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HIGHLIGHTS

Amazon to Start Collecting Colorado Sales Tax February 1
Amazon.com LLC said it will start collecting Colorado sales tax for the first time. A spokesman told Bloomberg BNA that the online retailer ''will be required to collect sales tax in Colorado'' beginning Feb. 1. **Page 116**

What Will the Future of State Tax Law Look Like Without Scalia?
With the sudden passing of Justice Antonin Scalia, the empty seat on the U.S. Supreme Court is a reminder of a three-decade era marked by an originalist jurist whose ''bigger than life'' presence reshaped the highest court's discourse, but whose absence may have a material impact on future state tax cases. **Page 158**

Airbnb Agrees to Collect Alabama Lodging Tax
Airbnb Inc. will begin collecting Alabama lodging taxes for its room rental listings in the state March 1, under an agreement reached with the Alabama Department of Revenue. ''This agreement will increase compliance in this area, and I commend Airbnb's willingness to take the steps necessary to ensure that the appropriate taxes are being remitted,'' Alabama Revenue Commissioner Julie P. Magee said. **Page 140**

Delaware Issues Draft Unclaimed Property Manual
A recently released manual on Delaware's unclaimed property audits is intended to increase transparency but in some cases does the opposite, practitioners say. The Delaware Department of Finance announced that it is gathering public comment through March on a draft copy of the manual, which explains unclaimed property audits in the state. **Page 100**

Bill to Clawback Washington Tax Break for Boeing Dies
The Boeing Co. announced job cuts in Washington state five days after a bill died in committee that would have tied the aircraft manufacturer's $8.7 billion package of tax exemptions and preferences to maintaining jobs at a baseline level. The bill, H.B. 2638, would have either cut in half or eliminated Boeing's preferential B&O tax rate and tax credit, depending on the amount of job loss. **Page 145**

PERSPECTIVE

Incredibly Captivating: Thriving Captive Insurance Marketplace Spurs Competition Between the States for Business Tax Revenue
What happens when a business has risks that can't be covered under a traditional insurance policy? In this article, Jeffrey D. Katz, Christopher L. Young and Dean Harris of JDKatz, P.C. answer that question by giving an overview of the benefits and risks associated with forming a captive insurance company. **Page 89**

ALSO IN THE NEWS

ELECTRONIC COMMERCE: Appeals court tosses Wisconsin sales tax assessment against Orbitz **Page 115**

EXEMPTIONS: Challenge to Princeton's tax-exempt status will proceed, New Jersey tax judge rules **Page 131**

PROPERTY TAX: Wind turbine ruled exempt from property tax in Rhode Island **Page 135**

PROCEDURE: Legally sound pathway exists to exempt state's hospital fee from revenue limits **Page 154**

EXCISE TAXES: Vermont panel proposes taxing retail marijuana sales at 25 percent **Page 138**

PROCEDURE: North Carolina Department of Revenue issues market-based sourcing guidelines **Page 92**

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Perspective

Captive Insurance

What happens when a business has risks that can't be covered under a traditional insurance policy? In this article, Jeffrey D. Katz, Christopher L. Young and Dean Harris of JDKatz, P.C. answer that question by giving an overview of the benefits and risks associated with forming a captive insurance company.

Incredibly Captivating: Thriving Captive Insurance Marketplace Spurs Competition Between the States for Business Tax Revenue

BY JEFFREY D. KATZ, CHRISTOPHER L. YOUNG AND DEAN HARRIS

In general, insurance companies are insurers of risk for individuals, businesses, and any other entity whose existence or operations carries associated and inherent risk. Accordingly, in the event a policy holder suffers a loss relating to an insured risk, insurance companies compensate policy holders for such loss. But what happens when a business exists or operates with certain risks that are not covered under traditional insurance policies offered by large insurance companies such as Allstate, Liberty Mutual, Hartford Mutual, etc.? For example, assume Company X is a federal government contractor whose business operations, revenue stream, and existence are almost entirely reliant upon the federal government. As such, government shutdowns, budget cuts, contract non-renewals, and even terrorist events are all risks Company X carries and could severely affect and diminish Company X's bottom line should any of them occur. In addition, as it happens, insurance coverage for these risks may be unavailable under a traditional insurance policy. While Company X's options are limited, they are not completely lacking. Indeed, Company X may inquire about forming a captive insurance company as a means of hedging the monetary loss associated with any realized loss on these risks.

Jeffrey D. Katz, Esq. is the Managing Partner at JDKatz, P.C. located in Bethesda, Maryland where he brings 15 plus years experience of advising clients on all aspects of business planning and tax compliance, including captive insurance design and implementation. Christopher L. Young, Esq. is an Associate Attorney at JDKatz, P.C. where he focuses on issues relating to corporate governance and planning as well as tax and business controversy. Dean Harris is a law clerk at JDKatz, P.C. and is a May 2016 Juris Doctor Candidate at the Catholic University of America, Columbus School of Law.

All insurance companies are formed pursuant to state law, with captive insurance companies insuring the risk of the company that owns it. Instead of a company buying an insurance policy, they establish an in-

surance company—the captive—and then insure the risk associated with the company. In its purest form, the captive will be a subsidiary of the parent that it insures. However, the insurance model, as highlighted with Company X, is only one form of a captive. Indeed, there are other types of captives as well as other legitimate purposes for establishment. A captive can also be structured as a subsidiary company that re-insures a risk that is covered by regular insurance through a third party.[1] In addition, a captive can be a subsidiary that insures a parent's risk and then transfers that risk over to a third company.[2] In sum, captives are generally used by companies that either have high insurance premiums with a traditional plan, cannot find traditional coverage at all, engage in high risk activities, or where premiums are mispriced compared to the market risk.

Captives can also be used as a means to access the reinsurance market, an opportunity not presented to traditional insurance purchasers. Indeed, reinsurance often comes at a steep discount to retail insurance policies, and may be as much as 40 percent less than a commercial policy. Captives as insurance options not only present excellent opportunity for many businesses that could not otherwise find insurance, but also potentially provides access to newly emerging markets or a retreat from pricey or mispriced markets. Indeed, as entrepreneurs continue to dream up and implement new ideas, insurance companies try and keep pace with respect to insurance coverage for risks associated with those ideas. But without captives, a company owner would be forced to remain uninsured, or go to an insurance market such as Lloyds, who would then create a policy for the new idea, which could be cost prohibitive. Accordingly, whatever the type of captive, or whatever the purpose for setting one up, they can have wide and varying positive uses for companies that utilize them. However, captives are not without controversy.

IRS Scrutiny

Like many business formations and transactions, forming and owning a captive insurance company has associated state and federal tax benefits. It is because of the exploitation and abuse of these tax benefits that the IRS has historically scrutinized the legitimacy of captives and challenged abusive arrangements.

Specifically, pursuant to §831(b) of the Internal Revenue Code, a captive insurance company may elect to be taxed on its net investment income as opposed to the normal tax rates computed by §11.[3] In other words, in the event a captive's payouts for claims during a given year do not exceed the amount of premiums collected during that respective year, the captive may thereafter use those premiums for investment purposes. Under §831(b), if a captive's gross annual premiums do not exceed $1.2 million, the captive can elect to be taxed only on its net investment income.[4] Thus, captives collecting premiums less than $1.2 million may opt to operate untaxed on its premium income.

Accordingly, the IRS focuses on red flags to detect abuse and weed out captives with a focus on sheltering income as opposed to insuring risk. Marketing information promoting captive insurance as tax mitigation, not as an insurance tool, is frequently identified as a red flag. In addition, the IRS will analyze whether the insured risk's likelihood of being realized is low. The IRS will also investigate the captive's history of claims made versus claims paid, as well as instances when the premiums are always $1.2 million. Other red flags include the flow of premiums back to the hands of the captive's parent company (and owner of the captive), a lack of risk distribution, poorly supported or unsupported actuarial findings, little or no analysis of the non-captive market for the same rates, marketing materials promoting estate planning benefits of creating a captive as well as excessive guarantees, and little or no claims history within the risk pool.

However, despite such tax abuse and increased IRS scrutiny, captives remain popular as ever as more and more states are throwing their hats into the captive ring. Indeed, there are currently 35 jurisdictions supporting captive regimes in the U.S. (not to mention the numerous foreign countries that have active and thriving captive regimes). In general, each jurisdiction that maintains a captive regime treats and taxes the captive entity in a unique way. As such, companies can afford to be choosy regarding when and where they decide to set up a captive, effectively creating a captive marketplace and allowing companies to jurisdiction shop for the most favorable captive regime to fit their circumstances. Recently, as more states have recognized the revenue potential of a captive regime and with more businesses realizing the usefulness and benefits of utilizing a captive, the marketplace is expanding and thriving.

Accordingly, as more states have either entered the captive marketplace, or they have revised existing captive regimes to attract and entice businesses into setting up shop within their borders, states are engaged in an unintentional race to the bottom whereby states adopt less cumbersome administrative procedures and more favorable fee structures. For instance, North Carolina offers an online application process, while Oregon has moved to tax alternatives, such as annual fees, in an effort to draw more attention. However, when deciding where to set up a captive, businesses take many factors into consideration. Of chief concern for most businesses is the stability with the state's captive regime. Vermont, being one of the more prolific captive insurers with more than 1,000 captives domiciled in the state, enjoys a successful captive regime thanks in large part to its longstanding captive laws that were established two decades ago.

In addition, the size of the business' operations and whether it would be economically or administratively practical to set up a captive outside its home state should be taken into consideration. Other concerns include capitalization requirements, a standard which may be subject to change in certain jurisdictions; premium taxes; whether the state even permits the captive to write the respective insurance policy; reporting and

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[1] See Rev. Rul. 77-316, 1977-2 C.B. 53 (declared obsolete in Rev. Rul. 2001-31) (Rev. Rul. 77-316 presents three (3) situations in which a taxpayer sought insurance coverage for itself and its subsidiaries via a captive insurance company).

[2] Id.

[3] I.R.C. §831(a); See I.R.C. §11(b).

[4] I.R.C. §831(b)(2)(A). Beginning January 1, 2017, the $1.2 million limit will be raised to $2.2 million and a new diversification requirement for captive insurance companies will be implemented.

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maintenance requirements; changing definitions and standards of insurable risks; restrictions on investing net premiums; sustainability of the local and national economy; and even political unrest. At stake is the revenue used to set up and maintain a captive, which is usually quite substantial and which, in most circumstances, involves diverting potentially taxable revenue, and effectively creating an expense in the first state.

Considerations for a Captive

For example, let's say our aforementioned Company X was incorporated, maintained a principal place of business, and operated exclusively in North Carolina. Let's also say that Company X had a phenomenal year, significantly expanding its business operations into new and unchartered areas and, in the process, tripling its gross revenue to $10 million. In addition, Company X has identified new risks associated with such expansion, and it has determined that a captive insurance company would be the most effective way to protect itself. Accordingly, Company X enters the captive marketplace and begins to jurisdiction shop. During its search, Company X determines that North Carolina's captive regime is not as compatible with its needs as Delaware's, and, thus, decides to form in Delaware. To form its captive, Company X's capitalization and maintenance costs, premiums, and other associated fees are drawn from Company X's newly tripled revenues. Thus, the revenue used to set up and maintain Company X's captive was originally revenue earned while conducting business in North Carolina—revenue which was potentially taxable in North Carolina. However, that revenue is now diverted to Delaware, where the captive will be subject to Delaware tax law and other annual fees and costs. In addition to the transfer of revenue, any premiums paid into the captive also creates a tax deduction as an ordinary business expense, thereby offsetting North Carolina taxable income in the process.

While Company X's circumstance is not much different than another business sinking an expense into a purchase or investment in another state, a captive's initial capitalization and annual maintenance and administrative costs can be quite substantial. However, the largest transfer of potential taxable revenue comes with the annual premiums being paid to the captive. Since the IRS allows up to $1.2 million of premiums to be paid into a captive without being subject to federal income tax, it's not unrealistic or inconceivable to posit that most captives are structured so that a parent company's premiums total an amount close to that figure. In addition, captives receiving premiums in excess of $1.2 million may be subject to income taxes on underwriting income, which may not accrue for years or even decades, depending on the policies written. Thus, let's say that the premiums that Company X pays to its captive totals $1.1 million per year. Well, that is $1.1 million per year that would have likely been subject to corporate income tax in North Carolina (or it could have been reinvested into Company X's infrastructure in North Carolina), but is now diverted to Delaware. As North Carolina is undoubtedly aware, Company X's annual premiums of $1.1 million will add up pretty quickly when considered with other North Carolina businesses that either have or will form a captive outside the state. While the $1.1 million or a portion of it may one day make its way back to North Carolina (whether as a claim payout or, if no claims in that respective tax year, by virtue of investment), the likelihood of that money ever being subject to North Carolina tax is remote.

Some states (such as Texas and Illinois), recognizing the need to recoup or recompense lost tax revenue, have adopted self-procurement taxes whereby a home state will impose a tax on the amount of premiums paid to a captive in another jurisdiction by certain businesses located in the home state. While most self-procurement tax rates are nowhere near a state's corporate income tax rate, the concept at least serves both as a (sort of) deterrence for home state businesses and as a means of recovering what may be lost tax revenue. Others would argue that self-procurement taxes are an attempt by conventional insurance companies to limit choice in the captive marketplace and drive businesses to conventional insurers.

Conclusion

In sum, captives can be an incredibly useful tool for companies that are either unable to find insurance coverage, find coverage mispriced, want easier access to the reinsurance market, or desire to supplement their commercial insurance. The tax benefits associated with captives may also attract businesses with illegitimate intentions. As such, they can be misused and abused as tax shelter tools. Furthermore, as states continue seeking an advantage in an effort to attract business and tax dollars, the captive's popularity will continue to grow, causing the IRS to try and rein in the inherent abuses associated with them. The pertinent business owner should ensure that their captive is in good order, insuring actual and realistic risks, and that it can sustain scrutiny when red flags are raised by federal and state tax authorities. In addition, an independent analysis of the associated risks must be complete in order to appropriately price the premiums going to the captive. However, at some point, businesses may decide that the scrutiny associated with setting up and maintaining a domestic captive is no longer worthwhile or that the ''juice ain't worth the squeeze,'' and will accordingly begin looking at the offshore captive marketplace.

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Income Taxes

Wisconsin

Procedure

Insurance Company Left Holding Bag On Lottery Withholding

An insurance company wasn't entitled to a refund of taxes withheld from a stream of payments purchased from a winner of the Wisconsin ''Megabucks'' lottery (*Great-West Life & Annuity Ins. Co. v. Wis. Dep't of Revenue*, 2016 BL 22344, Wis. Ct. App., No. 2013AP2605, *unpublished* 1/28/16).

The Wisconsin Court of Appeals ruled Jan. 28 in an unpublished opinion that Great-West Life & Annuity Insurance Co. couldn't claim a refund of $428,943 that the state's department of revenue withheld from prize money paid to a trust for the benefit of lottery winner J. Donald Bottolfson, because state law prohibited lottery winners from assigning their rights to annual payments.

Ex-Wife Wanted Share. Bottolfson won $9.77 million in the Wisconsin lottery in 1994 and opted for 25 annual payments. The trust was set up in 1997 to receive the payments in order to settle a lawsuit by Bottolfson's ex-wife, who claimed she was entitled to a portion. At the same time as, but independent from, the creation of the trust, Bottolfson sold his income stream from the trust to Great-West.

The court said the department properly withheld the disputed amount in 2001 to satisfy back taxes owed by Bottolfson, because the assignment was in violation of state law at the time, and, thus, ''Bottolfson continued to own the prize for the purposes of tax liability.''

In addition, the department wasn't estopped from denying the validity of Bottolfson's assignment, because although it agreed to the formation of the trust, it didn't agree to or approve Bottolfson's assignment of his interest in the prize to Great-West.

By Erin McManus

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☐ *Text of the decision is at http://www.bloomberglaw.com/public/document/GREATWEST_LIFE__ANNUITY_INSURANCE-_CO_AND_BOTTOLFSON_TRUST_BY_FIRS.*

Delaware

Apportionment

Delaware Revamps Corporate Income Tax; New Law Aims to Encourage Job Growth

Delaware has changed the way corporate income tax is calculated to encourage jobs and unburden small business, the governor's office announced.

Gov. Jack Markell (D) signed the Delaware Competes Act (H.B. 235) on Jan. 27. The new law eliminates payroll and property holdings as factors used to determine what portion of a company's total income is apportioned to Delaware, leaving only total sales as a factor in the calculation.

The law puts Delaware on a more even playing field with neighboring states, according to House Majority Leader Valerie Longhurst (D), who sponsored the measure.

The bill also changes the filing process for small businesses by allowing them to file 25 percent estimates quarterly, rather than making 70 percent of their estimated total tax for the year by June 1.

Some sections of the law take effect July 1, 2016; other sections will apply to taxable periods that begin after Dec. 31, 2015.

By Leslie Pappas

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☐ *Text of H.B. 235 is at http://src.bna.com/cgn.*

Multistate Developments

Apportionment

Multistate Tax Commission Sets Hearing on Market-Based Sourcing Rules

The Multistate Tax Commission's Executive Committee voted to set up a public hearing on draft regulations on market-based sourcing and related regulatory definitions.

Meeting via teleconference Jan. 29, the committee voted to direct that a hearing be held on the draft amendments to the commission's general allocation and apportionment regulations as approved by the Uniformity Committee in December 2015. The amendments are necessitated by changes to the model Multistate Tax Compact Article IV of the Uniform Division

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for Income Tax Purposes Act, adopted by the commission in July 2014.

At the commission's fall meeting in December, MTC Executive Director Gregory S. Matson said the goal is to move the regulations through the promulgation process for the MTC's adoption in July 2016. The public hearing is one more step in that process (22 Multistate Tax Report 833, 12/25/15).

Changes to Section 1 of UDITPA concern the definitions of ''apportionable'' and ''nonapportionable'' income and the definition of ''receipts.'' Changes to Section 17 affect the way receipts from transactions other than sales of tangible property are attributed or ''sourced'' to a particular state for purposes of computing the receipts factor.

Shift in States. Section 17 now requires that receipts be sourced to the market rather than to the place of the predominant cost of performance. Increasingly more states are shifting from cost of performance to market-based sourcing for purposes of determining apportionment of business income.

The committee also referred, for consideration during the public hearing, a letter from the Council On State Taxation asking for changes to be made to the regulations, Helen Hecht, general counsel of the MTC, told Bloomberg BNA Jan. 29.

In the Jan. 26 letter, COST said it is concerned that several provisions within the proposed regulations ''undermine fair and efficient tax administration.'' For example, it said, the ''reasonable approximation'' rules, a key feature of the proposed Section 17 market sourcing regulations, are currently drafted in a way ''that tilts the playing field in favor of the state tax agency.''

The proposed amendments were drafted by two workgroups. In December, the MTC Uniformity Committee, after reviewing the drafts and taking public input, decided the workgroups had satisfactorily addressed the various issues that had been raised, and voted to refer the proposed amendments to the Executive Committee for further action.

Also in its Jan. 29 teleconference, the Executive Committee approved the Uniformity Committee's decision to discontinue its Model Whistleblower Statute project, Hecht told Bloomberg BNA.

By Tripp Baltz

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North Carolina

Procedure

North Carolina DOR Issues Market-Based Sourcing Guidelines

The North Carolina Department of Revenue has released information on market-based sourcing principles to help certain corporate taxpayers file new reports.

Legislation enacted in October 2015 calls for a legislative committee to study the calculation of the sales factor for corporate income taxation using market-based sourcing (H.B. 259, Session Law 2015-268). Certain information is required of larger multistate businesses to help inform the committee, and the NCDOR is required to provide guidance on submitting that data.

The NCDOR is barred from using the reporting guidelines it develops for developing rules or any other purpose without further action by the state Legislature.

Larger Companies Must Report. The 2015 law requires information reports from corporate taxpayers doing business in North Carolina and other states whose apportionable income is more than $10 million and is based at least in part on a sales factor. Those reports (Form CD-400 MS) are due April 15 and must contain information that is detailed in the two guidance documents issued Jan. 29 by the NCDOR.

S.L. 2015-268 calls for the NCDOR's guidelines to be based on certain specified principles and model laws and regulations issued through the Multistate Tax Commission. Those approaches differ in certain ways from North Carolina's current sourcing provisions.

Among the differences, receipts from services currently are sourced to North Carolina if the income-producing activities are performed within the state, and receipts from intangible property are sourced to North Carolina if the receipt was generated within the state. Both of those approaches would be sourced differently under a market-based approach, but there would be no change in sourcing for sales of real or tangible personal property.

Overview, Detailed Documents. The NCDOR provided a general description of the information reporting requirements and market-based sourcing principles in its ''Introduction and Summary'' document. That notice also contains an overview of North Carolina's current requirements, model approaches crafted by the Multistate Tax Commission and a series of tables summarizing the guidelines for sourcing receipts from services and intangibles as a reference tool for taxpayers.

A more detailed and lengthy description is offered in the NCDOR's second document, ''Guidelines for Computing the Sales Factor Based on Market-Based Sourcing,'' which includes examples aimed at assisting taxpayers in understanding the provisions of market-based sourcing.

The guidelines cover general rules for market-based sourcing as well as descriptions of provisions related to the sale, rental, lease or license of real property; the sale, rental, lease or license of tangible personal property; the sale of a service; the license or lease of intangible property; and the sale of intangible property. Special rules for transactions involving software, digital goods and services and financial institutions also are detailed.

Under separate legislation enacted in 2015, North Carolina is phasing in single sales factor apportionment over the next three years .

Kate Catlin, spokeswoman for the North Carolina Chamber, told Bloomberg BNA Feb. 2 that market-based sourcing ''is a complex issue that impacts different industries in different ways.''

"We look forward to an open, deliberate process to engage those discussions," she said.

By Andrew M. Ballard

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☐ *The introductory document is at http://src.bna.com/cmE.*

The computational guidelines are at http://src.bna.com/cmF.

For additional discussion of allocation and apportionment in North Carolina, see Corporate Income Tax Navigator, at North Carolina 6.

Maryland

Procedure

'Suspicious' Filings Prompt Maryland To Freeze Tax Returns by Certain Preparers

Maryland Comptroller Peter Franchot (D) has put a hold on processing returns from dozens of tax preparers after flagging "thousands of highly suspicious filings" while simultaneously asking lawmakers for greater statutory authority to tackle fraud.

Franchot told a General Assembly committee Feb. 10 that an "extraordinary" surge in potentially fraudulent returns warrants passage of legislation (H.B. 162) that would expand his agency's authority to investigate and prosecute "unscrupulous preparers" who have grown "more sophisticated and more brazen."

The bill would increase from three to six years the statute of limitations for prosecuting tax fraud and would provide legal authority to prohibit persons from acting as tax preparers while they are under investigation for fraud.

Penalties Possible. The legislation also would levy penalties on preparers who file false returns, expand existing police powers of the comptroller's Field Enforcement Bureau to include income tax violations and move up the filing deadline for W-2 data from Feb. 28 to Jan. 31 to give the comptroller's office more time to compare potentially fraudulent claims against actual W-2 information.

Another provision aimed at stopping those who might use detailed information about public employees' salaries to file false returns would shield from release under the Maryland Public Information Act documents that list public employee salaries, unless stated in salary ranges instead of specifics, and documents that list public employee classifications or grades and steps, which also could be linked to specific salary amounts.

Deputy Comptroller Sharonne Bonardi told the House of Delegates Judiciary Committee on Feb. 10 that seven other states' tax collectors have authority similar to what the bill would provide, naming Alabama, Connecticut, Florida, New Jersey, New Mexico, New York and Wisconsin.

H.B. 162 remained in the House committee as of Feb. 18, and no companion bill has been filed in the Senate.

Processing Halted. While awaiting legislative action, Franchot has used his authority to suspend the processing of tax returns from preparers said to have filed "a high volume of questionable returns."

The freeze began last month when the comptroller stopped processing returns from seven Liberty Tax Service franchises in the Baltimore area and was expanded by Feb. 9 to include 23 Liberty franchises and 14 other private tax preparers at 18 locations.

Suspicions were raised by traits such as business income reported when the taxpayer didn't own a business; requested refund amounts significantly higher than in prior years; inflated and/or undocumented business expenses; improper claiming of dependents; and inflated wage and withholding information.

"When I took office as comptroller in 2007, we detected and stopped 314 fraudulent returns with a total value of just over $650,000," Franchot said.

By 2015, "the number of fraudulent returns detected and blocked that year skyrocketed to almost 20,000 returns worth more than $38 million," he said. "And now, less than two months into the new year, we've already detected thousands of highly suspicious returns," the comptroller said, prompting the freeze on processing those filed by certain preparers.

Jim Wheaton, Liberty Tax's chief compliance officer, said in a statement that in response to Maryland's concerns, the company has cooperated with the state, launched its own investigation of the offices involved, "and will continue to conduct that investigation aggressively, and support the state's review, until all questions are resolved."

By Kathy Lundy Springuel

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☐ *Text of H.B. 162 is at http://mgaleg.maryland.gov/2016RS/bills/hb/hb0162F.pdf.*

Additional information on the bill is at http://src.bna.com/cHJ.

Wisconsin

Tax Base

Wisconsin Backs Gov. Walker's Plan For Expanded Tax Deductions on Student Loans

Wisconsin taxpayers carrying student loans would be able to claim a slightly larger deduction for interest paid on those debts under legislation gaining momentum in the state Legislature.

The Wisconsin Assembly Feb. 16 passed A.B. 739, a key feature of Gov. Scott Walker's (R) college affordability plan. The measure passed by a vote of 61-37. The

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proposed law is expected to win swift support in the Senate.

"The Assembly has taken a big step forward in helping make college more affordable and transparent for Wisconsin students and families," Walker said in a statement following action in the Assembly.

A.B. 739 boosts the deduction available to state income tax filers by eliminating the cap on qualifying student loan interest. Wisconsin law currently conforms to federal law, permitting taxpayers to claim a student loan interest deduction capped at $2,500. The deduction phases out as the taxpayer's adjusted gross income climbs. A.B. 739 retains the income phase-out provisions, but removes the $2,500 cap for students carrying high debt loads.

The Wisconsin Department of Revenue estimated the measure would cost the state $500,000 in 2016, but $5.2 million annually beginning in 2017. The state's Legislative Fiscal Bureau estimated approximately 30,000 taxpayers would be able to take advantage of the enhanced deduction.

Democrats Critique Bill. Assembly Democrats opposed the bill and other portions of Walker's higher education affordability plan. The critics argued Walker and his majorities in both the Assembly and the Senate had stitched together a flimsy package that would do little to remove barriers to higher education and relieve debt pressures weighing on thousands of Wisconsin students and graduates.

"Republicans chose to go for cheap political points and offer a legislative package that essentially does very little to help the hundreds of thousands of Wisconsinites who face student loan debt," commented Rep. Dana Wachs (D). "Wisconsin citizens ought to know the truth about this legislation and demand more from their elected officials in the future."

BY MICHAEL J. BOLOGNA

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☐ *Text of A.B. 739 is at https://docs.legis.wisconsin.gov/2015/related/proposals/ab739.pdf.*

South Carolina

Apportionment

Duke Energy Loses $126M Tax Refund Bid in South Carolina

Duke Energy Corp. can't use principal recovered from the sale of short-term securities to reduce the percentage of its income attributable to South Carolina (*Duke Energy Corp. v. S.C. Dep't of Revenue*, 2016 BL 43621, S.C., No. 2014-002736, 2/17/16).

The South Carolina Supreme Court ruled Feb. 17 that inclusion of principal in the calculation of the company's total sales—when determining how much of its income is subject to South Carolina tax—would result in distortion leading "to absurd results that could not have been intended by the General Assembly."

Duke sought a $126 million refund by claiming that the total proceeds from the sale by its treasury department of short-term securities, which had no connection to South Carolina, should be included in the denominator of the fraction of its income taxable by South Carolina, thereby reducing that tax.

Subject to Misinterpretation. Although Chief Judge Costa M. Pleicones reached the same conclusion that the South Carolina Court of Appeals did in October 2014, he disagreed with the lower court's analysis (21 Multistate Tax Report 647, 10/24/14).

Pleicones said the lower court's description of the principal of the investment as Duke Energy's "own money"—and not a "receipt"—employed "nomenclature that is subject to misinterpretation."

The court said "the appropriate determination is whether principal recovered from the sale of short-term securities could be included as 'total sales' in the sales factor of the multi-factor formula, the relevant term under the apportionment statutes."

Apportionment Calculations. The matter involves a request filed by Duke Energy in 2002 for a $126 million refund of corporate income tax payments, plus interest, covering tax years 1978 to 2001. The power company had sought the refund based on the use of an apportionment formula applicable to non-manufacturing companies and the addition of gross receipts from sales of short-term investments in the formula's denominator, an approach to calculating taxes that the South Carolina Department of Revenue rejected.

In South Carolina, manufacturers are subject to an income apportionment formula that includes property, sales and payroll (S.C. Code Ann. Section 12-6-2252). All other companies use a formula that is solely based on sales (S.C. Code Ann. Section 21-6-2290).

An administrative law judge upheld the department's denial of the refund request, as did the South Carolina Court of Appeals in an October 2014 ruling.

'Distorting the Sales Factor.' Upon its consideration, the supreme court said that it was "undisputed" that the multi-factor apportionment formula applies in the case at hand. That formula uses the term "total sales" and whether principal recovered may be included in that factor "is a novel issue in South Carolina," the high court said.

According to the state supreme court, principal from short-term investments could be used by taxpayers to manipulate the sales factor "by the simple expediency of a series of purchases using the same funds." Such activities would distort the intent of apportionment provisions that aim to reflect the amount of a businesses' total income that is reasonably attributable to the business activity within a certain state, the court said.

Therefore, the court said, "we agree with the states that have found the inclusion of principal recovered from the sale of short-term securities in an apportionment formula leads to absurd results by distorting the sales factor within the formula, and be defeating the legislative intent of the apportionment statues."

Impact in Other States? ''Obviously, we are disappointed in the Supreme Court's ruling, but we will abide by the court's decision in this matter,'' Ryan Mosier, a spokesman for Duke Energy, told Bloomberg BNA in a Feb. 17 e-mail.

Mosier declined to say whether the utility had taken the approach at issue in apportioning income to North Carolina or other states in which it does business. ''Tax matters are confidential between a state and a taxpayer, so we do not discuss those,'' he said.

In addition to the Carolinas, Duke Energy sells power in Florida, Indiana, Kentucky and Ohio.

Trevor Johnson, a spokesman for the North Carolina Department of Revenue, told Bloomberg BNA Feb. 17 that his agency couldn't discuss how Duke Energy apportions its income in reporting to that state. However, Johnson said, generally speaking, ''the sale of short-term securities should not be included in the sales factor for apportionment purposes'' under North Carolina law (N.C. Gen. Stat. Section 105-130.4(a)(7)(d)).

By Andrew M. Ballard

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☐ *Text of the ruling is at http://www.bloomberglaw.com/public/document/Duke_Energy_Corporation_Petitioner_v_South_Carolina_Department_of.*

For additional discussion of the special apportionment formula for manufacturers in South Carolina, see Corporate Income Tax Navigator, at South Carolina 6.10.3.

Ohio

IRC Conformity

I.R.C. Conformity Measure Saves Ohio Taxpayers $18.9 Million

Ohioans have been spared an $18.9 million tax hike by legislation that brings state rules into conformity with the Internal Revenue Code.

The measure (S.B. 2) expressly incorporates recent federal tax code changes into state law, Ohio Department of Taxation spokesman Gary Gudmundson told Bloomberg BNA Feb. 17.

Gudmundson said the changes extend federal tax benefits currently used in the computation of federal adjusted gross income—specifically, alterations contained in the Protecting Americans from Tax Hikes Act of 2015 (PATH Act; Pub. L. No. 114-113, Division Q), which was signed into law by President Barack Obama on Dec. 18.

During January testimony on the bill before the Ohio House Ways and Means Committee, Nick Cipiti, the state's deputy tax commissioner for tax policy and budget, said, ''In the absence of this conformity, Ohio taxpayers' liability would increase, resulting in a tax hike of approximately $18.9 million.''

Yet, Cipiti told lawmakers, conforming to the new federal changes would keep tax preparation and administration efficient without raising taxes.

Exclusions, Deductions From AGI. Almost all the conforming changes involve exclusions and deductions from adjusted gross income that otherwise would have had to be added back to determine Ohio adjusted gross income.

Permanent changes include an enhanced earned income tax credit, an extension of tax-free distributions from individual retirement plans for charitable purposes and an extension of research credit modifications.

Among extensions that run through 2016 are the above-the-line deduction for qualified tuition, the energy efficient commercial buildings deduction and the exclusion from gross income of discharge of qualified principal residence indebtedness.

Gov. John R. Kasich (R) signed the bill Feb. 14 and it took effect immediately, after the governor declared it an emergency measure.

By Bebe Raupe

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☐ *Text of S.B. 2 is at http://src.bna.com/cHs.*

For additional discussion of IRC conformity and the earned income tax credit in Ohio, see Corporate Income Tax Navigator, at Ohio 5.2 and Individual Income Tax Navigator, at Ohio 3.6.3.1.

Alabama

Corporate Taxes

Latest Combined Reporting Bill Faces Long Odds in Alabama

Alabama's Legislature once again will consider a combined reporting requirement for corporate income taxes—a proposal backed by the state's revenue commissioner but strongly opposed by the business community.

Alabama S.B. 202, introduced Feb. 11, would require that a corporation's related subsidiaries file a single, combined return for corporate income taxes. The requirement is common in some regions of the U.S., but opponents of the legislation have said Alabama would be the only state in the Southeast with such a requirement, putting it at a competitive disadvantage for recruiting new companies to the state.

''I would expect the business community to rally together to defeat this bill again—for the eighth or ninth time,'' Bruce Ely, a state and local tax attorney at Bradley Arant Boult Cummings LLP,told Bloomberg BNA Feb. 9, in anticipation of the bill being filed.

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Business advocates including the Council on State Taxation argue that a unitary combined reporting rule can force multistate companies to attribute more income to a particular state than is accurate or appropriate.

Proposal Failed in 2015. The Legislature considered a combined reporting bill in two special sessions during the fall of 2015. The bill won approval from a Senate committee in the first session, but the same committee voted to table the proposal in the second session.

The Alabama Department of Revenue publicly supported a combined reporting requirement. Deputy Commissioner Joe Garrett Jr. said the state's current separate reporting system allows large multistate companies to shift or avoid some tax liability.

''That's not a good attribute for a tax system,'' he told Bloomberg BNA in a Q&A published Nov. 6. Nevertheless, Garrett acknowledged that a combined reporting policy might hurt economic development efforts in Alabama and said its chances of passage in the Legislature aren't strong .

Rep. Steve Clouse (R), chairman of the Alabama House Ways & Means General Fund Committee, also told Bloomberg BNA that a combined reporting bill would face long odds in 2016 .

''No one else in the Southeast does it, so we would be putting ourselves at a competitive disadvantage. I don't anticipate that passing this year,'' Clouse said Dec. 17, in previewing the 2016 legislative session. He added that he doesn't expect the Legislature to approve any form of tax increases this year.

BY CHRIS MARR

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☐ *Text of S.B. 202 is at http://src.bna.com/cHR.*

For additional discussion of combined reporting in Alabama, see Corporate Income Tax Navigator, at Alabama 8.3.

Arizona

Procedure

Arizona Bill Would Eliminate Tax on Legal Tender Exchange

Arizona's House of Representatives will take up legislation (H.B. 2043) specifying that the state wouldn't collect a capital gains tax on the income derived from the exchange of one kind of legal tender for another.

By a 6-to-3 vote, the House Ways and Means Committee Feb. 15 advanced the measure sponsored by Rep. Mark Finchem (R) of Tucson. Action by the full House may come as soon as the week of Feb. 22, Finchem told Bloomberg BNA Feb. 17. If approved, H.B. 2043 would then go to the Senate.

To explain his bill, Finchem used a scenario under which a holder of 1,100 Federal Reserve notes exchanges them for one $20 U.S. Mint golden eagle piece. Two weeks later, the holder converts it again, this time into 1,200 notes.

The holder has experienced the net effect of inflation, not a gain of 100 notes, he said. But he added, ''The federal government seems to think it is OK to tax inflation,'' referring to the 100 Federal Reserve note difference. By law, he said, a tax on the exchange of money isn't allowable.

Finchem's bill would effectively carve that out of Arizona's income tax structure, he said. Under his bill, ''That exchange would not trigger a capital gains tax,'' he said.

He acknowledged that the bill would affect a relatively small number of individuals, and said the state Department of Revenue told him it has insufficient data to measure the bill's impact on the state treasury.

BY WILLIAM H. CARLILE

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☐ *An overview and summaries of H.B. 2043 are at http://src.bna.com/cHE.*

California

Professional Athletes

Super Bowl Taxes Could Exceed Winnings for Some NFL Players

Some of the players for the Denver Broncos and Carolina Panthers, who faced each other in the Super Bowl 50 football championship, could actually lose money by playing in the event due to tax implications in California.

Jack Trachtenberg and Jason Feingertz, tax attorneys for Reed Smith LLP, say National Football League players aren't paid their regular season salary during the playoffs and instead only receive a ''bonus'' for their participation. Members of the winning team each receive a $102,000 bonus and those on the losing team get $51,000. However, California requires that taxes be paid on a player's full season salary, so some players may see a loss.

''For players earning a high salary, when you factor in California's high tax rate, those Duty Days spent practicing and playing in California can result in a tax bill larger than the $51,000 bonus the player receives for being on the losing team,'' Trachtenberg, counsel for Reed Smith in New York, told Bloomberg BNA in a Feb. 5 e-mail. ''Therefore, without even considering the federal tax implications of the Playoff bonus, a player can lose money by participating in the game.''

Trachtenberg and Feingertz agreed that any NFL player would trade the tax liability to play in the Super Bowl, but said the tax implications are interesting nonetheless.

Duty Days. Trachtenberg and Feingertz say California imposes a tax on nonresident athletes for any "Duty Days" they spend working in the state during the year. As a result, according to the lawyers, every player competing in the Super Bowl will have a higher tax bill in 2016 due to extra days spent preparing for and playing in the event.

"Depending on their exact travel arrangements, the players on both teams will spend about 7-9 days in California for the Super Bowl for practices and the big game," Feingertz, an associate in Reed Smith's state tax department, told Bloomberg BNA in a Feb. 5 e-mail. "All of these days will qualify as Duty Days for California purposes."

Feingertz said that California's top personal income tax rate of 13.3 percent is "the highest individual income tax in the United States." California imposes that rate on an athlete's income apportioned to the state under the "Duty Day" formula, he said.

Additional Tax Revenue. Feingertz said the state of California also will benefit, thanks to additional tax revenue generated by hosting the event.

"Hosting the Super Bowl can come at a high cost for a state, but the Jock Tax will help offset some of the expenses associated with the event," he said. "The additional revenue typically will go into the state's General Fund, which allows the state to use it for many different purposes."

However, Feingertz said, California won't see any additional tax revenue from the sales tax associated with tickets to the Super Bowl.

"The NFL requires that every state which hosts the Super Bowl specifically exempt Super Bowl tickets from the sales tax imposed by that state," he said. "However, California can still benefit from local hotel taxes and sales taxes for other purchases made by tourists attending the game."

California Taxes. In 1991, California became the first state to "aggressively impose a tax on non-resident athletes," according to Trachtenberg. Since then, he said, most states with a personal income tax have instituted their own form of the "Jock Tax."

"For example, New York currently uses the Duty Day formula to impose tax on non-resident athletes for all Duty Days spent in the state," Trachtenberg said.

Feingertz said the California Franchise Tax Board is unique in that it has a specific "Sports Program," which ensures nonresident professional athletes file California returns and that the correct state source income is reported by those who file returns voluntarily.

"Additionally, California is known to be one of the most aggressive states for Residency Audits of professional athletes who own a home in the state," Feingertz said.

By David McAfee

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☐ *For a discussion of taxes on nonresident professional athletes in California, see 1900-2nd T.M., California Personal Income Tax, at 1900.08.C.4.b*

New York

False Claims Act

Whistle-Blower Asks New York Court To Allow Case Against Citigroup to Proceed

An Indiana University economics professor argued that his whistle-blower tax case against Citigroup Inc. should go forward in federal court.

Eric Rasmusen on Feb. 4 asked the U.S. District Court for the Southern District of New York to deny Citigroup's motion to dismiss the case, which would force the company to pay some $800 million in New York state taxes on net operating losses (*New York ex rel. Rasmusen v. Citigroup, Inc.*, S.D.N.Y., No. 1:15-cv-07826, *memorandum in opposition to motion to dismiss*, 2/4/16).

The case stems from Citigroup's handling of net operating losses in relation to the sale of stock to the Treasury Department in 2009 under the Troubled Asset Relief Program (TARP).

Citigroup was able to take the NOL deductions, despite the sale, under notices from the Internal Revenue Service that said the sale and acquisition of stock by the Treasury didn't cause an ownership change within the meaning of tax code Section 382.

Citigroup has until March 18 to file its reply brief.

State Tax Law. The case is one of three high-profile qui tam tax cases wending their way through the courts in New York, with three others possible .

Rasmusen argues that the case should proceed under the New York False Claims Act (NYFCA) for Citigroup's failure to pay state taxes, because the IRS notices don't apply to state taxes.

The case is exactly what the NYFCA's tax whistleblower provisions were designed to remedy—"a defendant's culpable failure to pay a significant tax liability," according to the brief opposing Citigroup's motion filed by attorneys Daniel C. Oliverio, John L. Sinatra Jr. and Aaron M. Saykin of Hodgson Russ LLP.

"While Citigroup's reliance on the Notices may or may not put Citigroup in a safe place *vis a vis* its *federal* tax returns (which are not at issue here), the same is not true for its *New York State* tax liability," it said. "New York tax law incorporates the Internal Revenue Code, the plain and unambiguous text of which directly contradicts the Notices."

"It is black letter law in New York that federal administrative interpretations of statutes that contradict unambiguous statutory language must be rejected," the brief said. "Thus, Citigroup was forbidden from applying the federal NOL deductions at issue to its New York State returns."

Rasmusen argued that the case should proceed to discovery to determine if Citigroup knowingly claimed false deductions on its New York tax filings and was "deliberately ignorant" or acted with "reckless disregard."

Corporations Beware. Peter L. Faber, a partner at McDermott Will & Emery, told Bloomberg BNA that the case "illustrates the need for corporations to be aware that positions taken on their federal income tax returns

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can have implications under the New York State False Claims Act.''

''The tax laws are complicated and often ambiguous,'' he said in an e-mail. ''Because New York's definition of taxable income is based on federal taxable income, this means that a corporation that in good faith challenges a position of the IRS on a matter of federal tax law runs the risk of incurring treble damages in New York State if it does not do appropriate due diligence and have a solid legal basis for its position.''

Faber, whose firm represents Citigroup, but not in this case, said the case is an example of the ''mischief that self-styled vigilantes can cause when they take it upon themselves to enforce the tax laws.''

Faber also noted that New York Attorney General Eric T. Schneiderman (D) declined to take up the case under the state False Claims Act.

Jack Trachtenberg, counsel at Reed Smith LLP, told Bloomberg BNA that the suit ''borders on the frivolous.''

''If it is allowed to proceed, I fear it will further encourage the march toward the very thing we have been warning about and which we have seen in Illinois and other states,'' he said in an e-mail. ''Namely, meritless strike lawsuits by plaintiffs looking for a quick settlement and payout.''

Citigroup's Motion to Dismiss. Citigroup, in its Dec. 7 motion to dismiss the case, said the state False Claims Act requires that the suit be dismissed because the plaintiff's allegations were publicly disclosed before the suit and he isn't the ''original source'' for the information.

In addition, Citigroup said the plaintiff has failed to show that Citigroup violated the state tax law, made statements that were ''knowingly false'' or acted with ''deliberate ignorance or reckless disregard.''

''Put simply, plaintiff's grievance is that he does not agree with the IRS's guidance,'' Citigroup said in a brief filed by attorneys Mario J. Verdolini, Edmund Polubinski III, Jessica L. Turner and Alexander F. Mindlin of Davis Polk & Wardwell LLP. ''But a *qui tam* suit is not a vehicle for challenging regulatory actions or the government's legal interpretations.''

''And it is certainly not a source of windfall recoveries—at the expense of private parties relying in good faith on government guidance—for opportunistic individuals who challenge government guidance years after the fact,'' it said.

Citigroup said the tax deductions were expressly permitted by IRS guidance. It said Rasmusen ''asserts his personal opinion that the IRS guidance was ill-advised and improperly promulgated and, on the basis of his opinion, presents himself as a purported whistleblower.''

''Plaintiff offers no non-public facts in support of his claims,'' the Citigroup brief said. ''He identifies no statement from any federal or New York taxing authority to support his views. He even acknowledges that Citigroup relied on authoritative guidance from the IRS which permitted the very deductions he now contests.''

By Gerald B. Silverman

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☐ *Rasmusen's brief is at http://www.bloomberglaw.com/public/document/State_of_New_York_ex_rel_Eric_Rasmusen_v_Citigroup_Inc_Docket_No_/1.*

☐ *Citigroup's brief is at http://www.bloomberglaw.com/public/document/State_of_New_York_ex_rel_Eric_Rasmusen_v_Citigroup_Inc_Docket_No_/2.*

District of Columbia

Transfer Pricing

D.C. Appeals Judge Questions Court's Ability To Rule on Merits in 'Chainbridge' Disputes

The District of Columbia's unorthodox transfer pricing program is nothing more than a ''shakedown'' of taxpayers, an attorney for ExxonMobil Oil Corp. said, urging a panel of appellate judges to intervene any way it can.

''What's going on here is an abuse of the litigation process by OTR,'' said M. Miller Baker of McDermott Will & Emery LLP in oral arguments Feb. 9 before the Court of Appeals of the District of Columbia (*D.C. Office of Tax & Revenue v. ExxonMobil Oil Corp.* , D.C. Ct. App., No. 14-AA-1401, *oral argument*, 2/9/16).

Baker decried the fact that the D.C. Office of Tax & Revenue has continued to use the services of contractor Chainbridge Software LLC, despite having lost repeated legal challenges questioning the validity of the Chainbridge transfer pricing method.

Miller represents ExxonMobil and two other oil companies, Shell Oil and Hess Corp., which are fighting $3.7 million in tax deficiencies based on transfer pricing analyses conducted by Chainbridge. The adjustments were struck down by the Office of Administrative Hearings in November 2014, and OTR appealed.

Nonmutual Collateral Estoppel. Baker urged the appeals court to apply a legal doctrine called nonmutual collateral estoppel—which would force OTR to abide by an earlier administrative ruling that found the Chainbridge method was invalid as a matter of law. It was on the basis of that legal doctrine that Administrative Law Judge Beverly Sherman Nash struck down the tax deficiencies against ExxonMobil, Shell and Hess (21 Multistate Tax Report 717, 11/28/14).

''I would urge the court, if it is not going to apply nonmutual collateral estoppel against the District, to actually reach the merits,'' Baker said, warning that if the court didn't do so in the present case, it might never have the chance.

Baker noted that OTR has lost four lawsuits challenging the company's methods—including a $2.75 million dispute involving Microsoft Corp. and the three cases on appeal—and settled a similar lawsuit filed by BP Products North America in the D.C. Superior Court
.

'Twenty-Four Victims a Year.' He noted that there are six other cases pending in the Office of Administrative Hearings challenging transfer pricing adjustments by

Chainbridge—but those account for a fraction of the taxpayers who have received deficiency notices from OTR.

''Their vendor has a contract to go out and find 24 victims a year—and make the assessment against 24 different companies every year,'' Baker said.

Associate Judge Phyllis Thompson interjected: ''It doesn't say 'victims.' ''

Baker persisted: ''Effectively that is what it is, your honor.''

The three cases on appeal account for $3.7 million in disputed taxes, he said, but with interest the amount at issue is closer to $7 million. For many other taxpayers, facing smaller tax liabilities, the cost of litigation is enough to persuade them that it is cheaper to settle than to sue.

''A company with a tax bill of $400,000—and the cost of litigation is $200,000—if they can settle for $200,000 and get certainty, why proceed? What's going on here—I hate to use strong language in front of this court—what is going on here is an abuse of the litigation process by OTR of the District's courts. This is a cash cow for the District. This is a cash cow.''

Reaching the Merits. Baker noted that OTR appealed the *Microsoft* ruling initially to the appeals court, then dropped the appeal. The move was apparently strategic, he suggested, because in the absence of a final decision from the appeals court, the District could continue to use the services of Chainbridge.

''If they never had to take that issue to this court and they lose repeatedly in OAH, time after time after time, they effectively can shake down the taxpayers for the District of Columbia,'' Baker said.

He warned that if the appeals court rules that nonmutual collateral estoppel doesn't apply to OTR, ''they will have no incentive to appeal. And that's another reason why this court should reach the merits.''

Thompson questioned whether the appeals court had the ability to weigh the merits of the Chainbridge method. ''Is there a record that would allow us to do that?'' she asked.

Baker responded that the taxpayers had filed a motion for summary judgment ''that is fully briefed,'' although he conceded that Nash had limited OTR to responding only on the issue of nonmutual collateral estoppel and ''did not entertain an argument on the merits.''

Said Thompson: ''So how could we possibly reach the merits?''

Baker replied that the question a matter of law ''and what you have in the record should be sufficient.''

Thompson wasn't convinced, noting that D.C. Superior Court Judge John Campbell had declined to grant summary judgment in the BP Products case because he found questions of fact that should be addressed at trial.

That case was ultimately settled, with OTR retaining $581,000 of the $722,585 assessment that BP Products had paid and was seeking to have refunded. Under the agreement, BP Products received a refund of $140,985, plus interest.

Thompson said that, while it is understood the Chainbridge method doesn't track federal regulations, it is not clear why the method could not be considered ''an adequate proxy'' for a more detailed transfer pricing analysis.

''I have to say it is not clear to me that the methodology is unreasonable,'' she said. ''Maybe by looking a little harder, one could reach that conclusion, but I don't know that we have enough that we could reach the merits.''

Ruling in Error. Arguing for the District, Senior Assistant Attorney General Richard Love disputed Baker's depiction of the Chainbridge program as a shakedown of taxpayers.

''This case is about taxes,'' he said. ''It isn't about found money. OTR represents in good faith that the oil companies didn't pay their fair share of taxes.''

In its briefing to the court, the District has argued that Nash had applied the doctrine of nonmutual collateral estoppel in error. The briefs cited the U.S. Supreme Court's opinion in *United States v. Mendoza*, 464 U.S. 154 (1984), which held that the doctrine doesn't apply to the federal government. Under the same reasoning, the doctrine shouldn't apply to the District government, either.

In *Mendoza*, the Supreme Court held that the nature of government litigation creates compelling reasons to treat the government differently for the purposes of collateral estoppel. Government litigation frequently involves ''legal questions of substantial public importance'' and the government is more likely than any private party to be involved in different lawsuits involving the same legal issues, the court said.

The taxpayers in their briefing noted that the D.C. Court of Appeals has allowed the use of nonmutual collateral estoppel against the District government, applying a 13-step test that includes the question of whether there are compelling circumstances that make it appropriate for a party to relitigate an issue.

Associate Judge Roy W. McLeese asked Love if he agreed that if the District were to continue to lose challenges in the Office of Administrative Hearings and ''keep losing and never appeal, that this court has exceptional circumstances'' that would justify applying the doctrine of nonmutual collateral estoppel against the District.

Love responded that applying collateral estoppel on that basis would be ''a disproportionate response.'' There are other, more appropriate methods, he said, to address abusive conduct by government.

ExxonMobil, Shell and Hess are also represented by Stephen P. Kranz and Diann L. Smith of McDermott Will & Emery in Washington.

By Dolores W. Gregory

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Multistate Developments

Apportionment

'No Factor' Corporations to Headline Issues For Multistate Tax Work Group to Consider

A work group of the Multistate Tax Commission has placed a top priority on examining the issue of when a corporate taxpayer has ''no factor'' for purposes of apportioning business income for taxation.

The ''no apportionment factor'' issue is related to one of six topics under consideration by the work group, which met via teleconference Feb. 9. The MTC Uniformity Committee formed the group in December to develop regulations under the Uniform Division of Income for Tax Purposes Act (UDITPA) Section 18. The purpose of the work group is to address general Section 18 regulatory issues created by amendments to UDITPA that were adopted by the commission in 2014 and 2015, and by proposed changes to the commission's Model General Allocation and Apportionment Regulations made by work groups to UDITPA Sections 1 and 17.

One of the charges to the group is to consider the MTC definition of ''receipts,'' which now excludes receipts from securities and hedging, where they represent ''transactional'' receipts for select taxpayers, such as brokers, and how distortion—such as churning of investments—can be avoided.

'Factor-Based' Nexus Standards. In its discussion the work group noted there could be a lot of special purpose entities with no factors anywhere, and entities might end up equating a lack of apportionment factors with a lack of nexus anywhere, especially in those states which have adopted ''factor-based nexus'' standards.

Previously the Uniformity Committee had agreed that in the case of a conflict between special industry regulations and the new Section 17 rules, the former would control until new rules, if any, are adopted.

However, that could cause some problems, especially in the context of the television and radio broadcasting, since those sectors are covered under the new Section 17 regulations, the group said. The MTC's publishing and broadcasting regulations are more than 20 years old and may need to be updated, the group said. Providers such as Hulu aren't covered by the 1996 MTC regulation.

By Tripp Baltz

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☐ *Information on the work group is at http://src.bna.com/cyM.*

Delaware

Unclaimed Property

Delaware Issues Draft Guidance on Unclaimed Property for Public Comment

A recently released manual on Delaware's unclaimed property audits is intended to increase transparency but in some cases does the opposite, practitioners say.

The Delaware Department of Finance announced Feb. 1 that it is gathering public comment through March on a draft copy of the manual, which explains unclaimed property audits in the state.

The Feb. 1 public notice, ''Voluntary Disclosure Agreement and Escheat Examination Manual,'' proposes guidelines for a manual that would give holders of unclaimed property a basic understanding of the audit processes and the state's expectations around the voluntary reporting of unclaimed property.

The goal of the manual is to ''ensure greater transparency and predictability in the process,'' the notice says.

Vague and Lacking. Lack of specificity in the draft regulations may undermine that goal, according to a Feb. 8 blog post by Karen Anderson and Will King, vice president and associate general counsel, respectively, at Keane, a New York-based unclaimed property consulting firm.

The proposed regulations ''are vague and lacking detail in significant areas such as sampling and estimation techniques, field work standards, work paper requirements, burden of proof, the scope of records to be reviewed and in criteria for penalty abatement,'' they write.

The draft manual also includes several provisions that ''perpetuate an unreasonable holder burden'' and actually provide less predictability and transparency, Anderson and King say. These include provisions that permit Delaware to conduct an audit up to three years after a company makes a voluntary disclosure; escheat property with a foreign address; divide audits into multiple parts by property type or years, allowing parts of an audit to be closed while others remain open; and audit a company without having to provide a justification for doing so.

Task Force Recommended. The guidance follows the enactment of S.B. 11 in January 2015, which directed the Delaware Secretary of Finance to develop ''a detailed manual containing procedural guidelines for the conduct of Delaware unclaimed property examinations,'' the notice says. The manual was supposed to have been completed by Dec. 31, 2015, according to an excerpt from the 2015 law that was cited in the notice. A manual on unclaimed property audits was the first of nine recommendations that the Unclaimed Property Task Force made to the General Assembly in its final report in December 2014.

The manual is part of continued efforts by the state to revamp its unclaimed property program. Delaware Gov. Jack Markell (D) last year signed S.B. 141 into law, enacting a dramatic overhaul that shortened audit

review periods, eliminated surprise audits and shifted the focus of the program to voluntary to self-assessment(22 Multistate Tax Report 577, 8/28/15).

The proposed regulations released Feb. 1 include one section for voluntary disclosures and another for audits, with most of the 14-page notice focusing on audit activity.

According to the proposed guidance, Delaware has jurisdiction to seize unclaimed property in which the last known address of the owner:

- is located in Delaware;
- is unknown, and the Holder is incorporated or formed under the laws of the State of Delaware; or
- is not located in the U.S. or U.S. territory, and the holder is incorporated or formed under the laws of the State of Delaware.

Subject of Litigation. Foreign property is currently a topic of litigation in *JLI Invest SA v. Cook*, according to a Feb. 5 blog post from Barganier and Associates, an unclaimed property consulting firm in Atlanta, Ga., that specializes in helping Fortune 500 clients with unclaimed property compliance .

In that case, two Belgium researchers with stock in Idenix Pharmaceuticals filed a lawsuit in Delaware Chancery Court alleging they lost $12 million when the state illegally seized and sold their shares, Barganier said.

The proposed rules would continue to allow auditors to estimate a liability when records are incomplete, also the subject of controversy in the past, Barganier notes. One element of concern, according to Barganier, is language that disregards name and address detail in performing the estimation for periods without records, ‘‘thus allowing the state to assess based on an estimate that includes property it would not otherwise be entitled to.’’

The estimation issue is currently being litigated in *Temple Inland Inc. v. Cook*, which challenges extrapolation methods that the state auditor used to demand a $1.38 million unclaimed property payment, saying they violate federal law, according to the complaint.

Echoing Keane’s analysis, Barganier also pointed out a provision in the proposed rules regarding audit selection, which states, ‘‘At no time is the State required to justify its selection of a Holder for examination.’’ Barganier noted that Delaware’s selection process is already being litigated in *Plains All American Pipeline, LP v. Cook* , which challenges the way the state selects companies for audit.

In its complaint, the company claims that the state bases its selections on profitability rather than neutral criteria, which infringes on the company’s rights under the Fourth Amendment to be free from unreasonable searches and seizures.

Comments on the draft guidance will be taken until April 1, 2016.

By Leslie A. Pappas

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☐ *The draft guidance is at http://src.bna.com/cAV.*

For additional discussion of unclaimed property in Delaware, see Corporate Income Tax Navigator, at Delaware 14.

Kentucky

Corporate Taxes

Kentucky Bill Would Implement Combined Reporting, Throwback Rule

Omnibus tax legislation before a Kentucky House committee would change apportionment methods to use a throwback rule and market-based sourcing for receipts, as well as require combined reporting for corporations.

Other provisions in the measure (H.B. 342) would make the film industry tax credit nonrefundable and nontransferable; require review and sunset of all economic development tax credits; and tax all income apportioned or allocated to countries recognized as tax havens.

However the bill’s chances of clearing the 2016 Kentucky General Assembly seem remote, because Gov. Matt Bevin (R) has said he wants lawmakers to take up comprehensive tax overhaul in a special legislative session later this year.

Lexington tax attorney Erica Horn told Bloomberg BNA Feb. 11 that some version of this ‘‘perennial bill’’ has been introduced by the same state representative for several years and has never passed.

Rep. Jim Wayne (D), the bill’s sponsor, and other supporters of the throwback rule and combined reporting seem to think these approaches would cure Kentucky’s revenue challenges, Horn said, when, in truth, they could trigger ‘‘an onslaught of litigation, absent bright-line rules.’’

Horn, of Stoll Keenon Ogden PLLC, said the proposed changes could drive business out of Kentucky and into one of its seven neighboring states because they would have ‘‘a disparate impact’’ on those companies ‘‘that make Kentucky’s economy tick.’’

According to the Kentucky Legislative Research Commission, if Kentucky enacted a throwback rule and combined reporting, annual tax revenue could increase by $66 million.

Support Lacking. Mark Loyd, Tax & Finance Group chair at Bingham Greenebaum Doll LLP in Louisville, told Bloomberg BNA Feb. 11 that H.B. 384 would have a significant impact on corporations in Kentucky.

Section 10 of the bill would amend Ky. Rev. Stat. Ann. Section 141.120 to provide for market-based sourcing of receipts for purposes of computing the receipts apportionment factor, Loyd said.

Kentucky is now a cost of performance state for sales other than those of tangible personal property by statute, he said. The proposed change, as currently worded, could be read to apply not only to services and intangible property but to also to tangible personal property, which could lead to ‘‘quite a bit of confusion.’’

Loyd said Section 15 of the bill would amend Ky. Rev. Stat. Ann. Section 141.205 to include income

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shifted to a tax haven country in gross income subject to apportionment in Kentucky and would likewise disallow deductions related to transactions with tax haven countries. ''Essentially, this would appear to treat tax haven income and deductions like certain related party that are disallowed,'' he said.

'GTE' Case. The Kentucky General Assembly has rejected the unitary combined reporting method since the mid-1990s, after the *GTE* case, Loyd said.

In the 1994 case—*GTE v. Revenue Cabinet*, 889 S.W.2d 788 (Ky. 1994)—Kentucky's highest court considered whether related companies were authorized to file a combined income tax return using the unitary combined reporting method. Reversing a lower court's decision, the state supreme court held that Ky. Rev. Stat. §141.120 granted the right to GTE and its unitary subsidiaries to file an income tax return on a combined unitary basis.

In recent years, legislation like H.B. 384 has been proposed to adopt the unitary combined reporting method in place of the mandatory nexus consolidated return method, which was put in place in the mid-2000s, he said.

''Both unitary combined reporting and the mandatory nexus consolidated return method are complex reporting methods. While the former is used in many states, it had previously sparked quite a bit of litigation in Kentucky,'' Loyd said. ''The latter is somewhat unique to Kentucky, which makes Kentucky a bit of an outlier and creates uncertainty; not surprisingly, the mandatory nexus consolidated return rules are now being litigated.''

Basis for Conversation? Loyd said he doesn't think there is widespread support for the bill. However, as with past tax legislation submitted by Wayne, it may serve as a basis for conversation, he said.

Kentucky's new governor has called for repeal of the inheritance tax, lower income tax rates and a simplified tax code.

''H.B. 384 does not appear to be wholly compatible with the governor's view of tax reform,'' Loyd said. ''One could even say that it is at odds with it.''

When Wayne introduced the bill Feb. 5, he said ''the time for tax reform is long overdue.'' H.B. 384 moved into the House Appropriations & Revenue Committee Feb. 8.

By Bebe Raupe

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☐ *Text of H.B. 342 is athttp://www.lrc.ky.gov/record/16RS/HB342.htm.*

California

Corporate Taxes

Supreme Court Review of 'Gillette' Deemed Long Shot, but Fight Isn't Over

Attorneys asking the U.S. Supreme Court to review the California Supreme Court's ruling in a Gillette Co. lawsuit know their request is a long shot, but questions of contract law and differences in state court rulings could favor the high court taking the case, Edwin P. Antonlin, of Silverstein & Pomerantz LLP, said.

Antonlin's firm represents the Gillette Co. in the California case, as well as corporations litigating similar issues tied to the Multistate Tax Compact's income apportionment formula in other states. The firm is preparing a petition for review with the U.S. Supreme Court in the wake of the California court's Dec. 31 ruling against the company and in favor of the Franchise Tax Board (23 Multistate Tax Report 23, 1/22/16).

''Certainly the tide has shifted in favor of the states,'' Antonlin said Jan. 29 at the American Bar Association tax section midyear conference in Los Angeles. ''But the fight isn't over. We think we have issues compelling enough to get the Supreme Court to take the case.''

The petition for review will definitely focus on whether there has been a violation of the U.S. Constitution's contracts clause, and probably will include other issues as well, Antonlin said.

Inconsistent Rulings. State courts haven't been consistent in their rulings on the compact election cases, and have been finding ways to rule against the taxpayer under different theories, Antonlin said. This diversity of reasoning could support the view that compacts like the Multistate Tax Compact, and compacts in general, should have a uniform body of law that applies to them, he said.

The attorneys will be ''pounding the pavement'' to encourage others to file amicus briefs in support of their petition, Antonlin said.

''It's a long shot,'' Antonlin said, adding that he and his firm are pushing hard to improve their odds of making it before the U.S. Supreme Court.

By Laura Mahoney

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☐ *For a discussion of the election to use the three-factor formula under the Multistate Tax Compact, see 1150-2nd T.M., Income Taxes: Principles of Formulary Apportionment, at 1150.02.B.*

California

Passthrough Entities

California FTB Mulling Whether to Follow New Federal Partnership Audit Rules

The California Franchise Tax Board has launched an internal effort to decide whether to follow new Internal Revenue Service rules governing federal audits of partnerships, FTB Chief Counsel Jozel Brunett said.

''We're just now getting a team together to see how it impacts us and whether we'll conform,'' Brunett said Jan. 29.

The new rules, included in the 2015 federal budget, impose entity-level tax liability for audit adjustments. The budget act directed the Treasury Department to issue guidance on how it will carry out the new rules, which will apply beginning with tax year 2017 for returns filed in 2018 (22 Multistate Tax Report 844, 12/25/15).

Other Audit Issues. In other audit developments at the FTB, Brunett said the tax agency is continuing to streamline its audits and claims for refund. Auditors work to define the scope of an audit, and issue single-issue information requests to taxpayers.

The agency is open to discussing response times and documentation required to satisfy information requests, Brunett said. Taxpayers should inform the FTB if they can't respond within 30 days or don't have documentation to satisfy the request. The FTB can extend deadlines and consider other types of documentation, she said.

Brunett urged taxpayers to engage with the FTB early if they will have difficulty responding to an information request, rather than face penalties for failure to respond.

In response to feedback from taxpayers and practitioners, the tax agency is now sending letters to taxpayers acknowledging it has received a claim for refund, to assure taxpayers the claims are received, she said. The letters include contact information for the supervisor in charge of the claim.

Brunett made her remarks at the American Bar Association Section of Taxation 2016 midyear meeting in Los Angeles.

By Laura Mahoney

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California

Like-Kind Exchanges

California FTB Educating Taxpayers On Section 1031 Like-Kind Exchange Reporting

The California Franchise Tax Board is emphasizing taxpayer education over enforcement of new filing requirements for participants in like-kind property exchanges under Internal Revenue Code Section 1031, an FTB attorney said.

Since Jan. 1, 2014, participants in Section 1031 exchanges have been required to file a Form 3840 with the FTB whether or not they must file California income tax returns .

Although failure to file the information form can result in tax assessments with interest and penalties, the agency is informing taxpayers first of their duty to file the Form 3840, FTB attorney Ciro Immordino said Jan. 30 at the American Bar Association Section of Taxation midyear meeting in Los Angeles. ''Our big push right now is to educate taxpayers and not penalize them.''

Assessments Possible. On the Form 3840, participants in exchanges of California property for property outside the state must inform the FTB regardless of whether they recognized the gain on sale of the property yet, Immordino said. If taxpayers fail to file the information form, the FTB will require them to recognize the deferred gain, meaning some taxpayers who haven't yet sold the replacement property acquired in their transactions could receive assessments from the FTB.

''You can go through the appeal process and show the property hasn't been sold, and the assessment can go away,'' Immordino said.

With about 40 percent of all Section 1031 exchanges involving California, and 70 percent of them involving Western U.S. states, California rules for the transactions have a ripple effect across the country, said Lou Weller, a partner with Weller Partners LLP in San Francisco. ''1031 is a product of California, and it has been for many years,'' he said.

Many tax practitioners and Section 1031 participants aren't aware that California's new filing requirements apply to taxpayers or entities that have left the state entirely, said Adam Handler, a principal of PricewaterhouseCoopers LLP in Los Angeles. Participants in the transactions must file a Form 3840 for the year in which the exchange takes place, and all subsequent years in which the gain or loss from the exchange isn't yet recognized.

California Clawback. California is one of four states—along with Massachusetts, Montana and Oregon—that claws back gain on the ultimate sale of the exchanged property in a Section 1031 transaction if the exchange stemmed from a California property, Handler said.

When exchanging for a property in a state without a similar clawback, tax liabilities will be complex and often depend on the extent to which the other state allows a credit for tax paid in another state, he said.

The FTB has begun drafting new regulations that would apply to the sourcing of gains or losses from Section 1031 exchanges, and specify which year's appor-

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tionment factors would be applied for apportioning taxpayers, Immordino said.

At its first meeting with interested parties, scheduled for Feb. 3, the FTB is asking for suggestions and feedback on several scenarios, such as those involving an exchange of California property for out-of-state property that is ultimately sold for a gain or a loss, or transactions involving multiple exchanges in or out of California with various apportionment factors.

SBOE Ruling. A recent precedent-setting opinion from the State Board of Equalization may cloud California's regulation of Section 1031 exchanges depending on whether they are held for any period before they are transferred, said Edward I. Kaplan, an attorney with Greene Radovsky Maloney Share & Hennigh LLP in San Francisco.

Kaplan represented Rago Development Corp. in the case (*In re Rago Development Corp.*), which was a win for the company, but came with a board-approved opinion that may pull the state away from conformity with federal tax treatment of the transactions, he said (22 Multistate Tax Report 492, 7/24/15).

In *Rago*, two groups of investors sold properties and entered into like-kind exchanges with the same third party to buy a shopping center and two adjacent undeveloped parcels as tenants in common. After seven months, they transferred the properties into a single-purpose limited liability company because the lender required them to do so. The investors were the only shareholders in the LLC.

In the opinion, the five-member elected board rejected the FTB's arguments that the transaction wasn't a like-kind exchange because the investors exchanged the property for an intangible interest in the LLC.

Holding Period. Kaplan said the potentially troubling part of the ruling is that the seven-month holding period was a factor in favor of the company, with some board members saying they thought the holding period showed it was a legitimate Section 1031 exchange.

''The issue of how long a property has to be held before it is subsequently transferred seems to create a timing requirement that is not in the statute,'' Kaplan said.

California conforms to federal law on Section 1031 exchanges, but the SBOE seemed to be making its own law in the *Rago* decision, Kaplan said. ''What would qualify in 49 other states wouldn't qualify in California,'' he said.

Immordino agreed, saying federal guidance focuses on the substance of the transactions and not a holding period.

''I don't think federal guidance does anything but support FTB's position here,'' he said. ''Timing isn't the issue, it's the intent at the time of the exchange.''

The SBOE has dozens of appeals pending involving Section 1031 exchanges, and although some have been resolved in light of the *Rago* ruling, others are likely to come before the board in oral hearings soon, Immordino said.

By Laura Mahoney

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Puerto Rico

Corporate Taxes

Wal-Mart Battles Puerto Rico's Tax Imposed on Intercompany Transfers

Wal-Mart goes to court Feb. 2 in a constitutional challenge to Puerto Rico's corporate alternative minimum tax—a levy based not on net income but on the value of goods purchased from related parties outside Puerto Rico, primarily in the mainland U.S. (*Wal-Mart Puerto Rico, Inc. v. Zaragoza-Gomez*, D.P.R., No. 3:15-cv-03018, *pretrial memorandum*, 1/29/16).

According to a pretrial memorandum, jointly filed Jan. 29, the company seeks a permanent injunction against enforcement of the tax, which it argues violates the dormant commerce clause, the equal protection clause, the bill of attainder clause and the Federal Relations Act.

If the tax is sustained, the company said, it faces an estimated tax burden equal to 91.5 percent of its net income in Puerto Rico—three times the average effective tax rate that Wal-Mart affiliates pay worldwide.

Wal-Mart Puerto Rico Inc. filed the lawsuit in federal district court on Dec. 4, arguing that the tax discriminates against interstate commerce. Under the AMT, a transfer from a related entity that is doing business in Puerto Rico isn't subject to tax, but a transfer from a related entity located outside Puerto Rico is taxed at between 2.5 percent and 6.5 percent .

Thus, the company said, the AMT violates the dormant commerce clause and the Federal Relations Act by discriminating against goods produced outside Puerto Rico. The company maintains that the tax is structured as a ''punishment for Wal-Mart's supposed violations of Puerto Rico's transfer-pricing regulations, even though no such violations have been established.''

The AMT also violates the equal protection clause because the tax is based on the volume of goods transferred and sold—thus discriminating against businesses with high volume and low percentage of profits, the company said.

Further, Wal-Mart said, the AMT constitutes an unconstitutional bill of attainder by specifically targeting Wal-Mart for the highest bracket of the tax, and thus subjecting the company to an ''unsustainable burden.''

Treasury's Argument. The defendant, Puerto Rico Treasury Secretary Juan C. Zaragoza-Gomez, argues that the matter should be heard in state court, but Wal-Mart maintains that if it pursued the usual course of administrative and judicial appeal, it would be forced to pay as much as $155 million over a period of six years—the amount of time it would take to obtain a refund of taxes paid from Puerto Rico's Treasury.

Given the severity of Puerto Rico's current fiscal crisis, the company said, there is no certainty that it would be able to obtain a refund at all.

''Time is of the essence because the collection of this unconstitutional tax, if not enjoined by the Court, will continue for years and will have a devastating effect on Wal-Mart PR (and on the Puerto Rican economy),'' the company said in its Dec. 4 petition.

In the pretrial memorandum, Zaragoza-Gomez denied that the tax discriminates against interstate commerce. Because the AMT applies to ''captive transactions'' for which there is no economic market, he said, it can't violate the dormant commerce clause.

Nor does the tax violate the bill of attainder clause, he said, because ''being subject to a tax has never been the type of burden that can be considered a punishment within the meaning'' of the clause.

Largest Employer. Wal-Mart PR is the largest private employer on the island, with more than 15,000 employees working in 55 stores. It purchases $1.6 billion in products and services from Puerto Rican vendors and suppliers each year and collects nearly $100 million in sales tax annually for Puerto Rico, the company said.

At issue is the tangible property component of the corporate AMT, which taxes the value of property transferred to any entity doing business in Puerto Rico from any related party outside Puerto Rico. This transfer pricing component was originally adopted in 2011, but its impact on Wal-Mart had been negligible because the company's tax burden under the alternative calculation had never exceeded its burden under the ordinary net income tax.

That changed in 2015, when Puerto Rico amended the AMT to increase the tax rate on tangible property transfers from 2 percent to as high as 6.5 percent.

Under Act 72-2015, the tax on tangible property is imposed on a sliding scale depending on the size of the taxpayer. It ranges from 2.5 percent for companies with gross receipts between $10 million and $500 million to 6.5 percent for companies with gross receipts exceeding $2.75 billion. Wal-Mart argues that it is the only taxpayer in Puerto Rico subject to the highest rate—and that as a result of the legislation, its total tax bill for 2016 will exceed $45 million—nearly 91.5 percent of the company's estimated net income for the year. Of that sum, the company said, more than 57 percent is attributable to the AMT.

In the future, the company said, its tax liability could exceed 100 percent of its net income.

Intentional Discrimination. Citing legislative history and public statements by sponsors of Act 72, Wal-Mart argues that the law was intentionally designed to discriminate against large retailers based outside of Puerto Rico. The company said officials from the Treasury Department and the Government Development Bank of Puerto Rico (GDB) have accused multinational chains of evading Puerto Rico's taxes by manipulating intercompany prices.

The company cited testimony Zaragoza-Gomez made before Puerto Rico's House Treasury and Budget Committee, stating that the AMT was a means of offsetting revenue losses caused by inappropriate transfer pricing.

Melba Acosta Febo, president of the GDB, also told elected officials that multinational corporations used transfer pricing to commit tax evasion, the company said.

Wal-Mart denied that it had manipulated its transfer pricing.

''Rather than policing its tax laws through the ordinary auditing process—as U.S. states successfully do—Puerto Rico through Act 72 has essentially created an irrebuttable presumption that all intra-corporate transfers to Puerto Rican companies from related entities in the mainland United States are fraudulently priced to evade taxes.''

Though governments are permitted to address tax evasion, they may not do so through the ''blunt instrument of a tax that facially discriminates against interstate commerce,'' Wal-Mart said.

The trial is expected last four to seven days and will involve the presentation of expert testimony by both the company and the government.

Wal-Mart Puerto Rico's attorneys include Neal Manne and Joseph S. Grinstein of Susman Godfrey LLP in Houston and Juan A. Marques-Diaz and Francisco Bruno of McConnell Valdes LLC in San Juan. Attorneys for Zarazoga-Gomez include Jose Luis Gonzalez-Castaner and Robert A Fernandez-Quiles of Gonzalez Castaner PSC in San Juan and H. Marc Tepper and Susan Seabrook of Buchanan Ingersoll & Rooney PC in Philadelphia.

By Dolores W. Gregory

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☐ *Text of the pretrial memorandum is at http://www.bloomberglaw.com/public/document/WalMart_Puerto_Rico_Inc_v_ZaragozaGomez_Docket_No_315cv03018_DPR_/2.*

Multistate Developments

Procedure

MTC Work Group Examines California Rule on Securities Dealers

A work group of the Multistate Tax Commission is considering whether to develop model rules creating a special regulation for securities dealers that would source receipts from trading activities on behalf of third parties to the ''marketplace'' for those services.

The Uniform Division of Income for Tax Purposes Act Section 18 regulatory work group, meeting Feb. 2 via teleconference, discussed that alternative, which would be similar to an approach taken by California's extensive securities dealer regulation.

The work group was formed by the MTC Uniformity Committee during the commission's fall meeting in December to consider six topics flowing from changes to the UDITPA adopted by the MTC in 2014 and 2015. The topic relating to securities dealers focuses on exceptions to the compact's definition of receipts. A 2014 amendment to Article IV, Section 1 of the Multistate Tax Compact excludes securities from the receipts factor.

Securities Dealer Exception. The Uniformity Committee recognized that for those engaged in the securities business, the exclusion may not be appropriate. California's market-based sourcing statute excludes securities ''except for securities dealers,'' according to a memo

prepared by MTC staff and distributed to the work group before the meeting. The current MTC regulatory definition of receipts, amended into the compact in 2003, does the same thing—excludes securities ''except for securities dealers.''

The concern of some in the work group is that a general operating company might also have a licensed security dealer, leading to a situation in which the mix of inventory sales gross amounts and ''unitary'' trading gross amounts could result in distortion.

The California securities dealer regulation allows a ''look-through'' to the ultimate customer's location for services performed for mutual funds and similar entities, the memo said. Under that approach, receipts from securities trading on the taxpayer's own account—and perhaps trading on behalf of related entities—wouldn't be included in the receipts factor.

Mike Fatale, chief of the rulings and regulations bureau of the Massachusetts Department of Revenue and a member of the work group, suggested the problem could be solved more directly by excluding receipts from trading on one's own account and limiting other receipts to true commissions for trading for others. The work group agreed to continue studying the issue.

By Tripp Baltz

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☐ *The work group's website is http://www.mtc.gov/Uniformity/Project-Teams/Section-18-Regulatory-Project.*

New Jersey

Corporate Taxes

New Jersey Mulls Combined Reporting; Bill Offers 'Water's Edge' Option, Senator Says

Exxon Mobil Corp., Wal-Mart Stores Inc., Johnson & Johnson and Home Depot Inc. are just some of the companies in New Jersey that would be subject to combined reporting under a proposal introduced in the Senate.

The legislation aims to combat tax avoidance and prevent large corporations from shifting profits out of New Jersey, the bill's sponsors, Democratic Sens. Raymond J. Lesniak, Linda R. Greenstein and Paul A. Sarlo, said during a Jan. 28 news conference.

S.B. 61 would require companies to file combined returns, instead of computing corporation business tax (CBT) on a separate-company basis, as is currently the case.

The proposal would give companies an opportunity to opt out of reporting certain foreign income, contrary to an earlier version of the bill posted on the Legislature's website that didn't include a ''water's edge'' election.

Lesniak told Bloomberg BNA Feb. 1 that the version of S.B. 61 originally posted on the New Jersey Legislature's website was actually an old bill being used as a placeholder, and the new version would be posted after the bill was formally introduced Feb. 4, when the Senate met for its first quorum of the legislative session.

The new version of the bill ''has a limited water's edge election'' that allows the option, except for income from entities located in tax havens, Lesniak said. The tax director will publish a list of jurisdictions deemed to be tax havens, according to the draft legislation.

Tax Havens. The tax haven language is ''pretty broad'' and ''vague'' and is likely to ''cause consternation among taxpayers,'' David J. Gutowski, a partner in Reed Smith LLP's State Tax Group, told Bloomberg BNA Feb. 4.

Gutowski said there are concerns about whether it is legitimate for a state tax director to determine whether a jurisdiction is a tax haven, and it might even violate the commerce clause of the U.S. Constitution by ''preventing the federal government from speaking with one voice.''

However, having a water's edge election does put the bill ''more in conformity with other states' approaches,'' Gutowski said.

Gutowski flagged the earlier omission of a water's edge election in a Jan. 28 client alert, and told Bloomberg BNA that failure to include the option ''would make New Jersey an outlier'' compared to other states that do combined reporting.

25 States and the District. Twenty-five states and the District of Columbia now require combined reporting, according to a report from New Jersey Policy Perspective (NJPP), a research and advocacy group that works to advance progressive policies.

Of New Jersey's 98 largest for-profit employers, 92 are already subject to combined reporting in at least one state outside of New Jersey, according to the report. That figure excludes casinos, which are already subject to combined reporting.

Combined reporting would help small and local business in New Jersey, NJPP senior policy analyst Sheila Reynertson told Bloomberg BNA Feb. 1.

''Local businesses are more likely to have to pay taxes on all their profits, because unlike their larger counterparts, they have nowhere else to shift them,'' she said. ''What combined reporting does is foster a level playing field for all businesses.''

New Revenue? Lesniak told Bloomberg BNA the bill is intended to make large corporations ''pay their fair share'' of New Jersey taxes, and estimates the proposal could generate $200 million in new revenue for the state. ''It could be more,'' he said.

Gutowski said it isn't clear how much money combined reporting would generate for the state.

Anti-abuse provisions on intercompany transactions that New Jersey put in place in 2002 already address a number of tax-planning methods involving out-of-state affiliates, Gutowski said.

The tax burden ''could go up, could go down on any given taxpayer'' depending on the situation, Gutowski said. ''I don't know if anybody knows how much it could generate.''

Lesniak said he hopes the bill will pass the Senate by March and reach the governor's desk by May.

BY LESLIE A. PAPPAS

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☐ *A draft version of S.B. 61 is at http://src.bna.com/clL.*

For additional discussion of group taxation in New Jersey, see Corporate Income Tax Navigator, at New Jersey 8.

Pennsylvania

Corporate Taxes

Pennsylvania Drafting Guidance On Add-Back Provision, Seeking Feedback

A Pennsylvania Department of Revenue discussion draft on guidance regarding its intangible add-back provision takes several positions that could be challenged as going beyond statutory authority, Reed Smith LLP said in a client alert.

The discussion draft covers an add-back provision found in Pennsylvania 2013 Act 52 that disallows corporate income tax deductions for certain related-party transactions for tax years beginning after Dec. 31, 2014.

The provision was part of legislation former Gov. Tom Corbett (R) signed into law in 2013 making numerous changes to the state's tax code .

Definitional Changes. In a client alert written in 2013 shortly after the law was enacted, Reed Smith said the add-back provision ''does not do much to change the status quo in Pennsylvania,'' given that it included broad exceptions that taxpayers could use.

In its Feb. 2 alert, Reed Smith said the guidance in the recent discussion draft expands the definition of ''intangible expenses'' to include items like payments for franchise and contract rights, includes embedded costs and makes certain presumptions about interest expenses.

It also narrows interpretations on exemptions, such as allowing the credit provision to apply only to taxes paid in separate company states, according to the alert.

'Narrow Interpretation.' ''Not surprisingly, while the Department adopts a broad interpretation of the add-back provision in its Discussion Draft, it at the same time adopts a narrow interpretation of the statutory exceptions,'' Lee A. Zoeller, Michael A. Jacobs and Christine M. Hanhausen of Reed Smith's State Tax Group in Philadelphia, wrote.

Reed Smith expects that the final version of the notice will include revisions based on comments the department receives, Hanhausen told Bloomberg BNA in an e-mail Feb. 4.

Hanhausen pointed out that under Pennsylvania regulations, an information notice like the draft document is merely ''revenue information'' issued for informational purposes only. ''Thus, the Department's Discussion Draft of an Information Notice on add-back (or even a final Information Notice) does not have the force of law,'' she said.

The draft document hasn't yet been posted on the DOR's website because it isn't final, Kevin Hensil, the department's press secretary, told Bloomberg BNA in an e-mail Feb. 4. ''When the document is ready for public comment, it will be posted online,'' he said.

Hensil didn't provide a timeline.

BY LESLIE A. PAPPAS

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☐ *The discussion draft is at http://src.bna.com/cqF.*

Iowa

Tax Credits

Iowa House Agriculture Panel Endorses Bill Extending Tax Credits for Renewable Fuels

The Iowa House Agriculture Committee Feb. 3 unanimously endorsed legislation that would extend the state's tax credits for the production and sale of biofuels.

H.S.B. 519 would also create a new tax credit for the production of B-11 biodiesel blends. Iowa currently has only one tax credit for biodiesel blends: 4.5 cents per gallon for fuels containing at least 5 percent biodiesel.

While the bill received the full support of the House panel, Grant Menke, policy director for the Iowa Renewable Fuels Association, said it's too early to predict whether it will make its way into law. The state is facing a tight budget, and the farm economy has slowed. Such factors could limit what the statehouse does for renewable fuels, he said.

Under current Iowa law, retailers selling biofuels containing between 15 and 69 percent ethanol, or E-15 blends, receive an income tax credit of 3 cents per gallon for each gallon sold. They also receive a tax credit of 16 cents per gallon for each gallon sold of E-85, ethanol blends containing between 70 and 85 percent ethanol.

Retailers selling B-5, a biodiesel blend containing at least 5 percent biodiesel, receive an income tax credit of 4.5 cents for each gallon sold.

Refund Also Available. Producers are also eligible for a tax refund. They can claim a refund of 2 cents per gallon for all biofuels they produce. They can't claim a refund on more than 25 million gallons produced at any one facility, however.

Each of the tax credits is scheduled to expire Jan. 1, 2018. H.S.B. 519 would set a new expiration date of Jan. 1, 2025, for all of the credits.

Menke said H.S.B. 519 also introduces a new tax credit for B-11 biodiesel blends, those containing at least 11 percent biodiesel. Those selling the higher

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blend would be eligible for a tax credit of 7 cents per gallon for each gallon sold. He said the credit aims to expand B-11 production in Iowa, as well as keep pace with Illinois, which already has a B-11 tax credit in place.

He said while Iowa had a record-setting year for biodiesel production, with 242 million gallons produced, the tax credit extensions are necessary because national production of biodiesel was down last year. He said biodiesel usage increased, but much of the biodiesel used came from foreign countries like Argentina and Singapore. The renewable fuels group believes the state's tax credits encouraged biofuel production, he said, at a time when the federal tax policy on their production was unclear.

A fiscal note on H.S.B. 519 has yet to be prepared. Victoria Daniels, spokeswoman for the Iowa Department of Revenue, was unavailable for comment. When the credits were last extended in 2011, however, the department estimated their effect on revenues to be about $80 million over six years' time.

By Mark Wolski

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☐ *More information on H.S.B. 519 is at http://www.legis.iowa.gov/legislation/BillBook?ga=86&ba=hsb519.*

For a discussion of energy credits in Iowa, see 1460-2nd T.M., Credits and Incentives: ID Through MS, at 1460.9.E.

Multistate Developments

Procedure

'Baseless' Transfer Pricing Audits Might Rise as States Seek More Revenue

Due to increased revenue demands and an incomplete understanding of transfer pricing, audits and enforcement actions from state governments on related-party transfers may continue to rise, according to practitioners.

''I really am concerned that we are going to see an increase in some rather baseless assessments on taxpayers, because when you look at the way transfer pricing is done, and done correctly, it's a highly technical and expensive exercise,'' said Caleb Gauen of PricewaterhouseCoopers LLP. ''It will be tempting for states to take shortcuts.''

Unlike the federal government, which has been enforcing transfer pricing rules for decades, some states can approach the issue assuming that related-party activity is a sign of tax avoidance. ''When they see intercompany transaction, they just default that this has some nefarious root of tax planning, they're not understanding the fundamental business purpose behind it,'' Gauen said during a Jan. 26 PwC webinar on state and local issues.

''No one wants to raise taxes—it's not popular,'' said Anthony Curtis, a principal with PwC in New York. ''But everyone wants more tax revenue. And the only way you can do that, without raising taxes, is to collect more from existing taxpayers.''

The Multistate Tax Commission is currently developing a transfer pricing program to assist states with audits, although it has said it won't begin the program until more states sign on.

Documentation Essential. Documentation—even where it isn't yet formally required—can be key to navigating requests from state tax authorities, the panelists said. Curtis said having information handy so a company can quickly reply to a request can reduce suspicions that the transfer pricing in question is nefarious.

''It's only a matter of time before something is required, and even if it doesn't end up being the case that you have to prepare formal documentation today, it will be the case that it's going to be best practice to have something in place, ready to address a question that may come from a state down the road,'' Curtis said.

Yet he advised against simply taking documentation provided at the federal level, and providing to the states.

''Handing it over outright just runs a lot of risks. Are the transactions exactly the same? Do you have additional transactions internationally that don't involve this state, that would muddy the waters, and make the picture less clear?'' Curtis said. ''If you just hand over all of that, you're really just setting yourself up for more questions.''

By Alex M. Parker

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Delaware

Procedure

Delaware Proposes Seizure of State Refunds To Collect Unpaid School, Property Taxes

Delaware residents who fail to pay their school and property taxes could have their tax refunds seized under a proposal passed by the House.

H.B. 85, approved Jan. 26 by a vote of 38-0, would amend title 30 of the Delaware Code to allow school districts and political subdivisions to intercept state income tax refunds in order to collect unpaid school and property taxes.

The bill would attempt to collect more than $32 million owed to Delaware's public schools, according to the legislation.

Delaware law currently prohibits school taxes from being collected by intercept, even though the state uses the method to collect on other types of obligations, according to the bill's sponsor, House Minority Leader Danny Short (R).

School taxes are currently collected by county governments, and their options are limited to putting a lien on the debtor's property or pursing a sheriff's sale, which costs about $2,000 per case, Short said in a video posted on his website.

A House education committee report in June found that the bill would help increase funds owed to public schools and voted it should move forward.

DASA Supports Change. The Delaware Association of School Administrators (DASA), which lobbies for education matters on the state and local level, ''is solidly behind HB 85,'' Kevin E. Carson, the association's executive director, told Bloomberg BNA in a Jan. 26 e-mail.

''The bill provides access to resources to which the school districts have been entitled. Receipt of those resources will also delay the next request for funds, through the referendum process, for the tax payers of the school district.''

Short has introduced a similar measure in the General Assembly twice before, but both times it stalled.

H.B. 85 has been assigned to the Senate's education committee.

By Leslie A. Pappas

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☐ *Text of H.B. 85 is at http://src.bna.com/cdW.*

Additional information on H.B. 85 is at http://src.bna.com/ceP.

Florida

Business/Nonbusiness Income

Florida Landowners Argue Against IRS's Developer Label, Ordinary Income

The proceeds from the sale of a 1,000-acre parcel in Florida should be treated as capital gains, not ordinary income, because there was never any chance that the property would be developed, a couple argues in a brief to the Eleventh Circuit.

The couple, Gregory G. and Melanie M. Boree, are appealing a 2014 Tax Court decision that sided with the IRS's determination that the couple owed an additional $1.8 million in taxes because the income was mischaracterized as long-term capital gain (*Boree v. Commissioner*, 11th Cir., No. 14-15149, *brief filed*, 1/25/16).

In their Jan. 25 brief, the Borees' said the IRS ''never really denies that the one-sentence penalty imposition by the Tax Court violates the mandate by this Court'' that the Tax Court explain the basis for imposing any penalty.

''Instead, the Commissioner assumes away his own ordinary-income conclusion that 'this is not a close case' when the Tax Court reached the opposite conclusion at the end of trial,'' the brief argued.

The IRS said the Borees owe tax on their gain from the sale of the parcel near Jacksonville, Fla., because the Borees treated the property as development property held primarily for sale in the ordinary course of business based on their extensive and successful efforts to obtain local land-use approvals.

Forcing Hands. According to the Borees, governmental action, including a paving ordinance in January 2006 that ''dropped an $11.4 million obstacle'' on the couple, placed any development of the land ''beyond the realm of possibility.''

Arguing further, the couple said that long-standing Tax Court authority establishes that enhancing value through zoning doesn't constitute development, and that the IRS cites no case to the contrary. The couple also testified that Melanie never would have agreed to the debt that the more than $11 million in paving costs would have created.

The Borees also contested that no opinion better demonstrates why capital treatment applies to their scenario than the adverse-government-action majority in the 1966 U.S. Court of Appeals for the Fifth Circuit Case, *United States v. Temple*.

David D. Aughtry of Chamberlain, Hrdlicka, White, Williams & Aughtry represents the Borees.

By Matthew Beddingfield

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☐ *Text of the reply brief is in TaxCore.*

New York

Filing Requirements

New York Tax Agency Issues Draft Rules for Combined Reporting

The New York Department of Taxation and Finance has issued draft regulations governing combined reporting for lines of business to reflect legislative changes made in 2014 as part of a broad corporate tax overhaul.

The draft rules, released Jan. 22, describe requirements for filing a combined report, including detailed descriptions of capital stock and unitary business requirements. They also describe requirements for commonly owned group elections.

The guidance project stems from legislative changes made in 2014 to update the state's corporate franchise tax, as part of a broad revision intended to make it easier for businesses to operate in New York (see related story in this issue).

Comments on the combined reporting draft are due by April 21.

As drafts of various regulatory amendments are developed in the broad guidance project, they will be posted for public comment prior to formal proposal and adoption under state administrative procedures, the de-

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partment said. The drafts aren't final and shouldn't be relied upon, it added.

Due dates for comments are intended to facilitate the drafting process, it said, but comments submitted after the due date may still be considered.

Abandons Old Scheme. ''Under corporate tax reform, New York abandoned its former combined reporting scheme and adopted what is generally referred to as full unitary water's edge with a greater than 50 percent ownership test,'' according to a summary prepared for a Jan. 26 New York State Bar Association (NYSBA) Tax Section session moderated by practitioner Irwin M. Slomka of Morrison & Foerster LLP in New York.

Key topics, according to the summary, include guidance for determining the existence of a unitary business and the members of the unitary group; implementation issues for the new commonly owned group election; and guidance for determining ownership and control for purposes of applying the capital stock requirement's ''greater than 50 percent'' test.

Discussing the draft at the NYSBA session, Robert Plattner, the state's deputy commissioner for tax policy analysis, said it replaces a time-consuming and cumbersome system for combined reporting with a unitary system.

To avoid controversies over who is in a combined group, he said, the draft addresses topics that have been litigated historically and borrows from a Massachusetts approach for commonly owned groups.

''Combined reports will be the rule, not the exception,'' he said.

Expansive Definition Used. For the draft, New York used ''as expansive a definition as possible'' for unitary groups, Plattner said. New York is ahead of other states in listing components and factors to be considered in the criteria, he said.

In general, he said, the state will look to the strength of centralized management to establish a unitary group, using presumptions as an important tool. The presumptions can be overcome by ''presentation of clear and convincing evidence,'' he said, and if the presumption doesn't apply, the inquiry will look to facts and circumstances.

Asked by Slomka about treatment of passive holding companies in light of a May 2015 state Tax Appeals Tribunal decision in *Matter of SunGard Capital Corp.* (No. 823631), Plattner said the draft regulations weren't affected by the decision.

Looked to Other States. New York, he said, ''mostly looked to other states'' to craft a rule generally treating passive holding companies as part of a unitary group. He pointed to rules in California, Massachusetts, Wisconsin and Minnesota as showing a ''general tendency'' in that direction.

The SunGard decision included a broad unitary business analysis under the law as it stood before the 2014 changes.

By John Herzfeld

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☐ *The combined reporting draft regulations are at http://src.bna.com/cfO.*

Michigan

Procedure

Michigan Appeals Court Uses 'Gillette' To Reject Use of Three-Factor Apportionment

A Michigan Court of Appeals ruling turning back 16 requests that companies be allowed to use the three-factor apportionment formula for calculating business income tax liability will be appealed, according to the consolidated case's lead attorney (*Sapa Extrusions, Inc. v. Dep't of Treasury*, Mich. Ct. App., No. 326414 , 1/21/16).

Gregory A. Nowak, a partner at Pepper Hamilton LLP, told Bloomberg BNA that these 16 cases involve the same issues decided by the appeals court in September in *Gillette Commercial Operations N. Am. v. Dep't of Treasury*, which challenged Michigan's retroactive repeal of the Multistate Tax Compact (2014 PA 282) (22 Multistate Tax Report 720, 10/23/15).

Nowak said Jan. 25 that an ''application for leave'' to the Michigan Supreme Court in these cases will be filed by March 3, 2016.

The court, in a unpublished decision issued Jan. 21, affirmed Michigan Court of Claims rulings that upheld the elimination of a multistate taxpayer's option to elect the three-factor apportionment formula that is a provision of the compact. As in *Gillette*, the court rejected all of the plaintiffs' arguments, noting that the compact wasn't a binding agreement on the state but merely an advisory agreement and as such Michigan's withdrawal from compact membership wasn't prohibited.

Moreover, the court said, '' 'the retroactive repeal of the Compact did not violate the Due Process Clauses of either the state or federal [C]onstitutions or Michigan's rules regarding retrospective legislation.' ''

Flaws in 'Gillette.' Nowak said the plaintiffs had filed a motion asking the court of appeals to hold these cases in abeyance pending the final resolution of *Gillette* by the Michigan Supreme Court, but the motion was denied.

Several other cases decided on the basis of *Gillette* are also pending before the Michigan Supreme Court, he said.

Michigan has a ''first out'' rule, which provides that the first decision on an issue of law by the court of appeals is binding on subsequent panels of the court, Nowak said.

However, a subsequent panel may indicate that it disagrees with that first decision, and is following it only because it's bound to do so, he said. ''While this is rare, our panel could have expressed disagreement with the *Gillette panel*, and that was what we asked them to do here,'' Nowak said.

''We pointed out the flaws in the *Gillette* court's federal due process analysis, its complete failure to consider our distinct state due process arguments, and the weaknesses in its analysis of other provisions of the

Michigan constitution which we feel were violated here,'' he said.

''Unfortunately one of the three judges on this panel, Kathleen Jansen, was also on the unanimous *Gillette* panel, so it was pretty clear we were not going to get her vote,'' said Nowak.

The companies bringing the 16 cases are Sapa Extrusions Inc.; Ball Corp.; Family Dollar Stores Inc.; Goodyear Tire and Rubber Co.; Webloyalty Holdings Inc. & Subsidiaries; Affinion Group Holdings Inc. & Subsidiaries; EMC Corp.; International Business Machines Corp.; Deluxe Financial Services LLC; Schwan's Home Service Inc.; and Monster Beverage Corp.

BY BEBE RAUPE

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☐ *The court's unpublished opinion is at http://src.bna.com/ccv.*

Utah

Electronic Filing

Utah Employers Fight Identity Theft, Fraud With Electronic Returns; Effective Jan. 31

Utah employers are facing a new deadline to electronically file state income tax documents of employees.

The new law (S.B. 250), approved by the Utah Legislature in 2015, is designed to combat identity theft and income tax fraud, the Utah State Tax Commission said Jan. 14 .

It requires all employers to electronically file their annual withholding reconciliations by Jan. 31, including federal Forms W-2, Wage and Tax Statement, and 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. The law directly impacts about 60,000 of Utah's 80,000 businesses that previously didn't file withholding documents electronically, the commission said.

The new law also prohibits the Tax Commission from issuing income tax refunds before March 1, unless both the employer and the employee have filed all required returns and forms.

''The law protects citizens by checking return accuracy and refund validity,'' said Charlie Roberts, Tax Commission spokesman. He said the commission electronically will compare a filer's income tax return with the employer's withholding reports.

In the past several months, the commission has notified all covered employers by mail, updating its website, training tax practitioners, offering business workshops and directly contacting payroll companies, large employers and associations.

BY TRIPP BALTZ

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☐ *The commission's website on the withholding tax changes is at http://tax.utah.gov/withholding/filing-changes.*

Kansas

Tax Breaks

Taxpayers Call Themselves Businesses As Kansas Tax Plan Continues to Fizzle

Investment adviser Brad Stratton didn't pay Kansas any income taxes last year. He doesn't feel good about that.

Stratton, who runs Overland Park Wealth Management LLC in Overland Park, is among hundreds of thousands of taxpayers who have been exempt from the state levy since 2012 because they are considered small businesses. As a group, they are contributing to a budget crisis Kansas can't seem to escape.

Officials estimated 191,000 taxpayers would be eligible for the break, which the administration of Gov. Sam Brownback (R) designed to spur job creation. Instead, in 2013, more than 330,000 self-employed filers—lawyers, accountants, architects, even farmers—took advantage of it, according to the Kansas Revenue Department.

''When people figured out they could create a business and filter their income through it and avoid paying taxes, who isn't going to do that?'' Rep. Mark Hutton (R) said. ''This is only going to get worse.''

Plugging Holes. As lawmakers get down to business in Topeka this month, the effectiveness of Kansas's tax regime, which was re-engineered by Brownback as part of his bid to make Kansas a Tea Party showcase, remains a sore point. Budget officials forecast a shortfall of as much as $190 million starting July 1 .

Since 2013, urgent attempts to plug budget holes—increasing the sales tax, cutting education support, borrowing for pensions and raiding a fund used to maintain highways—have focused attention on an unanticipated effect of eliminating the small-business levy and installing other breaks: continuing deficits.

Brownback, who has repeatedly signaled he won't support repealing or modifying his tax cuts, didn't mention the budget forecast in his Jan. 12 State of the State address.

''Working together, we've created an economic environment that has seen Kansas gain more than 78,000 private-sector jobs,'' the governor told a joint session of the Legislature last week.

Surplus to Shortfall. But since the adoption of Brownback's tax package, which included cutting the top income-tax rate by 26 percent and increasing standard deductions for married and single head-of-household filers, Kansas has gone from a $709 million surplus to shortfalls, said Duane Goossen, who served as budget

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director for both Republican and Democratic Kansas governors.

''It's here we go again, again,'' Goossen said.

Brownback's goal is to eliminate the income tax entirely. Repeated fiscal crises have slowed that effort. Last year, lawmakers raised the sales tax to 6.5 percent from 6.15 percent, and boosted the cigarette levy by 50 cents a pack. They eliminated most income-tax deductions and halved property-tax and mortgage-interest deductions.

Those moves, as well as siphoning more than $400 million from the highway construction and maintenance fund since 2013, haven't stanched the bleeding. The revenue department reported that December's take was short of expectations by $26 million. Kansas budget director Shawn Sullivan said an additional $25 million will be taken from transportation funding next year.

Divided Opinion. Business associations have been divided on the tax break. The Kansas Chamber of Commerce, the largest such group, is a strong supporter, arguing that lower levies always speed job growth. At the local level, though, there is opposition.

''We certainly haven't seen the trickle-down effect to keep it rolling through the economy. It hasn't happened,'' said Tracey Osborne, president of the Overland Park Chamber of Commerce.

Osborne said schools and roads have been hurt by declining revenue—a deterrent to economic growth.

Jason Ball, president and chief executive officer of the Hutchinson/Reno County Chamber of Commerce, said it is premature to call the tax break a mistake. Low taxes are good for business, he said. However, the law should be re-examined because it hasn't been a boon to job creation.

Tax 'Fatigue.' ''Is this policy creating the result we wanted it to?'' Ball said. ''I think views on the success or failure of this largely depends on who you're talking with and what their core political philosophy is. That colors perceptions, and that's unfortunate.''

The prospects for any change in the policy will be heavily influenced by election-year politics. Kansas lawmakers will face voters in November, and Hutton—who favors repealing the small-business break and removing the state sales tax from food purchases—said he sees no political appetite for revisiting taxes before then.

''Quite frankly, there's still a lot of fatigue from last year and just talking about taxes will get you killed,'' Hutton said.

In the meantime, Stratton has mixed feelings at best.

''The folks I employ are all paying a state income tax, and I'm not,'' he said. ''That's not equitable.'' As for job growth, he said, ''the tax break wasn't enough for me to hire anyone.''

By Tim Jones

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Massachusetts

Millionaire Tax

Petition to Impose 'Millionaire Tax' Could Hinder Massachusetts Revenue, Panel Told

Opponents of a Massachusetts ballot initative that would impose an additional tax on income in excess of $1 million warn that such a measure could actually hinder efforts to raise additional revenue by driving high-income taxpayers out of the state.

Backers of the initiative say, however, that the additional funds raised by the action, which would be earmarked for transportation and education, would boost the economy by providing a more well-trained workforce and improving the state's roads, bridges and public transportation.

The Jan. 19 hearing before the Massachusetts Legislature's Joint Committee on Revenue is the latest step in the process that could ultimately lead to the constitutional amendment being placed on the Nov. 6, 2018, ballot.

If approved, the initiative would place an additional tax of 4 percent on that portion of annual taxable income in excess of $1 million for tax years beginning on or after Jan. 1, 2019. That $1 million figure would be subject to cost-of-living adjustments applicable to federal income tax brackets. Currently, the state taxes all earned income at 5.1 percent.

The initiative would amend the state's constitution, which currently requires that taxes ''shall be levied at a uniform rate throughout the commonwealth upon incomes derived from the same class of property.''

The constitutional amendment is being promoted by an organization known as Raise Up Massachusetts. To move the measure forward, backers had to collect more than 64,000 signatures in support of the petition. Massachusetts Secretary of the Commonwealth William F. Galvin certified in December that proponents had secured more than 100,000 signatures to transfer the initiative petition to the Legislature for further action.

In information provided to Bloomberg BNA Jan. 19, the Massachusetts Department of Revenue (DOR) said it estimates that the amendment would generate between $1.6 billion and $2.2 billion in additional state tax revenue with a midpoint of $1.9 billion in tax year 2019.

The DOR said it is projecting that in tax year 2019, about 19,500 returns—about 0.5 percent of all returns filed with the DOR—would be affected by the proposal.

Taxpayers Foundation's Concerns. During the Jan. 19 public hearing, Eileen McAnneny, president of the nonpartisan Massachusetts Taxpayers Foundation, expressed several concerns about the petition.

She told the panel that the state is already overly reliant on income tax as a source of tax revenue and that the proposal would further exacerbate the situation. ''While the prospect of taxing less than one-half of 1 percent of the taxpayers and raising between $1.6 billion and $2.2. billion in new revenue is appealing on its face, there are inherent problems with this approach.''

In addition to the increased reliance on income tax, McAnneny said the ballot initiative would increase the volatility of the state's revenue stream since it may drive

higher-income individuals out of state, thus lowering not only the level of income tax, but also lowering the amount of capital gains taxes that may be paid by those same individuals.

She also said it isn't likely the funds would be able to be dedicated to education and transportation.

McAnneny and others at the hearing testified that a separate constitutional provision prohibits any appropriation from being made by an initiative petition.

AG Certifies Language. Supporters noted, however, that Massachusetts Attorney General Maura Healey (D), whose office is required to examine proposed petitions before they can proceed, has certified the language of the proposed initiative petition.

John Regan, executive vice president of government affairs, Associated Industries of Massachusetts, also testified at the hearing. He urged the panel to be cautious in pursuing the initiative petition process and noted that General Electric Co. recently announced plans to move its Fairfield, Conn., headquarters to Boston just months after the Connecticut Legislature approved significant changes to the state's tax code .

During the hearing, a number of community activists, union members, teachers, municipal officials and others testified in support of the measure. Backers of the initiative also released a petition signed by 71 Massachusetts economists who expressed support for the measure.

Federal Offset. David Saliba, chair of the Massachusetts Bar Association Taxation Law Section, told Bloomberg BNA Jan. 19 that under existing federal rules, Massachusetts taxpayers who would be subject to the higher tax rate on income above $1 million would receive a larger deduction on their federal return for state income tax, providing an offset for those taxpayers.

The revenue committee must now consider the amendment and decide whether or not to recommend that the proposal be sent to the constitutional convention by April 27. If it is considered by the constitutional convention, one-quarter of the Legislature must approve the amendment in joint session meetings in both 2016 and 2017. At that point, it would be cleared to appear on the Nov. 6, 2018, ballot, where it would need to be approved by a majority of voters.

By Martha W. Kessler

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☐ *The legislation to move the initiative petition is at http://malegislature.gov/Bills/189/House/H3933.*

Wisconsin

Procedure

Wisconsin Mulls Corporate Tax Overhaul, Including Economic Substance Transactions

Business interests in Wisconsin are pushing for a major rewrite of the state's corporate tax code that would modify rules for evaluating transactions for the purposes of economic substance, reduce evidentiary standards in evaluations of intercompany transactions and remove the state from the Multistate Tax Commission's audit program.

Omnibus tax legislation, Assembly Bill 623/Senate Bill 503, has already raised concerns from the Wisconsin Department of Revenue over potential revenue impacts. In a fiscal estimate dated Jan. 6, WDOR estimated the economic substance proposal alone would result in the loss of $296 million in income and franchise tax revenue annually. The revenue department estimated the entire package would cost the state between $335 million and $384 million annually.

Jason Culotta, director of tax policy for Wisconsin Manufacturers and Commerce, said Jan. 20 the sponsors of the bill were drafting amendments based on the revenue department's concerns, expressed during two legislative hearings on the bill. He predicted a slimmer version of the original legislation would be released within the next week.

''We are expecting amendments based on the department's response, creating a bill with a neutral fiscal impact,'' Culotta told Bloomberg BNA. ''I'm speculating, but my guess is that some of the seven provisions will be left on the table and then a consensus position will be reached between the department and the authors over the remaining provisions.''

Jon Peacock, director of the Wisconsin Budget Project, predicted A.B. 623/S.B. 503 would be ''pared back considerably'' because of Wisconsin's tight fiscal climate.

''I'm guessing the co-authors will come back and say they plan to pass a bill that is all about tax fairness, and it will have a far smaller fiscal estimate,'' Peacock told Bloomberg BNA Jan. 19. ''The state just isn't in a position to offer a significant tax cut at this point.''

Economic Substance. A.B. 623/S.B. 503 would eliminate certain factors under current law used to determine whether a transaction has economic substance and replace them with factors articulated in Section 7701(o) of the Internal Revenue Code.

WDOR Secretary Richard Chandler told lawmakers full adoption of the federal rules would open the door for some corporations to structure transactions that wouldn't be subject to the federal economic substance doctrine, but would significantly diminish income taxable in Wisconsin.

''This provision as drafted has a significant $296 million fiscal effect,'' Chandler said in testimony Jan. 7 before the Wisconsin Assembly's Committee on Ways and Means. ''We believe, based on past experience, that if this provision is passed, a small number of large multistate corporations with large tax bills would structure

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themselves to move large amounts of income outside of Wisconsin.''

A related provision of the proposed law would change the evidentiary standard used by corporate taxpayers for establishing that a transaction with one or more members of a controlled group holds economic substance. The bill would shift the current ''clear and convincing evidence'' standard to a ''preponderance of the evidence'' standard.

Chandler said the provision would trigger a loss of revenue to the state, but the amount is unknown. He estimated, however, that a revenue shift of as little as 10 percent in cases where evidentiary issues are in dispute could cause a $5.7 million annual loss to the state.

Past Audits. A.B. 623/S.B. 503 also includes a provision affecting taxpayers' capacity to rely on determinations made by WDOR in past audits. Current law permits reliance on these determinations unless the taxpayer failed to provide the department with complete and accurate records regarding the tax issue. The bill, however, confines WDOR to its prior determination, even if the taxpayer provides incomplete or inaccurate records.

Chandler said the change would undermine the quality of the records presented during audits. He speculated the change would trigger a loss of up to $13.3 million per year for the state.

''This would result in taxpayers having an incentive to withhold or provide inaccurate information and could discourage compromise settlements and prolong cases, costing the state and taxpayers more in the long run,'' Chandler said in his testimony.

Additional features of A.B. 623/S.B. 503 include:

■ MTC Audits. The bill would repeal WDOR's authority to participate in the MTC audit program. The department estimated the change would reduce state revenues by $1.25 million per year.

■ Tax Records. The bill would substantially limit WDOR's authority to impose penalties in cases where a taxpayer fails to produce records and documents requested by the agency to substantiate a tax return. A.B. 623/S.B. 503 would prevent WDOR from imposing such penalties until after it has issued a summons seeking the records, and the taxpayer has failed to comply with the summons. WDOR said the change would have a minimal impact on state revenue.

■ Manufacturing and Agriculture Credit. The current rules for calculating qualified production activity income under the credit specify that indirect costs are defined as ordinary and necessary expenses that are deductible as business expenses as described in the Internal Revenue Code. The bill changes those rules such that Section 179 expensing would no longer be included in the definition of indirect costs. WDOR said this exclusion would have the effect of boosting qualified production activities income, thus raising the credit. WDOR estimated the change would result in a tax loss of $5.3 million annually.

■ Nexus and Apportionment. The bill directs WDOR to issue new rules to establish criteria for determining whether a business has nexus with Wisconsin and other states for the purposes of apportionment. WDOR said it would be difficult to estimate the revenue impact of the proposal because the proposed nexus revisions are not known. Still, WDOR estimated a change that triggers a 1 percent cut in apportionable income for the largest corporations in the state would result in an annual revenue loss of $6.5 million. Any adjustment causing a 5 percent reduction would result in a tax loss of $31 million.

■ Lump Sum Contracts. Current law permits a sales and use tax exemption for property and services sold by contractors under lump sum contracts for ''real property construction activities'' in cases where the total sales price is less than 10 percent of the total contract price. The bill extends the exemption to all ''construction contracts involving real property construction activities'' if the total sales price of taxable contracts is less than 10 percent of the total contract price. In addition, the bill specifies that if the general contractor qualifies for the exemption, it also applies to all of the subcontractors. WDOR estimates the change would reduce state tax revenue by approximately $1.1 million.

BY MICHAEL J. BOLOGNA

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☐ *A.B. 623/S.B. 503 is at http://docs.legis.wisconsin.gov/2015/related/proposals/ab623.pdf.*

Sales&Use Taxes

Wisconsin

Electronic Commerce

Appeals Court Tosses Wisconsin Sales Tax Assessment Against Orbitz

A state appeals court shot down a Wisconsin Department of Revenue demand for $111,253 from Orbitz LLC, ruling the DOR didn't have the authority to assess retail sales tax on ''markup'' fees collected from consumers when booking hotel rooms online (*Wis. Dep't of Revenue v. Orbitz, LLC*, Wis. Ct. App., No. 2015AP200, 2/11/16).

A three-judge panel of the Wisconsin Court of Appeals on Feb. 11 unanimously affirmed an earlier decision of the state Tax Appeals Commission and a circuit court ruling, which both rejected the Wisconsin DOR's assessment against Orbitz. The appeals court found no basis for the department's view that Orbitz's hotel room reservation services are taxable under Wis. Stat. Section 77.52(1)(a)1, which addresses the imposition of retail sales tax on the ''furnishing of rooms or lodging.''

''We conclude that the Commission's interpretation is not contrary to the clear meaning of the statute and that there is not another, more reasonable interpretation of the statutory language,'' Judge Gary E. Sherman wrote on behalf of the panel.

A DOR spokesperson told Bloomberg BNA that its attorneys are reviewing the ruling to ''determine any next steps.''

Win for OTCs. The ruling marks another win for online travel companies, including Orbitz, Expedia Inc., Travelocity.com LP and Priceline.com Inc., which face dozens of lawsuits from municipal and state revenue agencies for purportedly unpaid sales and hotel occupancy taxes (22 Multistate Tax Report 514, 7/24/15).

The Wisconsin tax dispute dates back to 2008 when the department imposed an assessment against Orbitz for tax years 2001 through 2006. As with other OTC disputes around the country, the Wisconsin litigation considered whether the travel provider should pay taxes on the higher retail rate paid by consumers, rather than the discounted wholesale rate negotiated between OTCs and hotels. OTCs have consistently argued they aren't obligated to submit taxes to states and municipalities on the markup—the difference between the retail rate paid by consumers and the lower wholesale rate OTCs provide to hotels.

The appeals court's ruling relied heavily on the tax commission's interpretation of Section 77.52(1)(a)1, which determined the Orbitz business model ''does not furnish lodging to travelers in any traditional sense of the word'' and that Orbitz ''lacks the essential functions and characteristics of a business which provides lodging accommodations.'' The commission also found that any ambiguity in the state statute must be resolved in favor of the taxpayer.

The appeals court agreed with these interpretations of the statute and noted that the commission's findings meshed with legislative intent. Specifically, Sherman wrote, ''the legislature did not intend to impose a tax on those selling the services of making hotel reservations but not actually furnishing the accommodations.''

Agency Principles. The court showed little patience for the department's arguments that Orbitz's markup should be considered taxable under Section 77.52(1)(a)1 based on agency principles. The DOR asserted that Orbitz acts as an agent of the hotels, which furnish the taxable service of furnishing rooms. In this agency capacity, the DOR contended that any fees collected by Orbitz, including the markup, must be taxable.

But the court found the DOR had misconstrued the relationship between Orbitz and hotels.

''Orbitz does not make reservations on behalf of the hotels, but rather makes reservations with the hotels *on behalf of the travelers*,'' Sherman wrote. ''We are not persuaded that Orbitz is an agent of the hotels and, therefore, reject this argument.''

Philip Minardi, a spokesman for the Travel Technology Association, an OTC industry association, applauded the court's finding.

''As the court recognized in this case, and as a lot of other courts across the country have recognized, online travel companies are obviously not hotels that furnish hotel rooms,'' Minardi told Bloomberg BNA. ''Online travel companies provide a valuable service for consumers booking travel within Wisconsin. So this is a welcome ruling for the industry.''

By Michael J. Bologna

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☐ *The opinion is at http://src.bna.com/cBv.*

For additional discussion of sales tax for online travel companies in Wisconsin, see Sales and Use Tax Navigator, at Wisconsin 4.11.

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Texas

Oil and Gas

Texas Comptroller: Tax Refund Case Would Wipe Out Budget Surplus

An upcoming ruling before the Texas Supreme Court favoring a Texas oil and gas company seeking a tax refund would expose the state to a financial liability large enough to wipe out the state's projected budget surplus, the state's chief tax collector and treasurer told Bloomberg BNA.

The Texas Supreme Court is set to hear oral arguments March 8 in a challenge examining whether an application for a refund of sales tax paid on oil and gas processing equipment should be allowed (*Sw. Royalties, Inc. v. Hegar*, Tex., No. 14-0743, *oral argument scheduled*, 3/8/16).

The Texas high court said Jan. 22 it had agreed to hear a case that, if found in favor the petitioner—according to the state's top finance official—would likely trigger a wave of refunds that would not only blow a hole in the state's projected budget surplus but cost the state an estimated $500 million annually.

''Obviously if they get a refund, there will be others who would seek a similar refund,'' Texas Comptroller Glenn Hegar (R) told Bloomberg BNA Feb. 4.

Southwest Royalties Inc. seeks a sales tax refund for mineral extraction equipment on the basis of a tax exemption for property used in manufacturing instead of the exemption for mineral exploration or production equipment.

Central to the case is a determination on whether metal pipes, tubing and other equipment used in oil and gas production should be exempt from sales tax.

Processing and Manufacturing. In a December 2015 brief, the Midland, Texas-based subsidiary of Clayton Williams Energy Inc. asserted that the plain-meaning construction of ''processing'' in Tex. Tax Code Section 151.318 doesn't depend on the statutory language in Section 151.324.

Further, Southwest Royalties contends that a traditional plain-language interpretation in Section 151.317 distinguishes it as a stand-alone activity, even when manufacturing sometimes includes processing (23 Multistate Tax Report 40, 1/22/16).

The state says the manufacturing exemption isn't applicable, arguing that the extraction of minerals from underground formations isn't ''actual manufacturing, processing, or fabrication of tangible personal property.''

Potential Cost. ''Based on our estimates, this roughly hinges to be about a $4.4 billion potential liability for the state of Texas if we were to lose at the Texas Supreme Court level,'' Hegar said.

On top of that, Hegar said a decision favoring the sales tax refund for Southwest Royalties would cost the state's treasury ''about another $500 million every single year moving forward'' after getting past the initial $4.4 billion cost for refunds.

The state had previously denied the refund request based on the manufacturing exemption for paying sales tax that has been on the books. Southwest Royalties lost its challenge at the district court and appellate court levels.

Hegar said the comptroller's office and the state—through the Texas Attorney General's office—are arguing that Southwest Royalties is wrong on the grounds that ''the equipment is not processing or manufacturing the product as it is coming up out of the ground, and they're not manufacturing a tangible personal property because these are minerals that are under the ground.''

End of Surplus. Hegar said the case carries particular heft when taking into account the October 2015 revenue estimates given by the comptroller's office, forecasting an estimated $5 billion surplus following the conclusion of the two-year budget cycle ending in August 2017.

''Point being, this pretty much wipes out our cash-carryover balance at the end of this current budget year,'' said Hegar, referring to the impact of a ruling finding in favor of the oil and gas company.

''It would wipe out a significant portion of the state's cash-carryover balance, or you could take a look at that it would essentially take half the money out of our state savings account in order to pay for these refunds if that was the direction of the Legislature.''

Pointing to the state's legal victories at the district and appellate court levels, the comptroller expressed optimism that the state's argument would be upheld.

''I feel like ultimately we'll win on the Texas Supreme Court level, but you don't know,'' Hegar said. ''So you have to make sure that everybody is aware of this potential liability that's out there.''

Known as the Emergency Stabilization Fund or Rainy Day Fund, the state savings account holds $9.6 billion. Following voter approval of ballot initiatives, the fund has been tapped to bolster road funding and to target the development of water infrastructure.

By Paul Stinson

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Colorado

Electronic Commerce

Amazon to Collect Sales Tax in Colorado, Says It's 'Required' to Do So Starting Feb. 1

Amazon.com LLC said it will start collecting Colorado sales tax for the first time.

A spokesman told Bloomberg BNA Jan. 19 that the online retailer ''will be required to collect sales tax in Colorado'' beginning Feb. 1. The spokesman said he didn't have any additional information to provide, including why the company is required to start collecting the tax. Until now, Amazon hasn't collected sales tax on purchases shipped to Colorado.

Lynn Granger, spokeswoman for the Colorado Department of Revenue, told Bloomberg BNA Jan. 19 the department and the company reached an agreement this month leading to the decision by Amazon to start collecting the tax. Nothing has changed with respect to state tax policy to precipitate the agreement, she said.

In March, Amazon bought 2lemetry, a tech startup based in Denver. It was unclear whether that purchase resulted in Amazon having nexus in Colorado for the purpose of state sales tax collection. Granger said she didn't have ''any information about that.''

Notification Law. The Colorado General Assembly in 2010 approved a law (H.B. 1193) requiring out-of-state retailers to notify consumers of their obligation to pay sales and use tax on remote sales and requiring vendors to report sales above a certain threshold to the state DOR.

While lawmakers were debating the bill, Amazon announced it had decided to stop doing business with its affiliates in Colorado in response to the measure. The company said the law was ''clearly intended to increase the compliance burden to a point where online retailers will be induced to 'voluntarily' collect Colorado sales tax.''

The Direct Marketing Association sued Colorado over the notification statute, alleging the law violates the dormant commerce clause. The U.S. Court of Appeals for the Tenth Circuit is now reviewing a federal district court ruling striking down the notification law (*Direct Mktg. Ass'n v. Brohl*) .

A decision is pending in the case.

Currently Amazon and its subsidiaries collect sales tax when items purchased on the company's website are shipped to destinations in 27 states. Colorado would become the 28th state on Feb. 1.

By Tripp Baltz

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☐ *More information on Amazon's collection of state sales taxes is at http://src.bna.com/b7b.*

Louisiana

Exemptions

Louisiana High Court Considers DOR Rule Expanding Tax Exemption

A Louisiana drilling company wants the state's high court to uphold a Department of Revenue (DOR) regulation allowing tax exemption status on purchases made to reconstruct one of its offshore oil rigs (*Coastal Drilling Co. v. Dufrene*, La., No. 2015-C-1793, *oral arguments*, 1/26/16).

Coastal Drilling Co., which operates inland barge rigs in the shallow waters of the Gulf Coast, said an appeals court erred when it ruled that a sales and use tax exemption for new construction of sea vessels couldn't be used on reconstruction as well.

Louisiana Rev. Stat. 47:305.1(A) provides that materials and equipment that become component parts of ships, vessels or barges in their construction or reconstruction are exempt from sales tax. The Louisiana Department of Revenue, in Regulation 4403, extended the exemption to reconstructions.

The Louisiana DOR didn't exceed the scope of a tax statute exempting some sea vessel construction from sales and use tax when it extended that exemption to reconstructions, Cheryl Kornick, a shareholder with Liskow & Lewis who represents Coastal Drilling, said Jan. 26 during oral arguments in the Louisiana Supreme Court.

''The function of the Louisiana Department of Revenue is to promulgate regulations that will apply those taxing statutes to specific facts, and that's what they did here,'' Kornick said. ''Because they acted within their authority, and because the regulation is not inconsistent with the intent of the statute, the regulation is constitutional.''

Background. In 2005, one of Coastal's rigs was damaged in a fire. It was restored in Jefferson Parish and put back into use in St. Mary Parish. The company didn't pay state or local sales tax on parts, materials, equipment and machinery purchased to restore the rig. The local tax collector for St. Mary Parish issued a use tax assessment for the items. Coastal paid the taxes under protest and sued to recover the amount paid.

The original case in trial court centered on whether the rig damage constituted a reconstruction or just damage. The local taxing authority said that Coastal's rig wasn't destroyed—only damaged—and therefore, Regulation 4403 wouldn't apply.

The Louisiana Court of Appeal June 5, 2015, vacated judgment on the issue and ruled that extending the exemption to reconstructions was unconstitutional and that Regulation 4403 exceeded the scope of the exemption's statutory language (22 Multistate Tax Report 436, 6/26/15).

The original purpose of the exemption was to make Louisiana shipyards competitive with those in other states that don't have a sales tax. The exemption doesn't apply to repairs, Kornick said. The DOR promulgated rules to extend the exemption to cover reconstruction after a large ship sank in the Mississippi River.

''Ships are not like cars, you don't total them,'' Kornick said. ''Because of the expense, it makes more economic sense to reconstruct the ship from the remnants than to buy a new ship.''

The DOR's regulation said that if a vessel is damaged to the extent that it's no longer functioning, it's covered by the exemption. If it's still functioning, it's a repair and the exemption doesn't apply.

''The Legislature amended this statute three times since this regulation was put into effect, and not once did the Legislature address this part of the statute,'' Kornick said. ''That's powerful evidence that the Legislature accepted that the regulation was in accordance with the legislative intent.''

St. Mary Parish. The regulation violates Article II of the state constitution, which separates the powers of government among the three branches, Robert R. Rainer, a partner at Rainer Anding Talbot & Mulhearn representing St. Mary Parish, told the justices.

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When the rig was originally built in Jefferson Parish, there were no sales tax implications, Rainer said. It also didn't pay sales tax when the rig was restored after the fire. When the rig returned to St. Mary Parish, the parish assessed a use tax on the cost of the materials only.

''So Coastal Drilling has avoided sales tax twice,'' Rainer said.

Rainer added that there is no evidence that the exemptions for reconstruction of vessels has ever been applied other than the original case that prompted the department to issue the rules in 1987.

Coastal Drilling requested that if the Supreme Court upholds the appellate court's decision, the regulation should be applied prospectively only, and not retroactively.

BY NUSHIN HUQ

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Utah

Electronic Commerce

Utah Mulls Affiliate Nexus Bills to Require Online Retailers to Remit Sales Taxes

Utah lawmakers have proposed bills in the 2016 legislative session that would require out-of-state vendors—including online retailers—to collect and remit state sales and use taxes.

Two bills (S.B. 85, H.B. 235) would establish forms of affiliate nexus for out-of-state retailers that sell products to consumers in Utah. Other states have such laws, modeled after New York's affiliate nexus law, that require certain out-of-state businesses to remit sales and use taxes when they have an affiliate or a subsidiary relationship—such as an advertiser—with an in-state counterpart. The concept of affiliate nexus has been upheld by the U.S. Supreme Court, and states have had success using it as a way to get out-of-state retailers to collect and remit taxes.

S.B. 85 ''is very similar to the full affiliate nexus bill passed in New York authorizing the collection of due sales and use taxes in that state,'' bill sponsor Rep. Wayne Harper (R) told Bloomberg BNA Feb. 11.

Harper said the bill is ''still under review and discussion, with a substitute bill likely.'' Harper is also sponsoring S.B. 65, which would require reports to the State Tax Commission relating to certain out-of-state sellers. Colorado has a reporting and notification statute covering out-of-state sales, but that law is currently on hold pending a court case in the U.S. Circuit Court of Appeals for the Tenth Circuit (*Direct Mktg. Ass'n v. Brohl*) (22 Multistate Tax Report 727, 10/23/15).

'Remote Parity.' Meanwhile, the Utah House is considering the Remote Transactions Parity Act, (H.B. 235), also an affiliate nexus bill imposing a requirement that out-of-state sellers submit state sales and use taxes. The bill was pending before the House Rules Committee as of Feb. 12.

Utah has been a battleground in the debate over Internet taxation recently. Sen. Curtis Bramble (R), current president of the National Conference of State Legislatures, has mounted a national effort to get online and other out-of-state retailers to collect and remit Utah sales and use taxes whenever they sell to a customer in the state.

The Utah chapter of Americans for Prosperity opposes all the bills, saying they would create a regime of ''taxation without representation.''

Small Business Disadvantage. ''Why is the legislature forcing us to pay sales taxes online?'' the chapter said in a petition posted on its website. Such an effort will put small businesses ''at disadvantage to big-business counterparts who can afford to comply.''

The R Street Institute, a nonpartisan public policy research organization, released a poll Feb. 4 saying Utah residents oppose Internet sales tax collection ''schemes at the federal and state level that would require online businesses to collect and file taxes.'' The group said 71 percent of those polled said they oppose the proposed online sales tax legislation.

BY TRIPP BALTZ

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☐ *S.B. 85 is at http://le.utah.gov/~2016/bills/static/SB0085.html.*

H.B. 235 is at http://le.utah.gov/~2016/bills/static/HB0235.html.

S.B. 65 is at http://le.utah.gov/~2016/bills/static/SB0065.html.

For additional discussion of affiliate nexus in Utah, see Sales and Use Tax Navigator, at Utah 2.1.

North Carolina

Tax Base

Motor Vehicle Service, Repair Taxation Changes in North Carolina March 1

Beginning March 1, repair, maintenance and installation services on motor vehicles in North Carolina will be subject to state sales taxes.

Installation charges for motor vehicle parts or equipment will be taxable even if they are separately stated on an invoice or other documentation, the state Department of Revenue said in a notice dated Feb. 11.

Previously, such repair, maintenance and installation services were generally exempt from North Carolina sales taxes.

However, a budget bill signed into law in September 2015 (H.B. 97, Session Law 2015-241) imposed such taxes on repair and maintenance services. The change was estimated to result in an additional $44.5 million in revenue during the current fiscal year and $159.5 million in the fiscal year that begins July 1

Service Contracts Also Covered. Certain specific situations apply to services and contracts related to motor vehicles, and the DOR's notice describes the applicability of sales taxes under such conditions.

Exceptions for state vehicle inspections, self-service cleaning, towing and storage fees are described. Also outlined in the notice are the exemption from the sales and use tax of the sales price of or gross receipts derived from a motor vehicle service contract and the imposition of such taxes on the cost of parts or repair, maintenance and installation services sold at retail and covered under such contracts.

The DOR previously released several other notices aimed at assisting taxpayers in compliance with the state's recent expansion of its sales tax base, including one covering tire recapping or retreading services .

North Carolina has a general sales and use tax rate of 4.75 percent and local governments may impose up to another 2.75 percent.

By Andrew M. Ballard

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☐ *Text of the notice is at http://src.bna.com/cEW.*

For additional discussion of the taxation of installation and other charges in North Carolina, see Sales and Use Tax Navigator, at North Carolina 4.

For additional discussion of North Carolina's sales tax rates, see Sales and Use Tax Navigator, at North Carolina 3.

Georgia

Exemptions

Georgia Considers Tax Break for Super Bowl Tickets as Atlanta Bids for Game

Atlanta's bid to host a future Super Bowl may hinge partly on the Georgia Legislature's decision regarding a proposed sales tax exemption for tickets to ''major sporting events.''

H.B. 951 would provide the exemption for admissions to events including championship games for the National Football League and national collegiate tournaments; all-star games for Major League Soccer, Major League Baseball, and the National Basketball Association; and any other sporting event estimated to generate at least $50 million of revenue in the host city.

The NFL announced last year that it had selected Atlanta, Miami, New Orleans and Tampa as finalists for hosting the 2019 and 2020 Super Bowls, while Los Angeles also could be eligible if it has a stadium and an NFL team in place. The league said it would announce its final choices by May 2016.

The NFL requires host cities and states to provide sales tax exemptions for Super Bowl tickets, parking and entry fees to related events, or else to refund the amount of those taxes to the NFL, according to the Tax Policy Center, which has voiced opposition to the policy.

H.B. 951 awaits consideration in the state House as part of the Legislature's 2016 general session, which is scheduled to end March 24.

By Chris Marr

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☐ *Details on H.B. 951 are at http://www.legis.ga.gov/legislation/en-US/Display/20152016/HB/951.*

South Dakota

Electronic Commerce

South Dakota Panel Unanimously Votes To Levy Sales Tax on Remote Sellers

The South Dakota Senate State Affairs Committee unanimously passed legislation that would allow the collection of sales tax on certain remote sellers.

S.B. 106, sponsored by Sen. Deb Peters (R) and passed by the committee Feb. 17, would allow the state to collect sales tax from online retailers whose gross revenue from sales in South Dakota exceed $100,000, as well as online retailers who complete 200 or more sales transactions in the state in a calendar year.

The bill provides, however, that the obligations it would create for online retailers would be stayed until its constitutionality has been determined.

Proponents of the measure testified that it is an attempt to force Congress to address the issue of online retailers collecting state sales taxes. The issue has been languishing for 20 years or more, they said, and brick-and-mortar retailers are tired of being disadvantaged by collecting and remitting a tax that online retailers have ignored.

Revenue Loss Doubly Felt. Peters, testifying on behalf of the bill, said while all states that collect sales taxes have felt the effect of online retailers, South Dakota has been especially stung because the state doesn't collect an income tax. It relies on a very broad-based sales tax to fund state government, she said.

Peters said that state sales tax revenue in the past year increased by slightly more than 1 percent, which indicates a shift in commerce in South Dakota.

She said that while the Streamlined Sales and Use Tax Agreement has managed to get about 2,700 online retailers to collect and remit sales tax across the country, only 22 of those retailers are collecting and remitting South Dakota's sales tax.

S.B. 106 would help the state level the retail playing field.

Shawn Lyons, executive director of the South Dakota Retailers Association, said the effects of online retailers having an advantage over Main Street retailers aren't just felt in revenue collections. He said online retailers can be one of the reasons a local business fails. With such a failure, foot traffic can be reduced for

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neighboring shops, which can lead to fewer services in communities and weakened economies.

Under S.B. 106, remote sellers would be required to collect and remit the state sales tax, following the same procedures and requirements as in-state retailers, provided their yearly gross revenue from sales in the state was at least $100,000. An online retailer would also be required to collect and remit the tax if its number of annual retail transactions from South Dakota was at least 200.

The legislation, despite its provision staying its mandates until constitutionally ruled upon, carries an emergency clause. If the measure is signed by Gov. Dennis Daugaard (R), whose chief of staff testified on behalf of the bill, it would take effect on the first day of the first month at least 15 days after its signing.

Officials with the South Dakota Department of Revenue were unavailable for comment on the legislation.

By Mark Wolski

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☐ *More information on S.B. 106 is at http://legis.sd.gov/Legislative_Session/Bills/Bill.aspx?Bill=106&Session=2016.*

North Carolina

Tax Base

North Carolina to Begin Taxing Repairs, Maintenance Services on March 1

Businesses providing certain repair and maintenance services will have to begin collecting and remitting sales taxes in North Carolina beginning March 1.

To assist in compliance, the North Carolina Department of Revenue has issued a series of notices covering the application of such taxes on:

- tire repair services;
- jewelry repair and cleaning;
- service contracts for tangible personal property; and
- shoe repair and polishing.

The NCDOR also issued more general directives on the issue, with one covering the definition of ''retail trade'' (No. SD-16-1), and the other an outline of issues related to the expansion of the state's sales tax base (No. SC-16-2.

Previously, such repair, maintenance and installation services generally were exempt from North Carolina sales taxes.

However, a budget bill signed into law in September 2015 (H.B. 97, Session Law 2015-241) imposed sales tax on repair and maintenance services. The change was estimated to result in an additional $44.5 million in revenue during the current fiscal year and $159.5 million in the fiscal year that begins July 1

The NCDOR previously released a related notice describing the state law's repeal of an exemption for installation charges.

North Carolina has a general sales and use tax rate of 4.75 percent and local governments may impose up to another 2.75 percent.

By Andrew M. Ballard

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☐ *Text of Session Law 2015-241 is at http://src.bna.com/cui.*

A notice on tire repair services is at http://src.bna.com/cus.

A notice on jewelry repair and cleaning services is at http://src.bna.com/cuw.

A notice on service contracts for tangible personal property is at http://src.bna.com/cuy.

A notice covering shoe repair and polishing services is at http://src.bna.com/cum.

A directive (No. SD-16-1) on the definition of retail trade for taxes on sales occurring on or after March 1 is at http://src.bna.com/cuA.

A directive (No. SD-16-2) on general issues related to the taxation of repair, maintenance and installation services is at http://src.bna.com/cuB.

For additional discussion of sales tax on services in North Carolina, see Sales and Use Tax Navigator, at North Carolina 6.

Alabama

Procedure

Alabama Legislature Considers Tweaks to Simplified Out-of-State Seller Tax Program

Out-of-state vendors selling into Alabama could keep participating in the state's simplified use tax remittance program even if they established physical presence, such as building a distribution center, under an Alabama legislative proposal that's also designed to help position the state for nexus-related litigation.

Alabama H.B. 116 proposes revisions to the voluntary Simplified Use Tax Remittance Program that the state established through legislative action in 2015. Under those revisions, sellers who have registered and participated in the program for at least six months could continue remitting tax to the state at a flat rate of 8 percent—regardless of the applicable local tax rate—even if the seller establishes certain kinds of physical nexus with Alabama. As written now, the program is open only to sellers without a physical presence in the state.

The intention of the bill is to ensure out-of-state vendors that join the program and begin remitting use tax will no longer have to worry about whether they have a

physical presence in Alabama, said Joe Garrett Jr., deputy co-commissioner at the Alabama DOR.

If they wanted to send salespeople into the state or even build a distribution center, ''they could, and they could stay in the simple system,'' Garrett told Bloomberg BNA Feb. 10. ''The only thing that would kick them out of the program would be operating physical bricks-and-mortar retail stores.''

The simplified program has registered about 30 out-of-state vendors so far, he said, including some ''larger companies, but not the largest.'' In a few cases, companies have applied for the program and been rejected, including the online affiliate of a company that has in-state retail locations, he added.

In addition to the benefit of a simplified flat rate, companies in the program get to keep a discount of 2 percent of the tax amount, according to an Alabama Department of Revenue notice issued in September, prior to the program taking effect Oct. 1.

H.B. 116 is awaiting hearing in a House committee. The Alabama Legislature began its 2016 general session on Feb. 2.

Exception Could Be Clarified. The language for the retail stores exception is somewhat ambiguous, but overall the bill helps make the remittance program attractive for Internet retailers, said Bruce Ely, a tax attorney with Bradley Arant Boult Cummings LLP in Birmingham, Ala.

''This legislation does address an issue that several of us have raised,'' Ely told Bloomberg BNA Feb. 9. ''The exception (that subsequently disqualifies a registrant company) is a bit too broad. It needs some tweaking, but I think the spirit is there.''

The language of the bill says companies that have participated in the program for at least six months will remain eligible unless the seller or an affiliate ''establishes a presence through a physical business address for the purpose of making instate retail sales.''

The simplified remittance program is part of what Ely called the state's ''interesting carrot-and-stick approach'' to get out-of-state vendors to remit use tax.

Alongside launching the remittance program in fall of 2015, the DOR also announced a rule that requires out-of-state vendors with annual sales of more than $250,000 into the state to collect and remit use tax, solely on the basis of an economic nexus.

Potential Litigation a Factor. Alabama's governor and tax officials have publicly invited a lawsuit over the regulation, with the hope of seeding a case that could lead the U.S. Supreme Court to throw out the physical presence rule established in its 1992 *Quill* decision, and Garrett indicated this legislation also might aid the state in its hypothetical case (*Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)) (22 Multistate Tax Report 869, 12/25/15).

H.B. 116 would also revise current statute so that a federal law change related to sales tax nexus would close the simplified remittance program to new entrants only if the change comes by federal legislation, whereas the current statute includes a change resulting from a Supreme Court ruling.

Garrett said the state wants to be able to argue in court that its simplified remittance program demonstrates a relatively light compliance burden on out-of-state sellers, but he added the argument wouldn't make sense if the state planned to shut down the program following a favorable Supreme Court ruling.

Taxpayer Advocate Change Proposed. Alabama's Legislature also is considering a proposed change to the state's taxpayer advocate program.

H.B. 38 would shift the power for appointing the state's taxpayer advocate from the revenue commissioner to the governor—a move that tax practitioners in the state see as improving the fairness and independence of the position, Ely said.

The state House passed the bill Feb. 9 and sent it to the Senate for consideration. Among other duties, the taxpayer advocate can review disputed tax cases based on new evidence that comes to light following an Alabama Tax Tribunal ruling, according to the bill language.

Also passing the House Feb. 9 and due for Senate consideration, H.B. 36 would create a job tax credit program for small businesses.

Companies with fewer than 75 employees that hire and retain new workers for at least a year earning at least $40,000 annually would be eligible for a one-time income tax credit of $1,500 per new hire.

By Chris Marr

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☐ *H.B. 116 is at http://src.bna.com/cz0.*

The notice detailing the state's Simplified Use Tax Remittance Program is at http://src.bna.com/cz3.

H.B. 38 is at http://src.bna.com/cz1.

H.B. 36 is at http://src.bna.com/cz2.

For additional discussion of Alabama's simplified use tax remittance program, see Sales and Use Tax Navigator, at Alabama 2.1.

Multistate Developments

Electronic Commerce

Senate Sends Permanent Internet Tax Ban to President's Desk

After a month's-long logjam in the Senate, lawmakers approved, 75-20, a measure that makes permanent a ban on taxing Internet access as part of a broader conference report to a customs bill.

''Making the state and local tax ban permanent is good news for consumers,'' Sen. Charles E. Grassley (R-Iowa), said in a statement. ''It sends the message that a resource like the Internet ought to be available as widely as possible, and that taxes shouldn't be a barrier.''

Grassley has been a long-time supporter of the permanent tax ban, known as the Internet Tax Freedom Act.

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Approved Feb. 11, the conference report to the customs bill (H.R. 644) now moves to the White House, where President Barack Obama is expected to sign it. The House approved the conference report in December.

The Senate vote marks the end of a long path to permanency for the tax ban. Lawmakers enacted the ITFA in 1998 and regularly renewed it since.

''After 17 years and seven short-term extensions later, it was long past time for Congress to make this policy permanent,'' Jay Driscoll, executive director of the Internet Tax Freedom Act Coalition, said in a statement. ''Allowing ITFA to expire would have unduly burdened millions of hard-working Americans with excessive taxes that would have hit their own pockets directly.''

Deal Making. Lawmakers had planned to vote on a conference report in December, but Senate Minority Whip Richard J. Durbin (D-Ill.) said he would bring a point of order against the tax provision unless it was stripped from the measure.

A point of order would have stalled a vote on the conference report, and it took a deal with Senate Majority Leader Mitch McConnell (R-Ky.) to move the measure. As part of the deal, Durbin would allow a vote on the bill in exchange for McConnell's promise to hold a Senate vote on legislation allowing states to tax online sales on out-of-state purchases, known commonly as the Marketplace Fairness Act, later this year.

Popular Language. The ITFA language is popular in Congress, and Marketplace Fairness Act backers such as Durbin have for years tried to attach their legislation onto the Internet tax bill with no success. Other lawmakers, particularly those in states without a sales tax, have blocked that effort. Senate Finance Committee ranking member Ron Wyden (D-Ore.), opposed combining the two provisions.

Durbin told reporters Feb. 9 that a Marketplace Fairness Act bill will originate in the House later this year, and if it doesn't advance to a floor vote, McConnell will allow a freestanding bill in the Senate.

Brick-and-mortar retailers, who stand to benefit from state taxes on online purchases, praised the deal.

''We're encouraged by Majority Leader McConnell's commitment to allow movement on e-fairness legislation and now the onus is on the House of Representatives,'' said Tom McGee, president and chief executive officer of the International Council of Shopping Centers. ''The retail landscape is changing and it's time for Congress to catch up. Millions of America's community-based businesses are looking for Congress to provide leadership in today's multichannel retail environment. We must level the playing field immediately for our economy and small businesses.''

By Casey Wooten

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☐ *For a discussion of the Internet Tax Freedom Act, see 1350-2nd T.M., Sales and Use Taxes: Communications Services and Electronic Commerce, at 1350.08.D.*

For additional information regarding congressional measures aimed at permitting states to tax remote vendors selling products on the Internet, see 1420-2nd T.M., Limitations on States' Jurisdiction to Impose Sales and Use Taxes, at 1420.06.E.8.

New York

Tax Base

Dunkin' Donuts Pocketed Sales Tax On Packaged Coffee, Lawsuits Claim

A pair of class action complaints filed in federal and state courts alleged that the Dunkin' Donuts chain has illegally collected sales tax in New York and New Jersey on packaged coffee (*Estler v. Dunkin Brands, Inc.*, S.D.N.Y., No. 1:16-cv-00932, *complaint filed*, 2/9/16).

In one of the lawsuits, filed Feb. 9 in the U.S. District Court for the Southern District of New York, the plaintiffs alleged that Dunkin Brands Inc. and its franchise stores collected a surcharge on packaged coffee ''in the guise of'' an 8.875 percent sales tax, in knowing violation of state regulations.

Attorneys from the Mayer Law Group LLC and the Law Office of Ted M. Rosenberg which brought the suits, estimated that Dunkin' Donuts stores in New York made about $10 million on the illegal charges and that the New Jersey stores took in about $4 million.

The lawsuits maintain that the company sets and controls what its stores charge, programming cash registers from its Canton, Mass., headquarters. The chain has 11,000 stores in 33 countries, with about 515 locations in New York, the New York lawsuit said.

New York tax regulations, the plaintiffs argued, exempt most food from sales tax, if it is sold for human consumption, sold unheated and sold ''in the same form and condition, quantities, and packaging as is commonly used by retail food stores.''

State-Issued Bulletins. In a pair of April 2011 tax bulletins (Nos. ST-525 and ST-806), the plaintiffs said, the state specifically listed coffee among the items not to be taxed.

The bulletins also spell out the conditions under which restaurants can't charge sales tax on items purchased to go, including if the product is being sold in the same way ''you would normally find it in a supermarket or grocery store.''

Despite knowledge of the tax bulletins and customer complaints, the defendants still collected sales tax on packaged ground coffee ''sold unheated and for off-premise consumption,'' the plaintiffs alleged.

The lawsuits cited a 2013 news article on the sales tax charges that they said had alerted the company to the issue. The article included a response from the company, which said it had addressed the issue with its franchisers, the lawsuits said.

Yet ''to this day,'' the company continues to ''dupe'' its customers and ''flout the law,'' they alleged.

Bottled Water. The New Jersey complaint, *Frate v. Dunkin' Donuts Franchised Rests., LLC*, filed in the Superior Court of the State of New Jersey, added unsweetened bottled water to packaged coffee as the products for which the tax was charged.

In a statement, a spokesman for Dunkin' Donuts said its 2,000-plus restaurants in the two states ''are owned and operated by individual franchisees, who are expected to comply with all applicable state and federal laws including those relating to taxation.''

''We are in the process of reaching out to the franchisees identified in the complaint in order to determine whether these taxes were charged to customers,'' he said.

BY JOHN HERZFELD

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☐ *The New York complaint is at http://src.bna.com/cCf.*

The state tax bulletins are at http://src.bna.com/cBn and http://src.bna.com/cBo.

The New Jersey complaint is at http://src.bna.com/cCd.

For additional discussion of sales tax on food in New York, see Sales and Use Tax Navigator, at New York 5.6.

California

Procedure

California SBOE to Work With Taxpayers Due Refunds In Wake of 'Lucent' Ruling

Now that it has a more specific ruling about the application of sales tax to software on storage media in the *Lucent* case, the State Board of Equalization will be working with taxpayers in deciding how to implement the decision, SBOE Chief Counsel Randy Ferris said.

''We will be engaging with interested parties,'' Ferris said Jan. 29. ''Ultimately our board members will make the policy decision on how the *Lucent* decision will be implemented.''

About 900 taxpayers have filed protective claims for refund while *Lucent* worked its way through the courts (*Lucent Techs., Inc. v. State Bd. of Equalization*).

State May Owe Millions. The California Supreme Court said Jan. 20 it won't review the appellate court ruling, meaning the state may owe millions of dollars to those taxpayers .

SBOE Chair Jerome Horton (D) said in a Jan. 26 news release that he is calling for a board discussion on its next steps.

''I have called for a closed session briefing at the February 23-25 board meeting to allow the board to consider next steps and how best to expedite the administration of this decision and take appropriate action to implement the Court of Appeal's decision,'' Horton said.

Clearer Guidance. Although the state appellate court ruled against the SBOE in finding that software on telephone switches licensed to Lucent customers are exempt from tax, the ruling provides clearer guidance than rulings in an earlier case on the subject, Ferris told attendees of the American Bar Association Section of Taxation midyear meeting in Los Angeles. The earlier case was *Nortel Networks Inc. v. State Bd. of Equalization* (18 Multistate Tax Report 99, 2/25/11).

''They had to address tangibility in a much more direct way,'' Ferris said. ''We declare a form of victory in that we got the court to be more specific.''

Ferris said he wasn't speaking for the five-member elected board, but one way to interpret the *Lucent* ruling is to determine that when a technology transfer agreement exists, the correct measure of tax is on the blank storage media used in the transitory conveyance of software.

Such a reading would prevent absurd results the court cautioned against by ensuring consumers would pay the same amount of tax on intellectual property contained on storage media regardless of the location from which they purchase it, he said.

BY LAURA MAHONEY

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☐ *For a discussion of the application of sales and use tax to technology and intellectual property in California, see 1920-2nd T.M., California Sales and Use Taxes, at 1920.06.F.*

For a general discussion of computer software and services subject to sales tax in California, see 1350-2nd T.M., Sales and Use Taxes: Communications Services and Electronic Commerce, at 1350.16.D.

Illinois

Procedure

Illinois Judges Dismiss 139 Abusive Whistle-Blower Actions Against Wine Sellers

Illinois Attorney General Lisa Madigan (D) has gained court orders dismissing 139 purportedly abusive whistle-blower actions alleging that online wine merchants failed to apply the state's use tax on shipping and handling charges associated with electronic purchases. Motions to dismiss are pending in more than 200 additional suits.

Eileen Boyce, a spokeswoman for Madigan, told Bloomberg BNA Jan. 29 the suits were dismissed in two groups over the last six weeks.

On Jan. 20, Cook County Circuit Court Associate Judge Thomas R. Mulroy granted the state's motion to dismiss 28 cases brought by Stephen B. Diamond P.C.

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under the Illinois False Claims Act against wine sellers that failed to collect and remit to the state use taxes on Internet-based wine sales shipped to Illinois customers. All of the dismissed cases involved wineries that were able to demonstrate they offered Illinois consumers the option of picking up their purchases at the seller's location .

111 Cases Dismissed in December. Boyce said another 111 cases were dismissed on Dec. 17 by Cook County Circuit Court Judge James E. Snyder (*Illinois, ex rel. Stephen B. Diamond P.C. v. Nils Venge*, Ill. Cir. Ct., No. 2015 L 666, *dismissed*, 12/17/15).

This series of cases, also filed by Diamond, involved wine and spirits coming into Illinois from unlicensed out-of-state shippers. Snyder found Diamond, the relator in the various actions, had failed to file a timely response brief. Snyder noted that his order is final and appealable.

Boyce said the state found the 111 defendants weren't licensed to sell alcohol into the state and thus had no tax collection duties in Illinois.

''Our position is that the relator's complaint does not include allegations that would support an argument that these out-of-state entities have sufficient presence in Illinois to create tax liability,'' Boyce said in an e-mail.

Cease and Desist. Terry Horstman, a spokesman for the Illinois Liquor Control Commission, said the defendants could be in violation of state liquor control statutes. The commission has responded by sending out 160 cease-and-desist letters to unlicensed shippers during 2015.

Horstman said the commission may take additional enforcement steps in the future.

''Our efforts since the cease-and-desist letters were sent have been to continue to monitor shipments,'' Horstman said in a Feb. 1 e-mail. ''If non-compliant shipments are identified and the non-compliant shippers have already received cease-and-desist letters, the matter will be referred to the appropriate law enforcement officials for further prosecution.''

Despite the dismissals, the drama around Diamond's hundreds of qui tam actions on behalf of Illinois in Cook County Circuit Court will continue. Boyce said the state is seeking dismissal of another 202 cases pending against unlicensed alcohol retailers.

Dozens of wineries are also petitioning the court to dismiss their individual cases.

BY MICHAEL J. BOLOGNA

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Multistate Developments

Electronic Commerce

Practitioners Want Clarity On Remote Sales Tax Collection

As sales tax collection becomes more complex in a digital age, the need for clarity through legislation or case law is increasingly important, according to leading practitioners in state tax issues.

Opponents of remote sales tax collection say that collecting sales tax from large numbers of customers would be ''too complex,'' but for Max Behlke, manager of state/federal relations for the National Conference of State Legislatures, this is an outdated way of thinking. ''That may have been the case in 1992, but this is 2016,'' he said.

The issue of remote sales tax collection reminded him of the movie ''Groundhog Day.'' In the film, the main character experiences the same day multiple times and, likewise, we keep revisiting the same issues pertaining to remote sales tax collection, according to Behlke. However, we will soon break the cycle, Behlke said Feb. 2 in the keynote address at a Bloomberg BNA and Reed Smith event.

Challenge Physical Presence Rule. States have given up on waiting for Congress to act and are instead pursuing their own legislation in the hopes that the Supreme Court will revisit *Quill Corp. v. North Dakota*, according to panelists.

Joe W. Garrett Jr., the deputy co-commissioner of the Alabama Department of Revenue, says that Alabama's new mandate, effective Jan. 1, that remote sellers that make sales over $250,000 into Alabama collect sales tax ''was explicitly done as an attempt to challenge *Quill*.'' In making the point that *Quill* affirmed a much older ruling, Garrett added that ''it's time for that 50-year-old *National Bellas Hess* rule to go.''

In discussing the legality of the Alabama rule, panelists discussed whether delivery itself constitutes a physical presence in the state. Garrett said regarding the new rule, ''the distribution system that is prevalent in the states is a complete burden on the states to support.''

The panelists were in agreement that in order to challenge *Quill*, there would need to be a remote seller willing to contest an assessment imposed on it. Steve DelBianco, the executive director of NetChoice, stated that ''there's going to need to be a taxpayer [with] an interesting case.''

The panel, which also included Fredrick J. Nicely, senior tax counsel at the Council On State Taxation, and Kelley C. Miller, an associate at Reed Smith, also concurred that there was some doubt as to whether the Supreme Court would even hear a direct challenge to *Quill*.

DelBianco was skeptical that the court would want to revisit *Quill* as ''not a single jurist joined Kennedy on his concurrence'' in the *Direct Mktg. Ass'n v. Brohl* case that suggested that the Supreme Court re-examine *Quill*. DelBianco added that the Supreme Court's failure to grant certiorari in December 2013 to Overstock.com Inc.'s challenge of New York's click-through nexus law

was a ''little bit of a slamming door on the aspirations for *Quill*.''

Clarity and Uniformity. During another discussion, panelists emphasized the need for solutions and clarity. ''From our perspective, we don't care if a state taxes something or exempts it. What we want is the clarity and uniformity wherever we can get it so that people know whether it's taxable or not,'' said Craig Johnson, executive director of the Streamlined Sales Tax Governing Board Inc.

Panelists, however, disagreed on whether that clarity should come from administrators or legislators. Joseph Henchman, vice president at the Tax Foundation, said that new laws should originate from the state legislatures. He said he is worried that state administrators had the potential to either provide too little guidance or overstep their bounds.

When asked how taxpayers seeking guidance should find it in the absence of legislation, Henchman said, ''I'm old-fashioned. If the law says you can't do something, that means you can't do it. If you want to change that, you have to change the law.''

But the panel, which included Robert E. Weyman, counsel at Reed Smith, also expressed concerns over the speed at which technology changed. ''Every year, especially in the digital arena, you're going to have to go back to that Legislature and have a new law passed because something new has evolved,'' he said.

BY RISHI AGRAWAL AND EMILIE BURNETTE

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☐ *For additional discussion of nexus, see 1420-2nd T.M., Sales and Use Taxes: Limitations on States' Jurisdiction to Impose Sales and Use Taxes at 1420.02.*

North Carolina

Procedure

North Carolina Outlines New Reporting Rules for Alcohol Vendors, Licensing Boards

Alcohol vendors and licensing boards in North Carolina must provide certain information to the state revenue department under a new sales tax compliance and fraud prevention effort.

The North Carolina Department of Revenue informed alcohol wholesalers and related vendors in a Jan. 6 notice that they must provide the name, license number, business address and other relevant information for permittees to which they sell alcohol by July 1. The submission should cover permittee information available from calendar year 2015, it said.

In a separate notice dated Jan. 27, the NCDOR told occupational licensing boards that they need to submit the name, license number, tax identification number, business address and other pertinent information for all of their licensees by July 1. That submission should include information on licensees available for calendar years 2013, 2014 and 2015, it said.

2015 Law Created Program. The new reporting requirements were enacted in October 2015 and included in legislation (H.B. 117; Session Law 2015-259) that also provided incentive grants and certain tax breaks for data centers, among other tax changes (22 Multistate Tax Report 758, 10/23/15).

The new reporting requirements are aimed at increasing tax compliance and helping the NCDOR combat tax fraud by comparing the submitted information with tax remissions.

Other states have similar compliance programs.

In Tennessee, officials say their program—covering alcohol and tobacco—has proven successful and resulted in the collection of more than $60 million in additional revenue during its first two and a half years. That state's program was recently expanded to cover additional goods, a move that business groups are trying to roll back .

Kate Catlin, spokeswoman for the North Carolina Chamber, told Bloomberg BNA Feb. 2 that the ''compliance reporting requirements for occupational licensing boards and alcohol vendors is not an issue we are following as of now.''

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☐ *Text of the notice for alcohol vendors is at http://src.bna.com/clU.*

The notice for licensing boards is at http://src.bna.com/clV.

California

Procedure

California Court Won't Review 'Lucent' Ruling on Taxation of Software

The California Supreme Court said it won't review a lower court ruling that software on telephone switches licensed to Lucent Technologies Inc. customers is exempt from sales tax, possibly setting the stage for millions of dollars in refunds to taxpayers (*Lucent Techs., Inc. v. State Bd. of Equalization*, Cal., No. S230657, *petition for review denied*, 1/20/16).

The court's Jan. 20 denial of a review petition from the State Board of Equalization (SBOE) is consistent with lower court rulings against the tax agency and in favor of Lucent that the company is owed a $24 million sales tax refund and $2.6 million in attorney fees. Most recently, a state appellate court ruled Oct. 8 in favor of Lucent that the software is a non-taxable technology transfer agreement (22 Multistate Tax Report 795, 11/24/15).

The SBOE hasn't acted so far on claims for refund from other taxpayers with similar circumstances while

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the case was pending, despite rulings against it in *Lucent* and a nearly identical case that is closed, *Nortel Networks, Inc. v. State Bd. of Equalization* (18 Multistate Tax Report 99, 2/25/11).

The state may owe millions of dollars through the pending refund claims.

''The board will take appropriate action to implement the Court of Appeal's decision,'' SBOE spokeswoman Venus Stromberg told Bloomberg BNA Jan. 22.

Taxpayers are waiting to see how and when the board addresses refund claims, and whether the members seek a legislative change on the issue, Mark Nebergall, president of the Software Finance and Tax Executives Council in Washington, told Bloomberg BNA Jan. 21.

''The business community looks forward to working with the board on both fronts,'' Nebergall said.

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Louisiana

Exemptions

Co-Generator Wants Louisiana Exemption For Sales Taxes Based on By-Product Sale

A Louisiana co-generator wants the state's high court to rule that it can claim a sales tax exemption for an emissions-controlling input, because it sells the by-product (*Bridges v. Nelson Indus. Steam Co.*, La., No. 2015-c-1439, *oral arguments*, 1/25/16).

Nelson Industrial Steam Co. (NISCO), which co-generates electricity and steam, argued that a lower court erred when it ruled that the company wasn't entitled to a sales and use tax exemption for limestone it purchased to burn with petroleum coke to reduce sulfur emissions, because although Nelson sold the resulting ash, the sale of the ash wasn't the economic purpose of the purchase of the limestone.

The Louisiana Court of Appeal erroneously applied an economic purpose test, which narrowed the focus of a manufacturing tax exemption and made subject to tax the purchases of material that it never before deemed taxable, the company's attorney said.

The appellate court departed from the manufacturing focus of the three-part test the Louisiana Supreme Court had established in previous cases to determine sales tax exemption, Linda Akchin, a partner at Kean Miller LLP who represents NISCO, said during Jan. 25 oral arguments. The three-prong test examines whether the material is identifiable in the end product, whether it benefits the end product and whether the material was purchased for the purpose of processing and including it in the end product.

''It's a very straightforward rule,'' Akchin said. ''Is a material purchased? Is that material further processed? Is it processed into other tangible personal property? And is it ultimately sold?''

'Further Processing Exclusion.' Under Louisiana tax law, sales tax is imposed on a ''sale at retail,'' and La. R.S. 47:301(10)(c)(i)(aa) excludes raw materials that will be further processed into articles of tangible personal property from sales tax. This is known as the ''further processing exclusion.''

NISCO bought limestone for $46 million and used it to capture sulfur when it burned petroleum coke to make electricity. Burning the limestone with the petroleum coke helps reduce sulfur emissions. Ash is also produced and the company sold the ash to another company for $6 million. The appellate court found that the exemption didn't apply because the company didn't buy the limestone to process further in an effort to create an end product.

NISCO and its supporters said the lower court decision significantly limits the scope of the tax exemption and could have far-reaching ramifications in the state's manufacturing industry. Whether it made business sense for NISCO to purchase limestone for $46 million and sell the ash produced for $6 million isn't what the court should be focusing on—it should focus on the end product, Akchin said.

''That's sort of the dilemma that we face, isn't it?'' Justice John L. Weimer asked Akchin. ''What is the end product? Is it the electricity that has no ash in it or is it the ash itself? You're suggesting there's two end products, the electricity and the ash?''

International Paper Co. In *Int'l Paper Co. v. Bridges*, the state supreme court resisted any further narrowing of the exclusion clause, Jesse Adams, a partner with Jones Walker LLP who represents the Louisiana Pulp and Paper Association, told the justices (*Int'l Paper Co. v. Bridges*, La. 2007-11511/16/08). The Louisiana Pulp and Paper Association and the Council On State Taxation filed a joint brief to the supreme court supporting NISCO (22 Multistate Tax Report 848, 12/25/15).

''This case is another opportunity to narrow this exclusion,'' Adams said. ''As noted in the dissent for the Third Circuit, the majority relies on a primary product decision.''

This is a limitation that isn't in the statute or case law, Adams said. Any limiting of the exclusion should be considered by the Legislature and not by the judicial process.

Taxing Authorities. Local and state taxing authorities disagree. At issue in this case is the third prong of the exclusion test, which centers around purpose, said Russell J. Stutes Jr., managing partner of Stutes & Lavergne LLC, who represents the Louisiana Department of Revenue and the Calcasieu Parish School Board Sales and Use Tax Department.

The sole purpose of purchasing the limestone was to use the carbon when burning petroleum coke to limit sulfur emissions, Stutes said. If limestone wasn't needed to capture the sulfur, the company wouldn't have purchased it simply to produce ash.

''The only answer to what determines whether NISCO purchases limestone is whether or not they need to inhibit sulfur,'' Stutes said.

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Louisiana

Procedure

Louisiana Parish Asks State High Court To Reverse Tax Record-Keeping Decision

The burden of proof in a tax audit should be on the taxpayer, the Calcasieu Parish School System told the Louisiana Supreme Court, in a case alleging ambiguities in the state's record-keeping statute (*Yesterdays of Lake Charles, Inc. v. Calcasieu Par. Sales and Use Tax Dep't*, La., No. 2015-c-1676, *oral arguments*, 1/26/16).

The Calcasieu Parish School System Sales and Use Tax Department is seeking a reversal of the May 2015 majority decision by the state's Court of Appeal for the Third Circuit and acceptance of the dissent's interpretation of the suitable records law.

The dissent opinion in the appellate case properly places the burden of proof on the taxpayers—which in this case are two nightclubs, said Scott Scofield, of Scofield, Gerard, Pohorelsky, Gallaugher & Landry LLP, who represents the department.

The appellate court ruled, 3-2, that the burden of proof was on the tax collector and that the records provided to the school system were suitable under the statute, La. R.S. 47:337.29, which requires taxpayers to keep suitable records, other books of accounts and other information as may be required by the collector for an audit.

Looking for Z Tapes. Yesterdays of Lake Charles Inc. and Cowboy's Nightlife Inc. are two of the largest nightclubs in Lake Charles. The businesses, both owned by Clarence ''C.O.'' Vallet, are mainly cash-based and their primary source of income is liquor sales and cover charges.

The company's business practice was for the clubs' managers to count the amount of cash taken in and compare that to the amount reflected on the cash register's paper trail, called a Z tape. Every night, the managers would use the cash in the on-site safe to pay any bands that performed and the security personnel. The rest of the cash would go into each club's safe before deposit in the bank.

In 2009, the clubs were audited by the parish for the periods of Jan. 1, 2005, through Dec. 31, 2008. The clubs turned over bank account statements and deposit slips. The parish told the club owner that these weren't thorough enough.

The parish also requested the Z tapes, which were the only source of detailed information of sales at the clubs, but the clubs hadn't saved them. The parish issued penalties totaling $155,662.95 for Yesterdays and $49,973.99 for Cowboys.

Both a trial court and appellate court ruled in favor of the clubs. The appellate court said that the parish never required, prior to the audit, that the club keep Z tapes as suitable records. No rules from the local taxing authority were promulgated either.

The trial court ruled and the appellate court affirmed that the burden of proof lies with the collector, not the taxpayer. Because there were no rules or guidance under the suitable records statute, the bank statements and deposit slips alone were suitable records and the tax assessment was ruled ''arbitrary.''

Disparity in Assessments. Justice John L. Weimer noted the large disparity between the auditors' initial assessment—$217,000 for Yesterdays—and the final assessment of $85,000 for the same club.

''That's a wide range,'' Weimer said. ''I believe the court of appeal just said 'Well, they just picked the numbers out of the air.' The opposing counsel said that the auditors said 'We were just trying to get the club's attention with the first numbers we came out with.' ''

The clubs were given three assessments, but only one notice of assessment, Scofield said. Once the school system explained how it would determine the tax owed, the taxpayer gave additional information, such as $1 beer nights, and giveaways that reduced the estimated revenue. It was during the audit period that Hurricanes Katrina and Rita hit as well. That also reduced the assessment.

Investigating Cash Business. ''How do you investigate a business that is a cash-run business, that doesn't keep accounting records, but bank account records and throws away the only thing reliable to back up what income was sale?'' Justice Jeannette Theriot Knoll asked David Kelly of Breazeale, Sachse & Wilson LLP, representing the nightclubs.

For 20 years, the clubs have used the same process for calculating the sales and use tax without being challenged by the state or parish, Kelly said.

In an separate audit, the state taxing authority accepted the same records submitted to Calcasieu Parish by these clubs but didn't issue an assessment.

''According to the Louisiana Association of Tax Administrators, by their own publication, exhibit 22, bank statements and tax returns, which we provided, are considered sales records,'' Kelly said.

''It just seems to me that if you are a cash-based business, and you don't have anything to back up how many transactions you had to acquire that cash, that becomes very questionable,'' Knoll said.

Vallet kept the Z tapes for years, Kelly said, but when no one asked for them—including the owner's certified public accountants—Vallet threw them away, which was years before the audit commenced.

Kelly outlined the procedure by which the money was accounted for and deposited in the bank. Knoll questioned whether he believed that was proper accounting procedure.

''It is our position that the clubs adequately complied with the suitable records statute,'' Kelly said.

By Nushin Huq

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☐ *Text of the May 2015 appellate court decision is at http://www.la3circuit.org/Opinions/2015/05/051315/14-0413opi.pdf.*

Washington

Constitutional Limitations

Two-Thirds Majority Tax Initiative Ruled Unconstitutional in Washington State

A Washington state voters' initiative intended to coerce lawmakers into adopting a constitutional amendment requiring a two-thirds vote of the Legislature for any tax increase is itself unconstitutional, a state trial court ruled (*Lee v. Washington*, Wash. Super. Ct., No. 15-2-28277-8, *order*, 1/21/16).

Initiative 1366—which passed in November 2015 with a vote of 51.5 percent in favor—would cut the state retail sales tax to 5.5 percent from 6.5 percent April 15 unless lawmakers refer an amendment to the state constitution to the electorate asking whether a two-thirds vote of the Legislature should be required to pass a tax increase. If 1366 were enacted, a tax increase could pass by a two-thirds supermajority of the Legislature or by a majority vote of the people.

The state Office of Financial Management said if such a cut were enacted, sales tax revenue would decrease by a projected $8 billion over the next six fiscal years.

Washington Superior Court Judge William L. Downing of Seattle struck down the initiative Jan. 21, saying it usurps the authority of the Legislature to propose constitutional amendments. ''It is solely the province of the legislative branch of our representative government to 'propose' an amendment to the state constitution,'' Downing wrote in his order.

''The intended process—one that is constitutionally mandated—is one that facilitates a calm deliberation and independent weighing of alternatives before a proposed amendment is submitted for public review,'' the order says. ''That process is derailed by the pressure-wielding mechanism in this initiative which exceeds the scope of the initiative power.''

Initiative Backers to Appeal. ''I-1366 violates Article XXIII of the Washington constitution in usurping the role of the legislature by *proposing* precise terms for a constitutional amendment while applying compulsion to quickly move it forward,'' Downing wrote. ''I-1366 abridges the plenary powers of the 2016 legislature by tying its hands in an impermissible way.''

The initiative was the latest gambit in a more than two-decade long political chess match between anti-tax forces lead by Tim Eyman, the lead proponent of the measure, and a state government long dominated by Democrats.

The Washington Supreme Court in 2013 struck down a requirement that the Legislature muster a two-thirds vote to pass any tax increase that emerged from a previous Eyman initiative passed by the electorate.

Eyman—a named defendant in the lawsuit to overturn I-1366 brought by a coalition that included two state legislators and the League of Women Voters—learned of his defeat in trial court, while testifying before a legislative committee on a bill that would refer to the electorate a constitutional amendment imposing the two-thirds supermajority requirement.

When Eyman learned of the news, he told the assembled lawmakers: ''We obviously disagree with the judge and his decision. But it does not change what the voters decided and I would certainly encourage this Legislature to move forward with it as it goes upward to the Supreme Court.''

The bill, Senate Joint Resolution 8211, has virtually no chance of passage with Democrats in control of both the House and the governor's office.

Gov. Jay Inslee (D) said immediately after the court order: ''Today's ruling is not unexpected and ensures the Legislature can continue focusing on the necessary priorities of this year's short session. I appreciate the Court's expeditious review of the case so legislators aren't distracted by the uncertainty of the initiative's impact.''

'Coercive Choice.' Plaintiffs' attorney Paul J. Lawrence of the Pacifica Law Group told Bloomberg BNA in a telephone interview Jan. 22: ''Ultimately, what the initiative was trying to achieve is a constitutional amendment limiting the ability of the state Legislature to raise taxes. And the Washington courts have held previously that you can't achieve that result by the initiative process.''

''Here the initiative really did set up a coercive choice for the Legislature,'' Lawrence said. Either they could face a massive reduction in sales tax revenue or send a proposed constitutional amendment to a vote of the people.

''The court felt that that was just an abuse of the initiative process and was unconstitutional,'' he added. ''I would expect that there would be an appeal to the Supreme Court, and the Supreme Court will accept the case.''

BY PAUL SHUKOVSKY

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☐ *Text of the decision is at http://src.bna.com/cbG.*

Nebraska

Tribal Taxes

Supreme Court Hears Nebraska Tax Case Disputing Indian Reservation Boundaries

The U.S. Supreme Court heard oral arguments in a case involving the imposition of a 10 percent tax on alcohol purchases within an Omaha Tribe's Indian reservation, and whether or not an 1882 act of Congress diminished the boundary of the reservation (*Nebraska et al. v. Parker*, U.S., No. 14-1406, *oral arguments*, 1/20/16).

During oral arguments Jan. 20, the Nebraska solicitor general and the assistant to the solicitor general at the Justice Department argued over a request by individual petitioners to remit the 10 percent tax. The Omaha Tribe denied the request and informed the petitioners they were subject to the Omaha Tribal Code because the disputed area of Pender, Neb., was within the Omaha reservation .

Nebraska Solicitor General James D. Smith told the court that the disputed Indian area ''is that of a land that long ago lost its Indian character,'' and that it was the intent of Congress through an 1882 act that the disputed area would be diminished from the reservation.

Justice Antonin Scalia challenged Smith regarding the diminishment of the tribe's boundaries, saying that it ''doesn't make any sense'' that actions of a later Congress concerning a reservation's excess land would automatically align with the intent of the 1882 Congress when it enacted a particular statute.

What's at Stake. Justice Sonia Sotomayor also questioned Smith as to what the state would lose if it didn't win the case. The U.S. government already limits the tribe's power to tax by requiring the tribe to obtain governmental permission, she added.

Smith responded that the issue for the state becomes adding an additional sovereign—the tribe—into an area over which the tribe hasn't previously exercised authority, which would cause confusion as to the justifiable expectations of those who live in the disputed area.

A further concern is whether or not the tribe decides to provide services that the state can provide when collecting the tax, Smith added.

''And, in fact, the idea of local control is if the people in the disputed area are unhappy about what the Tribe is doing, unlike it's their local city council, they don't get to vote,'' Smith said.

Paul D. Clement, of Bancroft PLLC and a former U.S. solicitor general, who represented the individual petitioners challenging the tax in dispute, argued that Congress hadn't diminished the reservation, but simply opened up a portion of the reservation for settlement within existing boundaries.

No Supporting Language. According to Clement, ''there is no language in the statute that supports a finding of diminishment.''

Clement added that if the court were to rule in favor of Nebraska, the parties would then have to reconstruct a right-of-way in order to preserve a jurisdictional boundary.

Justice Ruth Bader Ginsburg questioned Clement on what else the tribe could do in the way of governance in the area besides the liquor sales tax. Clement responded that there is a potential to disrupt the existing revenue-sharing agreement with the state, as well as make cooperative agreements with the state to tax Indians when they make purchases in Pender, the only village on the disputed land.

Further, when two tribal members are involved in an altercation in Pender, the tribal authorities could be contacted and could handle the matter in tribal court, he explained.

The DOJ's Allon Kedem, who argued against Nebraska, urged the court to consider that the outcome of the case could have potentially disturbing ramifications.

''The single most unsettling thing that this Court could do would be to suggest that the borders of those reservations depend not on what Congress said about them, but on shifting demographic patterns or who provides what services where,'' Kedem said.

No date has been set as to when a decision is expected.

By Matthew Beddingfield

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☐ *A transcript of the oral arguments is at http://www.supremecourt.gov/oral_arguments/argument_transcripts/14-1406_8n59.pdf.*

South Carolina

Procedure

South Carolina Department of Revenue Issues Motor Vehicle Sales Tax Guide

The tax implications in South Carolina for motor vehicle sales, rentals, leases, loans and repairs have been outlined for dealers doing business in the state.

The Sales and Use Tax Guide for Automobile and Truck Dealers (2016), released by the state Department of Revenue (DOR) Jan. 20, covers transactions to both in-state and out-of-state residents and also describes the taxation of guaranteed asset protection waivers, a financial product authorized under a recently enacted state law (S. 441; Act No. 2015-31).

Guaranteed asset protection waivers are offered to vehicle purchasers and are generally an additional charge for a waiver of amounts due on a borrower's finance agreement in the event of a total loss of the vehicle. According to the DOR, such waivers provided by auto dealers aren't subject to state sales tax as long as associated charges are only included in the finance agreement and are separately stated from the vehicle's sales price.

Bonnie Swingle, a spokeswoman for the DOR, told Bloomberg BNA Jan. 20 that vehicle dealerships had sought guidance on the taxes they face from her department. The tax treatment of loaner cars and the newly authorized guaranteed asset protection waivers were of particular concern, she said.

By Andrew M. Ballard

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☐ *Text of the guidance is at http://src.bna.com/b9e.*

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Tennessee

Tax Compliance

Bills Pending in Tennessee Aim To Roll Back Sales Tax Compliance Effort

An effort to roll back the recent expansion of a Tennessee sales tax compliance program is underway.

Companion bills (H.B. 1490/S.B. 1475) have been introduced in the state Legislature to repeal an expansion of the retail accountability program that was enacted during the 2015 session. Business groups have said compliance with the expanded law has been costly due to a substantial reporting requirement that frequently triggered audits.

The compliance program at issue was initially launched in 2012 and aimed to compare wholesalers' reports of beer and cigarette purchases against tax returns filed by retailers in an effort to encourage sales tax remittance. The program was expanded to cover sales of additional goods—such as snacks, automotive products and beauty care items—under Public Act 2015-342 enacted in May 2015

Under the pending legislation, the program would revert to covering beer and tobacco products. The measures also would require the Tennessee Department of Revenue (DOR) to conduct audits of sellers prior to issuing assessments, rather than doing so just on the basis of the information reports submitted by retailers under the current requirements.

Businesses Seeking Changes. Bradley Jackson, vice president of government affairs and community outreach for the Tennessee Chamber of Commerce & Industry, told Bloomberg BNA Jan. 21 that his group has joined with several other business groups representing the retail and grocery sector in seeking the changes included in the pending bills.

According to Jackson, ''we understand the problems and the logic in the 2012 legislation'' aimed at addressing tax evasion and other compliance issues from retail sales of beer and tobacco products. However, he said, the 2015 expansion has imposed a substantial burden on grocers through its reporting requirements and frequent audits.

The DOR has made ''a number of pretty significant changes'' to the program administratively, according to Jackson. However, he said, business groups support an easing of requirements made through changes to the law, so they are less likely to be altered administratively.

''We are trying to reign in the program and make it workable,'' Jackson told Bloomberg BNA.

DOR: Program Successful. Kelly Cortesi, a spokeswoman for the Tennessee DOR, told Bloomberg BNA Jan. 19 that the compliance program and its 2015 expansion were important to collecting taxes due to the state.

According to Cortesi, the retail accountability program ''vastly improves the state's ability to collect taxes that Tennessee consumers pay to retailers, but retailers do not remit promptly to the state.'' She said that Tennessee has collected more than $60 million in additional revenues during the program's first two-and-a-half years.

The state revenue agency pushed for the expansion during the 2015 legislative session because of the program's success, Cortesi told Bloomberg BNA. ''We have been working with the business community on improvements to the program since [the expansion] legislation was passed last year,'' she said.

Among the improvements Cortesi cited were the imposition of new reporting requirements only for food and beverage products; the simplification of such reporting; and an exemption for wholesalers making less than $500,000 in food and beverage sales. She said the DOR also has created an inquiry letter to provide additional time and opportunity for taxpayers to review department findings prior to an assessment.

By Andrew M. Ballard

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☐ *Text of the pending legislation is at http://src.bna.com/b6t.*

Property Taxes

California

Water Restoration

San Francisco Voters to Decide Fate Of $500 Million Water Restoration Measure

San Francisco Bay Area voters will decide in June whether to levy a $12 a parcel tax to fund $500 million in water restoration projects and climate-related flood protection.

The San Francisco Bay Restoration Authority approved a resolution to put on the ballot the measure that would raise $25 million a year for 20 years in the nine-county Bay Area.

The funds would be used for activities that would reduce toxins and trash, improve water quality, restore habitat and increase shoreline access along the interconnected waterways.

About 90 percent of the wetlands around the San Francisco Bay have been destroyed or permanently altered, while much of the surrounding lands are fully developed or heavily urbanized, said Ian Wren, staff scientist for San Francisco Baykeeper, an organization that advocates for the health of the San Francisco Bay.

Public-Private Partnerships. ''As sea levels rise, a lot of our existing wetlands are going to be inundated, so there's a need to restore the areas upland of those and some of the historic wetlands in order to provide for wetlands that may be lost in the future,'' which will provide water quality improvement and reduced flood risk, Wren told Bloomberg BNA on Jan. 15.

The $25 million ''can get you so far when you're talking about restoration projects,'' and can then be used to leverage more funding from the private and public sectors for larger restoration projects, Wren said.

Sejal Choksi-Chugh, executive director of San Francisco Baykeeper, said Jan. 15 that she expects great support. ''It is a very small amount but it is going to result in a large amount of money for protecting the shoreline from rising waters.''

The measure also is backed by the Silicon Valley Leadership Group, Choksi-Chugh told Bloomberg BNA. The group's members include Facebook Inc., Google Inc. and Oracle Corp.

Tax Proceeds to Pay Project Bonds. The San Francisco Bay Area Clean Water, Pollution Prevention and Habitat Restoration Measure would authorize projects in Alameda, Contra Costa, Marin, Napa, San Francisco, San Mateo, Santa Clara, Solano and Sonoma counties.

The measure approved Jan. 13 would split funds among the areas. A minimum of 9 percent would fund projects in the North Bay, 18 percent in the East Bay, 11 percent in the West Bay and 12 percent in the South Bay. The remaining funds would be allocated and, like the designated projects, would be overseen by an independent citizen committee.

The tax proceeds would pay off bonds the authority issues for water projects. The California Legislature in 2008 created the restoration authority to raise local funds to restore critical bay water habitat.

By Joyce E. Cutler

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New Jersey

Exemptions

Challenge to Princeton's Tax-Exempt Status Will Proceed, New Jersey Tax Judge Rules

A closely watched challenge to Princeton University's tax-exempt status will go to trial in October after a New Jersey Tax Court judge denied the university's motion to dismiss the case (*Fields v. Trs. of Princeton Univ.*, N.J. Tax Ct., No. 005904-2014; 007556-2015, 2/5/16).

The Feb. 5 denial by New Jersey Tax Court Judge Vito L. Bianco is the latest setback for Princeton in a lawsuit filed by four property owners in the town. The ruling follows Bianco's decision in November that Princeton has the burden of proving it deserves its tax-exempt status. Nonprofits in New Jersey say they're closely watching the case and are concerned that a ruling against Princeton could open them up to costly third-party challenges.

''While the judge refused to dismiss the complaints, he did order the plaintiffs to file, within 30 days, a list of the specific properties that are challenged,'' Princeton spokeswoman Min Pullan told Bloomberg BNA in a Feb. 10 e-mail. ''This is essential for trial preparation, and we appreciate the judge's order that plaintiffs provide a specific listing.''

Since 2011. The case began in 2011, when the taxpayers filed a complaint challenging property tax exemptions on 21 parcels owned by Princeton, saying the buildings operated as concert halls, private clubs and restaurants, and served various other non-academic functions that did not deserve tax-exempt status (*Lewis v. Trs. of Princeton Univ.*, N.J. Tax Ct., No. 10656-11, 4/1/11).

After the municipal tax assessor continued to grant Princeton's tax exempt status in 2012, 2013 and 2014, four of the taxpayers from the initial complaint filed

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complaints in 2014 and 2015 challenging Princeton's exemption in toto, court documents say.

The plaintiffs argue that the university's tax exemption is improper and their property taxes are higher as a result. The plaintiffs say Princeton isn't qualified to receive a tax-exempt status since it engages in profit-seeking conduct through patent, trademark and copyright licensing; venture capital businesses; retail; real estate rental; and other investment operations, according to the complaints.

Princeton University received more that $117 million in patent royalties in 2011 alone, the 2014 complaint says.

Burden of Proof. In November, in response to a July 14, 2015, motion from Princeton asking the judge to clarify which party had the burden of proof, Bianco ruled that Princeton held the burden of proving it deserves its tax-exempt status, even though the challenge came from a third party and not the tax assessor or the municipality.

''This court can find no compelling reason why an appeal by third-party taxpayers challenging a tax exemption granted by either an assessor or a county board of taxation should be treated any differently than a similar appeal instituted by the taxing district,'' Judge Bianco wrote in his Nov. 5 ruling. The Superior Court of New Jersey upheld that decision in January, denying Princeton's appeal.

Broader Impact. The tax court's rule transferring the burden of proof from third-party taxpayers to the university sets ''a dangerous precedent'' that could make nonprofit property owners ''vulnerable to arbitrary and sweeping challenges that would be extremely costly, time-consuming and difficult to defend,'' the Center for Non-Profit Corporations, Inc., an umbrella organization serving the state's 30,000 nonprofits, said in a Dec. 7 amicus brief in support of the university.

''We are very concerned at the implications to the broader community,'' Linda M. Czipo, the Center for Non-Profits' executive director told Bloomberg BNA Feb. 17.

The center is advising nonprofit organizations in New Jersey to look closely at their operations, talk to legal counsel and assess their vulnerabilities to challenge, Czipo said. ''Nonprofits need to be prepared. It's another facet for risk management,'' she said.

The university is preparing for trial, which the court has scheduled to begin in October 2016, Pullan said.

Attempts to reach Bruce I. Afran, the plaintiffs' attorney, were unsuccessful.

By Leslie A. Pappas

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☐ *The Feb. 5 denial is at http://src.bna.com/cG8.*

For additional discussion of property tax exemptions in New Jersey, see Property Tax Navigator, at New Jersey 7.1.

Illinois

Exemptions

Illinois AG Appeals Ruling Voiding Statute Giving Tax Exemptions to Nonprofit Hospitals

The legal battle between local units of government in Illinois and nonprofit hospitals over the provision of property tax exemptions in return for ''charity care'' is headed to the Illinois Supreme Court, with the state attorney general and one of the affected hospitals planning appeals, sources told Bloomberg BNA.

The appeals respond to a Jan. 5 ruling by a three-judge panel of the Illinois Appellate Court, which unanimously voided Section 15-86 of Illinois Public Act 97-688, which sought to create a new category of ownership for charitable property tax exemption to be applied to nonprofit hospitals and hospital affiliates (*Carle Found. v. Cunningham Twp.*, Ill. App. Ct., No. 140795, 1/5/16).

The panel found the Illinois General Assembly had inappropriately expanded the property tax exemption available under Article IX, section 6 of the Illinois Constitution, which reserves such tax benefits for properties used exclusively for charitable purposes (23 Multistate Tax Report 44, 1/22/16).

Spokespersons for both Illinois Attorney General Lisa Madigan (D) and Carle Foundation Hospital in Urbana, Ill., confirmed Feb. 3 that appeals will be filed prior to a Feb. 9 deadline.

''This is about much more than a local property tax exemption,'' Carle Foundation said in a statement dated Jan. 28. ''It is about defining the rules and making clear the laws that govern hospitals and municipalities alike. Most importantly, it is about tens of thousands of people in Illinois receiving lifesaving treatment for free via charity care programs at not-for-profit hospitals.''

The hospital's statement came one day after the Champaign County Board of Review voted to shift the tax status of Carle Foundation and Presence Covenant Medical Center, also affected by the appeals court ruling, from exempt to nonexempt. County officials were expected to quickly provide the hospitals with assessments for 2015 taxes.

Previous Ruling Raises Doubts. The Illinois Supreme Court has previously expressed doubts about the tax-exempt status of nonprofit hospitals. In a landmark 2010 decision (*Provena Covenant Med. Ctr. v. Dep't of Revenue*), the court found Provena Covenant Medical Center in Urbana, Ill., wasn't entitled to a property tax exemption, citing lack of evidence the hospital functioned as a charitable institution (17 Multistate Tax Report 216, 4/23/10).

The *Provena* ruling led to an aggressive lobbying effort from the hospital industry in 2012 for P.A. 97-688, which was supposed to provide legal certainty to nonprofit hospitals over the status of their coveted property tax exemptions. Among other things, the law created standards for the provision of charity care to indigent and low-income individuals and permitted hospitals to categorize a menu of new services, subsidies and support activities as charity care.

In a related development, attorneys for Madigan filed a motion for a stay of enforcement pending a review by the supreme court. The motion was filed on behalf of the Illinois Department of Revenue, which is currently reviewing five applications for property tax exemption from hospitals.

''The Department of Revenue is seeking further appellate review in the Supreme Court of Illinois, but anticipates that it will continue to receive exemption applications based on section 15-86 during the time the Carle appeal progresses,'' Assistant Attorney General Carl J. Elitz wrote on Jan. 28. ''Without relief from the judgment, its authority to do so (or to take any action on pending applications) is unclear.''

BY MICHAEL J. BOLOGNA

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☐ *The motion is at http://src.bna.com/coQ.*

New York

Assessment/Collection

Court Sides With Campground Owner In New York Town's Assessment Appeal

A mid-level appeals court in New York has backed an upstate campground owner's successful challenge to a town assessment that valued his property at more than $6 million, rather than the approximate $1.4 million determined by his own appraiser (*Matter of George A. Donaldson & Sons Inc. v. Assessor of the Town of Santa Clara*, N.Y. App. Div., No. 521264, 1/14/16).

In rejecting an appeal by the assessor of the town of Santa Clara, N.Y., a five-judge panel of the Supreme Court, Appellate Division, Third Judicial Department, ruled Jan. 14 that the property owner had rebutted the town's assessment with ''substantial evidence.''

Under New York law, a tax assessment is presumptively valid, but may be rebutted by substantial evidence where the property owner can demonstrate the existence of a valid and credible valuation dispute. The court noted that the ''substantial evidence'' threshold is minimal and ''not a heavy'' standard, and if the property owner's evidence is based on sound theory and objective data, the presumption of validity disappears.

The case ''affirms a well-established principle of New York tax assessment law: that while the initial burden is on the taxpayer to come forward with credible evidence of an over-valuation, once he does so the burden shifts to the municipality to present equally substantial evidence to rebut the taxpayer's proof,'' according to a property tax valuation practitioner.

Presumption of Assessment Validity. In the *Donaldson* decision, the appeals judges backed a Dec. 30, 2014, decision in state Supreme Court, Franklin County, that the property, including a lakeside campground resort in the Adirondack Mountains, had been overvalued for four years in question—2007, 2008, 2009 and 2010.

The property consisted of 700 acres, with 300 acres developed, including 100 campsites, a beach, a stone boathouse, small rental cabins and trailers, a store, other buildings and three historic wooden houses, two of which are rented and one vacant due to its poor condition. The remaining 400 acres of undeveloped excess or back land were marked by limited access, wetlands, steep slopes and drops, and a closed landfill.

Rejecting the town's argument that the property owner failed to rebut the presumption that the assessments were accurate, the court explained that a court must then weigh the entire record, including evidence of the claimed deficiencies in the assessment, to determine whether the preponderance of the evidence shows the property to be overvalued, they said.

''The case does not mean that a taxpayer will win simply by introducing such evidence, but rather that when he does do so his case cannot be summarily dismissed, and that the municipality must do more than simply rely upon a presumption that the assessment is valid,'' David Wilkes, an attorney with Huff Wilkes LLP in Tarrytown, N.Y., who chairs the Westchester County Bar Association Tax Certiorari Committee, said in a Jan. 20 e-mail. He added that ''a municipality that chooses to rely solely upon a defense that the taxpayer failed to meet its burden, and does not submit its own evidence, acts at its peril.''

Taxpayer's Proof. The case also speaks to the types of evidence that meet—or would fail to meet—the burden of overcoming the presumption of validity, Wilkes told Bloomberg BNA, pointing to the court's observation that the evidence ''will most often consist of a detailed, competent appraisal based on standard, accepted appraisal techniques and prepared by a qualified appraiser.'' He further explained that the taxpayer's proof must be based on established and recognized methods of valuation, but need not be extensive.

Agreeing with the trial court that the property owner had produced substantial evidence to rebut the presumption of the town's assessment's accuracy, the appellate panel gave weight to the private appraisal's income-based approach to value the developed acres and his market or comparable-sales approach to value the back land. Credit was given to his detailing of the specific sources of rental income for valuation of the developed income-producing portion of the property as ''a valuation method that has been recognized to be the best indicator of value with respect to income-producing property.''

The appellate court also found that the private appraiser's capitalization rate, ''although based in part on his personal experience and knowledge, was appropriately based upon specific income and expense numbers, as well as specified debt/mortgage and equity rates and the corresponding local sources of those rates.''

And there was no error found in the trial court's determination that the town shouldn't have valued the three historic cottages as if they could be subdivided from the property and sold for private residential use.

While calling the court's guidance helpful, Wilkes noted that ''an appraisal is not the only means by which a taxpayer may meet the substantial evidence test.''

Also, New York court rules set out the minimum requirements of an appraisal submitted for trial, Wilkes

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said, adding that ''anything the appraiser is relying upon for valuation must be included in the report—it's not enough to merely say on the witness stand if it's not in the written report.''

Zoning Restrictions Cited. Rental income generated by two of the cottages under ''their current state of use,'' minus repairs and maintenance costs, was properly relied upon by the trial court in the valuation, especially because outdoor zoning restrictions wouldn't have permitted any private residential subdivision.

Similarly, the appellate panel backed the trial court in its finding that the town had overvalued the back land ''without full appreciation of the topographical restrictions that would limit development.''

Justice Christine M. Clark wrote the opinion, with Presiding Justice William E. McCarthy and Justices John C. Egan Jr., Robert S. Rose and Michael C. Lynch concurring.

The town was represented by E. Stewart Jones Jr. and David R. Murphy of E. Stewart Jones Hacker Murphy in Latham, N.Y. The property owner was represented by Margaret J. Gillis of Whiteman Osterman & Hanna LLP in Albany.

By John Herzfeld

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☐ *The decision is at http://src.bna.com/b2L.*

For additional discussion of property tax assessment in New York, see Property Tax Navigator, at New York 6.3.

Illinois

Constitutional Limitations

Illinois Supreme Court Reviews Challenge To Chicago's Personal Property Lease Tax

The Illinois Supreme Court has agreed to review the constitutionality of Chicago's personal property lease transaction tax as it applies to rental car leases obtained from suburban locations within three miles of the city's boundaries (*Hertz Corp. v. City of Chicago*, Ill., No. 119945, *appeal accepted*, 1/20/16).

On Jan. 20, the court accepted a petition for leave to appeal filed by Hertz Corp. and Enterprise Leasing Co. The two vehicle-rental companies are calling on the court to review a September 2015 Illinois Court of Appeals ruling that found Chicago's taxation program wasn't an extraterritorial exercise of the city's authority (22 Multistate Tax Report 728, 10/23/15).

A Supreme Court clerk told Bloomberg BNA Jan. 26 that the court hadn't yet scheduled oral arguments in the matter.

Ruling No. 11. Tax attorney Stanley R. Kaminski, representing Enterprise, said the appeals court's ruling raises troubling questions about municipalities' authorities to impose their taxes on activity in neighboring jurisdictions.

''It could have wide-ranging implications if you could start expanding all of your laws to suburban transactions based on a presumption that maybe use will occur'' within your own jurisdiction, Kaminski, a partner with Duane Morris LLP in Chicago, told Bloomberg BNA in an interview Jan. 26.

The tax dispute involves Chicago's Personal Property Lease Transaction Tax Second Amended Ruling No. 11, which became effective May 1, 2011.

The 8 percent tax was imposed on personal property leased or rented in the city, as well as the privilege of using, while in the city, personal property leased or rented beyond the city.

While the tax must be paid by the lessee, the lessor is obligated to collect the tax and remit the funds to Chicago's Department of Revenue. The ruling placed collection obligations on rental agents with suburban addresses within three miles of the Chicago city limits.

Lower Courts Differ. Hertz and Enterprise won the first round in the dispute, arguing in circuit court that Ruling No. 11 was an extraterritorial exercise of Chicago's home rule authority. The companies also claimed the tax program violated the scope of the use tax ordinance and the due process and commerce clauses of the U.S. Constitution.

The circuit court agreed, declaring Ruling No. 11 to be facially unconstitutional. In addition, the court enjoined Chicago from imposing the tax as it pertained to vehicle leases transacted beyond the boundaries of the city.

The appeals court reversed the circuit court's ruling, affirming the constitutionality of Ruling No. 11. Among other things, the appeals panel said the challenge by Hertz and Enterprise had characterized the program as a transaction tax, rather than as a use tax. The court agreed that Ruling No. 11 is in fact a use tax, defined in the Chicago Municipal Code as ''a tax on the privilege of using leased personal property inside the city, regardless of where the lease transaction occurred.''

Surprising Opinion. Kaminski said the court's finding was inconsistent with traditional understandings of municipal taxing authorities' jurisdictional reach.

''The appellate court's decision was kind of a surprise because it basically allowed the city to extend its jurisdiction to suburban rental transactions based on an administrative presumption that use may occur in the city in the future,'' he said.

''So we thought that was really putting the cart before the horse,'' Kaminski said. ''Normally you determine you have jurisdiction and then you do a presumption. Here you have a presumption to give yourself jurisdiction.''

By Michael J. Bologna

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☐ *Text of Ruling No. 11 is at http://src.bna.com/cez.*

North Carolina

Valuation

County Improperly Assessed Solar Installation, North Carolina Court Rules

A North Carolina county arbitrarily assessed a solar heating system in a manner that appears to have substantially exceeded its actual value, an appeals court ruled (*In Re FLS Owner II, LLC*, N.C. Ct. App., No. 14-1399, 1/5/16).

, The North Carolina Court of Appeals said Jan. 5 that FLS Owner II LLC sufficiently demonstrated that Randolph County failed to follow statutory guidelines for appraisal and otherwise performed a flawed assessment of a solar heating system the taxpayer installed on its property in Asheboro. Therefore, the matter needs to be reconsidered by the North Carolina Property Tax Commission, the appeals court said.

In its ruling, the court said its consideration was a ''matter of first impression'' over the interpretation of N.C. Gen. Stat. Section 105-277(g), which requires solar heating and cooling systems to be valued by counties in the same manner as conventional systems.

A practitioner with expertise in state property tax issues told Bloomberg BNA Jan. 14 that the ruling is significant in that it calls for such solar installations to be assessed at the same value as their conventional counterparts and affirms a previous rejection of valuation methods long used by North Carolina's counties.

Replacement Cost. According to court filings, FLS purchased the solar heating system from its parent company for $1.7 million in August 2010. The system consists of 200 solar panels, two heat exchangers, indoor and outdoor piping and two storage tanks. It is used to produce hot water for the manufacturing process at FLS's Asheboro facility.

In 2011, the county initially appraised the system for $571,000 based on the installation cost listed in the building permit, then revised the appraisal to $1,056,917 later that year, based on the system's cost cited in a news release issued by the governor's office.

FLS contested the appraisal with the North Carolina Property Tax Commission, arguing that the county's appraisal was almost 19 times higher than it should be based on what it would cost to replace the system with an equivalent conventional one. In a September 2014 ruling, the commission dismissed the challenge and affirmed the county's assessment, which was based on the cost of replacing the system with another solar heating system.

The North Carolina Court of Appeals found that because the county used a news release to determine the system's value, failed to follow statutory guidelines for appraisal and didn't consider other relevant factors, FLS demonstrated that the county ''used an arbitrary or illegal method'' for appraising the system.

Because an expert testified before the commission that the county's appraisal was 19 times greater than the value of an equivalent conventional heating system, FLS also showed that the appraisal ''*substantially* exceeded the true value in money of the property,'' the appeals court said in ordering the commission to reconsider the issue.

Attorney: Significant Implications. Justin M. Hardy, an attorney with the Winston-Salem, N.C.-based law firm of Bell, Davis & Pitt who specializes in North Carolina property tax issues, told Bloomberg BNA Jan. 14 that there are two significant implications of the decision.

First, according to Hardy, the appeals court interpreted N.C. Gen. Stat. Section 105-277(g) to apply to solar heating and cooling systems themselves, rather than to the buildings to which the systems are attached. ''Solar heating and cooling systems should now be assessed at the same values as their conventional counterparts, regardless of the fact that they typically cost more to buy and install,'' he said.

''To the extent that there are solar heating and cooling systems in North Carolina which have not been given that treatment, their owners should certainly consider appealing assessments based upon the decision,'' Hardy said.

The second significant implication, he said, was that the appeals court cited its previous ruling in *In re IBM Credit Corp.* that rejected the application of historical cost to trending schedules issued by the state Department of Revenue, a valuation method that all 100 of North Carolina's counties have used .

The appeals court's citing of *IBM* in Randolph County's attempt to use that previously rejected method ''is, in effect, an affirmation that the long-used county method of valuing business personal property in North Carolina may no longer be acceptable,'' Hardy said.

By Andrew M. Ballard

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☐ *Text of the ruling is at http://src.bna.com/b15.*

Rhode Island

Property Tax

Wind Turbine Ruled Exempt From Property Tax in Rhode Island

The Rhode Island Supreme Court has ruled that a wind turbine located on residential property which produces energy that is sold to National Grid is manufacturing equipment and is therefore exempt from local property taxation under state statute (*DePasquale v. Cwiek*, R.I., No. 2015-83-Appeal, 1/14/16).

The court said in its seven-page opinion issued Jan. 14 that the wind turbine in question is used exclusively for the purpose of transforming raw material—wind—into a finished product—electricity—and as a result the taxpayer meets the definition of a manufacturer, making the turbine eligible for tax-exempt status.

The decision comes in an appeal from Linda Cwiek in her capacity as Tax Assessor for the town of North Kingstown, R.I.

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Assessed at $1.9 Million. The town had assessed a wind turbine built on property owned by Mark DePasquale at a value of $1.9 million and issued a tax bill seeking the payment of annual tangible personal property taxes. DePasquale took the position that the turbine was tax-exempt and appealed the assessment to two local tax boards, both of which denied the appeal.

DePasquale appealed the matter to the Rhode Island Superior Court which found that the wind turbine is manufacturing equipment and thus exempt and granted DePasquale's motion for summary judgment.

The town appealed that decision to the Rhode Island Supreme Court.

Town Argues 'Wholesale.' In its opinion, the supreme court rejected the town's argument that the manufacturing exemption allowed under state statute was inapplicable because DePasquale's sale of electricity from the turbine to National Grid constitutes a "sale at wholesale," which would place the turbine within the exclusion from the definition of manufacturing equipment.

The court also rejected the town's contentions based on a separate statute which allows that municipalities may, by ordinance, exempt from taxation any renewable energy system located in the city or town. Citing the statute, the town argued that renewable energy systems are tax exempt *only* if a municipality enacts an ordinance to that effect.

The town also argued that this statute reflects legislative intent that renewable energy systems are generally taxable and that, in adopting this statute, lawmakers gave municipalities that authority to exempt such systems from taxation should the municipality choose to do so.

Grant Tax Exemption. But the court said, contrary to the town's argument, the state statute "merely grants the various cities and towns the authority to grant tax exemption to renewable energy systems **in addition to** the tax exemptions already provided" under statute.

Providence, R.I. attorney Lauren E. Jones, who represented DePasquale before the supreme court, told Bloomberg BNA that they were pleased with the court's decision. And she noted that importantly, the decision applies state-wide to alternative energy sources and not just to the single turbine located in North Kingstown.

Providence Attorney Seth Handy, who also represented DePasquale, told Bloomberg BNA Jan. 21 that they had offered to settle with the town by agreeing to the payment of a fee in lieu of taxes, but that North Kingstown has declined to settle the case. Handy said he is working with state legislators and municipal officials to develop legislation creating a state program under cities and towns would receive a host payment. This would allow the communities in Rhode Island to receive a fee, but in a manner that is consistent across the state and in a way that wouldn't discourage the development of alternative forms of energy.

The town was represented by James H. Reilly of Kelly, Kelleher, Reilly & Simpson in Providence. He couldn't be immediately reached for comment.

By Martha W. Kessler

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☐ *The court ruling is at http://src.bna.com/b9s.*

Ohio

Exemptions

Ohio Supreme Court Says County-Owned Profit-Generating Land Not Tax-Exempt

Park-adjacent land owned by Cuyahoga County that's leased for commercial purposes isn't eligible for a property tax exemption, according to the Ohio Supreme Court (*Cuyahoga Cty. v. Testa*, Ohio, Slip Opinion No. 2016-Ohio-134, 01/19/2016).

Affirming a ruling by Ohio's tax commissioner, upheld by the Board of Tax Appeals (BTA), the court said Jan. 19 that marina and restaurant operations run by an outside agent "must be evaluated separately from the public park."

The county argued that Whiskey Island, which has an event venue, marina and restaurant, should be evaluated together with Wendy Park as a unit. Both are owned by the Cleveland Metroparks system.

Ohio tax commissioner Joseph Testa invoked his authority under R.C. 5713.04 to order a split between the taxable and exempt portions: the park was declared to be exempt as "public property used exclusively for a public purpose" pursuant to R.C. 5709.08(A)(1), while the marina and restaurant were retained on the taxable-property list.

Not 'Unreasonable.' In its unanimous ruling, the high court ruled that the BTA's finding—that Whiskey Island, when considered separately from the park, isn't exempt—"is neither unreasonable nor unlawful."

Whiskey Island, a 65-acre lakefront property acquired by Cuyahoga County in 2004, is run by a third-party management team that receives a management fee of 7.5 percent of the gross revenue realized from the operations of the marina and restaurant.

Although Cuyahoga County contested the "view to profit" finding put forth by the commissioner and the BTA, over time, Whiskey Island enterprises served as a revenue source for developing the park, the court said, "thereby raising the inference that its purpose in the eyes of the county was to generate funds."

This revenue didn't simply cover the costs of maintaining Whiskey Island, the court said: "It was 'profit' in the sense that the surplus was used for something other than defraying the costs incurred by the marina and restaurant themselves."

In addition, long-term dock leases, running 90-years or more, can be viewed as a use of property "in furtherance of or incidental to" a public purpose in the qualitative sense, the court said.

By Bebe Raupe

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☐ *The court's opinion is at http://src.bna.com/cas.*

For additional discussion of property tax exemptions in Ohio, see Property Tax Navigator, at Ohio 7.1.

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Miscellaneous Taxes

Alaska

Excise Tax

Alaska Department of Revenue Proposes Draft Marijuana Tax Regulations

The Alaska Department of Revenue is proposing a two-tiered system for levying excise tax on recreational marijuana in draft regulations issued Jan. 15.

The draft regulations call for a $50-per-ounce tax rate on the potent flowers and immediately surrounding foliage called sugar leaf, and $15 per ounce for the remainder of the plant. The underlying statutory authority, Alaska Stat. Section 43.61.010, provides that the department may exempt certain parts of the plant or establish a rate lower than $50 for specified parts of the plant.

Voters passed a 2014 ballot measure legalizing the sale of marijuana and providing for its taxation. The measure took effect in February 2015. Retail establishments can start applying for a license in February and the state Marijuana Control Board has three months to issue those licenses. The revenue department is planning on first collecting tax revenue in FY 2017, the department's fall 2015 Revenue Sources Book says.

The amount of revenue is ''highly unpredictable,'' the sources book says, because ''it is unknown how many marijuana businesses will be licensed to open, how many consumers there are, and what percentage of those will switch their consumption to the legal and taxable market.'' Department officials have been using a preliminary revenue estimate for FY 2017 of $12 million.

'Benefit to the Industry.' Brandon Spanos, deputy director of the Tax Division, told Bloomberg BNA Jan. 20 that adopting different rates for different parts of the plant is ''a benefit to the industry'' because of the divergent commercial value of the potent flowers and less potent portions of the plant that are used for making oils that can go into products such as baked goods and electronic cigarettes.

The draft regulation would require a cultivation operation, as defined in Alaska Stat. Section 17.38.090, that is also a licensed marijuana product manufacturing facility to pay tax on all marijuana transferred from the growing operation to the manufacturing facility. A cultivation facility that is also licensed as a retail store must pay the excise tax on marijuana transferred from the grow operation to the store.

Spanos said of those provisions that while the marijuana ''is only taxed once, we are just noting that if you have different types of the business, that you can't avoid the tax by simply transferring it to another site.''

Federal Law Hampers Industry. Because marijuana remains illegal under federal law, the industry has been hampered in states where it has been legalized, such as Washington and Colorado, by a lack of access to banking services .

To address that limitation, Spanos said the department will ''most likely have a cash-deposit location in Anchorage where a taxpayer can bring their cash in and deposit it in a drop box.'' But he added that the department is hopeful that tax payments will follow the pattern that he said has emerged in Washington where about 80 percent of tax payments have been made electronically.

By Paul Shukovsky

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☐ *The draft regulations are at http://src.bna.com/b9Q.*

For additional discussion of excise tax on nonmedical marijuana in Alaska, see Excise Taxes Navigator, at Alaska 2.4.

Vermont

Excise Taxes

Vermont Panel Proposes Taxing Retail Marijuana Sales at 25 Percent

Vermont's Senate Finance Committee has proposed a 25 percent tax on recreational marijuana as part of a bill to legalize the drug in the state.

On a vote of 6-1, the panel Feb. 12 approved S. 241 with language calling for an excise tax of 25 percent on sales of marijuana at retail outlets. The excise tax would be in addition to any local sales and use taxes, according to the bill.

Sales through medical marijuana dispensaries would be exempt from the excise tax.

The bill attempts to soften the impact of Section 280E of the federal tax code , which states that expenditures in connection with the illegal sale of drugs aren't allowed as business deductions or credits. The Internal Revenue Service has said it plans to provide guidance addressing the issue .

Under the bill, Vermont net income won't include amounts a marijuana retailer would have been able to deduct from federal income taxes for testing, cultivation, processing and sales of marijuana if not for the Section 280E provision.

''It's a good bill if you are looking to be in this business,'' Richard Wolfish, a certified public accountant with Gallagher, Flynn & Company LLP in South Burlington, Vt., told Bloomberg BNA Feb. 16.

Tax License. Retailers would have to apply for a marijuana excise tax license from the commissioner of taxes and pay a $15,000 retailer licensing fee.

Retail outlets would be able to open for business starting Jan. 2, 2018. Retail establishments would have to provide a statement to the Department of Taxes by the 15th day of each month detailing the amount of sales and the estimated amount of taxes owed.

The taxes collected would go into a marijuana tax fund. Twenty-five percent of the tax revenues would be allocated to drug abuse prevention, 25 percent to drug abuse treatment and 25 percent to combat the illegal drug trade. The remaining 25 percent would go to the general fund to administer, implement and enforce the provisions of the bill.

State government would spend $2.21 million to administer the legalization program, including $920,000 within the Department of Taxes, Andy Pallito, commissioner of the Department of Finance and Management, told the committee during a Feb. 9 hearing.

The tax would generate between $13.4 million and $20.8 million in revenue in 2018, the first full year of marijuana legalization, according to estimates provided to the finance committee by Sara Teachout, senior fiscal analyst with the Legislative Joint Fiscal Office.

Vermont residents would be allowed to purchase up to one ounce of marijuana in a single transaction, and buyers from out of state could purchase one-quarter ounce.

End of Marijuana Prohibition. ''I am encouraged by the deliberate approach the Senate is taking on this issue, using the lessons learned from other states to craft a bill that is well thought out. We can take a smarter approach and I look forward to continuing to work to get a bill that ends the failed era of marijuana prohibition in Vermont,'' Gov. Peter Shumlin (D) said Feb. 12.

If the bill is adopted, Vermont would join Alaska, Colorado, Oregon and Washington state in legalizing recreational marijuana. Vermont's marijuana stores would have competition from nearby retailers in Maine if a Nov. 8, 2016, ballot initiative there to legalize recreational marijuana is adopted. It would impose a 10 percent tax on retail sales of marijuana .

S. 241 is now under consideration by the Senate Appropriations Committee and must also be approved by other Senate committees. Proponents have a goal of favorable passage by the full Senate by March 1. It would then head to the House on a tight schedule, as the Legislature will adjourn in May.

By Adrianne Appel

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☐ *Text of S. 241 is at http://src.bna.com/cFd.*

For additional discussion of taxes on medical and non-medical marijuana in Vermont, see Excise Taxes Navigator, at Vermont 5.3 and Excise Taxes Navigator, at Vermont 2.4.

Colorado

Tobacco Tax

Colorado Cigarette Sales Rise for First Time Since 2005 Tax Hike

Cigarette sales in Colorado increased in 2015 for the first time in almost 10 years, reversing a trend of decreasing sales that began after voters increased the state's tobacco tax in 2004, according to the Colorado Department of Public Health and Environment.

Sales of cigarettes in Colorado rose to 194.4 million packs in 2015, up 1.1 million, or 0.7 percent, from 2014, the department said in a Feb. 17 news release. State cigarette sales stayed at about 300 million packs a year from 1990 through 2004. After voters raised taxes by 64 cents per pack, sales plunged to 226.7 million packs in 2005 when the tax took effect, recovered temporarily in 2006, then continued to fall over the next decade to a low of 193.2 million packs in 2014.

Studies confirm that increases in the cigarette tax reduce smoking, especially among young people, but that tax increases lose their effectiveness after about seven years. Colorado's cigarette tax was one of the lowest in the nation before the 2004 increase. Now, Colorado's 84-cents-per-pack tax ranks 37th in the nation and is about half the national average of $1.60 per pack, the department said.

''While we've made progress in protecting Coloradans from the toxic effects of tobacco, this increase in cigarette sales tells us there is more work to be done,'' said Larry Wolk, the department's executive director and chief medical officer. ''Colorado's tobacco tax initially encouraged many smokers to quit, and continues to fund our efforts to prevent young people from starting and help current smokers quit.''

Smoking rates continue to fall in Colorado, but at a slower pace. From 2004 through 2014, the percentage of adult tobacco users decreased from 20 percent to 15.7 percent.

By Tripp Baltz

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☐ *Text of the news release is at https://www.colorado.gov/pacific/cdphe/news/colorado-cigarette-sales-rise-first-time-decade.*

For additional discussion of taxes on cigarettes in Colorado, see Excise Taxes Navigator, at Colorado 2.1.

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Illinois

Electronic Commerce

Illinois Towns Seek Summary Judgment In Claims Targeting Online Travel Companies

Confident that Expedia Inc., Orbitz LLC, Priceline.com Inc. and Travelocity.com LLC can no longer hide behind a previously shrouded business model, 13 Illinois municipalities are seeking an order imposing liability on the online travel companies in their campaign for tens of millions of dollars in unpaid lodging taxes, penalties and punitive damages (*Vill. of Bedford Park, et al. v. Expedia, Inc.*, N.D. Ill., No. 1:13-cv-05633, *motion for summary judgment*, 2/9/16).

The municipalities, led by the Village of Bedford Park, Ill., filed a motion for summary judgment in U.S. District Court for the Northern District of Illinois on Feb. 9 as part of their long-running tax dispute with the OTCs.

The towns and villages called on Judge Matthew F. Kennelly to find the travel companies liable on their claims for declaratory judgment and violations of each community's ordinance taxing hotel and motel accommodations. A win for the municipalities would open the door to a penalty phase in the litigation.

Like dozens of similar lawsuits brought by states and municipalities across the country, the Illinois suit focuses on the OTCs' merchant model, which was developed in the 1990s, long after most local hotel occupancy taxes were enacted. The merchant model amounts to a distribution strategy that uses third-party websites to offer hotel rooms, instead of offering that inventory directly from a hotel or a travel agent. The hotels generally offer their inventory to the OTC merchants at a 25 percent discount.

The 13 Illinois communities contend the OTCs should remit taxes calculated against the higher retail rate paid by consumers, rather than the discounted wholesale rate negotiated between OTCs and hotels. OTCs have successfully argued in various courts across the country that they aren't obligated to submit taxes to states and municipalities on the markup—the difference between the retail rate paid by consumers and the lower wholesale rate OTCs provide to hotels (22 Multistate Tax Report 514, 7/24/15).

New Evidence. The Illinois plaintiffs, however, are armed with additional evidence that could force new defensive strategies for the OTCs, which also are also referred to as online travel agencies (OTAs).

According to the plaintiffs' petition, discovery during the litigation forced Expedia to disclose previously unknown mathematical formulas used to calculate the taxes and fees it charges consumers. While information about such formulas was redacted from the petition, the plaintiffs stated the OTCs revealed they calculate all taxes and fees based on the total cost consumers pay for accommodations—the retail rate.

Additionally, the municipalities argued that while the OTCs portray themselves as mere facilitators in room rental transactions, they are actually controlling players. In that capacity, the towns and villages asserted the OTCs have engaged in a ''well-guarded scheme'' to cheat them of tax revenue.

''They collect from consumers the retail rate of the room plus, as their formulas show, applicable taxes based on the retail rate of sale,'' the petition states. ''Further, from the time of payment until the consumer checks in to the hotel, the OTAs control all aspects of the transactions, including reservation modifications, cancellations, refunds, and customer service. Per the plain language of Plaintiffs' tax ordinances, these facts demand judgment against the OTAs and in favor of the Plaintiffs on Plaintiffs' claims for declaratory judgment (Count 1) and violations of municipal ordinances (Count 2).''

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☐ *The motion is at http://www.bloomberglaw.com/public/document/Village_of_Bedford_Park_et_al_v_Expedia_WA_et_al_Docket_No_113cv0/3.*

For additional discussion of the hotel tax in Illinois, see Excise Taxes Navigator, at Illinois 10.1.

Alabama

Hotel Tax

Airbnb Agrees to Collect Alabama Lodging Tax Beginning March 1

Airbnb Inc. will begin collecting Alabama lodging taxes for its room rental listings in the state on March 1, under an agreement reached with the Alabama Department of Revenue.

''This agreement will increase compliance in this area, and I commend Airbnb's willingness to take the steps necessary to ensure that the appropriate taxes are being remitted,'' Alabama Revenue Commissioner Julie P. Magee said Feb. 17.

Airbnb has reached similar agreements with other jurisdictions, including Illinois, Florida, North Carolina, Rhode Island, Philadelphia, Phoenix, San Diego and Paris (22 Multistate Tax Report 862, 12/25/15).

The company provides online listings and bookings for room rentals, often in private homes and bed-and-breakfast inns that customers choose as an alternative to hotels.

Alabama law already requires payment of its state and local lodging taxes for these types of rentals, but collection and enforcement are challenging because the property owners often are private individuals, not businesses, according to the DOR.

Taxes Estimated at $300,000. Under the agreement, Airbnb will collect the tax on behalf of property owners and remit it to the Alabama DOR. This includes the state lodging tax of 4 percent or 5 percent—varying by county—as well as all local lodging taxes that the DOR

collects, although some Alabama counties collect their own.

Alabama's DOR estimated the agreement would generate up to $300,000 in tax revenue over the next year, with the figure expected to grow in future years, Frank Miles, a DOR spokesman, told Bloomberg BNA Feb. 17. He declined to comment on what promises or incentives Alabama might have agreed to, saying the terms of the agreement are confidential.

Airbnb released a four-page community compact in November 2015, in which the company said it will work cooperatively with cities to develop appropriate regulations for home-sharing rentals and to help ensure hotel and tourist taxes are paid (22 Multistate Tax Report 804, 11/24/15).

By Chris Marr

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☐ *For additional discussion of Alabama's hotel tax, see Excise Taxes Navigator, at Alabama 10.1.*

South Carolina

Fuel Tax

South Carolina DOR Issues Fuel Conversion Guidance

Every gallon of liquefied propane gas used in vehicles is equivalent to 0.73 gallons of motor fuel for purposes of the South Carolina user fee, according to the state Department of Revenue.

In Revenue Ruling No. 16-1, released Feb. 8, the DOR said that every 126.67 cubic feet of compressed natural gas is equivalent to one gallon of motor fuel. In addition, 5.66 pounds of natural gas dispensed using a mass flow meter is equivalent to one gallon of motor fuel, and the diesel gallon equivalent for liquefied natural gas is 6.06 pounds.

South Carolina imposes a tax of 16 cents per gallon as well as 0.75 cents per gallon in inspection and environmental impact fees on users of motor fuels. Taxpayers had requested that the DOR provide guidance on how to convert compressed and liquefied natural gas used in a motor vehicle to gallon equivalents.

The revenue ruling includes the same information as a draft version released in December 2015, but adds a conversion for liquefied propane gas .

By Andrew M. Ballard

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☐ *Text of Revenue Ruling No. 16-1 is at http://src.bna.com/czv.*

For additional discussion of the motor fuel user fee in South Carolina, see Excise Taxes Navigator, at South Carolina 8.1.

Multistate Developments

Constitutional Limitations

Retailer Asks D.C. Circuit to Keep Alive Challenge to Tax on Internet Cigarettes

A Seneca Indian retailer of tobacco products urged the D.C. Circuit Court to keep alive its five-year constitutional challenge to a federal law—the Prevent All Cigarette Trafficking Act—requiring e-sellers of tobacco to comply with state and local excise tax requirements on all sales (*Gordon v. Lynch*, D.C. Cir., No. 15-5113, *oral arguments*, 2/5/16).

Aaron M. Streett, counsel for taxpayer Robert Gordon, argued Feb. 5 that the lower D.C. District Court erred by dismissing the matter as moot after Gordon ceased operations. Seeking reversal and remand, Streett raised concerns with state and local taxing authorities initiating proceedings to claim unpaid back taxes owed by Gordon under the Prevent All Cigarette Trafficking (PACT) Act.

Observing that the PACT Act ''is the only thing that causes the tax burden to arise on Mr. Gordon in the first place,'' Streett argued that there remains a live controversy and the District Court should consider the merits of Gordon's request for declaratory and injunctive relief.

''A declaration that those tax provisions are unconstitutional and cannot be applied to Mr. Gordon would prevent the burden from arising in the first place and would eliminate the harm that Mr. Gordon suffers,'' Streett said.

The three-member D.C. Circuit panel appeared to resist a revival of Gordon's claims, with Chief Judge Merrick B. Garland and Judge Stephen F. Williams maintaining that any ruling wouldn't bind those states not party to the case. Doubts also surfaced over Streett's arguments that equitable principles worked against the District Court's finding of mootness.

''I am constantly reminded by the Supreme Court that I should try to avoid thinking about whether a Congressional statute is constitutional if I don't have to,'' Chief Judge Garland said, adding later that ''even if I had jurisdiction, I wouldn't exercise my equitable authority here, my equitable discretion here, because I don't want to reach a constitutional question I don't have to, and I don't need to because you guys are protected.''

Absence of Future Harm. Gordon initiated the lawsuit prior to the PACT Act taking effect in 2010, contesting the law as violating the due process clauses of the Fifth and Fourteenth Amendments. The district court granted a preliminary injunction enjoining the provisions mandating compliance with excise collection requirements .

Before a divided D.C. Circuit panel affirmed the preliminary injunction and remanded for consideration of a declaratory judgment and permanent injunction, Gordon closed his business. He and the government later submitted with the D.C. District Court a joint stipulation explaining that Gordon wouldn't reopen. The District Court dismissed the case as moot and vacated the preliminary injunction.

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Invoking the collateral consequences doctrine, which can override mootness where future adverse repercussions may arise, Streett argued that Gordon has a tax liability on the books. Without a judgment declaring the PACT Act unconstitutional, the law continues to authorize states to demand unpaid taxes from Gordon, who didn't pay taxes while the preliminary injunction was in effect.

Garland and Williams dismissed the impact of a judgment on states not named as parties and shared skepticism regarding the likelihood that states would pursue taxes unpaid ''during a preliminary injunction which authorized your behavior.''

Garland, in particular, noted that the taxpayer has a remedy insofar that he can defend against future claims by raising a constitutional challenge to the PACT Act at that time.

''There is no future act that you need protection from, and therefore no chilling effect in the normal sense that we are concerned about with a preliminary injunction,'' Garland said. ''It is only about your past acts, which you've already done. You've either violated the law or not. You're either going to be sued by a state or not. It's not going to affect your primary behavior anymore. And so you have an adequate remedy.''

Agreement Not to Prosecute. In another lawsuit, the Southern District of New York awarded New York City a preliminary injunction against Gordon for alleged violations of state and federal anti-trafficking laws. Gordon later entered into a consent decree prohibiting him from selling cigarettes again.

Along with the joint stipulation submitted to the D.C. District Court, the government also filed a declaration—executed by a branch of the Bureau of Alcohol, Tobacco, Firearms and Explosives—representing there is no intention to recommend or request an enforcement action against Gordon.

Representing the government, Department of Justice attorney William E. Havemann argued these documents nullify any impact from the PACT Act.

He further noted that the D.C. Circuit observed the risk of mootness when it affirmed the district court's preliminary injunction.

''I also think it's noteworthy the court recognized that although the case was not then moot, the court recognized that circumstances could develop on remand that would moot the case going forward,'' Havemann said. ''And it's difficult to imagine what this court thought could possibly moot the case, if not the permanent closure of Mr. Gordon's business coupled with a declaration by the United States that we don't intend to prosecute him for his past violations.''

No ''Sunk Costs.'' Highlighting the five-year stretch, Streett argued that ''sunk costs'' to the judicial system justified continuation of the case.

Seemingly unpersuaded, Garland said he regarded ''the question of whether the statute is constitutional or not a very difficult question, upon which two of my colleagues vociferously disagreed previously. I have not yet sunk the costs of thinking about this question.''

Judge Janice Rogers Brown also sat on the panel but didn't question the parties.

By Jennifer McLoughlin

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Multistate Developments

Severance Taxes

Severance Tax Revenues Drop in Eight States as Prices of Oil, Coal Decline

The steep drop in oil and coal prices took a toll last year on tax revenues in eight states that rely heavily on severance taxes to fund their budgets, according to a Feb. 1 report from the Nelson A. Rockefeller Institute of Government.

The report said severance tax revenues in the eight states—Alaska, Louisiana, New Mexico, North Dakota, Oklahoma, Texas, West Virginia and Wyoming—declined by 35.5 percent in the four quarters ending in September 2015, compared with the same period a year earlier. The states raised about $16 billion in severance taxes in 2014, according to the report.

The decline in severance taxes also put a drag on overall tax revenues in the eight states, where total tax revenues declined by 3.2 percent for the one-year period. By contrast, overall tax revenues in other states rose by 6.5 percent during the period, the report said.

''The oil- and mineral-dependent states are all facing fiscal challenges and budget shortfalls, particularly Alaska, North Dakota and Wyoming, where severance taxes comprise a significant share of total taxes,'' the report said.

''The steep price declines are leading to cuts in production and employment, weakening mineral-state economies and likely leading to slower growth in revenue from other tax sources,'' it said.

A recent report from Standard & Poor's reached similar conclusions .

Key Points. The key points in the report include:

■ The eight states rely on severance taxes for 16 percent of their total tax revenues, as opposed to 0.2 percent for the rest of the states.

■ Oil, natural gas and mining in the eight states account for about 10 percent of their gross domestic product.

■ Alaska was hardest hit, with severance tax revenues down by 87.9 percent and total tax revenues down by 67.2 percent.

■ Wyoming was the only one of the eight states to experience an increase in severance tax revenues, albeit a small one of 0.1 percent.

By Gerald B. Silverman

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☐ *The report is available at http://www.rockinst.org/pdf/government_finance/2016-02-By_Numbers_Brief_No5.pdf.*

Multistate Developments

Fuel Tax

Oil's Collapse Hurting States Counting on $50-a-Barrel

When Louisiana, one of the nation's biggest energy-producing states, decided how much tax money the government would have to spend this year, it forecast that the price of oil would be almost $50 a barrel. It has since tumbled below $30, casting economic ripples that helped create a $750 million budget shortfall.

The price of crude, now at a 12-year low, has emerged as a major source of fiscal strain on the nation's oil-patch states, none of which predicted how swift or deep the drop would be. That has prompted a reversal-of-fortune in capitals that once reaped revenue windfalls from America's energy-industry renaissance and are now racing to adjust.

''They're playing catch-up in getting their estimates in line with what's happening with spot prices,'' said Gabriel Petek, a municipal-bond analyst in San Francisco for Standard & Poor's who's been tracking the fiscal impacts, speaking of energy states revising price forecasts. ''It doesn't look like prices are coming up soon, so if the prices stay low it could pressure their budget positions.''

A report released Jan. 21 by S&P said the energy rout is a main culprit in at least five of the 11 states that are facing financial pressure this year as jobs and counted-on tax collections disappear. The price of oil, which traded for more than $100 less than two years ago, has been cut in half since June amid concerns about the slowing pace of overseas economies.

Besides Louisiana, it's being felt largely in Alaska, New Mexico, Oklahoma, and North Dakota, the credit-rating company said. But it's also cropping up elsewhere: In Texas, the largest producer, the impact has crimped sales-tax collections and increased the cost of public-assistance programs for those out of work. In states with the big energy industries, payrolls expanded by 0.9 percent in the year through November, less than half the rate for the U.S., according to S&P.

Sales-Tax Increase. For Louisiana, the lower prices–along with rising health-care costs—are a driver of the projected $1.9 billion deficit for the year that begins in July. To help close the gap, Gov. John Bel Edwards, a Democrat in his second week in office, proposed raising the sales tax by 1 percentage point to 5 percent. That would give the Gulf Coast state the highest average state and local sales-tax rate in the country, according to the Tax Foundation.

Edwards has also proposed tapping reserves, cutting spending by about 10 percent and drawing on compensation Louisiana received for the BP Plc oil spill.

''The decline in oil prices certainly isn't helping us,'' said Julie Payer, the governor's deputy chief of staff. ''It's a factor in layoffs that are affecting industries in the state.''

Louisiana may reduce the $48 barrel oil price it used in budget projections in November when it puts out new estimates next month. ''It hasn't been getting any better,'' Payer said.

Oklahoma expects tax collections to fall short of its initial estimates by 7.7 percent in the current budget year and by 13 percent in the next, which led Gov. Mary Fallin to implement across-the-board spending cuts, according to S&P. Similar reductions are likely in North Dakota.

Alaska, with 79 percent of its operating revenue drawn from oil, lost its AAA rating from S&P this month after its deficit widened. The state assumed prices of more than $67 a barrel when it passed its budget last year, only to cut it later to about $50. The rating outlook remains negative, indicating another downgrade could come if the state fails to curb its deficit during this year's legislative session. Gov. Bill Walker said in a statement this month that the cut ''further solidifies the need to address our state's fiscal challenges.''

''Alaska stands out as the most exposed,'' said Petek, the S&P analyst.

Texas Comptroller Glenn Hegar revised his revenue estimate for fiscal 2016 and 2017 down in October to $110.4 billion from $113 billion. Even so, the state's vast and diversified economy has left it better buffered than other states: The revised figure still exceeds the $106 billion in the current two-year budget, said Chris Bryan, spokesman for Hegar.

The drop in Texas's collections of energy-severance taxes will cut contributions to the government's funds that are used to build highways and mitigate the impact of economic slowdowns on the budget. Estimates for contributions to those funds have been cut by half for fiscal 2017. The state's reserves are still expected to be about $10.5 billion in 2017.

''We're still way ahead of where we would have to be for energy prices to have an impact on the state budget,'' said Bryan.

By Darrell Preston

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New York

Procedure

New York Pursuing 'Unprecedented' Business Tax Changes, Practitioner Says

The New York Department of Taxation and Finance has embarked on a broad rule-making drive to implement 2014 changes made in the state's corporate franchise tax, circulating informal drafts for comment before undertaking formal promulgation of new rules.

The state's effort is ''unprecedented,'' practitioner Irwin M. Slomka of Morrison & Foerster LLP in New York said Jan. 26 at the New York State Bar Association's (NYSBA) annual meeting, where he moderated a

Tax Section panel discussion on corporate tax overhaul. ''I've never seen so much openness.''

Billed by the department on its website as ''the most significant reform'' of the state's corporate tax system since the 1940s, the changes are aimed at modernizing and streamlining the tax code. They generally took effect Jan. 1, 2015, although revisions have continued in state budget legislation enacted for 2015-16 and proposed for 2016-17.

During the NYSBA session, Deborah R. Liebman, the department's deputy counsel, said the state began circulating informal draft regulations as a short-cut through the ''strict requirements'' of New York's administrative procedure law.

The plan is to seek informal comment on pieces of the department's thinking on specific topics, gather feedback and then roll the results together into a whole regulation for a formal proposal.

'Long Process.' ''We want to hear what people think about the ideas we've put out there,'' Liebman said, expressing hope that the outreach would go expeditiously. ''It's a long process to make all the changes that have to be made.''

Drafts on apportionment and economic nexus were released in 2015 (22 Multistate Tax Report 787, 11/24/15).

A draft on combined reporting was released Jan. 22 (see related story in this issue).

The department is planning future drafts on investment capital, investment income, prior net operating loss (NOL) conversion, NOLs in general and additional guidance on apportionment, Liebman said.

The state official also pointed to guidance available through the department's Frequently Asked Questions features, which allow practitioners to submit queries, and the issuance of technical memorandums.

Technical memos published in December addressed interest attribution and S corporation apportionment transition issues, she said.

The state department is also working closely with New York City officials to coordinate guidance and collaborate on forms and instructions, with biweekly meetings to review drafts, Liebman said.

NYSBA Comments. Reviewing NYSBA comments on the economic nexus draft, Slomka pressed Liebman and Robert D. Plattner, the department's deputy commissioner for tax policy analysis, on the treatment of corporate general partners who have been deemed in the draft to have nexus in the state regardless of their partnership share.

The NYSBA report, which came out in December 2015, also questioned the state's nexus approach to corporate limited liability company members (22 Multistate Tax Report 837, 12/25/15)

Liebman responded that in the draft regulation, as in traditional rules, share doesn't matter for the purposes of establishing nexus, a decision she said ''represents strides made in the aggregate theory of partnerships.'' The new draft regulation, however, wouldn't change the treatment of limited partners, she told Slomka.

It also doesn't address partnership filing deadlines, she said, but a provision of the current state budget proposal by Gov. Andrew M. Cuomo (D) would change the filing dates to match the federal government's.

Draft Nexus Rule Revised. On taxation of corporate members of LLCs, Plattner said the department revised the draft nexus rule on Jan. 22 in its treatment of non-managing limited liability company partners.

To respond to comments that the earlier draft's approach was ''harsh,'' the department has inserted language that would look to the LLC operating agreement to see if a corporate member has the same kind of limited role as in a limited partnership, he said.

Noting that the new language had just gone out, Plattner said the state hadn't yet received much feedback. ''We'll see if it has some legs as a solution, or will help us move toward a solution,'' he said.

Answering a question from Slomka, Liebman said that because the inquiry into the status of an LLC member would depend on facts and circumstances, the issue wouldn't be suitable for a binding advisory ruling.

Apportionment Issues. In discussing the state's apportionment draft regulation, practitioner Jack Trachtenberg of Reed Smith LLP in New York said that the NYSBA report on that project is pending. ''The state did a great job,'' he said.

He raised questions, however, on the draft's treatment of due diligence, presumptions in statutory hierarchies and the issue of services provided through, versus ''on behalf of,'' intermediaries.

BY JOHN HERZFELD

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□ *An explanation of corporate tax changes is at http://src.bna.com/cfi.*

Text of the draft regulations is at http://src.bna.com/cfl.

Technical memorandums are at http://src.bna.com/cgf.

Text of the Jan. 22 revisions to the draft nexus regulation is at http://src.bna.com/cfr.

Credits&Incentives

Kentucky

Tax Incentives

Noah's Ark Attraction Eligible For Kentucky Tourism Incentive, Judge Rules

A religious-theme attraction is nonetheless eligible for Kentucky's tourism tax incentive, a federal judge has ruled (*Ark Encounter LLC v. Parkinson*, E.D. Ky., Civ. No: 15-13-GFVT, 1/25/16.

U.S. District Court for the Eastern District of Kentucky Judge Gregory F. Van Tatenhove said a replica of Noah's Ark ''meets the neutral criteria'' for tourist attraction tax breaks offered by the state, which can't deny the incentives by saying the attraction ''advances religion.''

In 2014, Kentucky granted the project partial recovery of construction costs through sales tax rebates allowed by Ky. Rev. Stat. Section 148.853(1)(b), but rescinded the agreement, valued at $18 million, when builder Answers in Genesis (AiG) demanded that development workers be Christians who hold creationist beliefs.

AiG filed suit in the district court last February, accusing the state's then-tourism secretary and then-governor of engaging in ''unconstitutional viewpoint discrimination'' and of violating the group's First Amendment religious freedom and the equal protection clause of the U.S. Constitution by excluding it from the economic development program ''because of who the plaintiffs are.''

Jessica Ditto, spokeswoman for Kentucky's new governor, Matt Bevin (R), told Bloomberg BNA Jan. 27, ''We are pleased the Court has ruled in favor of the Ark project. This Administration does not support discrimination against any worthy economic development projects.''

Van Tatenhove, in his Jan. 25 opinion, said that because AiG ''qualifies for the ministerial exception under Title VII [of the Civil Rights Act], it can choose to hire people who adhere to certain religious beliefs while still being in compliance with state and federal law as agreed in the [tax incentive] application and without their hiring practices being attributed to the Commonwealth.''

The judge enjoined Kentucky from applying the Kentucky Tourism Development Act (Ky. Rev. Stat. Section 148.853) in a way that excludes the project based on its religious purpose or its desire to use any Title VII exemption.

'Significant Impact' Potential. The Kentucky Tourism Development Act allows an attraction—deemed by outside appraisers to have ''significant economic impact'' potential—to receive a rebate on a portion of the sales tax generated at the site, following 12 months of operation.

The rebate unfolds over 10 years and is calculated as a percentage, based on initial capital costs, of the sales tax generated within the attraction, up to a predetermined maximum.

A proposed project must meet certain criteria: its total eligible costs must exceed $1 million; the attraction must be open to the public at least 100 days of the year, including the first year of operation; and the project must attract at least 25 percent of its visitors from outside the state.

AiG's incentive application was unanimously approved by the Kentucky Tourism Development Finance Board in July 2014. The board noted at the time that AiG's Creation Museum in Petersburg, Ky., opened in 2007, has attracted more than 2.3 million visitors.

The rebate program has allowed many other tourist-attraction developers to qualify for a gradual rebate of up to 25 percent of their development costs.

AiG's attraction, centering on a 510-foot-long replica of Noah's Ark, is scheduled to open July 7 in Williamstown, Ky.; the first phase of the project is expected to cost $92 million.

Terry Sebastian, spokesman for Kentucky's attorney general, told Bloomberg BNA Jan. 27 that this lawsuit ''has been defended by other agencies inside state government. Whether to appeal falls within the discretion of those agencies.''

Kentucky tax practitioners contacted by Bloomberg BNA said the situation is unique, therefore the judge's ruling may never impact another economic development agreement.

By Bebe Raupe

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☐ *Text of the opinion is at http://src.bna.com/ce9.*

Washington

Special Industry Credits

Bill to Clawback Washington Tax Break For Boeing Dies Just Before Company Cuts Jobs

The Boeing Co. announced job cuts in Washington state five days after a bill died in committee that would have tied the aircraft manufacturer's $8.7 billion package of tax exemptions and preferences to maintaining jobs at a baseline level.

The bill, H.B. 2638, would have either cut in half or eliminated Boeing's preferential B&O tax rate and tax

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credit, depending on the amount of job loss. The legislation died Feb. 5 in the Democrat-controlled House Finance Committee by a vote of 7-8, with a single Democrat siding with Republicans.

The richest package of state tax breaks in U.S. history has been under bitter assault from Boeing unions and their allies, who point to thousands of jobs being moved to other states since November 2013, when the package passed under threat from the company that it would locate final assembly of its new 777X commercial aircraft out of state .

While the bill's main sponsor, Rep. June Robinson (D), acknowledged its defeat in committee, she doesn't foreclose its possible resurrection. ''There are always other possibilities, especially given the announcement yesterday—less than a week after they killed the bill in Finance—with Boeing coming out and announcing reductions in their workforce,'' she told Bloomberg BNA Feb. 11.

Boeing E-Mail. Boeing announced reductions in force without specifying numbers in a Feb. 10 webcast to employees. In an e-mailed response to a Feb. 11 Bloomberg BNA query on the number of layoffs and whether jobs will be moved out of state, Boeing said:

''In this competitive environment, we are now taking thoughtful steps to reduce the cost of designing and building our airplanes, part of which involves evaluating our employment levels across all of Commercial Airplanes. We will start reducing employment levels beginning with executives and managers first. We will also use attrition and voluntary layoffs. As a last resort, involuntary layoffs may be necessary. The overall employment impact will depend on how effectively we bring down costs as a whole. The purpose of these changes is to make the company cost-competitive in the future, not to shift work to other locations.''

The driving force behind the move to put clawback provisions in the tax incentive package are Boeing's two largest unions: the International Association of Machinists (IAM) District 751 and the Society of Professional Engineering Employees in Aerospace (SPEEA).

'Quite a Bit of Anger.' IAM 751 Legislative and Political Director Larry Brown told Bloomberg BNA Feb. 11 that there is support to attempt resuscitation of the bill.

''We heard from our lobbyist down in Olympia that last night at the Working Family Caucus there was quite a bit of anger over the announcement of these layoffs. So it's kind of a dynamic situation. I would not be betting that this thing is going to pass the House or somehow get up for a vote. But I know that there are those in the Democratic caucus that are calling for that. We'll see; it depends on what Boeing does,'' Brown said.

Both Robinson and Brown readily acknowledged that even if the bill were to get a vote in the House, it would be an uphill battle for it to pass the Republican-controlled Senate.

After Boeing announced pending job cuts, Robinson issued a statement expressing her disappointment. ''When the legislature passed the historically large tax break in 2013, it was done with the understanding that it would keep aerospace industry jobs in Washington. Unfortunately, since that time, the investment that Washingtonians have made in Boeing in the form of a tax break, has been met with announcement after announcement that Boeing jobs are decreasing in our state. Whether the jobs are moving to other states, overseas or just evaporating, the taxpayers deserve to see a return on their investment.

''I introduced common-sense legislation to hold Boeing accountable to the taxpayers of Washington by requiring that job growth occur in order for Boeing to continue taking advantage of the tax exemption,'' Robinson's statement said. ''But, under pressure from corporate interests, the bill did not have enough votes to pass out of committee. On behalf of all of Washington's taxpayers and families, we need to keep working to demand tougher accountability measures for aerospace tax breaks.''

'Would Have Been Hamstrung.' In its e-mail to Bloomberg BNA, Boeing said: ''Had H.B. 2638 passed through committee last week, Boeing would have been hamstrung from competing to win in the market and to operate as a healthy business. Boeing leadership is committed to ensuring Boeing remains the worldwide leader in aerospace by successfully navigating in this highly complex, highly competitive environment. We are focused on making sure this company is as strong as possible, in order to continue building airplanes in Washington for many years to come.''

In arguing for the unfettered continuation of the tax preferences, Boeing cited subsidies received by its competitors. ''Today we are facing highly subsidized and focused competitors determined to lower their own cost structures,'' the company said. ''We also are seeing a slowdown in some of the world's economies, bringing newfound uncertainty to our business. Legislators have considered these incentives in 2013, 2015 and now 2016. Each time the result has been the same—maintaining incentives that allow Boeing to run its business, anchor Washington's aerospace industry and significantly enhance the state's broader economy.''

Robinson and Brown both cited states such as Missouri, South Carolina, Oklahoma and Alabama where tax breaks come with conditions tying the continuation of those incentives to job numbers. ''Unfortunately, there was a much more trusting attitude in Washington and I don't think that the Legislature could have anticipated what Boeing was doing,'' Brown said. ''I don't think that many of the legislators would believe that Boeing would have a plan, which they had in their pocket, to ship jobs out of state when they were asking for a huge extension of tax breaks to maintain and grow aerospace jobs in the state of Washington. But that is in fact what they did.''

Unions Allege Bad Faith. Brown's assertion stems from an unfair labor practice charge filed by SPEEA, involving information requests the union made to Boeing regarding plans to move jobs to other states.

SPEEA Executive Director Ray Goforth told Bloomberg BNA in a Feb. 11 e-mail that he thinks the requested information ''would prove that Boeing was simultaneously lobbying the Washington state legislature for the largest tax break in US history ($8.7 billion) AND planning to move thousands of jobs out of Washington state. Boeing refused to provide the information and litigation ensued. Boeing was found guilty of illegally withholding this information from the union. That decision will almost certainly be appealed by Boeing.''

A March 2015 Boeing brief in the case before the National Labor Relations Board provides evidence of the assertion from Goforth and Brown that Boeing was planning to pull jobs from Washington even as it sought tax breaks from the state to grow its workforce there.

The brief, given to Bloomberg BNA by SPEEA, cites instances around the November 2013 time frame when the tax breaks were extended in which Boeing is considering moving union work to other states.

In a Feb. 11 e-mail response to the union allegations, Boeing spokeswoman Deborah Feldman said: ''We shared that information with our employees, lawmakers and SPEEA as our plans developed. Boeing has kept its commitment to build the 777X in Everett, along with a $1 billion composite wing center.''

By Paul Shukovsky

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☐ *The Boeing brief is at http://src.bna.com/cDz.*

For a discussion of aerospace credits in Washington, see 1480-2nd T.M., Credits and Incentives: OR Through WY, at 1480.16.B.

Oklahoma

Procedure

Oklahoma Bill Halting Tax Credits Gains Momentum, Draws Caution From Governor

Set against the backdrop of worsening general revenue projections for the state, Oklahoma's Senate Finance Committee approved a bill establishing a two-year moratorium on multiple tax credits, evoking a plea from the Oklahoma governor to be mindful of the potential impact such a measure could have on the state's business climate.

Sent to the Senate floor Feb. 10, the bill's emergence out of committee follows a Feb. 8 warning by Oklahoma's top finance official to state agency directors that a worsening revenue picture would result in a second round of state agency spending cuts stemming from a December 2015 revenue failure declaration by state finance officials .

Approved by a 9-3 tally, S.B. 977 proposes a moratorium on nearly two dozen tax credits and additional forms of tax relief, effective July 1, 2016, and expiring June 30, 2018.

In the bill's current form, the suite of measures would reduce the state's earned income tax credit, low-income sales tax relief, the state child-care tax credit, and a tax credit available to producers of electric power using renewable energy resources.

Together, a moratorium on those four tax credits is projected to increase income tax collection by $129.6 million in fiscal year 2018, according to a fiscal impact statement for the bill authored by the Oklahoma Tax Commission.

All told, enactment of the bill would increase income tax collections by nearly $4.3 million for fiscal 2017 and $146 million for fiscal 2018, according to the statement.

Consideration for Projects. Issuing a Feb. 9 statement in response to a reporter's question about the state's fiscal budget, Oklahoma Gov. Mary Fallin (R) went on to express her concerns about the bill.

''Just the fact a measure was being considered that would have placed across-the-board moratoriums on economic tax incentives resulted in a major business eliminating Oklahoma from consideration for two future projects,'' according to Fallin.

''While the intent may be good to temporarily eliminate some incentives that may be ineffective, we must be careful not to affect incentives that are valuable to Oklahoma.''

Responding to a question as to whether the governor opposed the bill, a spokesman from the governor's office told Bloomberg BNA Feb. 11 that the governor ''usually withholds comment on specific bills until she has seen the final form.''

As part of that revenue failure narrative, Fallin suggested during her annual address to the Oklahoma Legislature that the state could bring in an additional $200 million annually via the modernization of the state's sales tax code. That process, she said, would include revisiting the state's $8 billion in annual sales tax exemptions .

By Paul Stinson

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☐ *S.B. 977 is at http://src.bna.com/cEm.*

For a discussion of credits and incentives in Oklahoma, see 1470-2nd T.M., Credits and Incentives: MO Through OK, at 1470.17.

South Carolina

Energy Credits

South Carolina Offers Tax Credits For Solar, Geothermal Installations

South Carolina is providing income tax credits for certain solar energy and geothermal installations as part of legislation signed into law by Gov. Nikki R. Haley (R).

Under H. 3874, signed Feb. 16, businesses that construct, purchase or lease solar energy property located on a Superfund site or certain other similar contaminated property may take an income tax credit equal to 25 percent of the costs.

The new credit is limited to $2.5 million per site and must be taken in five equal annual installments, beginning in the year in which the solar energy property is placed in service. The property for which the credit is being provided must have a capacity of at least 2 mega-

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watts and must use solar power for a number of energy uses.

The new incentive is offered beginning with the current tax year and expires in 2018, but those credits can be carried forward past that date. A maximum of $2.5 million in credits may be claimed (after the five equal installments are considered) in any given year and are provided ''on a first come first serve basis.''

Residential Geothermal Systems. H. 3874 also adds geothermal machinery and equipment to renewable energy systems for which existing tax credits are provided. Taxpayers are now eligible to take a credit of up to 25 percent of the cost of purchasing and installing geothermal systems in their homes against income tax liability.

That credit is limited to $3,500, or 50 percent of an individual or business' tax liability in any single year, beginning in 2016. It expires in 2019, but taxpayers may carry forward excess credits for up to 10 years.

Previously, only purchases and installation of solar energy and small hydropower systems were eligible for the credit (S.C. Code Section 12-6-3587). The new law includes a description of qualifying geothermal machinery and equipment.

By Andrew M. Ballard

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☐ *Text of H. 3874 is at http://src.bna.com/cGF.*

For a discussion of energy credits in South Carolina, see 1480-2nd T.M., Credits and Incentives: OR Through WY, at 1480.09.E.

Arizona

Tax Credits

Arizona Bill Offers Tax Credit For Firearm-Safety Instruction

In Arizona, where much of the state's Wild West history is wrapped around the lore of guns, it is legal for a person to openly carry a weapon so long as certain conditions are met.

A bill (H.B. 2494) being considered in the Arizona Legislature this session would go a step further. The legislation would make an applicant for a concealed-carry weapons (CCW) permit eligible for a tax credit of up to $80 upon completion of firearm-safety training.

According to House Majority Leader Steve Montenegro (R), the bill's sponsor, the tax credit ''is a way of encouraging firearms education and safety,'' he said in a Jan. 25 statement.

But the Democratic minority in the Republican-controlled Legislature thinks otherwise. House Democratic leader Eric Meyer calls the legislation ''another gimmick by a few of those Republicans who try to support the gun lobby, while not supporting our schools.''

Meyer told Bloomberg BNA Jan. 26 that he won't vote for the bill and doubts that other Democrats in his caucus would either.

Quarter-Million Weapons Holders. There are currently 251,680 active CCW permit holders in the state, according to data from the Arizona Department of Public Safety's Concealed Weapons Permit Unit. At the maximum $80 allowable credit, the bill would cost the state treasury as much as $2 million.

Montenegro said that CCW training is beneficial in that it ensures gun owners are trained in firearms use, briefed on firearms laws, have passed a criminal background check and have passed a mental health background check.

His legislation would amend Ariz. Rev. Stat. Section 43-222 and would allow applicants for a CCW permit to claim a dollar-for-dollar tax credit for taxes owed on state returns. It would cover the cost of completed weapons safety instruction up to the $80 limit.

Tax Credit Would Shrink Fund. Democrats oppose the measure because tax credits have the effect of reducing the amount of money that otherwise would go to the state general fund to provide dollars for K-12 and university education programs and for public safety.

That is a sticking point among Democrats, who argue that the state last year made what many regard to be harmful spending cuts in all three programs in order to balance the state's budget. This year's fiscal 2017 budget proposal from Gov. Doug Ducey (R) seeks to hold the line on increased state spending, meaning the state's school system will receive only a fraction in restored cuts from the trims made last year.

''Unfortunately, we are always wasting time on tax policy that benefits a few and does not make sense, when we have the opportunity to craft legislation that would be better for everyone in the state. But that is not new in Arizona with some of the legislators that I work with,'' Meyer said.

By William H. Carlile

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Nevada

Tax Abatements

Faraday, Tesla Deals Boost Nevada's Profile

The auto industry is becoming a catalyst for some of the more exciting office developments coming online across the nation, and Nevada, with its recent pickup of two companies in the electric car market, is well-suited to accommodate that trend.

That is the opinion of John Boyd, president of Boyd Co., a New Jersey-based site selection company.

Boyd shared his thoughts with Bloomberg BNA in the wake of a Jan. 22 decision by the Nevada Gover-

nor's Office of Economic Development to give final approval to Faraday Future's plans for a $1 billion investment in a new electric vehicle manufacturing facility in North Las Vegas. The investment comes with a tax-incentive program valued at $215 million, as well as tax abatements (23 Multistate Tax Report 55, 1/22/16).

Groundbreaking has already begun on the site, and construction is expected to be completed in the next few years, according to the company.

Plenty of Benefits. Boyd, Jan. 27, characterized Faraday as a good deal for Nevada, with many drivers that make the North Las Vegas site desirable. One draw is what he called the ''premier business climate'' Nevada offers as a right-to-work state.

Another is the incentive and tax abatement program put into place by Gov. Brian Sandoval (R), who backed the project that recognizes the growth in the electric car market. Boyd said Nevada is now recognized as a leader in this field, having persuaded Faraday to locate in the southern Nevada market and Tesla Motors to locate operations in the northern Nevada market of Reno.

Boyd said the labor skill sets that Faraday places a premium on are more akin to those in the electronics and aerospace industries. Faraday will place more emphasis on accessing engineering and high-tech skills. Workers will come from Southern California, creating a strong precedent for translating California skill sets.

Another benefit is taxation and housing, Boyd said. Many of those transferees will find some big advantages to living in southern Nevada over Southern California, such as the lack of a state personal income tax. Despite the sluggish recovery in the Las Vegas housing market, there are significant savings for executive housing in southern Nevada versus Los Angeles, he said.

Prime Real Estate. Boyd, who said he wasn't involved in the Faraday site-selection process, said he knows about the North Las Vegas site from working with past clients.

He said it offers many advantages: access to Interstate 15, close proximity to intermodal rail service and access to renewable energy such as geothermal and solar power.

The site also is close to Nellis Air Force Base, enabling the company to hire former military personnel who have skill sets that Faraday will find desirable. Government incentives will make it attractive to hire former military workers, he added.

In addition, plans for an Interstate 11 transportation corridor between Las Vegas and Phoenix will serve as a catalyst for development of similar sites, Boyd said.

'Second War Between the States.' Boyd described the intense competition over tax incentives as the ''Second War Between the States.'' All cities and states must offer incentives to be competitive, he said. Tax abatements and clawback provisions are also considered.

Sandoval gets credit for these funds going beyond property and sales tax abatements to encompass workforce-training programs and infrastructure development programs, Boyd said. That enhances the state's ability to attract even more companies, he added.

States ''need to recalibrate what incentives they can offer. Incentives play a necessary role in attracting jobs,'' Boyd said.

Sandoval's success in pushing the Tesla and Faraday projects through the Nevada Legislature puts him ''into an elite category of superstar economic development governors,'' Boyd said.

By William H. Carlile

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Other Developments

Pennsylvania

Procedure

Pennsylvania Governor Proposes Budget Of $33.3 Billion; Stalemate Starts Again

Pennsylvania Gov. Tom Wolf (D) presented a $33.3 billion 2016-17 fiscal year budget to the Legislature, reviving many of the tax proposals that triggered a budget standoff with Republican legislators last year.

''I hate to say it, but it's the stalemate all over again,'' Jonathan Liss, senior director for State & Local Tax at BDO USA, LLP in Philadelphia, told Bloomberg BNA Feb. 10.

Wolf wants more money for schools and seeks tax increases to pay for it. The Republican Legislature, meanwhile, has ''dug in their heels'' about addressing the state's unfunded pension liabilities and overhauling the state-run liquor system, neither of which Wolf addressed in his budget speech, Liss said.

''In a nutshell, nothing has changed,'' said Liss. ''There's not going to be any movement.''

Entrenched Conflict. In a sharply worded budget address Feb. 9, Wolf warned the Legislature of a looming ''fiscal catastrophe'' that could lead to teacher layoffs, cutbacks for senior and childcare programs, de-funded domestic violence shelters and further credit downgrades. He called on lawmakers to ''face up to the reality'' that new revenue are needed.

''Anyone in this Chamber who claims we can simply cut our way out of this mess without also increasing revenue is just ignoring the math,'' Wolf said. ''If you won't take seriously your responsibility to the people of Pennsylvania—then find another job.''

Republicans quickly deemed the proposed budget unsupportable.

In a Feb. 9 statement, Senate Majority Leader Jake Corman (R) called it a ''retread budget proposal'' with ''sizable tax-and-spend'' policies that had ''already been soundly opposed by taxpayers.''

Senate Appropriations Committee Chair Patrick Browne (R) said the governor's ''proposed massive spending increases are simply unsustainable.''

New Taxes? Wolf's proposed $33.3 billion budget would raise $2.7 billion in new revenue by increasing taxes or creating new ones. The budget calls for $200 million in new funding for public schools, $60 million in new funding for childhood education, and $50 million for special education. It proposes an increase in the state's minimum wage to $10.15 an hour.

Among the proposals to raise new revenues, Wolf plans to:

- increase personal income tax from 3.07 percent to 3.4 percent;
- expand the sales tax base to include currently non-taxed items such as basic cable television, movie theater tickets and digital downloads;
- increase the bank shares tax from 0.89 percent to 0.99 percent;
- increase cigarette taxes from $1.60 to $2.60 per pack;
- tax other tobacco products at 40 percent;
- implement a 6.5 percent severance tax on natural gas extraction, with a credit for the state's impact fee; and
- create an 8 percent gaming promotional play tax.

Severance Tax. The natural gas industry collectively decried Wolf's most recent severance tax proposal, calling it a ''punitive, extra tax'' that would kill jobs and hurt Pennsylvania's economy overall.

''A severance tax on natural gas production was a bad idea last year and it's a bad idea now,'' Stephanie Catarino Wissman, executive director of the Associated Petroleum Industries of Pennsylvania (API-PA), said during a Feb. 10 conference call held with the Marcellus Shale Coalition (MSC) and the Pennsylvania Independent Oil & Gas Association (PIOGA). ''Any new energy tax threatens development in Pennsylvania, destroys more jobs and exponentially reduces local revenues that could pay for education, transportation, health care and other state programs.''

Dave Spigelmyer, MSC president, questioned projections that the new severance tax could generate $217.8 million in new revenue.

''Everyone knows that the revenue projections that have been put out for shale-related tax in Pennsylvania are unachieveable,'' he said during the Feb. 10 call. ''I believe we're having a debate over doing a severance tax for the sake of doing a severance tax.''

Budget Still Overdue. The governor released his 2016-17 budget proposal even though Pennsylvania has no budget for the current fiscal year. Wolf line-item vetoed a spending plan that lawmakers delivered to him just before Christmas after a compromise budget framework fell apart when House Republican leaders refused to vote on the plan .

The line-item veto released six months of emergency funding for schools and human services, yet failed to resolve a budget stalemate that is the longest since 1971, when the budget was passed 248 days late.

The governor's proposed budget for 2016-17 assumes that the $30.8 billion bipartisan budget framework that failed in December is ultimately enacted this year. That compromise budget, which passed the Senate but failed in the House, would have included $900 million in new revenue from tax increases (22 Multistate Tax Report 891, 12/25/15).

The Wolf administration maintains that the $30.3 billion spending plan the Legislature passed in 2015 for FY 2016-17 (H.B. 1460) puts the state $510 million out of balance and increases the structural budget deficit.

Based on appropriation amounts from H.B. 1460, P.N. 2626, the state's Independent Fiscal Office in a January 2016 report projected a $1.9 billion structural deficit in fiscal 2016-17, driven by increasing pension contributions and higher costs for human services.

Some Differences. There are a number of differences between the tax proposals in Wolf's 2016-17 budget compared to the previous year, according to associate Christine Hanhausen and counsel Kenneth Levine of Reed Smith LLP's State Tax Group in Philadelphia.

For example, although the governor once again proposed expanding the base of the state's sales tax, he did not propose an increase to the sales tax rate.

''Also, last year Gov. Wolf proposed many changes to the Corporate Net Income Tax, including unitary combined reporting, reducing the tax rate, and lowering the [net operating losses] cap,'' none of which appeared in this year's budget plan, Hanhausen and Levine told Bloomberg BNA in a Feb. 9 e-mail. The only change involving the corporate net income tax would be to extend the due date of the return from April 15 to May 15, to account for corresponding changes in federal law, they said.

The budget would continue the full phaseout of the unpopular Capital Stock and Franchise tax, effective Jan. 1, 2016 (23 Multistate Tax Report 22, 1/22/16).

''We expect to see competing proposals and ongoing negotiations,'' Hanhausen and Levine told Bloomberg BNA. ''If the past year has taught us anything, it's that the proposed budget does not mean the actual budget.''

By Leslie A. Pappas

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☐ *The FY 2016-2017 budget proposal, accompanying legislation and related analyses are at http://src.bna.com/czk.*

Delaware

Procedure

Delaware Governor Proposes $4.1 Billion Budget for 2017

Delaware Gov. Jack Markell (D) released his $4.1 billion fiscal year 2017 budget proposal, calling for increased spending on education and health care while maintaining funds for economic development and quality of life.

The proposed budget maintains the state's fiscal responsibility by appropriating 98 percent of available revenue, the governor's office said.

The recommended budget, released Jan. 28, draws 31.9 percent of its funds from personal income taxes, 26 percent from incorporation revenue—which includes corporate franchise taxes, business entity fees, limited partnerships and limited liability companies—and 11 percent from abandoned property, according to a financial summary released by the Office of Management and Budget.

The proposed budget spends 33.9 percent of funds on public education and 28.5 percent on health and social services.

$49.5 Million Deficit Addressed. A $49.5 million deficit between available funds and cost drivers in the FY 2017 budget will be made up in part through $18.6 million in agency and program cuts, $20.8 million in reallocations and reductions, and $15.2 million in cost driver reductions, according to the governor's budget presentation. The deficit would also be reduced by $2.9 million in ''targeted tax collection efforts'' that weren't further explained.

The budget took into account an $8 million reduction in tax revenue that's expected in FY 2017 as a result of the new Delaware's Competes Act, which Markell signed on Jan. 27 to revamp Delaware's corporate income tax rules (see related story in this issue).

Legislative budget hearings will take place in February and March, according to guidelines from the budget office.

By Leslie A. Pappas

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☐ *Additional information on the governor's budget is at http://src.bna.com/chJ.*

Illinois

Procedure

Think Tank Touts Income Tax Increase To Manage Illinois's Fiscal Crisis

An influential fiscal policy think tank is calling on Illinois lawmakers to substantially boost both the corporate and individual income tax rates, tax retirement income, broaden the sales tax base and enact constitutional pension overhauls as a comprehensive strategy for solving the state's unprecedented fiscal crisis.

The Institute for Illinois' Fiscal Sustainability, a research project of the nonpartisan Civic Federation, issued a 55-page report Feb. 11 examining the state's ongoing budget and fiscal problems. The report calls on Gov. Bruce Rauner (R) and Democrats controlling the Illinois General Assembly to work cooperatively on a comprehensive solution.

Among other things, the report notes Illinois has been without a budget since June 30, 2015, and has failed to address an operating shortfall of $4.6 billion for the current fiscal year. If this revenue and spending trajectory goes unaddressed, the Civic Federation said Illinois will have to confront a backlog of unpaid bills totaling $25.9 billion by the end of fiscal year 2019.

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Equally concerning is Illinois' worst-in-the-nation pension crisis. The state's unfunded liabilities for its various public retirement systems is estimated at $111 billion.

Eight Strategies. The report suggests eight strategies for managing the state's spending and revenue problems, including:

- cut state spending $1 billion below previously estimated ''maintenance levels;''
- raise the personal income tax rate from 3.75 percent to 5 percent, and the corporate rate from 5.25 percent to 7 percent, retroactive to Jan. 1, 2016;
- broaden the income tax base to include retirement income for taxpayers with taxable income above $50,000;
- expand the Earned Income Tax Credit for low-income residents from 10 percent of the federal credit to 15 percent;
- expand the sales tax base by temporarily suspending exemptions for food and nonprescription drugs, and imposing tax on certain consumer services;
- merge the Chicago Teachers' Pension Fund and the Teachers' Retirement System to ensure equitable retirement funding formulas and stabilize the budget of Chicago Public Schools;
- amend the ''pension protection clause'' of the Illinois Constitution to specify protections apply only to previously accrued benefits; and
- make supplemental pension payments until Illinois's five retirement systems are fully funded.

The comprehensive plan envisions a ramp up of the various tax provisions. The proposal projects: $3.5 billion in new revenue for FY 2016; $8.2 billion in new revenue for FY 2017; $9 billion in new revenue for FY 2018; and, $9.3 billion in new revenue for FY 2019.

Laurence Msall, president of the Civic Federation, said the path forward will be politically unpopular, but an urgent response is necessary.

''Despite this dire situation, our roadmap shows that with dedicated action and shared sacrifice, it is possible to enact a comprehensive plan that will get Illinois back on sound financial footing by FY2019,'' Msall said in a statement.

By Michael J. Bologna

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☐ *The report is at http://src.bna.com/cEk.*

For additional discussion of income tax rates in Illinois, see Corporate Income Tax Navigator, at Illinois 4 and Individual Income Tax Navigator, at Illinois 3.7.

For additional discussion of the earned income tax credit in Illinois, see Individual Income Tax Navigator, at Illinois 3.6.3.1.

Michigan

Procedure

Federal Judge Enjoins Michigan Tax-Funded Communication Law

A federal judge has issued a preliminary injunction blocking enforcement of a new Michigan campaign finance law limiting the way local governments can communicate with voters 60 days before an election (*Taylor v. Johnson*, E.D. Mich., No. 5:16-cv-10256, 2/5/16)

The law restricts local governmental entities from using taxpayer resources to distribute mass communications, which U.S. District Court Judge John Corbett O'Meara said in his Feb. 5 order that may unconstitutionally restrict their rights.

When Gov. Rick Snyder (R) signed the law (P.A. 269) in January, he asked Michigan lawmakers to fix confusing language ''about how the bill impacts the use of public resources to disseminate factual information prior to an election'' .

Seeking Clarity. In advance of that, Roseville Mayor Robert Taylor and 16 other public officials sought the preliminary injunction in order to communicate with constituents regarding local proposals on the March 8 and May 3, 2016, ballots without fear of legal action by the Secretary of State.

Their complaint, filed Jan. 26 in U.S. District Court for the Eastern District of Michigan, argues that city, county and school officials ''deserve clarity on this issue so that they may serve the public in the normal course without fear of arbitrary sanction or prosecution.''

The officials contend that they have historically used public resources to disseminate objectively neutral, factual information about issues, not ''attempts to influence voters'' envisioned by the law.

''Perhaps the confusion articulated by Plaintiffs stems from the fact that section 57(3)'s broad language appears inconsistent with the stated purpose of prohibiting 'electioneering' conduct with taxpayer funds,'' O'Meara said.

''One could arguably find a communication that 'references' a ballot question to be any communication that merely 'mentions' a ballot question,'' he said. ''This result appears absurd; it is difficult to imagine that regulators would attempt to sanction or prosecute a public official for merely mentioning a ballot question in a city newsletter, explaining the difference between a millage renewal and millage increase.''

By Bebe Raupe

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☐ *The judge's order is at http://www.bloomberglaw.com/public/document/Taylor_et_al_v_Johnson_et_al_Docket_No_516cv10256_ED_Mich_Jan_26_.*

Colorado

Procedure

Legally Sound Pathway Exists to Exempt State's Hospital Fee From Revenue Limits

A new legal review says it would be possible for Colorado lawmakers to exempt the state's hospital provider fee from revenue limits of the Taxpayer Bill of Rights in a ''legally sound and fiscally responsible'' way.

The review, conducted by two former attorneys to former Govs. Bill Owens (R) and Bill Ritter (D), released Feb. 11, concludes that it would be possible to create a state-owned business that would charge, collect and administer the hospital provider fee as an enterprise exempt from TABOR's revenue limits.

This latest legal analysis of the proposal to reclassify the hospital provider fee, first floated by Gov. John W. Hickenlooper (D) in the 2015 session of the state General Assembly and renewed in his 2016 State of the State address Jan. 14, conflicts with an earlier review that said such a move would be unconstitutional

'Legal Clout.' The attorneys, Trey Rogers, a partner with Lewis Roca Rothgerber Christie LLP in Denver and former chief counsel to Ritter, and Jon Anderson, a partner with Holland & Hart LLP and former chief counsel for Owens, said a provider fee created by the Legislature would have significant legal clout.

''Our courts have said that statutes enacted by the General Assembly enjoy a strong presumption of constitutionality and will not be overturned unless the statute is unconstitutional beyond a reasonable doubt,'' Rogers said in a statement. ''It is hard to imagine a court would find a provider fee enterprise to be unconstitutional beyond a reasonable doubt.''

The earlier review, a 2015 memorandum from the nonpartisan Office of Legislative Legal Services (OLLS), said shifting the fee off-budget would likely violate TABOR, a constitutional amendment approved by voters in 1992. TABOR requires voter approval for tax increases and limits annual government spending growth to inflation plus population growth. Any revenue collected in excess of the TABOR limit must be returned to taxpayers.

Self-Supporting. Currently, the hospital provider fee is counted toward TABOR revenue. Were the fee to be an enterprise, the enterprise would charge a fee to its customer hospitals, obtain matching federal funds and pay the combined fee and federal funds back to the hospitals to provide care for low-income patients. It would do so without financial support from the state, meeting the criteria provided in TABOR as a self-supporting state-owned business.

According to the Colorado Legislative Council, the fee contributed an estimated $532.7 million to the state's general fund in fiscal year 2014-15 and $689.2 million in FY 2015-16.

Hickenlooper said unless something is done about the fee, the state budget could face cuts in excess of $300 million to everything including education, health care and transportation. During the 2015 session, a Colorado Senate committee killed a proposal (H.B. 1389) to recast the fee.

Earlier Study Incorrect. The OLLS memo doesn't appear to have been drafted or intended to serve as a ''comprehensive, complete or definitive analysis,'' Trey and Rogers said. The OLLS study concluded, ''incorrectly, that the new entity 'would lack the characteristics of a business required for and shared by enterprises that are exempt from state revenue limits,' '' they said.

John Suthers, former Colorado attorney general and now the Republican mayor of Colorado Springs, said accounting for the hospital provider fees in the state budget causes numerous problems.

''If this situation is not addressed soon, important state programs will be cut that negatively impact Colorado Springs and every other local community in Colorado,'' he said in a statement. ''Based on my experience, I believe that some form of a Hospital Provider enterprise could be designed to be constitutional under state law.''

The Rogers-Anderson study was paid for by Fix The Glitch, a campaign supporting the recasting of the hospital provider fee into an enterprise.

By Tripp Baltz

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☐ *The legal review is at http://src.bna.com/cEf.*

New Jersey

Procedure

Christie Budget Speech Seeks Unity to Solve New Jersey's Pension, Transportation Woes

New Jersey Gov. Chris Christie (R) unveiled a $34.8 billion budget for fiscal year 2017, calling on the Legislature to work with him during his final 630 days in office to lower taxes, build critical infrastructure and fix the state's pension and health benefit system without partisanship.

The Feb. 16 speech marked Christie's first major address to the Legislature after suspending his presidential bid Feb. 10, and sparked hope among local lawmakers that he would renew his focus on state issues. Christie promised to keep fighting for fiscal restraint and making changes to improve New Jersey's economy long term.

''I am ready to work with you if you are willing to stop the partisanship and the reckless amending of our constitution just to score political points,'' Christie said in his budget address, referring to constitutional amendments proposed by Democratic lawmakers to raise the minimum wage to $15 and mandate payments for public worker pensions. ''We can sit and reason together for the next 630 days, or we can fight for the next 630 days and we can leave our citizens devoid of hope.''

Democratic lawmakers expressed disappointment that Christie downplayed what they call a crisis of state

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transportation funding and questioned his approach to state pensions, yet said they welcomed the governor's bipartisan tone.

"I'm encouraged by what I heard for the first time in a long time: a willingness to work together and an acknowledgement of the things that we have done in the past," Assembly Majority Leader Louis D. Greenwald said at a news conference following the governor's budget address.

Christie's budget plan calls for $34.8 billion in state appropriations, a 2.2 percent increase over last year's budget. It includes a $1.9 billion contribution to the state's pension funds, $2.2 billion in higher education funding, $13.3 billion in education spending and $127 million in substance abuse and mental health treatment.

Pensions. Christie proposed a $1.9 billion contribution to the state's pension funds, a payment he said would be $550 million more than last year. To pay for it, the budget calls for $250 million in savings from employee health and benefit plans by requiring more use of generic drugs, increasing co-pays and tweaking the delivery of primary care.

Without making any changes to the system, state costs for worker and retiree health care will increase by $487 million, Christie said.

Christie slammed a proposed constitutional amendment that would mandate pension payments for government workers, saying that it would divide the state and hurt taxpayers.

New Jersey would need to raise at least $2.8 billion in new annual taxes by 2022 under the proposed amendment, which would lock in existing public pension plans and mandate full payments, according to a Feb. 11 report from the New Jersey Pension and Health Benefit Study Commission, a group Christie created by executive order in 2014.

The commission recommended that the cost of public employee benefits must be kept below 15 percent of the state's budget and estimated that health and pension benefit would swell to 27 percent of the budget by 2022 if the constitution is changed to mandate full payments.

The proposed constitutional amendment passed both chambers during the last legislative session but didn't get the three-fifths majority it needed in both houses to be placed on the ballot. The measure, now known as Senate Concurrent Resolution No. 2 (S.C.R. 2), could still be placed on the ballot if both chambers pass it again this year by a majority vote .

Assemblyman Reed Gusciora (D) said Christie needed to be more transparent in the pension discussion.

"The Governor criticized lawmakers today on a proposed constitutional amendment to provide directed pension payments. However, nothing was said on how the State continues to spend hundreds of millions of taxpayers' dollars on fees for private investment managers to manage the pension fund," Gusciora said in a statement issued after the budget address.

Transportation. Christie minimized problems of transportation funding, insisting that there "is plenty of time to reach a reasonable agreement" on replenishing the state's Transportation Trust Fund (TTF).

A proposed constitutional amendment to dedicate all fuel tax revenues to transportation infrastructure passed both chambers in January and will be put on the ballot in November (23 Multistate Tax Report 67, 1/22/16)(2016 Weekly State Tax Report 27, 1/15/16).

Transportation advocates have warned that the fund will run dry at the end of June if no further action is taken. (22 Multistate Tax Report 817, 11/24/15).

"The reality is that New Jersey is fully able to support the current capital program as originally proposed in the current five-year authorization," and is still spending $3.2 billion a year, Christie said. "To imply that the TTF is in crisis and is suddenly and unexpectedly 'running out of money' is a politically driven mischaracterization."

In response to the governor's budget address, Assembly Speaker Vincent Prieto (D) disputed Christie's argument, saying that the TTF had to borrow funds last year and the fund will run dry as of July 1.

Christie called for a "discussion of tax fairness" and implored the Legislature not to rely solely on a gas tax increase to solve the problem.

Estate Tax. Greenwald said the governor mischaracterized discussion over the TTF, pointing out that Democrats have discussed proposals to offset a gas tax increase with corresponding cuts in inheritance or estate taxes.

"No one has ever suggested that the only way to solve this is through a tax hike alone," he said.

New Jersey is one of two states that has both an estate tax and an inheritance tax.

Christie again called for a repeal of the estate tax, and cited a recent report from the New Jersey Business and Industry Association that said 2 million people and $18 billion in annual revenue have left the state over the past 10 years due to what the governor called "our antiquated, tone-deaf tax policies."

Sixty-seven percent of businesses surveyed say they take estate and inheritance taxes into consideration when making business decisions, Christie said.

By Leslie A. Pappas

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☐ *Christie's budget address is at http://src.bna.com/cFB.*

For additional discussion of the motor fuel tax in New Jersey, see Excise Taxes Navigator, at New Jersey 8.1.

For additional discussion of the estate and inheritance taxes in New Jersey, see Estates, Gifts, & Trusts Navigator, at New Jersey 1 and Estates, Gifts, & Trusts Navigator, at New Jersey 2.

Multistate Developments

Tax Base

Pew Report: State Revenue Would Increases If Federal Credits Eliminated

A new report estimates that states would average a 34 percent jump in tax revenue if most federal tax expenditures were limited or eliminated.

Forty states and the District of Columbia incorporate federal tax adjustments, credits, deductions and exclusions into their state tax codes, according to a Feb. 17 Pew Charitable Trusts report.

Federal lawmakers routinely propose eliminating or limiting certain federal tax expenditures, and changes to the Internal Revenue Code are under debate by presidential candidates. The authors wrote the report to better inform federal and state policy makers about the impact of such proposals on the state level, they said.

''States have a lot at stake when the federal government changes tax policy. Because states link to federal provisions in many ways, federal changes could significantly impact state revenue, and that impact can vary from state to state. States will have to choose whether or not to accept these changes,'' Anne Stauffer, a director at the Pew Charitable Trusts, said in a statement Feb. 17.

The report examined what would happen to states' tax revenue if the federal government eliminated most federal tax expenditures and federal tax rates were reduced across the board by about 40 percent. The report assumed 2013 state tax codes were in effect.

Under this scenario, state tax revenue would increase an average of 34 percent across the 40 states that have significant conformity with the federal tax code. However, there would be much variability in revenue change from state to state, ranging from no change in Pennsylvania to a 61 percent increase in state tax revenue in Iowa, the report said.

Big Money. States with the most conformity to the federal tax code would see the biggest revenue increase. Louisiana and Nebraska would see a 57 percent increase, Montana a 55 percent boost, Hawaii a 52 percent jump, and New Mexico and South Carolina would each see increases of about 50 percent, according to the report.

Other states that would see increases include California (37 percent), Maryland (47 percent), Massachusetts (20 percent) and New York (40 percent).

The elimination of federal tax expenditures related to health insurance and retirement would have the biggest impact on state revenue, the report said. This is because many states conform to these taxes, they encompass a large amount of untaxed income and many people can take these deductions and credits, it said.

The untaxed value of employer-provided health insurance and deductions for health insurance premiums paid by the self-employed account for 36 percent of the scenario's total nationwide impact on state revenue, the report estimated.

Breakdown. According to the report, the jump in state revenue would be attributable to limits on or elimination of:

- tax credits and preferences for retirement plans, including 401(k) accounts and pensions (25 percent);
- itemized deductions (20 percent);
- capital gains tax exclusions related to inheritances and home sales (10 percent); and
- the Earned Income Tax Credit, which benefits primarily low-income workers with children (3 percent).

Federal Income Taxes. The federal income taxes paid by residents would increase in 29 states and decrease in 21 states and the District of Columbia. The amount of change up or down would be 10 percent or less in most states, the report said.

''Understanding the extent to which state income taxes are linked to the federal system is important for policymakers at both levels of government when evaluating federal revisions or reforms,'' the report said.

By Adrianne Appel

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☐ *The Pew report, ''Tax Code Connections,'' is at http://src.bna.com/cGr.*

Illinois

Procedure

Illinois Gov. Rauner Uses Budget Address To Demand Structural Change Before New Taxes

Gov. Bruce Rauner (R) had few new ideas for solving his state's ongoing fiscal crisis during his annual budget address Feb. 17, sticking with his demands for libertarian ''structural reforms'' before any compromises on a tax strategy to address a yawning budget shortfall.

Rauner, who still hasn't struck a Fiscal Year 2016 budget deal with the Democrat-controlled Illinois General Assembly, showed little patience for compromise in his plan for a fiscal year 2017 budget. Rauner emphasized themes he has repeated consistently since taking office at the beginning of 2015, arguing that tax increases without reforms addressing the cost of state government and Illinois' bleak business climate would only drive families and jobs out of the state.

''I won't support new revenue unless we have major structural reforms to grow more jobs and get more value for taxpayers,'' Rauner said. ''I'm insisting that we attack the root causes of our dismal economic performance.''

According to budget documents released with Rauner's address, the governor is proposing $36.3 billion in general fund spending against revenue of $32.8 billion. Rauner gave lawmakers two options for bridging the expected $3.5 billion gap: give the executive branch full authority to significantly cut spending, or engage in negotiations aimed at cost-saving structural reforms and new tax revenue.

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'Turnaround Agenda.' Some of those structural reforms were laid out last year in Rauner's ''turnaround agenda,'' a set of non-budgetary policy initiatives that the rookie governor believes will jump start the economy. The agenda includes reforms to the property tax code, tort system and workers compensation program. In addition, Rauner wants to see the General Assembly roll back local-level prevailing wage and collective bargaining requirements.

Rauner also laid out a series of budget-specific ''policy transformations'' that would save the state $15.5 billion over four years. The initiatives include reforms to the state's public retirement systems and programming for education, procurement, health and human services and criminal justice. The governor also pointed to savings from changes to the group health insurance program and new strategies for compensating state employees.

Democrats Balk. Democratic legislators expressed little support for Rauner's proposals.

Senate President John Cullerton (D) said Rauner failed to provide lawmakers with a credible strategy to fund state government and blasted the governor for again linking non-fiscal issues to his spending plan.

''[W]ith all due respect to the governor, his budget speeches don't help Illinois,'' Cullerton said. ''At this point, the courts are running more of the state than our governor. It's going to require real plans and real action on his part to resolve the impasse he created. I want to work with him to find practical solutions to our problems because nothing Governor Rauner did in his first year worked for anyone.''

State Sen. Daniel Biss (D) said Democrats would be willing to engage in negotiations over structural reform, but not if the strategies harm working families.

''Gov. Rauner spoke extensively about our state's real structural problems and demanded that structural reforms be a part of the solution. I agree,'' Biss said. ''However, he continues to prioritize anti-worker reforms that would push down wages and harm the middle class. In fact, he continues to imply that states can only thrive economically if they embrace right-wing, anti-union policies. Of course, this assertion is utterly false.''

By Michael J. Bologna

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☐ *More information on the budget is at http://www.illinois.gov/gov/budget/Pages/default.aspx.*

Oklahoma

Procedure

Oklahoma Budget Gap For 2017 Grows to $1.3 Billion

Revenue for fiscal year 2017 appropriations will be nearly 16 percent less than what was appropriated for FY 2016, Oklahoma finance officials announced, leaving the state with a $1.3 billion budget shortfall for 2017.

Oklahoma's Board of Equalization certified $5.85 billion in revenue for fiscal year 2017 appropriations, arriving $1.1 billion—or 15.9 percent—short of what was appropriated for FY 2016, the state's Office of Management and Enterprise Services (OMES) said Feb. 16.

''The true budget hole the Legislature will face is larger than what the board certified,'' according to the OMES statement. By law, the state noted, $150 million in FY 2016 Rainy Day Fund appropriations in addition to $77.5 million in revolving fund authorizations are not factored into the 2016 baseline amount used by the board.

''With those factors considered, there will be $1.3 billion, or 19.1 percent, less to appropriate for fiscal year 2017,'' it said.

Additionally, the board projected general revenue fund collections for 2016 to come up 9.6 percent short, or $549.2 million below the official estimate upon which the FY 2016 appropriated state budget is based.

Revenue Failure. In December 2015, the OMES declared a revenue failure, citing low oil prices and resultant falling revenue. A revenue failure occurs when collection to the general revenue fund falls below 95 percent of the certified estimate. It triggered a 3 percent reduction in monthly general revenue allocations to agencies at the beginning of 2016 .

The state missed its revenue collections estimates for January 2016 by more than 17 percent, Oklahoma's top finance official pointed out, warning of further spending reductions in the future for state agencies beginning in March and citing the ''more pronounced'' effects of low oil prices .

The precise amount of the ''deepened reduction to general revenue allocations'' will be determined in early March, after February revenue collections are received, according to the OMES statement.

By Paul Stinson

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Multistate Developments

Constitutional Doctrines

What Will Future of State Tax Law Look Like Without Justice Scalia?

With the sudden passing of Justice Antonin Scalia, the empty seat on the U.S. Supreme Court is a reminder of a three-decade era marked by an originalist jurist whose ''bigger than life'' presence reshaped the highest court's discourse, but whose absence may have a material impact on future state tax cases.

Scalia's legacy among state tax practitioners is most notably his indelible mark on dormant commerce clause jurisprudence, which is peppered with the late justice's criticism of the doctrine not found in constitutional text. The negative inference from the federal commerce clause, prohibiting state discrimination against interstate commerce, struck a chord with Scalia that brought forth such colorful characterizations as ''judicial fraud.''

Whether the new justice will take up his or her predecessor's mantle of containing the negative commerce clause remains an unanswered question, leaving practitioners to reminisce on Scalia's legacy and speculate on the doctrine's future.

Discussing the future of the doctrine, Brannon P. Denning, an associate dean and professor at Cumberland School of Law, observed that ''it's hard to say at this point, other than one of the dormant commerce clause intellectual antagonists has left the scene.''

And even with the appointment of a new justice, individual ideological leanings don't necessarily translate into predisposed opinions, so that time may be needed to determine whether the Supreme Court's new composition will change dormant commerce clause law.

Referring to *Comptroller of the Treasury of Md. v. Wynne*, with a 5-4 majority opinion that didn't follow the typical lines of division, Jeffrey A. Friedman noted that issues arising under the dormant commerce clause ''don't align well politically.''

''There is a lot of uncertainty,'' said Friedman, a partner with Sutherland Asbill & Brennan LLP in Washington. ''And I don't think we'll have any guess as to where this body of law is all going without allowing for the passage of time and more cases to be decided.''

Practitioners share the same speculation regarding the outlook for the *Quill* physical presence standard, which is increasingly under attack by states implementing new regimes to capture revenue from remote sellers with limited or no physical presence.

While the Supreme Court hasn't had the appetite to accept a challenge to its 1992 decision in *Quill Corp. v. North Dakota*—where the court said that states can only require collection of sales and use taxes by vendors with a physical presence in the state—Friedman suggests that the shifting makeup of the bench ''has the potential for increasing the chances of the court taking a case.''

'Quill' Challenge? As more states seek to collect tax from remote Internet retailers, practitioners are watching for a case challenging the long-standing *Quill* physical presence standard to finally climb to the Supreme Court. In Scalia's absence, practitioners speculate whether the court would grant certiorari to a *Quill* challenge, as it could depend on the new justice or other influences, such as the enactment of federal legislation or a streamlined agreement among states.

''It is noteworthy that both of the Justices who joined Scalia's opinion [concurring in *Quill*], Justice Kennedy and Justice Thomas, are still on the court and Justice Kennedy last year stated in his concurring opinion in *Direct Marketing Association* that it is time to reconsider the court's holding in *Quill*,'' Craig B. Fields, chair of Morrison & Foerster LLP's State + Local Tax Group, said in a Feb. 17 e-mail.

Noting that the chances of Supreme Court review may have increased by ''a very small extent,'' Charles A. Rothfeld, special counsel with Mayer Brown LLP, observed that Scalia ''would have been philosophically prepared to jettison *Quill* if the court were prepared to go that way.''

Rothfeld, who has argued 31 cases before the Supreme Court, added, ''In that sense, I don't know that a new justice is going to be any more hostile to the *Quill* doctrine or more willing to reconsider it than Scalia would.''

In his concurring opinion, Scalia agreed with the *Quill* court that the commerce clause holding of *Nat'l Bellas Hess v. Ill. Dep't of Revenue* shouldn't be overruled, but on the grounds of *stare decisis*, a doctrine that was a strong influence in his opinions.

''Even with his seemingly ironclad view that the Commerce Clause should not have a negative component that could be used to create 'judge-invented law,' Justice Scalia did note limited exceptions to that rule,'' Grant Thornton LLP principal Jamie C. Yesnowitz said in a Feb. 17 e-mail. ''Bowing in part to *stare decisis* concerns,'' Scalia would enforce the negative commerce clause against a state law that is facially discriminatory against interstate commerce or is indistinguishable from prior law that the court held unconstitutional.

Also embedded within Scalia's concurring opinion in *Quill* was language instructing lower courts to follow Supreme Court precedent that ''has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions,'' leaving the Supreme Court with the sole authority to overturn its decisions.

This instruction may be put to the test as courts start to contend with state schemes that test the boundaries of *Quill*.

''Starting with the legislatures who are considering, and in some cases passing, laws that are clearly running head-long into the *Quill*/*National Bellas Hess* line,'' Friedman questioned how courts will respond when those laws are challenged. ''Will courts kind of adhere to Scalia's admonition—let the Supreme Court decide and in the interim you're stuck with *Quill*? Or will they do something different? That's going to keep us busy for the next two to five years, while this gets further hashed out.''

Outlook for Dormant Commerce Clause. As the highest court's staunchest champion of strict constitutional construction, Scalia artfully penned numerous opinions that rejected the ''negative'' commerce clause as beyond the confines of the constitution, including *Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue* and *Itel Containers Int'l Corp. v. Huddleston*. With his final attack in *Wynne*, Scalia seemed to coalesce his

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prior opinions into one composite that offers a clean, and colorful, closing argument against the doctrine.

Richard D. Pomp, the Alva P. Loiselle professor at the University of Connecticut School of Law, told Bloomberg BNA in a Feb. 17 e-mail that Scalia's dissent in *Wynne* elevated his views on the dormant commerce clause to their ''zenith (or nadir depending on your own views).''

Pointing out what he termed the court's ''ad hocery,'' Scalia branded the negative commerce clause a ''judicial fraud,'' as evident by ''the utterly illogical holding that congressional consent enables States to enact laws that would otherwise constitute impermissible burdens upon interstate commerce. How could congressional consent lift a constitutional prohibition?''

Countering the majority's claim that the doctrine ''has deep roots,'' he responded, ''So it does, like many weeds.''

This last stand against the dormant commerce clause was a final curtain call for a justice who, while not voicing the popular view, managed to minimize the number of state tax challenges that found favor with the Supreme Court.

''Even though the court didn't buy into the full extent of his views, it probably diminished its willingness to expansively read these commerce clause restrictions on state taxation,'' Rothfeld said. ''With him gone, that kind of damper on tax challenges will be removed. There is some chance the court will be more open to expansive readings of the commerce clause and more restrictions on state taxation.''

Pomp suggested that there may be movement on the bench to preserve Scalia's position.

''Taxpayers now challenging the constitutionality of a state tax will not start off with two votes against them, but only one,'' he said. ''Of course, it is possible that some of the more liberal justices will move to Scalia's views if only to give states more latitude to tax.''

However, as Scalia often stood in the minority, his absence may not alter the outcome of future state tax cases, but his devotion to the tenets of textualism may continue to guide the court.

''More often than not he was in the dissent on a lot of the state cases,'' said Steve Wlodychak, a Washington-based principal with EY LLP's Indirect (State and Local Tax) Practice. ''So, I don't think it's going to change the majority view. But I do think he did serve as governor on folks to think about the positions they were taking.''

Limited Judiciary Role. Noting that ''you're going to miss that intellectual breathe of fresh air, if you will, with respect to the concepts of the dormant commerce clause,'' Wlodychak said that Scalia's rhetoric on the dormant commerce clause wasn't a solitary argument against the judiciary's role in that context, but rather feeds into a larger legacy regarding separation of powers.

He characterized Scalia as an ''activist judge in the sense of telling the liberal court to hold back and just be a textualist,'' adding that the justice's body of law was a reminder that ''there are three branches of government. They all have separate functions. And the judiciary should not intrude on the others.''

This confined approach, however, favored the government with ''unenumerated rights or ambiguous phrases or balancing tests,'' including the tax issues of retroactivity and the dormant commerce clause, said Joseph Henchman, vice president of Legal & State Projects at the Tax Foundation.

''This was very frustrating to someone who believes the role of the court is to protect individual rights from majoritarian abuses like retroactive and discriminatory taxation, but Scalia would have said to sort it out in the state legislators or the halls of Congress,'' Henchman said in a Feb. 16 e-mail. ''Not because he prized or valued legislators as infallible angels but I think because he didn't consider courts better equipped procedurally or credibly to handle them instead.''

Energized Court Dynamics. While Scalia's tenure is documented in written prose considered ''poetic,'' ''provocative'' and ''ascerbic,'' it remains to be seen whether his unwritten influence will continue to steer attorneys presenting before the Supreme Court.

''There was a dramatic change in how people argue cases before the Supreme Court, pre-Scalia and post-Scalia,'' said Mayer Brown's Rothfeld. ''His relentless focus on the text has really changed the way people argue,'' pointing out that the focus shifted from the legislative history to a plain language analysis.

Likewise, Scalia ushered in a Socratic approach to oral arguments, whereas before justices rarely engaged or questioned attorneys.

Remembering the force of Scalia's writing and personality, combined with his dominant presence during oral arguments, Rothfeld said the late justice had a unique impact ''on how people approach the court.''

BY JENNIFER MCLOUGHLIN

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California

Procedure

Bill Would Restrict Contributions To Members of California SBOE

A California State Board of Equalization member is backing a bill to tighten monetary contributions to—or at the request of—board members with the goal of ending perceived conflicts of interest at the only elected tax board in the country.

All contributions to members of the SBOE from individuals or companies with an interest in a tax appeal before the board, as well as contributions from them to outside organizations at the behest of a member, would be banned under a bill to be introduced Feb. 10.

SBOE member Fiona Ma (D), who is sponsoring the bill, and Assemblyman Bill Dodd (D), the bill's author, both told Bloomberg BNA they are acting in response to a recent Bloomberg BNA examination of payments from companies with business before the board to nonprofit organizations tied to the wife of SBOE Chair Jerome Horton (D) at his request .

''It goes directly to the fact that they're sitting as a judicial body, which is different from a legislative body,'' Dodd told Bloomberg BNA Feb. 8. ''Where such important decisions are being made for the financial future of the state, these are important standards to give the public the confidence they deserve in these decisions.''

Ma said board members should avoid even the appearance of a conflict of interest.

''Unlike Senators or Assemblymembers, the votes we make can have an immediate, sometimes multi-million dollar impact on businesses and taxpayers,'' Ma told Bloomberg BNA in an e-mail. ''BOE can't be seen as a pay-to-play agency. We should not be putting ourselves in the position where our motivations for voting a certain way are questioned, and I think legislators and the governor will be very receptive to our argument.''

Administrator, Adjudicator. Unlike other elected officials, the five SBOE members both administer the state's tax programs and adjudicate disputes between taxpayers and the state regarding those programs. They are free to accept campaign contributions from those taxpayers with some limits. Their dual roles as politicians and judges are at the heart of the bill.

''By enactment of this act, it is the intent of the Legislature to eliminate the perceived conflicts of interest associated with contributions and behested payments by parties, participants, their agents, and employees related to appeals before the board,'' according to the bill.

Like a similar bill introduced in January, Dodd's bill would change the current $249 limit to zero on contributions from taxpayers or their representatives who are parties to an appeal before the board, or who have a financial interest in the outcome of the appeal .

Dodd's bill would go further to expand the definition of prohibited contributions to include payments made at the behest of a board member for a legislative, governmental or charitable purpose. Such payments are legal for California elected officials, as long as they meet disclosure rules.

Horton: $731,835 in Payments. Bloomberg BNA found through its investigation that Horton has reported $731,835 in behested payments since he joined the board in 2009, with most of it going to or through non-profit organizations tied to his wife and used to host events and buy advertising loosely tied to the board's tax mission. Much of the money or in-kind donations Horton requested came from companies with business before the board.

The bill, amending the Quentin L. Kopp Conflict of Interest Act of 1990, would also expand the current restriction on contributions in the 12 months before a case is heard to apply to the 12 months after the board adjudicates a dispute. Members would be banned from ''requesting, suggesting, or accepting'' contributions from a taxpayer, representative or interested party in a case in the 12 months following a board decision in a tax appeal.

Dodd said his bill would also address instances in which companies or their representatives have aggregated $249 contributions from multiple employees to avoid the limit. The bill adds employees of a taxpayer, representative or other entity with an interest in a case to the definition of parties or participants to whom the contribution restrictions apply.

Bundled Contributions. Most recently, 40 employees of tax consulting firm Ryan LLC gave Horton $11,000 in $249 increments on Aug. 14, 2014, and 26 Ryan employees gave SBOE Vice Chair George Runner (R) $6,425 in $249 increments on May 19, 2014, according to campaign finance filings with the secretary of state.

Board members who receive contributions that fall under the bill would be required to disclose the contributions and recuse themselves from participating in cases tied to the contributions. Alternatively, the members could participate in the matters if they have returned the contributions within 30 days.

Members who violate the law would face misdemeanor charges, a four-year ban on running for public office or working as a lobbyist, and civil penalties of $10,000.

Taxpayers or their representatives making contributions to individual board members would be required to disclose the contributions to the full board within 30 days.

Potential for Corruption. The SBOE's current rules allowing contributions from individuals or entities to board members who can make decisions that specifically affect the donors create an inherent potential for corruption, Craig Holman, a government affairs lobbyist with Public Citizen in Washington, told Bloomberg BNA Feb. 9.

Even if the contributors don't exert undue influence over the public official receiving the money, questions about whether the money influenced the official's decision will always exist, Holman said.

Although no other body like the SBOE exists in the U.S., Dodd's bill is most akin to laws in 15 other states banning contributions to public officials who have the authority to award contracts to specific individuals or companies, Holman said.

''It is perfectly justifiable for a government agency to determine that the potential is so grave for corruption that rules like this are appropriate,'' Holman said.

By Laura Mahoney

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☐ *Text of the bill is at http://src.bna.com/cyG.*

California

Procedure

SBOE Offers Tax Relief for Businesses, Others Affected by Los Angeles Gas Leak

Business owners and others who pay sales and use tax or fees to the State Board of Equalization are eligible for relief from filing deadlines if they are affected by an ongoing leak from an underground natural gas storage facility in the Los Angeles area.

Tax and fee payers can ask for an extension on return filing deadlines, as well as relief from penalties and

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interest if they are in the area covered by Gov. Jerry Brown's (D) Jan. 6 state of emergency declaration, the SBOE said Feb. 8.

In addition to the sales and use tax, the relief applies to fuel taxes, alcoholic beverage taxes, cigarette and tobacco product excise taxes and more than a dozen other special taxes and fees.

The leak at the Aliso Canyon underground storage reservoir, owned by Southern California Gas. Co, a subsidiary of Sempra Energy, began Oct. 23, 2015, and has released more than 80,000 metric tons of methane into the area.

Residents in Porter Ranch and other neighborhoods near the facility have reported headaches, nausea, nosebleeds, dizziness and other ailments the state's Office of Environmental Health Hazard Assessment said can be caused by exposure to odorants used in natural gas.

The utility is temporarily relocating residents, installing air scrubbers, and weatherizing homes while it works to cap the leak, a project it expects to be completed by the end of February.

The SBOE said tax and fee payers can go online to request relief, or call the SBOE at 1-800-400-7115 Monday through Friday, 8 a.m. to 5 p.m. U.S. West Coast time.

By Laura Mahoney

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☐ *More information is at http://www.boe.ca.gov/elecsrv/esrvcont.htm#Request_Relief.*

Florida

Procedure

Florida House Passes Broad Tax Cuts Focused on Business Rent Tax

The Florida House passed a tax-cut package worth almost $1 billion, including a cut to the state's sales tax on commercial rent payments and the elimination of sales tax on manufacturing equipment purchases.

The House approved H.B. 7099 on Feb. 11 by a vote of 96-17, and the bill is due next for consideration by the state Senate, where some have questioned whether the state budget can handle such large revenue cuts.

The $1 billion figure matches the tax-cut package Gov. Rick Scott (R) proposed, although the details differ. Most notably, the House bill omits the governor's permanent elimination of corporate income tax on manufacturing and retail businesses at an annual cost of $770 million. Scott has promoted the tax cuts as a way to spur economic development and job growth .

The commercial rent tax reduction is the largest piece of the House plan, as bill sponsor Rep. Matt Gaetz (R) said Florida faces a competitive disadvantage as the only state in the nation with a sales tax on commercial rent payments.

H.B. 7099 would reduce the tax by a percentage point to 5 percent permanently starting in 2017, with a temporary further cut to 4 percent for 2018 only. The reduction would cost an estimated $290 million annually plus another $310 million in 2018, according to a legislative staff analysis. The governor's plan called for a smaller reduction in the rent tax.

The House and governor's proposals agree on permanently extending a sales tax exemption for manufacturing equipment at an estimated annual cost of about $75 million. The current exemption is due to expire in 2017.

Within a long list of sales tax exemptions, the House plan contains an exemption for equipment used to build data centers, while also temporarily increasing the corporate R&D and brownfields credits available. Both proposals also include various sales tax holidays and a one-year renewal of the sales tax exemption on college textbooks.

By Chris Marr

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☐ *Details and text of H.B. 7099 are at http://www.myfloridahouse.gov/Sections/Bills/billsdetail.aspx?BillId=56550.*

Legislative analysis of the bill is at http://src.bna.com/crg.

New Jersey

Procedure

Voters Would Decide on Casino Expansion Under New Jersey Constitutional Proposal

Voters in New Jersey would decide in November whether to expand casino gambling outside of Atlantic City under a proposed constitutional amendment winding its way through the Legislature.

"Hopefully this is something that the voters will be open to and will pass, because New Jersey has lost its exclusivity to our surrounding states," Vincent Prieto (D), one of the proposal's sponsors, said in a press conference Feb. 8 when the resolutions advanced out of committee in both chambers.

Republican Assemblyman Chris A. Brown, who opposes expanding casinos to the northern part of New Jersey, argued that the bill shouldn't pass without first specifying the tax rate that new casinos would pay on gambling revenue.

"If we're supposed to have an intelligent debate and an intelligent conversation about amending the constitution, why wouldn't we be honest with people and tell them what the tax rate is going to be so they know exactly what they're voting on?" Brown was quoted saying in a Feb. 8 post on the Assembly Republicans website.

$1 Billion Investment. Assembly Concurrent Resolution No. 1 (A.C.R. 1), introduced Jan. 27 and reported out of committee Feb. 8, would amend the state constitution to allow casinos in two other counties outside of Atlantic City. No more than two casinos would be permitted, only one casino in each county would be permitted, and each casino would need to be located at least 72 miles away from Atlantic City, according to an Assembly Judiciary statement accompanying the measure. Under current law, casino gambling is only permitted in Atlantic City in Atlantic County.

The measure would require new operators invest at least $1 billion in each new facility. For the first 15 years, up to a third of tax revenue from gambling would be used to stabilize and improve Atlantic City.

The proposal would give existing Atlantic City casino operators first crack at owning the new gambling facilities. Eligibility for an initial license to establish a new casino would be limited to those whose majority equity owners are already a holder of a New Jersey casino license, or were principal owners of a holder of a New Jersey casino license, and were operating a casino when the resolution passed.

Senate Amendments. An identical concurrent resolution in the Senate, S.C.R. 1, was introduced Jan. 12, amended Feb. 4, and placed on the desk in both the Senate and the Assembly Feb. 8. The Senate and the Assembly must pass identical resolutions with a three-fifths majority by August to put the question to New Jersey voters in November.

The Senate's amendments shortened the amount of time that casino owners have to apply for new casino licences, from 180 days to 60 days. If an eligible applicant doesn't apply for a license within 60 days after applications are accepted, then any person may apply for that license, a statement from the Senate Budget and Appropriations Committee says.

Revenues Plummet. Atlantic City, once the largest U.S. gambling market outside of Las Vegas, has seen gambling revenue plummet as nearby states have opened casinos. Lawmakers agreed in January to back a proposal to expand gambling in the state and share the revenue with Atlantic City, which is teetering on the edge of bankruptcy.

Casino revenue in New Jersey have fallen from $5.2 billion in 2006 to $2.8 billion in 2015, Assemblyman John F. McKeon (D) said in a press conference about the proposal Feb. 8.

''Between Delaware, Pennsylvania and New York, the proliferation of casino gaming has really taken a heck of a dent into our aspect of those revenues and that aspect of the economy,'' he said, according to a transcript.

A different proposal to expand casinos to the northern part of the state was among a flurry of proposed constitutional amendments that failed at the end of the last legislative session that ended mid-January (22 Multistate Tax Report 879, 12/25/15).

New Jersey's constitution has been changed 71 times since its current version was adopted in 1947.

By Leslie A. Pappas

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☐ *The most recent version of S.C.R. 1 is at http://src.bna.com/cBP.*

New York

Procedure

N.Y. Assembly Speaker Proposes Tax Hike For Wealthy, Rate Cut for Middle Income

New York state's so-called millionaire's tax would be made permanent and the top personal income tax rate would be raised to 9.82 percent for taxpayers earning more than $10 million a year, under a bill (A. 9179) introduced by Assembly Speaker Carl E. Heastie (D).

The bill, introduced Feb. 2, which would lower personal income tax rates for middle-income taxpayers, would generate an additional $1 billion a year in revenue for the state, according to a statement from Heastie.

The bill comes as Heastie, Gov. Andrew M. Cuomo (D) and Senate Majority Leader John J. Flanagan (R) are negotiating the terms of a state budget for the 2016-17 fiscal year. It was also released as the Legislature's fiscal committees took testimony on the tax provisions of the governor's proposed budget.

Heastie's proposal faces opposition in the Republican-controlled Senate.

''Whether it's income taxes, property taxes, business taxes, user fees or tolls, we don't support raising taxes or asking hard working New Yorkers to dig deeper into their pockets to pay more,'' Flanagan said in a statement.

''New York should be cutting taxes across the board to help families make ends meet and to spark economic growth and opportunity all across this state,'' he said.

Rate Changes. Under the bill, New York's tax rates would be 6.25 percent for those with incomes between $40,000 and $150,000, 6.65 percent for those with incomes between $150,000 and $300,000, and 6.85 percent for those with incomes between $300,000 and $1 million.

Those with incomes from $1 million to $5 million would have a tax rate of 8.82 percent, while those with incomes between $5 million and $10 million would face a rate of 9.32 percent.

The rates would take effect in 2017 when the state's current personal income tax rates expire. Under a 2011 bill, the state raised its top rate to 8.82 percent from 6.85 percent for those earning over $2 million and reduced its rate to 6.45 percent from 6.85 percent for those earning between $40,000 and $150,000.

In testimony before the fiscal committees, the Heastie bill was supported by the liberal Fiscal Policy Institute, but opposed by the conservative Empire Center for Public Policy.

By Gerald B. Silverman

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☐ *The text of the bill is at http://src.bna.com/cnC.*

New York

Estate Taxes

CPAs Urge New York to Amend Estate Tax, Eliminating 'Cliff'

The New York State Society of Certified Public Accountants urged state lawmakers to amend the state's estate tax to eliminate a ''cliff'' that causes portions of certain estates to be taxed at a marginal rate of up to 164 percent.

New York increased its basic estate tax exclusion from $1 million to the federal level, under a 2014 law, but the exclusion begins to be effectively phased out for estates valued at 100-105 percent of the basic exclusion amount, leaving a steep cliff in place.

''This tax cliff goes against any rational hope of making New York state a more favorable environment for its residents planning the later stages of their life,'' Joseph M. Falbo Jr., president of the group, said during a Feb. 2 hearing of the joint fiscal committees of the state Legislature.

Falbo said, for example, a decedent with a gross New York estate of $5,512,500, will receive the current exclusion of $5.25 million, leaving a taxable estate of $262,500. This taxable estate, under the current law, will produce a New York estate tax liability of $430,050.

''This is a marginal New York estate tax rate of nearly 164 percent,'' he said. ''As CPAs, when clients come to us for estate planning advice, we are professionally and ethically bound to inform those who find themselves in this situation to consider leaving New York State to protect their estate assets.''

Tax Commissioner. Jerry Boone, the state tax commissioner, told the hearing that ''major investments in data analytics and cybersecurity'' allowed the Department of Taxation and Finance to identify 291,000 fraudulent refund claims last year, saving the state about $500 million.

''While many other states will be delaying refunds this year in an effort to combat identity theft, New York uses sophisticated fraud prevention systems that will allow us to process refunds without such delays,'' he said.

According to Boone, 2.7 million taxpayers, including 1 million businesses, have opened ''online service accounts'' with the department to obtain about 80 different tax services. In addition, 92 percent of all personal income tax returns were e-filed this year, he said.

''These efficiencies allow us to process over 26 million returns and collect over $100 billion a year in revenue with a reduced workforce,'' he said.

Boone was questioned by lawmakers on the elimination of 92 full-time equivalent positions at the department, under Gov. Andrew M. Cuomo's (D) proposed budget for the 2016-17 fiscal year. Boone said the positions would be eliminated through attrition, but couldn't specify exactly where in the department.

''We will certainly focus on the direct revenue generation areas to make sure that those are adequately staffed so that we fulfill our mission of collecting revenues efficiently,'' Boone said.

By Gerald B. Silverman

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☐ *For additional discussion of New York's estate tax, see Estates, Gifts, & Trusts Navigator, at New York 1.*

Connecticut

Procedure

Connecticut Governor's Budget Plan Contains No New Taxes

Following a year in which tax issues dominated the legislative landscape, Connecticut Gov. Dannel P. Malloy (D) has proposed a FY 2017 budget that contains no new taxes.

The package, which represents revisions to the second year of the state's biennial budget, contains several elements stemming from recommendations offered by a state tax review panel in late December (22 Multistate Tax Report 878, 12/25/15).

Those proposals include exempting the first $10,000 of business personal property from the local property tax and placing a maximum cap on the amount a decedent's estate will have to remit to the probate court to fund its services.

In addition, the budget notes that the Department of Revenue Services is moving forward with examining business taxation in the state, including the apportionment method for income derived from the sale of services and methods to enhance nexus determinations under the sales tax for remote sales.

The budget note states that many of the other recommendations made by the panel ''will have to wait for a time when the state's revenue picture improves.''

Change in Budgeting Model. Malloy told lawmakers in his State of the State address during the opening day of the 2016 legislative session on Feb. 3 that his mid-year budget proposal is based on ''not on how much we want to spend, but how much money we actually have to spend.'' He said the budget represents a shift from the ''current services model of budgeting'' to an ''accountability model of budgeting.''

Joe Brennan, president and chief executive officer of the Connecticut Business and Industry Association—the state's largest business lobby—said in a Feb. 3 statement that the proposals contain the ''tough, necessary changes'' the Connecticut needs to enact in order to ''resolve its fiscal issues and build a strong competitive economy.''

"The Governor's responding to what he's hearing from residents and large and small businesses, that government must change the way it operates if Connecticut's going to see strong, vibrant economic growth," Brennan said. "And the uncertainty created by the state's short- and long-term fiscal problems is what threatens that growth. Reforming the budget process will drive business confidence, investment, and job creation."

Deep Cuts. Office of Policy and Management Secretary Benjamin Barnes said in a budget briefing for reporters that the budget "is extraordinarily challenging and includes deep cuts to all areas of discretionary spending."

The budget unveiled by Malloy represents a second look at the budget for FY 2017. Connecticut operates on a two-year budget cycle and allows for midterm revisions to the second year of the budget. The revised budget announced by Malloy on Feb. 3 calls for spending to be reduced from the original FY 2017 budget by 2.8 percent, according to Barnes.

Barnes said the slower pace of economic growth and growth in state revenue means the state has $560 million less in general fund revenue to support state government compared to the expectations in place when the biennial budget was adopted.

The budget discusses several significant issues facing the state, including the need for pension overhaul and a call for a transportation spending lockbox.

Also contained in the budget is a reduction in the size of the state workforce.

Follows 2015 Action. Numerous steps were taken by lawmakers in 2015 to amend the state's tax laws to help cover a significant deficit facing Connecticut .

Following the initial legislative action, representatives of the business community, including General Electric Co., said the changes would severely impact their ability to do business in the state. This led to a December special session during which the Legislature enacted some significant revisions.

Those changes included placing an overall cap on the impact of the state's switch to a unitary method of taxation, instituting single factor apportionment based upon sales for all industries and gradually increasing the cap on the use of certain tax credits.

The budget bill will now go before the Joint Committee on Appropriations.

Changes Likely. Deputy House Speaker Bob Godfrey (D) said after Malloy's Feb. 3 speech that he appreciated the "broad-brush principles" laid out in the governor's remarks, but that the real analysis of the budget and how lawmakers would proceed would begin when they begin reviewing the details.

Godfrey said the governor was taking a "bold" step in confronting the fiscal issues confronting the state, but noted that the budget "never gets passed without changes."

Senate Minority Leader Kevin Witkos (R) said that Malloy's statement that Connecticut needs to look at what it has to spend, and not just start from what it has spent in the past, shows that "the governor took the Republican playbook, dusted it off, and said, 'I'm going to run some plays out of here because that's what we need to do.' "

Members of all parties said they support the governor's call to not wait until the last minute to pass a budget, as has happened in previous years.

The Legislature is scheduled to adjourn May 4.

By Martha W. Kessler

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☐ *Text of the governor's FY 2017 budget proposal is at http://src.bna.com/cpE.*

The governor's budget legislation for the fiscal year ending in 2017 is at http://src.bna.com/cqy.

Missouri

Filing Requirements

IRS Gives Missouri Disaster Victims Relief From Tax Filing Deadlines

Victims of the December-into-January storms in Missouri have until May 16 to file their tax returns and pay any taxes due, the IRS said.

Workers assisting the relief who are affiliated with a recognized government or philanthropic organization also qualify for the deadline relief, the IRS said in a Jan. 22 news release (IR-2016-9).

The relief postpones tax filing and payment deadlines that occurred starting on Dec. 23.

The Federal Emergency Management Agency issued a major disaster declaration Jan. 21 for the storms and flooding events of Dec. 23, 2015, through Jan. 9, 2016.

The IRS relief includes 2015 income tax returns that would otherwise be due April 18, this year's filing deadline. It also includes the Jan. 15 and April 18 deadlines for making quarterly estimated tax payments. A variety of business tax deadlines are also affected, including the Feb. 1 and May 2 deadlines for quarterly payroll and excise tax returns and the special March 1 deadline for farmers and fishermen who choose to forgo making estimated tax payments.

In addition, the IRS is waiving late-deposit penalties for federal payroll and excise tax deposits normally due on or after Dec. 23 and before Jan. 7 if the deposits are made by Jan. 7, 2016.

☐ *Text of IR-2016-9 is in TaxCore.*

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California

Procedure

California SBOE Will Elect New Chair, Ending Five-Year Run for Horton

The California State Board of Equalization (SBOE) will elect a new chair in February to replace member Jerome Horton (D), who has chaired the tax board for five years.

The five-member board voted unanimously Jan. 26 to put the question of the chair and vice chair on next month's agenda after member and current Vice Chair George Runner (R) raised the question during the monthly board meeting. Members Diane Harkey (R) and Fiona Ma (D) both told Bloomberg BNA Jan. 27 they are considering seeking the chairmanship.

The SBOE's policy manual calls for board officer elections every January. Runner told Bloomberg BNA Jan. 20 that he asked that the item called Organization of the Board be placed on the Jan. 26 meeting agenda while it was being drafted, and was surprised to see it wasn't on the agenda when it came out 10 days in advance, as is required by state open meeting laws.

As chair, Horton has the authority to approve board meeting agendas.

''It's clearly not just an oversight,'' Runner told Bloomberg BNA.

Long-Serving Chair. Horton is the longest serving chair since Richard E. Collins filled the post from 1915-1946, according to a listing of SBOE chairs and vice chairs on the agency's website. The office has generally rotated among board members every year or two since then, with the exception of one chair who held the post for almost four years from 1991-1994. Horton was first elected chair in 2011, and held the post without another vote until January 2015, when the most recent vote was conducted and he was re-elected.

At the Jan. 26 meeting, Runner made a motion to place the matter on next month's agenda. While discussing the motion, Horton and Runner both referenced a memo Horton sent to members on the topic Jan. 25.

Horton's Memo. In the memo, obtained by Bloomberg BNA, Horton said he intended to place the election of chair and vice chair on the agenda for January, but was unable to ''due to a few unresolved issues.'' He said he would place the item on the Feb. 23 agenda.

In the memo, Horton pointed out that historically the chair has rotated among members.

''I have come to appreciate the wisdom of this policy,'' Horton said in the memo. ''I recommend that we consider the reinstitution of such a policy as a fair and organized method for selecting the office each year in conformity with our constitutional tax administration and adjudicatory role.''

He also suggested new procedures for placing items on the agenda, and for selecting chairs for the board's various committees.

''I look forward to supporting the transition of our new chair at the February board meeting and sincerely appreciate your understanding, as well as your consideration of these recommendations,'' Horton said.

Rotation a Possibility. Before the vote, Runner and Horton agreed the board should discuss rotation of the chair, and other options for handling board leadership, at the February meeting.

Ma told Bloomberg BNA Jan. 26 she asked executive staff members about placing the item on the agenda in recent weeks, but didn't make a request directly to Horton.

''Per the BOE's procedures, we elected a chair last January and I expected this to be on the agenda,'' Ma said. ''The board will instead decide at the February meeting who will lead this organization as we overcome the challenges we are facing, with the priority being the controller's recent audits.''

Ma was referring to an audit from State Controller Betty T. Yee (D) released in November that found widespread deficiencies and lack of oversight in the sales tax fund, as well as the revolving fund used for salaries, travel and vendor payments and several other funds from 2013 to 2015. SBOE Executive Director Cynthia Bridges is no longer handling day to day operations of the tax agency, but is instead working on correcting the problems raised in the audit

As controller, Yee serves as the fifth member of the SBOE along with the four members elected from geographic districts in the state.

Through a spokesman, Yee and her deputy controller for taxation, Yvette Stowers, declined to comment on the question of the board's organization and leadership.

Harkey said she believes she could have the votes necessary to secure the chair when the board votes in February.

''I think it would be a great honor,'' she said.

Ma said Jan. 27 she doesn't presume she has three votes, but will see in February if she does.

''But if called upon, I would gladly assume leadership of this board and will work hard to improve transparency, accountability and improve our relationships with the Legislature, [Department of Finance], [Department of General Services] and other agencies.''

By Laura Mahoney

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North Carolina

Electronic Filing

North Carolina Waives Electronic Filing Requirements to Complete System Testing

Delays in electronic filing system testing mean employers may file paper or CD copies of Form NC-3, Annual Withholding Reconciliation, for tax year 2015, the North Carolina Department of Revenue said.

The bulk transmittal and web upload options for electronic filing are undergoing the final stages of testing and aren't yet available. Employers unable to file

electronically because of the tests may file using existing methods, the department said Jan. 1.

The department did not specify when the electronic filing options would become available.

Informational returns for tax year 2015 were to be the first forms required to be filed electronically after a law change (Session Law 2015-259) in October.

Informational returns are due Jan. 31, 2016.

By Caitlin Reilly

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☐ *The DOR's webpage on the NC-3 electronic filing process is at http://www.dornc.com/headlines/2016/nc3_update.html.*

A news release on the law change is at http://src.bna.com/b2e.

Nevada

Procedure

Nevada High Court Upholds C-Tax Distribution Formula

The Nevada Supreme Court upheld the state Department of Taxation's motion for summary judgment in a case challenging the constitutionality of a local government tax distribution formula known as the C-Tax.

In its unanimous Jan. 14 opinion, the court said the Nevada Legislature's enactment in 1997 of the Local Government Tax Distribution Account wasn't ''special or local'' legislation in violation of the state's constitution, as Fernley, Nevada had maintained (*Fernley v. Nev., Dep't of Taxation*, Nev., No. 66851, *advance opinion*, 1/14/16).

Joshua J. Hicks of Brownstein Hyatt Farber Schreck LLP's Reno office, who argued on behalf of appellant Fernley, told Bloomberg BNA Jan. 19 the ruling ''will make it more difficult and discouraging for municipalities to incorporate in Nevada.''

Pieces of the Pie. The C-Tax system is essentially a pie, and all counties, cities and towns have a piece, Hicks explained. To make one piece bigger means others have to get smaller. Whether a recipient likes or dislikes the C-Tax system all depends on how big of a slice they get from that pie.

According to C-Tax opponents, since the Legislature doesn't undertake any kind of thorough review of who gets what, but instead everyone gets the same relative distribution they got in 1997, there is no in-depth and objective analysis of whether C-Tax recipients are getting too much or not enough.

Now that the court has ruled against Fernley, ''it will most likely discourage future municipal incorporations in Nevada,'' Hicks told Bloomberg BNA.

The Nevada Attorney General's office didn't have a comment on the ruling.

By William H. Carlile

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☐ *The ruling is at http://src.bna.com/b50.*

Louisiana

Procedure

Louisiana Governor Presents Tax Plan, Proposes One-Cent Sales Tax Increase

With current deficits totaling about $300 million and future deficits totaling more than $1 billion in the coming fiscal year, Louisiana Gov. John Bel Edwards (D) outlined suggestions to bridge the gap, including increasing the sales tax by a penny.

Other proposals include repealing the business utilities sales tax exemption and suspending refundable ad valorem tax credits for business inventory, offshore vessels and public service properties.

Edwards outlined revenue-raising measures during a Jan. 19 news conference, but also suggested non-revenue measures such as tapping the state's rainy day fund, redirecting the first-year payment of the BP settlement that isn't earmarked for coastal redevelopment and cutting 10 percent of discretionary funds that aren't constitutionally protected.

''This is not the budget plan I want to bring in my second week in office, but these problems are bigger than our state has ever seen,'' Edwards said in a Jan. 19 statement.

''The challenge before us is one we must address collaboratively and comprehensively in order for our state to prosper again. The sharp drop in oil prices, while significant, only contributes to a fraction of the problem our state faces,'' he said. ''What I offer is a responsible plan to stabilize our state's budget shortfall and minimize severe cuts in the next three months that would deeply hurt our citizens, hospitals, public schools and universities.''

In the current fiscal year, ending June 30, Louisiana faces a general fund shortfall of at least $227 million as well as a gap of more than $1 billion, potentially up to $3 billion, between revenue and projected expenses in the 2017 fiscal year budget, a report by the governor's transition committee on fiscal matters said.

The governor's plan includes a one-cent increase in the state sales tax, called the ''clean penny'' sales tax. It would add one cent to the existing four-cent state sales tax but wouldn't provide any exemptions to who pays the additional one-cent tax, except for constitutional exemptions for groceries, prescription drugs and residential utilities.

Burden on Business. This could make paying sales tax in Louisiana for businesses even more complicated, Bill Backstrom, a partner at Jones Walker LLP who leads

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the firm's tax and estates practice group, told Bloomberg BNA. If the clean penny sales tax passes, a business could be exempt from paying local and state sales tax, except for the 1 percent clean penny sales tax.

For example, purchases of materials and supplies for vessels operating in interstate and foreign commerce are currently exempt from paying local and state sales tax under La. Stat. Ann. Section 47:305.1, Backstrom said. Under the governor's plan, those purchases could still be subject to the one-cent tax.

''If this clean penny passes, the local and state tax would still be exempt, but they'd have to pay the one percent tax, an additional burden,'' Backstrom said. ''That's just one example—I could list at least a dozen others.''

Other parts of the governor's plan to raise revenue in the short term include repealing the business utilities sales tax exemption; suspending refundable ad valorem tax credits for business inventory, offshore vessels and public service properties; and suspending net operating loss deductions for corporate income tax.

''In the short term, it seems like the burden will be on the business community,'' Backstrom said.

Long-Term Solutions. The governor's plan also addresses structural changes to the state's tax system, which he calls long-term solutions. His plan would cut income and corporate taxes across the board in exchange for eliminating the ability for both groups to deduct federal income tax. It would also enact add-back provisions for corporate income tax and a flat tax for corporations.

The flat tax and cuts in income tax in exchange for federal income tax deduction elimination are based on a proposal by the Transition Committee on Fiscal Matters. The group, a consortium of representatives of taxpayers, taxing authorities and academics, was appointed by Edwards to find solutions to the state's current and future projected deficits.

The budget deficits are expected to widen as energy prices continue to fall, putting downward pressure on state collections, the report said. The group said that short-term solutions such as budget cuts, consolidations, eliminations and privatizations had already been used during the past seven years. These methods have diminished ''the viability of these measures for dealing with the magnitude of the projected shortfalls outlined in this report.''

The report emphasized changes in the tax system that would make tax collection more efficient, which would broaden the tax base. Streamlining the tax collection system would also bring Louisiana's system into compliance if federal legislation on taxing Internet sales becomes law.

Voters Will Decide. The changes Edwards proposed aren't a done deal, Backstrom said. The changes would have to be approved by the Legislature, in some cases by a two-thirds vote.

Changes such as a lower tax bracket in exchange for giving up deductions would have to be approved by voters, which might pose a challenge. Simplifying the tax code by eliminating federal income tax deductions while lowering the tax rate across the board is considered good tax policy by tax policy groups and economists, Backstrom explained, but it might be harder to convince Louisiana voters to vote in favor of giving up a tax deduction.

''Lawmakers will have to clearly explain these changes to voters and how it will affect them if they want these to pass,'' Backstrom said.

Legislative Special Session. Edwards plans to call a three-week special session of the Legislature Feb. 15 to address the fiscal problem. With the current fiscal year ending June 30, there is a time crunch to make changes to the law and enact them so the state can raise funds in time.

''Business needs to be gearing up for the legislative session,'' Backstrom said. ''It looks like the short-term fixes are going to fall on the backs of businesses for the most part, and that's in an environment when businesses in Louisiana, especially in the energy sector, are already suffering.''

By Nushin Huq

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☐ *Text of Edwards' statement is at http://gov.louisiana.gov/news/gov-edwards-announces-initial-solutions-to-fy16-and-fy17-budget-shortfalls.*

Edwards' plan is at http://gov.louisiana.gov/assets/docs/Issues/State-Budget/LABudget-Options.pdf.

The transition committee's proposal is at http://gov.louisiana.gov/assets/docs/TransitionTeam/Final-Report_Committee-on-Fiscal-Matters.pdf.

For additional discussion of sales tax rates in Louisiana, see Sales and Use Tax Navigator, at Louisiana 3.

New Jersey

Procedure

Christie Signs New Jersey Estate Transfer Bills, Vetoes Hotel Tax, Others

New Jersey Gov. Chris Christie (R) signed bills to make it easier to settle estates in New Jersey and vetoed measures to raise hotel taxes, exempt certain nonprofit hospitals from property taxes and expand tax breaks in innovation zones.

In his final action Jan. 19 on bills passed during New Jersey's 216th legislative session, Christie signed S. 2251, which increases the threshold for transferring an estate to a surviving spouse without administration, and S. 2110, which requires nursing homes to offer a form to residents to designate a beneficiary of personal needs allowance accounts. The bills were approved as P.L. 2015, c.232 and P.L. 2015, c.230, respectively.

''Both of these measures will ease what is often a costly and lengthy process for families already undergoing a very difficult time and also save time and resources at the county level,'' Sen. Steven Oroho (R), the bill's sponsor, said in a Jan. 19 statement.

Under the first measure, estates valued up to $50,000 where there is no will could be transferred to a surviving spouse or partner without having to go through administration, as compared to the previous limit of $20,000. If there is no surviving spouse, the bills raise the threshold to $20,000 from $10,000.

The second measure also allows easier settling of small estates, by allowing the transfer of amounts of less than $1,000 that remain in a nursing home resident's personal needs account to be transferred to a pre-designated beneficiary without probate or administration.

Pocket Veto. Christie pocket-vetoed A. 4772, which would have allowed counties in New Jersey to impose a 1 percent hotel tax; S. 3299, which would have allowed certain nonprofit hospitals to pay services fees rather than property taxes; and S. 726 and 1257, which would have expanded the state's ''innovation zones'' and increased available tax credits (23 Multistate Tax Report 67, 1/22/16).

A pocket veto occurs when a governor doesn't act on a bill passed within the last 10 days of a legislative session. It is the only time the New Jersey governor can reject a measure without giving the Legislature an opportunity to override his veto.

Other tax-related measures signed, according to a Jan. 19 release from the governor's office, include:

- A. 2935, which authorizes property tax deferment for deployed military personnel. Approved as P.L. 2015, c.277.
- S. 2880, which provides up to $25 million in tax credits under the Economic Redevelopment and Growth Grant program for certain infrastructure at Rutgers, the State University of New Jersey. Approved as P.L. 2015, c.242.
- S. 3019, which requires filing of financial agreement for long-term tax exemption with county finance officer and counsel; requires quarterly payment of county share of payment in lieu of tax. Approved as P.L. 2016, c.247.
- S. 3168, which limits increase in annual budget requests of certain county entities. Approved as P.L. 2015, c.249.
- S. 3182, which delays certain documentation submission deadlines under certain business tax credit programs. Approved as P.L. 2015, c.252.
- A. 2943, which provides for voluntary contributions by taxpayers on gross income tax returns for active duty members of U.S. armed forces, components thereof and National Guard from New Jersey. Approved as P.L. 2015, c.278.

By Leslie Pappas

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☐ *S. 2251 is at http://src.bna.com/b7G.*

S. 2110 is at http://src.bna.com/b7I.

A. 2395 is at http://src.bna.com/b7t.

S. 2280 is at http://src.bna.com/b7u.

S. 3109 is at http://src.bna.com/b7w.

S. 3168 is at http://src.bna.com/b7x.

S. 3182 is at http://src.bna.com/b7z.

A. 2943 is at http://src.bna.com/b7A.

Alabama

Procedure

11th Circuit Affirms Alabama Tax Appeal Process, Dismisses Pro Se Residency Dispute

The Eleventh Circuit reaffirmed Alabama's taxpayer rights measures as providing a sufficient remedy for contesting tax assessments in ruling on a residency dispute argued by a taxpayer (*Kelly v. Ala. Dep't of Revenue*, 11th Cir., No. 15-12124, 1/15/16).

In an unpublished opinion from Jan. 15, the U.S. Court of Appeals for the Eleventh Circuit affirmed a lower court's decision to dismiss taxpayer Kaswana A. Kelly's complaint against the Alabama Department of Revenue (DOR) for lack of jurisdiction, due largely to the Tax Injunction Act's restrictions on federal courts interfering in state tax matters.

Though not surprising, the ruling ''does confirm there is a program in place in Alabama, and you don't need to go to the federal courts,'' William B. Sellers, a state tax attorney with Balch & Bingham LLP in Montgomery, Ala., told Bloomberg BNA Jan. 19. ''It upholds what we've all thought to be the case.''

Tennessee Residency Claimed. Kelly sought to contest income tax assessments for the years 2010 and 2011, totaling $1,707, since she said she had moved to Tennessee and no longer had Alabama tax liability.

The DOR said it deemed her to be an Alabama resident based on her still having an Alabama driver's license, according to the case summary in the Eleventh Circuit's opinion.

The taxpayer alleged numerous federal and state claims including violation of due process rights, the Fair Credit Reporting Act, and the Fourth Amendment by imposing a tax lien that prevented her from transferring property or refinancing her home. She sought injunctive and declaratory relief, as well as $200,000 in compensatory and $750,000 in punitive damages.

The appeals court agreed with the lower district court in finding her complaint failed to overcome the bar set by the Tax Injunction Act (TIA). In order to justify federal court intervention in state tax matters, the TIA requires a plaintiff to show there isn't a ''plain, speedy and efficient remedy'' for contesting the taxes through the state legal system.

Kelly attempted to argue that she couldn't contest the assessments through an Alabama DOR appeal because the deadline for appealing had passed. The taxpayer could still contest the taxes, however, by paying them, then requesting a refund and then filing a lawsuit when the DOR rejected the refund request, Sellers said.

Taking the case to federal court seemed an extreme approach, especially for a residency dispute, Sellers said. ''These aren't difficult to prove, and the revenue department has been pretty conciliatory when the taxpayers can show they're not a resident,'' he said.

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Arguments Similar to 'Hyatt.' Bruce Ely, a tax attorney with Bradley Arant Boult & Cummings LLP in Birmingham, Ala., said he also recently litigated a similar case in a federal district court, and he agreed the outcome of dismissal here wasn't surprising.

''But she put up a heck of a fight, especially as a pro se taxpayer,'' Ely told Bloomberg BNA Jan. 19. ''She raised a number of peripheral issues and arguments that resembled Gilbert Hyatt's successful claims against the California FTB a few years ago.''

Like the millionaire inventor Hyatt in his case against the California Franchise Tax Board, Kelly alleged the Alabama DOR and its agents were guilty of criminal fraud in their handling of her case

Ely also expressed concerns about the remedy left available to the taxpayer in this case.

''The court's ruling that a post-payment refund procedure also qualifies as a 'plain, speedy and efficient remedy' is the most troubling, but there are several cases on which it relied for that proposition,'' he said.

By Chris Marr

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☐ *Text of the opinion is at http://src.bna.com/b36.*

Maryland

Procedure

Maryland Panel Recommends Corporate Rate Cut, Other Tax Policy Changes

Suggestions that Maryland should gradually reduce its corporate income tax rate, allow a tax exemption for certain passthrough entity income and refrain from adopting combined reporting were among 14 recommendations issued by a panel that has been examining the state's tax policy for nearly a year.

The Maryland Economic Development and Business Climate Commission initially offered suggestions in 2015 on how to improve the state's business climate and then was recruited for a second round of analysis focused solely on tax matters (22 Multistate Tax Report 96, 2/27/15).

Having concluded its tax analysis, the commission Jan. 19 recommended various policy changes that would cut annual state and local tax revenue by an estimated $380 million once phased in over five years, if lawmakers were to implement all elements of the commission's 112-page report.

Would Require Legislation. A spokeswoman for Gov. Larry Hogan (R) told Bloomberg BNA in a Jan. 20 e-mail that the governor ''is supportive of any and all tax cuts that the commission proposes to improve our business climate and help change Maryland for the better. The administration looks forward to working with the General Assembly on the bills they will introduce from these important recommendations.''

The commission noted that it didn't have the expertise or the time to craft its recommendations into legislation, a task that would be left to the discretion of the General Assembly, which opened its 90-day session Jan. 13.

The 26-member panel, convened by top lawmakers in the General Assembly, has been dubbed the Augustine Commission because it is chaired by Norman R. Augustine, retired chairman and CEO of Lockheed Martin Corp.

Its recommendations address the individual income tax, corporate income tax, estate tax, data collection, tax credits, tax administration and—a topic suggested for future consideration—Maryland's combined state and local individual income tax rates and brackets.

Corporate Income Tax. The panel issued four recommendations regarding corporate taxation, including the suggestion that Maryland reduce its corporate income tax rate over three years from 8.25 percent to 7 percent.

Once phased in, such a rate cut would reduce state revenue by an estimated $175 million, the commission said.

The panel also recommended that Maryland use a single sales factor apportionment formula for all corporations, instead of the three-factor apportionment formula currently required for most corporations that takes into account property, payroll and double-weighted sales in the state.

The report noted that single sales factor apportionment will decrease tax liabilities for some corporations and increase them for others, but ''it will help reduce overall corporate income tax liabilities for corporations headquartered in the state or with significant amounts of property and payroll in the state.''

Although the panel didn't have concrete estimates of how such a move would affect revenue, it cited figures from the state comptroller stating that, if single sales factor apportionment had been in effect, corporate income tax revenue would have decreased by $14 million in tax year 2011 and increased by $22 million in tax year 2012.

No Combined Reporting. The panel recommended that Maryland should continue using separate entity reporting for the corporate income tax.

The report noted that lawmakers have debated for several years whether to require combined reporting, which would treat all members of a group of corporations engaged in a multistate enterprise as unitary for purposes of determining income attributable to a given state.

''This debate causes uncertainty and sends a negative message to businesses,'' said the panel, urging that lawmakers ''do not adopt combined reporting and indicate clearly the intent not to do so.''

Additionally in the area of corporate taxation, the commission urged adoption of a policy that eliminates Maryland corporate income tax on repatriated overseas earnings that have been taxed abroad, to the extent that the funds are invested in Maryland.

Passthrough Entities. The panel recommended an income tax exemption for up to $20,000 of the nonpassive income earned by members of passthrough entities, provided they have federal adjusted gross income of

$200,000 or less if filing singly or $250,000 or less if filing jointly.

The commission cited arguments that the taxation of passthrough entity income is unfair for some taxpayers, including many small business owners, because their income can be subject to a higher combined state and local income tax rate (up to 8.95 percent) than it would be under the corporate income tax rate of 8.25 percent.

Estimates indicate that such an exemption would reduce total state revenue by approximately $75 million annually and local revenue by $50 million annually.

Estate Tax. Regarding Maryland's estate tax, the commission noted that lawmakers approved legislation (H.B. 739) in 2014 that will gradually increase the value of the state exclusion by 2019 to mirror the federal amount .

Under that law, the amount that can be excluded under the state estate tax will rise gradually from $1.5 million for those dying in 2015 to $4 million for those dying in 2018, after which time the state exclusion will be ''recoupled'' with federal law.

The commission urged lawmakers to accelerate to 2016 the time frame for recoupling the state exclusion amount to the federal exclusion, a move that it said would reduce state revenue by an estimated $140 million over the current policy's five-year phase-in period.

Earned Income Tax Credit. The commission also recommended accelerating by two years the phase in of the currently planned increase in the refundable earned income tax credit.

Maryland already is on track to gradually increase the value of the refundable credit from 25 percent to 28 percent of the federal credit over four years, starting with tax year 2015, pursuant to legislation (H.B. 198) enacted in 2014.

The commission recommended raising the refundable credit amount to 28 percent in tax year 2016, as Hogan proposed recently when outlining his tax priorities for the 2016 legislative session (23 Multistate Tax Report 71, 1/22/16).

Estimates indicate such a move would reduce state income tax revenue by $25 million over a two-year period.

Tax Credits and Rates. Regarding current tax credits, the panel found that such programs are ''too many, too small and often uncoordinated and ineffectual'' in promoting economic development and business attraction and retention.

It urged a more rigorous evaluation of tax credits, the adoption of sunset provisions and the development of better methods to analyze and track tax credit claims.

In the area of tax administration, the panel recommended reducing the interest rate for tax deficiencies and refunds and instituting a private letter ruling process to provide tax guidance.

Finally, the commission suggested a review of Maryland's combined state and local individual income tax rates, which it said can reach as high as 8.95 percent depending on one's tax bracket and the county in which one resides.

The report warned that it might not be advisable to simultaneously pursue this suggestion and its other 13 policy recommendations because of the potential fiscal impact, but it strongly endorsed such a review once the state has fully recovered from the recent economic downturn and had a chance to ''assimilate and benefit from'' other tax policy changes called for in the report.

By Kathy Lundy Springuel

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☐ *The commission's report is at http://src.bna.com/b9L.*

Multistate Developments

Tax Base

Rising Incomes Pushing Average State Tax Burden Lower: Report

Average state and local tax burdens have declined and could fall further as personal income growth outpaces tax collections, with the possible exception of oil-rich states looking to counteract falling oil prices, a Tax Foundation economist told Bloomberg BNA.

The research and advocacy group's Jan. 20 report, ''State-Local Tax Burden Rankings FY 2012,'' showed a decline to 9.9 percent of total U.S. income being paid toward state and local taxes for fiscal 2012, down from 10.1 percent in FY 2011 and 10.4 percent in FY 2010.

''I think that trend probably will continue. That's mostly because personal income has been increasing faster than tax collections since the end of the Great Recession,'' Tax Foundation economist Nicole Kaeding told Bloomberg BNA Jan. 21.

The report found residents of New York, Connecticut and New Jersey faced the largest state and local tax burdens, with New York taking the No. 1 spot at a 12.7 percent tax burden. These three states frequently appear near the top of the foundation's rankings, and New York in particular has been No. 1 all but a few years since the foundation began reporting the figures in 1977, Kaeding said.

On the other end of the spectrum, residents of Alaska had the smallest state and local tax burden, at 6.5 percent of income, followed by Wyoming and South Dakota, both at 7.1 percent.

Oil States Under Pressure. The report, which lags a few years because it relies on Census Bureau and other government agency data, provides tax burden estimates based not only on tax collections within a resident's own state but also taxes paid across state lines—for example by tourists who pay sales tax when visiting another state or by owners of vacation homes who pay property taxes to another state.

Those taxes are estimated as part of the tax burden in the state where the person lives. Tax exporting helps keep the tax burden relatively lower for residents of some states, in particular those who collect taxes on oil and gas extraction conducted by companies based in

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other states. Kaeding noted, however, that such states could be faced with needing to increase the in-state tax burdens in the months and years ahead.

''A lot of the states at the lower end of the tax burden rankings are states with a lot of oil and gas extraction. As the price of oil has fallen dramatically, many of those states are facing budget deficits,'' she said.

In Alaska, for example, the Legislature and governor are considering various tax policy ideas to address a large budget deficit, including possibly creating a personal income tax.

''Alaska hasn't had an income tax since the Carter administration,'' Kaeding said. Such tax policy changes would increase the state and local tax burden for in-state residents, she added.

One factor not being compared in the rankings is the cost of tax compliance, which can vary from state to state depending on the complexity of corporate tax laws and even personal income tax returns, Kaeding said.

''Unfortunately there's not good data on compliance costs,'' she said. ''That's not being captured by the report.''

BY CHRIS MARR

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☐ *The Tax Foundation's tax burden rankings are at http://taxfoundation.org/article/state-local-tax-burden-rankings-fy-2012.*

Noteworthy

Duke Energy Loses $126M Tax Refund Bid in South Carolina

Duke Energy Corp. can't use principal recovered from the sale of short-term securities to reduce the percentage of its income attributable to South Carolina (*Duke Energy Corp. v. S.C. Dep't of Revenue*, 2016 BL 43621, S.C., No. 2014-002736, 2/17/16).

The South Carolina Supreme Court ruled Feb. 17 that inclusion of principal in the calculation of the company's total sales—when determining how much of its income is subject to South Carolina tax—would result in distortion leading ''to absurd results that could not have been intended by the General Assembly.''

Duke sought a $126 million refund by claiming that the total proceeds from the sale by its treasury department of short-term securities, which had no connection to South Carolina, should be included in the denominator of the fraction of its income taxable by South Carolina, thereby reducing that tax.

Subject to Misinterpretation. Although Chief Judge Costa M. Pleicones reached the same conclusion that the South Carolina Court of Appeals did in October 2014, he disagreed with the lower court's analysis (21 Multistate Tax Report 647, 10/24/14).

Pleicones said the lower court's description of the principal of the investment as Duke Energy's ''own money''—and not a ''receipt''—employed ''nomenclature that is subject to misinterpretation.''

The court said ''the appropriate determination is whether principal recovered from the sale of short-term securities could be included as 'total sales' in the sales factor of the multi-factor formula, the relevant term under the apportionment statutes.''

Apportionment Calculations. The matter involves a request filed by Duke Energy in 2002 for a $126 million refund of corporate income tax payments, plus interest, covering tax years 1978 to 2001. The power company had sought the refund based on the use of an apportionment formula applicable to non-manufacturing companies and the addition of gross receipts from sales of short-term investments in the formula's denominator, an approach to calculating taxes that the South Carolina Department of Revenue rejected.

In South Carolina, manufacturers are subject to an income apportionment formula that includes property, sales and payroll (S.C. Code Ann. Section 12-6-2252). All other companies use a formula that is solely based on sales (S.C. Code Ann. Section 21-6-2290).

An administrative law judge upheld the department's denial of the refund request, as did the South Carolina Court of Appeals in an October 2014 ruling.

'Distorting the Sales Factor.' Upon its consideration, the supreme court said that it was ''undisputed'' that the multi-factor apportionment formula applies in the case at hand. That formula uses the term ''total sales'' and whether principal recovered may be included in that factor ''is a novel issue in South Carolina,'' the high court said.

According to the state supreme court, principal from short-term investments could be used by taxpayers to manipulate the sales factor ''by the simple expediency of a series of purchases using the same funds.'' Such activities would distort the intent of apportionment provisions that aim to reflect the amount of a businesses' total income that is reasonably attributable to the business activity within a certain state, the court said.

Therefore, the court said, ''we agree with the states that have found the inclusion of principal recovered from the sale of short-term securities in an apportionment formula leads to absurd results by distorting the sales factor within the formula, and be defeating the legislative intent of the apportionment statues.''

Impact in Other States? ''Obviously, we are disappointed in the Supreme Court's ruling, but we will abide by the court's decision in this matter,'' Ryan Mosier, a spokesman for Duke Energy, told Bloomberg BNA in a Feb. 17 e-mail.

Mosier declined to say whether the utility had taken the approach at issue in apportioning income to North Carolina or other states in which it does business. ''Tax matters are confidential between a state and a taxpayer, so we do not discuss those,'' he said.

In addition to the Carolinas, Duke Energy sells power in Florida, Indiana, Kentucky and Ohio.

Trevor Johnson, a spokesman for the North Carolina Department of Revenue, told Bloomberg BNA Feb. 17 that his agency couldn't discuss how Duke Energy apportions its income in reporting to that state. However, Johnson said, generally speaking, ''the sale of short-term securities should not be included in the sales factor for apportionment purposes'' under North Carolina law (N.C. Gen. Stat. Section 105-130.4(a)(7)(d)).

By Andrew Ballard

COMING EVENTS

- ABA/IPT Advanced Income Tax Seminar, Feb. 29 - March 1, New Orleans, LA, http://www.ipt.org/
- MTC Winter Committee Meetings, March 2- 4, Salt Lake City, Utah, http://www.mtc.gov/

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