

Step toe

State and Local Taxation: Headline News and Trends

December 18, 2019

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What We Will Cover



Megatrends
(focus on
economic nexus)



**Business
Activity Taxes**



**Transaction
Taxes**



**Miscellaneous
(Tax or Fee)**

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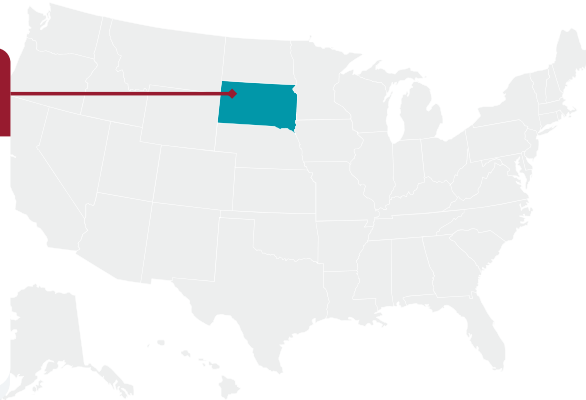
Megatrends and Developments

Economic Nexus



REMINDER #1

In *Wayfair*, South Dakota's sales tax threshold was \$100K or 200 transactions



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REMINDER #2

Balancing test must be satisfied. *Pike v. Bruce Church*, 397 US 137 (1970)



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REMINDER #3

In *Wayfair*, the United States argued that a single sale is enough to create economic nexus – but did not persuade the S. Ct.



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EXAMPLE:

\$100,000

@ 5% rate

\$5,000 in taxes.

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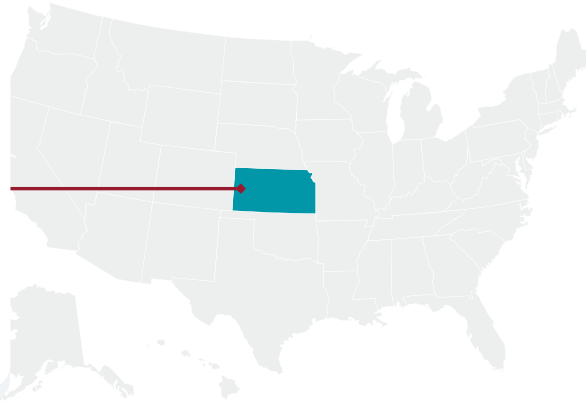
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Kansas Rumble:
Attorney General vs.
Dept. of Revenue



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MTC 2019 White Paper
*“Wayfair Implementation
Marketplace Facilitator”*
(December 2, 2019)



Wayfair Implementation &
Marketplace Facilitator
Work Group
2019 White Paper

MTC UNIFORMITY COMMITTEE
WAYFAIR IMPLEMENTATION AND MARKETPLACE
FACILITATOR WORK GROUP

DECEMBER 2, 2019

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MTC White Paper:
Trend noted—
Transaction thresholds
losing luster



Wayfair Implementation &
Marketplace Facilitator
Work Group
2019 White Paper

MTC UNIFORMITY COMMITTEE
WAYFAIR IMPLEMENTATION AND MARKETPLACE
FACILITATOR WORK GROUP

DECEMBER 2, 2019



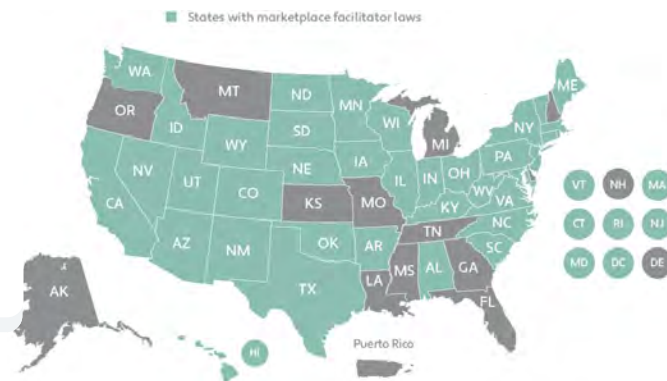
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MTC White Paper:
37 states have
enacted marketplace
facilitator laws



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Tax Foundation Report:
“State Sales Taxes in a
Post-Wayfair Era”
(No. 680, December 2019)



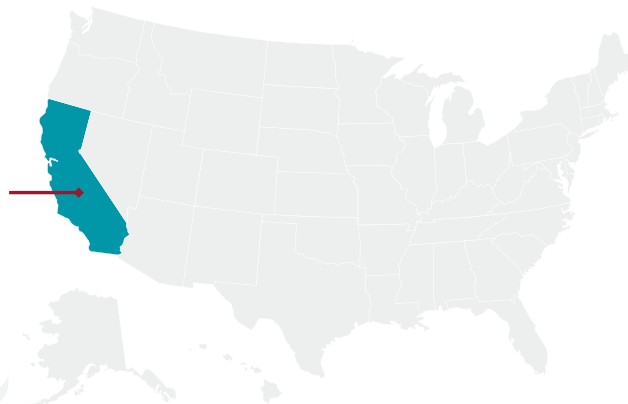
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California.
Application of
Marketplace
Fairness Law
retroactive to
2012



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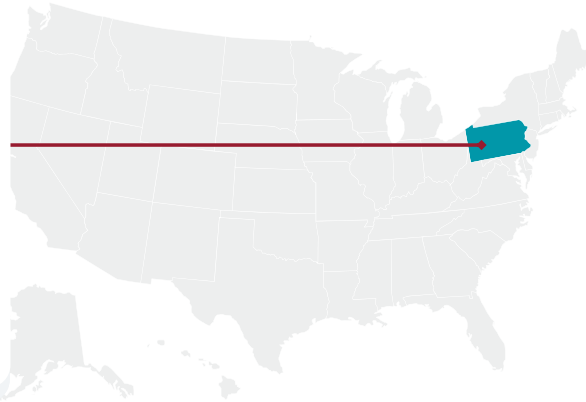
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States shift to income taxes:
Pennsylvania.
(\$500,000 threshold)



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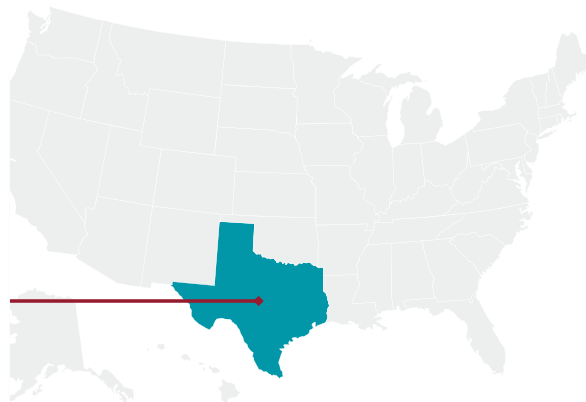
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States shift to income taxes:
Texas -- Proposed regulation 3.586
(\$500,000 threshold)



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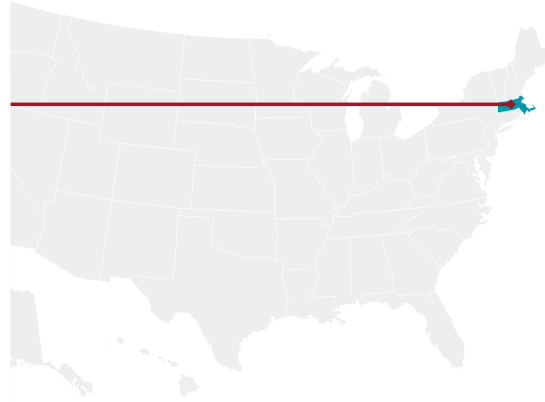
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States shift to income taxes:
Massachusetts (\$500,000, determined on a unitary basis). 830 CMR 63.39.1(3)(d)



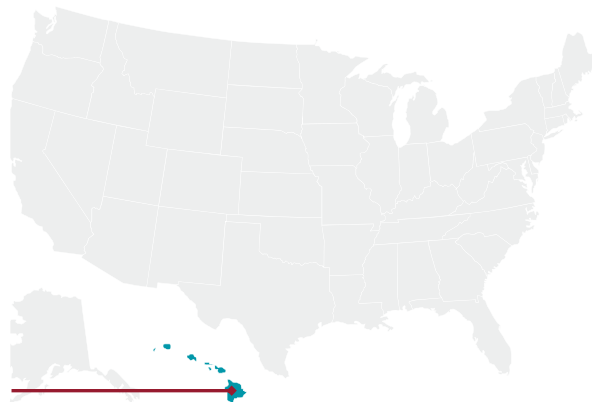
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States shift to income taxes:
Hawaii adopts thresholds of \$100,000 or 200 transactions. S.B. 495



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EXAMPLE:

Remote business has \$10M in sales, and COGS/ payroll/other expenses averaging 80% of sales. So apportionable income is \$2M.



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If the business has in-state sales of \$100K, its apportionment percentage on a three-factor, double-weighted sales, basis is .5%. This yields \$10,000 in taxable income.



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If the state's corporate
income tax rate is 6%,
the tax due is...

\$600.



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Who *really* thinks a
\$100K sales threshold
for corporate income
tax satisfies a
balancing test?



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What might be a
fair threshold for
income tax?



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Using *Wayfair's*
\$5,000 in taxes...



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Taxes must increase
by 833%, as must
taxable income,
apportionable income,
and in-state sales.



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To meet the standard
reviewed in *Wayfair*, in-
state sales must be
\$833,333.



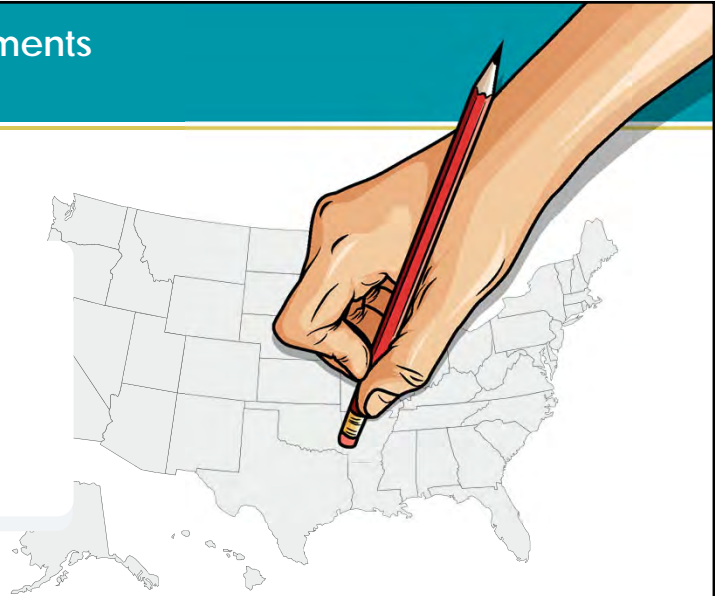
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A related issue:
Nexus
Gerrymandering

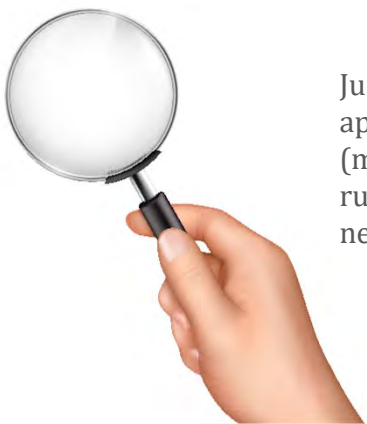


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Jurisdictions use apportionment (market sourcing) rules to evaluate nexus.

- 1 Is there an appropriate connection?
- 2 What about shift to market sourcing?

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From 1957, when UDITPA was issued, and for well over 50 years, all but a few states sourced sales of other than tangible personal property by reference to the seller's costs of performance.

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Economic Nexus



But in the last decade, there has been a dramatic shift to market sourcing for such sales. A near reversal in the method of situsing sales.

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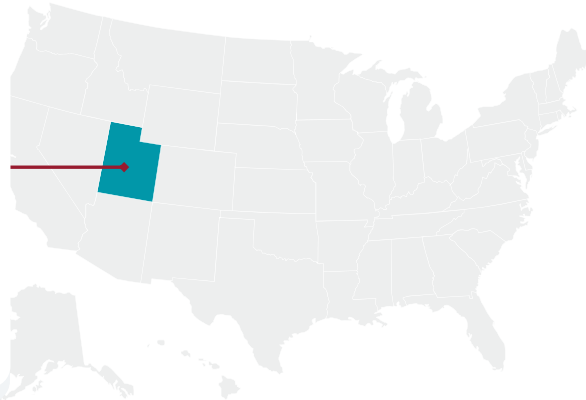
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Utah.

“...sells or performs services in Utah in which the customer receives the greater benefit of the service in Utah”



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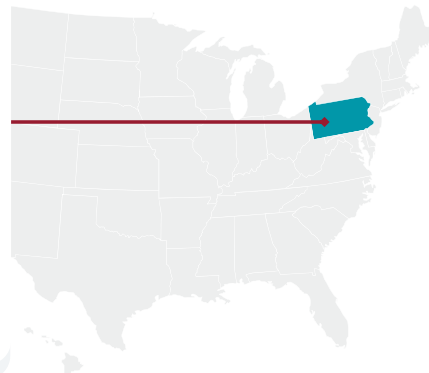
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Philadelphia #1: “Only receipts from business done in Philadelphia, as determined under our sourcing rules, are considered Philadelphia gross receipts....”



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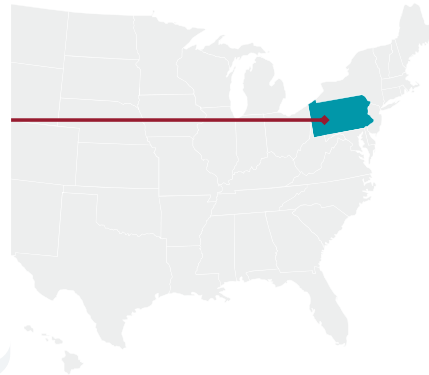
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Philadelphia #2: “Receipts from sales of services are Philadelphia receipts to the extent the service is performed in the City.”



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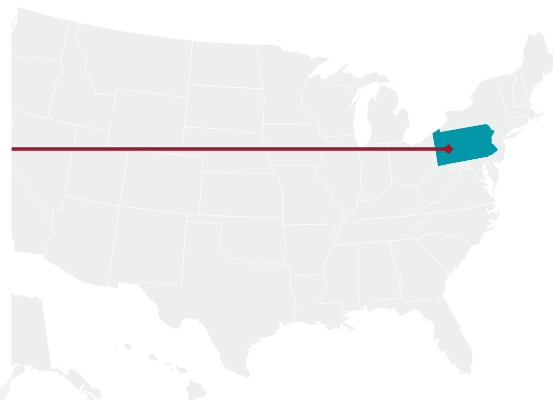
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Pennsylvania:
“Gross receipts from the sale of services”

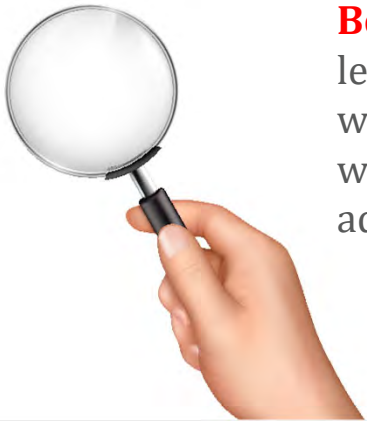


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Be aware: States are redrawing legal lines and asserting nexus where none existed before – and where none would exist under the adoption of economic nexus alone.

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Business Activities Taxes

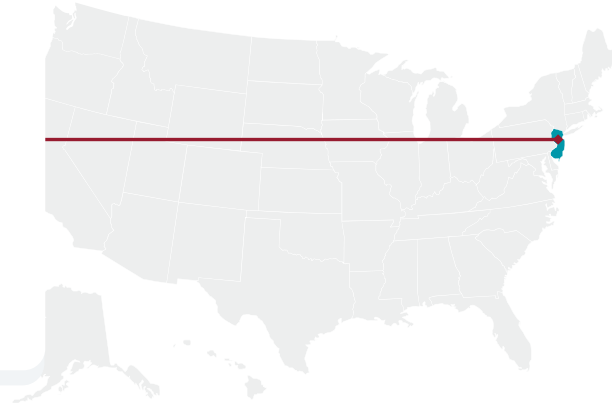
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Business Activities Taxes

Insurance

New Jersey.

Due to 2011 federal law and a mere partial change to New Jersey law, premiums paid to an (unauthorized) captive insurer are not subject to NJ premiums tax. (Tax applies to surplus lines premiums only.)

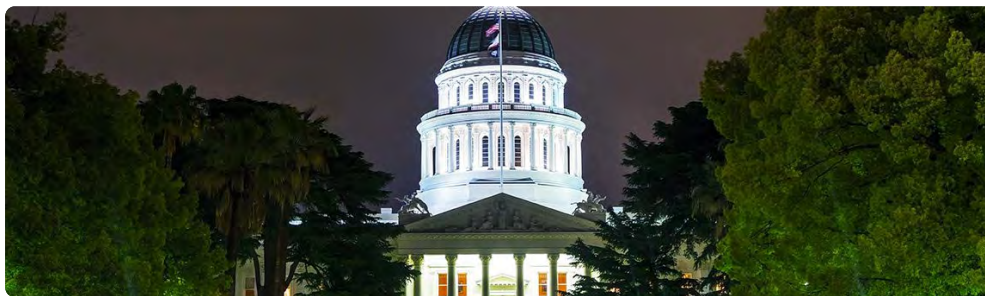


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Business Activities Taxes

Treatment of VAT Payments



California Office of Tax Appeals rules that a business's VAT payments on services may be included in its sales factor denominator

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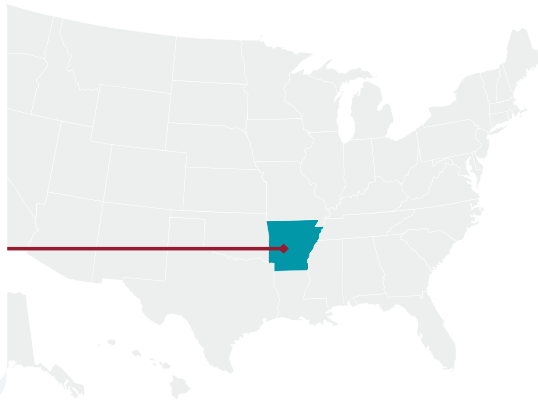
Business Activities Taxes

Interest Deduction



Arkansas.

Taxpayer failed to prove that the loans from its non-nexus affiliates were on arm's length terms. Interest deduction denied.



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Business Activities Taxes

Characterization of Receipts

A screenshot of a "Texas Franchise Tax No Tax Due Information Report" form. The form includes fields for taxpayer number (2015), report year (05/15/2015), and due date (01/01/2015 - 12/31/2015). It also contains checkboxes for "This entity is a passive entity as defined in Chapter 171 of the Texas Tax Code," "This entity's annualized total revenue is below the no tax due threshold," "This entity has zero Texas Gross Receipts," and "This entity is a Real Estate Investment Trust (REIT) that meets the qualifications specified in section 171.0002(c)(4)." The form is titled "Texas Franchise Tax No Tax Due Information Report" and "FILING REQUIREMENTS".

Texas franchise is not an improperly imposed occupation tax because, if it is an occupation tax, then its revenues are being misdirected. (And we all know that is not possible?)

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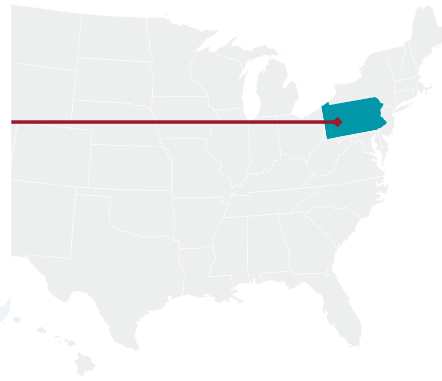
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Business Activities Taxes

Net Operating Losses

Pennsylvania.

Remedy for cap on NOL carryovers held unconstitutional in 2017: Strike the cap as legislative intent was to “promote business investment in (Pa.)” (DOR argued to strike NOL carryovers.)



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Transaction Taxes

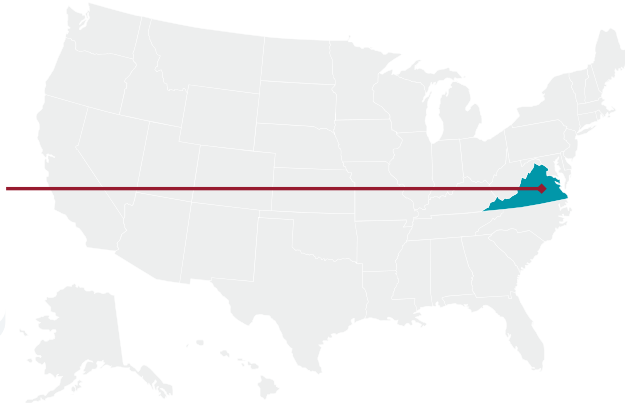
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Transaction Taxes

Insurance

Virginia.

Retaliatory tax assessment abated.
Issue: How to treat fees another state charges its domestic insurance companies?



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Business Activities Taxes

Marketplace Facilitator Liability

South Carolina:
Marketplace facilitator is liable for unpaid sales taxes on the sale of third-party merchants' products via the facilitator's marketplace.



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Business Activities Taxes

Marketplace Facilitator Liability

2019

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On October 22, 2019, the Louisiana Supreme Court heard oral arguments in *Normand v. Wal-Mart.com USA LLC, La.*, No. 2019-C-263

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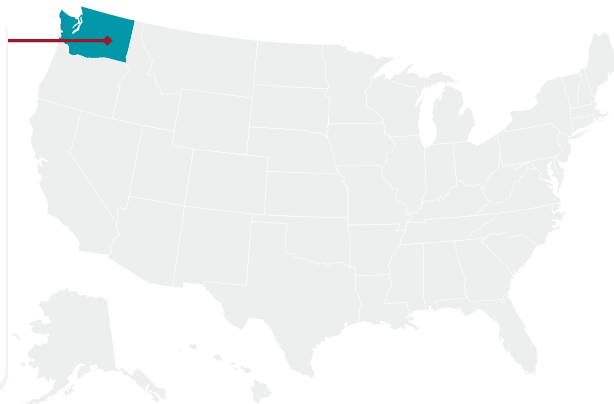
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Transaction Taxes

Characterization of Service

Washington.

Corporation was selling non-insurance coverages. Held: Not subject to B&O tax as insurance. Rather, taxed at higher rate imposed on general services



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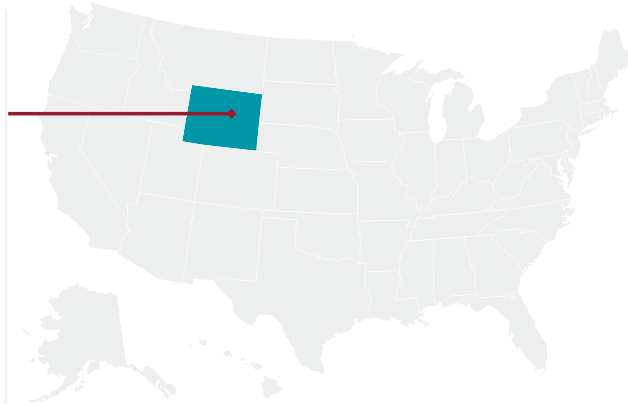
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Transaction Taxes

Sales Tax or Use Tax?

Wyoming.

DOR repeatedly alleged *use* tax liability but then assessed *sales* tax -- on the *use* of services. Taxpayer argued *use* tax, was called out by the BOE for doing so, and lost. And no review of penalties (because?)



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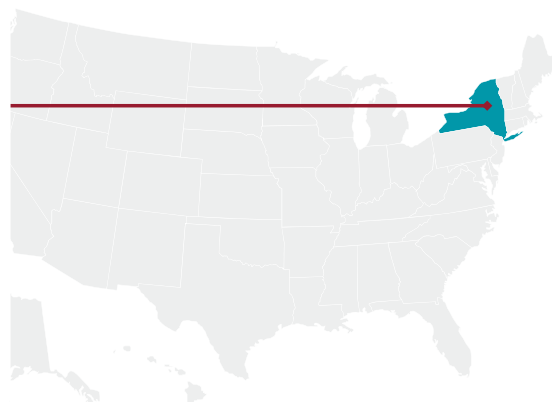
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Transaction Taxes

Taxing Reimbursed Discounts I



New York AG accuses large retailer of defrauding New York State in its treatment of coupons



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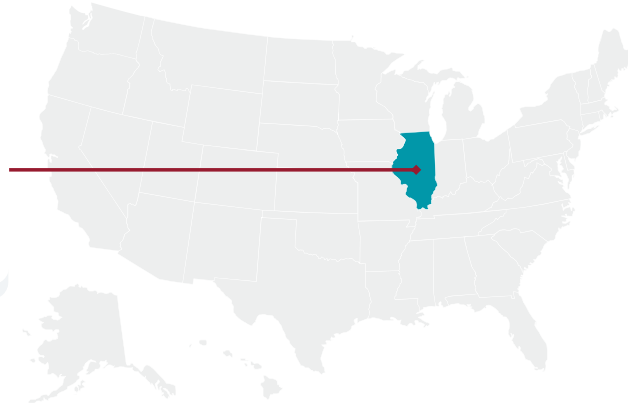
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Transaction Taxes

Taxing Reimbursed Discounts II

Illinois.

Retailer's receipt of manufacturer credits are not taxable.

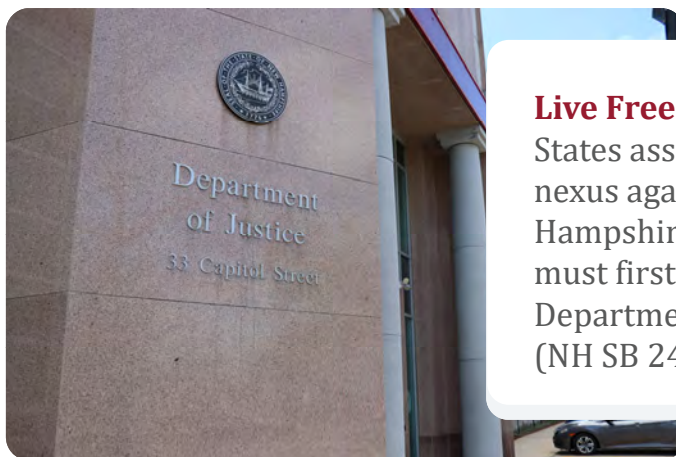


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Transaction Taxes

Economic Nexus



Live Free or Die.

States asserting economic nexus against New Hampshire businesses must first notify the NH Department of Justice. (NH SB 242)

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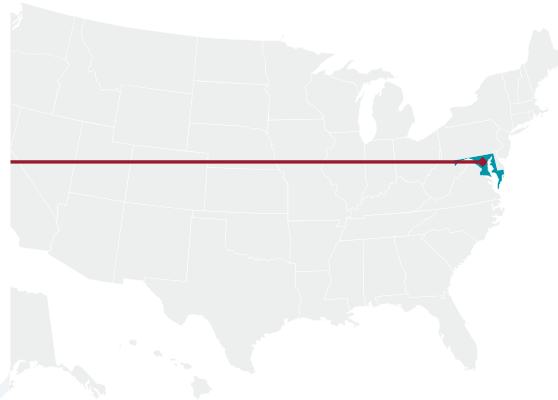
Transaction Taxes

Overpayment Remedies

Maryland.

Court considers successor rights, voluntary payment doctrine, and equitable recoupment. Lessons:

- (i) Do not overpay; and
- (ii) If overpay, file a timely claim for refund.



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Transaction Taxes

Characterization of Service

Texas.

Business held to provide a taxable data processing and information service rather than a nontaxable proprietary information service.



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Transaction Taxes

Manufacturing Exemption

Illinois S. Ct:

Exemption for chemicals causing a “direct and immediate” change on a product being manufactured was not satisfied if additional steps are required to cause a chemical reaction.



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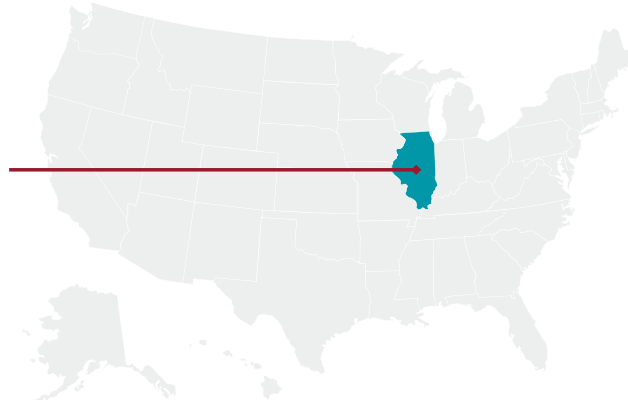
Transaction Taxes

Statute of Limitations



Illinois.

Audit does not toll statute of limitations for when a refund may be claimed.



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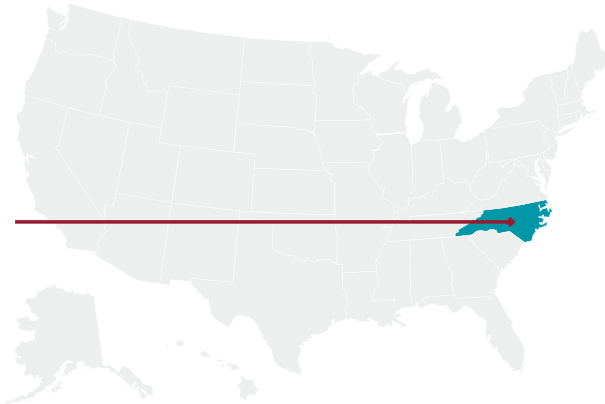
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Transaction Taxes

Digital Goods

North Carolina.

Department of Revenue issues “Important Notice: Certain Digital Property” (October 18, 2019) explaining the taxation of specific items delivered or accessed electronically.



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Miscellaneous

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Miscellaneous

Mobile Workforce



Illinois enacts mobile workforce legislation. For tax years ending on or after 12/31/20, nonresident employees may work in Illinois for up to 30 days without being subject to employer withholding

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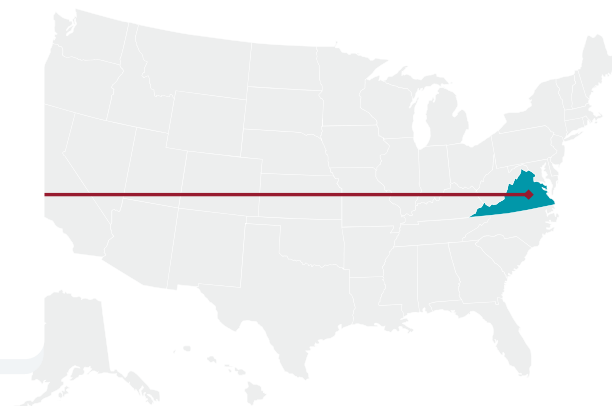
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Miscellaneous

Credits for Other States' Taxes

Virginia.

Wynne does not require granting S corporation shareholders a credit for DC franchise taxes, as the DC tax is not an income tax



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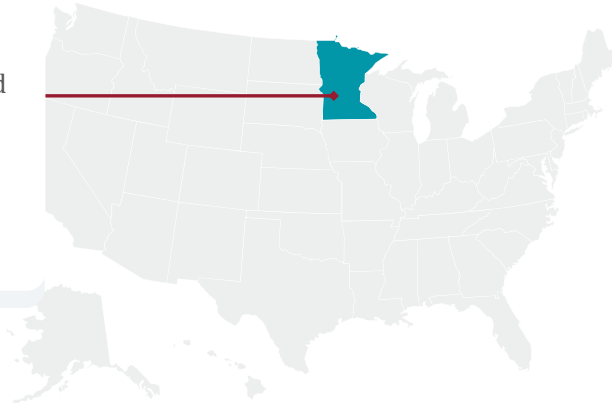
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Miscellaneous

Use Your Brakes #1

Minnesota.

Bond disclosure required due to expected refunds. Prospectus \$661M General Obligation State Bonds at p. 15 (August 6, 2019).



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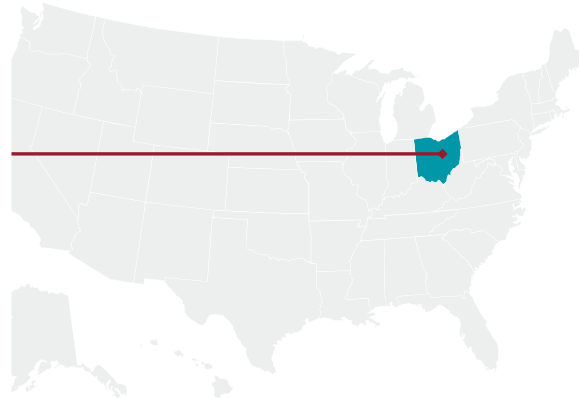
Miscellaneous

Use Your Brakes #2



Ohio.

Village of Amelia dissolves rather than pay new, inadequately tax. Dissolution vote certified November 25, 2019



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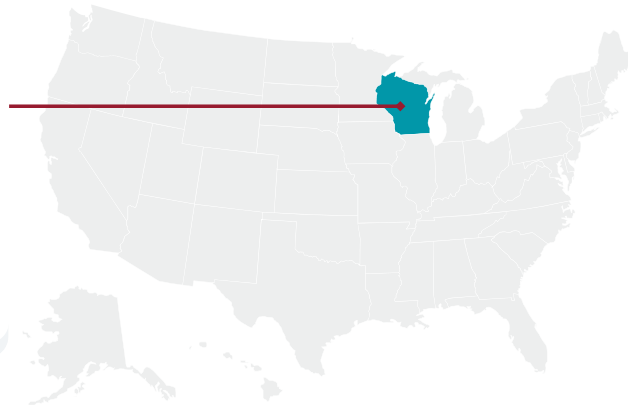
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Miscellaneous

Planning Rejected

Wisconsin.

Real estate transfer tax due on transfer from a trust and its SMLLC. Trust is a legal entity distinct from its members



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Miscellaneous

Licensing Fee

Baltimore County cannot assess licensing fees on machines and then seize the machines for being illegal



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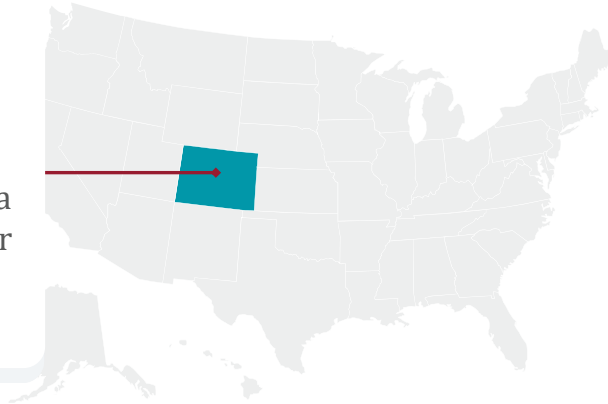
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Miscellaneous

Tax or Fee?

Colorado.

TABOR challenge. Tax or a fee issue not reached as no showing that charges were a new tax, tax rate increase, or policy change resulting in net revenue gain.



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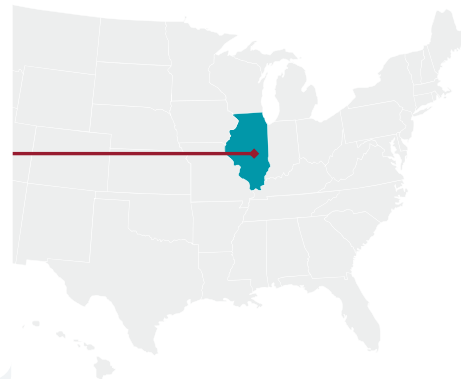
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Miscellaneous

Tax or Fee?

Illinois.

“Taxes” are unrelated to service rendered and are assessed to provide general revenue rather than compensation. “Fees” are proportional to a benefit or service rendered. Municipal stormwater utility fee was reasonable under Illinois constitution and was related to the service for which the fee was imposed.



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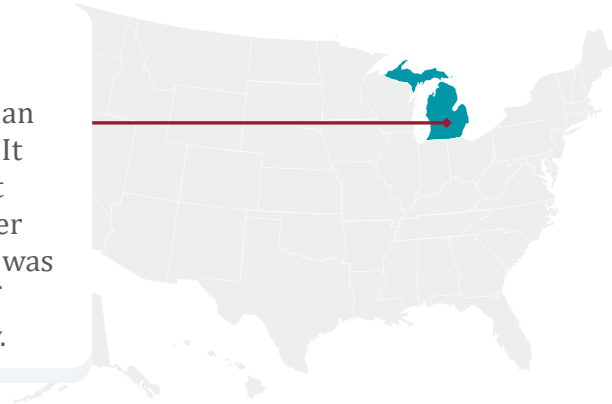
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Tax or Fee?

Michigan.

City's storm water charge was an unconstitutional property tax. It was not a user fee, as it did not clearly serve a regulatory rather than revenue-raising purpose, was disproportionate to the cost of service; and was not voluntary.

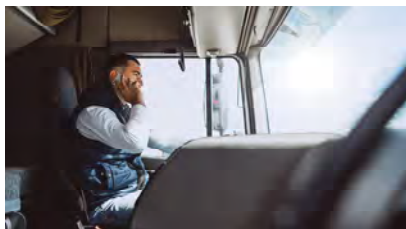


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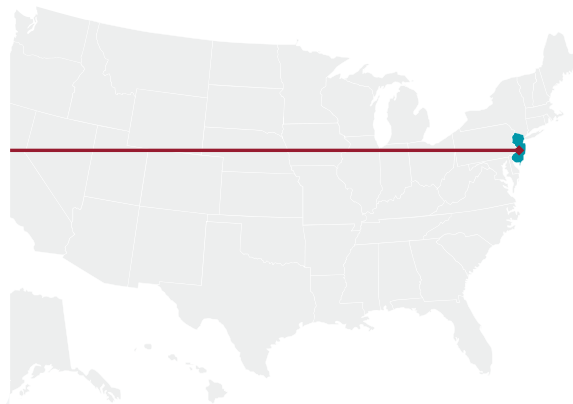
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Miscellaneous

Employee or Independent Contractor?



New Jersey claims victory in reclassifying truck drivers as employees.



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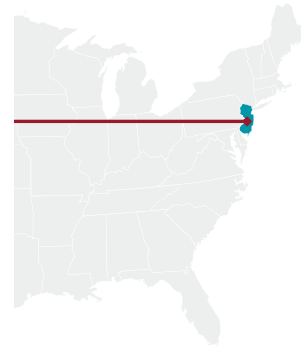
Miscellaneous

Characterization of Relationship



Media reports (11/19):

New Jersey alleges Uber employs its drivers. More than \$520M in employment taxes said due, plus some \$120M in interest and penalties. *But see* NLRB General Counsel Advice Memorandum (April 16, 2019)



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Questions????



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David Fruchtman provides state and local tax planning and controversy advice. His representations involve almost all subnational taxes for businesses and individuals, including income, franchise, sales, use, real property transfer, and a variety of other state and local taxes. His clients include public and privately held heavy equipment manufacturers, marketing companies, travel lodging providers, and vehicle rental companies, as well as mid-sized retailers and other businesses.

David's tax planning work includes tax efficient structuring of businesses and transactions, and regularly requires working with tax authorities to obtain favorable guidance, as circumstances require. He advises foreign companies expanding into the United States, and his experience includes assisting an American affiliate of an Israeli company in one of Wall Street's most successful IPOs of 2010.

You can read David's full firm biography [here](#).

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Notes

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DOR Notice 19-04 (August 1, 2019); DOR letter to AG (September 4, 2019); AG Opinion 2019-8 (September 30, 2019); Governor's Response (October 1, 2019)

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Rev. & Tax. Code Section 6487.07 and California Dept of Tax and Fee Administration Special Notice "Marketplace Sellers May Be Affected by New Marketplace Facilitator Act Beginning October 1, 2019" (August 2019).

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Pennsylvania Bulletin 2019-94 (September 30, 2019).

Notes

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See Utah Department of Revenue Publication 37 (September 2019).

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City of Philadelphia Department of Revenue "Frequently asked questions regarding economic nexus in the City of Philadelphia" (Updated December 10, 2019) and "The City of Philadelphia's Policy Regarding Economic Nexus for Business Income & Receipts Tax (BIRT)" (Updated December 10, 2019).

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See Pennsylvania Bulletin 2019-94 (September 30, 2019).

Notes

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Johnson & Johnson v. Director, No. A-5423-17T3 (N.J. Super. Ct. App. Div. 9/25/19)). Appeal filed 10/15/19, NJ S. Ct. Dkt. No. 083612.

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Robert Half International Inc and Subsidiaries, California Office of Tax Appeals Case No. 18011756 (October 3, 2019).

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Arkansas Office of Hearing and Appeals, Arkansas Dept of Fin. And Admin., Dkt. 5 Nos 20-109 and 20-110 (December 9, 2019).

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SOAH Docket No. 304-19-3739.13 (June 20, 2019, finalized September 11, 2019).

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General Motors Corporation v. Commonwealth, No. 869 F. R. 2012 (Comm. Ct. November 21, 2019).

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Amazon Services, LLC v. South Carolina Department of Revenue, Dkt. 17-ALJ-17-0238-CC (S.C. Admin. L. Ct., September 10, 2019. Appeal filed October 10, 2019).

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Washington Tax Determination No. 18-0149, 38 WTD 229 (October 7, 2019).

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QEP Energy Resources, Dkt. No. 2018-47 (Wyoming State Board of Equalization September 17, 2019)

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NYS AG's Office Press Release "Attorney General Sues B&H Foto & Electronics for Defrauding New York Out of Millions in Sales Tax" (November 14, 2019)

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Martin Equipment v. Illinois Dept of Rev., 18 TT 86 (Illinois Independent Tax Tribunal August 23, 2019)

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