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Voluntary disclosures: Coming forward at *your* pace without stumbling on states' info sharing

So you've discovered your company has triggered nexus in another state and a voluntary disclosure is in order. But what happens with the tax history you divulge to that state? Will it become subject to an information-sharing agreement and be distributed to other states? Will a member of a multistate compact necessarily share with other members?

Diane Yetter, of Yetter Consulting Inc. in Chicago, expresses concern about participating in a voluntary compliance hosted by a multistate alliance such as the Multistate Tax Commission. The MTC promises that a taxpayer's information remains confidential. But with all the information-sharing agreements between states nowadays, Yetter sees a clear risk.

"Your information is in the database," she says. "Any member state can get in that database."

Instead, Yetter proposes going forward directly with the state in question under its voluntary disclosure program. Most states approached directly will keep the entire proceeding confidential.

"That has never been a fear that I've had," she adds. "I've never had an experience to lead me to believe that is a risk."

A decade past, Yetter had seen some information sharing between the city of Chicago and the state of Illinois. But in recent times, Yetter has represented, for instance, clients who came forward in a voluntary disclosure to the state first, and then the city of Chicago the following year. The city was unaware of the taxpayers' nexus-creating activities. So the state obviously wasn't passing out taxpayer information.

Besides, states have it in their interest to remain mum. "If they get the reputation of not keeping information confidential, they're not going to get people coming forward for voluntary disclosures," Yetter observes.

Remember, in states with state-administered local taxes, the state will proceed in calculating your local liabilities, also. "Think of it as a component of the sales tax rate," says Yetter. "It's part and parcel of what you're disclosing to the state."

Forming your approach

States vary in the amount of confidentiality extended during the disclosure process as well as the type of form used for disclosure. Some, like Illinois, use a one-page form in which the taxpayer must disclose identity in the first stage. Others use a form that can be customized. Take full advantage of the customization feature if you are worried the state might pass on your information. Create a provision that precludes that state from sharing your tax data, Yetter says.

Brian Ertmer, a partner in multistate tax services with Deloitte & Touche in Milwaukee, agrees. He insists on a statement in the voluntary disclosure agreement that prohibits sharing with other

states. This works because some states have statutes authorizing information sharing but not necessarily mandating it.

"A lot of it comes down to the agreement the state has-whether it is automatic or not," he says. "You don't want an inquiry in another state to be triggered automatically, before you have a chance to seek voluntary disclosure in that state."

In fact, Wisconsin has historically been less concerned with sharing information than with fielding auditors to go after Wisconsin liabilities, though that is changing with budget constraints, Ertmer notes. Specifically, during October 2002, Wisconsin officially executed a contract with the MTC and joined their audit program.

Nonetheless, a possible scenario that could be troublesome for taxpayers would be where a canned software provider, for instance, typically situated on either the East Coast or West Coast, would enter into a disclosure, he adds. Perhaps the software provider spends small amounts of time with customers in various states installing software but may not register in some of those states. States might target such a disclosure for sharing.

Timing a disclosure

Practitioner's tip: Yetter encourages the savvy sales tax manager to monitor states' amnesty programs. Some states suspend their disclosure programs during an amnesty. Weigh the benefits of both voluntary disclosure and the amnesty. Yetter recalls an instance where she advised a client to wait until after an amnesty to come forward. Though the interest was waived in part during the amnesty, there was no limitation to the lookback period. The client owed less money in the voluntary disclosure since that lookback period was limited to three years.

In another instance, a client was in negotiations for a voluntary disclosure. In the meantime, an amnesty began in that state. The state allowed the taxpayer to choose whether to proceed with disclosure or to participate in amnesty.

"You always want to be aware of when amnesties occur," Yetter notes. "States begin very aggressive searches after an amnesty."

Likely, penalties will then be harsher for those taxpayers the state happens to find on its own. Usually states that recently conducted amnesty will ramp up nexus questionnaires and nexus audit activities. Nonetheless, a voluntary disclosure after amnesty may be well timed.

"States are anxious to get as many taxpayers registered as possible," Yetter adds. "They'd rather get someone registered and paying on a go-forward basis than get a little bit of past-due (sales tax)."

This windfall annuity is a less expensive process than hiring auditors for the difficult task of hunting for past-due revenue from taxpayers with typically no physical presence, only the presence of traveling salesmen, Yetter says. She rarely is called upon to administer a voluntary disclosure for a taxpayer in its home state.

Agreements trumped

H. Beau Baez, counsel for the MTC, says that some 300 to 400 taxpayers per year disclose through the MTC's voluntary disclosure agreement. Such taxpayers "won't be flagged," but, nonetheless, whatever statutes a state may have in place regarding a sharing agreement with other states remain effective.

"The thing to keep in mind is that states that have sharing agreements—that trumps the MTC (disclosure agreement)," Baez warns.

For instance, sharing agreements triggered by a certain dollar amount will still be in force in the instance of an MTC disclosure.

While the normal sharing mechanisms remain effective, no special efforts are taken to make the taxpayer stand out among member states, Baez notes. If, however, a state gets a valid request from another state concerning a mutual sharing agreement, information must be turned over.

"State A won't call up State B and say, 'Hey, I've got this great taxpayer...'" Baez says

But beware of puffy promises known legally as *ultra vires*, meaning "beyond powers." A state cannot carry out promises that exceed the limitations of state statutes. While private confidentiality agreements in business may bear broad parameters, confidentiality agreements in the public sector are limited by the statutes in effect at that time, Baez notes.

"The government can only do what it is told to do through the statutes," he adds.

Commonly used clause

Nonetheless, the MTC's agreement provides a confidentiality provision. Baez says many states have copied the clause. It reads as follows:

The making of this Agreement and its terms shall not be disclosed by the parties, however the Signatory State may make disclosures that are in compliance with the applicable confidentiality laws of the Signatory State. The Multistate Tax Commission and the Signatory State shall not reveal the identity of Anonymous YY-NN as a voluntary disclosure or the terms of the Agreement to a non-signatory state, except in routine reports in which Anonymous YY-NN is not identified as being a party to this Agreement.

The main concern of most taxpayers is that they will be targeted in another state, Baez says.

"I think most companies are willing to take their chances in the 'audit lottery,'" he adds. "They just don't want their odds increased."

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