

**COST PACIFIC NORTHWEST REGIONAL STATE TAX SEMINAR**

# **Current Developments in the Pacific Northwest States and Certain Other Significant States Around the Country**

**July 10, 2012**

**Presented By: Carolynn lafrate Kranz  
Kerne H. O. Matsubara  
Annie H. Huang**



# Sales & Use Tax / Gross Receipts Tax

# Washington

# Base Expansion - Washington Law

► **Digital products law addresses items transferred electronically:**

- Digital goods
- Digital codes
- Digital automated services (DAS)
- Remote access software (RAS)

# Washington - Digital Automated Services

- Introduction:
  - Unique and broad tax category addressing digital service transactions including some cloud computing.
  - Digital automated service (DAS) :
    - “.....any service transferred electronically that uses one or more software applications...”
  - WA anticipated:
    - Rapid change in business models
    - Rapid change in and technology
    - Rapid change could make digital good and remote access software categories obsolete.

# Washington - Digital Automate Service Defined

## ▶ **Definition:**

- “...any service transferred electronically that uses one or more software applications...”

## ▶ **Definition encompasses many services including some cloud services:**

- E.g. Computers remotely accessed, controlled, configured etc by software layer.

## ▶ **Also includes other services “provided in the cloud:”**

- E.g. Online searchable database.

# Washington Sample Exclusions from DAS

- ▶ **Broad imposition makes exclusions from DAS important.**
  - Protect WA business models (e.g. server farms)
    - Hosting, storage and back up.
  - Preserve existing industry tax treatment
    - Data processing.
    - Telecommunications & internet access.
  - Tax neutrality for online and offline activities
    - Primarily human effort (e.g. electronic contract sent via email)

# Washington Rulings

## ► B&O – Nexus

- An out-of-state seller's two visits to a buyer in Washington to promote sales of its product shipped from and delivered outside the state did not establish nexus in Washington. The taxpayer's sales manager visited a wholesale customer in Washington for the purpose of selling its merchandise overseas, and its products were shipped directly to the customer at a location outside of Washington. The product sales to the customer never entered the marketplace in Washington, and the taxpayer did not sell any of its products at the customer's stores in Washington or engage in any other marketing activities in Washington. Consequently, the taxpayer did not have substantial nexus with Washington. (Washington State Department of Revenue, Determination No. 11-0225, 07/15/2011, 31 WTD 52 (2012), released 06/28/2012.)



# Washington Rulings

## ► B&O - Repossessed property

- A used car dealer was not entitled to a bad debt deduction against business and occupation (B&O) tax for the value of automobiles that it subsequently repossessed. The taxpayer deducted the outstanding balance of loans in default with no reduction for the value of automobiles that it subsequently repossessed. Washington statutes expressly provide that the amount of bad debt that can be deducted from the measure of B&O tax cannot include the value of repossessed property. (Washington State Department of Revenue, Determination No. 10-0201, 06/29/2010, 31 WTD 43 (2012), released 06/28/2012.)

# Washington Rulings

## ► B&O - Mineral Lease

- The Department of Revenue's Appeals Division denied the taxpayer's petition protesting the imposition of business and occupation (B&O) tax on amounts received under a “mineral lease.” The mineral lease allowed the lessee to use the taxpayer's land only for “mining, processing, stockpiling and removal” of minerals and permitted the taxpayer to use the premises without restriction so long as the lessee's permitted use of the premises was not impaired. Consequently, the lessee's right to mine the land was not a possessory interest in land which carries with it the right to exclusive possession and control, and amounts received under the agreement were subject to B&O tax as the grant of rights to extract sand and gravel rather than exempt payments for the rental of real property. The Appeals Division rejected the taxpayer's contention that the agreement was a lease or rental of real estate; the “maximum annual royalty” paid by the lessee was not in exchange for the occupancy or possession of real estate, and it was “obvious that the Agreement would not have been entered into, but for the existence of sand and gravel on the taxpayer's land.” (Washington State Department of Revenue, Determination No. 11-0080, 03/07/2011, 31 WTD 24 (2012), released 05/31/2012.)

# Washington Legislative Update

## ► **B&O - Law Changes - *Mortgage Interest***

- A financial business located in more than 10 states cannot deduct interest received on investments or loans primarily secured by first mortgages or trust deeds on nontransient residential properties. The joint legislative audit and review committee must review the first mortgage deduction by June 30, 2015.
- Amounts received as interest on loans originated by a financial business located in more than 10 states or an affiliate and primarily secured by first mortgages or trust deeds on nontransient residential properties are subject to business and occupation tax. A person is located in a state if the person or an affiliate maintains a branch, office, or one or more employees or representatives in the state and the in-state presence allows borrowers or potential borrowers to contact the branch, office, employee, or representative concerning the acquiring, negotiating, renegotiating, or restructuring of, or making payments on mortgages issued by the person or affiliate.

# Washington Legislative Update

## ► B&O Law Change – Situsing of Sales

- The Department of Revenue has readopted:
  - WAC 458-20-19402 (Single factor receipts apportionment—Generally);
  - WAC 458-20-19403 (Single factor receipts apportionment—Royalties); and
  - WAC 458-20-19404 (Financial institutions—Income apportionment) on an emergency basis, effective June 18, 2012;
- Taxpayers may use the rules to determine tax liability until the Department adopts a permanent rule. The rules were previously adopted on an emergency basis, effective January 13, 2012, and provide guidance on the application of nexus threshold and apportionment rules for the business and occupation tax enacted by 2010 legislation. There are no changes from the previous emergency rules.

# Washington Legislative Update

## ► Sales and Use Tax Law Change - *Data centers.*

- Effective April 11, 2012, the new law (SB 6635) allows data centers that began construction after March 31, 2012, and before July 1, 2015, to qualify for the sales and use tax exemption on server equipment and power infrastructure.
- The new law also extends the sunset date for the exemption from April 1, 2018 to April 1, 2020.



# Idaho

# Idaho Legislative Update

- ▶ ***Gratuities:*** Amended Idaho Admin. Rule § 35.01.02.043 reflects 2011 legislation that provides a sales and use tax for all gratuities, whether voluntary or mandatory, if the gratuity is given for services provided as a supplement to the income of the service provider.
- ▶ ***Motor vehicles:*** Amended Idaho Admin. Rules § 35.01.02.043 and § 35.01.02.107 reflect 2011 legislation that provides a use tax exemption for motor vehicles used by nonresident full-time college students enrolled in Idaho colleges or universities.
- ▶ ***American Red Cross:*** Amended Idaho Admin. Rule § 35.01.02.094 clarifies that the American Red Cross is an instrumentality of the federal government for purposes of the sales and use tax exemption for sales to and purchases by the federal government and its instrumentalities.
- ▶ ***Foreign diplomats:*** Amended Idaho Admin. Rule § 35.01.02.098 reflects the altered appearance of the diplomatic exemption card system by eliminating specific language describing the previous appearance of the cards and containing a more generic description of the new cards

# Idaho Legislative Update

- ▶ ***Military personnel:*** Amended Idaho Admin. Rule § 35.01.02.107 reflects 2011 legislation that exempts from use tax items owned by military personnel temporarily assigned to Idaho and their spouses if they acquired the items while residing in another state and used them primarily outside Idaho.
- ▶ ***Amusement device permit:*** Amended Idaho Admin. Rule § 35.01.01.109 771 requires another permit to be obtained and affixed to an amusement device if its original permit is lost, stolen, or destroyed.
- ▶ ***L. 2012, H489 (c. 55), effective 03/13/2012,*** exempts free tasting of certain beverages including, but not limited to wine and beer, from use tax. “Free tasting” is defined as a beverage provided to a potential customer at no charge and to occur individually at that specific location and time.
- ▶ ***L. 2012, H417 (c. 47), effective 03/09/2012 through 06/30/2016,*** exempts industry standard, Federal Aviation Administration (FAA) approved materials, parts, and components installed on nonresident privately owned aircraft by qualified employees of an FAA approved Idaho repair station.



# Idaho Legislative Update

- ▶ **L. 2012, H361 (c. 3), effective 07/01/2012**, provides that, in the context of the tax exemption for motor vehicles and trailers substantially used in interstate commerce and registered under the International Registration Plan (IRP), “substantially used in interstate commerce” means that the vehicle or trailer is operated in a fleet that logs at least 10% of its fleet miles outside of Idaho in the four fiscal quarters beginning July 1 and ending June 30 of each year (previously, in an annual registration period) under the IRP. If such motor vehicle or trailer is not substantially used in interstate commerce during the four fiscal year quarters beginning July 1 and ending June 30 of each year (previously, during an annual registration period), it is deemed to be used in Idaho and it is subject to the Idaho use tax.

# Idaho Legislative Update

- ▶ **L. 2012, H361 (c. 3), effective 07/01/2012**, provides that, in the context of the tax exemption for motor vehicles and trailers substantially used in interstate commerce and registered under the International Registration Plan (IRP), “substantially used in interstate commerce” means that the vehicle or trailer is operated in a fleet that logs at least 10% of its fleet miles outside of Idaho in the four fiscal quarters beginning July 1 and ending June 30 of each year (previously, in an annual registration period) under the IRP. If such motor vehicle or trailer is not substantially used in interstate commerce during the four fiscal year quarters beginning July 1 and ending June 30 of each year (previously, during an annual registration period), it is deemed to be used in Idaho and it is subject to the Idaho use tax.

# SST Update

## ▶ Streamlined Sales and Use Tax (“SST”)

- SST Agreement became effective October 1, 2005.
- 21 full members:
  - Arkansas, Georgia, Kansas, Kentucky, Indiana, Iowa, Michigan, Minnesota, Nebraska, New Jersey, Nevada, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont, Washington, West Virginia, Wisconsin, Wyoming
- 3 associate members:
  - Ohio, Tennessee, Utah

## ▶ Streamlined Sales and Use Tax (continued)

- SST member states' tax revenue hit \$1 billion this year.
- Federal Main Street Fairness Act was introduced November 9, 2011.
  - Internet-based commerce continues to grow and states are currently unable to collect the estimated \$23 billion in revenue unless Congress acts.

# Current Workgroup / Hot Topics

## ► Vouchers

- Workgroup currently working on a rule to determine the appropriate measure of sales price:

- Paid value; or
- Promotional value.

**\*\*\* Both business and state community agree that the time of tax is time of redemption.**

## ► Sourcing of Services

- Workgroup focused on interpretive rules for sourcing. Thus far, two interpretive rules have been adopted: (1) sourcing of services to tangible personal property; and (2) sourcing of personal care services.

# Current Workgroup / Hot Topics

## ▶ **Digital Sourcing**

- Workgroup focused on sourcing of digital goods. Currently working on a white paper outlining issues. No rule currently in process.

## ▶ **Remote Access of Software**

- Workgroup focused on whether remote access of software can be taxed as a sale of tangible personal property (i.e., prewritten computer software).

## ▶ **Credit for Tax Paid**

- Workgroup currently trying to develop a rule addressing this issue.

# Other Sales Tax Cases & Updates of Interest



# Sales/Use Tax Exemption Attack

## ***Bodman v. South Carolina Dep't of Revenue***

- Citizen filed challenge, directly at the S.C. Supreme Court level, as to all of South Carolina's sales and use tax exemptions.
- Citizen argued that the exemptions constitute arbitrary classifications that violate the Equal Protection Clause of the U.S. Constitution.
  - That the sales tax base has become "dangerously narrow;" and
  - That every government service is underfunded because the state is losing \$2.19 billion in sales tax from the exemptions.
  - S.C. DOR responded that *stare decisis* from *Ed Robinson Laundry & Dry Cleaning Inc., v. S.C. Dep't of Revenue*, 356 S.C. 120 (2003), should apply and that this is a decision for the S.C. legislature to determine.

## ▶ Alabama

- *Magee v. The Home Depot U.S.A., Inc.*, No. 2100715 (Ala. Ct. Civil App. Nov. 4, 2011).

## ▶ Massachusetts

- *Sears, Roebuck & Company v. Commissioner of Revenue*, Mass. App. Tax Bd., Dkt. No. C293755 (1/11/2012)

## ▶ Michigan

- *Home Depot USA, Inc. v. Dept. of Treas.*, Mich. Ct. App., No. 301341 (May 24, 2012)

## ▶ North Carolina

- *Taxpayer v. North Carolina Dept. of Revenue*, OAH No: 09 REV 3211 (Jan. 13, 2011)

# Updates of Interest: Capital Improvement

## ► Pennsylvania

### – *Northeastern Pennsylvania Imaging Center v. Pennsylvania*

- The Supreme Court of Pennsylvania reversed a lower court decision and held that installed MRI and PET/CT scan systems should be treated as personal property for sales tax purposes. *No. 93 MAP 2009 (Pa. 2011)*.
- The court held that property retains its identity as personal property if property can be disassociated from realty without injury to the property.
- Northeastern was held responsible for sales tax on the equipment because the scan equipment and systems were removable and replaceable, and therefore retained their identity as personal property.

# Updates of Interest - Software

## ► Taxability of Software

### – *Colorado*

- H.B. 11-1293's software exemption becomes effective July 1, 2012. The new law exempts software that is:
  - delivered through an application service provider;
  - delivered electronically; or
  - transferred by load and leave.

# Manufacturing Exemption - Georgia

## ▶ Georgia

### – *H.B. 386*

- Creates a new exemption for energy used by manufacturers to be phased in over four years, beginning January 1, 2013 with a 25 percent exemption.

# Manufacturing Exemption - Indiana

## ▶ Indiana

### – *H.B. 1072*

- Effective December 31, 2012 , the exemption for sales of electricity, natural or artificial gas, water, steam, and steam heat by a power subsidiary or public utility is extended to use in processing, repairing, floriculture, and arboriculture.
- Retroactively effective January 1, 2012, H.B. 1072 establishes a broad exemption for energy, materials, machinery, and consumables used in a recycling process.
- Effective July 1, 2012, there will be a sales tax exemption for certain wrapping materials and nonreturnable containers used by processors and service providers.

# Manufacturing Exemption - Florida

## ► Florida

### — *H.B. 7087*

- Effective July 1, 2012, H.B. 7087 creates a new category of oil designated as “mature field recovery oil” subject to a lower rate of taxation.
- H.B. 7087 expands the sales or use tax exemption for machinery and equipment sold to a new or expanding manufacturing facility. Under current law, to qualify, the new equipment or machinery had to increase the productive output of a manufacturing facility by 10%. Effective July 1, 2012, purchases must increase productive output by only 5% to qualify for the exemption.
- Effective July 1, 2012, H.B. 7087 adds a new exemption for chemicals, machinery, parts, and equipment used and consumed in the manufacture or fabrication of aircraft engines and gas turbine engines.

# Administrative Issues: Amnesty

## ▶ **Amnesty Program Common Characteristics**

- Penalties for Failure to File Under Amnesty Program
- Stringent Filing and Payment Requirements
- Interest Waiver
- Penalty Waiver



# Administrative Issues - Amnesty

## ▶ **Amnesty Under SST (Associate Members)**

- Utah
- Tennessee
- Ohio

# Administrative Issues - Amnesty

## ► Ohio's Amnesty Programs

### – *Use Tax Amnesty Program*

- Provides all consumers (individual and businesses) that did not have a consumer use tax account with a waiver of all penalties and interest, provided that all use taxes outstanding on or before January 1, 2009 are paid in full.
- Payment plans for up to 7 years available.
- Program runs October 1, 2011 to May 1, 2013.

# Administrative Issues - Amnesty

## ▶ Ohio's Amnesty Programs (continued)

### – *General Tax Amnesty Program:*

- Delinquent taxpayers have the opportunity to resolve their tax liabilities by paying all tax in full (plus 50% of interest due) as of May 1, 2011. The remaining 50% of interests plus all penalties are waived.
- Program runs May 1, 2012 to June 15, 2012.

# Administrative Issues - Amnesty

## ► Kentucky's Tax Amnesty Program

- Legislation signed authorizing a tax amnesty program to be conducted during the fiscal year ending June 30, 2013, for a period of not less than 60 days nor more than 120 days.
- Available to all taxpayers owing taxes, penalties, fees, or interest subject to the administrative jurisdiction of the Department of Revenue, with the exception of property taxes or penalties related to cigarettes or fuel licenses.
- The tax amnesty program will apply to tax liabilities for taxable periods ending or transactions occurring after December 1, 2001, and prior to October 1, 2011.
- The program will not be available to any taxpayer who is on notice, written or otherwise, of a criminal investigation.
- No refund or credit will be granted for any interest, fee, or penalty paid prior to the time the taxpayer requests amnesty and no refund or credit will be granted for any taxes paid under the amnesty program. The legislation bars any judicial or administrative proceeding seeking refund or recovery of any amount paid under an amnesty program.

# Administrative Issues - Amnesty

## ▶ Texas's Tax Amnesty Program

- Begins June 12, 2012 and ends August 17, 2012.
- Offers a waiver of penalty and interest on taxes paid during the amnesty period.
- Applies to taxes that were due before April 1, 2012 and is available for franchise tax, sales and use tax, and most taxes and fees administered by the Comptroller.
- Amnesty does not extend to unclaimed property, Public Utility Commission (PUC) gross receipts assessments, property tax, and sports and community venue taxes.

# Administrative Issues - Amnesty

## ► Rhode Island Tax Amnesty Program

- The Rhode Island 2013 budget bill (H.B. 7323), that includes a Rhode Island Tax Amnesty Program, is currently awaiting the Governor's approval.
- If enacted, the tax amnesty program will last 75 days, ending November 15, 2012.
- During this time, businesses who owe delinquent sales taxes for any taxable period ending on or prior to December 31, 2011 may apply for amnesty from monetary penalties and civil or criminal prosecution.
- To qualify, they must pay the taxes and interest owed the Department, or set up a payment plan for the amount owed.

# Administrative Issues

## ► Statute of Limitations Issues

### – *Florida*

- *Verizon Business Purchasing, LLC v. Florida Department of Revenue*
  - Dispute in *Verizon* is over the legal significance of Form DR-831 – "Notice of Proposed Assessment." Specifically, the issue is whether a "Notice of Proposed Assessment" is an "assessment" for statute of limitations purposes. *Case No. 2011-CA-1498 (Fla. 2d Cir. Ct., Jun. 8, 2011)*.
  - The Department routinely issues a Notice of Proposed Assessment near the end of the applicable statute of limitations deadline. It is used for almost every tax administered by the Department. If Verizon prevails in its civil action, it would effect a large portion of Florida taxpayers.
  - On June 1, 2012, Verizon's motion for summary judgment was denied and the state's motion for summary judgment was granted, effectively punting the issue to Florida's 2<sup>nd</sup> District Court of Appeals.

# Administrative Issues

## ► Tax Tribunals

### – *In General*

- The last decade has seen a rise in legislation proposing the creation of separate administrative processes to hear taxpayer complaints.
- 27 states, and the District of Columbia, currently have well-established tax courts or other forums not staffed by tax experts.
- 21 states do not have independent tax courts at all, including California, Texas, and Florida.



# Administrative Issues

## ► Tax Tribunals

### — *Georgia*

- H.B. 100 establishes the Georgia Tax Tribunal under the supervision of the Office of State Administrative Hearings and completely independent from the Department.
- Beginning January 1, 2013, taxpayers may file tax appeals in the Tribunal. The Tribunal will have deficiency jurisdiction, meaning the taxpayer does not need to pay tax, interest, or penalty until a final decision has been issued.
- The Tribunal's decisions may be appealed to the Superior Court of Fulton County. All decisions issued by the Tribunal, excluding the small claims division, will be published and available to the public.

# Administrative Issues

## ► Tax Tribunals

### – *Illinois*

- House Bill 5192 allows taxpayers to protest an adverse Department of Revenue assessment before an independent administrative tribunal.
- New tribunal would have deficiency jurisdiction, removing the disincentive and financial hardship currently associated with Illinois tax appeals.
- The bill has passed both the House and the Senate and awaits Governor Pat Quinn's approval.

# Income Tax Issues

## ► Statutes (Quantitative)

- California Rev. & Tax. Code §23101
  - lesser of \$500K in sales or 25 percent of the taxpayer's total sales
- Michigan Comp. Laws Ann. §206.621
  - \$350K in sales
- Ohio Rev. Code Ann. §5751.01
  - \$500K in sales (“bright-line presence”)
  - *In re L.L. Bean, Inc.* (Ohio Dep't of Taxation, Final Determination, Aug. 10, 2010).

## ▶ Statutes (Qualitative)

- Conn. Gen. Stat. §12-216a
  - “(a) Any company that derives income from sources within this state and that has a substantial economic presence within this state, evidenced by a purposeful direction of business toward this state, examined in light of the frequency, quantity and systematic nature of a company’s economic contacts with this state, without regard to physical presence...”

## ▶ Statutes (Qualitative – cont.)

- N.H. Rev. Stat. Ann. §77-A:1.XII
  - “substantial economic presence evidenced by a purposeful direction of business toward the state examined in light of the frequency, quantity, and systematic nature of a business organization’s economic contacts with the state.”
- Wis. Stat. §71.22(1r)
  - “regularly selling products or services of any kind or nature to customers in this state”

## ► Recent Cases

- ***Lamtec v. Washington Dep't of Rev.***, 246 P.3d 788 (Wash. 2011), *cert. denied* 132 S.Ct. 95 (2011)
- ***KFC Corp. v. Iowa Dep't of Rev.***, 792 N.W.2d 308 (Iowa 2010), *cert. denied* 132 S.Ct. 97 (2011)
- ***Revenue Cabinet v. Asworth Corp.***, No. 2007-CA-002539 (Ky. Ct. App. Feb. 5, 2010), *cert. denied* No. 10-662 (U.S. S. Ct. Jan. 24, 2011)
- ***In the Matter of the Petitions of Shell Gas Gathering Corp. #2***, Nos. 821569 and 821570 (N.Y. Tax App. Trib. Sept. 23, 2010)

## ► Recent Cases (cont.)

- ***BIS LP, Inc. v. Director***, No. A-1172-09T2 (N.J. App. Div. Aug. 23, 2011)
- ***Utelcom, Inc. v. Bridges***, No. 2010 CS 0654 (La. Ct. App. Sept. 12, 2011)
- ***Ann Sacks Tile and Stone, Inc. v. Dep't of Revenue***, Oregon Tax Court, No. TC 4879 (Nov. 29, 2011)
- ***Skagen Designs Ltd. v. Comm'r of Revenue***, Minn. Tax. Ct., No. 8168-R (Apr. 23, 2012)



## ► Recent Cases (cont.)

- ***In re Scioto Insurance Co.***, Oklahoma Supreme Court, No. 108943 (May 1, 2012)
- ***Telebright Corp., Inc. v. Dir. Div. of Taxation***, No. A-5096-09T2 (N.J. Super. Ct. App. Div. March 2, 2012)
- ***In re Warwick McKinley Inc.***, Cal. State Bd. of Equal., No. 489090 (Jan. 11, 2012)

# Business/Nonbusiness Income

## Gain from Stock Sales

- ▶ ***Oracle Corporation v. Department of Revenue*, Oregon Tax Court, No. TC MD 070762C (Jan. 19, 2012):**
  - Gain from sales of subsidiary stock was business income under functional test
  - Taxpayer originally held stock as a business asset and could not show the stock had been converted to nonbusiness use (i.e., investment)
  - Gain from stock sale included in sales factor denominator
  - Note: Taxpayer not estopped from nonbusiness position despite taking business income position in other states, due to varying state interpretations (see *Oracle Corp. v. Dept. of Rev.*, No. TC-MD 0707762 C (Feb. 11, 2010) (denying Dept's motion for summary judgment))
- ▶ ***Appeal of Crane Co. & Subsidiaries*, Cal. St. Bd. of Equal., No. 357027 (2009); *Appeal of Rheem Manufacturing Co.*, Cal. St. Bd. of Equal., No. 485872 (2011):**
  - Gain from sale of stock of less-than-50%-owned company was business income under functional test

# Apportionment – Sales Factor

## Income Producing Activity – Cost of Performance (COP)

- ▶ ***AT&T Corp. v. Department of Revenue*, Oregon Tax Court, No. TC 4814 (June 28, 2011)**
  - Sales other than sales of TPP are assigned based on COP
  - Issue whether greater proportion of income producing activity with respect to interstate and international telephone calls was performed in New Jersey and not in Oregon
  - Tax Court adopted transactional approach and rejected taxpayer's operational approach
  - Case pending on appeal
- ▶ **Compare with *AT&T Corp. v. Commission*, Mass. App. Tax Bd., No. C293831 (June 8, 2011)**
- ▶ **Other COP issues**
  - All-or-nothing vs pro rata
  - Use of alternative apportionment to produce market-based sourcing results

# Apportionment – Sales Factor

## Goodwill Excluded from Sales Factor

- ▶ ***Tektronix, Inc. v. Department of Revenue, Oregon Tax Court, No. TC 4951 (June 5, 2012):***
  - Taxpayer sold all of the assets of one of its subsidiaries in the 1999 tax year
  - Court held taxpayer properly excluded the value attributed to goodwill from its sales factor, where gain from sale of goodwill could not “readily be attributed to any particular income producing activity of the taxpayer” (Ore. Reg. § 150-314.665(4)(3)(b))
  - Department also was barred by the statute of limitations from assessing additional tax for the 1999 tax year, a closed year, and was limited to offsetting a refund

# Apportionment – Sales Factor

## Broker-Dealer Receipts

### ► FTB Chief Counsel Ruling 2012-1 (Apr. 30, 2012):

- Taxpayer's subsidiary is a registered broker-dealer (Broker-Dealer) and a member of the National Association of Securities Dealers; Broker-Dealer is not a financial corporation
- Broker-Dealer engages in both (1) principal trades (buys/sells securities for its own account) and (2) agency trades (buys/sells securities to third parties on behalf of customers for a fee)
- Greater cost of performance of Broker-Dealer's transactions occurs in California
- FTB ruled that taxpayer should include gross receipts from principal trades (i.e., including return of capital) and commissions from agency trades in the numerator of its CA sales factor
- FTB also ruled that intrastate apportionment is not a proper subject for distortion analysis under Rev. & Tax. Code § 25137

# Add-Back Cases

- ▶ ***Beneficial New Jersey, Inc. v. Dir., Div. of Taxation*, No. 009886-2007 (N.J. Tax Ct. Aug. 31, 2010)**
  - Interest paid to parent finance company met “unreasonable exception” and not subject to addback
  
- ▶ ***Kimberly-Clark Corp. v. Comm’r of Rev.*, Nos. C282754, C295077, and C299008 (Mass. App. Tax. Bd. Jan. 31, 2011)**
  - Taxpayer must demonstrate that it is entitled to the addback exception by “clear and convincing evidence”

## Tax Credits – Offset of Minimum Tax

- ▶ ***Con-way, Inc. & Affiliates v. Department of Revenue, Oregon Tax Court, No. TC 5003 (Dec. 27, 2011)***
  - Tax Court held that the state’s Business Energy Tax Credit may be used to offset the corporate minimum tax
  - Decision suggests that all corporate tax credits can be applied against the corporate minimum tax if not specifically prohibited by statute
  - Case is on appeal with Oregon Supreme Court
  
- ▶ ***Appeal of NASSCO Holdings, Inc., Cal. State Bd. of Equal., 2010-SBE-001 (Nov. 17, 2010)***
  - SBE held that taxpayer entitled to apply its Enterprise Zone (EZ) and Manufacturers’ Investment Credits (MIC) to reduce its alternative minimum tax liabilities
  - FTB issued Notice 2011-02 (Mar. 18, 2011) to provide guidance in light of NASSCO

## Tax Credits – R&D Credit

### ► FTB Legal Division Guidance (LDG) 2012-03-01

- In June 2011, FTB issued LDG 2011-06-01 advising that a purely service company with no “gross receipts” within the meaning of RTC § 23609(h)(3) could not claim the California R&D credit
- In July 2011, FTB withdrew LDG 2011-06-01
- On March 16, 2012, FTB issued LDG 2012-03-01 and confirmed that a taxpayer with no “gross receipts” under RTC § 23609(h)(3) can claim the R&D credit

### ► *Appeal of Pacific Southwest Container, Inc., Cal. State Bd. of Equal., No. 473587 (Mar. 22, 2011)*

- SBE ruled in favor of the taxpayer and concluded the taxpayer met its burden of proof demonstrating that its activities constituted “qualified research”
- SBE rejected FTB’s attempt to impeach the taxpayer’s documentation and other evidence



## Tax Credits – R&D Credit (cont.)

- ▶ ***Appeal of Leonardini*, Cal. State Bd. of Equal., No. 449478 (Nov. 10, 2010)**
  - Issues related to whether sufficient evidence was presented to demonstrate that taxpayers' activities constituted "qualified research" under IRC § 41
  - SBE concluded that taxpayers did not meet their burden of proof

Questions?

# Contact Information

- ▶ **Carolynn lafrate Kranz**
  - (215) 837-9767
  - cskranz@industriysalestax.com
  
- ▶ **Kerne H. O. Matsubara**
  - (415) 983-1233
  - kerne.matsubara@pillsburylaw.com
  
- ▶ **Annie H. Huang**
  - (415) 983-1979
  - annie.huang@pillsburylaw.com