

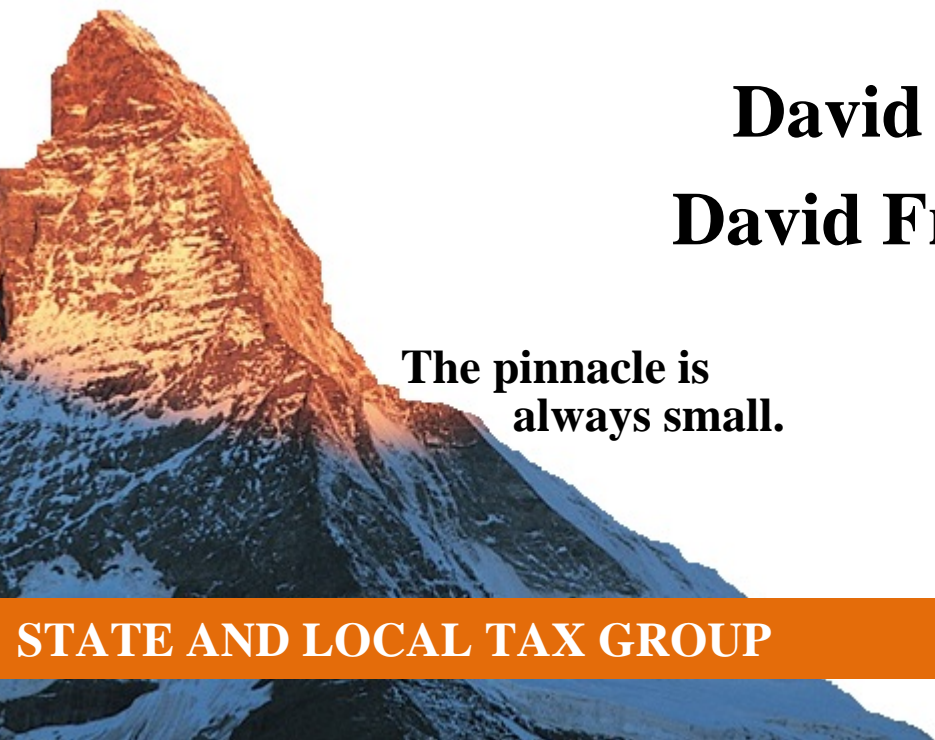


A Peek Into the Future: State and Local Tax in 2015

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**The pinnacle is
always small.**



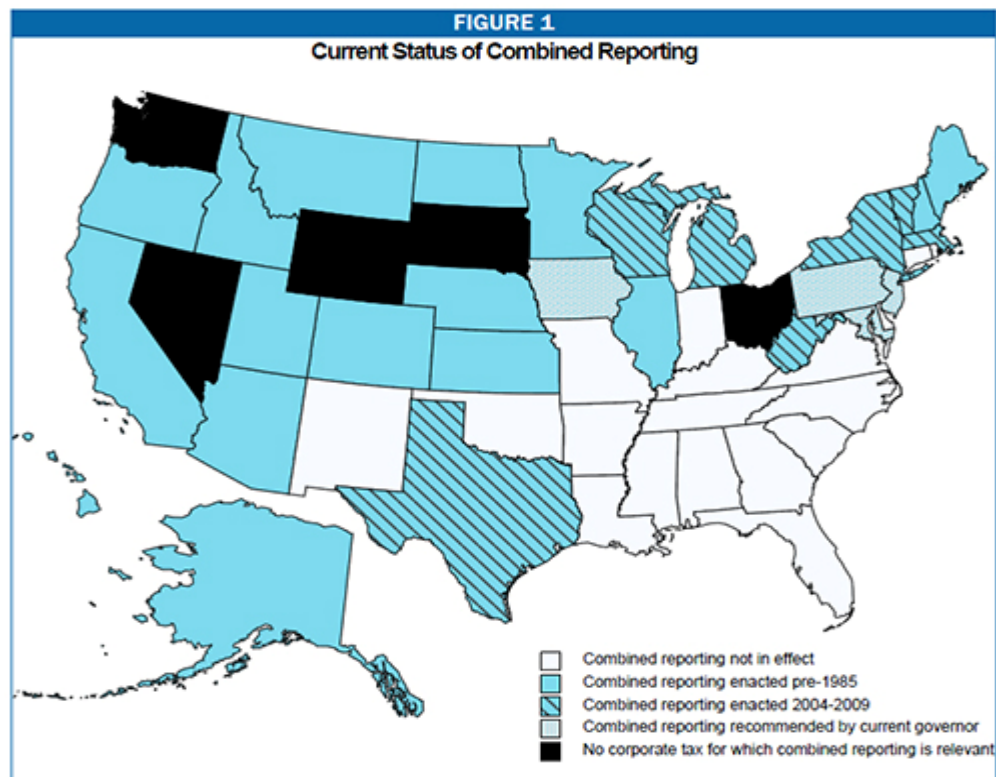


INCOME TAX TRENDS



Combined Reporting

- 23 states have implemented combined reporting
- 7 states have adopted combined reporting since 2004



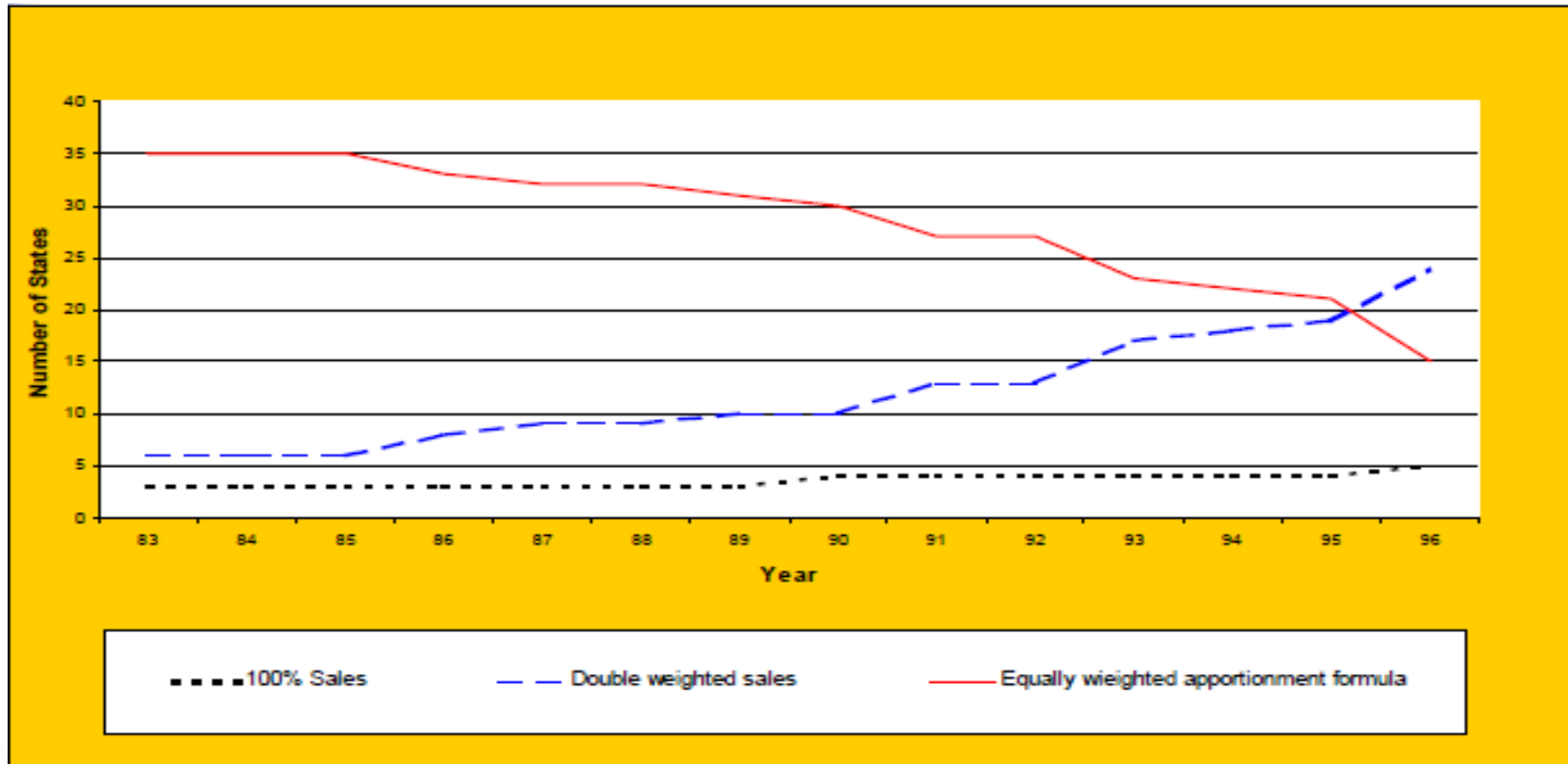


Single Factor Apportionment

- As of 2011, at least 39 states employ at least a double weighted sales factor.
- In 2008, 11 states employed a single sales factor. Today, approximately 13 states employ a single sales factor.
- 18 states increased the weight of the sales factor from 2001 to 2008.
- Prior to 2001, 7 states increased their sales factor apportionment weight.



Sales Factor





Cost of Performance to Market Based Sourcing

- 13 states currently employ a “market based” sourcing approach:

California, Georgia, Illinois, Iowa,
Maine, Maryland, Michigan, Minnesota, Ohio,
Oklahoma, Utah, Washington, and Wisconsin.





Addback

- From 2000-2008, 18 states enacted addback rules.
- 21 states currently require a taxpayer to addback deductions of intangible expenses paid to affiliated entities, taken for federal income tax purposes, when determining the taxpayer's net income.





Replacing the Net Income Tax

- Ohio: Commercial Activity Tax
- Texas: Margin Tax
- Proposals to eliminate income taxes in Oklahoma, Kansas and Missouri





SALES TAX TRENDS





Sales Tax Trends

- Sales Tax Rate Increases
 - Since 2007, thirteen states have made changes to sales tax rates: all raising them.
 - This trend is likely to continue due to the widely-used sales tax exemptions and exclusions.
- Sin Taxes
- Changes to the Tax Base
 - Services?
 - Digital Goods





Sales Tax on Digital Goods

- Approximately 30 states impose their sales taxes on pre-written or "canned" software sold and delivered online
- More than 20 states currently collect taxes on digital goods such as downloaded books, music, movies or games. These states impose these taxes either by statute or administrative rule.
- Of these, 13 states have enacted sales tax statutes specifically to tax digital goods or services, including: Indiana, Kentucky, Mississippi, Nebraska, New Jersey, North Carolina, South Dakota, Tennessee, Utah, Vermont, Washington, Wisconsin, and Wyoming.
- At least four states—Minnesota, North Dakota, Ohio and Oklahoma—have made it clear that they do not subject intangible items, such as digital goods and services, to sales tax.





States Imposing a Sales Tax on Digital Goods (cont'd)

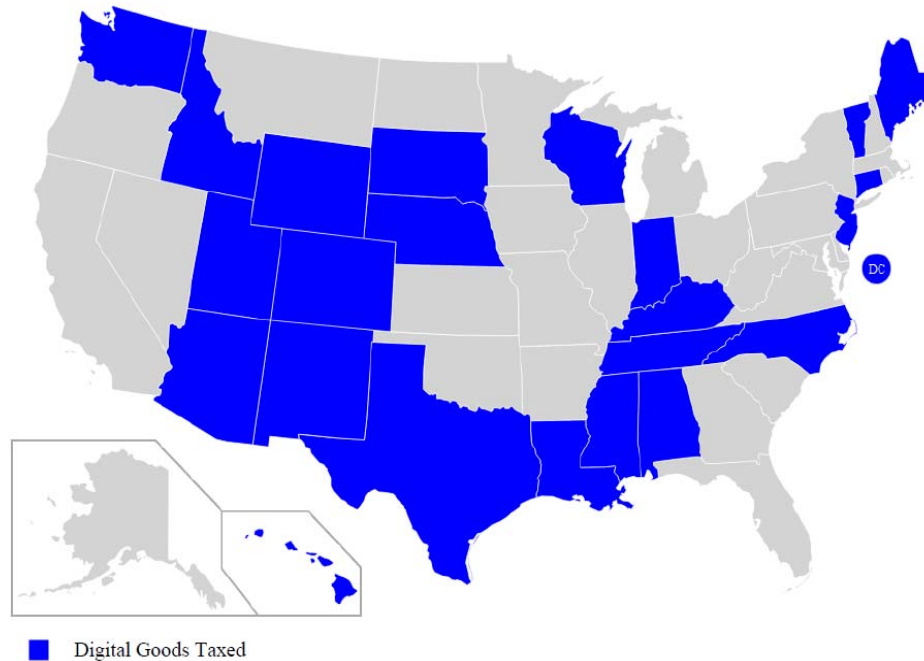


Figure 1: States Taxing Digital Goods, 2010



Click-Through Nexus Developments

A facilitation model (more on this below).

- Illinois. Circuit Court of Cook County held the state's "Amazon" law unconstitutional in May, 2012. *Performance Marketing Association, Inc. v. Hamer*. The Illinois Department of Revenue appealed to Supreme Court of Illinois June 4, 2012
- Colorado.
- New York.
- Where is this heading?





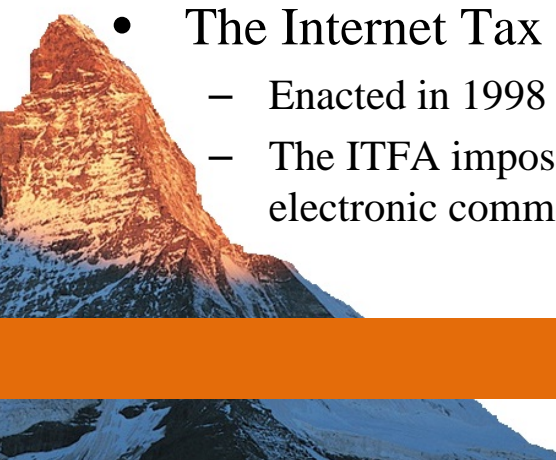
Federal Legislation





Federal Legislation: Examples

- The Mobile Telecommunications Sourcing Act
 - Enacted by Congress in 2000, serves as a poster child for horizontal federal-state tax coordination.
 - With the support of the telecommunications industry and the states, Congress permitted the states to tax all mobile telecommunications charges, regardless of origin or termination, at the customer’s “place of primary use.”
 - The MTSA both expands and restrains state tax power while simultaneously offering a much simpler tax code.
- The Internet Tax Freedom Act
 - Enacted in 1998
 - The ITFA imposes a moratorium on taxes on Internet access, discriminatory taxes on electronic commerce, and multiple taxes on electronic commerce.





Federal Legislation: Areas for Change

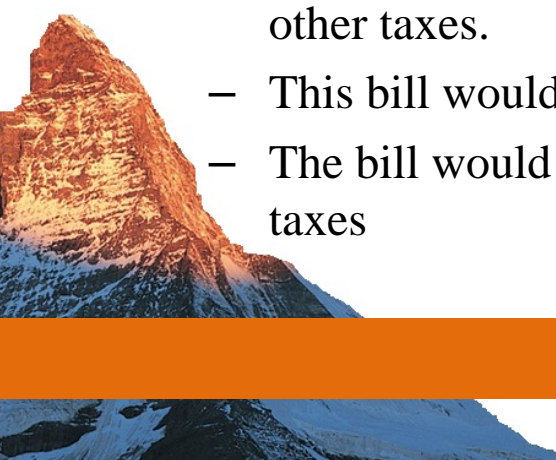
- Nonresident Withholding
 - In May 2012, the House passed H.R. 1864: The Mobile Workforce State Income Tax Simplification Act of 2011.
 - Created to protect employees who travel on temporary assignments to nonresident states.
 - Under the Act, employees working in a nonresident state for thirty or fewer days do not pay personal income tax to the nonresident state.
 - Provides a simple, bright-line rule for employees and employers.





Federal Legislation: Areas for Change

- Business Activity Tax Nexus
 - In October 2011, the House reported out H.R. 1439, the Business Activity Tax Simplification Act of 2011.
 - This Act addresses whether a business is actually subject to tax in a particular state.
 - Although the Supreme Court, in *Quill v. North Dakota*, concluded that a state cannot impose a sales tax on a seller that does not have a physical presence in a state, states have increasingly refused to apply the physical presence rule to other taxes.
 - This bill would extend the physical presence rule beyond sales and use tax.
 - The bill would also extend the protections of PL 86-272 beyond net income taxes





Federal Legislation: Areas for Change

- Remote Sales Tax Collection
 - Policy argument: Current physical presence rule protecting online sales from sales tax potentially damages local brick-and-mortar retailers.
 - Congress has the authority to remove this exception and allow states to collect sales taxes from remote vendors.
 - Several pieces of legislation currently pending:
 - Main Street Fairness Act
 - Marketplace Equity Act of 2011
 - Marketplace Fairness Act
 - But will Congress ever act?



New Business Models





Current Tax Issues Involving Conduits and Other Facilitators

Click-through nexus

Representative?

Deal of the Day

Sales tax issues

Escheat issues

• Retailer?

• Tax collector?

• Neither?



Facilitator

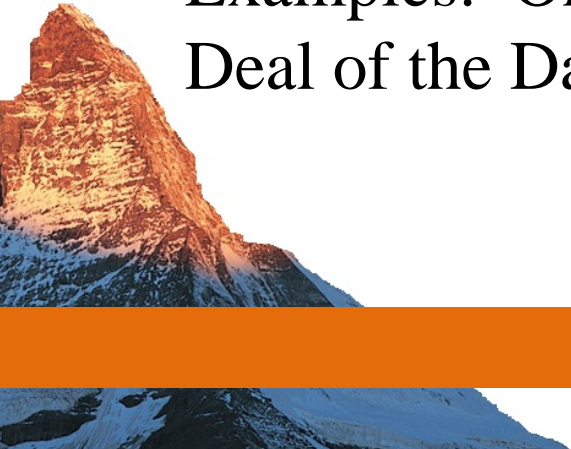
- Suggested definition: A facilitator is an entity that is compensated for providing a service that increases the sales of another entity.
- Example: Click-through representatives.





Conduit

- Suggested definition: A conduit is a type of facilitator that (i) receives payments from a consumer that includes a payment for the facilitator's services, and (ii) forwards to another entity an amount net of the payment for the conduit's services.
- Examples: On-line Travel Companies and some types of Deal of the Day arrangements.





- Some old wine in new bottles...





- But some new issues, too...





Issues

Is an entity a conduit or is it a retailer? *See e.g.*, the discussion of online travel companies below.

- If it is a retailer, does it have tax presence in the state in which the sale is made?

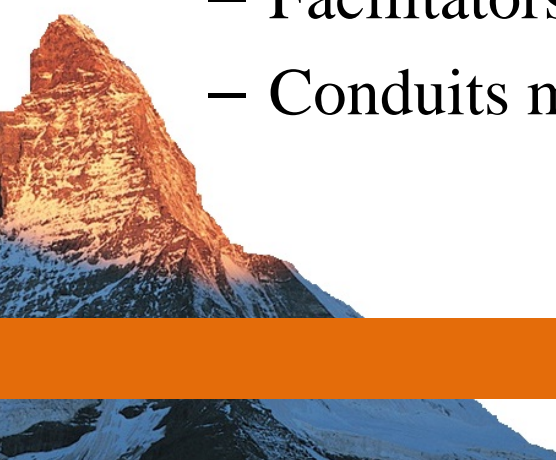
Even if the conduit or other facilitator is not a retailer, is it the retailer's representative?

- This issue never goes away.
- *See e.g., Scholastic Book Clubs, Inc. v. Commissioner*, 304 Conn. 204 (Supreme Court of Connecticut, 2012)



Tax Collection Obligation

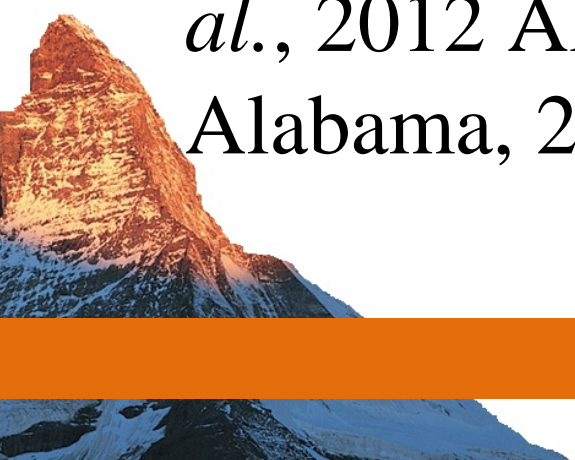
- If an entity is a representative, it generally will be treated as creating tax presence for the entity it represents. *See e.g., Scripto, Inc. etc., v. Carson*, 362 US 207 (1960)
- If an entity is a representative, what are its responsibilities for collecting and remitting tax?
 - Facilitators should not be responsible
 - Conduits might be held responsible





On Line Travel Companies

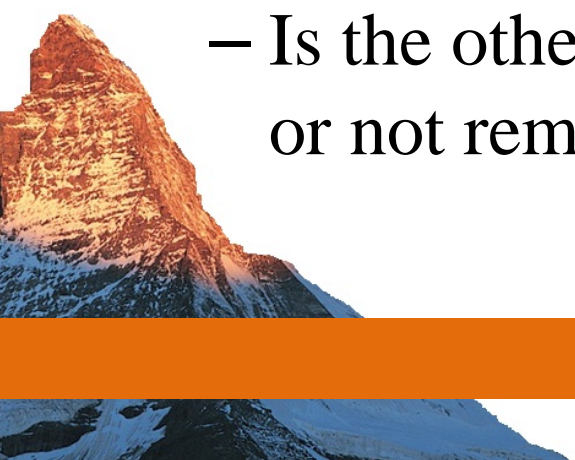
- There are many cases involving the “merchant model”. The conduit aspect creates difficulty.
- The most recent state supreme court decision is *City of Birmingham et al. v. Orbitz, LLC, et al.*, 2012 Ala. Lexis 43 (Supreme Court of Alabama, 2012).





Other Issues

- This issue extends beyond OTCs. For example, it potentially applies to a company providing a web site through which others sell their goods or services.
 - Which party's tax presence determines where tax is to be collected?
 - Which party is responsible for remitting taxes?
 - Is the other party liable if taxes are under collected or not remitted? What protection is available?





Deal of the Day A Basic Structure:

CONSUMER Pays \$60 for right to receive \$100 of goods of his choice from a retailer

DEAL COMPANY Keeps \$20 and sends \$40 to retailer

RETAILER Receives \$40; eventually delivers \$100 of goods to consumer





Deal of the Day

A Second Basic Structure:

CONSUMER Pays
\$60 for right to
receive a specific
\$100 lamp from a
retailer

DEAL COMPANY
Keeps \$20 and
sends \$40 to
retailer

RETAILER Receives
\$40; eventually
delivers the lamp to
the consumer





Deal of the Day Sales Tax Issues

- Many issues here.
- States are addressing them individually and inconsistently, but many hoped that the Streamlined Sales Tax Governing Board (“Board”) would provide guidance.
- 21 states are full members of the Board.





Deal of the Day Sales Tax Issues

- The Board conducted a survey of its member states:
 - 100% of the states treat the retail sale as occurring when the certificate is redeemed for merchandise.
- Measurement of the tax base is an important point of contention. Should it be the face amount of the voucher? The amount paid for the voucher? Should there be different results depending on whether the voucher is for a specific item or, instead, for any merchandise in a store?
- On May 24, 2012 the Board voted on competing proposals for determining the tax base. These were put forth by the states of Tennessee and Nebraska. Both proposals failed.



Deal of the Day Abandoned Property Issues

- When a voucher is unclaimed, which party (the deal company or the retailer) is responsible for unclaimed property remittance requirements? That is, which party is the holder of the unclaimed property?
 - Did the deal company make the required transfer of funds to the retailer?
- What is the amount of unclaimed property to be remitted?
 - Is the voucher for any merchandise in the retailer's store or for a specific item?
- New Jersey developments



Independent Tax Tribunals





Independent Tax Tribunals: Benefits

- Utilized by approximately 20 states.
- Adopted to provide greater consistency and transparency in tax decisions.
- Only judges experienced in tax law handle the decisions in tax tribunals.
- Tax tribunal decisions are written and published, taking away some of the past unpredictability of tax issues.
- Greater guidance given to taxpayers.
- Clearly-defined appellate process in almost all instances.
- A more level playing field





Independent Tax Tribunals: Current Developments

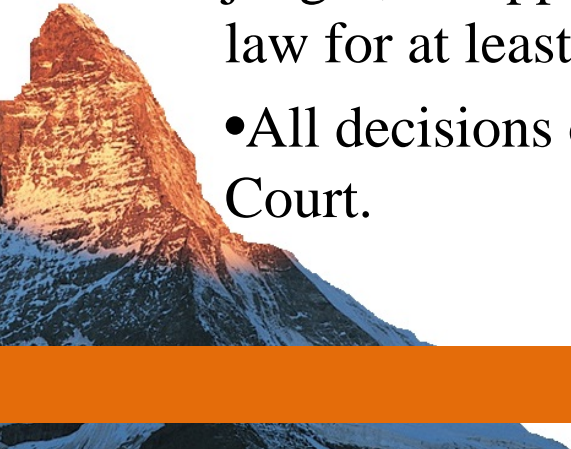
- Illinois
 - The Illinois Senate recently passed HB 5192, an act which will implement the Illinois Tax Tribunal upon the governor's signature
- Georgia
 - Governor Deal signed H.B. 100, establishing an independent tax tribunal in April.
- Alabama
 - Governor Bentley allowed SB 549, which would establish the Alabama Tax Appeals Commission, to die without his signature.
- Pennsylvania
 - Legislature is considering measures meant to improve the state's taxpayer appeal process, including automatic extensions of time for federal purposes.





Independent Tax Tribunals: Illinois As An Example

- Tribunal will have the jurisdiction to hear all cases involving an asserted tax or penalty or the denial of a refund that exceeds \$15,000.
- All cases that fall below the required amount will be retained within the Illinois Department of Revenue.
- Tribunal will consist of one chief judge and up to three additional judges, all appointed by the governor, who have all practiced tax law for at least eight years.
- All decisions of the Tribunal will be appealable to the Appellate Court.





Alternative Litigation





Qui Tam a/k/a Whistleblower Lawsuit

- Currently, 29 states have adopted state or municipal-level False Claims Acts with qui tam provisions.
 - Many state FCAs operate without a tax bar: DE, FL, NV, NH, NJ, NY, IL, IN, and RI.
- FCA statutes with qui tam provisions allow private persons to bring a civil action against alleged wrongdoers on behalf of the government.
- FCA statutes also provide a financial incentive for private persons to initiate FCA lawsuits by rewarding them with a portion of recovered damages in exchange for uncovering information that results in liability under the act.





Qui Tam: Implications

- A trend is developing in state and local taxation: the use of false claims acts with qui tam provisions as a basis for challenging taxpayers' tax return filings.
- A law firm in Illinois is actively pursuing FCA lawsuits against taxpayers claiming undercollection of sales taxes on Internet sales and shipping charges.
- These whistleblower actions are creating an incentivized class of citizen watchdogs.





Class Actions

- States maintain provisions that authorize class actions in situations where the class of affected members is so numerous that joinder of all parties is impracticable.
- Actions are now being brought on behalf of a class of taxing authorities for the failure to collect a tax that needed to be collected.
- Actions are also being brought on behalf of taxpayers to recover taxes paid that should not have been collected.





Class Action Cases: Some Examples

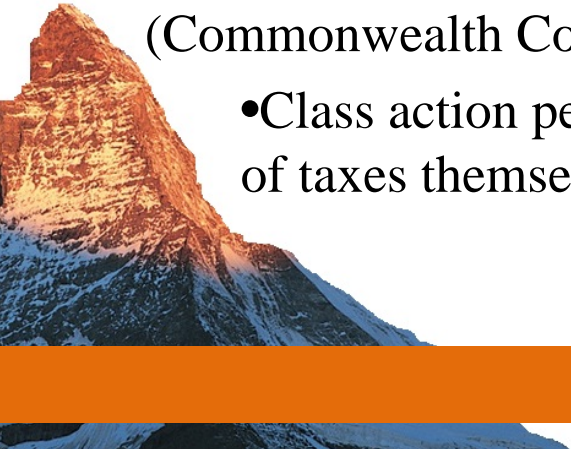
- *Loeffler v. Target Corp.*, 173 Cal.App.4th 1229 (2009)
 - CA Court of Appeal held that individual customers themselves had no standing to assert a claim for refund of a tax, and the retailer must file a refund claim first to avoid needless litigation.
- *Volbers-Klarich v. Middletown Management, Inc.*, 125 Ohio St.3d 494 (2010)
 - The Ohio Supreme Court concluded that it would make no sense to require a customer to seek relief from the taxing authority for a tax that does not exist.
 - The Court allowed the customer to proceed directly against the vendor collecting the non-existent tax...but only as an individual and not as a class





Class Action Cases: More Examples

- *McWilliams v. City of Long Beach*
 - Class action permitted for a Telephone Users Tax refund.
- *City of Winchester v. The Honorable Michael T. Jamison*, 357 S.W.3d 589 (MO 2012)
 - Class action on behalf of the City of Winchester permitted.
- *Muscarella v. Commonwealth of Pennsylvania*, 39 A.3d 459 (Commonwealth Court 2012)
 - Class action permitted for tax rebates, but not for unlawful collection of taxes themselves.





Third-Party Auditors





Third-Party Auditors

- There has been a recent trend of states delegating their audit function to private firms.
- Reasons against private contractors auditing taxpayer records:
 - Breaches of confidentiality.
 - Tax authority maintains less than complete control over the contractor's practices.
 - When contractors are paid according to how much they assess, they are often overaggressive.
- Tax agencies turn to private help for several reasons:
 - Budget constraints.
 - Policymakers desire more tax revenue without new taxes.
 - Private contractor persuasion.





Third-Party Auditors: Taxpayers Fight Back

• *Washer & Refrigeration Supply Co., Inc. and David Smith v. PRA Government Services, LLC*

- Class action suit filed against prolific third-party auditor for violations of the Alabama Taxpayer's Bill of Rights.
- Alleged violations include: failure to notify taxpayers of procedures for filing a refund claim; failure to notify of right to administrative appeal; entering into contingency fee auditing contracts and using incentive bonuses on tax collections or assessments to compensate employees.
- Members of the class include citizens and businesses that have remitted local taxes to, been audited by and/or have participated in administrative reviews conducted by Revenue Discovery Systems (aka Alabama Tax).





QUESTIONS? THANK YOU!

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