



**Karl A. Frieden**  
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**National Association of Publicly Traded  
Partnerships Annual Meeting**

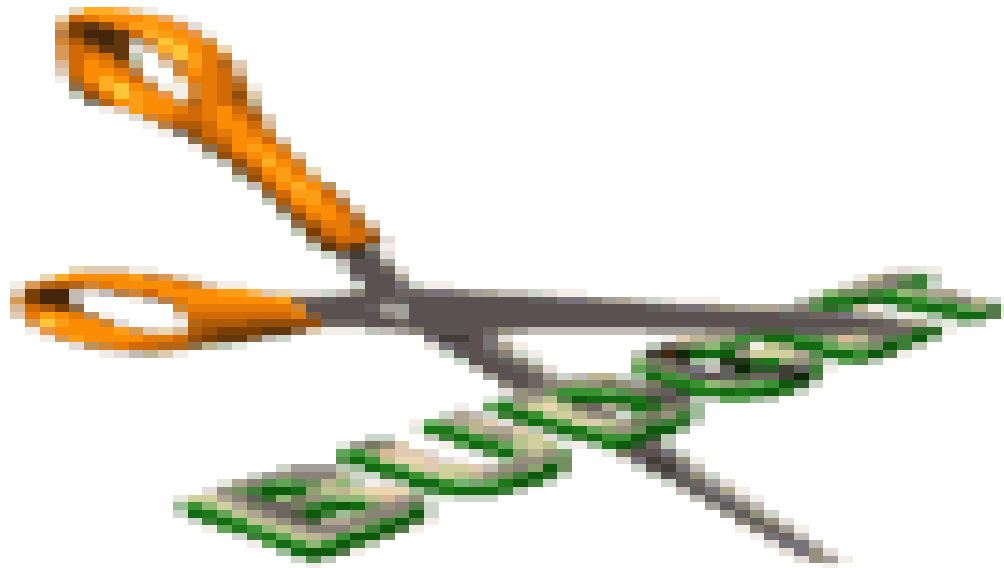
**July 18, 2013**

# **Discussion of State Tax Developments and Trends**

# AGENDA

- State of State Budgets: Getting Better?
- Attempting to Extend the Sales Tax to Services
- Combined Reporting Trends
- Apportionment Trends
- The MTC and *Gillette*
- Sales Tax Nexus and Remote Sellers
- Federal Legislation on State Tax Issues
- Corporate Disclosure Bills

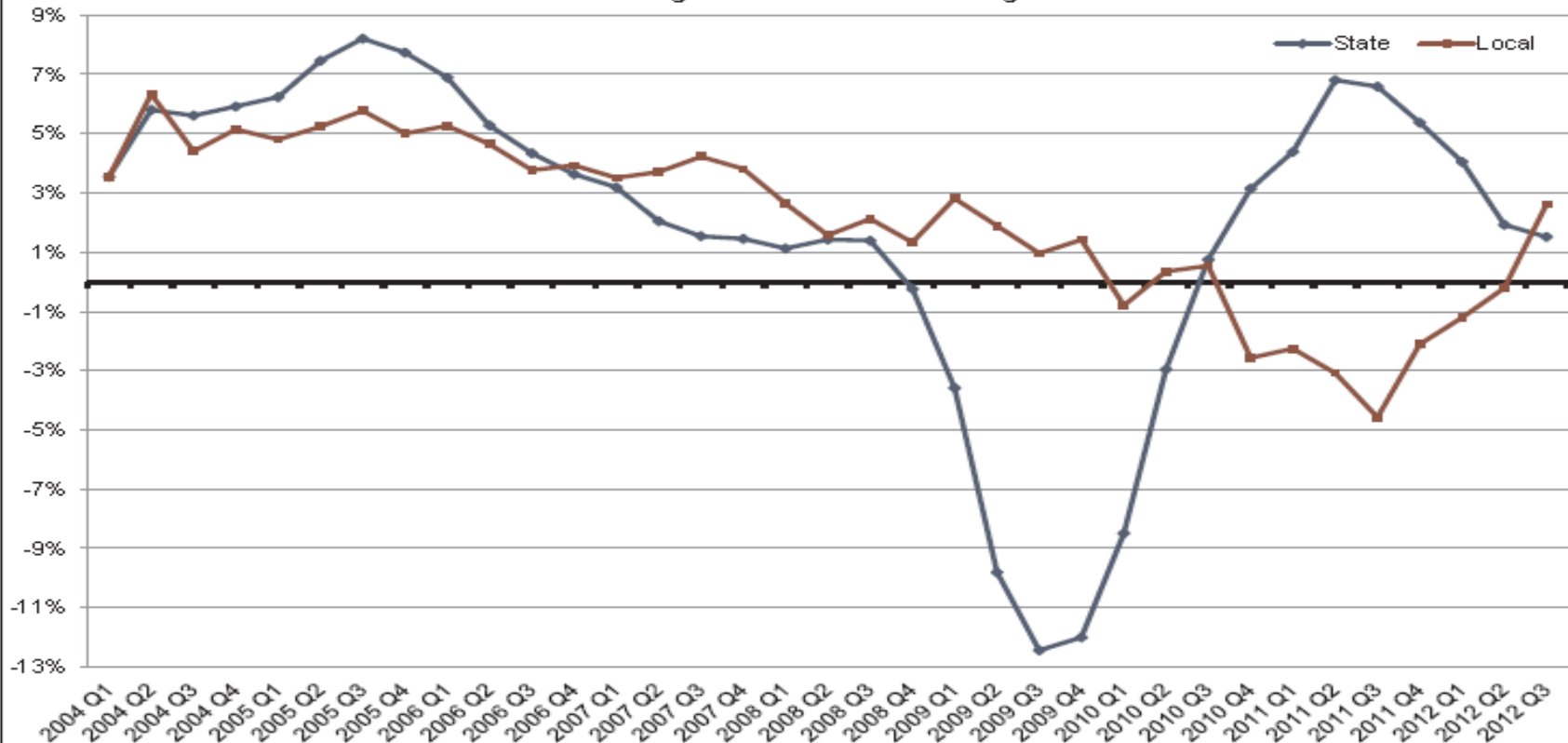
# State of the States - Budget Situation



# States improving, but growth softens

**Figure 2. Overall State Tax Growth Continue Softening**

Year-Over-Year Change in Real State Taxes and Local Taxes  
Percent Change of Four-Quarter Average

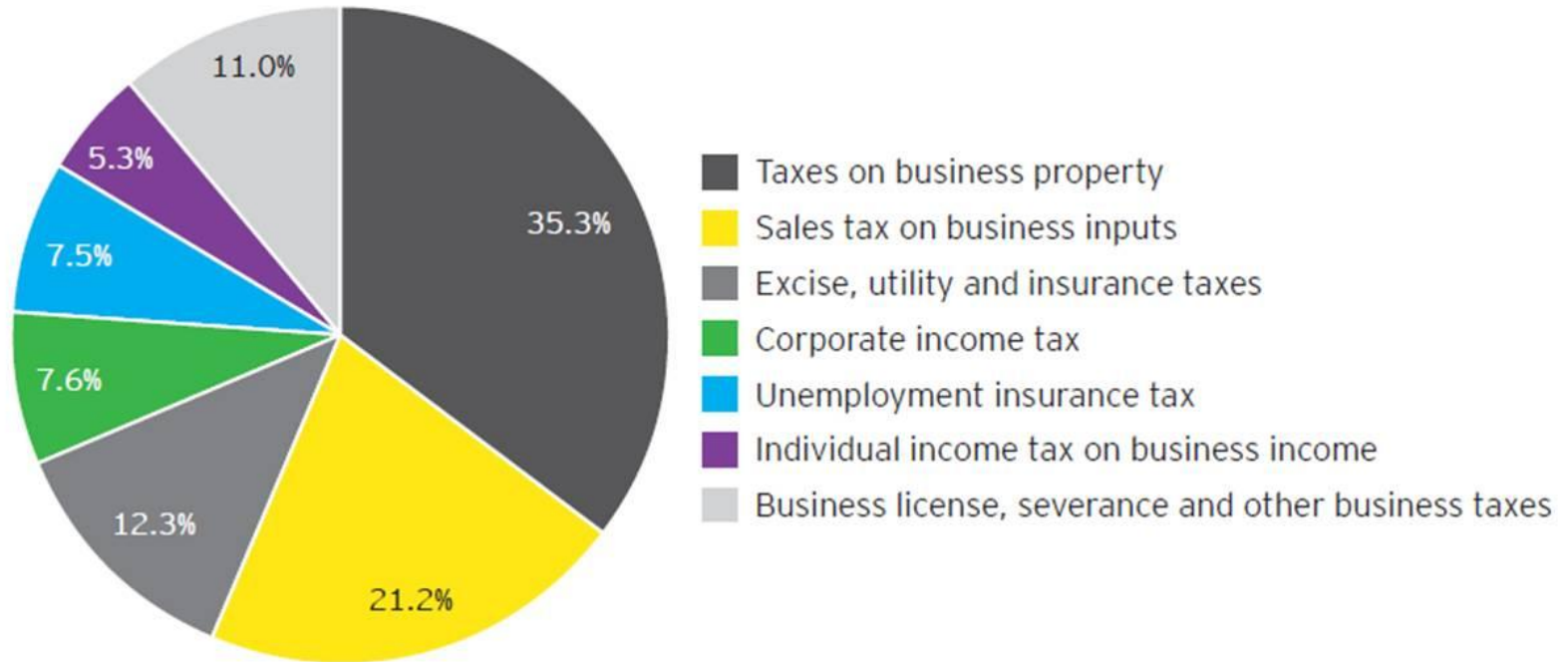


Sources: U.S. Census Bureau, Quarterly Summary of State & Local Government Tax Revenue and Bureau of Economic Analysis (GDP).  
Notes: (1) 4-quarter average of percent change in real tax revenue; (2) No adjustments for legislative changes.

From Rockefeller Institute of Government, State Revenue Report: *State Tax Revenues Continue Slow Rebound* (February 2013)

# Composition of Business Taxes

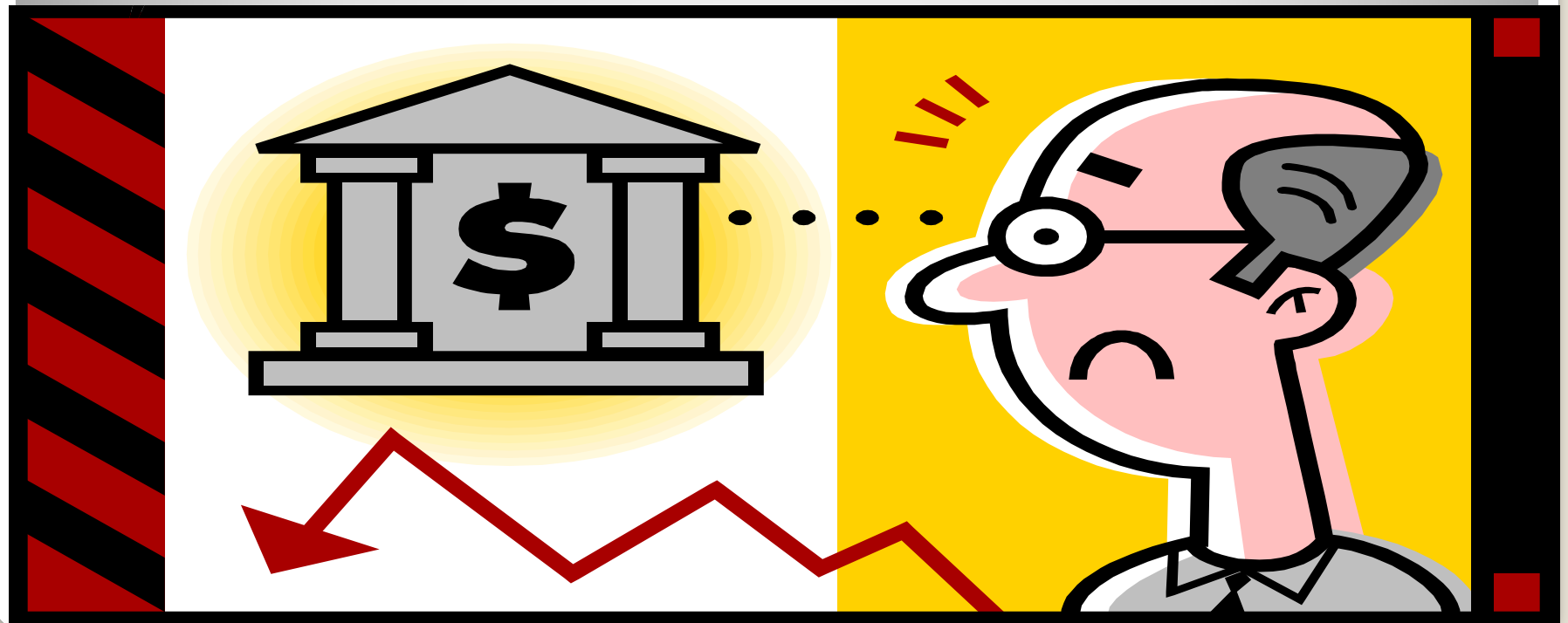
Figure 1. Composition of total state and local business taxes, FY2012



Note: Figures may not sum due to rounding.

Source: EY estimates based on data from the U.S. Census Bureau, State and Local Government Finances.

# Hottest State Tax Legislation



# The Rush to Tax Business Services (not so fast, my friend!)

- Nebraska – Gov. Heineman’s broad-based services tax put on hold; study underway
- Minnesota – Expanded sales tax to certain repair/maintenance and warehousing/storage services (HF 677, enacted May 23, 2013) (Gov. Dayton abandoned earlier broad-based services tax)
- Ohio – House GOP scaled down Governor Kasich’s broad-based service tax proposal (HB 59, enacted June 30, 2013, taxes certain digital products, but eschews service tax)

# The Rush to Tax Business Services (continued)

- Louisiana – Gov. Jindal “parked” his services tax after significant opposition; enacted budget ultimately relied on tax amnesty, limits on certain tax credit programs
- Massachusetts – Gov. Patrick proposed significant sales tax expansion; transportation finance bill includes tax on computer system design and certain software-related services
- Maine – Group of 11 bipartisan legislators introduced tax concept bill to eliminate exemptions; budget deal establishes committee to find \$40 million in “tax expenditure” savings
- North Carolina – House and Senate packages included substantial sales tax expansion; compromise HB 998 being considered this week is much narrower, taxing, for example service contracts for nonexempt property



# "What's Wrong With Taxing Business Services?"

- COST/EY Study on Problems with Taxing Business Services: April 4, 2013
  - 70-80% of taxes on new services would likely be imposed on business inputs.
  - 12 states presently derived 50% or more of their sales/use tax revenue from business inputs.
    - Arbitrary and hidden differences in effective sales tax rates on different goods and services that distort consumer choices;
    - Detrimental impacts on a state's business tax competitiveness; and
    - Extremely difficult compliance, sourcing and definitional burdens for taxpayers and tax administrators alike.

# Combined Reporting Consideration and Adoption

As of 18 July 2013

<sup>1</sup> NY state and city requires combined reporting when there are substantial intercorporate transactions






<sup>2</sup> DC combined reporting effective for tax years beginning after 31 December 2010

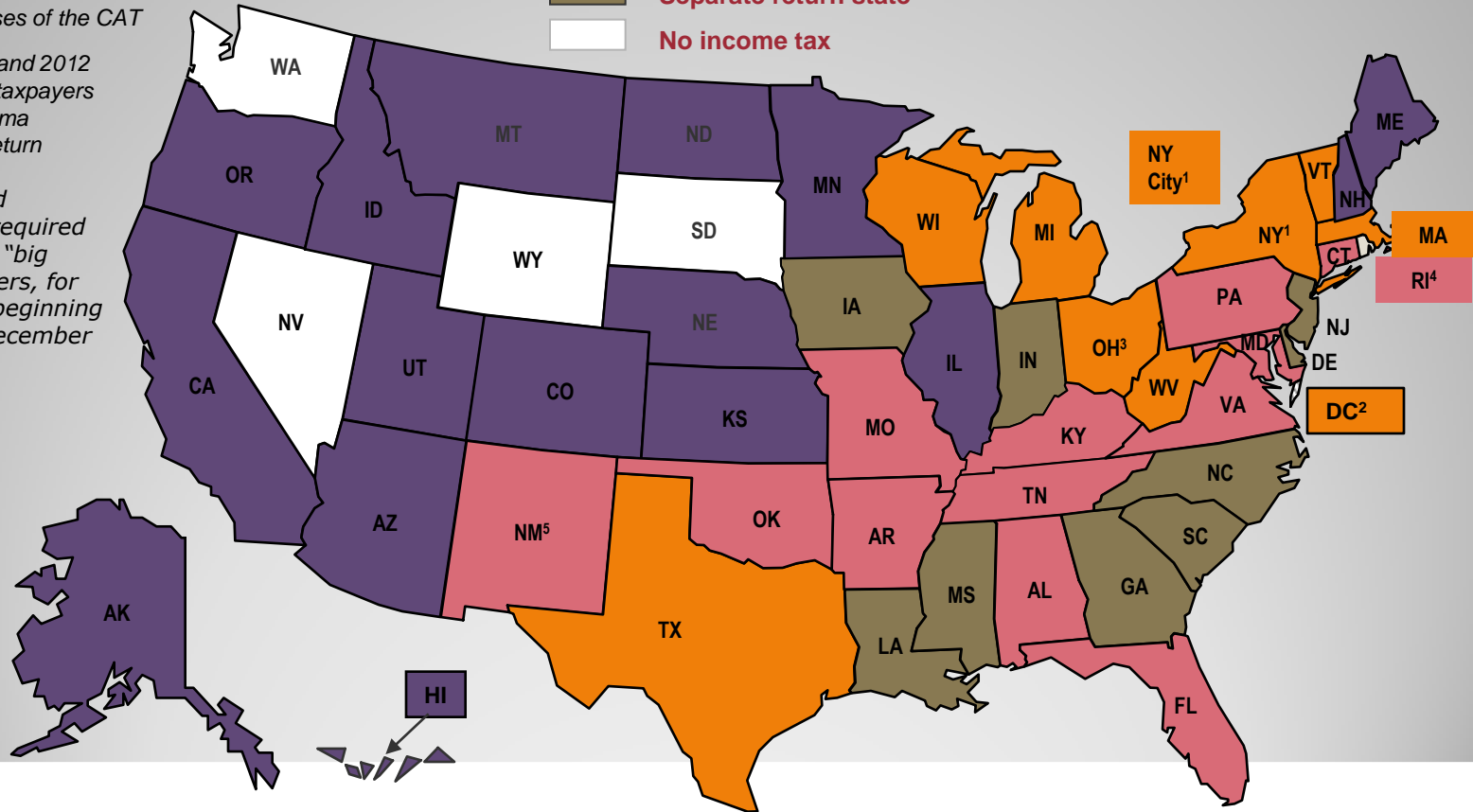
<sup>3</sup> For purposes of the CAT

<sup>4</sup> For 2011 and 2012 RI requires taxpayers file a pro forma combined return

<sup>5</sup> Combined reporting required for certain "big box" retailers, for tax years beginning after 31 December 2013

## Key

	Combined reporting/consolidated return required prior to 2004
	Combined reporting/consolidated return adopted for 2004 or later
	Combined reporting legislation proposed in 2012 / 2013
	Separate return state
	No income tax



# Apportionment Trends Time Line

1957

1990

2000

2012

## **Intentional Uniformity**

UDITPA 3-factor formula

## **Inconsistency**

Sales factor weighting  
and non-TPP sourcing

## **Inadvertent Uniformity**

Single-sales factor and  
market-based sourcing

- Modernization
  - Formula, sourcing changes reflect shifts in economy
  - Incentives to in-state business
- Continued push of factors out to the marketplace
  - Single-sales factor
  - Market-based sourcing for sales of intangible and services

# Revenue actions: Apportionment

- Continued movement to single-sales factor
  - AZ: Phase-in from 2013-2016
  - CA: Mandatory in 2013
  - LA: Certain businesses in 2012; currently required for manufacturing, merchandisers
  - MN: Phase-in from 2007-2014
  - NJ: Phase-in from 2010-2014
  - NYC: Phase-in from 2009-2018
  - NM: Phase-in full SSF election by 2018 for manufacturers
  - PA: Phase-in to 100% in 2013
  - UT: Phase-in 2011 for taxpayers with > 50% of total sales from economic activities classified in a NAICS codes, except certain codes (*e.g.*, mining, finance, etc.)
  - VA: Phase-in begins July 2011 for retail companies; optional SSF for manufacturing
  - WA: When apportionment is required

# Revenue actions: Market-based sourcing

- Market-based sourcing of services and/or intangibles
  - 2013 (enacted): PA HB 465, signed July 9, 2013
  - 2013 (proposed): KY, TX, MA (likely), OR, VA, NJ
  - 2012: AZ (2014 for certain taxpayers), NE (2014); CA (2013 for most taxpayers)
  - 2011: AL (regs. adopted April 2013), CA (if single sales factor is elected)
  - 2010: OK (July 11, 2010), WA
  - 2009 or earlier: GA, IL, IA, MD, ME, MI, OH, UT, WI

# Multistate Tax Commission



MULTISTATE TAX COMMISSION

# Apportionment under the MTC Election

- *Gillette Company v. Franchise Tax Board*, No. A130803 (Cal. Ct. App. 10/2/2012)
  - California Court of Appeal held that the Multistate Tax Compact is enforceable, and its three-factor election is binding on member states until those states withdraw from the Compact
  - No Compact Withdrawal – only way to repeal the MTC election was to withdraw from the Compact, which had not been done for the years at issue and could only be done prospectively
  - Doctrine of Elections? – decision did not address whether the election could validly be made on an amended return

# Apportionment under the MTC Election

- California's Reaction:
  - Recent Law Change – In June 2012, CA withdrew from the Compact pursuant to a budget trailer bill, SB 1015. That bill also contains language that may support the FTB's back-up argument in Gillette that TPs cannot change their reporting method to "elect the Compact" on an amended return
  - Two-Thirds Vote? – Issues arise as to whether SB 1015 violates Proposition 26, and what is the proper effective and/or operative date of the repeal of the election
  - FTB Notice 2012-2 provides procedural guidance on filing claims for refund



# Trends in Apportionment: MTC Litigation and Repeal

- *Gillette Company v. Franchise Tax Board*, No. A130803 (Cal. Ct. App. 10/2/2012); appealed to California Supreme Court.
- *IBM Corp. v. Michigan Dep't of Treasury* (Mich. Ct. App., Nov. 20, 2012); appealed to Michigan Supreme Court
- *Graphic Packaging Corp. v. Combs* (Travis County, Texas Dist. Ct., filed 9/27/2012)
- *Health Net, Inc. & Subs. v. Department of Revenue* (Oregon Tax Ct., filed 7/2/2012)
- MTC Repeal Enacted in CA, MN, OR, SD, UT

# Sales Tax re: Remote Sellers: End of an Era?



# Sales Tax Nexus

- Currently, legislation is pending or recently enacted in fourteen states that would expand those states' sales and use tax nexus provisions:
  - Florida
  - Hawaii
  - Indiana
  - Kansas
  - Maine
  - Massachusetts
  - Michigan
  - Minnesota
  - Mississippi
  - Missouri
  - New Jersey
  - Oklahoma
  - Utah
  - Virginia

# Click-through Nexus: Amazon Laws

State	Effective Date	Affiliate Threshold	Statute
<b>Arkansas (rebuttable presumption)</b>	Oct. 24, 2011	More than \$10,000	Ark. Code Ann. § 26-52-117
<b>California (rebuttable presumption)</b>	If federal legislation is enacted by 7/31/12 then click-through is effective 1/1/13. If a federal legislation is not enacted, then AB 155 is effective 9/15/12.	More than \$10,000 and (and more than \$1 million in annual in-state sales)	Cal. Rev. & Tax. § 6203(c)
<b>Connecticut (irrebuttable presumption)</b>	July 1, 2011	More than \$2,000	Conn. Gen. Stat. § 12-407(a)(12)(L)
<b>Georgia (rebuttable presumption)</b>	October 1, 2012	More than \$50,000	Ga. Stat. Ann. § 48-8-2(8)(K)
<b>Illinois (irrebuttable presumption)</b>	July 1, 2011	More than \$10,000	35 ILCS 105/2 and 110/2
<b>Kansas (rebuttable presumption)</b>	July 1, 2013	More than \$10,000	K.S.A. 79-3702(C)
<b>New York (rebuttable presumption)</b>	June 1, 2008	More than \$10,000	N.Y. Tax Law § 1101(b)(8)(vi)
<b>North Carolina (rebuttable presumption)</b>	Aug. 7, 2009	More than \$10,000	N.C. Gen. Stat. § 105-164.8
<b>Pennsylvania</b>	September 1, 2012	None specified	<b>Tax Bulletin 2011-01</b> ; proposed legislation in 2013 (HB 1043)
<b>Rhode Island (rebuttable presumption)</b>	July 1, 2009	More than \$5,000	R.I. Gen. Laws § 44-18-15
<b>Vermont (rebuttable presumption)</b>	When adopted in 15 other states.	More than \$10,000	Vt. Stat. Ann. tit. 32, § 9701(9)(I) (H.B. 436)

# NY “Click-Through” Nexus Challenge

- ***Amazon.com, LLC v. New York DT&F*** (Case 34); ***Overstock.com, Inc. v. New York DT&F*** (Case 33) – NY Court of Appeals, both issued 3/28/2013
  - Amazon.com and Overstock.com waived right to challenge “as applied” Commerce Clause and Due Process Clause claims
  - New York’s top court only addressed whether the “click-through” provision was facially unconstitutional under the Commerce and/or Due Process Clauses
  - With one dissent noting the affiliates were only passively advertising, the NY Court of Appeals upheld the law as facially constitutional
    - Due Process Clause – purposefully directed activities
    - Commerce Clause – more than slightest presence w/website links

# IL “Click-Through” Nexus Challenge

- Performance Marketing Ass’n v. Hamer, No. 2011-CH-26333 (Ill. Cir. Ct. May 7, 2012)
  - In 2011, Illinois passed an “Amazon” law that imposed sales and use tax registration and collection obligations on:
    - “[A]ny retailer that has a contract with a person located in Illinois where the person displays an advertisement on its website that links the Internet user to the retailer’s website in return for compensation”
  - The Cook County Circuit Court held Illinois’ “Amazon” law violated the Commerce Clause and the Internet Tax Freedom Act (“ITFA”)
  - Two findings:
    - Judge held that the law violated the Commerce Clause because it required retailers with no substantial nexus with the state to register and collect the state’s sales and use taxes
    - Judge held that the law violated the ITFA as a “discriminatory tax” on e-commerce
  - Judge’s order directly appealable to the Illinois Supreme Court
  - Illinois Department of Revenue has appealed the decision

# Federal Legislation



# Marketplace Fairness Act

- Objective: allow states to impose sales tax collection responsibility on remote sellers
- Approved by Senate on May 6, 2013 – vote 69-27
- To be eligible, a state must be either:
  - A streamlined sales tax full-member state, or
  - Adopt minimum simplification requirements set forth by the Act
- Small seller exception –
  - Gross annual receipts from US remote sales in the preceding calendar year do not exceed \$1 million
- Do the states really want this now?
  - States enact their own remote seller legislation
  - Conflicts with SSTP – will states drop out?
  - What will be added to the bill in the House that may restrict state taxing powers? (BATSA, Mobile Workforce, etc.)



# Digital Goods and Services Tax Fairness Act

- Would regulate state taxation of downloaded music and movies and online services
- Provides sourcing rules for digital goods
- Goal is to prevent “multiple and discriminatory” taxation of digital goods

# Permanent Internet Tax Freedom Act of 2013

- On January 22, Senator Kelly Ayotte (R-NH) introduced a bill that would make permanent the existing ban on state or local taxes on internet access and on multiple or discriminatory taxes on e-commerce.
- The most recent extension of ITFA is scheduled to expire on November 1, 2014.

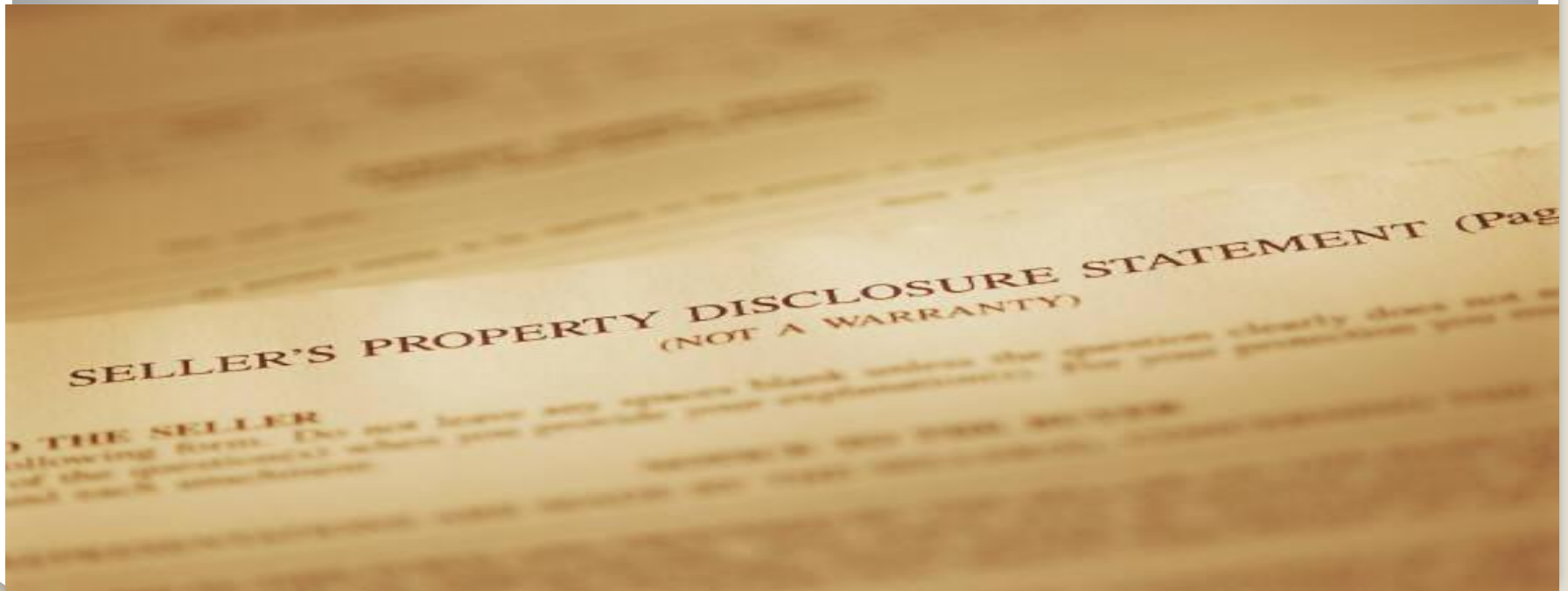
# Mobile Workforce State Income Tax Simplification Act of 2013

- H.R. 1129 (113<sup>th</sup> Congress)
- On March 13, Rep. Howard Coble (R-NC) and Rep. Hank Johnson (D-GA) reintroduced legislation identical to that which passed the full U.S. House in May, 2012.
- In general, this bill protects a nonresident employee (and employer) from a state's income tax if the employee works in the nonresident state less than 31 days.

# Business Activity Tax Simplification Act

- Business Activity Tax Simplification Act (“BATSA”)
  - Would modernize P.L. 86-272:
    - All business activity taxes (not just net income taxes).
    - All sellers (not just sellers of tangible personal property).
    - Other qualitative *de minimis* activities (not just solicitation).
  - Physical presence:
    - Economic nexus would be eliminated.
    - Tangible property or employees allowed in a jurisdiction for less than 14 days during the tax year (*de minimis*).

# Public Disclosure of Taxpayer Information



# Public Disclosure of Taxpayer Information

- States have become increasingly aggressive in sharing and disclosing taxpayer information.
- More frequent information sharing between states.
- Most states have exceptions that allow for disclosure of taxpayer confidential information to other states.

# Public Disclosure of Taxpayer Information

- Illinois SB 282 (2012):
  - Requires certain publicly traded corporations that do business in the State to file with the Secretary of State a statement containing information concerning the corporation's 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 in the form of a searchable database accessible through the Internet
  - **Rejected** by Illinois House Revenue and Finance Committee; reintroduced in 2013 as HB 3627
- Oregon HB 3161 (2013) - died:
  - Similar to Illinois proposal; would require any corporation doing business in Oregon to file a statement with the Secretary of State's Office disclosing extensive information regarding the corporation's confidential tax information and make that information publicly available
- Maine LD 1126 (2013) - died:
  - Requires filing of annual tax disclosure statement including gross receipts, cost of good sold, taxable income, apportionment factors, nonbusiness income and NOLs