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WHAT THE “L,” LOCAL TAXES?

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LOCAL TAXES

INTRODUCTION

While many tax professionals view local taxes as a nuisance, the issues that can arise can certainly have major implications as many local taxing jurisdictions have a higher combined rate than the State. Moreover, there are myriads of different taxing authorities that can exist even in one county or parish, each of which has their own separate tax rate and jurisdictional boundaries. Therefore, it is very easy for a tax professional who has to analyze the potential tax liabilities of a business operation in a jurisdiction that is far removed from a taxpayer's corporate office can face issues that are not necessarily easy to resolve, but can result in large potential liabilities.

The purpose of this paper is to hopefully alert the tax professional that is responsible for local tax compliance to issues that may need consideration. Hopefully, the information provided will not offend common sense, but one can only be amazed at the issues that may arise. Fortunately, they can be solved with a little planning and information.

A. WHO ARE THE LOCAL TAXING AUTHORITIES?

While it might seem a simple task to know who the tax administrators are for a particular locality, that is not always the case. While a county or parish typically has a centralized government, that entity may not be the only political subdivision of the State that is allowed to impose and collect sales and use tax. In many jurisdictions, there is a special taxing jurisdiction that is specifically dedicated to schools. For example, in Louisiana, local school boards impose the largest portion of local sales and use taxes and typically administer and collect them for a number of other taxing entities. In Colorado, Home Rule cities enact and administer their own sales and use taxes. There are also cities and incorporated municipalities that impose and collect their own sales and use taxes. Finally, there are special taxing districts that can be created that also have the power to tax.

As you consider your potential tax liability in a particular locale, it is important to understand (1) the entities that you are dealing with; (2) the individuals that act on behalf of those entities; (3) any differences that may exist in the boundaries of the particular taxing authority; (4) the law that will govern the imposition and the collection of the tax; and (5) any possible exemptions or exclusion from the tax. In the Appendices that are attached, information regarding these issues is provided. While it may seem simple, the issues can be complex and result in paying too much or too little tax. Examples of tax returns from local jurisdictions are attached as Appendix "A" for your review. These forms illustrate how one location can be governed by a handful of different taxing entities, each with its own rate of tax and each with its own territorial

boundaries. To understand one's potential liability, one must understand not only sales and use tax law, but geography.

The major local taxing entities are as follows:

1. County/Parish
2. City/Municipality
3. School Board
4. Special Taxing Districts

The majority of local taxes are collected by the State Department of Revenue and then allocated to local jurisdictions. See Appendix B (contains information on every state). In states where centralized collection occurs, the problems that local taxes can present are easily avoided. However, in the states that allow locals to impose and collect their own taxes, problems can easily arise for the unwary. See Appendix C for information on states where local taxing authority impose and collect.

The ultimate governing authority in a county or parish can have many different names. For example, in Louisiana parishes are typically governed by a "Police Jury." This elected group of officials act in the same manner as a City Council or Board of Alderman, or Supervisors. The power and authority of these entities are governed and limited by the Louisiana Constitution. These entities enjoy the power to impose sales and use tax up to a certain rate.¹

Counties and parishes typically share their taxing authority with School Boards or other educational districts. Typically, a School Board and the County are the only countywide political subdivisions that can impose and collect sales and use taxes.

Many states allow for special taxing districts to serve a specific purpose. For example, Louisiana allows for hospital service districts, garbage collection districts, fire and police districts, and sewage districts. Each of these entities is specifically created to provide a specific service and thus, has been given the statutory authority to impose and collect sales and use taxes to fund its operations. Typically, the boundaries of a special taxing district are limited (although not always well defined). These localized taxing bodies can be difficult to identify when analyzing tax liabilities because of their limited scope and jurisdiction.

¹The Louisiana Constitution specifically limits the rate of tax that local taxing authorities can impose to 3%. However, it is a relatively simple process for a local taxing authority to have that increased. The authority must get legislative permission and put the matter out to a vote of the electorate that will be subject to the tax. Using this procedure, practically every local taxing authority in the state has a tax rate that well exceeds 3%. In fact, many urban locations have tax rates of 5-6%.

PRACTICE NOTE:

In Louisiana, a taxpayer can avoid the sales and use taxes imposed by a special service district under certain circumstances. For example, if the service provided by a special service district was provided by the taxpayer prior to the enactment of the service district (i.e. fire or garbage service at an industrial facility), the taxpayer can argue that they should not have to pay the tax if it continues to provide those same services at its facility. See, generally, La. R.S. 33:130.11 *et seq.*

Many local taxing authorities assist by having a centralized collection authority for all bodies within the jurisdiction that impose and collect sales and use taxes. In this fortunate event, that one entity typically can provide the taxpayer with all the applicable information regarding rates and reporting requirements in the various jurisdictions. Obviously, some of the taxing jurisdictions will overlap and others will not. These centralized collection authorities also typically provide forms that ease compliance obligations and identify exemptions, exclusions, and other items that may affect the taxpayer's liability.

PRACTICE NOTE:

When first entering a new taxing jurisdiction, a taxpayer should identify the particular taxing authorities in the jurisdiction, both state and local. If there is a centralized collection authority, that entity typically can provide the necessary information to taxpayers to assist in registering, reporting and remitting the applicable tax at the appropriate rate for all the taxing authorities in the jurisdiction.

If there is no centralized collection authority, the taxpayer should contact the largest local taxing authority and inquire as to whether any other taxing authorities that may exist in the county or parish. Typically, the combined rates that all local taxing authorities in one county or parish can impose is capped or limited by the State Constitution or statute. As such, there is interplay between them even if there is no centralized authority that collects or administers the tax on behalf of all.

One local taxing authority that every taxpayer must look for and pay attention to is the *Home Rule City*. Under many State Constitutions, Home Rule Cities, Towns or Units are vested with the authority to create a charter, or other code, which is the organic and governing law of all local and municipal matters.² Under the authority of the State Constitution, a Home Rule City can enact any law or statute that supersedes the laws or statutes of the State that are in conflict, as long as it involves a *local* matter.³ As such, a Home Rule City can enact its own sales and use tax code.⁴ While it will undoubtedly target transactions involving tangible personal property, the

² See for example Article XX, Section 6 of the Constitution of Colorado.

³ See *Berman v. City and County of Denver*, 156 Colo. 538, 400 P.2d 434 (Co. 1965) (finding sales and use taxes are local activities).

⁴ *Id.*

transactions that it taxes, exemptions and exclusions that it allows and the procedures that it provides for can be very different.

For example, in *International Paper Company v. Cohen*⁵, the City and County of Denver sought to collect sales tax on the sale of a box plant as an ongoing business. Unlike the State of Colorado, the City of Denver did not have an exclusion for casual and isolated sales. Therefore, while the State did not tax the transaction, the City assessed and pursued collection. With no casual sale or bulk sale exemption, the taxpayer was forced to argue that much of the transaction involved real property and therefore was not subject to sales tax under the Code.

PRACTICE NOTE: Home Rule Cities

When dealing with a Home Rule City, be aware that the City may have a sales and use tax code that is different than the sales and use tax laws followed by the Department of Revenue in the particular state. Moreover, while the advent of the internet has made it easier to gather information, it is not always apparent that the Code is different or how it is different. Certainly, the best course of action is to contact the Home Rule City's Tax Department directly and request a copy of the tax code and any other documents or forms they have generated that may assist with tax compliance.

B. DO LOCALS HAVE TO FOLLOW THE STATE?

After the return puzzle has been solved (i.e. what local jurisdictions require the filing of a return), the next issue is what is taxable in each local jurisdiction and are there any exemptions or exclusions that apply. While many states have a centralized collection authority or limit the ability of local taxing authorities to impose tax as the same statutes, rules and regulations apply, there are many jurisdictions where the local taxing authorities are not limited in what transactions can be taxed or what transactions are exempted from tax. Included in the Appendices is information regarding the states that do allow local taxing authorities to impose and collect sales and use taxes and whether the local taxing authorities can create their own laws or must follow the states.

1. Substantive Law

Typically, sales and use taxes are imposed on all tangible personal property that is sold or purchased within the taxing jurisdiction or purchased outside the taxing jurisdiction and imported for use in the taxing jurisdiction. Moreover, sales taxes are typically imposed on certain limited services, such as repairs, parking and telecommunication services. Considering the eternal need for additional tax dollars, most local political subdivisions will impose as much sales and use tax as the states, or the local voters, will allow. However, many local political subdivisions, which rely on big industry to supply the majority of their local taxes (and local jobs), can enact

⁵ 126 P.3d 222 (Colo. App. 2005).

exemptions and exclusions from tax that are different than those in place at the state level, and actually consider the needs of local industry.

Another important consideration is the procedure that the local taxing authority utilizes in the reporting and collection of tax, its auditing procedures and protest and dispute procedures. An uninformed taxpayer can discover that too much or too little tax has been paid and the proper procedures have not been followed and, as such, the ability to protest or contest an assessment has been waived. Again, the key is to use the resources available from the local taxing authorities to ensure that neither of these situations occur.

a) Statutes and Regulations

While local political subdivisions typically have their own sales and use tax code or ordinance that define what can be taxed and the procedures to follow, one cannot forget that political subdivisions are just that, and only have the authority that has been granted to them by the State Constitution or by statute. Therefore, while a local taxing authority may have its own code or ordinance, it may be invalid to the extent that it is inconsistent with the statutes and regulations of the state.⁶ (Compare with Home Rule Cities). Moreover, it is not unusual for a state statute to permit a local taxing authority to choose whether it will exempt a particular transaction from tax. For example, in La. R.S. 47:337.10, the Legislature has identified a number of optional exclusions and exemptions that local political subdivisions may enact with respect to certain transactions. Moreover, the State Legislature may also exempt a transaction at the state level and not the local level and vice versa. Obviously, a tax professional confronted with this potential for inconsistent treatment must be aware of the potential pitfalls and problems one can face when dealing with a state that allows local political subdivisions to enact their own ordinances and does not require uniformity.

Uniformity is the concept that sales and use taxes imposed at the state level must mirror those imposed and collected at the local level. As indicated above, most states are uniform in their imposition of sales and use taxes and the exemptions recognized. However, there are systems that allow for differences. It is in these jurisdictions that one must be very careful in ascertaining its tax obligations. Below is a table of whether uniformity is required in the eight states that allow local taxing authorities to impose and collect their own sales and use taxes.

⁶ See, for example, *BP Oil Co. v. Plaquemine Parish Government*, 642 So.2d 1230 (La. 1994), amended in part, reversed in part, 651 So.2d 1322 (La. 1995).

STATE	UNIFORMITY REQUIRED
Alabama	NO; EACH COUNTY HAS INDEPENDENCE TO DECIDE
Alaska	STATE DOES NOT IMPOSE SALES OR USE TAX
Arizona	MODEL CITY TAX CODE (but cities may go out on certain provisions)
Colorado	YES FOR STATUTORY CITIES; NOT FOR HOME RULE CITIES OR COUNTIES
Louisiana	YES, BUT LEGISLATURE CAN VARY APPLICABILITY BETWEEN STATE AND LOCALS
Idaho	YES
Montana	YES (only at local level)
North Dakota	YES (Some cities have additional exemptions)

The issue of uniformity can come into play in two ways. First, does the state and local taxing authorities actually impose tax on the same transactions. Further, do both jurisdictions exempt the same transactions from tax.

i) Do state and the locals tax the same things?

While it may seem a silly question, because the intent of the sales and use tax is to tax transactions involving all tangible personal property, it is very common in a dual state and local system for there to be differences in what is actually taxed. For example, in *International Paper v. Cohen* (cited above), the State did not impose sales tax on the casual and isolated sale at issue. However, the City of Denver did.

Further, for example, in Louisiana, tangible personal property that is imported into the State and stored is only subject to tax if the property is to be used in the State.⁷ Typically, local sales tax ordinances mimic that language and therefore, only levy a use tax on tangible property stored *for use in that parish*. As such, if tangible property was imported into a warehouse in a particular parish, but was to be used in another parish, Louisiana state use tax would be due, but no parish tax would be due. Ultimately, a use tax might be due in the Parish where the property was first used. While this may seem trivial, if a use tax is reported and paid to the parish where the tangible property is warehoused, but not used, the parish where the property is first used may be able to assess and collect tax even though it was paid to the first parish.⁸

Unfortunately, there are many such nuances that can arise between the state and the locals, and even between the locals themselves. The only defense is to thoroughly review the local sales tax code to ensure full and proper compliance.

⁷ See La. R.S. 47:301(15); 302(A)(ii). See also, *Lafayette Parish School Board v. C & B Services, Inc.*, 735 So.2d 6 (La. App. 3rd Cir. 1999).

⁸ See *Terrebonne Parish Sales and Use Tax Dep't v. Callais Cablevision, Inc.*, 433 So.2d 820 (La. App. 1st Cir. 1983).

ii) *Is there uniformity in the available exemptions?*

Obviously, a review of all of the various exemptions from sales and use taxes that may be different between a state Department of Revenue and the local jurisdictions is well beyond the scope of this paper. However, in Appendix C, some basic information is provided in that regard. The most significant issue that can arise is usually when the state has exempted a particular transaction from sales and use tax, but the local taxing authorities have not. For example, in Louisiana, the sale of pharmaceuticals and other prescription medications are exempt from sales and use tax at the state level.⁹ However, prescription drugs are not exempt at the local level. There are numerous examples of a difference in tax treatment between the state and locals. As noted above, there are also instances where a statute or Legislature has given the local taxing authorities the option to opt in or out of exemptions and thus, further complicate matters.

To make matters more complicated, at least in Louisiana, exemptions can be suspended and thus, cause greater confusion. In 1986, to balance the budget in the wake of the downturn in the oil and gas industry, the state Legislature suspended a number of sales and use tax exemptions. Moreover, the Legislature altered the rates related to other exemptions. In fact, recently, in the 2015 legislative session, the Louisiana Legislature purported to suspend certain exemptions related to business utilities in an effort to balance the Louisiana state budget. House Concurrent Resolution No. 8 suspends business utilities related to the business's purchase and use of such things as electricity, natural gas, steam and other items used in the State.¹⁰ The suspension of exemptions at the state level, however, did not, and does not, influence the effectiveness of the exemptions at the local level.

To make things even more complicated, an exemption that may appear valid, in force and applicable to the transactions under consideration, may still not be of full force and effect. It is not unusual for a local government to borrow money by issuing bonds for a particular project or simply to meet budgetary needs. Typically, this is accomplished by issuing bonds that are secured by sales and use tax revenues. In such a circumstance, the local authority is guaranteeing repayment of the bonds through the stream of revenue generated by sales and use tax received. To protect that revenue, it is not unusual for the State Constitution or other legislation to prohibit the enactment of new exemptions or exclusions that could possibly diminish the sales tax revenue.¹¹ Therefore, even a review of the local taxing authority's ordinance may

⁹ La. R.S. 47:305(D)(j).

¹⁰ There is a legal challenge to the Constitutionality of House Concurrent Resolution No. 8 that is currently pending.

¹¹ See for example Article VI, Section 29 of the Louisiana Constitution of 1974; La. R.S. 33:2716.1(A).

not answer the question of whether a particular exemption is truly applicable to the transactions under consideration.¹²

PRACTICE NOTE:

When reviewing your business operations to determine whether any exemptions may apply, be aware that the state and local taxing authorities may not exempt the same transactions from tax. Moreover, there may be overlapping statutes granting relief from taxation and each one of those provisions must be reviewed in order to ensure that taxes are not erroneously remitted. Finally, exemptions that appear valid on the face of the ordinance may be suspended or impaired by outstanding bonds.

2. Are the Same Procedures Employed?

One of the biggest problems that a taxpayer can face when dealing with a local taxing authority is the compliance procedures that it must follow. While the state Legislature may dictate what is taxable and what exemptions and exclusions apply, the local jurisdiction will undoubtedly determine the tax rate (most likely subject to some legislative oversight or authorization) and more importantly dictate the appropriate procedures for reporting and remittance, auditing (including sampling) and assessments and protest procedures. Each of these items can present trap doors that can prejudice a taxpayer's right to challenge a tax or get a refund. Again, a full dissertation on the procedures that are in place for the various local taxing authorities is well beyond the scope of this paper. In fact, prior to the enactment of the Uniform Sales Tax Code in Louisiana,¹³ it would be a significant project to gather information regarding all of the appropriate procedures simply for the Louisiana Parishes.

a) Reporting and Collection

Typically, each taxing authority has prepared its own forms that it requires taxpayers to complete and file to report taxes collected or otherwise owed during the applicable period in question. Many times the forms are not standard and can at times be confusing. Nonetheless, taxpayers should always contact the central collection authority, or the largest collection authority in a particular jurisdiction and obtain all the necessary forms when reviewing the appropriate tax compliance procedures. One important feature of the returns and forms is that they should provide the time delays required by the particular taxing authority for reporting and remitting taxes. While sales and use taxes are typically due on the twentieth of the month following the transactions that are being reported, there are timing differences among various jurisdictions that should be noted.

¹² This issue can really become a quagmire if the local taxing authority has refinanced the bonds over a long period of time. An issue arises as to whether the refinancing of a bond after the enactment of a new exemption or exclusion would affect subsequent transactions. Again, these are issues that may need to be considered when determining one's local tax liability.

¹³ La. R. S. 47:337 *et seq.*

PRACTICE NOTE: Direct Pay Numbers

Many states issue direct pay permits to manufacturers or other large businesses that have a high volume of sales and use tax transactions. While most local taxing authorities recognize and accept direct pay permits, it is possible that a direct pay permit may only excuse the collection of tax by the taxpayer's vendors at the state level. For example, in Louisiana, a taxpayer seeking a direct pay permit must obtain written approval from local taxing authorities before receiving a direct pay permit. See La. R.S. 47:303.1(D). If the local taxing authorities withhold approval, the direct pay permit is only applicable to state sales and use taxes. *Id.*

b) Auditing

The big issues that surround auditing by both state and local taxing authorities relate to (1) sampling and (2) contract auditors (which are discussed more fully below). Unfortunately, many local tax codes do not authorize either sampling or the use of contract auditors.

With respect to sampling, many problems arise regarding the methodology to use and what are the proper standards for analyzing whether the result is appropriate and proper. While it may seem to be a fairly straightforward procedure, and one that many taxpayers are willing to agree to if it expedites an audit, it is important to have an understanding with the auditor regarding the method that will be used prior to the commencement of the audit. This is particularly true if there are no regulations, or other published standards, on which one can later base a protest if the taxpayer believes that the result of the sample is not appropriate or just. Again, the local tax code should be consulted to ascertain the taxpayer's rights, if any, with respect to the sampling techniques employed.

For example, in the Louisiana Uniform Sales Tax Code, the local taxing authority must notify the taxpayer of the sampling procedure that will be used, including how the tax will be computed, the population to be sampled and the type of tax to be calculated.¹⁴ The statute further requires that the sampling procedure reflect as close as possible the normal business conditions during the period of the audit and requires that non-representative transactions be eliminated and separately audited.¹⁵ The statute also requires that the taxing authority conduct sampling in accordance with generally recognized sampling techniques as determined by the American Institute of Certified Public Accountants.¹⁶ Therefore, as a taxpayer approaching a sampled audit in Louisiana involving a local taxing jurisdiction, its rights are clearly set forth. Taxpayers should clearly look for similar guidance in other local jurisdictions.

¹⁴ See La. R.S. 47:337.35(C)(1).

¹⁵ *Id.*

¹⁶ *Id.*

c) Assessment and Protest Procedures.

Typically, a state Department of Revenue, and most local taxing authorities, have a procedure in place to notify a taxpayer of the results of an audit. In a typical audit, a taxpayer will be provided with workpapers that it can discuss with the auditor and possibly provide additional information to resolve any identified items. Thereafter, typically, a proposed assessment is issued that allows the taxpayer to file a written response and identify any issues and items that it believes should be removed from the audit, and also to provide additional information to assist in resolving the matter. This review usually occurs at a higher level of authority. Finally, after that protest procedure has occurred, a final, or formal, assessment is issued.

Once a formal assessment is issued, the taxpayer must carefully review the appeal and protest procedures in place for the particular jurisdiction in question. Many will allow a more formal appeal to the taxing authority, including a hearing in front of a hearing officer designated by the taxing authority. Others, continue a more informal approach and allow a less formal hearing where the taxpayer and the taxing authority get together to discuss the issues prior to deciding how to move forward towards resolution. However, a taxpayer should nonetheless review all relevant requirements.

For example, in Louisiana, there is no longer a protest to a local taxing authority. Instead, the taxpayer must either pay the assessment, appeal to the Louisiana Board of Tax Appeals or pay under protest and file suit in court or petition with the Board of Tax Appeals.¹⁷ Others allow for the taxpayer to file a protest with the state Department of Revenue, which acts as a quasi-administrative tribunal to review the assessment issued by the local taxing authority.¹⁸ Most taxing jurisdictions allow a taxpayer that disputes an assessment to pay the disputed amount under protest and to file a lawsuit or other action for a review of the assessment and refund of the taxes. Again, the taxpayer must carefully review the procedural requirements to assure that they are met. If the taxpayer fails to comply with the deadlines, or statutory prerequisites to perfecting an appeal, the taxpayer can lose the right to protest the assessment and it can become final.

d) Refund Procedures

The caution that a taxpayer should use when navigating the assessment and protest procedures is equally true with respect to refunds. While states typically have a budget that allows for the refund of meritorious claims, local taxing authorities are typically not so accommodating. As such, a taxpayer must carefully review the refund provisions in place for the particular taxing jurisdiction.

¹⁷ See La. R.S. 47:337.51(A)(1).

¹⁸ See C.R.S. 29-2-1061(3)(a) (allowing appeal of decision of local tax manager to executive director of the Colorado Department of Revenue).

Louisiana has broadened the historically limited grounds for a refund found in the local ordinances in the Uniform Sales Tax Code to more closely follow that of the State.¹⁹ The main components of the refund statute allow for a refund where tax was overpaid “because of a construction of the law on the part of the taxpayer contrary to the Collector’s construction of the law at the time of payment,” or the overpayment resulted from “an error, omission, or a mistake of fact of consequence to the determination of the tax liability, whether on the part of the taxpayer or the collector.”²⁰

Despite the broadening of the statutory language providing for refund claims, the Parishes in Louisiana continue to throw up every procedural and legal roadblock available to avoid the merits of a refund claim and to avoid payment of them. Parishes have argued that the only opportunity for a taxpayer to receive a refund is if the taxpayer has paid the taxes under protest. The Louisiana Supreme Court in *Tin, Inc. v. Washington Parish Sheriff’s Office*,²¹ specifically rejected a tax collector’s claim that a taxpayer was obligated to pay under protest where the taxpayer had filed a series of refund claims that the collector had ignored. The collector argued that the taxpayer should have known that it disagreed with the taxpayer’s position with respect to the law by its silence. The court flatly rejected that claim and found that the tax collector’s silence did not mandate that the taxpayer pay under protest to have an opportunity to seek a refund.

PRACTICE NOTE:

As each local taxing jurisdiction has its own procedures for the protest of assessments and issuance of refunds, a taxpayer must carefully review the provisions relating to those matters at the outset. If a particular procedure is not followed, the rights of the taxpayer can be waived forever. Moreover, with respect to refunds, the criteria that the particular taxing authority employs should be considered whenever analyzing whether a certain transaction should be taxed or not. If refunds are impossible to receive, consider paying the taxes under protest. If there is no guidance to help resolve the question, and the refund provisions are similar to those previously in place in Louisiana, it is in the taxpayer’s best interest to pay the tax under protest and seek recovery through whatever means permitted by statute.

C. ABILITY TO SHARE INFORMATION

One common thread of taxing authorities everywhere is the confidentiality of taxpayer information. Typically, the disclosure of confidential taxpayer information by an agent or employee of a taxing authority will not only result in the loss of employment, but may have criminal implications as well. Nonetheless, it is not unusual for statutory

¹⁹ See IRS 47:337.77.

²⁰ *Id.*

²¹ 1127 3d 197 (La. 213).

exceptions that allow local taxing authorities to share information regarding taxpayers, if requested. Such a procedure is typically in place for requests by and among the state and local taxing authorities as well. If a taxpayer operates in multiple jurisdictions, the sharing of information, and even a multi parish audit, may streamline and expedite the audit process. It might also even reduce issues with respect to credits and offsets for taxes paid among the parishes. Nonetheless, it would serve the taxpayer's interest to understand what provisions are in place regarding the sharing of confidential taxpayer information by and among local taxing authorities. This issue becomes more important when dealing with contract auditors, which are discussed more fully below.

D. CONTRACT AUDITORS

A phenomenon that is moving into many states is the use of contract auditors. Caught in budget crunches caused by diminishing revenues, ever-increasing population, many home rule cities and other local taxing authorities have enlisted the services of contract audit firms. Their mission is simple: go out and get revenue. Their tactics are simple: find big delinquencies and new issues, wrap up the audit, get an assessment issued and hopefully paid and move on.

A taxpayer's preparation for contract auditors can be complicated, or simple, depending on the jurisdiction and the scope of the audit. The Louisiana legislation puts in place a system that vests contract auditors with certain rights and obligations, such as the preservation of taxpayer confidentiality. The key issues that a taxpayer should consider relate to (1) ensuring authorization from the local authority, (2) confidentiality of your records and (3) the ability to interact directly with the tax officials who ultimately will make the decisions regarding any purported tax deficiency.

Once contacted by a contract auditor, a taxpayer should demand evidence and verification that the contract auditor is authorized to audit on behalf of a particular taxing authority. Written evidence of the relationship between the taxing authority and the contract auditor should be provided. The taxpayer should also demand written notification of the periods to be audited and the taxes that will be under examination. The taxpayer should also request a copy of the contract between the taxing authority and the contract auditor. Prior to allowing the contract auditing firm in, the taxpayer should ascertain the name of each and every employee of the contract audit firm that will participate in the audit and the role each person will play in the audit.

Obviously, if the contract auditor is paid on a contingency basis, his or her interest will be in identifying as many audit issues as possible to increase the size of the assessment. Even if a contract auditor is compensated on an hourly basis, his success in garnering a high assessment might affect their ultimate compensation. Consequently, the most important provision in any entry agreement with a contract audit firm is the confidentiality provision, wherein the contract auditing firm agrees to hold all taxpayer information gathered during the audit in confidence just as an employee of the taxing authority would. It is advisable that the taxing authority be a

party to any such agreement. Nonetheless, if there is no confidentiality agreement that binds the contract auditor, a taxpayer should strongly consider whether it will allow such a firm access to its tax records. As such, a taxpayer facing a contract audit must demand certain protections to help avoid that circumstance.

PRACTICE NOTE:

To sum up, when faced with an audit to be conducted by a contract auditor, a taxpayer should obtain the following:

- Written verification from the taxing authority that the contract auditing firm is authorized to audit on behalf of that taxing authority.
- The written contract between the contract auditor and the taxing authority.
- An entry agreement signed by the taxpayer and the contract auditing firm, including:
 - The name of each employee of the contract auditing firm that will participate in the audit and their role.
 - Identify the point person from the taxpayer's organization and indicate that all communications will be handled through that person.
 - The taxing authority for which the contract auditor is auditing.
 - The audit period at issue.
 - The taxes to be audited.
 - Issues related to sampling.
 - Definitive dates when the audit will commence and end.
- AND, MOST IMPORTANTLY, a confidentiality provision that specifically bars the contract auditing firm from disclosing any information or documents gathered during your audit and an acknowledgement that they are bound by the confidentiality provision of the local taxing authority.
- Any legitimate and ethical contract auditing firm, of which there are many, should willingly sign such an agreement and begin the auditing process.

After you have obtained a satisfactory pre-entry agreement that protects the taxpayer's rights, it is time to deal with the day-to-day issues that will be confronted. As with any other audit, the taxpayer must establish appropriate ground rules for the audit. For example, the contract auditor should know what hours they will be welcome to be on premises to review your books and records. The contract auditor should be given a

space where they should remain while on your premises. It should be made clear to all contract auditors that they must interact only with the point person designated in the agreement. The point person should also act as the person to whom all document requests should be made and all documents should pass through the point person possession prior to being given to the contract auditors. A log of all documents provided to the contract auditors should be maintained and if any documents are copied, those copies should be made by the taxpayer's staff and a duplicate copy should be made to put in a separate file retained by the taxpayer. Finally, each member of the contract auditor's team that enters the taxpayer's offices should be made to sign an "in/out" log to verify the hours that they are your premises. As with any other audit, your office should be alerted that contract auditors are on premises and that they should refrain from talking with them about the company's business in any way, shape or form. As with any other visitor to your business, each contract auditor should be required to wear a visitor's badge. Contract auditors should be extended the same courtesies that you would extend to a visiting competitor.

Regardless of the fact that a contract auditor has been retained by the taxing authority to audit the taxpayer's books and records, it is imperative that the taxpayer remain in contact with the taxing authority and that a line of direct communication be maintained. If during the audit process, problems arise with the contract auditor, including staff issues or tax issues, the taxpayer should not delay in getting the taxing authority involved. The best time to resolve an open issue is during the audit process itself. Moreover, the taxing authority is more likely to consider the taxpayer's position in a thoughtful and fair manner. If left to their own devices, a contract auditor will likely write up every issue regardless of the merit, and forward it on the taxing authority for assessment.²² During the audit, the taxpayer should also request any workpapers generated by the contract auditor as soon as they are available. Again, this will assist in resolving issues and allow a taxpayer to provide additional documentation if it will resolve the issue during the audit.

At the conclusion of the field work, the taxpayer should request an exit conference where the disputed issues are discussed. At the conference, it should be verified that all documents and records provided to the contract auditor have been returned to the taxpayer. The taxpayer should also verify that it has a copy of each and every document that has been provided to the contract auditor for their files. The taxpayer should request that someone from the taxing authority be present at the meeting. Regardless, the taxpayer should inquire as to the procedural steps to follow, including the amount of time it will take for the contract auditors to issue final workpapers to the taxing authority. *Remember interest continues to run against a taxpayer on any items found to be delinquent.* The taxpayer should also ask for

²² Typically, as shown by experience, a taxing authority will "rubber stamp" the contract auditor's finding. Once an assessment is issued, the taxpayer must go through the appeal process in place in the particular jurisdiction.

information regarding its rights to review and appeal any issues contained in the workpapers.²³

E. HOW TO FIND INFORMATION

It should come as no surprise that in today's digital world that many local taxing authorities have websites that provide the relevant and important information regarding compliance with their sales and use tax codes. Further, in states, such as Louisiana, that have a highly developed system of local taxing authorities, tax administrators have created trade organizations such as the Louisiana Association of Tax Administrators. The LATA has its own website (www.laota.com). From that website, one can access each of the parishes in Louisiana that imposes sales and use taxes. These websites can provide a wealth of information regarding the local taxing jurisdictions, rules, regulations and procedures.

F. CALIFORNIA LOCAL TAX ISSUES

The State of California is home to a wide variety of local taxes of which companies need to be aware. They are imposed by both cities and counties and have their own unique set of substantive and procedural rules. The cities and counties are being much more aggressive and are constantly pushing the limits under California law and under the U. S. and California Constitutions. The types of local taxes have expanded over the years and range from local sales and use taxes to property taxes, documentary transfer taxes, gross receipts taxes, payroll taxes, manufacturing taxes, among many others. The potential exposure for companies has grown exponentially in the past 10 years and simply cannot be ignored. We will discuss some recent illustrations.

1. City of San Francisco Gross Receipts Tax

The City of San Francisco has a long and storied history with respect to its business tax. In the 1990's, the City imposed two taxes—a payroll expense tax and a business tax. Taxpayers were required to pay whichever tax was higher. That regime was ultimately held to be unconstitutional under the Commerce Clause. In 2001, the two taxes were repealed and replaced by a payroll expense tax.

In 2013, a new tax was approved by the voters. Beginning January 1, 2014, a gross receipts tax is now imposed on taxpayers engaged in business within the City.

²³ The taxpayer should maintain from the beginning of the audit a separate audit file that contains a copy of the taxing authority's contract with the contract auditor, the pre-entry agreement entered into between the taxpayer and the contract auditor, the log of documents provided to the contract auditor, the copies of any documents given to the contract auditor and the notes of all taxpayer representatives in the entry and exit meetings.

The tax is measured by gross receipts from all taxable business activities attributable to the City. The gross receipts tax combines features of California's unitary tax, combined reporting and apportionment formulas with an expansive definition of gross receipts. The law is extremely complex and very little administrative guidance has been issued by the City.

The gross receipts tax is being phased in over 5 years, while the payroll expense tax is being phased out over the same period. Thus, over the next several years, taxpayers will be subject to both taxes.

2. Documentary Transfer Tax

In California, cities and counties impose a documentary transfer tax ("DTT") on realty sold. The DTT was enacted in 1967 at the State level when the old federal Stamp Tax on the transfer or conveyance of real property was repealed by Congress. Cities and counties were then allowed, with some exceptions, to enact their own transfer tax provisions in conformity with the State DTT.

The DTT has long been considered a relatively sleepy tax. However, in the past 5-10 years, cities and counties have sought to expand its reach and its rate, so that it has become quite controversial.

In 2011, in an unprecedented action, the City of San Francisco sought to impose over \$20 million in DTT against the Archdiocese of San Francisco in connection with an internal reorganization between two church corporations. If the City's position had been upheld, there would have been significant ramifications for both non-profits and for-profit corporations seeking to reorganize their activities. The City's attempt was rebuffed by a California trial court judge who concluded that no realty had been sold under California law. The City did not appeal the adverse ruling. See *The Roman Catholic Archbishop of San Francisco, A Corporation Sole v. City and County of San Francisco*, San Francisco Superior Court, Case No. CGC-10-498795 (Jan. 9, 2012).

Currently, there is a DTT case from the County of Los Angeles which is pending before the California Supreme Court. In *926 North Ardmore Avenue, LLC v. County of Los Angeles*, Cal. App. Ct., Second App. Dist., Case No. B248536 (Sept. 22, 2014), the County is seeking to apply the change in ownership rules of California's property tax law (Proposition 13) to the DTT. Specifically, the County is attempting to impose the DTT with respect to transfers of entities owning realty, rather than simply transfers of the realty itself—a result which flies in the face of over 40 years of transfer tax law in California. If the County's position is upheld by the Supreme Court, this would be a sea change in how the DTT is applied in the State.

3. Local Sales and Use Taxes

California cities and counties are authorized by the Bradley-Burns Uniform Local Sales and Use Tax Law to impose a total tax of 1% on the sales or use of tangible personal property. California Revenue and Taxation Code § 7202. The tax is paid with the state tax. The California State Board of Equalization (“SBE”) administers the local sales and use tax for the cities and counties. Generally speaking, if transactions are taxable or exempt at the state level, the same treatment applies for the local level. The same generally applies for whether a sales tax or use tax is appropriate.

A major issue has arisen in recent years with respect to how the local sales or use taxes should be allocated. The SBE has a set of rules that essentially allocates the local taxes to the place of sale. Different rules exist depending on whether the sales or use tax is applicable and whether the taxpayer has one or multiple places of business in the State.

The area of controversy which has arisen involves situations where a city or county disagrees with how the local taxes should have been allocated and files a petition for reallocation with the SBE. This, in turn, often results from incentive agreements entered into between a company and a city whereby the company agrees to set up (or relocate) a place of business in the city and allocate all local sales taxes to that city, in exchange for the city refunding a certain portion of the local taxes to the company.

The procedures which exist for resolving such disputes are elaborate and are contained in Regulation 1807. They pit cities and counties against one another, with the company stuck in the middle. There can be numerous administrative hearings which may take place over a series of years. If a decision is rendered granting, in whole or in part, the petition to reallocate, the city which originally received the local taxes may be required to disgorge those local taxes going back a number of years. Obviously, this could have a devastating effect on that city if the funds have already been spent. Similarly, depending on the terms of the incentive agreement, the company may as well be adversely affected.

In sum, while the local sales and use tax allocation issues are relatively subtle, taxpayers who have entered into incentive agreements must be acutely aware of the potentially onerous procedures which are extremely time-consuming and constitutionally suspect. As the Court of Appeal stated in a scathing opinion in *City of Palmdale v. SBE*, 206 Cal. App. 4th 329 (2012), “this appeal deserves particular attention because, according to the judgment, the Board displayed repeated lack of

concern for the statutory and constitutional procedures that restrict its decision-making authority.”

4. Other Local Taxes

As noted, as the cities and counties seek additional revenues and enact new taxes, they are often testing the limits of the California and U. S. Constitutions, as well as California statutory law. An excellent illustration was a manufacturing tax enacted by the City of Richmond, California, and which targeted Chevron, which had a refinery in that city.

In November 2008, the voters of Richmond, California approved Measure T, which converted the local business license tax from a traditional per-employee assessment into a tax on the value of raw materials processed by a business. The new tax would have looked to the value of crude oil processed at Chevron’s Richmond Refinery, increasing Chevron’s local tax liability from \$60,000 to \$20 million per year.

Chevron challenged the tax on both constitutional and statutory grounds. While the trial court found that Chevron had been deliberately targeted through this new tax, this, by itself, was not a sufficient ground to set it aside. Rather, the Court concluded that the tax was facially invalid under the Commerce Clause and the internal consistency test since there was a significant risk of multiple taxation. In addition, the Court concluded that the tax was a type of “use” tax, which Richmond was not permitted to enact under California law. Accordingly, the Court granted refunds to Chevron of approximately \$20 million. The City did not appeal. See *Chevron v. City of Richmond*, Contra Costa Superior Court, Case No. C09-00491 (Dec. 16, 2009).