State Tax Matters
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In this issue:

Income/Franchise: Ohio Supreme Court Upholds CAT Factor-Presence Nexus Standard

Crutchfield Corp. v. Testa, Ohio (11/17/16). The Ohio Supreme Court has affirmed the Ohio Board of Tax Appeals' ruling that an out-of-state direct marketer of consumer electronics having no physical presence in Ohio was nevertheless subject to Ohio's commercial activity tax (CAT) because it met the CAT's statutory receipts threshold in having over $500,000 in taxable gross receipts to Ohio customers. In doing so, the Court explained that given the statutory $500,000 taxable gross receipts standard, the burdens imposed by the CAT on interstate commerce are not "clearly excessive" in relation to the legitimate interest of Ohio in imposing the tax "evenhandedly on the sales receipts of in-state and out-of-state sellers." As a result, the Court held that the CAT satisfies the substantial nexus standard under the dormant Commerce Clause, and declined to address the Ohio State Tax Commission's alternative "Internet

nexus theory" argument that the physical presence nexus standard had been satisfied by the taxpayer's interstate online sales and/or digital assets. A dissenting opinion follows, arguing that the Court's majority opinion runs counter to the US Supreme Court's reasoning in *Quill*.
URL: http://www.supremecourt.ohio.gov/rod/docs/pdf/0/2016/2016-Ohio-7760.pdf

See forthcoming Multistate Tax Alert for more details on this decision, as well as related taxpayer considerations.

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Income/Franchise:
Utah Trial Court Holds State Tax Commission Wrongfully Disallowed Intercompany Royalty Expenses

See's Candies, Inc. v. Auditing Div. of the Utah State Tax Comm'n, Utah Dist. Ct. (10/6/16). The Fourth Judicial District Court for Utah County, State of Utah Tax Court, held that the Utah State Tax Commission (Commission) abused its discretion in denying intercompany royalty payments made by a candy store retailer to its insurance company affiliate for use of intellectual property as "per se outside of arm's length," holding that the Commission should have exercised its discretion under the federal regulations accompanying IRC section 482 to the factual situation in this case. Applying these federal regulatory principles to the submitted facts – which included an independent transfer pricing study, unrebutted testimony on the nature of the intellectual property transfer and underlying business purpose for it, and a review of the arm's length price at issue – the court concluded that the transfer was arm's length justifying a deduction not barred under IRC section 482, and therefore not barred under the corresponding Utah statutory scheme (i.e., Utah Code Annotated section 59-7-113). Ultimately, the court permitted the taxpayer to deduct 90% of the intercompany royalty payments at issue for state corporate income/franchise tax purposes.

Note that the Utah State Tax Commission apparently has since filed a notice of appeal in this case. Please contact us with any questions.

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Sales/Use/Indirect:
California: Initial Voting Results Indicate Possible Local Utility Taxation of Certain Digital Streaming Services

Measure K-1: The Alameda Utility Modernization Act, City of Alameda, California; *Measure K: Ordinance No. 1339-16*, City of Watsonville, California (initial results from November 8, 2016 general election). Initial November 8, 2016 election voting results indicate that two cities in California have approved amended local utility tax ordinances that may include certain digital streaming services (e.g. certain Internet video and gaming services) as part of their tax bases in an apparent attempt to "modernize" their codes and reflect emerging technologies.
URL: https://alamedaca.gov/sites/default/files/document-files/article-files/alameda_utility_modernization_act_-_full_text_0.pdf

URL:
http://www.votescount.com/Home/UpcomingElections/November8,2016PresidentialGeneralElection/LocalMeasuresontheballot/MeasureKWatsonvilleUtilityUsersTax/FulltextofMeasureK.aspx

Note that this trend in local utility taxation may be a response to significantly reduced telecommunications tax revenue collections as consumers increasingly shift towards broadband as a means of purchasing various goods and services. Please contact us with any questions.

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Sales / Use / Indirect:
Illinois: Credit Card Company Entitled to "Bad-Debt" Refunds on Account Sales Made by Retailers

Citibank, N.A. v. Department, Ill. App. Ct. (11/2/16). An Illinois Court of Appeal has affirmed the trial court's approval of Illinois retailers' occupation tax (ROT) "bad debt" refund claims filed by a credit card company that financed customer credit account purchases from various retailers in Illinois and had written off as "bad debt" on its federal income tax returns, explaining that the credit card company was entitled to the refunds through its non-recourse agreements with retailers whereby all rights to any and all payments from the customers and the right to claim ROT refunds or credits were assigned to it. In doing so, the Illinois Court of Appeal held that the credit card company had standing to pursue a refund of the ROT attributable to the uncollected debts as a result of "stepping into the retailers' shoes via assignment," and that such assignment was neither limited by statute nor a violation of public policy. Because the retailers in this case would have been permitted to obtain a refund had they not assigned the accounts to the credit card company, the credit card company was permitted to obtain the underlying refunds at issue.
URL: http://www.illinoiscourts.gov/Opinions/AppellateCourt/2016/1stDistrict/1133650.pdf

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Sales / Use / Indirect:
Amended Administrative Rules Implement Affiliate Nexus and Remote Seller "Click-Through" Nexus Provisions in Nevada

LCB File No. R137-15: Amended NAC 372, Sections 2 through 7, Nev. Tax Comm. (eff. 11/2/16). Pursuant to legislation enacted in 2015 [*A.B. 380*; see previously issued Multistate Tax Alert for more details on this law change], which includes Nevada sales and use tax affiliate nexus and remote seller "click-through" nexus provisions that became effective beginning on July 1, 2015 and October 1, 2015, respectively, the Nevada Tax Commission has issued amended implementing administrative rules.
URL: http://www.leg.state.nv.us/Register/2015Register/R137-15A.pdf
URL: https://www.leg.state.nv.us/Session/78th2015/Reports/history.cfm?ID=843
URL: http://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-mts-alert-nevada-governor-signs-new-commerce-tax-into-law.pdf

Note that Nevada law now requires that a retailer impose, collect and remit Nevada sales and use taxes if the retailer is:

- Part of a controlled group of business entities that has a component member who has physical presence in Nevada; and
- The component member with such physical presence engages in certain activities in Nevada that relate to the ability of the retailer to make retail sales to Nevada residents.

The retailer may rebut this presumption by providing proof that the component member with physical presence in Nevada did not engage in any activity in Nevada that was significantly associated with the retailer's ability to establish or maintain a market in Nevada for the retailer's products or services.

Nevada law also requires that a retailer impose, collect and remit Nevada sales and use taxes if:

- The retailer enters into an agreement with a Nevada resident under which the resident receives certain consideration for referring potential customers to the retailer through a link on the resident's Internet website or otherwise; and
- The cumulative gross receipts from sales by the retailer to customers in Nevada through all such referrals is in excess of $10,000 during the preceding four quarterly periods ending on the last day of March, June, September and December.

The retailer may rebut this presumption by providing proof that each resident with whom the retailer has an agreement did *not* engage in any activity that was significantly associated with the retailer's ability to establish or maintain a market in Nevada for the retailer's products or services during the preceding four quarterly periods.

The adopted administrative rules provide examples of activities that are significantly associated with a retailer's ability to establish or maintain a market in Nevada for the retailer's products or services, including:

- Soliciting sales of goods in Nevada;
- Installing, assembling or repairing goods in Nevada;
- Constructing, installing, repairing or maintaining real property or tangible personal property in Nevada;
- Delivering products into Nevada other than by mail or common carrier;
- Having an exhibit at a trade show to maintain or establish a market for products in Nevada, but *not* "merely attending a trade show;"
- Selling products online and having a brick and mortar store in Nevada that accepts returns of such online sales; or
- Performing activities designed to establish or maintain customer relationships such as meeting with customers in Nevada to gather or provide product or marketing information, evaluate customer needs or generate goodwill; or being available to provide certain services associated with a product sold (e.g., warranty repairs, installation assistance or guidance, and specified training).

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