



# State Tax Hot Topics

*Detroit TEI – December 9, 2014*

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# SALT Hot Topics

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- U.S. Supreme Court Cases.
  - Cloud Computing.
  - Combined Reporting.
  - Passthrough Investor Nexus.
  - Multistate Tax Commission Update.
  - Retroactivity.
  - Incentives.
  - State Administration and Procedures.
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# U.S. Supreme Court Cases

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# Supreme Court Cases

## *Comptroller v. Wynne*

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- Issue: Whether the United States Constitution prohibits 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.
  - Background:
    - The Wynnes owned an interest in an S corporation operating in multiple states.
    - Maryland state income tax provides credit for taxes paid in other states, but the county income tax does not.
  - Argued November 12, 2014.
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## Supreme Court Cases

### *Comptroller v. Wynne*

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- County tax treated as state tax for purposes of Commerce Clause analysis.
  - Can the state of residency tax 100% of residents' income with no credit paid to other states?
    - Why should state of residence have to yield to state where income was earned?
    - Is this effectively a tariff?
  - Internal inconsistency?
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## Supreme Court Cases

### *Direct Marketing Association v. Brohl*

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- Suit to enjoin Colorado use tax notice and reporting statute.
  - Issue: Whether the Tax Injunction Act bars federal court jurisdiction over a suit brought by non-taxpayers to enjoin the informational notice and reporting requirements of a state law that neither imposes a tax, nor requires the collection of a tax, but serves only as a secondary aspect of state tax administration.
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# Supreme Court Cases

## *Alabama DOR v. CSX Transportation*

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- Whether a state “discriminates against a rail carrier” in violation of the 4-R Act when the state generally requires commercial and industrial businesses, including rail carriers, to pay a sales-and-use tax but grants exemptions from the tax to the railroads’ competitors.
  - Whether, in resolving a claim of unlawful tax discrimination under the 4-R Act, a court should consider other aspects of the state's tax scheme rather than focusing solely on the challenged tax provision.
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## Supreme Court Cases

### *Alabama DOR v. CSX Transportation*

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- In Alabama, railroads pay 4% sales tax on diesel fuel; trucking companies and barges do not.
  - *CSX I*, 131 S. Ct. 1101 (2011): Lack of sales tax exemption can be heard under the 4-R Act.
  - Should railroads be compared to competitors (trucking and barge companies) or to general businesses?
  - If so, how to address trucking companies' alternative tax burden, the motor fuels tax?
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# Cloud Computing

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# Cloud Computing

## Remote access litigation – taxpayer wins

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- *Thomson Reuters Inc. v. Dep’t of Treasury*, No. 313825 (Mich. Ct. App, May 13, 2014).
    - “In the instant case, any transfer of tangible personal property was incidental to the service provided. Checkpoint subscribers primarily sought access to up-to-date information relevant to their needs.”
  - *Auto-Owners Insurance Co. v. Dep’t of Treasury*, Dkt. No. 12-000082-MT (Mich. Ct. Claims, Mar. 20, 2014).
    - “The Department’s argument that mere ‘access’ to property equates with ‘use’ is not persuasive. Although computer software was involved in most of the transactions in question, there is no evidence in the record that Auto-Owners exercised a right or power incident to ownership in the underlying software. At the most, Auto-Owners accessed the computer power of the third-party providers and controlled the output of information by entering data.”
  - *Matter of Sungard Securities Finance LLC*, DTA No. 824336 (N.Y. Div. Tax App. Feb. 6, 2014).
    - “Under all of the facts, petitioner is not selling tangible personal property in the form of prewritten computer software, by direct or constructive license, but rather is providing an information service....”
    - “Petitioner performs its services during its own business hours by application of its own proprietary software program that is not licensed or otherwise transferred to, accessible or modifiable by its customers. Under these circumstances, petitioner is not making sales of prewritten computer software and the revenues derived therefrom are not subject to tax as such.”
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- Idaho Code § 63-3616(b) (eff. July 1, 2014) (exempting “computer software delivered electronically” and “remotely accessed computer software” from the definition of tangible personal property).
    - Proposed Idaho Admin. R. 35.01.027 (“Rule 027”) will implement the amendments.
  - Mo. Code Regs. 10-109.050 (revised eff. Aug. 30, 2014) (“the sale of software as a service is not subject to tax”).
  - Draft Vermont Reg. §1.9701(5)-1 (comments due by October 1, 2014).
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# Cloud Computing

## “Cloud Collaboration Service” rulings

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- Taxpayer requested multiple rulings on the same or similar set of facts: A “Cloud Collaboration Service” that routes and augments a customer's voice, video, messaging, presence, audio/web conferencing, and mobile telecommunication capabilities.
  - Taxable sale or lease of the use of software and/or hardware.
    - Utah Tax Commission Private Letter Ruling 13-003 (Dec. 4, 2013).
    - New Mexico Taxation and Revenue Dep’t Ruling 401-13-2 (Jun. 26, 2013).
  - Taxable telecommunications service.
    - Tennessee Dep’t of Revenue Letter Ruling No. 14-05 (Aug. 25, 2014).
    - Virginia Tax Commissioner Ruling 13-182 (Oct. 18, 2013).
    - Colorado Dep’t of Revenue PLR-13-006 (Sept. 18, 2013).
    - Kansas Dep’t of Revenue Private Letter Ruling P-2013-001 (Jul. 3, 2013).
    - Missouri Dep’t of Revenue LR 7248 (May 24, 2013).
  - Taxable automatic data processing service.
    - Ohio Tax Commissioner Opinion No. 14-0001 (Feb. 4, 2014).
  - Nontaxable.
    - Georgia LR SUT-2014-05 (Jun. 9, 2014).
    - Illinois Dep’t of Revenue ST 13-0074-GIL (Nov. 26, 2013).
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# Cloud Computing

## Other developments

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- Massachusetts “true object” analysis for database / information services being nontaxable.
    - Mass. Letter Rul. 14-1 (Feb. 10, 2014) (SaaS transaction was for non-taxable services, not the transfer of prewritten software, under the “object of the transaction” test).
    - Mass. Letter Rul. 14-4 (May 29, 2014) (similar analysis and conclusion, as applied to online employee training system).
  - IaaS rulings.
    - Florida Dep’t of Revenue Technical Assistance Advisement 14A19-001 (Mar. 13, 2014) (nontaxable).
    - S.C. Dep’t of Revenue Private Letter Rul. No. 14-2 (Aug. 26, 2014) (nontaxable).
  - General guidance.
    - New York Dep’t of Taxation & Finance: TB-ST-128 (Aug. 5, 2014) (remote access to software constitutes a taxable transfer of “constructive possession” of the software).
    - Wyoming Dep’t of Revenue Bulletin: Computer Sales and Services (July 1, 2014) (SaaS, PaaS, and IaaS not subject to tax).
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# Combined Reporting

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# Combined Reporting Overseas “tax havens”

- List states (MT, OR).
  - Factor states (AK, DC, RI, WV).
  - MTC model factor test: “Tax haven” means a jurisdiction that, during the tax year in question has no or nominal effective tax on the relevant income and:
    - (i) has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;
    - (ii) has tax regime which lacks transparency. A tax regime lacks transparency if the details of legislative, legal or administrative provisions are not open and apparent or are not consistently applied among similarly situated taxpayers, or if the information needed by tax authorities to determine a taxpayer’s correct tax liability, such as accounting records and underlying documentation, is not adequately available;
    - (iii) facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;
    - (iv) explicitly or implicitly excludes the jurisdiction’s resident taxpayers from taking advantage of the tax regime’s benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction’s domestic market; or
    - (v) has created a tax regime which is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial/other services sector relative to its overall economy.
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## Combined Reporting Taxpayers want it (sometimes)

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- *In re Knowledge of Learning Corp.*, DTA Nos. 823962, 823963 (N.Y. Tax App. Trib. Sept. 18, 2014).
    - Can taxpayers file a New York combined return where substantial intercompany transactions (SITs) are absent but separate filings would result in distortion?
  - *Allied Domecq Spirits & Wines USA Inc. v. Commissioner of Revenue*, No. 13-P-984 (Mass. App. Ct. Jun. 18, 2014) (Rule 1:28 decision – not binding precedent).
    - Can a taxpayer intentionally create nexus for an affiliated entity by transferring employees?
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# Passthrough Investor Nexus

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- *Wirth v. Commonwealth*, 95 A.3d 822 (Pa. 2014).
    - Pennsylvania personal income tax assessed to nonresident limited partners in a partnership owning and operating a skyscraper in Pittsburgh. Ownership interests ranged from 0.04% to 0.15%.
    - Commerce Clause arguments waived.
    - Sufficient minimum contacts under the Due Process Clause:
      - “The narrow argument proffered by Appellants, that they were out-of-state residents involved in a foreign, limited partnership and nothing more simply is not accurate. Instead, the Department’s contention that the primary purpose of the Partnership was to own, operate, and gain income from a Pennsylvania office tower rings true; and, were we to accept Appellants’ arguments, the ability to tax non-Pennsylvanians engaged in commercial real estate transactions within our state could be arguably foreclosed.”
  - *Swart Enterprises Inc. v. FTB*, no. 13CECG02171 (Fresno Cty. Super. Ct. Nov. 13, 2014).
    - 0.02% interest in passthrough California LLC engaged in capital equipment leasing.
    - FTB demanded that taxpayer file a franchise tax return and pay \$800 minimum tax.
    - “Passively holding an investment does not appear to constitute ‘doing business’ or actively engaged in a transaction for gain or profit.”
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# MTC Updates

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- Audits.
    - New transfer pricing program.
    - Joint audit authority for states that repealed the compact?
  - Uniformity.
    - Existing projects.
      - Section 18 revisions.
      - Market-based sourcing rules for services.
      - False claims act preclusion.
    - Potential new projects.
      - Federal RARs.
      - Trusts.
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# Retroactivity

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- Can New York amend a statute in 2010 to affect the taxability of a transaction that occurred in 2007-2008?
    - *Caprio v. N.Y. State Dep't of Taxation and Fin.*, No. 651176/11, 2014 NY Slip Op. 02399 (N.Y. App. Div. Apr. 8, 2014).
    - *In re Jeffrey and Melissa Luizza*, DTA No. 824932 (N.Y. Div. Tax App. Aug. 21, 2014).
  - Recent retroactive legislation:
    - Michigan MTC election repeal (eff. January 1, 2008).
    - Virginia add-back statute (tax years beginning on or after January 1, 2004).
  - Change, correction, or clarification?
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# Incentives

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# Incentives

## Recent developments

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- Major deals:
    - Tesla (Nevada): \$1.3 billion (sales tax abatements, property tax abatements, job tax credits, etc.) for 6,000 jobs and \$3.5 billion investment.
    - United Technologies Corp. (Connecticut): \$400 million of otherwise-unusable R&D tax credits.
  - New incentive programs (California Competes; StartUp NY).
  - Governmental Accounting Standards Board proposed governmental reporting of fiscal impact.
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## Incentives

### Clawbacks – no relief for partial performance

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- *Owens-Brockaway Glass Containers Inc. v. State Tax Commission*, Mich. Ct. App. No. 314190 (Oct. 24, 2014) (unpublished).
    - Partial closure of glass plant 9.5 years into 11-year tax abatement.
    - 100% clawback upheld as liquidated damages clause.
  - Ohio: *City of Westlake v. VWS, Inc.*, 2014 Ohio 1833 (Ohio Ct. App. May 1, 2014).
    - Closure of sewing machine plant 11 years into 15-year property tax exemption.
    - “Material failure” triggering clawback, or rescind incentive going forward?
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- *CDR Systems Corp. v. Oklahoma Tax Comm'n*, 2014 OK 31 (Okla. S. Ct. Apr. 22, 2014) (rehearing requested).
    - Oklahoma capital gains deduction for companies headquartered in the state for at least 3 years prior.
    - Florida-headquartered business claimed deduction.
    - How to distinguish between legitimate state tax incentives and prohibited discrimination against interstate commerce?
      - Legislative intent?
      - Unfair competition?
      - Distinction between penalizing out-of-state businesses and incentivizing in-state businesses?
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# State Administration and Procedures

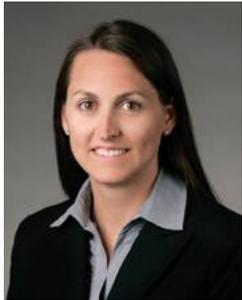
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- **Massachusetts Early Mediation Program.**
  - In October 2014, the Department of Revenue made permanent its pilot Early Mediation Program.
  - Early Mediation is generally available for any audit case in which the Department is proposing to assess tax in excess of \$250,000. (Under the pilot program, the threshold was tax in excess of \$1,000,000.)
  - The Department estimates mediation resolution takes four months, compared to 1 year in the traditional appeals process.
- **Don't call it an amnesty.**
  - New Jersey Tax Compliance Initiative.
  - Connecticut Corporate Tax Resolution Initiative.

- Independent Tax Appeals Tribunals.
    - Alabama: Established an independent Tax Tribunal. HB 105 (2014).
    - Pennsylvania: reconstituted Board of Finance and Revenue (Apr. 1, 2014).
    - Illinois: Independent Tax Tribunal operational.
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## Education

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Lindsay M. LaCava is a partner in the law firm of McDermott Will & Emery LLP and is based in the Firm's New York office. She focuses her practice on state and local tax. Lindsay assists businesses and individuals with state and local tax planning and litigation matters. In the controversy area, she represents clients at all stages of state and local tax disputes including the audit, administrative appeal, state trial court, and state appellate and supreme court stages. In the transactional planning and consulting area, Lindsay advises clients with respect to the state and local business activity tax, sales and use tax, and personal income tax consequences of various transactions and activities.

In addition to speaking on a variety of state tax topics, Lindsay recently co-authored a chapter on the state tax appeals process for the "State Business Taxes" treatise published by ALM Media. She is a member of the Connecticut Bar Association Tax Section's Executive Committee and the American Bar Association Tax Section's State and Local Tax Committee.

Lindsay has advised individual and corporate clients regarding state and local, federal, and international tax consequences of various business transactions, and has represented taxpayers in all aspects of federal and state tax controversy matters. In addition, she previously worked at a "Big Four" accounting firm, where her practice focused exclusively on state and local tax.

Lindsay is admitted to practice in Connecticut, New York and the United States Tax Court. She is also a certified public accountant.

# Matthew C. Boch

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Matthew C. Boch is an associate in the law firm of McDermott Will & Emery LLP and is based in the Firm's Chicago office. He focuses his practice on state and local taxes and incentives. Matthew represents taxpayers at all stages of state and local tax controversies, from audits to appellate litigation. He advises clients on planning, transactional and compliance issues relating to state and local income and franchise taxes, sales and use taxes, tax incentives, premium taxes, gross receipts taxes and other miscellaneous taxes. He also represents clients seeking and negotiating tax incentives.

Matthew speaks regularly on state and local tax issues and has authored several publications concerning nexus and enforcement issues. He is an Assistant Editor of the *Journal of Multistate Taxation and Incentives*. He is a member of the bar of the State of Illinois and has been admitted to practice before the U.S. Tax Court and the U.S. District Court for the Northern District of Illinois. He is a member of the American Bar Association Tax Section's State and Local Tax Committee and the Chicago Bar Association State and Local Tax Committee.

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