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Tax Policy

Criss-crossing the country, Crowell & Moring's state tax team meets regularly with state tax commissioners and their counsel to bring Bloomberg BNA's readers candid and timely observations from the country's top state tax decision-makers. Well into this 50-state journey, Walt Nagel, Don Griswold, and Jeremy Abrams spoke this month with R. Bruce Johnson, Outgoing Chair of the Utah State Tax Commission. In this column, Johnson discusses computing tax based on SEC-reported net income, the MTC's various uniformity projects, and ethics in the practice of tax law, among other topics. Johnson served 16 years on the Commission and four years as its Chair. With his final term recently expiring, Johnson is contemplating what his next chapter will be.

Crowell's Conversations: R. Bruce Johnson, Outgoing Chair of the Utah State Tax Commission



R. BRUCE JOHNSON, INTERVIEWED BY WALT NAGEL,
DON GRISWOLD, AND JEREMY ABRAMS

Background and Career

CROWELL: It's great to see you again, Bruce. How did you come to have a career in tax law and then ultimately with the Tax Commission?

JOHNSON: Somewhat accidentally. I had always planned on going into business. I majored in accounting, thinking that would be a good way to get an overview of the business world. I was working my way through college for some CPAs and, although I enjoyed it, I did enough auditing to know that I wanted to get into tax instead. Some of the tax accountants I talked to suggested that a law degree would give me some additional flexibility in doing tax work. So I took the LSAT, almost on a whim.

I graduated from Brigham Young University Law School in its second year of existence. The Dean of the Law School at that time was Rex Lee who later became Solicitor General of the United States. He took a leave of absence while I was at the school to be Assistant Attorney General of the Civil Division. He was anxious to get some people from BYU hired throughout the Justice Department and encouraged me to apply to the Tax Division. I was able to join the appellate section of the tax division and got a litigation background to go along with some substantive tax experience. When I went into private practice — the tax lawyers didn't like to do litigation, litigators didn't like to do tax, so tax litigation was a natural fit for me, and most of that was in the state and local area. I ended up practicing state and local tax for 17 years. Then one of my clients called and said "we know we couldn't pry you out of a law firm but our senator has asked us for some recommendations for the tax position." At that point my 401(k) was a little better than it has been subsequently. So I looked at the Tax Commission and I thought I could bring some tax expertise to it. I thought about it for a couple of days — I think I got the request on Monday and by Wednesday I was talking to the Governor's staff, and the rest is history.

When I went into private practice — the tax lawyers didn't like to do litigation, litigators didn't like to do tax, so tax litigation was a natural fit for me, and most of that was in the state and local area.

CROWELL: Utah's legislature and executive branch are both controlled by Republicans. Has this meant that your state has enjoyed relative political harmony on tax issues?

JOHNSON: Well, in the tax area it has worked out well. But even the Democrats in Utah are business friendly — it's in our DNA. We have a lot of small businesses and a lot of entrepreneurs in the state. There are certainly differences — for example, there is a lot of discussion about whether some individual exemptions or incentives go too far — but everybody recognizes that you don't want to kill the goose that lays the golden egg. So there has been a lot of bipartisan consensus about good tax policy and I don't think we have the kind of knock-down drag out conflicts that a lot of states probably have.

A Nonpartisan Commission

CROWELL: What are your thoughts on the recent resolution to eliminate the constitutional requirement that no more than two members of the Commission be from the same political party?

JOHNSON: The tax commission was created back in the 1930s at a time when there was a lot of civil service reform going on and a lot of concern about political overreaching. So, the tax commission was created with four members, which is tailor made for deadlock! And the constitutional provision said that you can't have

more than two commissioners from any single party and that's worked fine.

But the general perception now and I think it's correct — certainly it has been my experience in the last 16 years under four different governors — is that there is not undue political influence. So the people that support that resolution just think the position ought to be non-partisan, like our judges. And I agree with that. The people who oppose the resolution are afraid that the commission might become a refuge for political appointees that are not fully qualified. That would be a tragedy. In short, there are very good arguments to be made on both sides of the issue. I will note that the proponents of the amendment have also tried to strengthen the required qualifications for Commissioners to address the latter concern.

Computing Tax Based on SEC-Reported Net Income

CROWELL: What do you think of the idea of computing tax based on SEC-reported net income instead of the Federal 1120?

JOHNSON: I like the idea. I analogize it to property tax valuation and insurance. People make all kinds of arguments that their property tax valuation is too high for purposes of their property tax assessment. But when it comes time to deal with insurance coverage, they argue that the very same property is worth much more. I understand why they do that, but something about it seems wrong. Property value ought to be property value, and net income ought to be net income. So in theory I think it would be great to tie income to SEC-reporting. Some adjustments, of course, might be necessary. In general, however, if a company is telling its investors and lenders that its profitable, it should be paying some tax. The financial reporting will temper tax pessimism and the income tax burden will temper irrational exuberance in reporting earnings.

So in theory I think it would be great to tie income to SEC-reporting.

CROWELL: Speaking of property tax, what is the Commission's role in property tax administration and appeals in Utah?

JOHNSON: The Commission has a Property Tax Division that provides the initial assessments of "centrally assessed" taxpayers, primarily transportation companies, utilities and natural resources companies. If those companies believe they are overvalued, they can appeal the valuation directly to the Tax Commission. Because most of the property tax goes to local entities, however, Counties can and do often intervene in those proceedings on behalf of the affected local entities. They can also initiate their own appeals before the Commission if they believe a centrally-assessed taxpayer has been underassessed. The Commission also hears appeals from locally-assessed values and acts as the State Board of Equalization. If a Utah homeowner, for example, thinks her home is overvalued by the County Board, she can have a hearing before the Utah Tax Commission. We also do a lot of education, training and supervision of our elected County Assessors and their personnel.

CROWELL: What was the impetus behind recent legislation requiring local assessors to consider “diminished productive value” in determining fair market value?

JOHNSON: Our position before the legislature, and the position of the County Assessors, was that diminished productive value was already being considered. Presumably, at least one constituent didn’t think the assessor had adequately accounted for that. No one opposed the legislation, however, because we all agreed that it should be taken into account and additional clarification in the statute is certainly not harmful.

Strong Proponent of the MTC

CROWELL: Why have you been such a strong proponent of the MTC?

JOHNSON: I spent 17 years in private law practice representing a lot of multistate companies. There are many differences among the states that make it very hard to do business. Some of those differences represent valid policy decisions by state legislatures. Some of them, however, are just historical accidents. I think our economy, our taxpayers and our states will ultimately be better off if we can reduce unnecessary complexity. More uniformity among the states will help us achieve that goal. The MTC’s uniformity projects are well thought out, with a lot of business input. I wish more of them would be adopted. Secondly, from Utah’s point of view, we can leverage our audit resources. We simply don’t have the resources to effectively audit a lot of large, complex, multistate companies. By participating in MTC audits, we help ensure that those taxpayers are paying their fair share of Utah’s tax burden. So I believe the MTC is very valuable, both from a tax structure and a tax compliance point of view.

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CROWELL: Is the modified Compact that excludes the election and apportionment provisions consistent with the idea of uniformity?

JOHNSON: I think the best state income tax structure would be the one originally envisioned by the drafters of the Multistate Tax Compact. There should be an equally weighted three-factor formula available to every multistate business. If a state wanted to adopt an alternative formula (such as a super-weighted sales factor) that it viewed as more likely to promote economic development, it could. (Keep in mind that much of the push for heavily weighted sales factors comes from in-state taxpayers, or taxpayers who will promise to come to a state.) A multistate business could avail itself of the alternative, if it wanted to, but could continue to use the three-factor formula if it chose. That structure allowed state legislatures great leeway in taxing local business, without unduly shifting the tax burden to multistate businesses — and that was, in my view, what the drafters originally contemplated. Unfortunately, most states felt they couldn’t afford to lower the burden on local taxpayers without getting more revenue from multistate businesses — so very few states ever allowed an election. (The MTC, has repeatedly and consistently main-

tained that states are free to allow or preclude an election as each state sees fit, without affecting their membership in the Compact.) As states have moved to different formulas, uniformity has suffered. Having said that, however, the MTC still fosters a lot of uniformity. For most taxpayers, in MTC states, the factors are computed the same way. Multiplying the sales factor by two or eliminating the payroll and property factors has a significant effect on total tax burden, but it is not a complex calculation. The major exception, of course, is the sales factor for intangible property and services. It certainly adds to complexity when some states use “market based sourcing” and other states use “cost of performance.” In my view, the “costs of performance” method is an anachronism and I support the MTC’s proposal to move to market sourcing. I hope the states will all move in that direction. Finally, the MTC propounds model uniform rules for special types of property. To the extent those are followed by states, uniformity is enhanced.

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CROWELL: Has Utah seen any *Gillette*-style refund claims based on the Compact apportionment election?

JOHNSON: Because the Commissioners hear appeals from audit assessments and denials of refund claims, we avoid *ex parte* communications with our Auditing Division or our Taxpayer Services Division on issues that are likely to come before us. Accordingly, I have no direct knowledge of any claims. My understanding, however, is that some claims are working their way through the system. Because Utah’s allowance of a single-sales factor is quite recent, I think our overall exposure is relatively small.

CROWELL: What are your views on the proper application of alternative apportionment?

JOHNSON: Neither states nor taxpayers should jump to alternative apportionment when the real solution lies with the legislature. We had a company come in — they were a single sales factor company as I recall and they wanted to use a three-factor formula. The Utah statute, however, divides taxpayers into two groups, based on their NAICS code. One group is required to use single-factor apportionment. The other group may elect it, or may use a three-factor formula. This company argued that the legislature put them in the wrong group, and that a three factor formula would more fairly reflect their business activity in the state. We said, “Look, the legislature made this determination on a NAICS code basis. You weren’t worried about your classification at the time. Now your corporate structure has changed, and you wish you’d been treated differently. That is a legislative matter and we think you ought to go to the legislature and get it changed. We will be happy to tell the legislature that there is no policy reason why you shouldn’t get the treatment you request.” So even though a pretty decent argument can be made that the

three factor formula is a fair representation of business activity in the state, we have to give some effect to the legislative determination to impose a single sales factor formula.

So I would say the burden ought to be pretty high before you can get an alternative apportionment methodology. We need to give a lot of deference to the statutorily preferred formula. Furthermore, the burden ought to be the same on the tax agency that it is on the taxpayer. In its proposed rewrite of UDITPA, the MTC suggests some good language on that point based on Professor Pomp's recommendations. To me, there has to be a burden and it can't be a situation where the tax collector just comes in and says "I've got a better way to apportion your income that's going to get my state more revenue." I'm not smart enough to figure out what every taxpayer ought to pay. I want to be able to rely on the statute and if I think a group of taxpayers are getting away with something just because of some classification, my response ought to be to go to the legislature and say, "Look, this is a group of taxpayers for whom you need to consider changing this formula." If there are individual structuring issues or ad hoc issues that need to be dealt with on audit, I think that it is appropriate. Taxpayers ought to feel free to petition for an alternative method based on individual circumstances. But they ought to be real exceptions.

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CROWELL: Why should businesses come to Utah and what types of incentives are out there?

JOHNSON: We work closely with the Governor's Office of Economic Development but we also follow the statute. If we think somebody doesn't qualify for a particular incentive, we say, "look, if you want that company to come in and get that incentive, you need to change the incentive. You need to go to the legislature and change the terms." And GOED appreciates that. They also have the ability on some incentives to structure them as a more contractual matter and in those situations we've said, "To the extent the legislature's allowed GOED to do that, you do what you want and you give us a certificate that the taxpayer qualifies for that credit and we will honor that. But they have never tried to twist our arms to get something to qualify for a credit that doesn't qualify under the existing statutes. Having said all that, I don't know that our tax incentives are unusually generous. I don't think they're out of line with what other states do. I would encourage businesses to consider the overall philosophy of the state; consider the educated workforce; consider the fact that we are committed to being business friendly and have been for a long time – as I said before, it's kind of in our DNA. Here are some statistics: Utah was ranked number 1 in small business friendliness by a Thumbtack Kaufman Foundation study; number 1 in economic dynamism in the Information Technology Innovation Foundation study; top ten in almost every category in the U.S. Chamber's Most Enterprising States report; number 1

for economic outlook and number 2 for economic performance in ALEC's Rich States, Poor States Report; number 3 in best state for business and careers, Forbes Magazine; number 1 in the Pollina's list of Corporate Top Ten Business States; number 5 in CNBC's poll of America's top states for business; and I just saw a report by the Anderson Economic Group dated July 29, 2014, which says Utah has the fourth lowest business tax burden in the country.¹

CROWELL: Well, Bruce it's good to hear that because a lot of times—and we won't mention any names—but a lot of times you have states that provide large economic incentives and advertise themselves as being very business friendly but at the same time, the tax administration is very anti-business. So you end up seeing this schizophrenic approach, where it's "come set up shop here" and "we'd love you here," but the Department of Revenue is just squeezing every dollar that they can out of them once they get there.

JOHNSON: I agree and I think that's something that businesses need to be aware of because it can be a bait and switch type approach. You can get a nice fat incentive that applies in 2008 but if the economy goes south in 2010 and the incentives go away, you have to ask yourself — what is the state's real view on how they ought to treat businesses? What are their regulatory views in good times and in bad times?

I can't tell you how many times I went up to the legislature when we were in a severe budget situation. (Fortunately it wasn't as severe as most states.) What I heard from the legislature and especially the Governor was "businesses are struggling just as much as we are. We've got to get our own house in order. We can't dump our problems on the business community, they're hurting too. So let's share the pain." That's the philosophy of our policy makers.

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Changing Landscape of Tax Ethics

CROWELL: How has the professional ethos of tax practitioners changed since you first started your tenure?

JOHNSON: I'll give you a story on that. One of my former partners, a very well-respected estate planner, said when he began his practice in the '70s he'd go to na-

¹ Utah Accolades — National Rankings, available at <http://business.utah.gov/pdf/Accolades%20Report.pdf>; 2014 State Business Tax Burden Rankings, Anderson Economic Group Annual Report, available at <http://www.andersoneconomicgroup.com/LinkClick.aspx?fileticket=iKUlGCH87d8%3D&tabid=181>.

tional estate planning seminars and the well-respected lawyers were talking about how to keep their clients out of the clutches of promoters that were proposing hare-brained tax planning schemes. (And a lot of the work I did when I was a young lawyer was trying to get people out of those with the least amount of damage.) And he said twenty years later, those same firms were talking about how they could get a piece of the tax-shelter market. I think a lot of the professionals who used to be guardians at the gate were told that “we can’t sell you if you’re a cost to business; we want you to be a profit center.” And that changed the dynamic.

Nobody’s smart enough to draft laws to cover every situation. If you tried to do that then you end up with a situation where a judge is going to say, “well, you solved 99 problems; if you wanted to solve 100, you probably would have.” So, it’s almost counterproductive to try to draft such detailed statutes. Government has to be able to rely on the ethics and professionalism of tax professionals. Unfortunately, I think there has been a real shift in that area. I think the dot.com era exacerbated it because people were getting incredible returns without selling any products. Traditional businesses had to compete for capital, and they did it by artificially increasing their after tax revenues. I think there were a lot of things that went into it. A lot of bonuses became tied to those profits and there was a big incentive to shift money from one year to another to give short term benefits for bonuses and stock options and things like that. And I think there has been a decline in what you might call public morality. Now, some of my good friends in the private sector would concede that, but they’ll say that’s kind of gone away – we’ve learned our lesson. And I hope that’s true. But I also wonder if a lot of the aggressive planning has gone away because nobody has been making any money for the last four or five years. If people start getting big profits again, is overly aggressive tax planning going to return?

There are so many good people in the private sector — and most of us agree with Judge Hand that there is

not even a moral obligation to pay more tax than the law requires. But there are also a lot people who are going to come in and say “my brother-in-law said this was just fine and he says I’m being a sap.” Nobody wants to be a sap. So I think the lawyers, the CPAs, the in-house people, we all need to up our game a little bit. Some of the federal changes hopefully will encourage that. But basically you can’t legislate everything. And so I’m very thankful for all of the ethical practitioners and taxpayers we have and I hope that they prevail. And I hope we can work together and make this system fairer for everybody.

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Post-Retirement

CROWELL: Well, Bruce, congratulations on your retirement after 16 years of service to the State of Utah and the taxpayer community. What’s next for you — are you going back into private practice?

JOHNSON: My fourth term has expired and I’m going into greener pastures. I’m just looking to see what presents itself. I enjoyed private practice; I did that for 17 years. But I also enjoyed being involved with public policy and the national issues. So I’m flexible at this point.

CROWELL: Certainly too young to go off into the sunset, right Bruce?

JOHNSON: Well, that’s what my wife says and I’m usually smart enough to agree with her!

