for the Washington Post, but I used to write
for Tax Analysts, which was a great job. I was at
the Treasury Department in the 1990's when this
Barclays Bank case came to the Supreme Court. I'm
an economist, but it's the only Supreme Court
brief I've worked on. And I just thought there
was a couple of things to clarify. One, Treasury
did not tell the states what they had to do. We
worked very carefully with all the parties
involved to get to a voluntary agreement. Now,
it's clear there was a lot of disagreement about
mandatory worldwide combination. The states
backed away voluntarily from it. The reason that
state taxes are not covered by tax treaties, and
I've negotiated a lot of tax treaties, is because
they don't sit at the table. No one here would
want to have someone else negotiate on the behalf
and not have an ability to put a word in for them.
So while it may be nice to talk about getting the
states bound by U.S. international treaties, it's just not going to happen unless you put them all at the table.

Now, the Multistate Tax Commission has done a great job with protecting states' interests and it's not just in tax treaties, but it's also in that border agreement with Mexico. It's also in the World Trade Organization. So anyway, that's just to clarify some of the stuff that went on. The Senate did reject the U.S.-UK treaty because it bound the states and it was only approved after that provision was taken out.

Thanks.

MR. BRUNORI: I want to turn to a topic now that all of our panelists have alluded to and that is how is the tax base allocated among the taxing stations? Many of you know that at the state level this is done through formulary apportionment; at the international level. We use what is known as the arm's length standard and that has led to some suggestions that formulary apportionment may be a good thing for the
international arena. And I was hoping Joe might lead our discussion on formulary apportionment and maybe give a quick primer on how it works and maybe address the MTC's role in promoting uniform apportionment formulas.

MR. HUDDLESTON: Well, to be brief about this, which is virtually impossible, but I'll make an effort here. Formulary apportionment begins with the concept that if it is that businesses do business in jurisdictions that some percentage, some portion, of their income that's generated from various factors in that jurisdiction should be taxable in that jurisdiction. So the original standing, of course, is that you begin with the overall concept that 100 percent minus whatever statutory deductions are available should be taxed in the jurisdictions in which businesses do business. So that apportionment methodology then begins, at least in most states, beginning several decades ago with a concept of a three-factor apportionment formula: Payroll, property, and sales in your jurisdiction versus payroll,
property, and sales everywhere else. And that characterization would fairly apportion income for a tax base in each jurisdiction impacted.

Now, clearly that's not something which has been able to maintain itself overtime. While states move to a three-factor apportionment formula and discuss that and utilize it for a number of years, they begin to move away from that for a variety of reasons so that today we have only a handful of states that actually use an effective three-factor formula for apportioning corporate income. Today we see states moving toward adding weight to the sales factor or are going all the way to the end of that spectrum of using a single-factor of sales only in a jurisdiction to apportion income into various jurisdictions. California, for instance, a very large state is in a single-sales factor concept now, which basically says business activity carried on in your state is going to be measured by your sales in the state, not by payroll or property located in California. And a number of
states continue to move in that direction. So as we look at apportionment concepts, we see states moving toward a more uniform concept of apportionment, but that uniform concept is a single-sales factor.

That clearly is not the direction that the MTC has supported and proposed and has worked on over the years. We've looked at a three-factor apportionment formula basis as being fundamentally fair not only to the states, but to the corporate entities doing business in those states. And it either apports or it allocates income based upon an admittedly fairly complex set of rules as to how that income is divvied up. But the focus is to find a portion of income that fairly relates to the business taking place in each jurisdiction and to allow that portion to be taxed, to be the tax base, in that jurisdiction.

As far as uniformity goes, MTC has always been a proponent of uniformity. It was one of our basic concepts as we began our journey along with COST in the late sixties. We found
that uniformity is an extremely difficult thing to
deal with primarily because of one big reason.
Nobody seems to be very interested in uniformity
today, neither states nor businesses. During my
eight years in the Commissioner's office in the
state of Tennessee, I will tell you that of all
the business entities that came and sat down with
me and talked about their business operation in
Tennessee, not one ever asked me to be treated
just like everybody else, not one. So uniformity,
at least from my view of the business perspective,
is not something that businesses are really that
much interested in; and I want to be quick to say
it apparently is not something the states are very
interested in either. As you look at the world of
credits and incentives of tax competition that
we're going to touch on later on, we see an
environment where the states are certainly
prepared to slice and dice their tax bases for
benefits perceived. So everybody seems to go
their own way and do their own deal. Uniformity
is something that's still near and dear to my
heart. I see very positive aspects for it both at the state and the international level, but the practicality of reaching some kind of uniform base kind of flies in the face of what we see out there every day.

MR. BRUNORI: I have a follow-up question for Diann, but I thought we had a question on this side of the table.

MS. DICKERSON: Yeah, Valerie Dickerson, Deloitte. I'm curious what your reaction is when you were called upon to advise around maybe a type of model for allocating on an international basis. What do you say in the face of differing interpretations of the rules? And we'll go into the sales factor where this goes to the base, and I think that a single-sales factor and then market sourcing for services puts a lot of pressure around the nexus question of what the tax base is. And then kind of layer onto that, the states that judicially have gone to a term of apportionment. So they have maybe a performance-based factor allocation on the books, but in controversy,
they'll go the other way. So what would your
counsel be? Would it be the MTC model or watch
out or what's the counsel there?

MR. HUDDLESTON: Well, what I would say
is that the MTC has proposed for a number of years
what we believe to be a fair and concise method of
determining that and it's called factor presence.
We look at the factors of payroll, property, and
sales. If you have any of those above a certain
level -- and there's nothing sacrosanct about the
numbers, it's the structure here -- then you have
nexus in those jurisdictions for tax. What we
tell people when they talk about the complexities
here either at the state level or at the
international level is that tax is a complicated
world. And it's critically important that
jurisdictions are very quick in developing and
promulgating rules. The rules are certainly as
complicated in dealing with permanent
establishment or in the EU as they are in the
states. And it's my belief that no matter what
methodology we have going forward, it's not going
to make it less complex. So it's critically important that the jurisdictions involved have a transparent and rapid method of promulgating and establishing rules for any of these issues.

MR. BRUNORI: And Valerie and Joe bring up some very good points. So, Diann, can you just tell us and provide your thoughts on what you think the strengths and weaknesses are formulary apportionment? I mean what works, what doesn't, what the problems are?

MS. SMITH: Sure. I think when we talk about the strengths and weaknesses, some people it will be a strength and the exact same thing to someone else will be a weakness. So I will talk a little bit about here as kind of where some of the pressure points are.

One of the I think biggest problems that we see right now with the formulary apportionment and the way it's been implemented by the states is that we seem to be using an economic model that's several decades old to try to apportion the current income. And when I say that, it's things
like -- when you look at the property factor, for
the vast majority of states, the property factor
only includes real property and tangible property.
It doesn't include intangible property unless
you're a special industry like financial services.
And we can see over the past many years,
intangible property like trademarks has become
much more important yet it not included in the
property factor.

So some of those changes in the way the
economy has happened have not been really pushed
through to the way the apportionment formula is
calculated.

Another problem that comes up, and I
kind of think this is the perfect storm, is as Joe
said, many of the states are working toward
getting a single-sales factor. The reason for
that, and this is a problem that's inherent in an
apportionment formula that includes factors of
production like people and property, that whenever
people and property are in the apportionment
formula, that means that additional investment in
a state is going to increase the numerator for the taxpayer and thus increase their tax. So there's going to be pressure on the states to try to take out the disincentive to invest in the state. That's why we're moving toward the single-sales factor concept.

At the same time, the states are also moving toward the economic presence nexus. So states that have a single-sales factor and economic nexus, you've got taxpayers that have nothing in the state -- no property, no people. They're not using the infrastructure of the state the same way that companies that are actually there are and yet if their sales are equal, then they're going to have the exact same apportionment percentage. And that's another pressure that I think is going to be coming up in the nexus arena and coupled with the problems with the apportionment formula.

Another issue that I think is increasing in sensitivity is some of the definitional problems, but can create a very real risk of double
taxation and from the State's perspective also a risk that income isn't going to be taxed anywhere. And so when we look at historically, because it was talked about earlier, there was always this cost to performance standard if you were selling something other than tangible personal property like services or intangible property, this cost to performance standard. Well, states are now pretty drastically moving away from that to a market standard. The problem is that the definition of market is nowhere near equal among the states. The MTC has worked very hard at creating some type of definition. But, you know, this is an iterative process and many states have already come up with very different definitions. So even though they'll say we're a market state that's not the end of the story. You have to very carefully look behind, okay, do they have regulations, are they saying it's, you know, for services, is it where the benefit's received, if it's where the services are delivered. Those could be two very different concepts and I think that's something that we're
going to see going forward is going to be a real problem when we're trying to, you know, enforce the apportionment formulas.

MR. BRUNORI: I'm sorry, yeah, Peter.

MR. LOWY: Yeah, going back to Joe's comment about the breakdown in uniformity of factors and looking at what can the international community maybe learn from the state experience. So I mean it would seem to me that producer countries may have incentive to wait towards property and people, consumer nations, incentive to wait towards sales. And this would inevitably lead to double taxation. Going back to Peter Barnes' one pie concept, how do we avoid the double tax problem?

MR. HUDDLESTON: Yeah, can I just speak to a couple of those issues? One is that I agree with Diann, this is -- in the sense that we live in a fundamentally different world in the 21st century than we did in the 19th century when physical presence and PE standards found their home. We live in a consumption based world
certainly in the U.S. And producer nations quite
contrary to what Peter suggests, producer nations
have a pretty strong political incentive to go to
a single sales factor because it reduces the tax
burden on their localized industry if sales are
worldwide. You know, I guess what I would say to
you is that yes, there are some complexities,
there are some details that certainly have to
evolve over time as we look to an intangible kinds
of commercial base across the world, but that
speaks to the fact that physical presence can no
longer be a reasonable standard in the world that
we live in. That's not how people do business.
And the states and nations are going to have to
adjust their mechanisms for taxing business
entities that do business in their jurisdiction.
And the fact that you have property tax base nor
not doesn't drive the fact that it's almost
impossible to do business in the jurisdiction
without the ability to enforce your contracts,
without a requirement upon the government to be
able to protect the structure that you have
adopted. So it's not without requirements of the
government that people do business. They do
business all over the world, they can be located
wherever they want to do business and the fact is
that governments are going to have to adjust to
the 21st century, not the 19th century in how they
build their taxes basis.

MR. BRUNORI: We have a question in the
audience right there.

MR. DRENKARD: Thank you, David. Scott
Drenkard of the Tax Foundation. There seems to be
a lot of talk about how to -- well, this might be
coming from Joe mostly, talk of how to get at a
tax base or how to make sure that people are
paying based on activity, et cetera. How does the
benefit principle enter into the conversation here
because eventually we have to realize that,
especially for corporate taxes, these things are
going towards infrastructure costs and that really
only benefits people in a geographical area? So
sourcing that moves away from the geographical
basis to tax people seems a little bit out of
place. How do we enter the benefit principle into
the conversation and what is its place?

MR. HUDDLESTON: Yeah. I guess my focus
would be as I said before the structure of the
benefit received is, one, is a discussion that
really does come out of a period where everything
was -- you know, you had a local business inside a
corporate jurisdiction and you got fire and police
protection and everybody said, oh, you got fire
and police protection so you've got to find some
way to pay for it. Well, in the modern economy
that's not the only thing you get. In fact what
you get is a marketplace that's secure and that
your contracts and your ability to carry on
business and enforce those contracts and have
customers is protected and guaranteed and
maintained by a local jurisdiction. So, yeah,
it's certainly an argument we've heard over time.
I'm not sure that the benefit received argument is
as forceful as it was 75 years ago, but it's
certainly an argument that takes place. And if
the calculation is going to be oh, I get very
little so I shouldn't have to pay anything, that kind of rolls back to every single tax base out there. You know, I've passed the point that my children are in public school so I get no benefit from public schools whatever and boy would I like to stop paying property taxes. But that's not the world we live in.

MR. BARNES: Can I pull us back a minute?

MR. BRUNORI: Yeah.

MR. HUDDLESTON: Sure.

MR. BARNES: It's great to hear these state tax discussions because they bear closely on the international side. But I feel like this was a mile long race and we immediately jumped to the three quarter point which was, you know, how are we going to look at the factors and split this stuff up. Let me go back just a minute. There's an interesting discussion buried in Kimberly Clausing's piece in here and I recommend it to you very highly. From an international perspective we quickly in this debate, and it's smart, smart
people, it's Kimberly Clausing, it's Lee Sheppard, it's Mike Durst, we immediately set out two paradigms. At one paradigm is the separate entity arm's length side. At the end of end is global formulary apportionment. And we talk as if those are the two models and by god separate entity accounting arm's length standard is completely broken so let's go grab this global apportionment. I don't think that's the way the world is going to work in any realistic setting, but I also don't think that the apportionment approach, formulary apportionment approach is silly. Let me try to put it in context. Separate entity accounting, and I'll get to it in just a moment, I think is absolutely the way to go. It is the only way to go; we're going to go that way. The U.N. Has looked at it, the OECD has looked at it. I think we're going to stick it with separate entity accounting. But, but, but, within the transfer pricing methods there are a variety of accepted approaches, comparable uncontrolled price, cost plus, resale minus, profit split. In appropriate
cases, appropriate cases -- and there are not a
lot of them but there are some -- in appropriate
cases profit split is a reasonable way to allocate
income at arm's length in a separate entity
accounting world. And we've got plenty of
examples of that. The best one, the easiest one
to get our arms around are the advanced pricing
agreements for global dealing. The global trading
agreements between the U.S., the U.K., and Japan
are well developed. It's essentially a profit
split, there pieces of it unitary formula. So I
don't think we have a -- realistically, if we want
to talk about what's realistic here, I don't think
we have a world in which it's either separate
entity accounting, arm's length test here, or
formulary apportionment over here. I think the
real dialogue needs to be within separate entity
accounting are there places where formulary
apportionment of some manner is appropriate and is
helpful.

Now let me just very quickly say why I
don't think you're going to get global formulary
apportionment. The biggest tax issue in the international arena today is India's insistence that companies in India earn profits substantially higher than they earn elsewhere in the world. And India has economic data to suggest that's true. Counter to that, Japan -- economic data suggests Japan companies earn less than most companies earn on a global basis. It is inconceivable to me and not appropriate in my view to look India in the eye and to look Japan in the eye and say whatever factors you are, I don't care what factors we come up with, whatever the factors are you're going to earn the same profit level per factor in two countries where you demonstrably have different levels of profits. It's one thing to do that within the states but I don't think between California and New York, Florida, Texas, Montana, Tennessee, you have profit levels as dramatically different as you do between Japan and India. And so we can talk about formulary apportionment within the states. In the international context there's some utility but the utility is to say as
one of the transfer pricing methods for separate entity accounting let's keep formulary apportionment in appropriate cases like global dealing.

So anyway I think factors are important. I don't mean to pull us back from factors but factors is getting down to the red zone in the game and I think there's an awful lot of the field before we get there that's important.

MR. BERGIN: So, Peter, formulary apportionment is not the be-all end-all solution to the international taxation area?

MR. BARNES: It's not, but within the separate entity accounting arm's length standard there can be situations where profit split, and profit split would encompass formulary apportionment in appropriate ways, can be an appropriate way for allocating income under an arm's length separate entity accounting approach.

MR. BERGIN: Okay.

MR. LOBEL: Marty Lobel. The problem with formulary apportionment, every IRS
commissioner that has ever testified before Congress has said they cannot police it. The advanced pricing agreements are now all secret courtesy of legislation that exempted them from Freedom of Information Act. So we're trusting the Treasury and the IRS to do the right thing without any supervision. Formulary apportionment takes into consideration the increasingly growing value of intangibles. I mean the fact that the Cayman Islands is now the fifth leading banking center in the world really belies credibility. What we have to do, at least in my view, is go back to some sort of a formulary apportionment that will take into consideration the problems that you've mentioned and get away from unitary because it -- or get away from transfer pricing because it doesn't reflect real values when royalties and intangibles are increasingly valuable and located in Isle of Man, a solicitor's desk in Ireland -- that's what Microsoft did and saved $300 billion in taxes according to the Wall Street Journal. I mean this is getting worse and worse and even BEPS
has really given serious consideration, if you read international tax notes, to formulary apportionment modified to take into consideration the various producer versus consuming countries. So what I'm hearing now is the usual arguments industry makes, tax him behind the tree but not me. And they've learned how to take advantage of the international loopholes. And Treasury as far as I'm concerned has done nothing but aid them.

MR. BARNES: Well, I may not have been clear but I think we violently agree. (Laughter)

MR. LOBEL: I'm pleased to hear that.

MR. BARNES: I think there's -- I'm not saying there's no problem. Absolutely we have issues we have to concern. The question is do we throw out separate entity accounting? And to me I just don't see a system in which on an international basis getting away from separate entity accounting is going to get us very far.

India -- and I don't blame India, India has economic data to support its arguments -- India will say your company here makes profit levels of
20 percent, 30 percent higher. I'm not going to take your global profit level of 10 percent. That doesn't work for me. So I think the question is at a narrower level, not at the separate entity accounting versus global apportionment level, but at a narrower level, do you have integrated operations where some sort of profit split, formulary apportionment to deal with residuals may be appropriate. But that is very, very different form the notional idea that we're just going to throw the company all together and then split up its profits around the world. And that I think -- I'm characterizing -- I'm caricaturing it, but that is the notion that formulary apportionment says. It says I can't deal with any of this stuff, throw it in a pot and split it up. I just don't see that happening because profit levels are demonstrably different around the world.

MR. HUDDLESTON: Yeah. Let me briefly speak to that. The concept that I often hear is one which Peter espoused and right up until he said, "only way to go", I was really agreeing with
him on a lot of the things he had to say, but, you know, I want to point out to you that combined reporting has been operating in the United States far -- well, since the 1930s and has become more and more embraced by many states, maybe more than half the states have some sort of combination right now. It does in fact work. And if you look at the flow of what goes on in the U.S. as opposed to looking at a global entity structure, we really are a bottom up kind of structure so that the states operate kind of as separate entities as you will, sovereign states in their tax structures, and much the same way that many of the countries around the world do in their relationships to each other. So I don't want to say that there's not problems with combination, there certainly are and I recognize those that Peter outlined as being problems, but they're problems that the states have been facing now for decades and they have built rules and a basis for dealing in combination and in unitary business principles that do in fact work. Now we live in an environment in the states
where we have separate entity reporting states and we have combination states. The implication is that somehow you have to have this great world bubble that enforces combination on everyone. That's simply not the case. It's never been the case in the United States and I'll say to you that it wouldn't be the case in the rest of the world. And as India and Brazil and other countries out in the BRIC group have indicated, they're perfectly prepared to go their own way with their own structures that are meaningful to them. And each individual country out there could begin to adopt some type of apportionment regime because I'm not here saying gosh, we've got to walk away from arm's length pricing tomorrow, I'm not. I'm just saying the same thing that you're saying except I'm reversing it. I don't think that the concepts of arm's length pricing have a very long future in the world of tax either.

MR. BRUNORI: We had another question right here. Eric?

MR. TODER: Eric Toder, Tax Policy
Center. I actually want to ask two quick ones, following up on two comments by members of the panel earlier. One, Joe referred to tax competition and I understand tax competition among the states really has to do with attracting business or industry to your state. In the international world there seems to be another form of tax competition which countries seem to feel important, and that is getting companies to be resident in your country, supporting your national champion which may or may not have anything to do with the amount of domestic investment. And I'm just referring to the recent Medtronic merger where they've gone to Ireland, but apparently nothing is happening to their activities in Minnesota or anything like that. So that's one question about in looking at the state international, is the different forms of competition meaningful?

The other question I wanted to follow up was Diann's comment about the formulas not taking into account intangible property and so I just
wanted to know if anybody thought if you did have a formula how would you allocate intangible property?

MS. SMITH: You want me to start with that question?

MR. BRUNORI: Sure.

MS. SMITH: It's a great question because since the very concept of intangible property means that you can't actually find it anywhere. But I think that you can look at different types of property and for example, patents. You might decide well the patent should be sourced based on where they're being used. So is there a manufacturing plant that's using them, is there a research facility that's using them, are there several manufacturing plants. Trademarks, you might look at where they're being used, you might look at the area that they're being developed in, where they're being enforced. So I think that there are situational examples that you can use to source that intangible property that would be more reflective of actually
how the company's value is being generated.

MR. BARNES: Yeah, let me respond to Joe's point and Joe's points are well taken. The question is whether you're a glass half full or a glass half empty kind of guy. You make a very important point, Joe, which is that yeah the states -- we've lived with the fact that some are combined reporting, some are separate entity reporting and we don't have to have uniformity. And I agree with that completely and in the international setting we're not going to get complete uniformity. I get that. I would point out though that the states have tax rates generally running from zero to ten. In the international world it's from zero to forty. So the stakes are a lot higher. In the states there's a heck of a lot of commonality, we're one country, and there are only 50. In the international world there are 200 and a lot less cohesion. So I don't pretend that we're ever going to have a global system that works right for everyone. It's important to remember Brazil has
gone its own way. Brazil has said we are going to have stated profit -- I'm being very simplistic -- we're going to have stated profit margins. You want to do business here you're going to show this margin. Whether you do or don't that's that. So you can have a variety of countries go with separate entity and combined reporting and we'll learn to live with it. But, boy, talk about complexity. If on a going forward basis, you have combined reporting in France, you have combined reporting in Germany, but it's a different unitary group. If you have combined reporting in Japan, but it's a third combined group, and then six other countries that have separate entity reporting -- somebody's got to look taxpayers in the eye and say, yes, you're tripling your compliance team because we can't get our act together as tax administrators.

MR. BRUNORI: Peter and Diann and Joe actually raise a bunch of terrific issues, and the one that strikes me is that the state corporate income tax, long considered a sieve in that it is
not very robust, it is not very strong despite
Joe's efforts and the FDA's efforts and the
revenue department's efforts and a lot of good
college tries. The state corporate income tax is
always under siege. Increasingly on the
international side, and if you read tax notes and
tax notes international, you'll see this every
week, every day, that the international corporate
income tax regimes, because of aggressive planning
and interjurisdictional competition, et cetera, et
cetera, are under siege. And so the question is,
can anything be done? I mean, what is the
solution to two tax structures that are widely
considered less than robust?

MR. BARNES: I think it's a menu. I
don't think there is a panacea. I don't think
there's a specific issue. I think there are
probably more transaction taxes. We sit here
talking about the importance of the market, the
market countries, and I get that. It is crucially
important and those comments that, what do you get
if you have no physically presence but you sell
there, well you get a market. That's important.

I think you recognize that not through income
taxes but through transaction taxes of one type or
another, the U.S. that, we all know this backwards
and forwards, the U.S. does not have a V.A.T., and
therefore any comparison of how corporate income
tax compares to other countries' income taxes is
apples and oranges, because the other
jurisdictions, they have a V.A.T., so one
solution, a part solution, is a V.A.T. I think
you go with simplified methods and safe harbors.
If we think transfer pricing is so hard, and it
is, we can pick simplified methods and safe
harbors, the taxpayers will jump on that. That's
the discussion that's going on now between the
U.S. and India. It has not reached a conclusion.
But that would take a lot of issues off the table.
And then, enforcement. Sam Maruca and the IRS cry
-- cry for help, and what happens? The budget got
cut earlier this week by 300 million dollars.
Proper enforcement, so that you're picking your
cases, you're making sure the buy-ins are the
right value, that sort of thing. I think there's no single solution, but I think there's a menu of solutions that can make a real difference.

MR. HUDDLESTON: Yes, I agree. I think there's a menu of solutions out there also. I think from the other perspective on some of these issues, having to do with value added tax for instance, I think I would go back to what I mentioned earlier before. I think it's important to keep in mind that the U.S. structure really is a bottom up structure. Most of the countries with V.A.T.'s around the world are top down structures that largely had these value added structures given to them after World War II, with the exception of course, of Switzerland, and that the complexity and the problems of replacing -- and of course you have to first start with the question of are you talking about a V.A.T. or are you talking about an add-on or a replacement? And with either one of those, the complexity of either adding on or replacing in a bottom up system that has broad reliance, tremendous reliance out across
the states on a sales tax base to either lay on
the top of that or to replace that with a national
value added tax, albeit having local functions
would be stunningly complicated.

MR. BARNES: Let me touch one other
thing. There's been a hint in the first hour, and
not explicit. Usually it's explicit but maybe we
had a hint of it, of sort of morality, that these
amoral corporations are doing a host of things
that are bad, either aggressive tax planning or
other things that are bad. I'm perfectly willing
to accept, we need to have that discussion with
respect to corporate taxpayers. But there's a
hypocrisy here that drives me nuts. Joe touched
on it and he pointed out, he no longer has kids in
the school system, he'd love to not pay the
property tax. But let me just mention three quick
ones, and tell me -- you don't have to raise your
hands -- tell me if anyone you know has done any
of these things. They earned deferred comp in a
high tax jurisdiction like Washington, D.C. or New
York and they moved to Florida and received the
deferred comp with no state tax. That's one. They spent their work career in a high tax jurisdiction that had an estate tax; they retired to Florida where there was no estate tax. Third, they managed their days in and days out of New York City so that they would avoid the New York City tax. If you pick up Kiplinger's magazine, if you pick up Money Magazine, if you go talk to any personal advisor, these are pure vanilla -- simplistic tax planning things and there's not the slightest moral taint to any of it. And yet everything we're talking about here with respect to corporations is exactly this. It's deferring income one place, receiving it in another place. It's measuring your days in, measuring your days out. If we're going to have this sort of moral taint about corporations, and I'm not saying we shouldn't, let's have that discussion. We've got to be willing to look at our neighbor who does these things and look at our self who does these things and say, is there a difference? Is there a moral difference between the individual who does
this and the corporation who does this?

MR. BRUNORI: We had Harley and then Joann.

MR. DUNCAN: I think it was in the other room.

MR. BRUNORI: Oh, I'm sorry, Joann and then Harley.

MS. WEINER: Thanks, I just need one of these microphones. I just have three points that came to mind. The first is, Peter, you're talking about India having a 20 percent profit margin, how outrageous that is? I think Marty Sullivan at the end might raise the 200 percent profit margins in some of these tax havens as being a problem. Back in the 1990's, the Treasury Department had a conference. Eric Toter was at Treasury and so was I at the time, where we looked at all these issues. I feel like nothing has moved in the last 20 years in terms of looking at these issues about formulary versus arms-length, for the U.S. However, there has been tremendous movement in one area, where I think actually people can learn a
lot, and that's in European Union. Back in about
1990, the Rooter report came out, they totally
rejected formulary in 1994, the U.S. OECD new
transfer pricing, firmly arms-length. Well guess
what? In 2011, the European Union proposed, not
just talked about, not just issued a report, but
actually proposed formulary proportionment among
the E.U. member states. Now here's a catch there,
and Joe worked on some of this, and I worked on
the report as well. The catch is, is that it's
not mandatory. Companies can choose to stick with
separate entity if they would like, but if
companies feel like this spaghetti method of
connecting points just doesn't work, that the
compliance costs are so high, they can go to a
simple formula and use that to determine their
income within the E.U. They also learned a big
lesson from the U.S. states and state, uh-uh, none
of this unitary tax stuff and no worldwide
taxation. So it's water's edge and it's an entity
basis, not a combined report. Okay? So those are
the three points I wanted to make about that.
MR. BRUNORI: Thank you Joann. Harley.

MR. DUNCAN: Thanks. Harley Duncan with KPMG. I understand the motivation, Joe, having defended states for 25 years, but I think you let them off too easily on the uniformity question. It seems to me that it really is having, wanting your cake and eating it too, when you argue for economic nexus, 100 percent apportionability and then say, oh, but after that, we'll do whatever we want, and I'm not sure we need to get down to the level of benefits received versus services delivered and die in that quagmire, but instead, I think it's like Peter says, is there's a lot of halfway steps, whether it's elections, safe harbors and the like, that can be done to create greater consistency across the states, which seems to me to be necessary or at least a concomitant of 100 percent apportionability and nexus everywhere, and still deal with the compliance issues.

Because that, I think is a real burden that is coming down on the U.S. state corporate income tax system. Second, I'd echo what Joann indicated as
well. I think part of the subtitle here was lessons for international reform from the states. I think there are plenty of lessons we can still take here in terms of what, for example, they're doing in the European Union and in direct taxes for compliance burdens, for consistency in rules. And then the other thing about consumption taxes, and this is just the extraneous worthless comment, but if we continue down our path of single sales factor this and that, we will have a consumption tax that is broadly based, albeit poorly designed at the state level, because that's all we're taxing, is consumption in the state, of some consumption of our choosing from some taxpayers of our choosing. Not very well designed, but that's where we end up.

MR. BRUNORI: Diann?

MS. SMITH: One other thing, on the state level, is that also, it's not transfer pricing versus apportionment at the state level. Because the states also use a transfer pricing regime to decide in many cases, what the overall
tax base is that is going to be then apportioned among the states. We've got quite a few states that have historically looked at whether there's arms-length pricing between the affiliated entities to adjust the actual tax base. Any sort of effects on changes at the federal level on transfer pricing concepts have a significant effect on the states that use that transfer pricing concept.

MR. HUDDLESTON: Yes, let me address that. I agree with Diann. A lot of states do that, particularly the separate entity states and the where they can, they look at those things, but as I mentioned before, they are heavily reliant on federal taxable income, and their ability to actually go above the line and look at those numbers and make some calculation as to arms-length pricing is very difficult for any state and most states simply don't do it. They start with where they are at federal taxable income and that's where they stay. As to what Harley had to say, as letting the states off too
light, if I did, I didn't mean to. The states are as complicit in this as anyone else, in terms of their inability to reach or to dramatically drive toward more uniform processes. But what I would suggest to you is that the states are merely the hand maidens of the political process. The political process is largely driven by private industry throughout the country, and I would say to you that where there are any MTC uniformity proposals, if industry would join hands with me, I would go around the country to each of the legislatures and ask them to enact these uniform rules. Industry has no interest in doing that, and they're not going to. They'd a lot rather see states pre-empted by the federal government to achieve uniformity. They repeatedly focus on a national structure as opposed to a state sovereign structure. I understand that and towards Peter's point, I don't see any of these things as a morality play. Businesses do what they do because it's in their best interest and the best interest of their shareholders and they're the people who
receive dividends from the Fortune 5000. They expect their companies to pursue these avenues to reduce their costs to increase their dividends. That's the way of the world. I've got no problem with that. It's not immoral to make a profit. But I would suggest to you that my final point is that as I have often been known to say --

MR. BRUNORI: Doug or --

MR. HUDDLESTON: You don't always get what you pay for.

MR. BRUNORI: There's no doubt that Doug would --

MR. HUDDLESTON: Yes, Doug's fine. You don't always get what you pay for but you do always pay for what you get. And that proposition leads to taxation generally and the question is, is the structure we have fair? Not moral or immoral. But is it fair?

MR. LINDHOLM: You know, Joe and I have this conversation a great deal, at least 10 times a year. And let me sort of back up a little bit and talk about the notion, does business want
uniformity and why hasn't uniformity worked? Well what has not worked is voluntary uniformity. And I understand. It's pressures, it's political pressures driven both by business and by state interests. Business is not monolithic, so naturally when a business comes into Joe and asks him for favors, they're going to look at their own interests. But everybody here at the table sort of inherently realizes that uniformity is good. But we also realize the dichotomy of individual interests versus what's good for the business community as a whole, right? So how do we get past that dichotomy? We're not going to pre-empt state structures by going to the federal government. But there are, and this sort of backs up Harley's point, there are sort of situational areas where I think we should go to the federal government and impose uniformity on the states, impose thresholds, impose administrative uniformity that would tremendously ease the compliance burden, and ease the ability of our business community to compete on a global basis,
three areas that I consistently talk about -- one, thresholds. We have the most advanced economy in the world. A company still doesn't know how much of a presence that they will have in a state before they have a jurisdiction to tax. We don't know the answer to that. Second, administrative convenience -- why not, and kudos to the streamlined sales tax effort, but again, that's a voluntary effort that really has stagnated. And the third is areas like, thresholds like the mobile workforce bill. When you travel as a state employee, why should you be subject to fifty different sets of rules from state to state, half of which, most employees have no idea. Why not impose a single threshold before state rules kick in? It just makes common sense to me. And it's not that the business community wants to preempt state efforts. I think that there is a happy medium between areas where federal uniformity can be imposed on the states but not take away their sovereignty. And that's what we're looking for.

Joe, I'm happy to walk arm in arm with you through
the halls of Congress to try and get that.

MR. BRUNORI: Our twitter feed is buzzing.

MR. BERGIN: Does twitter buzz? I don't know.

MR. BRUNORI: But we're getting lots of social media questions. I wanted to propose a couple of them to our panelists. And this one I think would be for Joe and Diann, or anybody else up here who might know the answer. Is there any data or do you have any sense of how much money states lose from offshore tax planning by multinationals? So that seems like a pretty straightforward question. Joe, do you have any idea?

MR. HUDDLESTON: All I know is what I read in the paper and there's some question as to the validity of that kind of thing, but you know, I've certainly, and all of you have seen numbers ranging from as low as 1.7 trillion dollars offshore to -- and this is raw dollars, not taxable income, but 1.7 trillion to 20 trillion.
So the answer to your question from the perspective that I look at is, I haven't got a clue. It's big. The number's big.

Mr. Brunori: It's big.

Mr. Barnes: Except that's apples and oranges. I mean to say that because income is earned offshore and is kept offshore, of somehow, you know, reduced your state taxes, that's the tail wagging the dog here.

Mr. Huddleston: I might argue with you where that income was earned.

Mr. Barnes: I'm just saying it's an interesting question. It's a hard question, but I'm not sure that there's any data for it and I know the 1.7 offshore. We can argue whether that should be offshore or not offshore, but that's not offshore to deny states their taxes. That's a 35 percent U.S. tax, not the four percent state tax driving that decision.

Mr. Brunori: So a follow-up question, that certainly some of the practitioners on the panel who are up here might know the answer to,
is, do state tax considerations play into tax planning for multinationals? So if you're advising multinational corporations in terms of their international tax structures, are you thinking about state taxes?

MS. SMITH: I would say it affects them two ways. Number one, multinationals by definition in this case are doing business in the U.S. to some extent and so, yes, they are going to be looking at tax considerations. Is it going to trump decisions on their federal tax issues? Probably not, because of the difference in the rates, but on the margins, they're still going to be considering the state tax issues. Then also, when you look at the multinational arena, where we've got tax issues that really come into play, is when you have someone who's done some type of tax arrangement in the international arena, you want to make sure you're not making things worse in the state tax arena, for that tax payer. So those are two examples.

MR. HUDDLESTON: Yes, I think those are
all good points, and I think Peter is right. The
trickle down proposition that if there's a couple
of trillion dollars being held offshore in
repatriatable, if that's a word, dollars, the
first stop of that obviously is federal taxable
income, so the states are only taking a few
billion dollar hit instead of the really big
money, which the federal government is having to
forego. But what I would suggest to you is that
just as a matter of curiosity, I'd love to know
which of those Fortune 1000 worldwide companies
are actually paying 35 percent or even 15.

MR. BERGIN: I'm going to indulge myself
here, because tax is one of my favorite things.
I know what tax avoidance is. I know what tax
evasion is. I think I know what morality is. I
was raised by the Jesuits. But what I can't
figure out is tax and morality in the same
sentence. I'm sorry; it leaves me scratching my
head.

Peter, you said, about the issue of
taxes and morality -- which I first confronted in
Europe -- that it fits into the debate. I'm curious how -- because this really is a problem for me.

MR. BARNES: Today's discussion has actually had, I would say, less of the morality tone than most.

MR. BERGIN: Yeah.

MR. BARNES: But today has had, you know, that atmosphere about it, as well -- and I get it. We would not be having this discussion at all if everyone believed that arms-length pricing and separate entity accounting worked -- period.

MR. BERGIN: Good point.

MR. BARNES: We wouldn't have this meeting. We'd all be home. The only reason we're here is because of a perception that taxpayers push the envelope. Maybe it's legal, but it shouldn't be, you know. Maybe it's illegal. Maybe it's illegal, and the government doesn't have the tools to find it. But the only reason we're here is a perception that, somehow, fair payments of taxes to jurisdictions are not
occurring.

So, yes, there's a morality. And I want to have that debate. That's a fun debate. That's an important debate. The point I wanted to make was, we somehow have blinders on. And when it's an individual who earns deferred comp in one jurisdiction and takes it in another jurisdiction --

MR. BERGIN: That's tax planning.

MR. BARNES: It's tax planning, and it is pure vanilla. That is why Money Magazine exists. And we would not even say to our neighbor, "Oh, why are you moving out of the school district now that your son's a senior in high school?" We don't even think about that -- and yet, in the international tax arena, we have this, "It may be legal, but, gosh, it shouldn't be," as a cloud over the whole discussion.

So, I think morality's important. I think the morality discussion ought to occur. I think it ought to occur with respect to both corporations and individuals -- or somebody needs
to explain why the deferred comp example for
dividuals is just fine, and the counterparts for
corporations are somehow not fine.

MR. BERGIN: Yeah, and I have some
advice. If you don't wan to get in trouble at a
cocktail party where people are talking about
taking advantage of the charitable deduction,
don't say you admire G.E.'s tax planning. They
throw stuff at you.

MR. BARNES: G.E. is audited around the
world --

MR. BERGIN: Around the clock.

MR. BARNES: All the time. 25 agents
wake up every morning and go to the office and
audit.

MR. BERGIN: What, Eric?

MR. TODER: Hi. I'm sorry. I just
can't let this go.

MR. BERGIN: Neither can I.

MR. TODER: First of all, I don't think
it's a difference between individuals and
corporations. I don't think anybody objects if
corporations use bonus depreciation to reduce their tax liability. That's an incentive that Congress deliberately put in the law, for the purpose of stimulating investments. We may think it's good or bad policy, but there's no ethical issue there. I don't think there's any ethical issue if I put money in a 401(k). I mean, I am avoiding tax, because I could make the same investments outside the 401(k) and pay more.

I do think there's a question when people engage in transactions. And it's very hard to know where to draw the line. But I think we would not have a civilized society if every action by every human being -- that all we did was obey the law, and we showed no consideration for other human beings, other than obeying the law.

I think we have to really ask the question about, when we push the envelope, what is too far, and what is not too far, in terms of -- and I think it has to do, really, in some sense, of what the law's intended to do. When you do something that's different than what the law's
intended to do, it may actually technically be legal, and it applies to individuals, as well as corporations.

MR. BERGIN: Yeah, and you're --

MR. TODER: I do think those issues need to be engaged. I don't think it can be dismissed by saying that any response to incentives by a company -- they invest in a country which has a lower tax rate; that's fine. But the other, aggressive tax planning -- I think there are some issues, and I don't know where to draw the line.

MR. BRUNORI: Peter, excuse me one second. Eric, that's an interesting point. You hear the morality discussion. And Chris and I -- we've been talking about our tax handles for a long time.

You hear the morality discussion mostly on the international front, right? It started in the U.K. -- and Starbucks and all the -- you know, the Prime Minister and so on and so forth. You don't hear it much -- and I wanted to ask our state panelists here. We don't really hear the
morality issue of taxes and morality at the state
tax level all that much.

Would you -- I don't know if you would
agree with that, Joe or Diann.

MS. SMITH: Actually, I disagree. And I
think that a couple things come in. The first one
is that there's been a lot of work from a
professor out of Alabama that has used her
religious views as sort of a concept for morality.
And she's written a lot on how that should inform
state governments, and how -- so that's sort of
one area that we've seen, and I think other people
have taken her up on similar areas.

But, certainly, in the corporate arena,
there have been -- and I don't know if it's been,
you know, formally written about, but a lot of
discussion about, oh, you know, corporations are
bad because they set up their intangible holding
companies in Delaware.

And I think that when you read some of
the cases that have determined, for example, that
nexus existed, kind of one of the underlying
themes is that there was something bad -- not legally, necessarily. They found a legal reason for it -- but that there was something inherently bad about doing that, and that that's how the court got sort of justified.

So, I think that there is this definite underlying current of morality.

Joe?

MR. HUDDLESTON: Well, I guess there is, too, on some level. I guess I personally have a problem with the concept that an artificial legal structure somehow can be immoral. You know, from my own perspective, you know, that kind of falls into the area of who people are.

I go back to the concept of fundamental fairness as to questions that we can disagree on. The issue of morality or immortality is one that we can obviously agree or disagree on, but it comes at a completely different level.

MR. YESNOWITZ: It's Jamie Yesnowitz, Grant Thornton. It's the classic question of what one can do versus what one should do. And I know
that I, as a practitioner, I wrestle with that
question every day in the state tax arena.
I guess a question for Diann -- I'm going to tie it
back to what we talked about earlier -- when you have
a client that is multinational, has very little
presence in the U.S., but, all of a sudden, determined
that there's nexus even though it might not have a
permanent establishment, what do you tell that client?
Do you tell the client, "Well, the states aren't going
to catch you," or do you say, "Well, these are the
legal requirements. This is what you have to file."

MS. SMITH: Oh, it's definitely the
latter. California's out there. I'm never going
to tell them the states are never going to catch
them, because I do think that there are some very
sophisticated states that are being very careful.
And then I don't think it would be, you know, sort
of from a legal/ethical point of view, to bring up
the issue of you're never going to get caught.

And particularly when we're talking
about income tax, we do have the FIN 48 issues.
The concept of being caught is not even relevant.
MR. BARNES: Yeah, and in the international areas -- exactly the same thing. I mean, let's face it -- you want to file your return. And this goes back to my earlier statement -- whether or not you have nexus is not a big deal; the question is, what's the income attributable?

So, I would always counsel somebody to say you want to file that return if there's even a close call, because you want to be the one who has books and records and says, "This is the income attributable to" -- because if you don't, and there's later an issue, there the government is going to say, "Well, the income attribute to was 10 times what I think the income attributable to was, and I'm in a hole, because I didn't file a return at all."

So, on a morality basis or a cost-benefit basis, you will always counsel the taxpayer to file the return, figure out the income attributable to, report it, and then be off to the races.
MS. SMITH: And that's one big difference, I think, between state and international, is that there are certainly states where if you think that the company does not have nexus in the state, it may be a really bad idea to counsel them to file a return in that state, because the state may decide that merely by registering and filing the tax return, that is itself sufficient to create nexus.

That's a real dilemma for companies, because they don't have a way, then, to start the statute of limitations. They may say, "We really don't think we have nexus, but we don't want to file, because that could be creating nexus." So, that's a real issue between them.

MR. LOBEL: Marty Lobel again. I tend to agree with Joe that, unlike the Supreme Court, corporations have no persona. They're not real people; they're a collection of people trying to maximize their profits -- as they should.

The question I would like to raise is, what does this do to domestic companies that have to compete against
multinational corporations? And I don't characterize them as foreign or American, because they're all multinationals -- when, for example, the last time I looked, G.E. had a seven percent effective tax rate overall, and yet the American taxpayers owe G.E. a couple billion dollars.

And I buy G.E. products. I -- you know --

MR. BARNES: Let's take G.E. off the table, because I think it's a red herring, a distraction.

MR. LOBEL: Well, I don't --

MR. BARNES: But the issue is important.

Let me respond.

I think you're exactly right. That's an important point, which is competition between multinational firms and domestic firms -- important issue. I agree with you 100 percent.

But I would simply say we are always -- we as tax policy tax professionals -- we are always opportunistic in terms of designing our tax policy. We offer an incentive to the new company coming in; we don't offer an incentive to the nice
guy who's been running the factory down the street with 100 employees for 20 years. We are always looking at sort of the marginal investor, the marginal investment.

And I think the multinationals -- let's be clear -- the multinational competing in Illinois with an Illinois company is probably paying the same tax in Illinois for what it's doing.

In these intangibles cases that we're all concerned about -- and legitimately concerned about -- the company typically will have rights to the U.S. in the U.S. And rest-of-world rights somewhere offshore. I don't think -- your point's well-taken, and it's a legitimate and important issue.

Domestic competition between domestic-only and multinational companies -- I don't think there is a big distortion there, because, within the U.S., a multinational is going to be taxed by the states and by the federal government like any other company.
MR. LOBEL: Yeah, but the numbers don't bear you out. I mean, multinationals pay a much lower tax rate than 35 percent. I think the effective rate was seven percent. So, how does a domestic company, who has to pay a much higher tax rate, compete against the multinational who doesn't pay as much overall?

MR. BARNES: That's a blended rate. The multinationals' effective tax rate is a blended rate that reflects the taxes paid in the U.S. and the taxes paid outside the U.S.

And so you have apples and oranges for the multinational, being compared against apples for the purely domestic company.

We don't -- I don't believe -- we don't have data on the domestic element of the companies and the domestic element of the domestic-only companies. That, I think, is a pretty level playing field.

MR. BRUNORI: Well, so we have a question on the -- right here, yes.

MR. FISCHER: Charlie Fischer, Deloitte
Tax. We were talking earlier about state tax considerations, with respect to the international planning. And as was mentioned earlier, you know, we don't see the state driving international issues because of the difference between the 35-percent rate and maybe a four-percent state effective rate.

But what we find is often that it's very important to consider those state tax issues, because for a lot of the things we've talked about today, such as different nexus standards, different definitions of the tax base, how apportionment may come into play, that sometimes that may be overlooked in the international planning with respect to how foreign entities might be subject to tax in the U.S. may be an unexpected surprise.

So, it's very important to look through all those issues, and advise those companies -- as we talked earlier -- about those implications. And it's not only in the state income tax area, but, also, when we look at the state and local level, there's many different taxes to be concerned
with that are not based on income, that are not
tied into federal tax numbers.

And so you've got to think about your
sales and use taxes, your franchise taxes, gross
receipts. And oftentimes, those can be much more
problematic than the income taxes because of a lot
of the conformity.

The last thing I'd like to bring up is an
area with respect to states actually looking at
international transactions independently.

So, let's take a financing transaction
where a U.S. corporation has taken an interest
deduction with financing with maybe a foreign
affiliate -- something that the IRS would have a
very vested interest in -- and maybe, actually,
already evaluated and sustained it as a valid
interest deduction, but (inaudible) come in and do
an independent analysis, and maybe coming to
another conclusion.

We just saw a case come down in
Massachusetts where a deferred subscription
arrangement was challenged by the state as not
being valid interest.

So, I'd be interested here in the panel about your thoughts about states independently evaluating international transactions.

MS. SMITH: It's funny -- my colleague, Steve Kranz, and I have had this battle over the past couple days about this very issue -- that let's say, for example, if the federal government comes in and actually audits an issue, and decides we're either not going to make some type of change -- and in this case, we're talking about transfer pricing -- that they're not going to make a change -- or they actually make a change, and then the company either accepts it or challenges it and goes through the additional process -- anyway, there's some type of federal determination on that actual issue.

To what extent can the states come in and say, "We disagree with the federal government. We think the change should be more, you know, increase in tax"?

And I think one of the first things you
have to look at is, exactly what is the state conformity? How do they do the conformity to the federal government? Some states will, you know, basically adopt the Internal Revenue Code. Some states will -- well, there's a few of them that actually say, "We'll take whatever the federal tax base is," but look at, what is that federal conformity, and how closely does it bind that state to any federal determination?

There are some states, like New York, that don't specifically say, "We're following federal," at all. You know, they can go their own way. And there, I think whatever the federal government does might be slightly informative, but is not binding on the state.

I think some other states, particularly the ones that might have a 482, for example, concept at the state level that completely borrows from federal, they may be bound a little bit more closely to what the federal government has done, as long as the federal government has actually looked at it.
Joe?

MR. HUDDLESTON: Yeah, I kind of agree with that, in most areas -- in that if the states have bound themselves to the 482 rules, they have done just that.

But I think the example that you put out really would not so much fall into the transfer pricing-arms-length pricing kind of category, but in a more underlying question, which I think is a serious issue for the states.

I think there are any number of transactions that can create deductions from federal taxable income that are found on the M3, like the financing arrangement that you laid out -- that I think is a very legitimate and statutory deduction from federal taxable income, but may not be deductible from state apportionable income. And if the states look closely at it, would find a circumstance where many states would want to add that number back.

MR. BRUNORI: Did we have a question out here? Right there.
MR. FRIEDMAN: Hi. It's Karl Friedman, with the Council on State Taxation.

Just a couple of comments from a few things I heard -- I mean, one of the issues being posed is, we're looking at the states to see if there's lessons that we can learn from them that we could apply in the international tax arena.

And if you look at, you know, really, what's happened in income tax, we've had a 60-year experiment now with UDITPA -- so the formulary apportionment -- at least the basic one that was adopted by, you know, many states over time.

And we're clearly seeing, despite, you know, perhaps valiant efforts for the MTC to make it more uniform at this point still based on a double-weighted sales factor, the states have voted with their feet. And their feet are -- you know, almost half of them now have single-sales factor. And in probably 10 more years, 2/3 of them or more will have single-sales factor. So, they're increasingly moving away from balance factors towards consumption as the only factor.
And it's pretty clear why they're doing it. It's somewhat of the same reasons governments are having problems in the international tax arena, which is, there's a strong push to always favor your domestic companies -- favor them so they can do exports, and, you know, favor them so that you can tax them less, and, you know, they'll grow jobs in your jurisdiction.

And I don't think this applies any differently to the international tax arena -- which does, then, get you back to begging the question of -- if you look at -- you know, there's two decisions countries make. One is how much they want to tax as a percentage of GMP, and the other one is, what is the proportion of the different taxes?

And several speakers have mentioned this, but in consumption taxes, you know, Joe's certainly right. We have a difficult sub-national consumption tax right now, which doesn't allow for business inputs, generally -- which makes it very hard, as the states are finding, to build upon.
But if you look at it globally, about twice as much is raised by consumption taxes in the rest of the world as is raised in the U.S.

So, we have a serious problem. Our consumption taxes are at the sub-national level. It's a poorly-designed system that doesn't have business input exemptions like the VAT has.

Doesn't mean we have to move to the VAT, but as we look at how much time we spend on corporate income taxes at the state level -- they bring in less than 10 percent of all the taxes -- it does, again, beg the question, should we look more seriously at the balance of consumption in income taxes? If we do, how do we get there?

MR. BRUNORI: And you know what? Let me follow up on Karl's question, because we had a Twitter question along those lines that just came in from, actually, a very good friend of the organization. And the question was directed at Joe, but all of you can chime in.

And it says, "Why does Joe think replacing state-level retail sales taxes with a
federally-harmonized VAT would be so fiendishly complex? If 160 other countries can do it, including, frankly, a lot of little, backwards nations, why can't the U.S.? Is he scared of the metric system?"

MR. BERGIN: Well, before you go, Joe, I've had this running argument with this great guy for decades. He loves the VAT.

MR. HUDDLESTON: Well, my answer is, one, yes, I'm terrified of the metric system. And the other is that, as I've said now a couple of times, it's a fundamental understanding that we are a bottom-up structure. We have filled the gaps in what we do in our tax structure from the bottom, from the lowest level possible, from special taxing jurisdictions in -- you know, for alligator control in Louisiana and Florida to our school districts, all the way up to major components of our general fund revenue in the states. The level at which our sales tax has been structured over the decades that it's been in place, most sales tax started to come online in
the 1930s and really caught some momentum in the
40s and the 50s and by the middle of the 50s, the
sales tax were at the apex of where they are.

The difficulty in changing that
transaction is not the overlay concept that we see
in Europe. Yes, Europe and Japan and Asia were
able to do this largely because they were scorched
earth, for lack of a better phrase, and the world
economic community at Britton Woods and other
places didn't really deal with these tax
structures, but over time, certainly through the
-- from the period of the Great Depression after
-- through the war, these things were largely
overlaid. They didn't have this root system that
was built up of tax structures that is prevalent
in the United States today that every cubby hole
of need has been addressed by consumption-based
taxes in most jurisdictions, and to simply overlay
a national VAT to say, we're going to do 22
percent, which would be a replacement level that
I've seen, without any regards to the state and
local taxes at all, and somehow we're going to
compensate the state and local governments and we're going to pass back to them some revenues equivalent to what they currently raise, any of you who've ever dealt with a county clerk, let me just promise you that your promise to them of, oh, we'll take care of you, is not going to carry much weight in this country anywhere.

So, if you don't believe that there's a huge complexity here, let me just reinforce in your mind, there is a staggering level of complexity, not just in tax policy, but in public policy considerations relative to how we pay for what we get.

MR. BRUNORI: I'm curious. Peter and Diann, would you agree with that assessment? Because we're trying to learn something, the states may be able to learn something from the international community, 160 countries use it --

MR. BARNES: I teach a semester-long VAT class at Duke University. I love the VAT. I think it's fabulous. I've studied all sorts of places, Canada is the quickest example where they
1 overlaid and still respected the provincial taxes.
2 I think it's fabulous. I think in my lifetime I
3 will never, ever, ever see a U.S. VAT.
4
5 MS. SMITH: Yeah, and I think, you know,
6 we've got the two options. One is to overlay the
7 VAT on the existing sales tax and keep the sales
8 tax as it is, which would be sort of an instant
9 incredible increase in consumption taxes for
10 people, and then secondly we have the replacement
11 where the federal government steps in and then
12 gives it back to the states. The states, I think,
13 have a legitimate question as to whether, over the
14 long-term, the government would continue to give
15 them back at the same level to actually replace
16 any type of sales tax. So, I do think it's really
17 problematic.
18
19 MR. SULLIVAN: I think they're having
20 this debate right now in India.
21
22 MR. BARNES: Well, they are in India and
23 Malaysia is the better example.
24
25 MR. SULLIVAN: And it's called tax
26 reform. It's about upsetting those county clerks
and making them not do what they want, but do
what's better for the taxpaying public.

MR. BARNES: India is doing it across
the 29 states and Malaysia is doing exactly what
Joe described, Malaysia is implementing a VAT and
wiping out a whole host of smaller taxes -- the
alligator tax and all the rest. So, if you want a
microcosm, it will be interesting to see how
Malaysia does. I'm optimistic. I think it's a
huge positive for Malaysia to get rid of a lot of
the alligator taxes and put in a national VAT.

MR. BERGIN: And the comment before
Peter came from Marty Sullivan, a tax analyst.

Okay, we'll move on. I'm officially
scared of the metric system too. So, let's turn
to tax competition -- we're running out of time a
little bit here. The OECD is drafting a report on
that subject, but we also know that the states
have, for years, engaged in the race to the bottom
with respect to tax credits and incentives.

Anyone who is a dedicated reader of Mr. Brunori,
and I am one, knows he just loves credits. So,
this really should have been your question. But it's really for the whole panel. Can anything be done to address harmful tax competition?

MR. BARNES: Let me ask whether we all agree on what's harmful tax competition. We may know it when we see it, but let me take Singapore as an example. Many of you have probably been to Singapore. It's a very interesting, terrific country. They have made a policy decision. They have said, I'm not concerned about raising corporate income tax if you bring in 100 very smart, very highly paid people who will buy things and will pay personal income tax. So, I will have a 17 percent stated rate. You can negotiate with me for a lower rate, and that's fine because my policy decision, my considered, thoughtful policy decision is that I benefit as a jurisdiction from you bringing in 100 smart people who get high wages and build my economy.

Is Singapore engaged in harmful tax competition or has Singapore made a sovereign decision that it properly can make, may win, may
lose, but has made a sovereign decision that's sensible and appropriate.

So, I know incentives drive us nuts at the state level, they drive us nuts at the international level, but I'm not sure we know what we mean when we say harmful tax competition because I think Singapore has made a sovereign decision that ought to be respected.

MS. SMITH: Yeah, and I would say that, you know, the concept of tax incentives should just play into the overall environment that states have. Not all states have beautiful beaches, warm weather, nice skiing, and so you're not going to tell Colorado you can't advertise your skiing the same way I should allow states to say, we're going to choose how our economic environment is going to be used. It's just part of the pot.

MS. WEINER: Thank you again for inviting me to comment here. Again, back in the 1990s I worked on the first round of the OECD's harmful tax competition project and we had extended debates about, you know, what is harmful
tax competition and when the report came out with that title, it was completely blasted for saying, what do you mean, tax competition is good. How can it be harmful?

And I think we realized that after the negotiations and talking about the kind of stuff, you know it when you see it, what we saw as being harmful was not that countries would have lower tax rates or give incentives and do things that were designed to encourage companies to hire people and to build factories. We saw harmful as being, okay, we'll give a tax break in secret. You come in and talk to the tax authorities and we'll give you a deal and we won't tell anyone else about it.

Or, for example, they had something called ring fencing, in other words, to name names, Ireland had areas that said, if you come from outside of our area into here, we'll give you a tax break, but if you're a local company, you won't get it. So, that was deliberately trying to attract tax base from out of the country inside
it.

So, the harmful nature of it was not that incentives were offered. In fact, the OECD did a very good job at this point in getting rid of those secret deals and getting rid of that ring fencing and saying, okay, go ahead, give your tax breaks, but make them available to everyone. Don't try to steal the tax base. So, that's the idea there.

MR. BRUNORI: Well, and I would comment those of you who have archives of state tax notes, an article, which you can get online, by the way, an article that Harley Duncan wrote, which he may not even remember writing, it was about 22 years ago or so, called "The Good, the Bad, and the Ugly: Talking about Tax Incentives", and he said tax competition is a good thing and tax incentives, broadly speaking, if you're going to compete on taxes, that's a good thing. Industry-specific tax incentives were a bad thing and company-specific tax incentives were pretty ugly in the big scheme of things.
And so I think it depends on what kind of tax incentives you're looking at and what kind of -- you know, really what the base of that competition is. Anyway, if you get a chance you should read that article. It is one of the best things we published and it was a long time ago, it's still one of the best things we published.

MR. BERGIN: And we'll put it up when we get home on taxanalysts.com so everybody can get it.

MR. BRUNORI: It's really a terrific article.

MR. BERGIN: Okay, so just click on the website and it'll be right there.

MR. BRUNORI: Do we have time for a few more questions?

MR. BERGIN: I think we've got time for two if we're --

MR. BRUNORI: Another Twitter question or maybe it was from Facebook, "Would it be possible for a state to institute a state-level VAT to replace its own state sales tax rather than
thinking about a federal VAT?" I'll ask Peter, Joe, and Diann can chime in.

MR. BARNES: I think -- the answer is absolutely yes. I think it would be extremely challenging because the supply chain doesn't really think about state borders, our other tax rules don't require you to think about state borders. So, sure, you could do it, but all the headaches that Joe says would exist on a national level would be magnified if you did it at a state level.

MR. HUDDLESTON: Yeah, I think the states certainly have the capability to look closely at VATs. I think there's a handful of states who have, in fact, done those kind of things -- New Hampshire, Michigan in kind of a strange way has spent some time with a VAT structure, there are other states that have looked closely at other types of VAT structures to replace either their corporate income tax structure or in some cases their consumption taxes. So, it's something states certainly can
look at and I would say to you a number of states over the last 15 or 20 years have looked fairly closely at VAT structures, only a couple have chosen to go down that road.

MS. SMITH: And Joe, am I right, that the states that have used sort of a modified VAT or have even looked at the concept of a VAT, it's usually as a corporate income tax replacement rather than a sales tax replacement?

MR. HUDDLESTON: That's my understanding.

MS. SMITH: Which I think is a kind of interesting -- not sure why that's the direction it's gone.

MR. DUNCAN: Where the states have done it, they've done it at the entity-level, the New Hampshire Business Enterprise Tax and Michigan Single Business. Trying to do a transactional tax and get the money in the right place is really difficult among state -- with 50 states, but just to -- I would keep my eye on Puerto Rico. First of all, they're trying -- they're going through
some tax reform or lots of discussion in looking
at consumption taxes, but they're also making some
changes to their sales tax that have some VAT
characteristics such as collecting tax on the
import, collecting at each stage, crediting it
back, not working with the bases much, but at
least using the VAT transactional tax
characteristics to improve compliance with their
sales tax.

MR. BARNES: They kind of like the
pyramiding structure, don't they?

MR. DUNCAN: Well, but there's an
opportunity to recapture some of the tax that you
pay on the inputs, but it's based on the sales tax
base, not a VAT base, so it's just kind of a --
you know, it's a hybrid of hybrids probably is what
it amounts to.

MR. BERGIN: Anybody have any more
questions? I'm very sensitive to peoples' time.
I know you're all busy. So, we're going to -- we
almost got through all our questions, but we'll
end it now. First of all, thank you to the TA
staff that put this together and thank you to all
the TA folks who are here or who are watching.
The best part of my job is I work with the best
people in the world.

This has been a fantastic group,
including the audience. I want to thank
especially our panelists. This was a fascinating
discussion. I appreciate you all for coming. And
I hope you have a good day.

(Applause)

(Whereupon, at 10:57 a.m., the
PROCEEDINGS were adjourned.)

* * * * *

10
11
12
13
14
15
16
17
18
19
20
21
22
CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

I, Carleton J. Anderson, III, notary public in and for the District of Columbia, do hereby certify that the forgoing PROCEEDING was duly recorded and thereafter reduced to print under my direction; that the witnesses were sworn to tell the truth under penalty of perjury; that said transcript is a true record of the testimony given by witnesses; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this proceeding was called; and, furthermore, that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

(Signature and Seal on File)

-----------------------------------
Notary Public, in and for the District of Columbia

My Commission Expires: March 31, 2017