



Blackman Kallick

## HLB North America Tax Conference – SALT Update – December 5, 2012

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## Agenda

- “Amazon” nexus rules and e-commerce
  
- State updates
  - District of Columbia
  - Michigan
  - Illinois
  - Ohio
  - California
  - New York
  
- Apportionment for sellers of non-tangible personal property



## Amazon Nexus Rules: The Numbers (as of July 25, 2011)

- 1 – Amazon legislation originally introduced and signed into law in New York
  
- 21 – Amazon legislation introduced in 21 states in last two years
  
- 7 – Amazon nexus signed into law in seven additional states in last two years
  - Arizona, California, Connecticut, Illinois, North Carolina, Rhode Island, and Vermont



## What is Amazon Nexus?

- Background
  
- Reaction
  - Vendor
  - State
  
- Supporters and opponents
  
- Alternative approaches



## Amazon Nexus – Background

- *Quill Corporation v. North Dakota*
  - Physical presence required
  
- *Scripto*
  - Physical presence can include independent sales representatives soliciting sales in the state
  
- *Tyler Pipe*
  - Statutes must be internally consistent



## Amazon Nexus – Background

- Creates rebuttable presumption that retailer is “doing business” in the state if the retailer enters into an agreement with a person with physical presence in the state for which a commission or other consideration is received and, directly or indirectly, refers potential customers, whether by a link on an internet website or otherwise, to the retailer if cumulative gross receipts from referred sales exceeds a threshold during the preceding four quarterly periods
  - New York/Illinois = \$10,000
  - Rhode Island = \$5,000
  - Vermont = \$2,000
- Not rebuttable in Illinois



## Amazon Nexus – Background

- Model “Amazon” Statute
  - On July 24 and 25, 2011, Multistate Tax Commission (MTC) subcommittees announced plans to develop New York–style Amazon model statute
  - Requested language requiring rebuttable presumption
  - Two thresholds to establish rebuttable presumption



## Amazon Nexus – Background

- Model “Amazon” Statute
  - Associate threshold
    - *Minimum amount of cumulative gross receipts from associates in the state*
  - Vendor threshold
    - *A de minimis amount of vendor sales in the state*



## Amazon – Vendor Reaction

- New York Litigation
  - April 2008 – both Amazon and Overstock challenged constitutionality of the New York statute based on *Quill*
  - January 2009 – New York Supreme Court (trial court) rules in favor of New York
    - *Decision was upheld in part and remanded in part on appeal*



## Amazon – Vendor Reaction

- New York Litigation – Court’s Findings
  - Statute was facially constitutional and not unconstitutionally vague
  - “Passive” solicitation vs. “active” solicitation (paying commission on a per-sale basis)
  - No equal-protection violation
  - Case remanded for additional discovery on “as applied” challenge
    - *According to Amazon VP, only 1.5% of in-state sales through affiliate referrals*
  - Amazon and Overstock currently collecting tax from New York customers



## Amazon – Vendor Reaction

- Amazon has terminated its online affiliated marketing program in all states that have adopted Amazon laws
  
- California
  - On July 8, Amazon filed paperwork with California attorney general to put a proposed repeal of the law on the 2012 budget
  - California attorney general on July 18 approved petition language for proposed referendum that would ask voters to appeal Amazon law
  - California and Amazon agreed to a compromise – law will go into effect in 2012



## Amazon – State Reaction

- Texas, Tennessee, and South Carolina
  - Amazon offered all three states similar deals
  - Distribution center(s) and jobs in exchange for a sales tax moratorium
  - Which states agreed?



## Amazon – State Reaction

- Tennessee Agreed
  - Amazon plans to open two distribution centers in Tennessee
  - Negotiated with the governor for assurance that no tax due on sales to Tennessee residents
  - Tennessee attorney general on June 28, 2011 said the General Assembly could mandate that Amazon collect sales taxes when it opens facilities in the state
  - Retail Industry Leaders Association reportedly is willing to sue Tennessee over a proposal to exempt Amazon from collecting sales taxes



## Amazon – State Reaction

- South Carolina agreed
  - Bill S 36
  - Provides Amazon an exemption from collecting sales taxes
  - Became law June 8, 2011 without governor's signature
  - Exempts the online retailer from collecting sales taxes on purchases by South Carolina residents until 2016
  - Amazon agreed to create 2,000 jobs at a distribution center in the state



## Amazon Law – Supporters

- In-state brick-and-mortar retailers and organizations of which they are members
- Position: No different from “typical” attributional nexus cases, such as *Scripto*



## Amazon Law – Opponents

- Unconstitutional – using weak link to claim the power to exercise its taxing authority over that out-of-state retailer
- States have failed to collect additional revenue and have caught in-state affiliates in the crossfire
- Administrative issues –
  - All out-of-state retailers subject to the law, no matter their size
  - Obligated to track 8,000+ sales tax jurisdictions



## Amazon Law – Opponents

- Do not create level playing field because create three-fold unequal structure:
  - In-state brick-and-mortar businesses must collect sales tax based on where the business is located
  - Out-of-state online businesses must collect sales tax based on where the in-state customer is located
  - In-state online businesses face no additional obligation beyond collecting sales tax on in-state sales



## Amazon Laws – Alternative Approaches

- From Opponents
  - Require in-state affiliates be the source of a majority of out-of-state seller's sales in the state
  - Set a *de minimis* threshold of \$1 million or more of in-state referred sales
  - Replace collection obligation with requirement to notify customer by e-mail that a use tax obligation may exist



## Amazon Laws – Alternative Approaches

- Notification Requirement
- The Numbers:
  - 1 – Notification legislation originally introduced and signed into law in Colorado in 2010
  - 6 – Notification legislation introduced in six states in last two years
  - 3 – Notification laws signed into law in three additional states in last two years
    - *Oklahoma, South Dakota, and Vermont*



## Amazon Laws – Alternative Approaches

- *Amazon.com LLC v. Lay* (Wash.)
  - North Carolina cannot force disclosure of names of purchasers



## Amazon Laws – Alternative Approaches

- Colorado Reporting Statute
  - Statute was modified from click-through nexus statutes to affiliate nexus and required reporting for out-of-state internet sellers
    - *Creates rebuttable presumption that any subsidiary in controlled group [IRC 1653(a)] creates nexus for out-of-state retailers*
    - *Subpoena power given to DOR to request information from non-nexus Colorado retailers making sales into Colorado*
    - *Requires remote sellers to:*
      - *Collect sales taxes voluntarily or*
      - *Notify customers of their use tax obligation and*
      - *Send a report to the state department of revenue outlining the customers' purchases.*
    - *Must disclose in-state purchasers (with \$5 – \$10 penalty per occurrence)*



## Amazon Laws – Alternative Approaches

- Multistate Tax Commission (MTC) developed Model “Notification” Statute
  - Very similar to Colorado’s notification statute
  
- On July 20, 2011, MTC announced that it does not have enough support from its members to put its Colorado-style Amazon statute up for adoption at its 2011 annual meeting



## Amazon Laws – Alternative Approaches

- *Direct Marketing Association v. Huber*
  - Constitutional challenge to Colorado statute
  - Injunction granted against Colorado's enforcement of notification requirement
    - *Substantial likelihood of Commerce Clause violation*
  - District Judge Blackburn will rule on cross motions for summary judgment on the commerce clause issues
  - No time frame for decision – but could come any day



## Amazon Laws – Alternative Approaches

- Oklahoma/South Dakota/Vermont Disclosure Laws
  - Law requires vendor to notify the online purchasers that their purchases may be subject to use tax
  - Oklahoma – no penalty provisions
  - South Dakota – requires online retailers to place a prominent notice on their websites
  - Vermont – same as South Dakota, no penalty provisions



## Amazon Laws – Alternative Approaches

- Texas/Oklahoma/South Dakota Affiliate Nexus Statute
  - Law presumes nexus if affiliate company has distribution center in state
  - Affiliate in state in same line of business
  - Contracted for maintenance/repair



## District of Columbia Update

- Corporate tax provisions
  - Mandatory water's edge combined reporting
  - Can elect worldwide combined reporting (10 year election)
  - Double weighted sales factor
  - Increase in minimum tax to \$250 (\$1,000 if more than \$1M of DC gross receipts)
  - Tax years beginning after December 31, 2010



## District of Columbia Update

- Sales tax legislation
  - Remote vendor obligations on Internet sales to DC purchasers
  - Expansion of sales tax base
    - *Armored car services*
    - *Private investigation services*
    - *Security services*



## District of Columbia Update

- Individual tax provisions
  - Itemized deductions limited if AGI > \$200,000
  - Municipal bonds now considered taxable
  - High income tax bracket



## Michigan Update

- Effective January 1, 2012, Michigan Business Tax (MBT) replaced with Corporate Income Tax (CIT)
  
- Fiscal-Year Filers – two returns required:
  - Beginning FY through December 31, 2011 – MBT Return
  - January 1, 2012 through end FY – CIT Return



## Michigan – Opportunity to Continue Filing MBT Returns

- Available to taxpayers with unused “certificated” credits
  
- “Certificated” credits include
  1. Michigan Economic Growth Authority (MEGA)
  2. Renaissance Zone
  3. Brownfield Redevelopment
  4. Film Production, Battery, and others
  
- Election is irrevocable until credits are exhausted



## Michigan – Corporate Income Tax (CIT)

- Overview
  - 6% rate
  - Only applies to C corporations
  - Single-sales-factor apportionment
  - Sales other than tangible personal property use market-based sourcing
  - Credits under MBT not retained
  - MBT income tax losses do not carry forward



## Michigan – CIT

- Nexus
  - Every taxpayer with “business activity” in Michigan
    - *Substantial Nexus*
      - *Physical presence of more than one day,*
      - *Taxpayer “actively solicits” Michigan sales and has gross receipts of \$350,000 or more, or*
      - *Taxpayer has an ownership or beneficial ownership interest in a flow-through entity that has substantial nexus with Michigan*
  - Public Law 86-272 applies



## Michigan – CIT

- Unitary Group
  - Includes U.S. persons, other than a foreign operating entity, one of which owns or controls 75% of the ownership interest with voting rights or comparable ownership groups
  - Must have a flow of value between or among group members
  - Financial institutions and insurance companies are excluded
  - *Finnigan* sourcing rule for unitary groups



## Michigan – CIT

- Foreign persons
  - Treaty exemptions do not apply to foreign corporations
  - Exemption for foreign persons domiciled in a sub-national jurisdiction of a NAFTA country that does not impose an income tax on taxpayers domiciled in Michigan if presence in foreign country is the same as the foreign person's presence in the U.S.
  - Tax base does not include sales proceeds of sales where title passes outside the U.S.



## Michigan – CIT

- Tax Base
  - Federal taxable income plus/minus modifications
    - *Municipal income*
    - *Taxes based on or measured by net income*
    - *Carryback or carryover of net operating losses*
    - *Royalties, interest, and other expenses paid to related parties for use of intangibles*
    - *Dividends and royalties incurred from person other than U.S. persons and foreign operating entities*
    - *U.S. government interest*
    - *Business losses incurred after December 31, 2011 (10-year carryover)*



## Michigan – CIT

- Estimates
  - Due April, July, Oct, and Jan 15
  - If first taxable year is less than 12 months, each estimate must be proportional to the number of payments made in the first year



## Michigan – Flow-Through Entities

- Owners subject to personal income tax if activity exceeds Public Law 86-272
- Entities continue to have withholding requirements if more than \$200,000 of Michigan-apportioned income
- Lower-tier withholding flows through to upper tiers
- Single sales-factor apportionment



## Michigan – Personal Income Tax

- Rate continues at 4.35% thru December 31, 2012
- Rate reduced to 4.25% beginning January 1, 2013
- Personal exemption not allowed for single taxpayer with taxable income over \$100K, \$200K for joint
- Certain federal deductions not allowed:
  - Distribution from IRAs to pay qualified higher education expenses
  - Qualified charitable distributions from a retirement plan
  - Gains from certain initial-equity investments
  - Political contributions
  - Wages not deductible under IRC § 280C



## Michigan – Personal Income Tax

- Pension Benefits – exclusions curtailed based on taxpayer's birth year
  - Born before 1946 – total exclusion
  - Born 1946-1952 – exclusion limited to \$20K for single, \$40k joint
  - Born after 1952 – no exclusion, after age 67 may forgo the exclusion for social security to take a \$20K – \$40K pension deduction
  - Except for taxpayers born before 1946, pension deductions not available if taxable income exceeds \$75,000 single, \$150,000 joint



## Illinois Update

- January 2011 Legislation
  - Tax rate increases
  - Net operating loss (NOL) suspension
  - “Amazon” legislation



## Illinois Update

- **Individual, trust and estate tax rates**
  - For years before 2011, 3%
  - For 2011 – 2014 tax years, 5%
  - For 2015 – 2024 tax years, 3.75%
  - For years 2025 and thereafter, 3.25%
  
- **For owners of flow-through entities such as S corporations, partnerships, and trusts, the 1.5% Illinois replacement tax continues to apply**



## Illinois Update

- **C corporation tax rates (income and 2.5% replacement tax)**
  - For years before 2011, 7.3%
  - For 2011 – 2014 tax years, 9.5%
  - For 2015 – 2024 tax years, 7.75%
  - For years 2025 and thereafter, the rate will revert back to 7.3%
  
- **With a 9.5% combined corporate tax rate, Illinois has one of the highest tax rates in the nation**



## Illinois Update

- **C corporation net operating losses**
  - Suspended for tax years ending after December 31, 2010 and prior to December 31, 2014
  - The net operating loss carryforward: extension equal to number of years net operating losses were suspended
  - Special rules for taxpayers with fiscal year-ends



## Illinois Update

- **Amazon” nexus legislation**
  - Illinois’s first legislative attempt to require out-of-state online businesses to collect and remit Illinois sales tax
  - New definition of retailer and serviceman
  - Includes language aimed at web hosting



## Ohio – Consumer Use Tax Amnesty

- October 1, 2011 – May 1, 2013
- Full amount of any outstanding consumer use tax arising on or after January 1, 2009 must be paid
- Consumer use tax liabilities owed before January 1, 2009 waived
- All penalties and all interest waived
- Taxpayers issued assessments are not eligible
- Registered taxpayers are not eligible
- Payment plans are available



## Ohio – General Tax Amnesty

- May 1, 2012 – June 15, 2012
- Eligible taxes include:
  - Commercial-activities tax
  - Corporate-franchise tax
  - Individual income tax
  - Taxes on qualifying pass-through entities
  - Sales tax, and more
- Applies to all taxes due and payable as of May 1, 2011 that went unreported or underreported that remain unpaid as of May 1, 2012
- Taxpayers must pay all tax and 50% of interest
- Commissioner waives all penalties and 50% of interest



## California Update

- *Apple, Inc. v. Franchise Tax Board*
- *General Mills, Inc. & Subsidiaries v. Franchise Tax Board*
- *California Taxpayers' Association v. Franchise Tax Board*



## California Update

- Economic nexus
- Single sales factor election
- Series LLC guidance
- Net operating loss deduction suspension guidance issued
- Supply chain disclosure requirement



## New York Update

- Statute of limitations – collection of tax liabilities
- Hot audit area – residency cases
- Hot audit area – sourcing revenue for on-line services – sales tax and income tax purposes
- Are individual tax rates going down?
- *In the Matter of the Petition of Talbots*



## Planning – Costs of Performance v. Market

- Example
  - Engineering design work performed in State A for a customer and building in State B
    - *Design firm's costs incurred as follows:*
      - State A – 65%, benefit-received state
      - State B – 35%, COP state
    - *Contract revenue apportioned as follows:*
      - State A – 0%, benefit of services received in State B
      - State B – 0%, less than 50% of costs incurred in State B



## Different Interpretations of Costs of Performance

- *AT&T Corp. V. Dept. of Revenue* (Massachusetts Appellate Tax Board, June 8, 2011)
  - Does income-producing activity test applied broadly to the taxpayer's overall service of providing telecommunications services to Massachusetts customers or whether it should be applied narrowly to each transaction (i.e., call or data transmission)
    - *Board found the test must be applied to the taxpayer's overall operations*
    - *Board also held that access fees paid to local exchange carriers (LECs) were not direct costs included in determining the taxpayer's COP*



## Different Interpretations of Costs of Performance

- *AT&T v. Dept. of Revenue* (Oregon Tax Court, June 28, 2011)
  - Court held that test narrowly applied on a transactional basis (i.e., to each call to and from Oregon)
  - Court held that only direct costs incurred regarding any given phone call should be considered in determining COP
    - *Thus, no general or administrative costs were counted*
  - Court held that costs paid to local exchange carriers (LECs) were “direct costs” counted in determining COP



## Market-Based v. Costs of Performance for Services Does it Matter?

- *Ameritech Publishing v. Wisconsin Dept. of Revenue* (Court of Appeals of Wisconsin, June 24, 2010)
  - Taxpayer sold advertising for telephone directories
  - The services of solicitation, billing, graphics execution, and production were performed at offices outside of Wisconsin
  - For years in question, Wisconsin had a greatest-costs-of-performance rule for sales-apportionment purposes
  - Commission determined income-producing activity was “provision of access to a Wisconsin audience”
  - Court of Appeals found revenue should have been Wisconsin source income



## Blackman Kallick/Horwood Marcus & Berk Webinar Series

- **Webinar available online: State Tax Planning – It’s All About Apportionment**
- <http://www.blackmankallick.com/news/2011/11/webinar-available-online-state-tax-planning---its-all-about-apportionment/>



## Highlights

- “Amazon” nexus and e-commerce
  - Does it apply to your clients?
  
- Michigan’s new corporate income tax
  - Only applicable to C corporations
  - Withholding still required for flow-through entities
  
- Apportionment for service providers
  - Cost of performance
  - Benefit received
  - Am I going to steal your clients 😊



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