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SALT Savvy: Coast-to-Coast SALT Updates

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Agenda

1 East Coast Update Lindsay LaCava

2 South Central Update Stephen Long

3 West Coast Update Mike Shaikh

4 Mid-West Update Roman Patzner

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East Coast Update

New York Update

- New/Revised Draft Corporate Tax Regulations Released
 - Special Entities
 - Addresses qualified New York manufacturers, corporate partners, New York S corporations, REITs, and RICs
 - Reports (including combined reporting rules)
 - NOLs
- Notable Decisions
 - *Matter of Lewis*, DTA No. 827791 (May 21, 2020)
 - Tax Appeals Tribunal held retroactive application of law change designed to overturn a prior Tribunal decision unconstitutional under Due Process Clauses of US and NY Constitution.

CARES Act Conformity Update

- North Carolina (H.B. 1080)
 - Updates IRC conformity date from 1-1-2019 to 5-1-2020
 - Decouples from CARES Act changes to IRC 163(j) and NOLs
 - Conforms to exclusion from gross income for indebtedness forgiven on a loan covered by the CARES Act Paycheck Protection Program
- Georgia (H.B. 846)
 - Updates IRC conformity date from January 1, 2019 to March 27, 2020
 - Decouples from CARES Act changes to NOLs
 - State already decoupled from TCJA changes to 163(j)

Digital Tax Update

- Rhode Island (S. 2650-A)
 - Previously extended sales tax to digital downloads (eff. Oct. 1, 2019)
 - To comply with SSUTA, the new law defines “end user” and clarifies that tax applies to end users of specified digital products with both a permanent and less than permanent use.
- North Carolina (H.B. 1080)
 - Clarifies that digital codes for digital property are taxed in the same manner as the “property for which the digital code relates”
- District of Columbia
 - DC Council has proposed a 3% tax on gross receipts from the sale of ads (digital and other) and personal data.

Marketplace Facilitator Update

- New Marketplace Facilitator Laws
 - Louisiana (eff. July 1, 2020)
 - Mississippi (eff. July 1, 2020)
 - Tennessee (eff. Oct. 1, 2020)
- Marketplace Litigation
 - *Amazon Services LLC v. South Carolina Department of Revenue* on appeal with South Carolina Court of Appeals
 - Briefs were filed in June

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South Central Update

Hegar v. Sirius XM Radio, Inc.

- AKA *the most important franchise tax case ever (... probably)*
- Issue: How are services apportioned to Texas for purposes of the Texas franchise tax?
- The Rule: “Receipts from a service are apportioned to the location where the service is performed. If services are performed both inside and outside Texas, then such receipts are Texas receipts **on the basis of the fair value of the services that are rendered in Texas.**” Tex. Admin. Code 3.591(e)(26); see also Tex. Tax Code Ann. § 171.103(a)(2):
- OK, but how do you apply the rule?
 - Apportionment to where service is performed / “cost of performance”?
 - Apportionment to where the service is provided / market-based sourcing?

Hegar v. Sirius XM Radio, Inc.

Facts

- Sirius XM: Applying the “fair value” test, Sirius XM sourced its receipts based on where it produced its programming (primarily outside of Texas)
 - Argued that the “receipt producing, end-product” was “the production and distribution” of Sirius XM programming
- Comptroller: Only considered the final step to assess the “fair value” in a series of activities necessary to provide the overall service
 - Argued that the service was “unscrambling the radio system,” not the production of the satellite programming, which occurred at the radio receiver (in Texas)

Hegar v. Sirius XM Radio, Inc.

Holding

- Court of Appeals adopted the Comptroller's interpretation:
 - “The receipt-producing, end-product act that allowed each Sirius XM customer to receive Sirius XM programming occurred when Sirius XM decrypted the program by activating or deactivating the customer's chip set in their satellite-enabled radio, which Sirius could do remotely . . . where the satellite enabled radio was located . . . presumed to be where the customer resided . . .”

Implications of the *Sirius XM* Decision

- So, is Texas now a market state?
- Are all services sourced the same way? If not, how do I file my franchise tax report?
- What factors should I consider when defining my service? (AKA the *Sirius XM/Westcott* conundrum)
- How is the Comptroller applying *Sirius XM*?

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West Coast Update

San Francisco v. All Persons Interested in the Matter of Prop. C

Local Taxes in California — Voter Initiatives Require Simple Majority to Pass

- Proposition C – 0.175%-0.69% Homelessness Gross Receipts Tax for companies with more than \$50M gross receipts
- Passed by 61% (simple majority) vote
- Issue: Is a 2/3 supermajority required to pass tax measures by voter initiative?
- Background:
 - General initiative power requires only majority vote
 - Tax powers require 2/3 supermajority for special taxes (Prop. 218)
 - Recent case on a different topic held the Prop. 218 requirement for special taxes to be included in general election as inapplicable to voter initiatives
- Holding: 2/3 requirement does not extend to voter initiatives (only applies to tax initiatives added by local governments, not by citizens groups)
- Compare with Fresno Measure P

Decided June 30

Limitations on NOL and Credit Utilization

California Budget

- California's FYE 2021 budget was signed into law on June 29
 - NOL utilization limitation
 - NOLs cannot be utilized for tax years beginning 1/1/2020-12/31/2022
 - Carryovers are extended, but past FTB interpretation is problematic
 - Applicable to the "taxpayers" with more than \$1M income
 - Credit utilization cap
 - \$5M per year cap on credit use for tax years beginning 1/1/2020-12/31/2022 (cap measured by all members of the combined report)
 - Credits included: R&D, Cal Competes, motion picture production, and others
 - Unused credits subject to carryover

Newly-enacted and Pending Legislation

- California pending legislation
 - False Claims Act
 - Corporate disclosure
 - Split roll initiative
- Oregon CAT corrections

ABC, Inc. v. Oregon Department of Revenue

Oregon – Special Industry Apportionment (Broadcasters)

- Background:
 - Broadcasters use a special sales factor apportioning gross receipts from broadcasting using an audience or subscriber factor.
 - As a group, ABC operates many businesses that include media networks, parks/resorts, studio entertainment, consumer products, and “interactive media.”
- Issue is whether the special formula applies to all members of a consolidated group or only those members who engage in broadcasting
 - Alternatively, the general costs-of-performance sales factor formula would apply
- *Comcast* (2018): gross receipts from broadcasting include “all gross receipts of [the broadcaster] from transactions and activities in the regular court of its trade or business.” (not just broadcasting receipts)
- Court here held that the broadcaster statutes apply to the receipts of the entire unitary group, not just the entities doing the broadcasting.

Washington Bankers Association v. Washington

Washington Bank Surcharge

- In May 2019, Washington passed 1.2% B&O surcharge on banks with \$1 billion net annual income.
- King County Superior Court judge struck down the surcharge
 - Law discriminates against interstate commerce
 - Targets large out-of-state banks
- June 22, judge declined rehearing the case, so it is now ripe for appeal

Remote Workers

- Remote and Mobile Worker Relief Act (S. 3995)
- State-specific COVID-19 nexus relief laws
- Payroll tax/withholding considerations for out-of-state workers

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Mid-West Update

Vectren Infrastructure Servs. Corp. v. Dep't of Treasury

Apportioning Income in Michigan - Taxpayer Entitled to Alternative Apportionment

- The taxpayer's predecessor company, MLI, was an S-corporation engaged in HAZMAT response services, which, during the year of the sale, was headquartered in Minnesota and was retained to assist an oil spill in Kalamazoo, MI, bringing minimal equipment and employees to the state.
 - While providing cleanup services in Michigan, MLI was purchased by the taxpayer, which MLI deemed as an asset sale under the IRC.
- At issue was how to tax the gain on the sale of an out-of-state business under the Michigan Business Tax.
 - The taxpayer included the gain on the sale in both its business income and denominator of its apportionment sales factor.
 - A Department of Treasury auditor removed the proceeds from the denominator, increasing the apportionment percentage from approximately 15% to 70%.
 - The Department determined that the taxpayer failed to show by "clear and cogent evidence" that the statutory formula was distortive, warranting alternative apportionment.

Vectren Infrastructure Servs. Corp. v. Dep't of Treasury (Cont.)

Apportioning Income in Michigan - Taxpayer Entitled to Alternative Apportionment

- The Taxpayer appealed the assessment to the Court of Claims, seeking alternative apportionment relief and to exclude the sale's gain from the business income tax, each of which were denied.
- On appeal, the Michigan Court of Appeals held that the Department's application of the statutory formula attributing business activity to Michigan was unconstitutional as applied to the taxpayer, violating the Due Process and Commerce Clauses.
 - The Court examined the predecessor company's irregular concentration of activity in the state during the year of the sale alongside the fair market value of the company, most of which stemmed from operations outside of Michigan.
 - As applied to the taxpayer, the statutory formula did not fairly determine the portion of income attributable to its activity in Michigan.
 - The Taxpayer was entitled to alternative apportionment, but the Court did not determine the appropriate alternative method.
- The Department has appealed to the Michigan Supreme Court.

Honigman Miller Schwartz & Cohn LLP v. Detroit

Apportioning Income in Michigan – Sourcing for Services

- The taxpayer, Honigman Miller Schwartz and Cohn LLP, is a Detroit-based law firm, which apportioned its Detroit City Income Tax using three-factor apportionment.
 - For Detroit City Income Tax purposes, the taxpayer only sourced income from legal services for clients located in the city.
 - In contrast, Detroit recalculated the taxpayer's liability based on origin of the services rendered, disregarding the location of the client.
- The Michigan Tax Tribunal upheld Detroit's sourcing of income, while the Michigan Court of Appeals reversed, finding that the relevant sourcing consideration is where the client received the services.
- On appeal, the Michigan Supreme Court reversed the Court of Appeals, finding that legal services performed in Detroit for clients outside of the city should be sourced to the city for its income tax purposes.
 - The Court determined that “services rendered in the city” for the purposes of computing the sales factor uses an “origin test”, rather than a destination or market-based test.

Willacy v. City of Cleveland

Ohio Income Sourcing – Stock Options

- The taxpayer was issued stock-options as compensation for employment services rendered in Cleveland in 2007.
 - Subsequently, the taxpayer moved to Florida for retirement where she exercised some of the stock-options in 2014-2015.
 - The taxpayer's prior employer withheld and remitted Cleveland's income tax, which the taxpayer then sought a refund for.
- The taxpayer's requested refund was denied by the local review board, the Ohio Board of Tax Appeal, and the Ohio Supreme Court.
 - The taxpayer brought constitutional challenges against the municipal tax, arguing it violated the Due Process Clause's minimum-connection requirement.
 - Specifically, the Ohio Supreme Court found that the stock-option income was fairly attributable to her activity in Cleveland as compensation for work done in the city, satisfying the Due Process Clause's minimum-connection requirement.

Miller v. McClain (OH) & Sulit v. Dep't of Revenue (IL)

Individual Liability for Responsible Parties

Miller v. McClain - Ohio Board of Tax Appeals

- The Ohio Board of Tax Appeals on May 27 affirmed the tax commissioner's determination that Gary Miller, as president of Automotive Technologies Inc. for the tax periods at issue, was responsible for the company's fiscal responsibilities and thus could be subject to assessments under the Ohio Revised Code.
 - Ohio Revised Code Sect. 5739.33 allows for individual liability for those fiscally responsible for filing and remitting a corporation's sales tax. Further, the Ohio Administrative Code allows for joint and several liability between all responsible parties.

Sulit v. Dep't of Revenue – Illinois Independent Tax Tribunal

- Similarly, on May 20, the Illinois Independent Tax Tribunal affirmed a Notice of Penalty Liability against an individual taxpayer as the responsible officer for Alliance Home Healthcare Agency, Inc. for its failure to pay withholding tax.
 - The Tribunal found that the taxpayer, as the responsible officer, willfully failed to pay the withholding taxes and rejected her arguments that she was absolved of liability because she had delegated her duties and was incapacitated during the relevant periods.



Questions

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