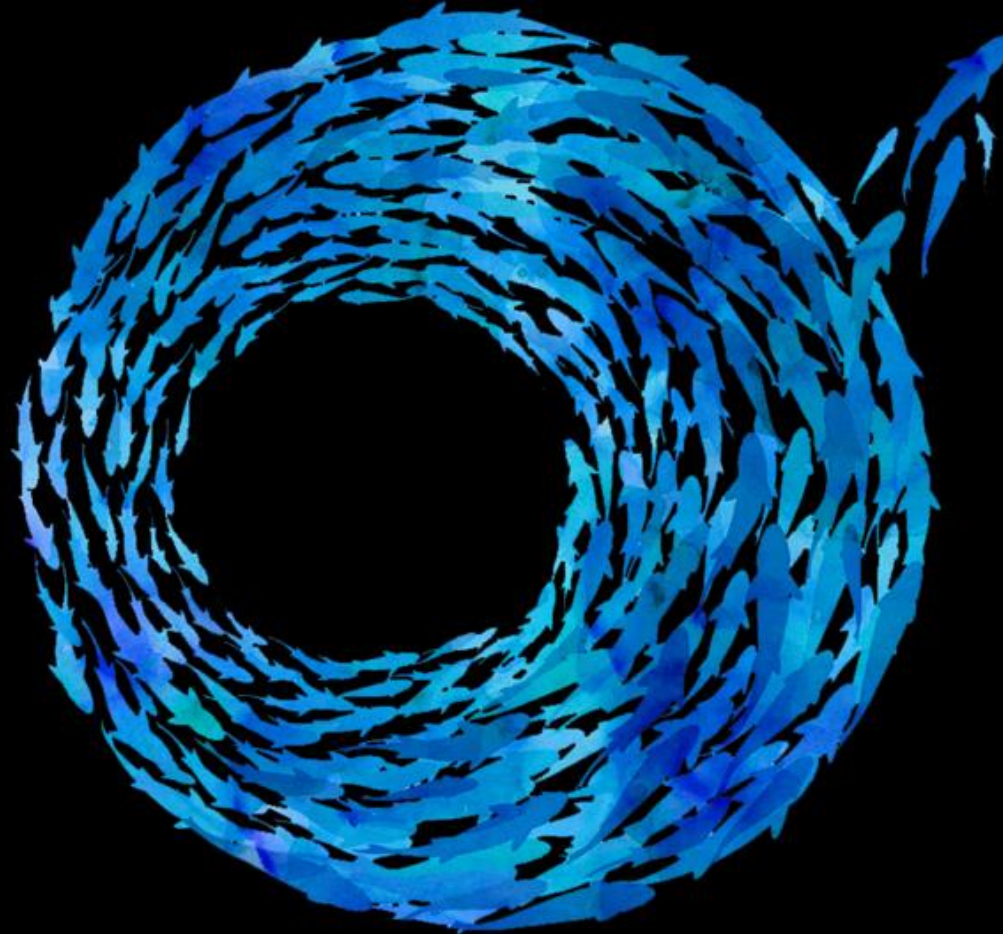


**Deloitte.**

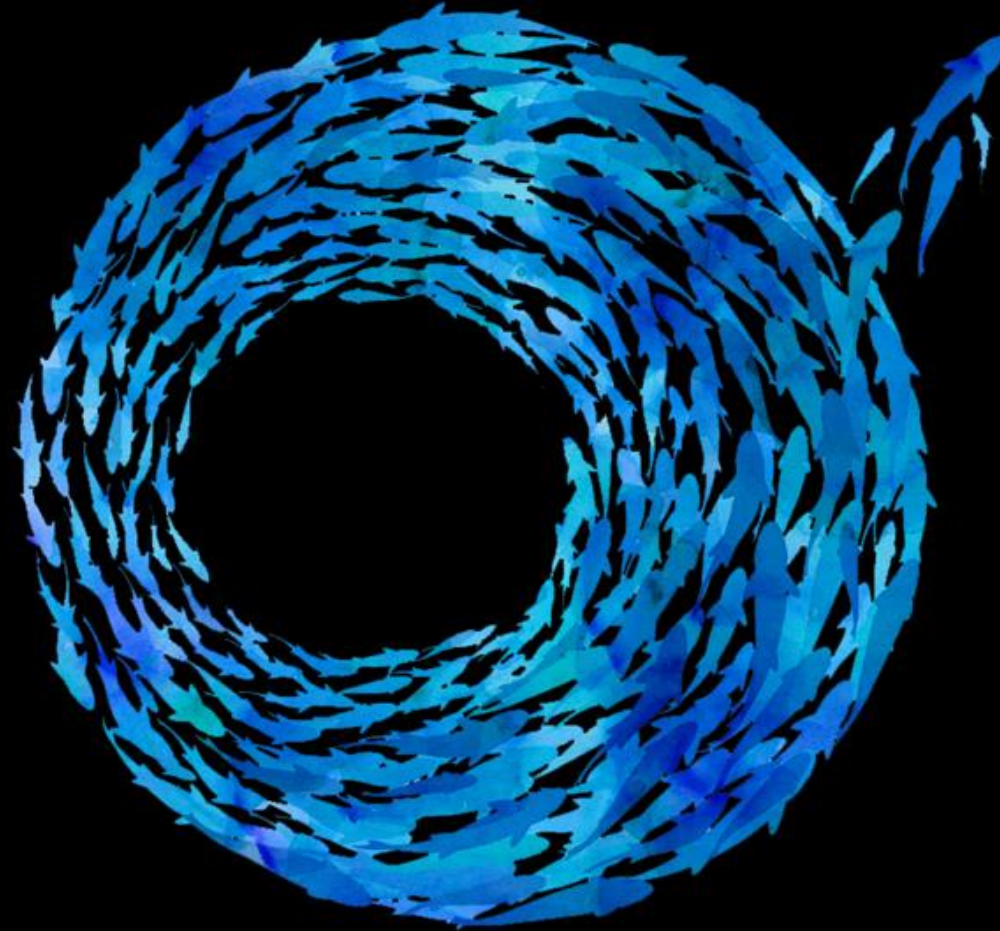


**The 2018 National  
Multistate Tax Symposium**

Take the lead—Tax reform and fortifying state positions

February 7-9, 2018





## **Positioning for more favorable outcomes: Income and franchise tax controversies**

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February 7-9, 2018

# Agenda

- Proactive Measures
- Contemporaneous Documentation Policies
- Refunds and Offsets
- Audits and Appeals

# Proactive measures

## 1. Informal communications with DOR officials

**a. Pro:** A generally fast and effective way to glean the Department's thinking on a particular issue.

**b. Con:** Because these communications are informal, they are likely not definitive.

## 2. Voluntary disclosure agreements

**a. Pro:** An opportunity to "fix" prior tax filings before an audit.

**b. Cons:** Can you come forward anonymously? If not, you may not be able to "get out" once you've applied. Also may not be available if you have been "contacted" or filed previously.

## 3. State amnesties

**a. Pro:** Eliminates a portion of historical liability and generally includes a waiver of penalties and some if not all interest.

**b. Con:** Generally does not address all taxes for all years. Some liabilities may still exist. May require complete concession of all issues for those taxes and the covered years.

#### **4. Private letter rulings/advisory opinions**

**a.Pro:** An opportunity for more definitive and potentially binding guidance.

**b.Cons:**

- i. May be a lengthy process.
- ii. If an adverse opinion is issued, you may be bound (unless you can withdraw your ruling request, which may not be permitted).
- iii. Must get facts correct or State may not be bound.
- iv. Some states can change position and prior PLR is only good for waiver of penalties.

#### **5. Informal and formal written opinions from outside advisors**

**a.Pros:**

- i. May assist in audit defense.
- ii. May provide grounds for penalty abatement.
- iii. May assist in defense against a False Claims Act lawsuit.

**b.Con:** Not binding on State unless fully disclosed and in writing.

# Contemporaneous documentation policies

# Nexus

**1. Nexus study:** periodic nexus studies should be conducted, according to each state's nexus standards, in all states where the taxpayer is engaging in business activities.

a. Three types of nexus standards:

- i. Physical presence
- ii. Economic presence
- iii. Factor-based

**2. PL 86-272:** generally shields a taxpayer from tax, despite its nexus in a state, if the taxpayer's activities are limited to solicitation of orders by its employees, representatives, or independent contractors for sales of tangible personal property, and orders are sent outside the state for approval/rejection, and are delivered from a point outside that state.

a. The taxpayer's business activities, and the reasons why these activities qualify for protection, should be documented.

**3. Registration as trigger:** the taxpayer may be required to file in a state where it lacks nexus if it is registered in that state.

a. The taxpayer should determine whether a filing requirement is triggered by mere registration in each state where registered, and should document this analysis.

b. Registration for any purpose may make "finding" a potential taxpayer easier.



## Group composition

- 1. Separate filing:** affiliated entities may be required to file separately if they do not meet ownership and unitary business requirements, or if they are filing in a separate filing state.
- 2. Group filing methodologies:**
  - a. Mandatory or elective
  - b. Water's edge or worldwide
  - c. Nexus only states
- 3. Approach:**
  - a. Combined: affiliates that satisfy the "unitary business" and ownership requirements are considered a "unitary business group" and may be required to file a combined return.
    - i. A unitary analysis (focusing on the relationship between the affiliates and any intercompany transactions) should be conducted to determine if combined filing is allowed or is required.
  - b. Consolidated: affiliates that meet a threshold ownership percentage and file a consolidated return for federal purposes, may file a consolidated return for state purposes when allowed.

# Apportionment

**1. Approach:** before the taxpayer can apportion its business income it must:

- a. Determine each state's apportionment formula;
- b. Determine applicable industry specific variations; and
- c. Consider alternative apportionment, if the standard apportionment formula does not fairly represent its business activities.
  - i. UDITPA Sec. 18
  - ii. The taxpayer should document its apportionment analysis, reasons why an industry specific variation does or does not apply, and/or reasons for seeking alternative apportionment.
  - iii. Ask permission or forgiveness.

**2. Common issues with the sales factor:**

- a. Definitions of "where the benefit is received"
- b. Definitions of "income producing activities"
- c. Definitions of "intangibles"

# Refunds and offsets

## **1. Typical areas:**

- a. Nexus
- b. Group filing
- c. Apportionment/sourcing
- d. Attributes: NOLs, credits, etc.

## **2. Considerations:**

- a. Claiming a refund on an original vs. an amended return:
  - i. Do the dynamics change if you're in a refund posture?
  - ii. Impact on administrative/judicial appeal rights.
  - iii. If filing an amended return, when should you file it?
    - During an audit? At what stage of the audit?
    - Does the state's tax code permit you to file for a refund after the statute of limitations for assessment has expired?

# Audits and appeals

## **1. Responding to IDRs:**

- a. Not a subpoena.
- b. More important to be accurate/strategic than answer in a rush.
- c. Deadlines are most often created and not statutory.
- d. Only answer what is being asked.
- e. Don't volunteer information.
- f. Answer with an eye towards appeals/litigation.
- g. If arguing a position, keep it simple and understandable.
- h. Don't box yourself in.
- i. May not want to provide all of the items listed in the IDR. However, consider whether the state's tax code or rules address withheld information in a subsequent appeal.

## **2. Interviews:**

- a. Audits should be document driven. Do you have grounds to push back if responsive documents exist?
- b. If the taxpayer agrees to an interview, extremely important to properly prepare.
- c. Will it be recorded?
- d. Should you have the right to interview DOR personnel?

### **3. Negotiating settlements:**

- a. A good working relationship with the auditor helps.
- b. When should you bring in supervisors or higher-level DOR officials?
- c. Is there an opportunity to provide certainty for future years?
- d. How can you get leverage?
- e. Do you need a formal closing agreement?

### **4. Preparing for and managing post-assessment appeals**

- a. Consider whether you are better off shutting down the audit and moving the case to appeals.
- b. Control the flow of information on audit. In forums where there is no discovery, you may be able to influence the evidence that will be available for consideration by the decision-maker.
- c. Carefully develop your facts and determine what is available to prove those facts.
- d. Consider the burden of proof and the nature of the forum (e.g., administrative appeal, quasi-judicial, judicial).
- e. Factual disputes v. tax law interpretation/policy disputes.
- f. Freedom of Information Law Requests.
- g. Procedural considerations in more formal litigation.

## **5. Other considerations:**

- a. Monitor the statute of limitations
- b. Managed audits
- c. Federal tax reform



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