The 2020 National Multistate Tax Symposium
Mastering the Art (and Articulation) of State Tax—Distilling the Complex

January 29-31, 2020
State tax policy: Recent developments in Multistate taxation
Nikki Dobay, Council On State Taxation
Todd Lard, Eversheds Sutherland (US) LLP
Scott Schiefelbein, Deloitte Tax LLP

January 29-31, 2020
Agenda

• 2020 State Outlook:  State and Local Tax Burdens and COST Legislative Priorities

• The Oregon Corporate Activity Tax Arrives in 2020

• Local Tax Update

• A word on Combined Reporting

• MTC Activity

• False Claims Act
State and Local Business Tax Burdens
Study and COST Legislative Priorities
OVERALL STATE AND LOCAL TAX REVENUE

Source: Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2018, study prepared by Ernst & Young LLP for the State Tax Research Institute and the Council On State Taxation (October 2019)
How much do businesses pay?

Businesses paid more than $781 Billion in U.S. state and local taxes in FY 18, an increase of 6.1% from FY 17 (Oregon: almost $8 Billion, an increase of nearly 3% from FY 17)

State business taxes increased by 7.1% and local business taxes grew by 5.1% (Oregon: State business taxes increased by 1.2% and local business taxes decreased by 2%)

In FY18, business tax revenue accounted for approximately 43.5% of all state and local tax revenue (Oregon: 36%)

Remarkably, the business share of SALT nationally has been within approximately 1% of 44% since FY 2003

Source: Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2018, study prepared by Ernst & Young LLP for the State Tax Research Institute and the Council On State Taxation (October 2019)
The Total Effective Business Tax Rate (TEBTR) Imposed on Business Activity by State and Local Governments (based on state GDP)

The average TEBTR across all states is 4.7%

Source: Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2018, study prepared by Ernst & Young LLP for the State Tax Research Institute and the Council On State Taxation (October 2019)
COST’s 2020 Legislative Initiatives to Improve State Tax Administration

- Ensuring State return due dates are at least one month after the federal deadline
- RAR Improvements, including partnership audit adjustments
- Mobile workforce minimum 30-day threshold
Oregon Corporate Activity Tax – HB 3427 and HB 2164
Oregon Corporate Activity Tax

- **General provisions (H.B. 3427 signed by Governor on 5/16/2019; HB 2164 signed by Governor on 7/23/2019, collectively “Oregon CAT legislation”):**
  - Effective for tax years beginning on or after 1/1/2020, new Corporate Activity Tax (“CAT”) would apply
  - Goal is to raise significant annual revenue to fund Oregon education (H.B. 3427 includes extensive education provisions)
  - Oregon CAT legislation does not repeal Oregon’s corporate income or excise tax, but includes slight personal income tax reduction
  - In addition to a flat $250 tax, CAT imposed at rate of 0.57% on taxpayer’s “taxable commercial activity” in excess of $1 million
    - Taxpayer with less than $1 million in taxable commercial activity is exempt from tax
  - Tax imposed on single taxpayers and unitary groups of taxpayers (unitary group treated as a single taxpayer)
  - Taxpayers entitled to one subtraction – 35% of the greater of either cost inputs or compensation (apportioned)
Oregon Corporate Activity Tax

- **Detailed provisions:**
  - “Taxpayer” means any person or unitary group required to register, file or pay the Oregon CAT
    - Includes tax-exempt entities that have UBTI under the IRC
  - “Person” includes individuals and combinations of individuals; firms; companies; business trusts; estates; partnerships; LLPs; LLCs; associations; joint ventures; clubs; societies; C and S corporations; disregarded entities; and trusts
  - “Unitary group” means a group of “persons” engaged in business activities that constitute a unitary business with more than 50% common ownership (direct or indirect)
  - “Unitary business” means a business enterprise that shares/exchanges value as demonstrated by:
    - Centralized management/common executive force;
    - Economies of scale through centralized administrative services or functions; or
    - Flow of goods, capital resources or services demonstrating functional integration
Oregon Corporate Activity Tax

• **Detailed provisions:**

  “Commercial activity” generally means gross receipts of a person from transactions and activity in the regular course of the person’s trade or business, without deductions, but excludes many items, including:

  ◦ Receipts from sales of 1221 and 1231 assets;
  ◦ Hedging transactions entered into primarily to protect a financial position;
  ◦ Interest income, except interest on credit sales or interest income received by financial institutions;
  ◦ Contributions to capital;
  ◦ Motor fuel (but electricity or batteries used to power vehicle are not motor fuel);
  ◦ Dividends received;
  ◦ Distributive income received from pass-through entities;
  ◦ Sale to wholesaler in Oregon where wholesaler certifies wholesaler will resell property outside Oregon;
  ◦ Receipts from the wholesale or retail sale of groceries; and
  ◦ Receipts from members of the unitary group
Oregon Corporate Activity Tax

• Detailed provisions:

  “Taxable commercial activity” generally means commercial activity sourced to Oregon using the following rules (less any subtraction as provided in CAT legislation):

  ◦ Real estate – gross receipts sourced to Oregon if real estate is located in Oregon

  ◦ Tangible personal property – gross receipts sourced to Oregon if and to the extent the property is in Oregon or delivered to a person in Oregon

  ◦ Services – gross receipts sourced to Oregon to the extent the service is delivered to location in Oregon

  ◦ Intangible property – gross receipts sourced to Oregon if and to the extent the intangible is used in Oregon

  ◦ Commercial activity of a financial institution or insurer, to extent not otherwise described in CAT legislation, is sourced to Oregon if commercial activity “is from business conducted in” Oregon

  ◦ If these sourcing provisions do not fairly represent the person’s commercial activity in Oregon, the taxpayer (or the state) may pursue alternative sourcing
Oregon Corporate Activity Tax

• **Detailed provisions:**
  
  − **Subtraction** – Taxpayer is entitled to subtract from taxable commercial activity 35% of the greater of either:
    
    ◦ “Cost Inputs” (defined as COGS as calculated in arriving at federal taxable income); or
    
    ◦ “Labor costs” (defined as total compensation of all employees, capped at $500,000 for any single employee)
  
  − Subtraction must be apportioned to Oregon using principles of ORS 314.605 – 314.675. Subtraction may not exceed 95% of taxable commercial activity, may not include expenses from transactions between members of the unitary group, or expenses related to receipts that are not commercial activity
  
  − **Nexus** may be established in any one of many ways (legislation provides CAT not subject to PL 86-272):
    
    ◦ Person owns or uses capital in Oregon;
    
    ◦ Person holds certificate of existence/authorization to do business in Oregon from Secretary of State;
    
    ◦ Has bright-line nexus with Oregon (defined as $50K property or payroll or $750K commercial activity in Oregon during year, or 25% of total property, payroll or sales in Oregon for year); or
    
    ◦ Has nexus with Oregon sufficient to create nexus under the United States Constitution
Oregon Corporate Activity Tax

• **Detailed provisions:**

  – **Registration:** Taxpayers with commercial activity exceeding $750,000 must register with Oregon DOR

  – **Compliance:** Every person doing business in Oregon with commercial activity for the tax year in excess of $1 million must file an annual return no later than April 15th of the following year;

  – Quarterly payments are required (HB 2164 provides these payments are estimated tax payments; anticipate that additional guidance may be forthcoming)

  – **Local tax preemption:** No city, county, district, etc., may impose a tax on commercial activity or on receipts from grocery sales unless:

    ◦ Tax is in effect and operative on April 1, 2019 or is adopted by initiative or referendum petition at an election held prior to March 1, 2019; or

    ◦ Tax at issue is a privilege tax not measured by commercial activity, a franchise fee or a right-of-way fee

  – **Imposition of Tax:**

    ◦ Tax imposed on the person receiving the commercial activity and is not a tax imposed on the purchaser

    ◦ HB 2164 provides vehicle dealers may collect from purchaser the estimated portion of CAT on sale
Oregon Corporate Activity Tax

• Additional provisions:

- **Exclusion for certain sub-contracting payments:** Subcontractors may exclude from taxable commercial activity 15% of payments for labor from general contractors (not applicable to materials, land or permits), limited to single-family residential construction projects in Oregon

  ◦ Applies to tax years beginning on or after January 1, 2020 and before January 1, 2026

- **Use Tax:** A person shall include as taxable commercial activity the value of property the person transfers into Oregon for the person’s own use in the course of a trade or business within one year after receipt outside of Oregon

  ◦ Same treatment applicable for unitary groups whose members transfer property into Oregon for use by any member within one year of acquisition of property outside of Oregon

  ◦ Such property is excluded from taxable commercial activity if the person or unitary group can show or if the Oregon DOR ascertains that the receipts of property outside of Oregon followed by its delivery into Oregon was not intended in whole or in part to avoid the CAT
Oregon Corporate Activity Tax

• Temporary Regulations (as of January 6, 2020)

- 150-317-1000: Definition of Commercial Activity
- 150-317-1010: Substantial Nexus – Guidelines for Corporate Activity Tax
- 150-317-1020: Factors Used in Determining Whether a Group of Persons Form a Unitary Group
- 150-317-1030: Sourcing Commercial Activity to Oregon from Sales of Tangible Personal Property
- 150-317-1040: Sourcing Commercial Activity Other than Sales of Tangible Personal Property in this State
- 150-317-1100: Agent Exclusion
- 150-317-1130: Property Brought Into Oregon
- 150-317-1200: Cost Input or Labor Cost Subtraction
- 150-317-1300: Estimated Tax – When Estimated Payments are Required
- 150-317-1310: Estimated Tax – Unitary Groups and Apportioned Returns
- 150-317-1330: Estimated Tax Payments – Delinquent or Underestimated Payment or Both, Constitutes Underpayment
- 150-317-1320: Estimated Extension of Time to File
Trends in Local Taxes
**Trends in Local Taxes: San Francisco**

- **Current gross receipts tax:** Phasing in since 2014 (fully phased in starting in 2018), the San Francisco GRT is imposed on every person “engaging in business” within San Francisco (except administrative offices and small businesses (those with less than $300k of City payroll and $1,090,000 in City gross receipts)).

  - Graduated rates: Rates vary based on industry and extent of gross receipts (top tax bracket across industries applies to gross receipts over $25 million)

  - Gross receipts broadly defined, but exclusions include:

    - Investment receipts
    - Amounts received from related entities
    - Separately stated federal, state or local taxes

  - Gross receipts generally apportioned using payroll (San Francisco payroll/total payroll) as well as destination/market principles for sales of TPP, services and intangibles (varies by industry)

Effective 1/1/2019, San Francisco applies economic nexus – “engaging in business” in San Francisco includes $500,000 or more of annual gross receipts from sales to customers located in San Francisco

- **Payroll Expense Tax:** Originally planned to be phased out in 2018, tax remained in effect @ 0.38%.
Trends in Local Taxes:  San Francisco (cont’d)

• **Homelessness Gross Receipts Tax**: Beginning 1/1/2019, San Francisco imposes a new GRT in addition to the existing GRT on City gross receipts in excess of $50 million.

  − Tax base is the same as current GRT

  − Rates vary depending on type of industry, but not amount of gross receipts. Rates range from 0.175% (Retail trade, wholesale trade, certain services) to 0.690% (private education and health services, administrative and support services, and miscellaneous business activities)

• **Commercial Rents Tax**: Beginning 1/1/2019, San Francisco imposes a commercial rents tax on landlords.

  − Gross receipts from lease or sublease taxable at the following rates:
    - 3.5% tax on gross receipts from the lease of commercial space; and
    - 1% tax on gross receipts from the lease of warehouse space

  − Proposed regulations released that clarify the treatment of common costs landlords pass along to tenants as subject to the tax (except certain taxes)

• Both taxes being challenged due to passage as initiatives by simple majority rather than two-thirds supermajority approval required under California Constitution and Proposition 218.
Pending Litigation

- The Commercial Rents Tax and Homelessness Tax are both local ballot initiatives that voters passed by a simple majority.

- Both taxes have attracted legal challenges based on a recent court decision in California

  - Decision held that initiatives placed on the ballot with the required number of signatures only need a simple majority rather than the two-thirds supermajority approval required under the California Constitution and Proposition 218.15.

- The Howard Jarvis Taxpayers Association filed suit asserting 2/3rds approval is required for both the Homelessness GRT and Commercial Rents.

- City officials have announced that they will seek to resolve the legal uncertainty surrounding the legislation and will enforce both taxes in the interim.
Trends in Local Taxes: Portland, Oregon

- **CEO Surcharge:** Effective for tax years beginning on or after 1/1/2017, Portland requires publicly traded companies subject to U.S. Securities & Exchange Commission pay ratio reporting requirements to pay a surtax in addition to the City business license tax.

  - Rates:
    - 10% of base tax liability if the reported pay ratio is at least 100:1 but less than 250:1
    - 25% of base tax liability if the reported pay ratio is of 250:1 or greater

- SEC Pay Ratio generally discloses and calculates the ratio of:
  - Median annual total compensation of all employees (excluding the CEO)
  - Annual total compensation of CEO

- Filing Group: Portland follows Oregon, which uses the federal affiliated group as the starting point for filing the state consolidated corporate income tax return. Portland generally will look to the CEO of the parent corporation (usually the publicly-traded entity subject to the SEC pay ratio reporting requirement) for the CEO pay ratio. If the taxpayer believes this is inappropriate (e.g., the publicly-traded entity is excluded from the Oregon return), the taxpayer may petition the City to permit an exception.
Trends in Local Taxes: Portland, Oregon (cont’d)

- **Gross Receipts Tax**: Effective for tax years beginning on or after 1/1/2019, Portland imposes a 1% “surcharge on gross revenues from sales within the City, unless otherwise exempted,” on “Large Retailers”

  - Large Retailer is a “business” that:
    - Is subject to the Portland Business License Tax
    - Had annual gross revenue from retail sales from all locations in the U.S. where the taxpayer conducts business that exceeded $1 billion in prior year
    - Had annual gross revenue from retail sales within Portland of $500,000 or more in the prior tax year

  - Large Retailer excludes:
    - Any manufacturer or other business that is not engaged in retail sales within Portland
    - Any entity operating a utility within Portland
    - Any cooperative recognized under federal or state law
    - Any federal or state credit union
Trends in Local Taxes: Portland, Oregon (cont’d)

• **Gross Receipts Tax (cont’d):** Effective for tax years beginning on or after 1/1/2019, Portland imposes a 1% “surcharge on gross revenues from sales within the City, unless otherwise exempted,” on “Large Retailers”

  – “National Gross Revenue” is the “gross revenue a business receives nationally in a given year from retail sales”

  – “Retail sale” is a sale to a consumer for use or consumption, not for resale, and includes services

  – Measure imposes the surcharge on a “business” rather than “taxpayer” or “taxfiler”

  – The following may be deducted from gross receipts:

    – No penalties or interest will be charged for failure to make estimated payments on surcharge during the 2019 tax year

    – No changes made to City apportionment statutes or rules

    – In December 2019, the Portland City Council appears to have added new exemptions from tax for: Construction companies, residential waste removal, and certain retirement plans
A Word on Combined Reporting
Combined Unitary Reporting

**West of the Mississippi**
- Alaska
- Arizona
- California
- Hawaii
- Idaho
- Kansas
- Minnesota
- Montana
- Nebraska
- North Dakota
- New Mexico (2020)
- Oregon (Corporate Excise Tax differs from Corporate Activity Tax)
- Texas
- Utah

**East of the Mississippi**
- Connecticut
- District of Columbia
- Illinois
- Kentucky (2019)
- Maine
- Massachusetts
- Michigan
- New Hampshire
- New Jersey (TYE 7/31/2019 and later)
- New York State
- New York City
- Rhode Island
- Vermont
- West Virginia
- Wisconsin
Renewed interest in worldwide combined reporting

**Institute on Taxation and Economic Policy (ITEP) Study (January 17, 2019)**

- Asserts that states are losing $17 billion a year because corporations are shifting earnings to off-shore to affiliates in tax haven jurisdictions
- Urges states to move to mandatory worldwide combined report or tax have legislation

**Other articles urging worldwide combined reporting include**

- **Why States Can Tax the GILTI**—David Gamage and Darien Shanske, Tax Analysts (March 18, 2019)
- **The Case for Worldwide Unitary: Stronger and Better Than Ever**—Dan Bucks, Tax Analysts (February 25, 2019)
- **States Should Embrace GILTI or Pursue an Alternative Path to Fairness**—Brian Hamer, Tax Analysts (February 11, 2019)

**Taxing GILTI is Good, But Worldwide Combination is Great**

- Bucks, Enrich, Mazerov, and Shanske argue that taxing global intangible low-taxed income is a prudent move for states if they cannot implement the more ideal policy of worldwide combined reporting. *State Tax Notes* (June 17, 2019)
Renewed interest in worldwide combined reporting

**Hawaii**—S.R. 87 (passed) would convene a task force to study mandatory worldwide reporting

**Illinois**—H.B. 2085 (died) would make worldwide combination the default and S.B. 1115 (died) would allow a water’s-edge election but includes tax haven blacklist and cap on DRD of 75%

**Massachusetts**—H.B. 3787 and H.B. 3788 (pending) would implement mandatory worldwide reporting

**Minnesota**—H.F. 2125 (failed) would require unitary CFCs that create GILTI to be included in combined group and provides a worldwide election (10 years)

**Montana**—S.B. 141 (died) would have repealed water’s-edge election

**Oregon**—H.B. 2149 (died) and H.B. 2697 (died) would require foreign affiliates to be included in the unitary group
Multistate Tax Commission (MTC) Activity
Finnigan Work Group

• Formed last year to create an “alternative” Finnigan combined reporting model
• Finnigan model is not intended to replace the MTC’s current Joyce model
• Fall 2018, the Uniformity Committee instructed the work group to take a “one taxpayer” approach, which would allow for the sharing of tax attributes among the members (similar to Utah)
• On April 25, 2019, the work group presented a model to the Uniformity Committee that provided for the sharing of NOLs in accordance with the Federal SURLY rules, and the Uniformity Committee voted to have the work group continue its work on the NOL sharing issues based on comments raised by members of the Uniformity Committee regarding states with established NOL sharing rule.
Finnigan Work Group

- On August 5, 2019, the Uniformity Committee voted to allow the current draft to contain language to allow for the sharing of NOLs among members after a robust discussion and a narrow vote. The working group will also consider including a consolidated election provision at COST request.

- Current model and a whitepaper prepared by MTC staff on NOL sharing can be found at the MTC’s work group project page: http://www.mtc.gov/Uniformity/Project-Teams/Model-Option-for-Combined-Filing

- Uniformity Committee did not vote on the draft at its fall meeting on November 6.
  - Work group will continue to work on sharing of capital gains/losses
  - Work group will include a drafters note regarding consolidated elections and draft whitepaper
P.L. 86-272 Work Group

Work Group began holding regular calls in 2019 to discuss whether the MTC’s PL 86-272 statement should be updated to address internet sales and internet sellers.

Work Group has held a series of calls during which various scenarios have been discussed.

• For example:
  − Seller maintains a website offering various goods and services for sale.
  − Seller maintains a website offering only items of TPP. The products are complicated to use and purchases often need post-sale assistance. Seller provides assistance in the following ways: toll-free numbers; electronic chat sessions; information posted on website; via email, etc.

• The conversations on the calls have been lively regarding whether the scenarios being discussed would impact a taxpayer’s PL 86-272 protection.

• General consensus on the calls by the state participants is that internet sellers are going beyond the protections of PL 86-272.

On April 26, 2019 the work group updated the Uniformity Committee and described the work group’s analysis as a “work in progress”.
P.L. 86-272 Work Group

• On April 26, 2019, the work group updated the Uniformity Committee and described the work group’s analysis as a “work in progress”

• On August 5, 2019, the work group again updated the Uniformity Committee and received significant blowback from the practitioners and the business community

• On November 6, 2019, the work group updated the Uniformity Committee, but will continue to work on its current draft statement
False Claims Act – Legislative Expansion
California AB 1270 — Overview

Currently, the California False Claims Act expressly excludes claims under the California Revenue & Taxation Code

AB 1270 would have expanded California's False Claims Act to allow whistleblowers to report alleged tax fraud

- Would have allowed whistleblowers to confidentially report to the attorney general information about fraudulent tax claims individuals or companies to state tax agencies
- Violators would be subject to treble damages (i.e., three times the amount of the underreported tax, interest and penalties), an additional civil penalty of $5,500 to $11,000 for each violation, plus the costs of the civil action to recover the damages and penalties (attorneys' fees)
California AB 1270 — Legislative History

• Introduced February 21, 2019
• Passed the California Assembly 56-19 on May 24, 2019
• On July 2nd and 10th, the bill cleared the Judiciary Committee (7-2) and then the Governance and Finance Committee (5-2), respectively
• Ultimately, referred to the Senate Appropriations Committee where it was placed on the suspense file
California AB 1270 – Some potential concerns

• Usurps authority of taxing agencies charged with overseeing tax administration and collection

• Lack of limitations for situations where the taxpayer believed that credible authority supported a potentially aggressive position on a tax return

• Opens door to trade secret and other confidential information to the qui tam plaintiff

• Unclear as to whether it would allow for dual enforcement of tax matters

• No consequences for plaintiffs' lawyer who wrongly sues taxpayer

• Arguably applicable to all taxes in the Revenue & Taxation Code
District of Columbia — Overview

- In 2017 and 2019, D.C. sought to amend its False Claims Act to allow tax claims (Bills 22-166 and 23-35, respectively)
- D.C. already offers a reward for supplying information regarding tax violations (D.C. Code § 47-4111)
- Proposed amendment limits scope to taxpayers with net income, sales or revenue of $1 million or more and at least $350,000 damages
District of Columbia — Some potential concerns

- Infringes on the D.C. CFO’s exclusive authority to administer and collect taxes
- Could lead to parallel enforcement action [Audit + FCA]
California CEO-to-Average-Wage Ratio Legislation
California AB 37 (the “CEO Tax”) — Overview

• Would increase tax rates for corporations with net income of $10 million or more as follows:
  – 10.84 percent for a compensation ratio between zero and 50;
  – 11.84 percent for a ratio between 50 and 100;
  – 12.84 percent for a ratio between 100 and 200; and
  – 14.84 percent for ratios over 300.

• The tax increase for financial institutions would range from 12.84 percent to 16.84 percent based on the compensation ratio.
California AB 37 (the “CEO Tax”) — Overview

“Compensation ratio” calculated as follows:

the greater of the compensation of the CEO, CFO or highest paid employee averaged over the three calendar years preceding the tax year
median compensation for all of the taxpayer’s U.S. employees (including contract employees) for the prior calendar year

Compensation for CEO, CFO or highest paid employee defined as amount reported for SEC purposes
Compensation for other employees defined as wages pursuant to IRC 3121(a)
Questions?
Contact information

Nikki Dobay
Council on State Taxation
ndobay@cost.org

Todd Lard
Eversheds Sutherland (US) LLP
toddlard@eversheds-sutherland.com

Scott Schiefelbein
Deloitte Tax LLP
sschiefelbein@deloitte.com
This presentation and related panel discussions contain general information only and the respective speakers and their firms are not, by means of this presentation, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This presentation is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. The respective speakers and their firms shall not be responsible for any loss sustained by any person who relies on this presentation.