



**NINETY-FIFTH ANNUAL
ARIZONA TAX CONFERENCE
FLAGSTAFF, ARIZONA AUGUST 2012**

**CURRENT DEVELOPMENTS IN STATE
AND LOCAL TAX POLICY**

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Agenda

Fiscal Condition of the States

Issues Among the States

- Income Tax Base & Computation
- Income Tax Apportionment
- Nexus

Feds to the Rescue?

Can the States Help/Regulate Themselves?

Looking Ahead



Fiscal Condition of the States



Where are we today?

➤ State tax collections continue to rebound

- BUT – revenues in 17 states are still lower than four years ago, and inflation-adjusted nationwide tax receipts show a 3.4% decline from four years ago.
- Local taxes, further, showed a 1.0% year-to-year decline, although an improvement compared to the 2.2% decline for the prior year.

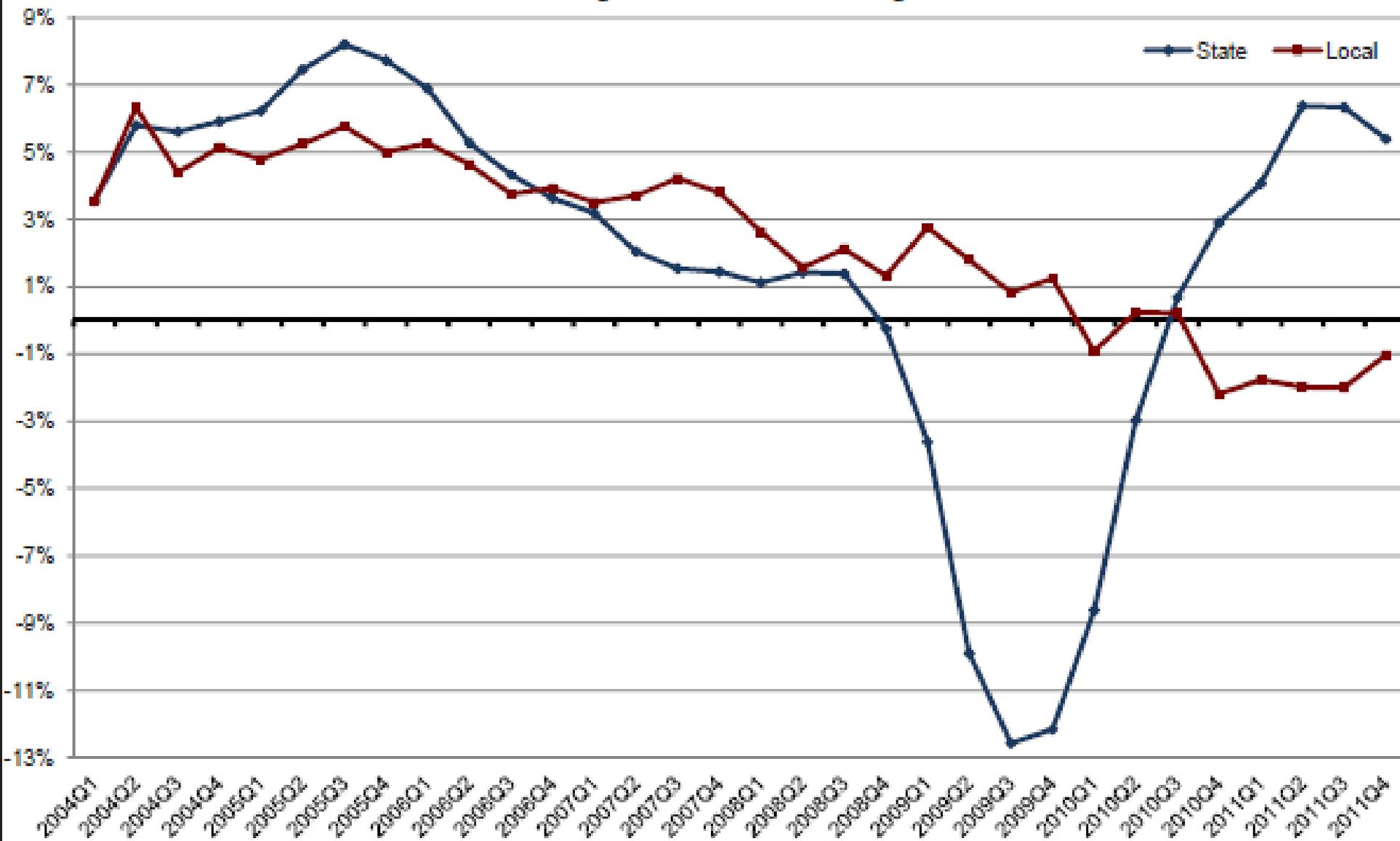


Where are we today?

- **State budget gaps are projected to narrow**
- **NGA / NASBO “The Fiscal Survey of States” (June 2012)***
 - 19 states project \$30.7B in budget gaps for FY 2013 (four states have \$3.1B in remaining FY 2012 gaps that must be closed by the end of the fiscal year)
 - 11 states project \$23.3B in budget gaps for FY 2014
 - This compares to \$146.3B in budget gaps over FY 2011-2012

Figure 2. State Taxes Are Improving While Local Taxes Continue to Decline

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

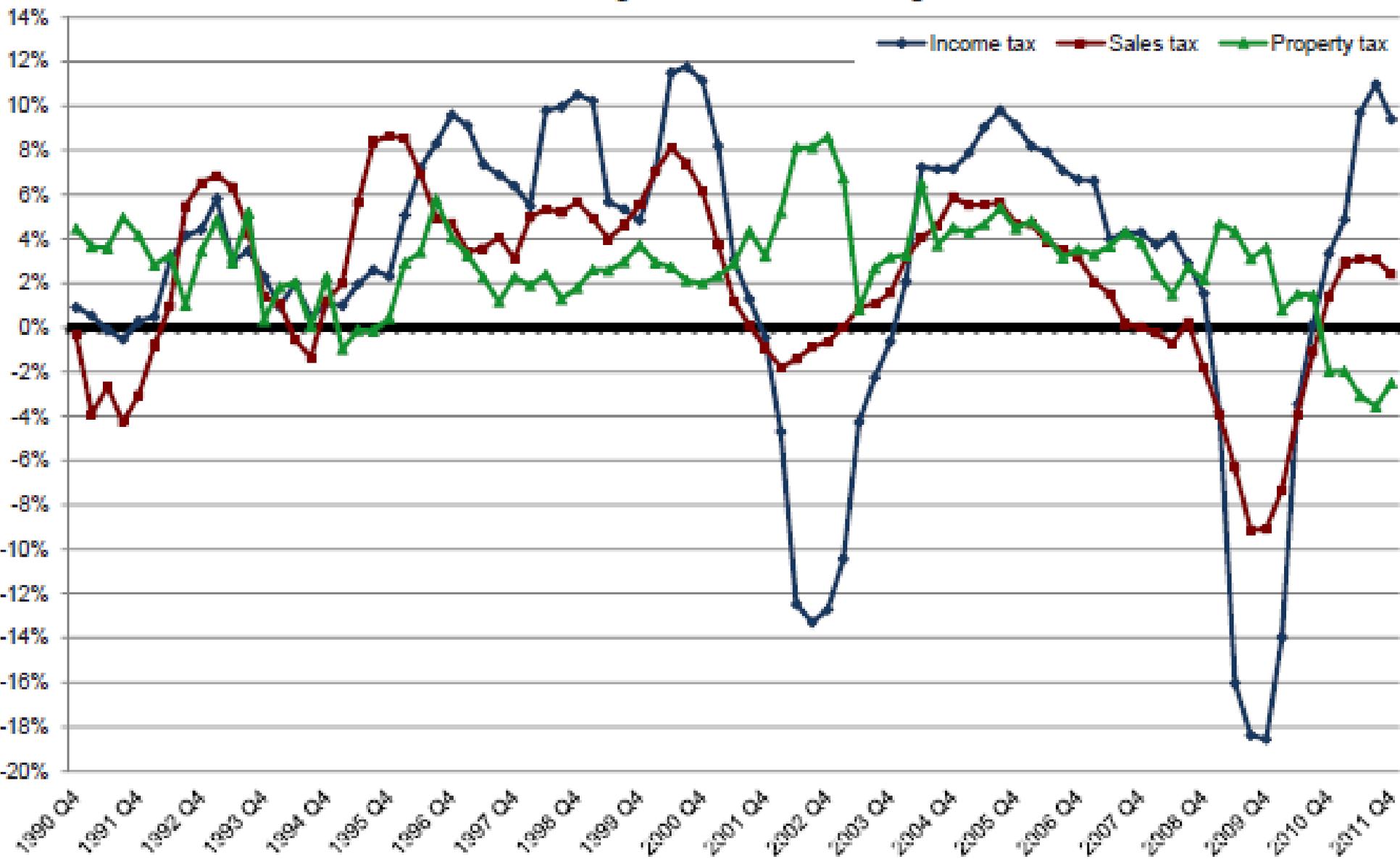


Sources: U.S. Census Bureau (tax revenue) and Bureau of Economic Analysis (GDP price Index).

Notes: (1) 4-quarter average of percent change in real tax revenue; (2) No adjustments for legislative changes.

Figure 3. Continued Weakness in Property Tax Collections

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



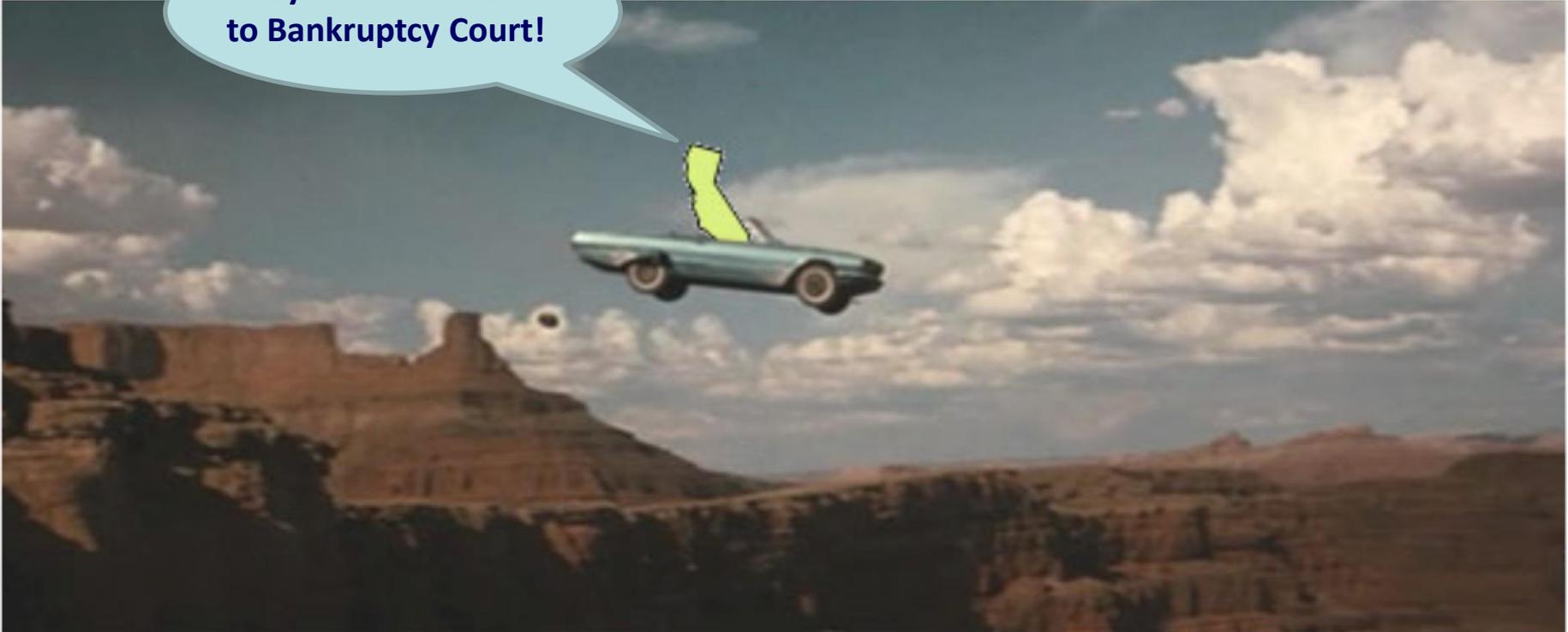
Sources: U.S. Census Bureau (tax revenue) and Bureau of Economic Analysis (GDP price Index).

Notes: (1) 4-quarter average of percent change in real tax revenue; (2) No adjustments for legislative changes.



California's Fiscal Condition

**They'll never take us
to Bankruptcy Court!**





Election year

- 86 of the 99 state chambers will hold elections on November 6, 2012
- 5,979 (81.0%) of the country's 7,384 state legislative seats will be up for re-election
- The 5,979 seats up for election is 146 fewer than the 6,125 that were contested in 2010
- As a result of 2010 turnover and 2012 redistricting, it is estimated that at least **½ of all state legislators will have two years or less experience**



Issues Among the States



Income Tax Base & Calculations

“Add Backs” – denial of inter company transaction expenses / IP

Combined Reporting

- Forced Combination as “distortion”
- Delhaize and Compliance by Guessing
- Throwback is it Joyce or Finnigan?

Business / Non-Business Income

- Should there be a distinction?



Combined Reporting

As of July 23, 2012

Key

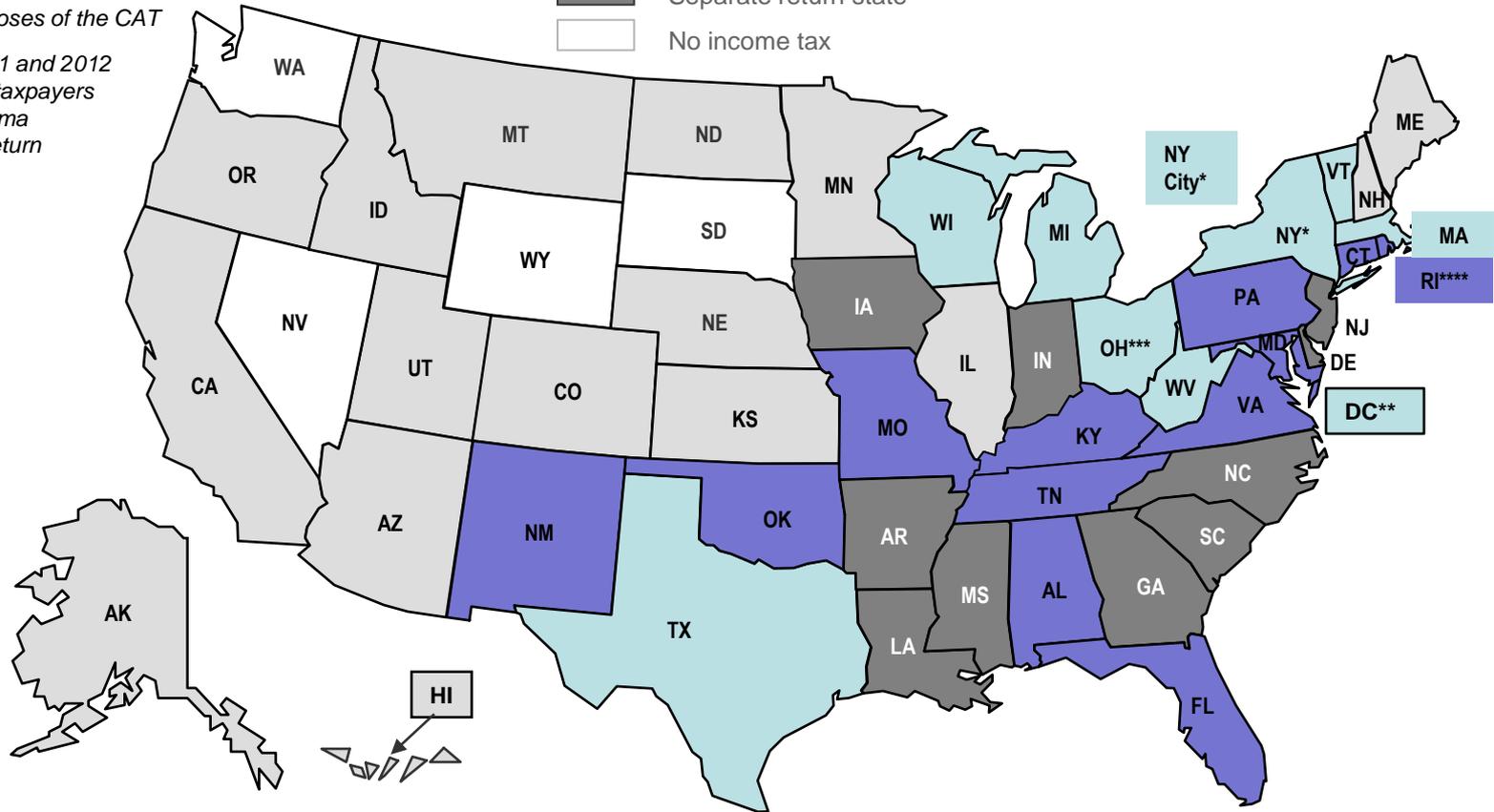
- Combined reporting/consolidated return required prior to 2004
- Combined reporting/consolidated return adopted for 2004 or later
- Combined reporting legislation proposed in 2012
- Separate return state
- No income tax

* NY state and city requires combined reporting when there are substantial intercorporate transactions

** DC combined reporting effective for tax years beginning after 31 December 2010

*** For purposes of the CAT

**** For 2011 and 2012
RI requires taxpayers file a pro forma combined return





Apportionment

Single Sales Factor

- Elective? Constitutional?

Multistate Tax Compact 3-Factor Election

Treatment of Intangible Property in Property Factor

Market Sourcing or Cost of Performance?

Alternative Apportionment



U.S. Constitutional Limits on State Taxing Power

Due Process Clause

- *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 131 S.Ct. 2846 (2011).
- *J. McIntyre Machinery, Ltd. v. Nicastro*, 131 S.Ct. 2780 (2011).

Equal Protections

- *Armour v. City of Indianapolis*, Dkt. No. 11-161 (6/4/2012)

Dormant Commerce Clause

- Substantial Nexus
- Non-Discriminatory
- Fairly Apportioned (Internal / External Consistency)
- Fairly Related to Services Provided



Dormant Commerce Clause Cases

Quill v. Heidkamp (N.D.) (1992)

- Difference between D.P. and C.C. Nexus
- “Substantial Nexus” requires a physical presence.
- **This is Congress’ Problem.**

***Tyler Pipe Industries v. WA Dep’t. Rev.*, 483 U.S. 232 (1987).**

- “significantly associated with the taxpayer’s ability to establish and maintain a market in [the] state for the sales.”

***Scripto, Inc. v. Carson*, 362 U.S. 207 (1960).**

- Independent Contractors / Attributional Nexus.



States Emboldened by Lack of U.S. Supreme Court Action

- **Geoffrey** (SC 1993), cert. denied
- **Kmart** (NM 2005), “Corrected” (NM Ct. App. March 2006)
- **MBNA** (WV 2006) & **Lanco** (NJ 2006), cert. denied 2007
- **Ford Motor Company** (Delaware 2008), cert. denied 2009
- **Capital One** and **Geoffrey** (MA 2009), cert. denied June 2009
- **Asworth Corp** (KY 2010)(limited partner), cert denied Jan. 2011
- **KFC Corp.** (IA 2010) (franchisees), cert. denied Oct. 2011
- **Lamtec** (WA 2010) (2-3 visits/year), cert. denied Oct. 2011
- **Griffith v. ConAgra Brands** (W. Va. May 24, 2012).



Sales Tax Issues on the Horizon

Taxing Digital Goods and Services

Nexus and Administrability



Sales and Use Tax Nexus

Amazon Statutes in 17 States

- *Click Through – In-state sales facilitator / presumption?*
- *Affiliate – Related in-state affiliate in similar LOB*
- *Group – In-state member of controlled group.*

Challenges

- *Amazon.com LLC v. New York State Dep't of Taxation and Finance, 81 A.D.3d 183 (N.Y. App. Div. 1st Dept. 2010).*
- *The Direct Marketing Ass'n v. Huber, No. 10-cv-1546, 2012 WL 1079175 (U.S.D.Ct. Colo; 3/30/12) Appeal filed.*
- *Performance Marketing Ass'n v. Hamer, No. 2011-CH-26333 (Ill. Cir. Ct. May 7, 2012).*



Feds to the Rescue

- **Business Activity Tax Simplification Act of 2011, H.R. 1439**
- **Mobile Workforce State Income Tax Simplification Act, H.R. 1864**
 - ✓ House approved H.R. 1864 on Voice Vote: May 2012
- **Wireless Tax Fairness Act, H.R. 1002/S. 543**
 - ✓ House approved H.R. 1002 on 1 November 2011
- **Digital Goods & Services Tax Fairness Act, H.R. 1860/S. 971**



Feds to the Rescue SUT

1. Main Street Fairness Act (“MSFA”) [H.R. 2701]

- Introduced on July 29, 2011.
- Referred to the Subcommittee on Courts, Commercial and Administrative Law on August 25, 2011.
 - Independent from, but somewhat parallel with, SST.

2. Marketplace Equity Act (“MEA”) [H.R. 3179]

- Introduced on October 13, 2011.
- Referred to the Subcommittee on Courts, Commercial and Administrative Law on October 24, 2011.

3. Marketplace Fairness Act (“MFA”) [S.B. 1832]

- Introduced on November 9, 2011.
- Hybrid of MSFA and MEA.

4. Equity in Sales Tax Collection Act (“ESTCA”) (Overstock.com Bill)

- Not yet introduced.
- MSFA +++++

	Main Street Fairness Act	Marketplace Equity Act	Marketplace Fairness Act		Equity in Sales Tax Collection Act
			Streamlined	Non-streamlined	
Sponsor	Conyers (MI), Co: Shuler (NC), Welch (VT)	Womack (AR), Co: Speier (CA), Poe (TX), Diaz-Balart (FL), Ross (FL), Maloney (NY), Welch (VT), McCollum (MN), Duncan (TN), Miller (NC)	Enzi (WY), Co: Durbin (IL), Alexander (TN), Johnson (SD), Boozman (AR), Reed (RI), Blunt (MO), Whitehouse (RI), Corker (TN), Pryor (AR)		TBD
Status	Referred to the Subcommittee on Courts, Commercial and Administrative Law (August 25, 2011).	Referred to the Subcommittee on Courts, Commercial and Administrative Law (Oct. 24, 2011)	Introduced Nov. 9, 2011; Referred to the Senate Committee on Finance.		N/A
Statewide Administration	✓	✓	✗	✓	✓
Statewide Tax Base	✓	✗	✗	✓	✓
Local Rates:					
• Zip Code	✓	✗	✗	✗	✓
• Blended+	✗	✓	✗	✗	✗
• Software	✗	✗	✗	✓	✗
Vendor Discount	✓	✗	✗	✗	✓
Threshold (Total/In-State)	TBD	1MM/0.1MM	✗	500K/None	20MM/None
SST Governing Board	✓	✗	✓	✗	✓
SST Simplification (uniform definitions, forms and bundling rules)	✓	✗	✗	✗	✗
Uniform Sourcing	✓	✓	✗	✓	✓
No Liability if Rely on Information From State	✓	✗	✗	✓	✓
Federal Court	✓	✗	✗	✗	✓
Industry Group/Organization Supporters	<i>Amazon.com, The National Retail Federation, The American Booksellers Association, Sears Roebuck and Co., National Conference on State Legislatures, SST Governing Board, National Association of Real Estate Investment Trusts and Simon Property Group, International Council of Shopping Centers</i>	<i>Wal-Mart Stores, Inc., Amazon.com, International Council of Shopping Centers, Performance Marketing Association, Retail Industry Leaders Association, National Retail Federation, Michigan Retailers Association, Jerome E. Horton, Chairman of the California SBE</i>	<i>Performance Marketing Association, Amazon.com, National Retail Federation, Retail Industry Leaders Association, National Governors Association, International Council of Shopping Centers</i>		<i>Overstock.com</i>
Those that Generally Oppose Federal Sales Tax Legislation	<i>Ebay, American Homeowners Grassroots Alliance, Computer and Communications Industry Association, The Electronic Retailing Association, The Information Technology Industry Council, National Taxpayers Union and TechNet.</i>				



Can States Help Themselves?

The Politics of Sovereignty

The Example of the Multi-State Tax Compact.

The Streamlined Sales and Use Tax Agreement



Why All SUT Fuss?

- 45 states plus District of Columbia impose SUTs
- Over 7,000 jurisdictions -- administered by state except in AL, AZ, CO and LA
- Retailers required to collect and remit sales tax to states where retailer has physical presence (*Quill v. North Dakota*).
- Use tax is owed by consumer when retailer does not collect the sales tax.



Who Has a Problem?

Remote Sellers

- Compliance with sales tax laws by multi-state corporations is too complex

Local Businesses

- Local merchants suffer from lack of level playing field

State & Local Governments (& Taxpayers)

- Significant losses of revenue



Streamlined Sales and Use Tax Agreement (SSUTA)

- **SSUTA approved November 2002 by the implementing states, and amended since.**
- **Agreement came into effect on October 1, 2005 (at least 10 states with 20% of the U.S. population)**
- **Provisions are based on simplification, uniformity and technology principles:**
 - **Simplification** (e.g., state-level administration of tax)
 - **Uniformity** (e.g., uniform definition of "lease," lease sourcing rule)
 - **Technology** (e.g., certification of tax calculation software).
 - **Balancing interests of state sovereignty.**



Goals of SSUTA (Sec. 102)

- A. State level administration of sales and use tax collections
- B. Uniformity in the state and local tax bases
- C. Uniformity of major tax base definitions
- D. Central electronic registration system for all member states
- E. Simplification of state and local tax rates
- F. Uniform sourcing rules for all taxable transactions
- G. Simplified administration of exemptions
- H. Simplified tax returns
- I. Simplification of tax remittances
- J. Protection of consumer privacy

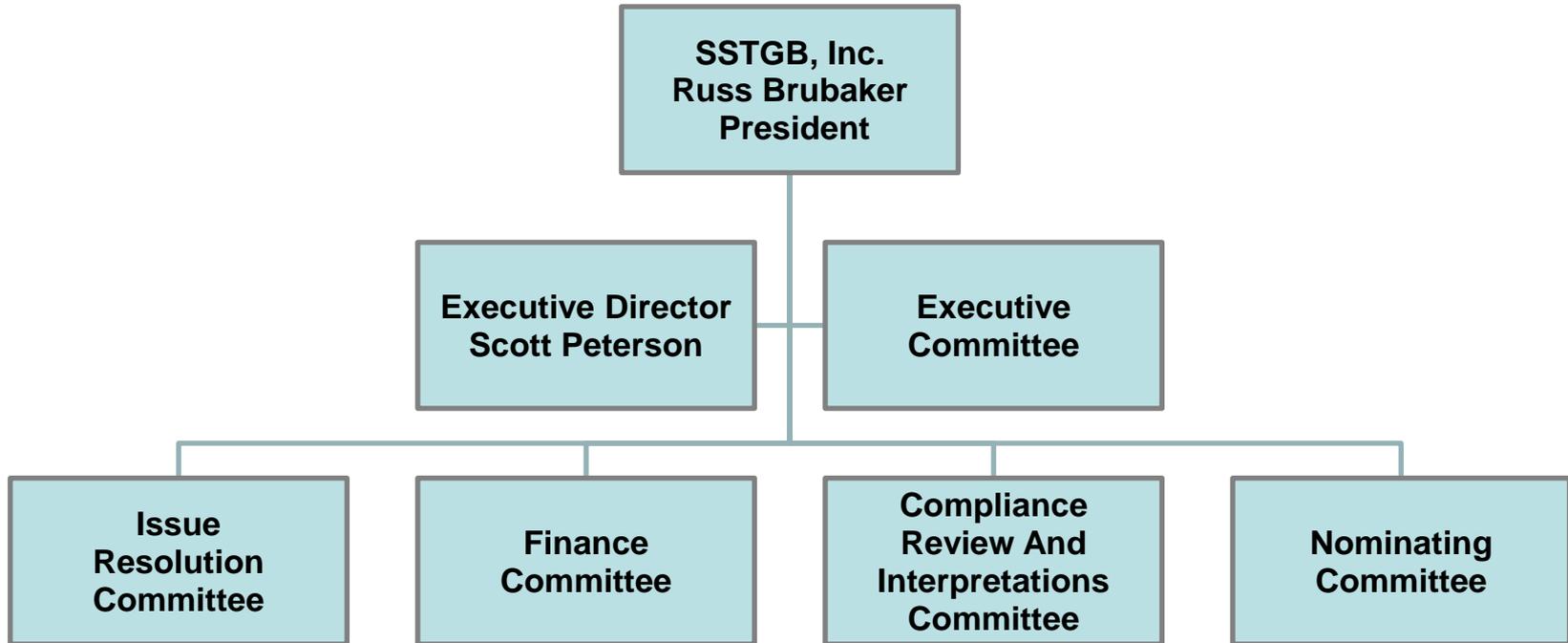


States Exploring SSUTA

- **California**
- **Florida**
- Hawaii
- **Illinois**
- Maryland
- Massachusetts
- Missouri
- Pennsylvania
- **Texas**
- Virginia



Governing Structure



SSUTA Website: www.streamlinedsalestax.org



SSUTA Governance Structure

- **Governing Board** – one vote for each full member state. BAC & SLAC are ex-officio members
- **Business Advisory Council (BAC)** – open to interested businesses – Meredith Garwood, President (bacssuta.org)
- **State and Local Advisory Council (SLAC)** – open to all participating states – many issues vetted before this group
- **Compliance Review and Interpretations Committee (CRIC)** – Makes initial decisions on interpretation request and also reviews the request for membership and each state's annual compliance certification (only full member states can have a member on this committee)



What's Been Made Uniform

- **Uniform treatment of bank holidays**
- **Uniform rules for sales tax holidays:**
 - limited to defined products and within administrative guidelines
- **Uniform drop shipment rule**
- **Uniform rule for bad debt credits**
- **Uniform definition of certain products**



What's Been Made Uniform, Con't

- Digital goods
- Food and food ingredients
- Prepared food
- Candy
- Soft drinks
- Dietary supplement
- Clothing
- Lease or rental
- Tangible personal property
- Bundled Transaction
- Drugs
- Durable Medical Equipment
- Computer Software
- Prewritten Computer Software
- Delivered Electronically
- Load and Leave
- Sales Price



What's Been Made Uniform, Con't

- **Simplified electronic tax return (work in progress – issue with reporting non-taxable sales)**
- **Uniform exemption certificate and simplified exemption processing**
- **Uniform rounding rule (accounting 5/4 rule instead of always round up)**



Central Registration & Amnesty

Central Registration System

- www.sstregister.org/sellers
- Must register for all full member states (optional for assoc. states)
- Must register on Central Registration System to be eligible for
- AMNESTY.

Amnesty

- A company can register and receive amnesty for any prior uncollected sales tax
 - Need to continue registration for 36 months.
 - Amnesty currently available for these states:
 - **Georgia** – ends July 31, 2012
- Ohio, Tennessee and Utah** – no time limit for assoc. member states



Central Registration Payments

- Sellers can voluntarily register to collect tax using the Streamlined system
- Through Sept. 30, 2011 (inception 10/1/2005) sellers under this system have collected and remitted over \$890 million in tax **(over \$205 million collected in FY 2010)**
- Over 1,400 registered sellers – most using their own system
- Seller can several certified service providers without charge - states pay the CSPs from the CSPs tax collections



Destination Sourcing Rules

Retail sale of a product is sourced pursuant to Section 310 as follows (hierarchical):

1. Business location of seller if purchaser receives the product at that location
2. Location where purchaser receives the product
3. Address of purchaser
4. Address of purchaser's payment
5. Address from which the product was shipped



New Alternative Sourcing – Origin Sourcing

- Alternative origin sourcing only applies to an intrastate sales – state must require use for all sales unless the seller's record keeping system does not capture the location where the order is received.
- If location is not captured (seller not required to capture) then destination sourcing under Sec. 310 used
- A purchaser can rely on the seller's representation concerning the location of order receipt.
- Physical location is where the seller initially receives the order (The following locations are not applicable - Where order is: accepted, fulfilled or shipped from).



New Alternative Sourcing – Origin Sourcing Continued

- Alternative sourcing provision must be adopted by at least five states for those states to become full member states
- Thus far, adopted by Ohio and Utah
- Potential states – **California**, **Texas**, Tennessee, Virginia, **Illinois**, Missouri and New Mexico



Pending SSTP Issues

- Sales price – treatment of Internet vouchers
- **Credit for tax legally imposed by another state**
- Sourcing of services (making first use)
- **Digital products and access to software**
- Small seller exclusion
- New amnesty for sellers provided by all states?



Simplified Electronic Return & Compensation Study

- **By January 1, 2013 states must allow all sellers to file a SER**
- **The SER has two parts:**
 - **Part 1** – Information relating to remittances and allocations - filed monthly
 - **Part 2** – Exempt sales information - goal is to have six information items (can be completed monthly or yearly with December return)

Cost of Collection Study

- Weighted average cost for compliance – 3.09% for all retailers
 - Sales over \$10 billion - 2.17% (large retailers)
 - Sales from \$1 million to \$10 billion – 5.2%
 - Sales less than \$1 million – 13.47% (small retailers)
- Governing Board Compensation
 - Three tier system, weighted average must be 0.5% for single jurisdiction states and 0.75% for all other states



COST/EY Tax Burden

Total state and local business taxes

State-by-state estimates for fiscal year 2011

July 2012



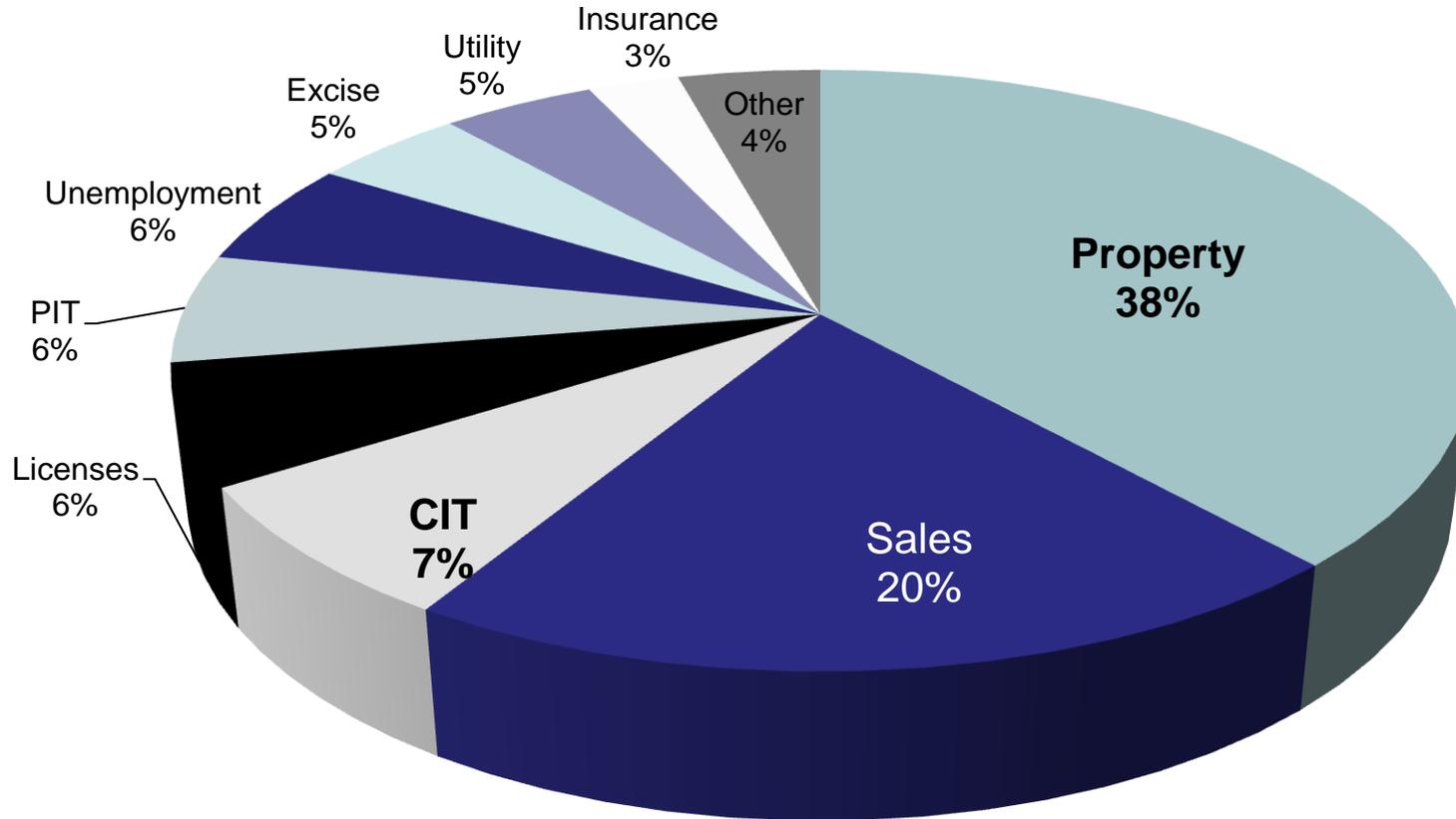


Key findings of the COST/EYstudy

- ▶ Level of FY 2011 collections reflects both
 - Significant lingering effects of the recession on business tax collections
 - Significant variation in the level of state and local taxes paid by businesses across the states relative to economic activity
- ▶ **State and local taxes paid by businesses in FY'11 totaled \$644 billion, a 4.5% increase compared to FY'10**
- ▶ **The 4.5% total increase in business taxes included a 9.8% increase in state business taxes and a 0.8% decrease in local business taxes**
- ▶ **While the corporate income tax is the focus of much debate, it only represented 7.2% of total state and local business taxes (individual income on pass-through business income accounted for an additional 5.6% of total business state and local taxes)**
- ▶ **Non-income based taxes account for more than 87% of state and local business tax revenue**



Taxes Paid by Business





State and Local Business Taxes FY2010 - FY2011 (\$billion)

<u>Business taxes</u>	<u>FY2010</u>	<u>FY2011</u>	<u>% total taxes</u>	<u>One-year growth</u>
Property taxes on business property	\$248.6	\$244.9	38.0%	-1.5%
General sales taxes on business inputs	123.3	129.7	20.1%	5.2%
Corporate income tax	42.7	46.3	7.2%	8.5%
Unemployment insurance	32.4	41.2	6.4%	27.1%
Business and corporate license	37.0	37.3	5.8%	0.9%
Individual income tax on business income	33.0	36.3	5.6%	10.0%
Excise taxes	30.5	35.0	5.4%	14.9%
Public utility taxes	28.9	28.8	4.5%	-0.3%
Insurance premiums taxes	16.6	17.2	2.7%	3.6%
Severance taxes	11.3	14.8	2.3%	30.9%
Other business taxes	11.8	12.4	1.9%	5.5%
Total business taxes	\$616.0	\$643.9	100.0%	4.5%



COST Administrative Scorecard



The Best and Worst of State Tax Administration

COST Scorecard on Tax Appeals &
Procedural Requirements

*Douglas L. Lindholm
Fredrick J. Nicely*

February 2010



COST administrative scorecard

1. Independent tax dispute forum?
2. Pay-to-Play (bond or prepayment requirement)?
3. Even-handed statutes of limitations (refunds and assessments)?
4. Equal interest rate applies to assessments and refunds?
5. Number of days to protest an assessment
6. Return due 30 days after Federal return & Automatic Extension?
7. Reporting Federal tax changes
8. Other issues.



COST administrative scorecard

	Independ-ent forum	Pay-to-Play	Even-handed Statute of Limit.	Equal Interest Rates	Ample Protest Period	Return Due Date/ Auto Ext.	Filing of IRS Changes	Other Issues	Total Points	Overall Grade
AZ	0	0	0	0	1	0	2	1	4	B+
LA	2	2	0	2	1	0	2	3	12	D
MS	0	1	0	0	0	1	2	0	4	B+
NM	0	0	0	0	1	2	2	1	6	B
OK	3	2	0	1	0	2	1	1	10	C-
TX	2	2	0	1	1	1	2	1	10	C-
CA	3	2	1	2	1	1	0	3	13	D-
FL	3	2	0	1	0	2	2	2	12	D
IL	3	2	0	1	0	1	2	2	11	D



Looking Ahead

The World is Getting Smaller

Service Based Economies

Federal Tax Reform

Federal Preemption



Questions?

