



TAXPAYERS'
FEDERATION
OF ILLINOIS

SALT CONFERENCE

National Update – Policy Issues & Discussion of State Tax Cases

September 21, 2023

Speakers:

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Learning Objectives

- Learn about recent COST/STRI studies & advocacy.
- Become familiar with some of the more significant recent income tax and sales and use tax decisions nationwide.
- Understand some of the “hot” SALT issues nationwide.
- Provide information on the states’ efforts to tax the digital economy.



Agenda

- COST/STRI Advocacy & Studies
- The U. S. Supreme Court
- Income Tax Issues
 - Combined Reporting
 - P.L. 86-272
 - Apportionment Issues
 - Tax Base
- Sales Tax Issues
- Taxation of Digital Services
 - Digital Service Taxes
- COST Proactive Initiatives



COST/STRI Studies & Advocacy

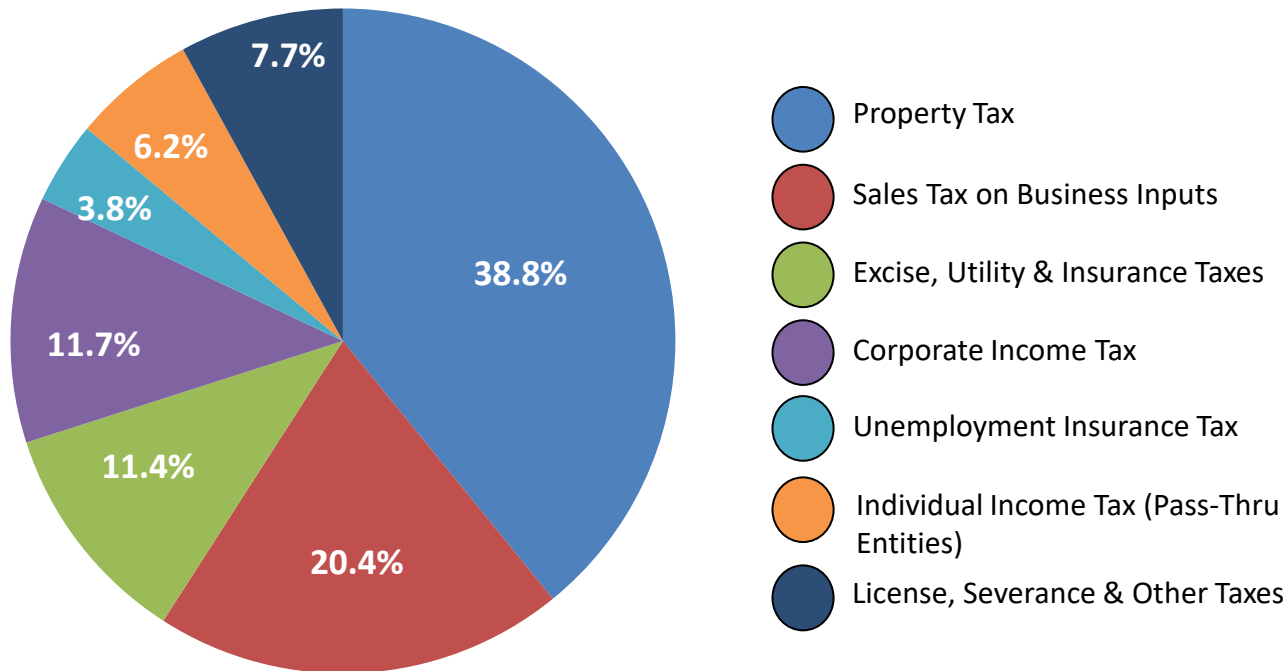


Recent COST/STRI Studies

- **State Digital Services Taxes: A Bad Idea Under Any Theory** (April 2023)
- **Five State Tax Policy Changes That Would Modernize Laws and Ease Administration and Compliance** (April 2023)
- **FY21 State and Local Business Tax Burden Study** (December 2022)
- **COST Scorecard on Sales Tax Administration** (December 28, 2022)
- **Resisting the Siren Song of Gross Receipts Taxes: From the Middle Ages to Maryland's Tax on Digital Advertising** (July 2022)
- **Locally Administered Sales and Accommodations Taxes: Do They Comport with Wayfair?** (July 2022)
- **A Global Perspective on U.S. State Sales Tax Systems as a Revenue Source: Inefficient, Ineffective, and Obsolete** (November 2021)
- **Convergence and Divergence of Global and U.S. Tax Policies** (August 2021)
- **State Adoption of European DSTs: Misguided and Unnecessary** (May 2021)



U.S. FY 2021 State and Local Business Tax Burden Study



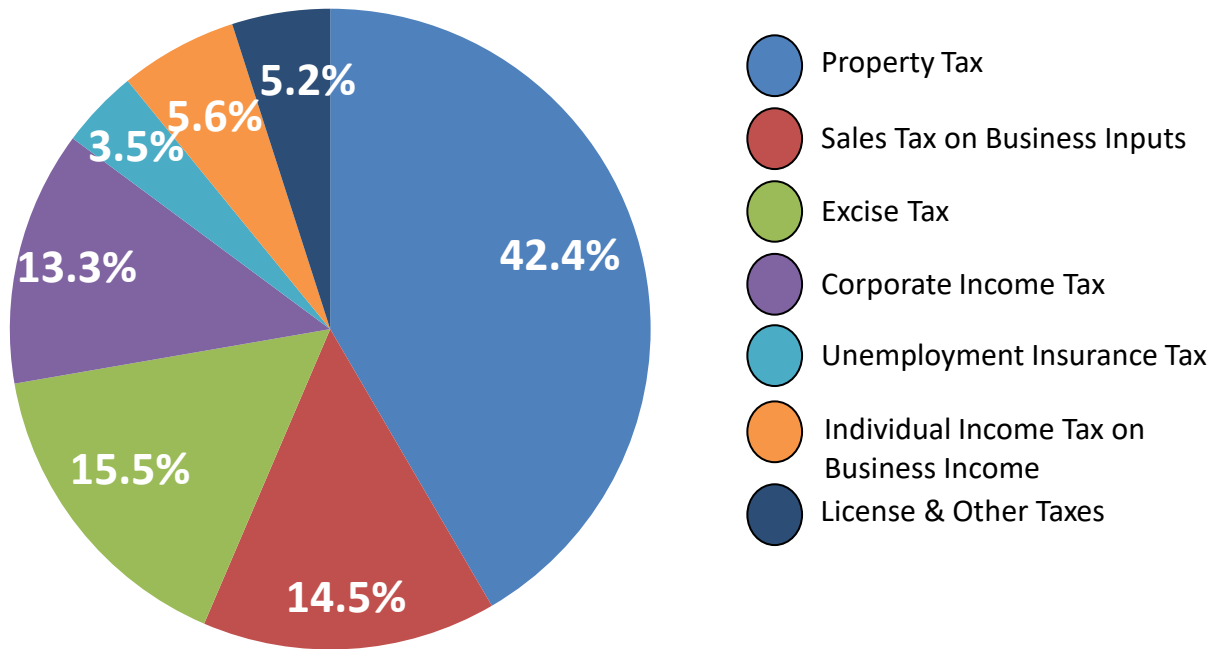
How Much Do Businesses Pay?

- Businesses paid more than \$951 Billion in U.S. state and local taxes in FY21, an increase of 13.6% from FY20
- State business taxes increased by 17% and local business taxes grew by 10.2%
- Corporate income tax revenue increased by 53.3% in FY21.
- In FY21, business tax revenue accounted for 43.6% of all state and local tax revenue
- Remarkably, the business share of SALT nationally has been within approximately 1% of 44% since FY03



Illinois FY 2021 State and Local Business Tax Burden Info

Illinois State and Local Business Taxes by Type



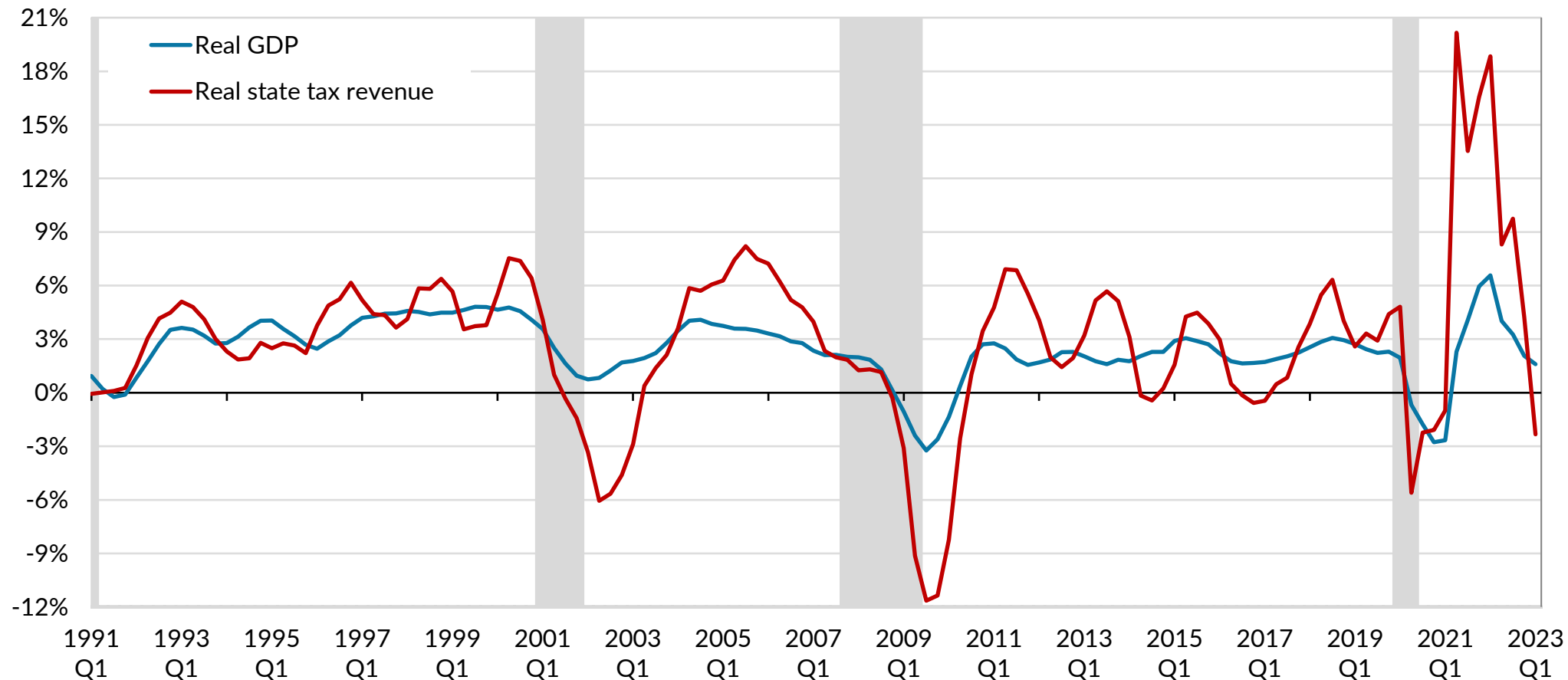
Source: Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2021, study prepared by Ernst & Young LLP for the State Tax Research Institute and the Council On State Taxation (December 2022)

How Much Do Businesses Pay?

- Businesses paid more than \$43 Billion in IL state and local taxes in FY21, an increase of 16.6% from FY20
- IL State business taxes increased by 24.26% and local business taxes grew by 7.3%
- IL corporate income tax revenue increased by 7.54% in FY21
- In FY21, IL business tax revenue accounted for 44.3% of all state and local tax revenue

State tax revenues are more volatile than the economy

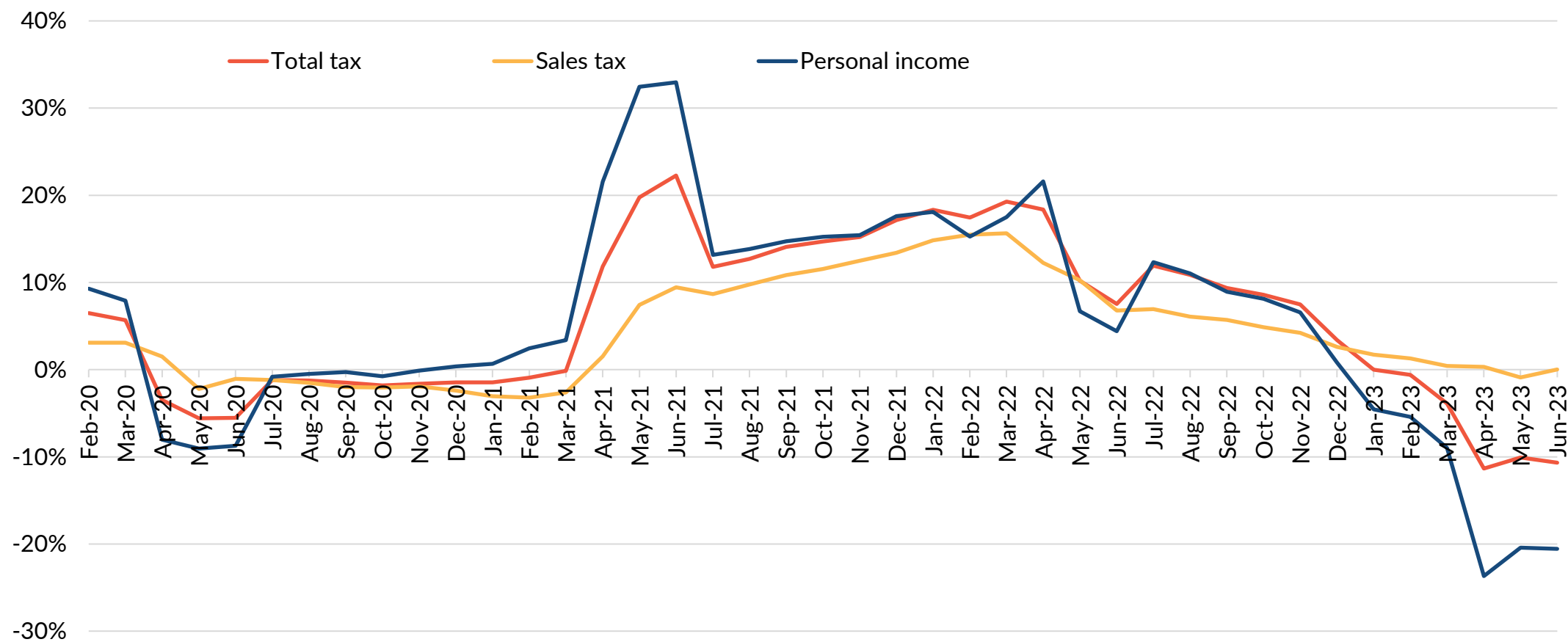
Year-over-year change in real state taxes and real GDP, 4-quarter moving averages



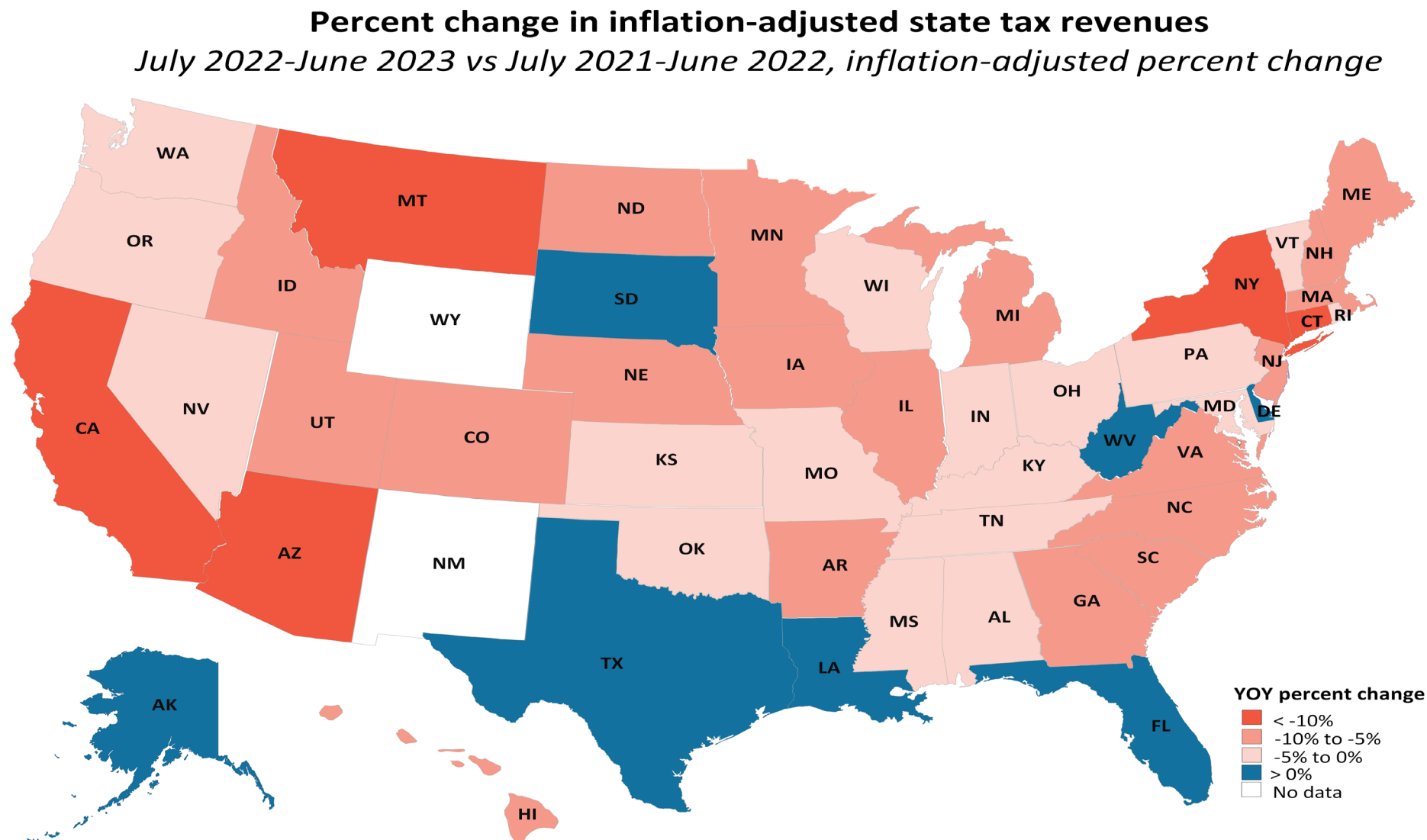
Trends in state tax revenues since the pandemic

Percent change in inflation-adjusted state tax revenues

Year-over-year percent change, 12-month moving averages



Current trends in total tax revenues: Large variation across states



Notes: Complete data is still not available for New Mexico and Wyoming.

<https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/projects/state-tax-and-economic-review>



Revised and New COST Policy Positions

COST's advocacy is governed by a broad set of public policy objectives. When advocating on issues, COST first looks to its official policy statements, which are approved by the Board of Directors. Members interested in participating in the development of COST's policy statements are encouraged to join the Policy Committee, the body that drafts policy statements (in conjunction with COST Staff) for Board consideration. The COST Staff and Policy Committee also develop "Policy Toolkits" for COST Member government affairs personnel to use in their individual advocacy efforts on discrete issues.

- **Four Categories:**

- State tax administrative issues focused on ease of compliance, fairness, efficiency
- Corporate income tax issues focused on constitutional overreach, fairness, efficiency
- Sales tax issues – taxation of business inputs, fairness, uniformity
- Other issues – focused on sound tax policy principles concerning property taxes, gross receipts taxes, unclaimed property, local taxes



COST Legislative Testimony

COST provides testimony/comments on legislative and regulatory SALT issues.

- **Thus far this year, COST has submitted over 55 comments to address SALT issues in about 20 states.**
- **Some of the issues covered in the comments:**
 - **Worldwide Combined Reporting**
 - **Digital Services Taxes**
 - **Unclaimed Property Issues**
 - **Repeal of Throwback Provisions**
 - **Many Others**
- **SALT issues directly related to a COST policy position allows COST staff to comment quickly on those issues.**



COST Amicus Brief Advocacy

COST files amicus briefs to support SALT litigation that impacts its membership. COST typically does not file an amicus brief until a case is pending at the highest court in a state or at the U.S. Supreme Court.

- **COST has a Legal Committee that works with COST staff to make recommendations to the COST Board on the filing of an amicus brief.**
- **An average of 10 to 15 amicus briefs are filed each year, below are some recent filings:**
 - ***Walmart Starco v. MO DOR* (9/14/23) - MO's resale and manufacturing exemption**
 - ***ADP v. AZ DOR* (5/19/23) – AZ's tax on SaaS as a rental of tangible personal property**
 - ***Petrogas v. Xczar* (WA 5/9/23) – WA's property tax imposition on good will (intangibles)**
 - ***Quad Graphics v. NC DOR* (US 4/18/23) – Sales v. use tax assessment and *Dilworth***
 - ***Comptroller of MD v. Comcast* (3/31/23) – Constitutionality of MD's digital advertising tax**



The U.S. Supreme Court



SCOTUS: *Pike* Balancing Test and the Commerce Clause

- *Loren J. Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970)
 - Where state statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.
- *South Dakota v. Wayfair Inc.*, 138 S. Ct. 2080 (2018)
 - Should the tax collection requirements be analyzed under the *Pike* balancing test?



SCOTUS: Application of the *Pike* Balancing Test

- ***National Pork Producers Council v. Ross*, 598 U.S. ____ No. 21-468. (May 11, 2023)**
 - The Petitioner’s challenged Proposition 12 which prohibited in-state sale of whole pork meat that comes from breeding pigs (or their immediate offspring) that are “confined in a cruel manner.” Proposition 12 changed the confinement standards for animals used in food production requiring each to have a minimum number of square feet. Petitioner argued that Proposition 12 violated the dormant Commerce Clause by impermissibly burdening interstate commerce. The Petitioner to support its argument relied on *Pike*. Specifically, do the law’s burdens on interstate commerce exceed the benefits to the local area?
 - The Court rejected the Petitioner’s arguments and affirmed the 9th Circuit Court of Appeals holding:
 - There is no *per se* rule under the dormant Commerce Clause forbidding enforcement of state laws that have the effect of controlling commerce outside the state;
 - Proposition 12 was not subject to any balancing test to assess whether the burden imposed on interstate commerce was clearly excessive in relation to the local benefits; and
 - Proposition 12 did not impose a substantial burden on interstate commerce.



SCOTUS: Challenge to Section 965 Transition Tax

- ***Moore v. United States***, Dkt No. 22-800, petition for cert. granted June 26, 2023.
 - At issue: Does the one-time Section 965 transition tax violate the 16th Amendment to U.S. Constitution because it is a “direct tax” that has not been apportioned among the states?
 - Section 965 deems the post 1986 deferred foreign income of a CFC to be Subpart F income in 2017. Effectively, taxing income that may have been earned decades earlier but held in the foreign jurisdiction
 - The Moores held an 11% investment in a CFC that supplied modern tools to farmers in India. The company had retained earnings of approximately \$508,000 as of the relevant 2017 date. As a result of applying Section 965, the Moores’ tax liability was increased by approximately \$15,000.
 - The Moores argued that Section 965 is not a tax on income because it fails the realization requirement — and is unconstitutional because it is not apportioned among states in accordance with their population.
 - Case is viewed as a test case for wealth tax impositions.



SCOTUS: *Mallory* on *Quad Graphics* in NC

Quad Graphics (Dec. 2022, cert denied June 20): NC Supreme Court implicitly overturned ***Dilworth*** by finding that sales tax applied to an out of state sale (as opposed to a use tax). Many observers (including COST and Prof. Pomp, in a joint amicus brief) felt the decision violated ***Rodriguez***, which says that only the Supreme Court can overrule its own precedents.

Mallory v. Norfolk Southern Railway, US Sup. Ct., decided June 27:

“As this Court has explained: “If a precedent of this Court has direct application in a case,” ... a lower court “should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions.” ***Rodriguez de Quijas v. Shearson/American Express, Inc.***



Income Tax Issues



Combined Reporting



Mandatory Combined Reporting

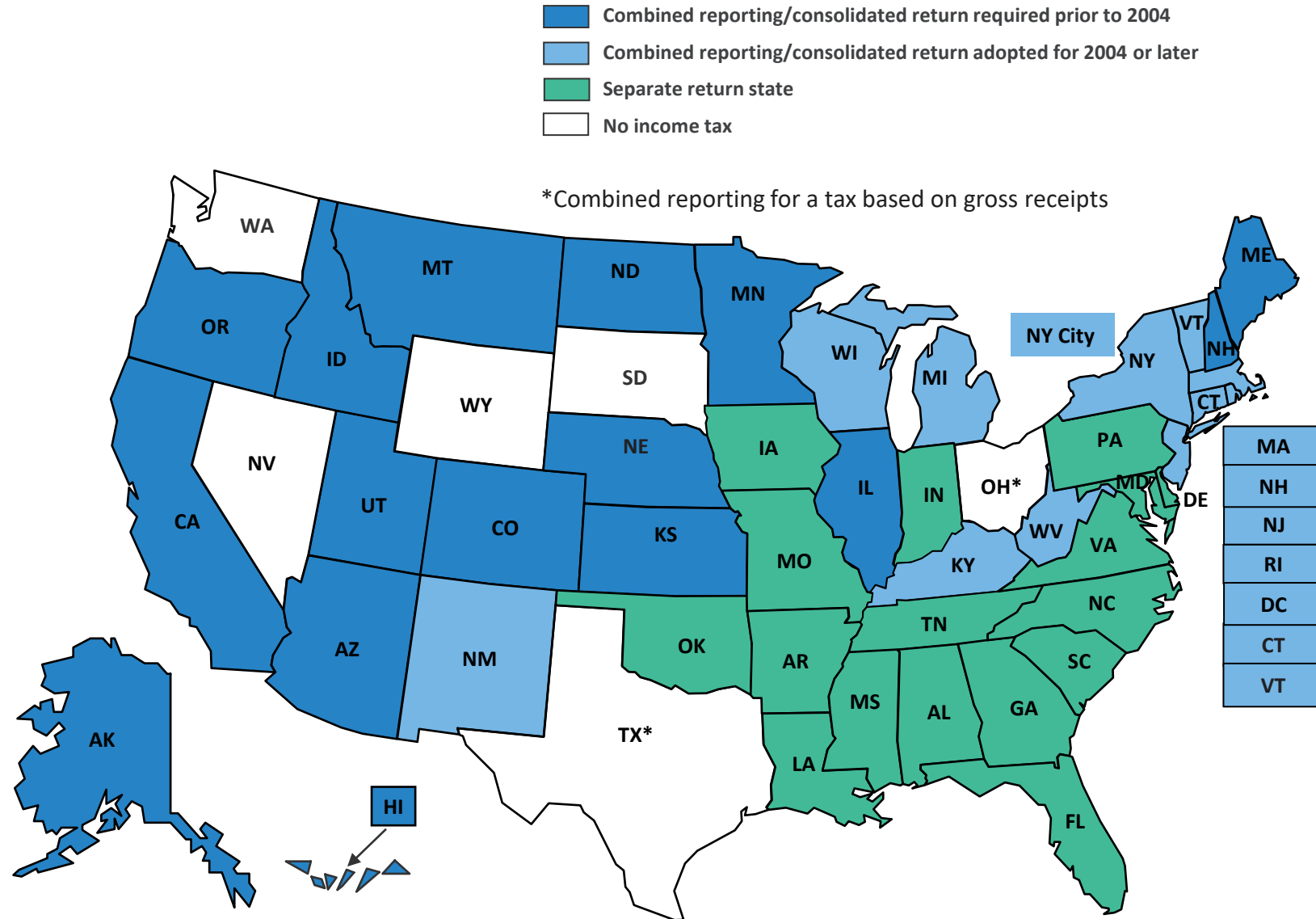
- **Legislation Introduced But Not Enacted:**

- FL H.B. 769, S.B. 1144 – Mandatory Combined Reporting (Water's-edge)
- HI H.B. 149, S.B. 986 – Mandatory Worldwide Combined Reporting
- OR H.B. 2674 – Worldwide Combined Reporting
- MD H.B. 46, S.B. 576 – Mandatory Combined Reporting (Water's-edge)
- MN H.F. 2883, S.F. 1811, H.F. 1938 – Worldwide Combined Reporting.
- NH H.B. 121 replaces water's edge with worldwide combined reporting for taxable years beginning after 12/31/23 – Study Commission's report due in November.

- **Legislation Pending**

- PA H.B. 1462 – Mandatory Combined Reporting (Water's-edge) pending House Finance Committee action.

COMBINED REPORTING ADOPTION



Disclaimer: This information should be used for general guidance and not relied upon for compliance.

Source: Council On State Taxation



Elective Consolidation

- **GA Act 824 (May 5, 2022) – Elective Consolidation for Affiliated Groups**
 - The GA General Assembly passed a bill in 2022 that will allow affiliated groups to elect to file as a consolidated group (Prior law only allowed consolidation upon application.)
 - Allows for the offset of NOLs of one group member against the taxable income of other group members (subject to SRLY rules)
 - Elections will be binding for 5 years
 - Effective for tax years beginning on or after 1/1/23.
- **VA HB 1405, SB 796 – Simplified Consolidated Election**
 - Enacted in March 2023, this legislation removes the requirement (one of three) that for the preceding tax year, the company would have paid higher taxes under the filing method they would like to adopt.
 - Companies still must wait 12 years to change filing status.
 - Companies still must calculate under both separate and consolidated methods for the first two years and pay the higher tax of the two.



Forced Combination in Separate Filing States

South Carolina

Tractor Supply Co. v. Dept. of Revenue (8/8/23), the SC Admin. Law Court upheld the SC DOR's use of combined reporting under an alternative apportionment theory (unique facts because both parties agreed that the original transfer pricing agreement/study was invalid).

- **Pending Legislation - S.298 – What it Does and Doesn't Do**

- Would impose common-sense and commonly used standards – identical to those used in North Carolina – on both the DOR and corporate taxpayers to determine when combined reporting can be used.
- Would not take away the DOR's ability to use forced combination reporting for entities with a corporate structure that lacks business purpose or economic substance or whose intercompany transactions are not at arm's-length.
- South Carolina has a reputation as a fair and efficient state in which to do business. The recent requirement of forced combination audits that the SC DOR is imposing on businesses jeopardizes the stability of the South Carolina business-friendly tax environment.



P.L. 86-272



MTC P.L. 86-272 Statement

- The Multistate Tax Commission approved proposed revisions to its Statement of Information Concerning Practices of Multistate Tax Commission and Supporting States Under Public Law 86-272 (Aug. 4, 2021).
- These revisions effectively revoke the protection provided by P.L. 86-272, as any taxpayer with a functioning website (one with more than static information) would not receive P.L. 86-272 protection.
 - COST opposes these revisions because they essentially render P.L. 86-272 a nullity
- **Several states have adopted or are considering adoption of the revised Statement, e.g., California** (litigation pending), **Minnesota, New York** (current proposal is different from the MTC's statement), **New Jersey** (adopted) and **Oregon** (rejected).



American Catalog Mailers Ass'n v. Franchise Tax Board No. CGC22601363, Sup. Ct. of California (San Francisco)

- The California FTB issued revised guidance regarding Internet activities in Technical Advice Memorandum No. 2022-01 and FTB 1050. The guidance aligns with the MTC's 2021 adopted revisions to the *Statement of Information Concerning Practices of Multistate Tax Commission and Supporting States Under Public Law 86-272*.
- ACMA argues the guidance is invalid because there is no difference between an unprotected interaction with customers on a website and a protected customer service assistance call. ACMA also claims that the FTB failed to follow California's rulemaking process. Alternatively, ACMA asks the court to apply the guidance prospectively only to avoid a violation of due process.
- The FTB asked that the complaint be dismissed based on standing, ripeness, and/or jurisdictional grounds.
 - Nov. 17, 2022 - Court denied the FTB's dismissal requests after a hearing.
 - Apr. 13, 2023 - ACMA filed a motion for summary judgment; opposition filed by FTB on July 13.
 - Aug. 29, 2023 – ACMA was held to have standing; however, the Court dismissed ACMA's request for summary judgement. The Court noted that certain aspects of the TAM were questionable, but ultimately dismissed the motion on grounds that generic hypotheticals were insufficient to grant summary judgement.



Apportionment Issues



Cost of Performance

Synthes USA HQ Inc. v. Commonwealth, 11 MAP 2021 (February 2023)

- This case originally concerned a matter of statutory interpretation. The A.G.'s office was at odds with the PA DOR on the interpretation of the State's prior cost of performance statute after the taxpayer provided additional documentation satisfactory to the DOR that some sales should not be sourced to PA. When Synthes filed its brief in the Commonwealth Court of Pennsylvania, taking a position consistent with how the DOR had traditionally interpreted the cost of performance statute, the A.G. responded by filing its own brief that took a diametrically opposite position. In response, the DOR intervened in the case and became a party alongside Synthes, opposite the A.G.
- The Pennsylvania Supreme Court, rejected the DOR's argument that the A.G. did not have the authority to take a legal position that conflicts with the legal position of the DOR. The Court pointed out that A.G. is the independently elected chief legal officer for the Commonwealth, stating, "While the Attorney General regularly represents the Department, it is not the Department's law firm." When the A.G.'s interpretation of the law is irreconcilable with a Commonwealth agency's interpretation, the Commonwealth agency and the A.G. may pursue adverse positions opposite one another in litigation.
- On the substantive issue, the Court agreed with the DOR that the term "income producing activities" meant activities that occur where the taxpayer's customer receives the benefit of the service.



Cost of Performance

Target Enterprises, Inc. v. Florida Dept. of Rev., Case No. 2021-CA-002158 (Fl. Cir. Ct. Nov. 28, 2022).

Florida is using a market-based sourcing approach despite the fact the regulations require cost of performance sourcing

- TEI provides marketing, merchandising, strategy/consulting, and brand building services to the Target Group. TEI employees perform these services at corporate headquarters in MN and provide them to Target Group employees at corporate headquarters in MN.
- The FL DOR contends that TEI is performing these services for Target Group retail stores and, due to the unusual and unique circumstances of the case, using a market-based sourcing approach based on the Target Group's retail square footage in FL is reasonable.
- The Leon County Circuit Court agreed with Target and rejected the Department's arguments that the service could be sourced to Florida based on total square footage of Target stores in Florida to total footage of Target stores overall. The judge noted 94.9 percent of Target Enterprise's payroll was attributable to Minnesota, while less than 0.1 percent was Florida payroll. The judge wrote "It is clear from the facts presented that TEI is not directly providing services to individual Target retail locations...."
- Department has not appealed decision.



Devaluing Cost of Performance

- ***Billmatrix Corporation et.al. v. State of Florida Department of Revenue***, Leon County Circuit Court Case No. 2020 CA 000435 (March 1, 2023)
 - The plaintiffs are related corporations that provide financial technology services to businesses on a national basis. The companies filed their Florida corporate income tax returns using the cost of performance consistent with the regulations. As a result, the receipts from the services were sourced outside of Florida.
 - The Department on audit adjusted the sales factor taking the position the services should be sourced to Florida because it was the activities of the Florida customers that generated the income from the services.
 - The Court citing *Target* rejected the Department's argument stating the plain language of the regulation required the use of cost of performance and a great portion of the direct costs associated with the services were incurred outside Florida.
 - Department has appealed this decision.



Alternative Apportionment

- ***Vectren Infrastructure Services Corp. v. Dep't of Treasury***, *Michigan Supreme Court* Docket No. 163742 (July 31, 2023).
 - The taxpayer sold its entire business, largely consisting of capital assets and intangible assets, in a year in which it had unusually high Michigan receipts. The Department asserted the sale produced business income, but the sales proceeds must be excluded from the taxpayer's sales factor under the standard apportionment formula, while the taxpayer argued the sales proceeds must be included in its sales factor because of the distortive effect of not doing so. The Court of Appeals held exclusion of the receipts from the sales factor resulted in unconstitutional distortion in violation of the Commerce Clause because the taxpayer's sales factor was unusually high in the year of the sale. This case went up to the MI Sup. Ct several times.
 - The Michigan Supreme Court reversed the Court of Appeals holding: (1) the Department properly included the gain from the sale of assets in the tax base and the apportionment formula as applied did not impermissibly tax income from outside the state; (2) the exclusion of the asset sale receipts from both the numerator and denominator of the apportionment formula did not offend either the Due Process or Commerce Clause of the U.S. Constitution; (3) the apportionment formula was both internally and externally consistent; and (4) the tax was fairly apportioned to Michigan given the services provided in Michigan.
 - Three judges dissented and would have affirmed the lower court because the inclusion of the receipts from the sale was distortive and unconstitutional.



Investee Apportionment

VAS Holdings & Investment LLC v. Commissioner of Revenue, No. SJC-13139 (May 23, 2022)

- The court held that Massachusetts could constitutionally impose tax on the sale of a capital gain without applying unitary business principles, however, the Massachusetts law required the application of the unitary business principal.
- VAS was an Illinois (and subsequently a Florida) corporation that merged with a Massachusetts LLC in 2011. After the merger, VAS sold its interest in another LLC and realized a substantial gain.
- Because VAS was not unitary with the subsidiary, Massachusetts could not tax the gain even though the subsidiary had a substantial Massachusetts presence.



Sales Factor



Sales Factor - Gross Receipts

CITGO Petroleum Corp. v. Hegar; TX App. Ct. No. 03-21-00011-CV; No. D-1-GN-18-002457 (October 4, 2021). **Appeal pending.** (See also *Conagra Brands, Inc. v. Hegar*, TX App. Ct. No. 22-790 (2022) – appeal pending).

- A significant and integral part of CITGO's business involves buying and selling securities in crude oil and related commodities. These transactions provides CITGO with the option to create price certainty on both its purchases and sales. The securities transactions also mitigate the market risks related to the timing involved in the purchase and transport of crude to its refineries, the refining process, and the distribution and sale of the refined products to its customers. For federal income tax purposes CITGO made an election under IRC § 475. This election resulted in CITGO's securities receiving the exact same federal tax treatment as securities inventory in the hands of securities dealers.
- CITGO argued under the plain language of the statute § 171.106(f) the gross proceeds from the transactions should be included in the denominator of the sales factor.
- The Appellate Court rejected CITGO's argument finding that § 171.106(f) only applied to securities sold to customers in the ordinary course of business irrespective of the tax treatment of those securities.



Sourcing Broadcasting Receipts

- ***NASCAR Holdings, Inc. v. McClain***, ___ N.E.3d ___, 2022 Ohio 4131 (2022)
 - For commercial activity tax purposes, Ohio law provides that gross receipts from the right to use intellectual property are situated to Ohio to the extent the receipts are based on the right to use the property in Ohio.
 - NASCAR, a Florida headquartered company without permanent offices, property, or employees in Ohio, earned four types of receipts: (i) broadcast revenue; (ii) media revenue; (iii) licensing fees; and (iv) sponsorship fees.
 - The Department used Nielsen data (Ohio cable TV households to total cable TV households) to situs broadcast and media revenues to Ohio and used census data (Ohio pop. to U.S. pop.) to situs licensing and sponsorship fees to Ohio.
 - The Ohio Supreme Court held that none of the gross receipts could be situated to Ohio because they were not based on the right to use property in Ohio; the underlying contracts called for fixed fees and did not mention Ohio at all.
 - The court did not reach NASCAR's Commerce Clause argument.



Tax Base



Taxation of Foreign Source Income

- ***Precision Castparts Corp. v. Nebraska Department of Revenue***, District Court of Lancaster County Dkt. No. C122-2106 (July 3, 2023).
 - Precision Castparts sought a refund of the taxes paid on § 965 income that was included in Nebraska taxable income. The company argued it was entitled to deduct the income under Nebraska Rev. Stat. § 77-2716(5) which provides for a deduction of dividends received or deemed to be received from a corporation not subject to tax under the Internal Revenue Code. Specifically, the § 965 income should be characterized as a deemed dividend.
 - Applying statutory construction principles, the court rejected the company's argument finding the income was not a dividend as that term is defined for federal tax purposes nor was there an intent to characterize it as a deemed dividend rather it was deemed additional income under Subpart F.



Expense Deductions – Business Purpose

- ***Skechers USA Inc. v. Wis. Dep’t of Revenue***, No. 10-I-071 & 10-I-072 (Wis. Tax Apps. Comm’n Feb. 24, 2023)
 - The Wisconsin Tax Appeals Commission held that Skechers USA’s wholly owned subsidiary was created for sham transactions that were part of a tax-avoidance scheme and had no valid business purpose. Therefore, Skechers could not claim royalty and interest deductions for transferring domestic intellectual property rights to a holding company and then licensing them back.
 - In June 1999 Skechers formed Skechers USA Inc. II (SKII) as a Delaware corporation to transfer its IP and license the IP back to Skechers. SKII was formed after Skechers was approached by its audit firm with a presentation on state tax minimization services.
 - Noting the assessment by the Department has a presumption of correctness and that Skechers has the burden of proving the transactions were not shams, the Commission said that “every piece of documentary evidence that was contemporaneously produced to justify the creation of SKII and the subsequent transactions at issue stressed the reduction of state tax liability.”
 - Taxpayer has appealed to Circuit Court.



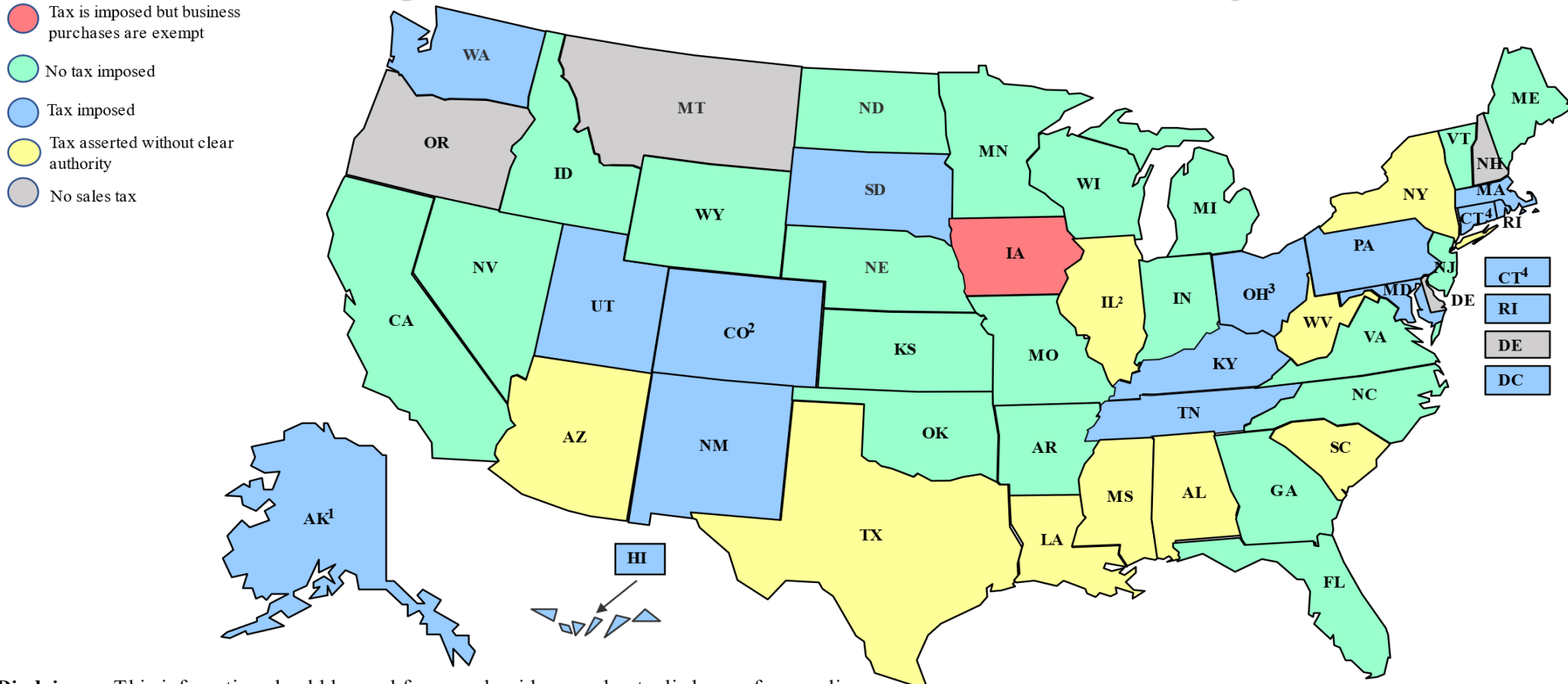
Sales Tax Issues



ADP, LLC v. Ariz. Dep't of Revenue, 524 P.3d 278 (Ariz. Ct. App. 2023)

- The Arizona Court of Appeals allowed the tax authorities to subject to sales tax a human resources service provider's licensing receipts from software that allowed clients' employees to login and enter employment data.
- All the taxpayers' customers used the same software code and servers, which were maintained outside of Arizona, but the software was configured to each customer's individual needs.
- The DOR and City of Phoenix argued the licensing revenue was from the taxable rental of prewritten software, while the taxpayer argued the transactions could not constitute rentals because all its customers accessed the same servers, and none had exclusive use of the software. The taxpayer also argued it was making sales of nontaxable human resources services and any software was incidental to the sales.
- The Appeals' Court held sales tax did apply because the software constituted TPP. While the taxpayer may have once been offering human resources services, it had changed to renting human resources software.
- 9/12/2023 – the AZ Supreme Court denied review of case – COST filed an amicus brief asking the Court to review this important issue, including an issue with the ITFA.

Tax on Digital Software Accessed Remotely (SaaS)



Disclaimer: This information should be used for general guidance and not relied upon for compliance.

Source: Council On State Taxation (COST)

¹AK - Data is based on local municipalities since Alaska does not have a state-wide sales tax

²CO/IL - State does not impose a tax, but tax may be imposed by some localities

³OH - Tax only applies to businesses

⁴CT - Electronically delivered software is taxed at a 1% rate for businesses



Wayfair LLC, v. City of Lakewood, Case No. 2022CV30710 (2022)

- Wayfair LLC, has sued Lakewood, Colorado, over its complex sales tax reporting requirements.
- Wayfair alleges that during the period from 2018 to 2021, Lakewood's decentralized sales tax system unconstitutionally violated the company's right to engage in interstate commerce, which would be a direct violation of the Commerce Clause.
 - Does a seller exceeding the State's economic nexus threshold allow Colorado's local sales tax jurisdictions to impose their sales/use taxes?
 - Use of "origin sourcing" is also challenged.



Digital Products – MTC Activity & State Tax Organizations’ Resolutions

Multistate Tax Commission (MTC) Project

- April 2021 – Washington State proposes a project to the MTC Uniformity Committee to consider a simpler and more adaptable approach to taxing digital products.
- July 2021 – The Committee approves the project to develop a whitepaper and asks MTC staff to start developing a detailed outline. Staff conducts over 40 stakeholder meetings during the next year and compiles information.
- September 2022 – First work group meeting of state representatives led by Gil Brewer from Washington State. Work group meets the first Thursday of each month at 11:00 am EST.
 - Project page on MTC website has meeting info and other resources: <https://www.mtc.gov/Uniformity/Project-Teams/Sales-Tax-on-Digital-Products>
- Fall 2022 – present – Work group members decide the first topic they want to study is definitions for digital products and what items exist in the marketplace. Presentation by Avalara representatives. MTC staff compile a 46-jurisdiction survey of state taxation of digital products.

Federation of Tax Administrators (FTA) – June 2023 – approved an FTA only resolution that it would work with MTC on digital products

SSUTA and MTC – July 2023 – approved a joint resolution to work together on digital product issues.



Issue with Sourcing of Digital Products - SSUTA

Sourcing – SSUTA Hierarchy

- Receipt of a product (§ 311 of SSUTA):
 - For tangible personal property it is “taking possession;”
 - For a service it is “first use;”
 - For digital goods it is “taking possession” or making “first use.”
- SSUTA is reviewing sourcing hierarchy rules: SSUTA § 310 (A.1 – over-the-counter; A.2 – delivery address, A.3 – business record, A.4 – billing address, and **A.5 – default to seller’s origin location**).
- Issues with Sourcing of Digital Products:
 - Where is the customer located for sourcing – “delivery address” not needed
 - Privacy concerns with certain digital products
 - Seller may not have any address information – *e.g.*, use of gift cards, crypto currency, credit card with no verification, etc.
 - Some sellers only have 5-digit zip code for credit/debit card verification – local tax issue
 - States and many sellers with address data want to limit sourcing under § 310.A.5
- Proposal by Certified Service Providers (CSPs) to amend the SSUTA to allow states to require at least a 5-digit zip code for sellers to have liability relief under the SSUTA. There is also a Business Advisory Counsel (BAC) proposal to broaden the use of a “digital code” to apply to SaaS, digital gaming, NFTs, etc. (Currently, it is limited to specified digital products.)



Taxation of Digital Products



Taxation of Digital Products:

Digital Services Taxes



Digital Advertising and Data Taxes – Background

- Proposals across 15 states from 2020 to 2023 would have established new regimes imposing taxes on “Big Tech.” Three categories of tax proposals:
 - **Digital advertising services**
 - Tax on apportioned gross revenue from digital advertising services
 - Connecticut, Louisiana, Maryland, Massachusetts, Montana, New York, Texas, Washington, West Virginia
 - **Social media advertising**
 - Tax imposed on social media companies’ gross revenue advertising services or number of users
 - Arkansas, Connecticut, Indiana
 - **“Data mining” services**
 - Tax on companies selling personal information or data, akin to a severance tax
 - District of Columbia, Massachusetts, New York, Oregon, Washington, West Virginia



Challenges to MD's Digital Advertising Tax

- *Comcast, et al. v. Comptroller*
 - October 2022 - Circuit court decides, without analysis, that the tax is invalid because it violates the Supremacy Clause, Internet Tax Freedom Act, the Commerce Clause, and the First and Fourteenth Amendments.
 - May 2023 - State supreme court heard the case and issued an Order holding the taxpayers failed to exhaust administrative remedies. As a result, the lower court did not have jurisdiction and its decision should be dismissed.
 - July 2023 - The Supreme Court issued a decision setting forth the reasoning for its May Order.
- *US Chamber of Commerce v. Franchot* (Pending 4th Circuit Ct. of Appeals)
 - Seeking injunctive and declaratory relief on similar grounds as the state case.
 - Dec. 2, 2022, U.S. Dist. Ct. decision, which dismissed the case without prejudice on the basis that the state circuit court's declaratory judgment rendered the Plaintiffs' case moot. Plaintiffs have appealed the decision to the Fourth Circuit, where it is currently pending. The case will likely be argued sometime during Fall 2023.



COST Proactive Initiatives



COST Proactive Legislative Initiatives

The Initiatives Promote Uniformity, Simplicity, and Ease of Compliance and Administration with Minimal to No State Revenue Impact

- Provide at least one-month extension from new federal extended tax return due date
- Enact a minimum 30-day threshold before non-residents are subject to state (and if applicable local) income taxes – with reciprocity provision
- Improve reporting of federal tax adjustments
 - General improvements to the process
 - Specific improvements related to new federal partnership audit regime
- Get engaged with the Streamlined Sales and Use Tax Agreement (SSUTA)

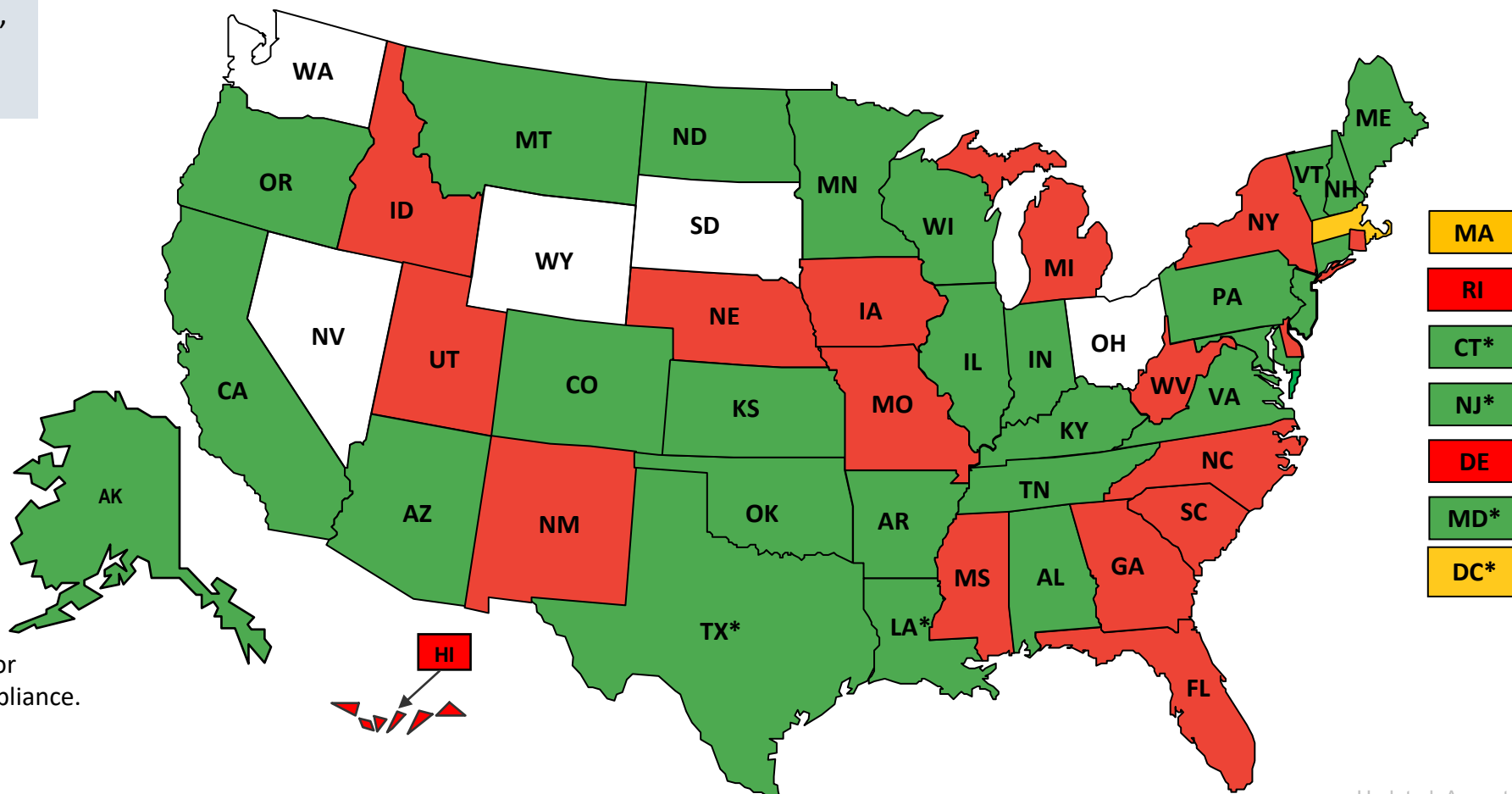
One Month Extension Beyond the Federal Extended Due Date for Filing State Corporate Income Taxes

2023 Enactments: CO, ME, OH (for net profits tax)

COST sent requests for penalty waiver if filed by Nov. 15 to DE, FL, GA, HI, ID, IA, MS, MO, NM, NC, RI, SC, UT, and WV

- Original or extended return deadline at least one month after federal
- Original or extended return deadline at least one month after federal for combined filers only
- Original and extended return deadline less than one month after federal
- States not impacted

* Original or extended return deadline one month after federal but extension is NOT automatic (CT, LA, MD, NJ, TX, DC)



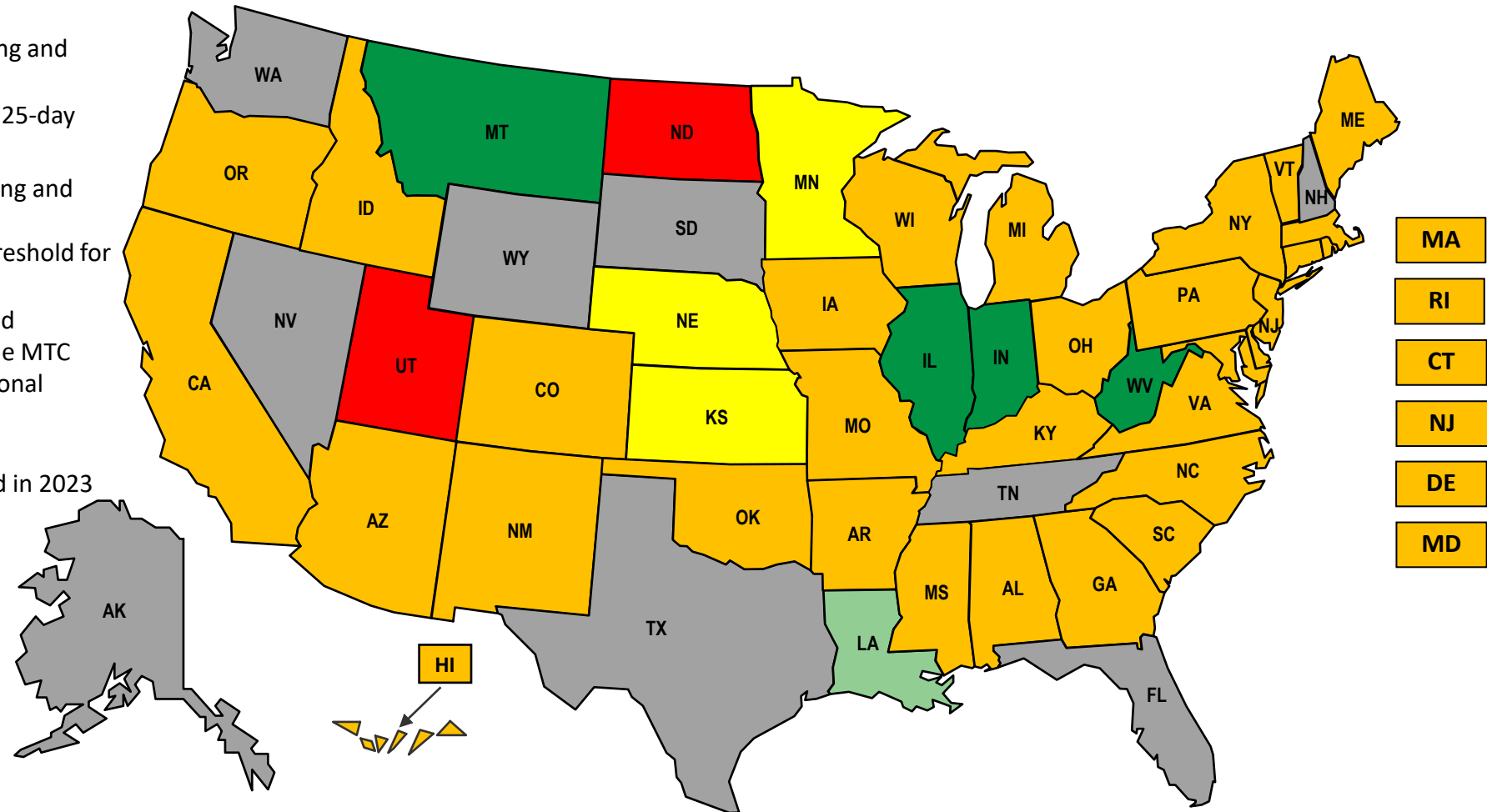
Disclaimer: This information should be used for general guidance and not relied upon for compliance.

Source: Council On State Taxation (COST)

30-Day Safe Harbor for Income Tax Filing Obligations on Nonresident Traveling Employees and Corresponding Withholding Obligations on Their Employers

- State has enacted a 30-day threshold for both filing and withholding
- State has enacted the COST model statute with a 25-day threshold for both filing and withholding
- States that need a 30-day safe harbor for both filing and withholding obligations
(AZ and HI have a 60-day, and VT has a 30-day threshold for withholding only)
- States that need a 30-day safe harbor for filing and withholding obligations and they have enacted the MTC model statute with a 20-day threshold and additional complicated provisions based on wages earned
- No general state personal income tax
- States with legislation introduced but not enacted in 2023

2023 Enactments: IN, MT



Disclaimer: This information should be used for general guidance and not relied upon for compliance.

Source: Council On State Taxation (COST)

Taxation of Teleworking Individuals

Personal Income Tax

- 41 states impose a personal income tax.
- AK, FL, NV, SD, TX, WA, and WY impose no personal income taxes.
- NH imposes an individual income tax on interest and dividend income.

Sourcing

- Most states source employee work based on location where performed.
- A handful of states impose permanent “convenience of the employer” rules.

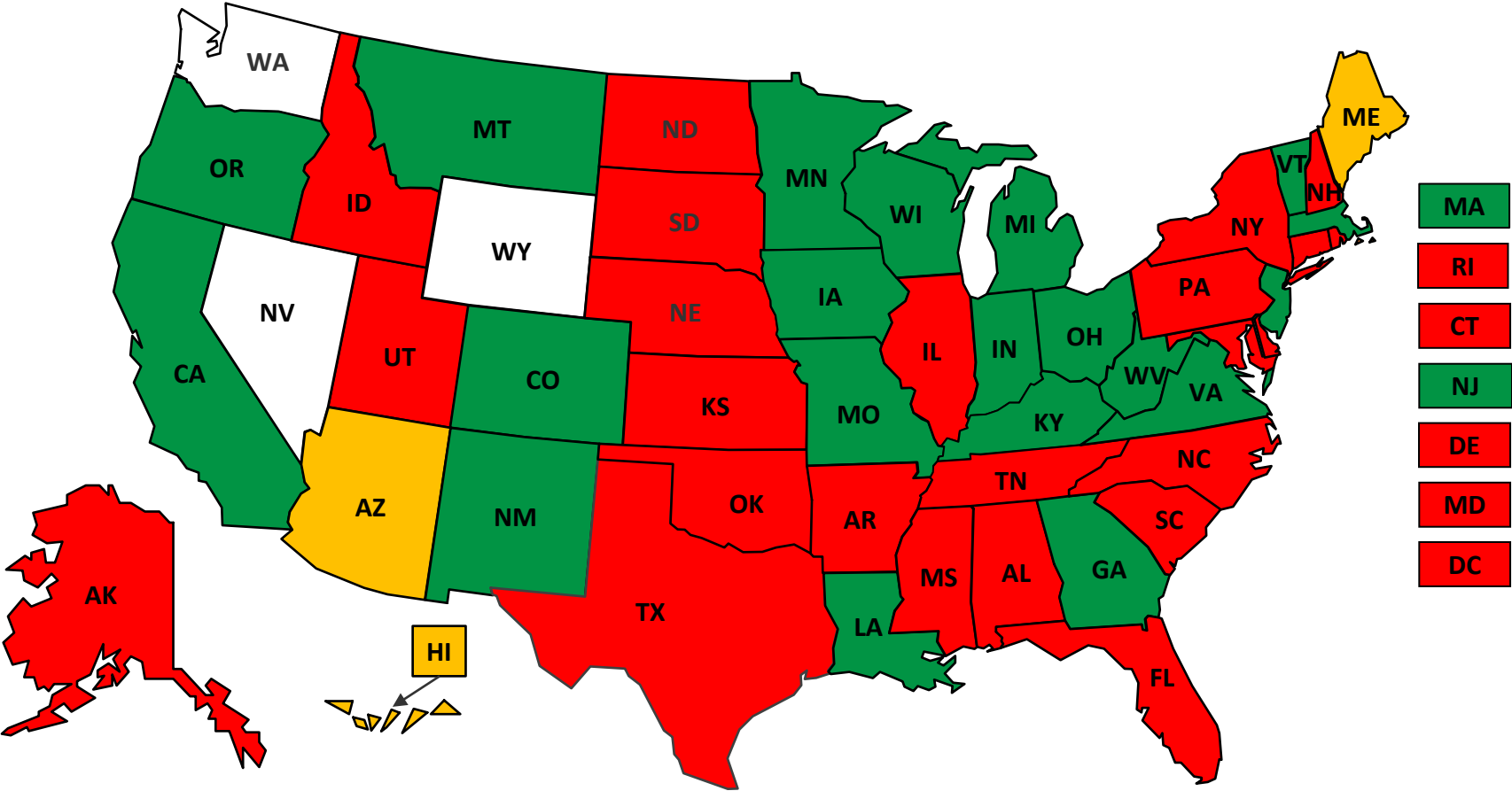
Convenience of the Employer Rule

- Taxes employees based on managing office location, not actual work location.
- NY, PA, CT, DE, NJ, NE, (MA during the pandemic)
- Applies if employee is working remotely just for the employee’s convenience (not for job duty):

MTC Consensus Model for Reporting of Federal Adjustments (RAR) and Federal Partnership Audit Adjustments


2023 Enactments: CO

- States that have enacted legislation
- States that have enacted legislation, but need improvement to more closely follow MTC Consensus Model
- States that potentially need legislation

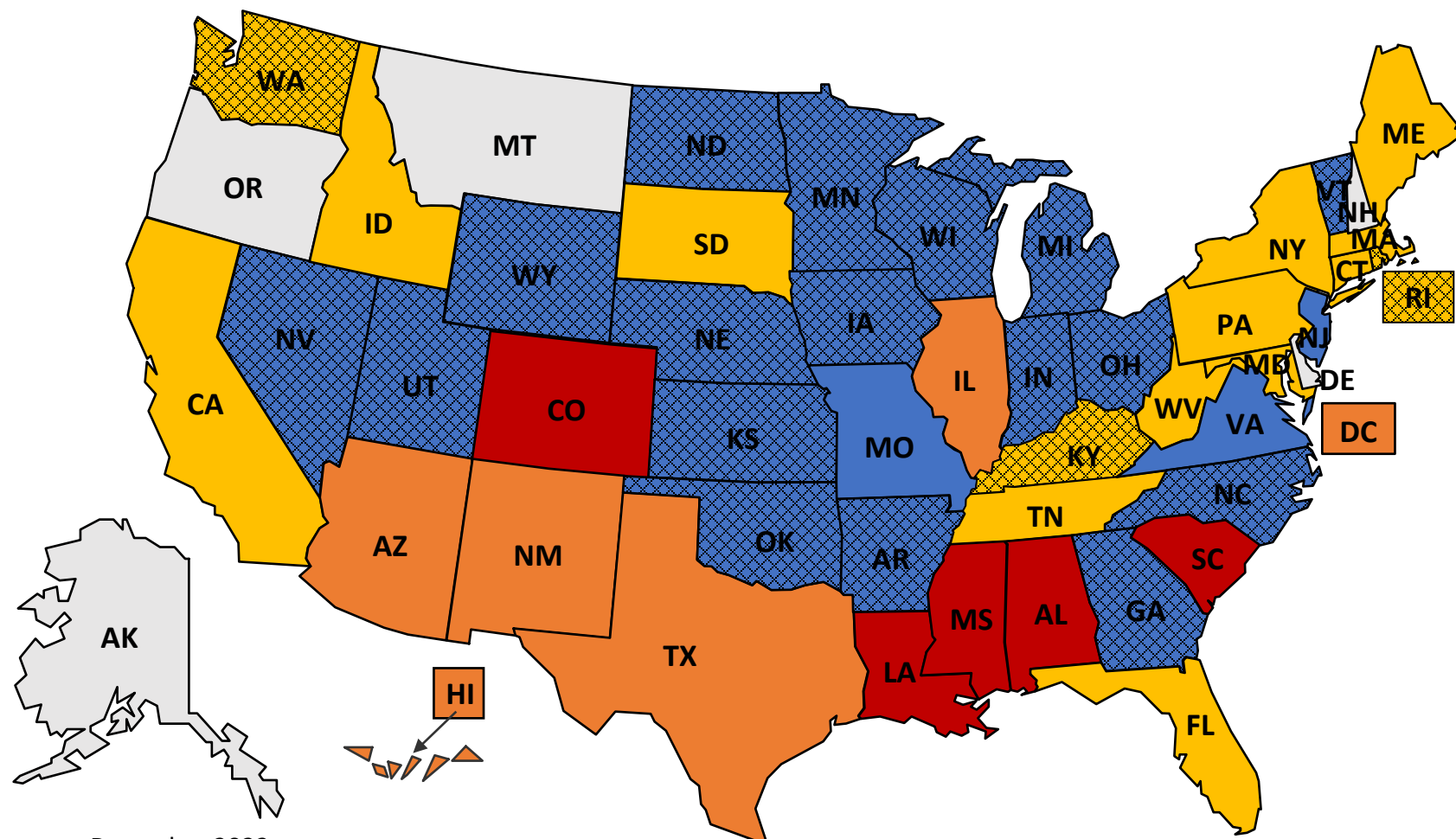


Disclaimer: This information should be used for general guidance and not relied upon for compliance.
Source: Council On State Taxation (COST)

SSUTA States Scores on COST's State Sales Tax Systems Scorecard

 State is a full member of the Streamlined Sales and Use Tax Agreement (SSUTA)

Overall Sales Tax Scorecard Grades					
N/A	0-12	13-20	21-26	27-29	30+
N/A	A	B	C	D	F



Note: Because Alaska has no statewide sales tax, it was not given an overall grade

Source: COST's Scorecard on State Sales Tax Systems, December 2022



Questions?

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