Legal Roundtable
Key State Tax Cases, Legislation and Trends for 2016

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2014-2015 US Supreme Court Cases

The *Wynne* Case

- *Comptroller of Maryland v. Wynne*, Dkt. 13-485, (from MD Ct. of Appeals, 431 Md. 147); decided 5/18/15
  - Question Presented: Does the U.S. Constitution prohibit a state from taxing all the income of its residents – wherever earned – by mandating a credit for taxes paid on income earned in other states?
- Maryland imposes two personal income taxes
  - State income tax (5%), and
  - County income tax (up to 3%)
    - Reported and collected on the SAME FORM!
- Maryland resident S corporation shareholder paid taxes on multistate tax business to all states
  - Not only claimed credit against the Maryland state income tax (allowed specifically by statute) but also against county tax (for which no statutory credit was available)

Maryland Comptroller of the Treasury v. Wynne

- Held:
  - Maryland's scheme violated the dormant Commerce Clause because it imposed tax on non-resident income sourced to Maryland while granting only partial credit for income earned by MD residents in other states.
    - Court applied the internal consistency test to reach this result (see next slide)
  - Wynne did not hold that a state must give full credit for income earned by residents in other states.
  - However, it clarified:
    - (1) that the Commerce Clause protects residents from discriminatory policies imposed by their own state;
    - (2) the Commerce Clause does not have different tests/rules for income earned by individuals & businesses; and

The Internal Consistency Test

The test: whether interstate and intrastate commerce would be taxed equally if every state were to adopt the precise tax scheme at issue

- State A imposes a 1.25% tax on all residents, regardless of where earned.
- State A also imposes a tax on nonresidents' source income at 1.25%
- No resident credits
- April and Bob live next door to each other in State A; Bob's business located in State B; April's is all in State A.
- To apply the I/C test, we have to assume all states have the State A scheme. State A fails the test!!

	April	Bob
State A Tax	1.25%	1.25%
Hypo State B Tax	0	1.25%
Total Bill	1.25%	2.5%

Wynne Implications/Questions

- Dual Residency and Resident Credits
  - Effect on statutory residency rules: is a credit required for taxes paid on intangible income?
  - Proposed "fix" in 1996 NESTOA Agreement?
- What local tax regimes could be implicated?
  - NYC and Philadelphia?
- Other Questions/Issues?

DMA – Does TIA Bar Federal Challenge?

- Tax Injunction Act provides that federal district courts "shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State." 28 USC § 1341.
- Colorado use tax reporting scheme not an assessment, levy, or collection of tax – so – not barred by TIA
  - More state cases in federal court? But, what about Comity Doctrine which counsels federal courts to refrain from interfering with fiscal operations of state governments?
  - TIA, along with Comity Doctrine, create hurdles
- Justice Kennedy gives "unqualified" concurrence to majority opinion; *however, he goes out of his way to say Quill needs to be reconsidered – it "now harms States to a degree far greater than could have been anticipated earlier."*
- **On Remand:** The 10th Circuit has asked both parties to brief the commerce clause and comity issues.

Selected Noteworthy State Tax Cases

Retroactive Legislation Litigation

- **Michigan Multistate Tax Compact cases – litigation on 6 year retroactive legislation.**
  - PA 282 retroactively repealed the Compact; ***Lorillard*** is effectively the lead case on "retroactivity"
  - The Michigan Court of Appeals subsequently vacated the Court of Claims order in *Anheuser-Busch* (holding the Compact binding on the state) and remanded to the Court of Claims to determine the validity of the retroactive legislation; Court of Claims Chief Judge Michael J. Talbot recently decided *Yaskawa America*, upholding the retroactive legislation
- **State of Washington 8 year retroactive legislation on estate tax law change.** *See Hambleton v. Department of Revenue* cert. being sought at SCOTUS.
- **New York: Retroactive law change to "correct" a Tax Tribunal decision.** *Caprio v. NY*, 2015 NY Slip Op. 05625 (2015).
- **Virginia 10 year retroactive legislation on add-back:** *See Lorillard Tobacco Co. v. Virginia Dep't of Taxation*, No. CL 13000509-00 (Va. Cir. Ct. filed July 22, 2013) (Danville City); and *Kohl's Dep't Stores, Inc. v. Virginia Dep't of Taxation*, No. CL 12001774-00 (Va. Cir. Ct. filed Apr. 16, 2012).

Other Noteworthy State Tax Cases

- **Alternative Apportionment:** *Vodafone Americas Holdings, Inc. v. Roberts*, 2014 Tenn. App. LEXIS 362 (Tenn. Ct. App. June 23, 2014), cert. granted (Tenn. Nov. 20, 2014); *see also Corporate Executive Board Co. v. Virginia.* Application of market sourcing rules to a non-domiciliary service business in a COP state.
- **Factor Presence Nexus:** *Crutchfield, Inc. & Newegg, Inc.* (Ohio BTA App. 2/26/2015)
- **Economic Substance/Unitary in MD***: ConAgra Brands Inc. v. Comptroller*, 09-IN-OO-0150 (Md. Tax Ct., Feb. 24, 2015); *Staples, Inc. v. Comptroller* 09-IN-OO-0148 (Md. Tax Ct., May 28, 2015)
- **False Claims Act:** *Sprint vs. People v. Sprint Nextel Corp.*, on appeal to New York Court of Appeals (on application of NY False Claims Act to the "under collection" of sales tax)

Business Tax Trends: 2015-16

What's Hot: Continued Interest in Broad-Based Tax Changes

- **CT** – Enacted legislation (H.B. 7061) includes unitary combination, corporate surcharge extension, further limits on credits/NOLs (simultaneously, S.B. 1502 delayed combined reporting to 1/1/2016, repealed sales tax increases on computer/data processing services)
- **LA** – Major corporate tax changes discussed included unitary combined reporting, related party expense "addback"
- **NV** – Enacted legislation (S.B. 483) includes receipts-based "commerce tax" with variable rates, with credit against increased payroll tax ("modified business tax")
- **TN** – Revenue Modernization Act (H.B. 644) expands economic nexus, adopts market-based sourcing for sales of services, imposes sales tax on cloud computing services
- **NY** – Major corporate tax reform including new combined reporting rules, market sourcing, and economic nexus

What's Hot: Governors Push Combined Reporting

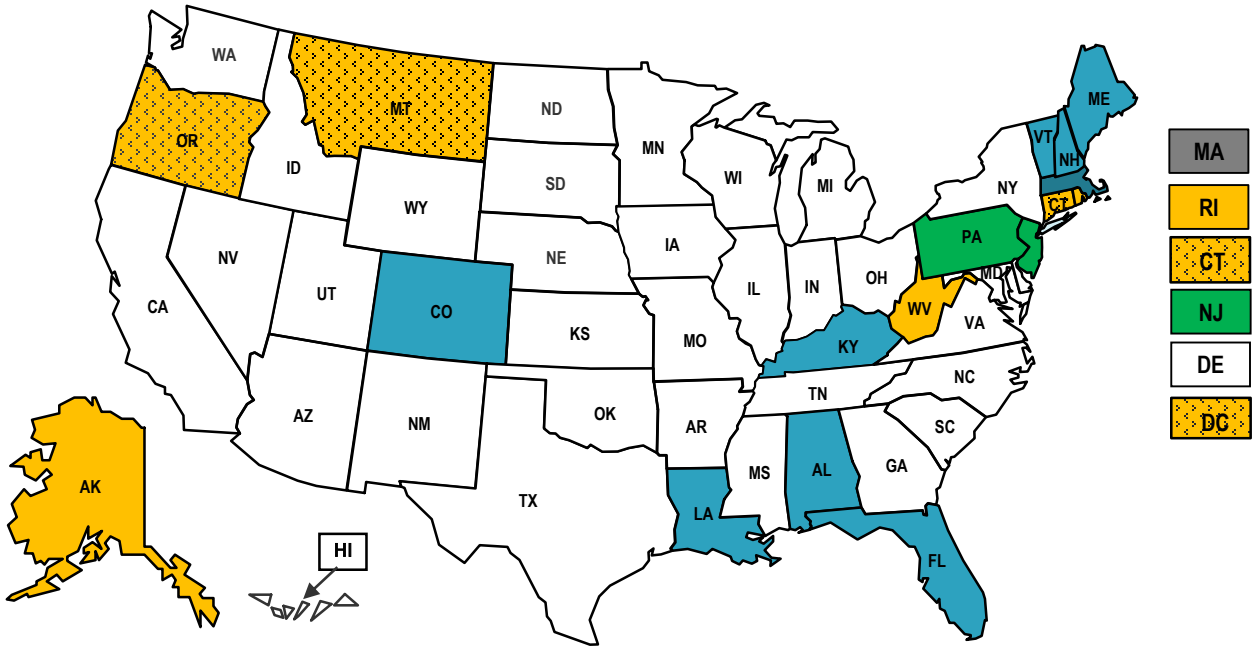
- **AL** – Governor Bentley proposes combined reporting among other more significant revenue increases (e.g., nearly triple the cigarette excise tax)
  - Broad combined reporting proposal, including many features of MTC model (*e.g.*, separate entity treatment for NOLs and credits, expansive water's edge with tax haven provisions)
  - Failed to advance in regular session
- **PA** – Governor Wolf proposes combined reporting with significant corporate tax rate decrease (but also significant revenue raisers, including sales tax rate and significant base expansion).
  - Proposals are stalled in the Legislature

What's Hot: Attempting to Broaden the Sales Tax Base

- **Maine Governor's Proposal** – Tax base would include a wide variety of services, but specifically exempt sales of installation, repair and maintenance, personal property services & professional services "to a business for use directly by that business"
- **Ohio Governor's Proposal** – Tax base would include a variety of services, including market research, lobbying, public relations, management consulting, debt collection
- **Pennsylvania Governor's Proposal** – Tax base would include a wide range of personal services, entertainment services, business support services, and professional services; exemption for B-to-B purchases for some categories
- **California S.B. 8, Senator Hertzberg's Proposal: "The Upward Mobility Act"**
  - "Broaden the tax base by imposing a sales tax on services to increase revenues…Health care services and education services would be exempted from the tax, and very small businesses with under $100,000 gross sales would be exempted from the sales tax on services."

MTC Transfer Pricing Program

- MTC's Transfer Pricing Program – Arm's Length Adjustment Service (ALAS)
- Committed States (6) as of May 7, 2015: Alabama, Iowa, Kentucky, New Jersey, North Carolina, and Pennsylvania
- Final Program Design approved by Executive Committee on May 7, 2015.
- Issues
  - MTC still needs support of additional 3 to 4 states
  - Will the states have sufficient resources
  - Separate entity vs. unitary states

"Tax Haven" State Enactment Status, with 2015 Proposals

- Enacted Tax Haven Provisions
- Tax Haven "Blacklist" Included or Required in Enacted Legislation
- 2015 Proposals- Still Live
- 2015 Proposals- Not Enacted