



Discussion of State Tax Cases, Issues and Policy Matters to Watch in 2015

Pacific Southwest Regional State Tax Seminar

February 19, 2015

Phoenix, Arizona



Agenda

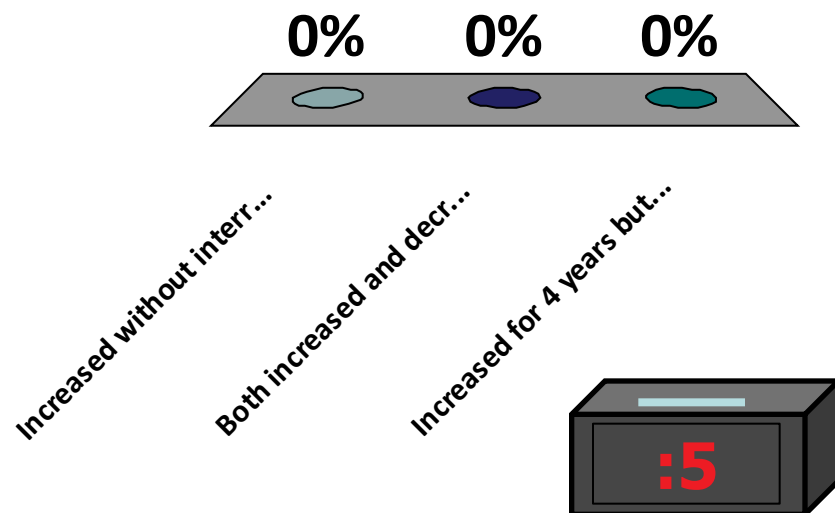
- State of the States
- Business Tax Trends
- Multistate Tax Compact Election
- Federal Legislation
- U.S. Supreme Court Cases
- Nexus
- Apportionment
- Combined Reporting
- Business/Nonbusiness
- Local Business Taxes



State of the States: Fiscal Conditions The Business Tax Burden Election Results

State tax revenues, as a whole, have:

- A. Increased without interruption over the past 5 years
- B. Both increased and decreased over the past 5 years
- C. Increased for 4 years but then declined in 2014





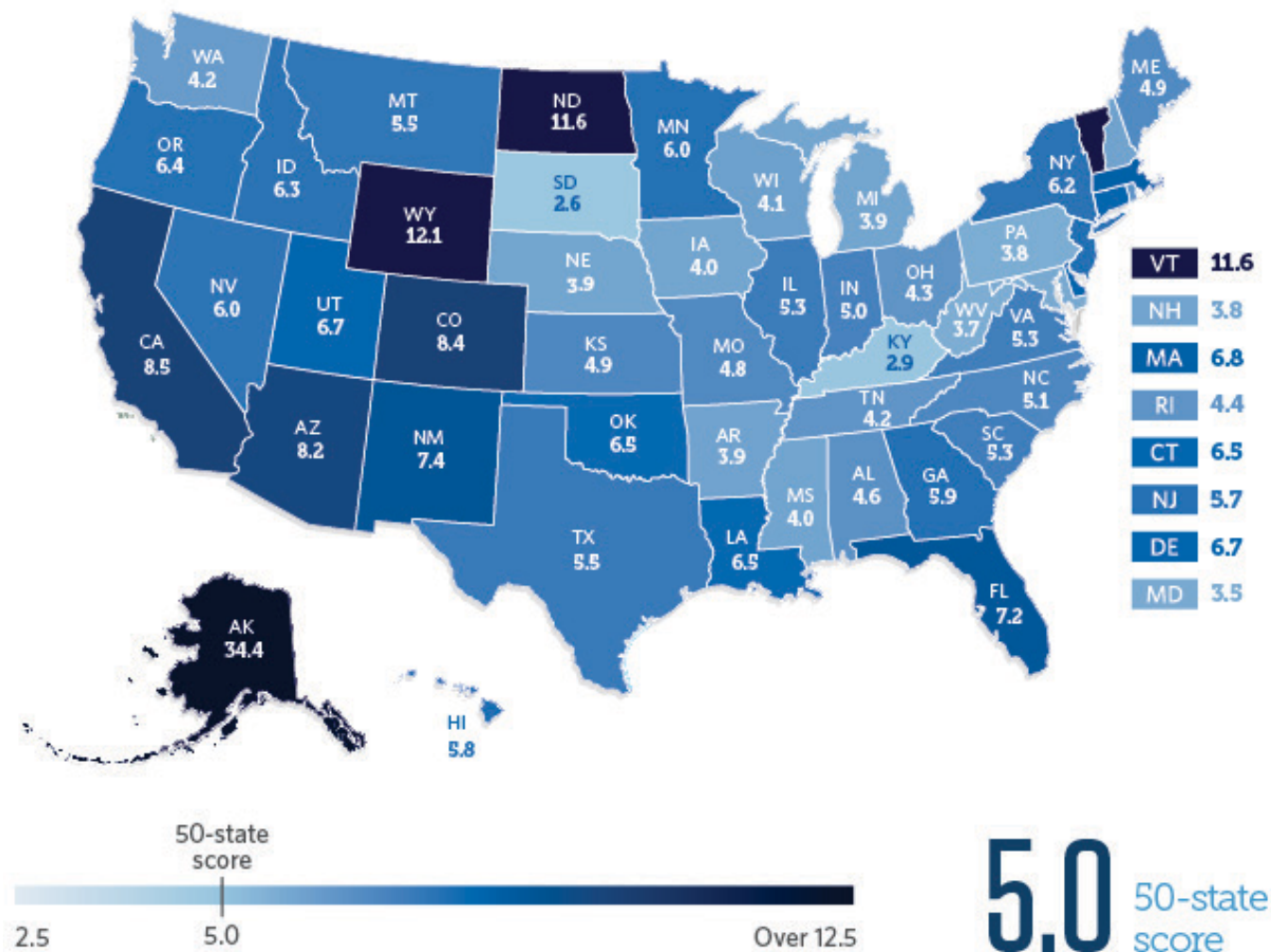
Seesaw: After 4 Years of Growth, State Revenues Fall, then Rise Again

- After 4 years of growth, state tax revenues collectively declined in the 1st and 2nd quarters of 2014
 - Overall state tax revenues decreased by 0.3% relative to the 1st quarter of 2013
 - The decline worsened to 1.7% overall in the 2nd quarter compared to the same quarter of 2013
- However, state tax revenues grew by 4.4% in the 3rd quarter of 2014

Rockefeller Institute of Government, *“After Weak Performance in the First Half of 2014, Tax Revenues Resume Growth in the Third Quarter,”* 2/12/2015

How Volatility of Tax Revenue Compares

Based on FY 1995–2013 tax revenue, adjusted for policy changes



Source: The Pew Charitable Trusts

Volatility scores for each state's total tax revenue were calculated using the U.S. Census Bureau's State Government Tax Collections historical data series for 1994–2013. Data were adjusted to control for the effects of tax policy change using the National Conference of State Legislatures State Tax Action reports for 1994–2012.

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What do Businesses Pay?

- Businesses paid close to \$671B in U.S. state and local taxes in FY2013, an increase of 4.3%
- Accounts for 44.9% of all state and local taxes
- The business share nationally has been within 1% of 45% since 2003
- “Tax/benefit ratio” for US businesses: 3.26/1 (1.2/1 if 50% of education spending benefits businesses)

COST/EY Study, *Total state and local business taxes: State-by-state estimates for fiscal year 2013*, August 2014



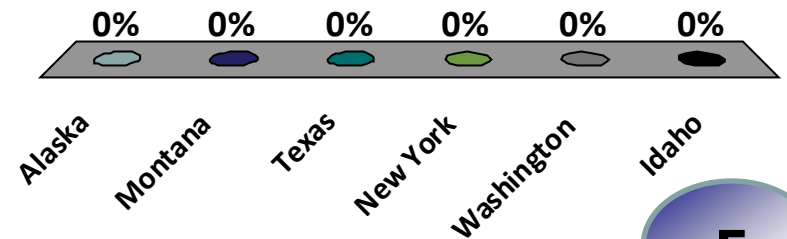
What do Businesses Pay?

- Relative share of total state and local business taxes for FY2013
 - Property taxes: 36.1%
 - General sales taxes: 20.8%
 - Corporate income tax: 7.9%
 - Unemployment insurance: 7.6%
 - Excise taxes: 5.7%
 - Individual income tax: 5.5%
 - Business and corp. license tax: 5.4%

COST/EY Study, *Total state and local business taxes: State-by-state estimates for fiscal year 2013*, August 2014

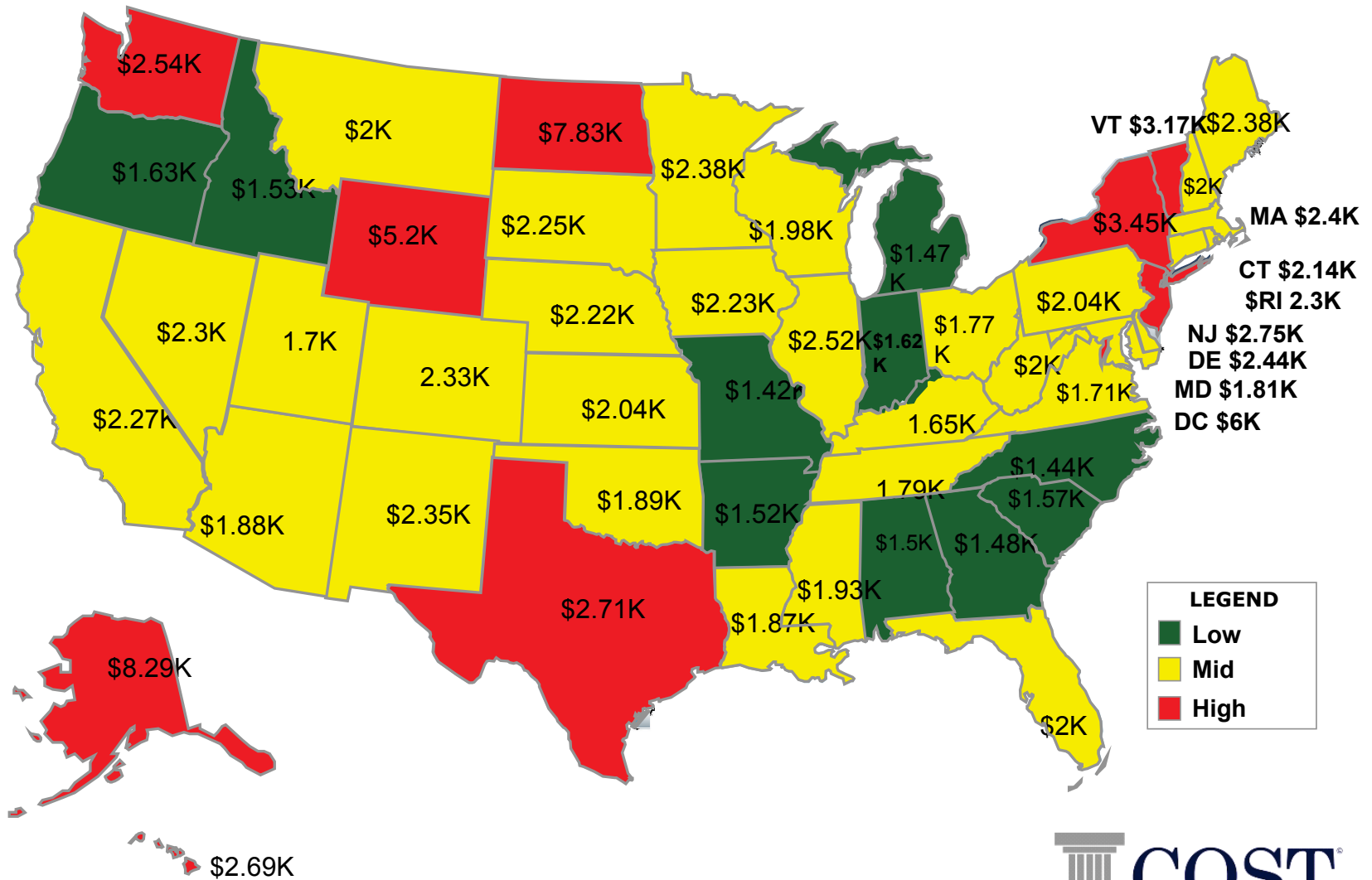
Which state has the highest business SALT revenues *per capita*?

- A. Alaska
- B. Montana
- C. Texas
- D. New York
- E. Washington
- F. Idaho

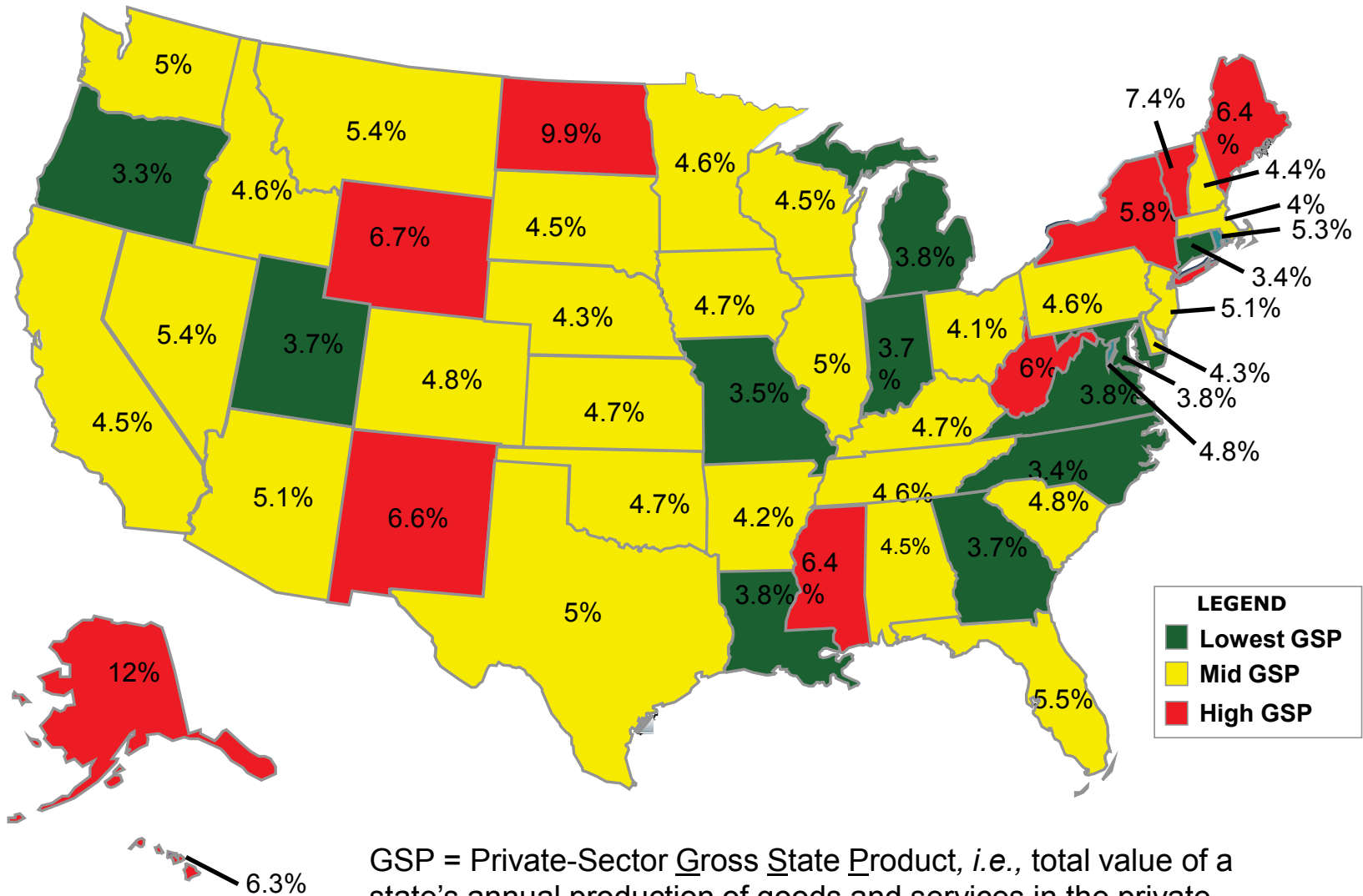


Business Taxes Per Capita

(Population data derived from US Census Bureau - April 2010 Census Data)



Business Taxes As a Share of Private Sector GSP, FY 2013



GSP = Private-Sector Gross State Product, *i.e.*, total value of a state's annual production of goods and services in the private sector



Elections 2014: And the Winner Is...

- Gubernatorial winners include:

- Hickenlooper (D-CO)
- Malloy (D-CT)
- Scott (R-FL)
- Deal (R-GA)
- Rauner (R-IL)
- Brownback (R-KS)
- LePage (R-ME)
- Hogan (R-MD)
- Baker (R-MA)
- Snyder (R-MI)
- Dayton (D-MN)
- Kitzhaber (D-OR)
- Wolf (D-PA)
- Walker (R-WI)



- Colorado Senate
- Maine Senate
- Minnesota House
- Nevada Assembly
- Nevada Senate
- New Hampshire House
- New York Senate
- New Mexico House
- Washington Senate
- West Virginia House.

Council On State Taxation



Elections 2014: And the Winner Is...

The Final Tally:

- **Legislatures: 30 R, 11 D, and 8 split**
- **Chambers: 68 R, 30 D (Republican gain of 10)**
- **Governors: 31 R, 18 D and 1 undecided (AK)**
- **State governments: 23 R, 7 D, 18 divided and 1 undecided (AK)**
- **FEDERAL: Republicans gain control of the U.S. Senate and increase majority in U.S. House**

Source: NCSL , Republican Wave Capsizes Democrats”, 11/5/14; NCSL Election Updates.



Possible Federal Tax Reform: Impact on State Taxation?

- Senate Majority Leader-Elect Mitch McConnell listed corporate tax reform as a possible issue to work on with President Obama
- The U.S. has one of the highest effective rates for corporate income tax of any country in the world
 - If the federal income tax rate is lowered, it will have little direct effect on state corporate income tax
- Any federal income tax reform is likely to include income tax base broadening measures
 - If the federal income tax base is broadened, this could have a significant effect on state corporate income tax – since most states do link significantly to the federal income tax base



Business Tax Trends



What's Hot: Continued Interest in Broad-Based "Tax Reform"

- NV – Governor Sandoval's "Business License Fee Modernization Proposal" is a tax on most types of business receipts from the sale of goods or revenue realized in the performance of a service, excludes interest, dividends, capital gains & wages
- OH – Governor Kasich's FY 2016-17 budget includes pass-through income exemption, individual rate cuts, limited service tax expansion, **CAT rate increase**
- ME – Governor LePage's FY 2016-17 budget includes individual *and* corporate rate decreases, consumer services base expansion, business tax credit repeal



What's Not? Taxing B2B Sales

2013 Lessons Learned:

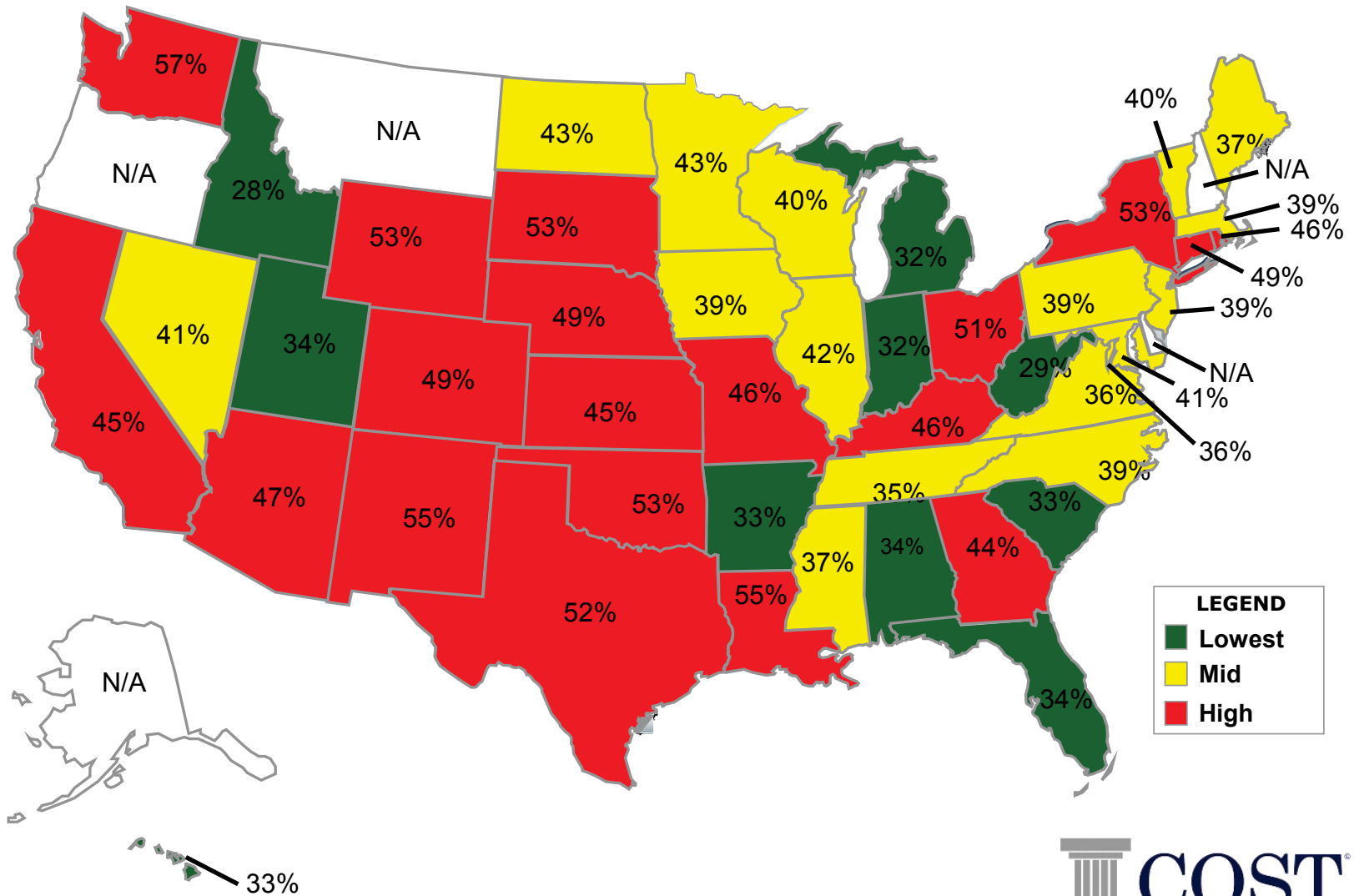
- Louisiana – Gov. Jindal “parked” his broad-based services tax after significant opposition.
- Nebraska – Gov. Heineman’s broad-based services tax put on hold; effectiveness of expanded consumption tax criticized.
- Minnesota – Gov. Dayton abandoned broad-based sales tax on services proposal. Subsequently repealed sales tax on certain B2B services.
- Ohio – House GOP scaled down Gov. Kasich’s broad-based service tax proposal. The final bill taxed certain digital products, but eschewed service tax.
- Massachusetts’ short-lived computer services tax.



Contrasting Some High-Profile Current Service Tax Proposals

- **Maine Governor's Proposal** – Tax base to include a variety of services, but specifically exempt sales of installation, repair and maintenance, personal property services & professional services “to a business for use directly by that business”
- **Ohio Governor's Proposal** – Tax base to include a variety of services, including market research, lobbying, public relations, management consulting, debt collection, parking, and travel services
- **New York Budget** – Includes certain intercompany transactions
- **California SB 8, Senator Hertzberg's Proposal: “The Upward Mobility Act”**
 - “Broaden the tax base by imposing a sales tax on services to increase revenues... Health care services and education services would be exempted from the tax, and very small businesses with under \$100,000 gross sales would be exempted from the sales tax on services.”
 - Re-referred to Senate Rules Committee with Author's amendments,
2/10/2015

State and Local Sales Taxes Imposed on Business Input Purchases, 2011





States Identifying “Tax Havens”?

- Under MTC model combined reporting statute, taxpayer members must take into account “the entire income and apportionment factors of any member that is doing business in a tax haven”
- States identifying “tax havens” by statutory list: Montana, Oregon
- States identifying “tax haven” characteristics: Alaska, D.C., Rhode Island, West Virginia
- Legislation vetoed in Maine in 2014; proposals offered in Massachusetts, West Virginia, Wisconsin
- Oregon, Massachusetts proposals lead concerns in 2015



Responses to “Base Erosion and Profit Shifting” (BEPS)

- The OECD is currently undertaking a multiyear project to address what the industrialized nations refer to as Base Erosion and Profit Shifting (BEPS)
- The OECD in 2013 defined BEPS as: “ instances where the interaction of different tax rules leads to double non-taxation or less than single taxation. It also relates to arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place.”
- The initial OECD BEPS Recommendations were issued in September 2014. A second set will be issued in September 2015.
- The keynote speaker at the MTC 2014 Annual Meeting was Edward Kleinbard, the former chief of staff of the US Congress Joint Committee on Taxation. He proposed as a solution to BEPS that the states should adopt worldwide combined reporting.



Previous State Responses to BEPS (Domestic Source Income)

- States have addressed what they perceive to be BEPS issues for decades
- The primary state tax approaches have included:
 - Unitary Combined Reporting
 - Commissioner's Discretionary Authority (state-IRC § 482 authority)
 - Forced Combined Reporting
 - Alternative Apportionment
 - Statutory related party expense addback requirements
 - Economic Presence Nexus
 - Pass Through Entity Taxation
 - Business Purpose & Economic Substance



Public Disclosure of Tax Return Information

- Illinois legislation (prior sessions)
 - Would require certain publicly traded corporations to file with the Secretary of State statements concerning their income tax liability. Provides that the Secretary of State shall make all information contained in those statements available to the public on an ongoing basis.
- Maryland 2015 HB 550 (Business Transparency and Financial Disclosure Act)
- Oregon 2015 HB 2077 (Corporate Tax Disclosure) / HB 2138 (Corporate Incentives Disclosure)



Recent State Administrative Reforms

- **“Most Improved” in the 2013 COST Administrative Scorecard**
 - PA: Bd. of Finance and Revenue reform
 - GA and IL: Tax Tribunal adopted
 - OK: *De novo* district court review; removes pay-to-play
- **Significant 2014 Reforms Impacting Scorecard**
 - AL: Tax Tribunal enacted (!)
 - LA: ability to appeal local sales tax assessments to Board of Tax Appeals
 - MI: repeals open-ended statute of limitations (S.B. 337)
 - MS: “*Equifax Fix*” enacted (H.B. 799)
- **Independent appeals** sought in 2015 in NM, WA



Multistate Tax Compact Election

Uniformity Revisited

- Can states help themselves?
 - Competition amongst the states
 - Viewpoints of Tax Administrators versus State Legislators
- Multistate Tax Commission: Headed towards a new direction?
- California *Gillette* case contrasted with Michigan *IBM* case: MTC still says compact is NOT binding
 - *IBM* case decided on 1/15/14, MI Supreme Court was not concerned with nature of the Compact – Court stayed focused on MI statutes and how to interpret them
 - Other States: TX - Graphic Packaging, OR: HealthNet, MN: Kimberley-Clark Corp.
 - Is the MTC still a quasi-governmental entity?
- Several MTC states have repealed Article IV of the compact

MTC 3-Factor Election

***Gillette Co. v. Franchise Tax Board*, 207 Cal.App.4th 1369 (Cal. Ct. App. July 24, 2012), Cal. S.Ct., No. S206587, petition for review granted 01/16/2013.**

- The Court of Appeals upheld taxpayers' use of the Multistate Tax Compact's three-factor apportionment election in lieu of the double-weighted sales factor mandated by California law.
 - The Compact, to which California was a signatory, is a binding, multistate agreement that obligates its member states to offer their multistate taxpayers the option of using either the compact's three-factor formula to apportion income, or the state's own alternative apportionment formula.
 - Since 1993, California required most corporate taxpayers to apply a double-weighted sales factor in their method of apportionment.
 - The Court of Appeals ruled that the Compact was binding on California, which had enacted it into law in 1974.
 - On June 27, 2012, in anticipation of an adverse decision in *Gillette*, the California Legislature withdrew from the compact.

MTC 3-Factor Election

***The Gillette Company et al. v. Franchise Tax Board*, No. A130803 (Cal. Ct. App. Oct. 2, 2012), Cal. S.Ct., No. S206587, petition for review granted 01/16/2013**

- FTB Response

- The FTB issued Notice 2012-01 on filing protective refund claims for earlier years.
- If *Gillette* is affirmed on appeal, the FTB will take the position that a taxpayer cannot make a Compact alternative apportionment election on an amended return.
- The FTB has taken the position that if *Gillette* is not affirmed on appeal, taxpayers filing in reliance on it will face California's 20% penalty for large corporation underpayment (the so-called "LCUP").

MTC 3-Factor Election

International Business Machines Corporation v. Department of Treasury, No. 146440 (Mich. S.Ct. Jul. 14, 2014)

- *Ford Motor Credit Company v. Department of Treasury*, No. 289781 (Mich. S. Ct. Jun. 10, 2010); U.S. cert. denied Jan. 18, 2011
 - Retroactive Denial of Refund?
 - Sales tax law M.C.L. § 205.54i retroactively denies corporate taxpayers an opportunity to file refund suits for bad debt deductions existing in excess of 5 years.
 - Taxpayer argued that the retroactive application of the statute violates the Due Process Clause of the U.S. Constitution.
- Michigan Dep't of Treasury (MDOT) proclaims \$1.1 Billion tax consequence from *IBM* decision.
- On 9/12/14, the Michigan Gov. signed legislation (S.B. 156) retroactively repealing the Compact, stipulating that multistate corporations weren't entitled to use the MTC's apportionment formula as of Jan. 1, 2008.
- MDOT motion for reconsideration pending.

MTC 3-Factor Election

Graphic Packaging Corp. v. Combs, No. 03-14-00197-CV, Travis Cty. Dis. Ct. (TX 2014)

- Holding:
 - The court dismissed Graphic Packaging's argument that it properly elected to use the Compact's 3-factor apportionment formula and granted the State's motion for partial summary judgment.
- Reasoning:
 - The order granting partial summary judgment on the State's motion included no discussion of the issues.
 - It is unclear the grounds for the court's dismissal of Graphic Packaging's claims.
- Posture:
 - Currently pending appeal at the 3d District of the TX Ct of Appeals
 - Graphic Packaging's opening brief was due September 12, 2014.

MTC 3-Factor Election

Health Net, Inc. v. Oregon Department of Revenue, T.C.-MD No. 120649D (filed July 2, 2012)

- The Oregon Tax Court heard oral argument on the case on July 22, 2014.
 - Oregon Tax Court Judge Henry Breithaupt distinguished *IBM* from the matter before the court on the grounds that Oregon, unlike Michigan, has a statute (ORS 314.606) that specifically disables the Compact election provision.
 - The judge requested additional briefing from the parties on the concept of an “illusory contract.” Under this concept, the parties can agree to be partners, but make no commitment.

MTC 3-Factor Election

Kimberly-Clark Corp. v. Comm'r of Rev., MN Tax Ct. Dkt. No.08670 (filed Dec. 12, 2013)

- Drawing heavily on the taxpayers' arguments in *Gillette*, Kimberly-Clark has filed a notice of appeal in the Minnesota Tax Court, arguing that it is entitled to use the Compact 3-factor formula on its Minnesota returns for tax years ending 2007 - 2010.
 - Kimberly-Clark argues that the Compact is binding and that a member state cannot unilaterally amend portions of the Compact. If a member state wishes to withdraw from the Compact, it must repeal its adoption entirely.
 - Therefore, despite Minnesota's repeal of Compact Arts. III and IV in 1987, the 3-factor election remained available to Minnesota taxpayers as a fundamental feature of the Compact in which Minnesota remained a member.



Federal Legislation



Pending Federal Legislation

- **Mobile Workforce State Income Tax Simplification Act**
 - Would protect nonresident employees from a state's income tax (and employers from withholding) if the employee is present in the state 30 days or less during the year
 - Reintroduced on Feb. 5, 2015 as S. 386
- **Marketplace Fairness Act**
 - Would authorize states to require remote sellers to collect sales/use tax
- **Business Activity Tax Simplification Act**
 - Would modernize P.L. 86-272
 - beyond sales of tangible personal property
 - apply more broadly than just net income taxes
 - Physical presence required for nexus



Pending Federal Legislation

Online Sales Simplification Act of 2015 (Draft)

- On Jan. 13, 2015, House Judiciary Chair Goodlatte (R-VA) released discussion draft of an origin-based sourcing sales tax plan
- State may impose or require collection of sales or use tax by seller on a remote sale only if:
 - State is the “origin state” for the remote sale, and
 - State is a party to a tax distribution agreement
- Tax applied at rate of origin (seller’s) state
- Tax sent to clearinghouse and distributed to destination (purchaser’s) state



U.S. Supreme Court Cases



USSC Cases

***Maryland Comptroller v. Wynne*, 431 Md. 147 (2013), cert. granted (U.S. May 27, 2014)**

- Maryland taxes residents on worldwide income, including “pass thru” income to S Corp shareholders
- County portion of Maryland income tax does not allow a credit for individual’s taxes paid to other states
- Maryland Court of Appeal held that failure to allow such credit violates the Commerce Clause
- On Nov. 12, 2014, USSC heard oral arguments



USSC Cases

***Direct Marketing Ass'n v. Brohl*, 735 F.3d 904 (10th Cir. 2013), cert. granted (U.S. July 1, 2014)**

- Colorado imposed use tax notice and reporting (not collection) requirements on retailers with no in-state physical presence
- Federal district court enjoined the Colorado requirements based on the Commerce Clause
- 10th Circuit held that district court lacked jurisdiction under Tax Injunction Act
- Commerce Clause claims not addressed
- On Dec. 8, 2014, USSC heard oral arguments



USSC Cases

Alabama DOR v. CSX Transportation, Inc. (CSX II)

- Issue is whether Alabama's motor fuel sales tax exemption for motor and interstate waterway carriers discriminates against railroads under 4-R Act
- On Dec. 9, 2014, USSC heard oral arguments



Nexus



Affiliate Nexus

- *Rent-A-Center, Inc. v. Dep't of Revenue, Or. Tax Ct. No. TC-MD 111031D (May 12, 2014)*
 - Wholly-owned operating subsidiary not unitary with its parent
 - Subsidiary lacked Oregon corporate excise tax nexus
 - Subsidiary was not “doing business” in Oregon simply by receiving royalties from Oregon franchisees
 - 4-day Oregon visit by 2 employees to inspect franchisee operations and provide training did not amount to doing business in the state



Affiliate Nexus

- *Harley-Davidson Inc. v. FTB*, 4th Appellate District Case No. D064241
 - Two special purpose subsidiaries formed to securitize loans originated by affiliated corporations had nexus with California because their activities were all part of one corporate enterprise to provide financing to buyers of motorcycles and related products, and their in-state affiliates acted as their agents.
 - Although the subsidiaries were organized in Nevada and had no physical presence in California, the court's finding of nexus was based on the fact that the activities of the special purpose subsidiaries were inextricably intertwined with the California activities of other Harley-Davidson subsidiaries.



Unitary Nexus

- *Gore Enterprise Holdings Inc. v. Comptroller*, 437 Md. 492 (Mar. 24, 2014)
 - Nexus cannot be based merely on unitary relationship with in-state affiliate
 - Nexus may be established where out-of-state entity has “no real economic substance” as a separate business entity from the in-state affiliate
 - Even where out-of-state entity is not a sham
 - Apportionment based on in-state affiliate’s factors



Nexus – LP Interest

- *Village Super Market of PA, Inc. v. Dir., Div. of Taxation*, 27 N.J. Tax 394 (2013)
 - Pennsylvania corporation (“PA”) had nexus in New Jersey based on its 99% limited partnership interest in a New Jersey limited partnership (“LP”)
 - PA and LP were in same line of business with overlapping officers
 - *BIS LP* case distinguished



Nexus – LLC Interest

- *Swart Enterprises v. FTB*, Fresno County Superior Court, Case No. 13CECG02171. Notice of Appeal filed Jan. 12, 2015 in Fifth Appellate District.
 - Does a corporate member of an LLC have nexus if the LLC has nexus?
 - FTB Legal Ruling 2014-01
- *Bunzl Distribution v. FTB*, First Appellate District, Case No. A137887
 - Does a corporate owner of a disregarded LLC have nexus if the LLC has nexus?
 - FTB Legal Ruling 2011-1



“Reverse” Nexus

- *Allied Domecq Spirits & Wines USA, Inc. v. Comm’r*, 85 Mass. App. Ct. 1125 (June 18, 2014)
 - Subsidiary’s transfer of Mass. employees and property to its Parent did not create sufficient nexus to be included in Subsidiary’s Massachusetts combined group
 - Court applied sham transaction doctrine
 - Does intent matter for physical presence nexus?



Nexus – Factor Presence

- *L.L. Bean Inc. v. Levin*, Ohio Bd. Tax App. (Mar. 6, 2014)
 - Upheld commercial activity tax assessment on a retailer with no physical presence in Ohio
 - Retailer had more than \$500,000 in gross receipts annually from Ohio customers through online and catalog sales
 - Statutory \$500,000 gross receipts threshold exceeded
 - BTA precluded from declaring statute unconstitutional



Economic Nexus, Single Sales Factor, and Market-Based Sourcing

- Economic Nexus – most states
 - income derived from in-state sources without physical presence
- Factor-Presence Nexus, e.g., CA, CO, CT, MI, NY, OH, WA
- Market-Based Sourcing, e.g., AL, CA, DC, GA, IL, IA, LA, ME, MD, MA, MI, MN, NJ, NY, OH, PA, UT, WA, WI
- Single-Sales Factor, e.g., CA, CO, CT, DC, GA, IL, IA, IO, ME, MI, MN, MS, NE, NJ, NY, OH, OR, PA, RI, SC, TX, UT, WA, WI



Apportionment



Apportionment – Throwout

- *Lorillard Licensing Co., LLC v. Dir., Div. of Taxation*, N.J. Tax Ct. No. A-2033-13T1 (Jan. 14, 2014)
 - For throwout purposes, company is “subject to tax” in another state based on “economic nexus” standard upheld in *Lanco*
 - Out-of-state licensing affiliate received royalties from tobacco sales in all 50 states
 - Affiliate was thus subject to tax in all other states and throwout rule did not apply to any of its sales
 - While the ruling specifically addressed intangible property, it is potentially applicable to tangible property as well



Apportionment – Alternative Method

- *Equifax, Inc. v. Dep't of Revenue*, 125 So. 3d 36 (Miss. 2013), *cert. denied* (U.S. June 30, 2014)
 - Mississippi Supreme Court held that taxpayer bears burden of proof showing that Department's use of alternative formula is unreasonable
 - Department used market-based sourcing as an alternative apportionment method instead of cost of performance as provided by statute
 - Effective 2015, Mississippi Legislature enacted legislation (HB 799) regarding use of alternative apportionment and burden of proof



Apportionment – Alternative Method

- *Vodafone Americas Holdings Inc. v. Roberts*, Tenn. Ct. App. (June 23, 2014)
 - Upheld Commissioner's imposition of market-based sourcing as an alternative apportionment method instead of cost of performance as provided by statute
 - Vodafone's sales factor included only its sales of tangible personal property to Tennessee customers
 - Under cost of performance, Vodafone excluded all revenues from its delivery of wireless services to Tennessee customers
 - Commissioner acted within scope of discretion
 - Pending at the Tennessee Supreme Court



Combined Reporting



Combined Reporting – Oregon

- *Rent-A-Center, Inc. v. DOR*, TC-MD 111031D (OR Tax Ct. 2014)
 - Court held that wholly-owned operating subsidiary was not unitary with its parent for the 2003 tax year
 - Companies were in same line of business, but had competing brands and were operated separately
 - Sharing of corporate officers who did not direct the subsidiary's operations was not “centralized management”
 - Because centralized management was absent, Court did not address functional integration or economies of scale



Combined Reporting – Oregon

- *DOR v. Rent-A-Center, Inc.*, TC 5224 (OR Tax Ct. 2015)
 - On Jan. 26, 2015, Regular Division of Oregon Tax Court held that, under the statute in effect for the 2003 tax year, single unitary business requires:
 - Centralized management or common executive force;
 - Centralized administrative services/functions resulting in economies of scale; and
 - Flow of goods, capital resources or services demonstrating functional integration
 - Statute was amended in 2007 to require only one of the three elements to establish a unitary business
 - Court rejected Department's retroactive application of Department's 2006 interpretive rule requiring only one or two of the three elements as inconsistent with the governing statute



Combined Reporting – New York

- Prior to 2007, combined reports permissible based on substantial ownership and distortion resulting from separate filing
 - *Matter of IT USA, Inc.* (N.Y.S. Tax App. Trib. 2014)
 - Parent properly filed combined reports with two of its subsidiaries
 - Parent and subsidiaries engaged in a unitary business
 - Intercompany provision of management, corporate, administrative and logistical services at cost were found to be distortive
- In 2007, combination required if have substantial ownership and “substantial intercorporate transactions”



Combined Reporting – New York

- *Matter of Knowledge Learning Corp.* (N.Y Tax Appeals Tribunal 2014)
 - Division decombined affiliated companies based on companies' failure to establish "substantial intercorporate transactions" under 2007 statutory change
 - On June 27, 2013, ALJ found lack of documentation to support the transfer of employees between affiliates
 - ALJ also held that distortion is no longer the proper analysis in light of the 2007 statutory change
 - On Sept. 18, 2014, Tax Appeals Tribunal reversed ALJ and held that taxpayers were permitted to file combined report
 - Sufficient evidence of substantial intercorporate transactions
 - Transactions had valid business purpose
 - Tribunal also determined that distortion as reason for combined reporting is still valid after the 2007 statutory change



Combined Reporting – New York

- Effective 2015, combined reports required for all unitary corporations that are more than 50-percent controlled by voting power (NY Tax Law section 210-C)



Combined Reporting – Arizona

- *Home Depot USA, Inc. v. Arizona Dept. of Rev.*, 233 Ariz. 449 (Ariz. Ct. App. 2013)
 - Retailer was required to file a combined report with its subsidiary that owned and licensed trademarks to the retailer
 - Arizona’s narrower unitary test under *Talley* requires operational integration at the revenue-producing level
 - Retailer and its subsidiary considered to be unitary because their basic operations were “substantially interrelated”



Business/Nonbusiness



Business/Nonbusiness Income

- *ComCon Production Services I, Inc. (“Comcast”) v. FTB*
 - On March 6, 2014, the trial court held that Comcast was not unitary with QVC, a television channel in which Comcast had a 57% ownership interest
 - No centralization of management, functional integration, or economies of scale between the two entities
 - Court rejected FTB’s arguments that because Comcast carried QVC and entered into certain joint ventures with QVC, there was a flow of value amongst the two companies
 - Break-up fee was business income
 - Judgment was entered on August 22, 2014.
 - On Feb. 9, 2015, the trial court awarded \$141,000 in litigation costs to taxpayer
 - Case on appeal



Business/Nonbusiness Income

- *Fidelity National Information Service Inc. v. FTB*,
Sacramento Superior Court No. 34-2013-00148015
 - On July 15, 2013, taxpayer filed suit regarding the issue of whether gain from the sale of a minority stock interest is business or nonbusiness income
 - Case pending at trial court



Business/Nonbusiness Income

- Taxpayer Information Ruling LR13-004
 - Proceeds from a patent infringement lawsuit are business income for Arizona corporate income tax purposes where the regular trade or business operations of the patent holder include developing, acquiring and holding patents, and earning income by using patents in manufacturing products or licensing patents to third parties.
- *Harris Corp. v. Ariz. Dep't of Revenue*, 233 Ariz. 377 (App. 2013)
- *First Data Corp. v. Ariz. Dep't of Revenue*, 233 Ariz. 405 (App. 2013)



Business/Nonbusiness Income

- *Appeal of Wyeth*, SBE No. 846195
- *Oracle Corp. v. Dept. of Rev.*, No. MD 070762C (Or. Tax Ct. Jan. 19, 2012) (Duty of consistency?)
- *Levi Strauss*, SBE No. 547505 (Classification of interest expense)
- *Pacific Bell Telephone*, SBE No. 521312 (Foreign investments)
- FTB Legal Ruling 2012-01



Local Business Taxes



Local Business Taxes

- Many cities and local governments impose business taxes, often called “privilege taxes” or “business license taxes,” based on gross receipts (e.g., Los Angeles, San Francisco, Oakland, Fresno, Fremont, Modesto).
- Some may assert nexus without physical presence
 - soliciting sales from City customers remotely (internet, telephone, etc.)
 - P.L. 86-272 inapplicable for gross receipts taxes. Solicitation of sales may be sufficient to create filing obligation.
- Some do not have specific apportionment provisions.



Local Business Tax Procedures

- Assessments may be issued within three years of filing return. Refund claims must be filed within one year from the date the tax was paid (e.g., Los Angeles Municipal Code sections 21.16(a) and 21.07).
 - Refund claims based on unconstitutional apportionment are waived if not raised within six months from date of payment (e.g., Fremont Municipal Code section 5.05.060; Modesto Municipal Code section 6-1.436).
- Appeal of audit determination must be filed within 10-20 days (e.g., Los Angeles Municipal Code section 21.16(b); Oakland Municipal and Planning Codes section 5.04.600).
- If no return filed, Tax Collector may make determination based on available information, and add 20 percent penalty to the bill (e.g., Modesto Municipal Code section 6-1.112).



San Francisco Gross Receipts Tax

Beginning in 2014, the Gross Receipts Tax (“GRT”) is imposed on a broad array of persons doing business in the City, including:

- sole proprietorships,
- limited liability companies (“LLCs”)
 - Entities that are disregarded for federal income tax purposes (e.g., single-member LLCs) will not be treated as separate taxable entities for GRT purposes. (Tax Collector Regulation 2014-2.)
- corporations
- S-corporations



San Francisco Gross Receipts Tax

“Doing Business” in the City includes:

- Presence in the City for more than 7 days during the year soliciting sales, performing services, or using City roads for business purposes.
- Owners of businesses that are “pass through” entities for federal income tax purposes (e.g., partnerships) are not doing business in the City solely because that entity is doing so.
- Single-owners of entities that are disregarded for federal income tax purposes (e.g., single member LLCs) are doing business in the City if the disregarded entity is doing so. (Tax Collector Regulation 2014-2.)



San Francisco Gross Receipts Tax

“Gross receipts” subject to the GRT are defined broadly as the total amount received from whatever source derived. There are several exclusions, including:

- certain types of investment income and distributions from business entities
- cost basis of sold real property excluded
- sales of real property subject to the City’s Real Property Transfer Tax
- cost basis to acquire financial instruments excluded
- gifts and certain grants
- taxes required to be collected and remitted to the government



San Francisco Gross Receipts Tax

- For taxpayers conducting business within and outside of the City, the gross receipts attributable to the City are generally determined by:
 - a payroll factor (payroll within the City to all payroll),
 - gross receipts allocation rules, depending on type of receipt,
 - receipts from the performance of services are allocated to where the purchaser received the benefit of the service.
 - receipts from intangibles are allocated to where and to the extent the property is used.
 - a combination of the above.



San Francisco Gross Receipts Tax

A person subject to the GRT and its related entities must file a single GRT combined return.

- “Related entities” are those permitted or required by the Franchise Tax Board to have their income reflected on the same California Corporation Tax combined report under CRTC section 25102, et. seq.
 - partnerships?
- A water’s edge election made for California Corporation Tax purposes is effective for GRT combined returns.



San Francisco Gross Receipts Tax

Procedural Issues:

- The 2014 GRT tax returns are due by March 2, 2015, but may be extended to May 1, 2015.
 - before the extended due date of 2014 federal and California income tax returns for calendar-year taxpayers.
- Deficiency notice may be served within three years of filing. (San Francisco Business and Tax Regulation section 6.11-2(a).)
- Refunds must be claimed within one year of overpayment. (San Francisco Business and Tax Regulation section 6.15-1(a).)
 - No special statute of limitation provisions for assessments or refunds where California or federal adjustments have been made.



QUESTIONS?

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