

**Baker
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SALT Savvy: Coast-to-Coast Updates

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Agenda

- 1 TCJA and CARES Act Conformity
- 2 Questions from the Audience
- 3 Texas Updates
- 4 Midwest Updates

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TCJA and CARES Act Conformity

State Conformity to the IRC

- Types of Conformity
 - Rolling or Automatic Conformity
 - E.g., Colorado (adopts the IRC in effect “for the taxable year”)
 - State Conformity (Specific Date)
 - E.g., Florida adopts the IRC as amended through 01/01/2020
 - Selective Conformity
 - E.g., Arkansas
 - California has been called both a selective conformity and fixed conformity (01/01/2015) state

TCJA & CARES Act Overview

- TCJA fundamentally reformed several key aspects of federal tax system at end of 2017.
- States must have issued guidance by now, right?
 - **GILTI Inclusion/FDII Deduction**
 - **163(j) Interest Limitation**
 - **Base Erosion and Anti-Abuse Tax (BEAT)**
 - NOL Limitations
 - FDII Deduction
 - Bonus Depreciation/Immediate Expensing
 - Pass-Through Entity Deduction
 - SALT Cap

- **CARES Act – COVID relief – put limitations on some of the revenue-raisers of the TCJA**

State Conformity to GILTI & FDII

■ Overview

- New category of income under IRC 951, intended to prevent taxpayers from shifting income from intangible assets such as patents and trademarks to controlled foreign corporations based in low-tax countries.
 - Not limited to intangible income
 - Not limited to low-tax countries at state level (no offsetting FTC conformity)
 - At federal level, “stick” to FDII “carrot”

■ State Conformity

- 21 states do not tax GILTI
- 18 states tax some percentage of GILTI and provide guidance
- 6 jurisdictions potentially tax GILTI **but have not issued guidance**: CO, DC, DE, KS, UT, WV

GILTI/FDII Case Study: New Jersey

- **Early mover on the GILTI issue**
 - Issued Technical Bulletin in December 2018 (N.J. Technical Bulletin TB-85(R))
 - GILTI and FDII- related revenue allocated using a combination of comparative gross domestic product (GDP) measures and separate allocation
 - Rescinded Aug. 20, 2019
 - Released TB-92(R) on Oct. 31, 2019.
 - GILTI sourced as all other business receipts. Generally included in denominator only. FDII sourced under existing allocation rules.
- **Recent Guidance – Temporary Regs. Eff. Apr. 8, 2020-Oct. 5, 2020**
 - GILTI / FDII included in entire net income – do not qualify for dividend exclusion
 - Section 250 deduction is disallowed if the amounts of income included for federal tax purposes are exempt or excluded from NJ entire net income
 - Addback exemption allowed
 - Exclusion permitted for income from combined group CFCs

Constitutionality of GILTI Inclusion

▪ *Kraft* principle

- Separate reporting state could not constitutionally conform to federal DRD, because it treated domestic dividends differently than foreign dividends.
 - Not necessarily limited to dividends
 - Takeaway: a state's corporate tax structure may not treat foreign operations less favorably than similarly situated domestic operations
 - Application to combined reporting states?
 - In GILTI context, is factor representation necessary to reach constitutional result?
- ALSO CONSIDER: Implications to TCJA impact under Section 245A

163(j) / CARES Act

- TCJA: Section 163(j) limited a company's interest expense deduction to 30% of adjusted taxable income
 - Significant conformity (revenue-raiser)
- CARES Act – increased 163(j) limit from 30% - 50%
 - Conformity to TCJA doesn't necessarily = conformity to CARES (163(j) and other provisions)
 - Depends on type of conformity (rolling, static, selective)
 - Even some general rolling conformity states specifically decoupled from CARES – e.g., New York

BEAT

- BEAT acts as a minimum tax triggered based on satisfying certain thresholds
 - Average gross receipts of at least \$500m
 - Base erosion percentage of 3% or more for the tax year
 - Generally, deductible payments to related foreign parties
- **Does not impact state tax as not included in taxable income base**
 - Additionally, constitutional prohibition on treating income from foreign sources differently than from domestic → *Kraft*, previously discussed

State Budget Deficits

- State revenue projections are down across the U.S.
 - New York is estimating a \$13.3B shortfall this year and \$61B over the next four years.
 - California estimates a \$54B deficit through 2021 (down from a \$5.6B surplus projection in January).
- Effect of deficit:
 - Proposed tax increases?
 - Enhanced audits?
 - Budget cuts?
 - Impact on settlements?

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Questions From the Audience

Sales/Use and Wayfair Updates

- Louisiana
 - Adopted economic nexus position effective July 1, 2020
 - \$100,000 or 200 or more separate transactions
 - Established “Louisiana Sales and Use Tax Commission for Remote Sellers”
 - Establish a uniform tax base and serve as single point to remit tax on sales into Louisiana
 - Required to collect sales tax based on rate in each Parish (based on delivery address)
 - Addresses the “home rule” issue in Louisiana for localities imposing their own tax.

Sales/Use and Wayfair Updates

- Mississippi
 - Enacted marketplace and remote seller nexus provision effective July 1, 2020
 - Applies to marketplaces with sales that exceed \$250,000 in any 12-month period.
 - Remote sellers previously required to collect via a bulletin (i.e., the provision was not statutory)
- Illinois
 - Un-“Leveling the Playing Field for Illinois Retail Act” effective January 1, 2021
 - Illinois retailers completing intrastate sales required to report/pay ROT based on origin of sale (as low as 6.25% combined state/local tax rate).
 - Remote retailers without physical location in Illinois required to report/pay ROT based on destination of sale (as high as an 11% combined state/local tax rate)
 - Remote retailers with physical location in Illinois required to report/pay Use Tax (standard 6.25% state rate). No locality imposes use tax other than Chicago (additional 1% use tax).

New Jersey

- Corporation Business Tax Increase
 - On Sept. 29, 2020, New Jersey increased its CBT surtax rate to 2.5% and extended the surtax through Dec. 31, 2023. A. 4721
 - Total corporate tax rate of 11.5% if subject to the surtax (corporations with taxable income over \$1m)
 - Applies for 2020 tax period.
- *Preserve II v. Director, Division of Taxation*
 - NJ Tax Court determined the Preserve, a foreign entity with no TPP or employees in the state, had New Jersey nexus based on 99% LP interest in a limited partnership that conducted business in New Jersey.
 - NJ Superior Court upheld NJ Tax Court, determining that Preserve was not a mere passive investor.
 - Similar to the *BIS, Village Supermarket* line of cases.

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Texas Updates

Hegar v. El Paso Electric Company

Texas Court Articulates New Standard for Statement of Grounds

- Texas law requires taxpayers to submit a statement of grounds explaining basis of disagreement with assessment or claim for refund.
 - “State fully and in detail each reason or ground on which the claim is founded.” Texas Tax Code § 111.104.
 - “To be stated in such a way as to put the Comptroller on notice of the legal basis of the claim.” *Hegar v. Ryan, LLC*.
- Taxpayer filed refund claim for sales taxes paid on telemetry units related to step-down transformers .
- Taxpayer originally argued a sale-for-resale exemption in its statement of grounds and added additional manufacturing equipment exemption in “additional filing” before Texas State Office of Administrative Hearings (“SOAH”).
 - Cited manufacturing exemption in Texas Tax Code § 151.318(a)(1) and (3)-(11) as foundation for claim.
 - SOAH rejected taxpayer’s argument based on timeliness of argument raised.
- District court ruled in favor of taxpayer.

Hegar v. El Paso Electric Company

Texas Court Articulates New Standard for Statement of Grounds

- The Texas Court of Appeals (3rd District) found that taxpayer's general citation to Texas Tax Code § 151.318 or § 151.318(a)(4) is not specific enough for purposes of the statement of grounds.
 - (a)(4) contains a list of over four dozen types of equipment.
- Different from *Silicon Laboratories* because that case cited a single subsection of Texas Tax Code § 151.318 that was applicable to a single type of manufacturing equipment.
- Alternative argument, that line items for supporting schedules provided necessary basis for statement of grounds, was also rejected.
 - Not specific enough to put the Comptroller on notice.
- Practice Point – Be as specific as possible in drafting the statement of grounds!
- Takeaway – May be more difficult in the future to file challenge to assessment or refund claim.

Texas Budget , Upcoming Legislation, & SiriusXM

Changes Likely in the Next Legislative Session

- Texas looking for additional sources of revenue to make up for budget shortfalls due to COVID-19 and low oil prices.
- Texas has high sales tax and property tax rates.
 - Significant pressure from residents over increasing property tax rate and school funding issues.
 - Likely tax legislation to lower property taxes.
 - Where will the additional revenue come from?
- Texas Legislature meets biannually
 - Next legislative session scheduled for January 12, 2021 – May 31, 2021.
- *Sirius XM Radio* case Update
 - Petition for review has been filed at the Texas Supreme Court.
 - Comptroller declined to respond to the petition.
 - Court has set a deadline of October 19 for other responses to petition.

Applicability of Sales Tax to Transit Authorities

- Texas has six metropolitan transit authorities, two city transit departments, one county transit authority, and one advanced transportation district. Rates range from ¼% to 1%.
- Sales taxes imposed by MTAs are imposed on the receipts from the sale within the entity area of all taxable items that are subject to the state sales tax.
- Maximum sales tax rate of 8.25%.
- Ultimately a sourcing issue.
 - General rule: Required to collect sales tax at seller's place of business.
 - As a result, if seller is located in local jurisdiction with no MTA, and selling into a jurisdiction with an MTA, no tax due if not engaged in business in the MTA jurisdiction.
 - Beware that a local use tax likely also exists, so that likely will have to be collected.
 - Many different exceptions to the general rule exist.

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Midwest Updates

Global Mail, Inc. v. Jesse White

Aggressive Enforcement of the Illinois Franchise Tax Continues Despite Phase-Out

- On June 5, 2019, the Illinois legislature enacted S.B. 689 to phase out the Illinois franchise tax starting with the 2020 tax year and culminating in full repeal by 2024.
- In *Global Mail, Inc. v. Jesse White*, the Illinois Appellate Court ruled that the Office of the Secretary of State improperly assessed an Ohio corporation, Global Mail, Inc., double the amount of franchise tax actually due.
- During a 2004 internal restructuring, Global Mail (Delaware) merged with and into Global Mail (Ohio). No notification provided to the Secretary of State.
- Global Mail changed its state of incorporation from Delaware to Ohio on its 2013 Corporate Annual Report. The Secretary of State caught the change on the 2015 annual report.
- The Secretary of State attempted to assess both the non-existent Delaware corp. *and* the Ohio corp. for all past periods due (2005-2016) due to Global Mail failing to report the merger.
- The Illinois Appellate Court held: “Delaware law dictates corporate existence and, once the Delaware corporation no longer existed under Delaware law, it no longer existed for purposes of incurring franchise taxes.”
- Despite phase-out, enforcement by the Secretary of State continues to be very aggressive. Taxpayers be warned!

Illinois Local Sales Tax Sourcing

City of Chicago vs. City of Kankakee – Let Them Fight!

- Allocation of the 6.25% state sales tax versus the 6.25% state use tax varies dramatically.
 - For sales tax, 5% goes to the State and the remaining 1.25% is distributed geographically to the municipality and county where the sale of the item occurred.
 - For use tax, 5% goes to the State and the remaining 1.25% is distributed as follows: 20% to the City of Chicago, 10% to the Regional Transit Authority Occupation and Use Tax Replacement Fund, 0.6% to the Madison County Mass Transportation District, \$3.15 million to the Build Illinois Fund, and the remainder to approximately 200 municipalities (other than Chicago) and counties based on population.
- During the tax years at issue, the Illinois Department of Revenue sourced sales solely based on where a retailer accepted a purchase order – ripe for abuse!
- Defendant Municipalities (incl. Kankakee, Channahon) entered into sales tax rebate agreements with certain internet retailers whereby the retailers would report to the Department that the situs of certain online sales occurred within either Kankakee or Channahon at pop-up offices (subject to sales tax), when in actuality, the real sales activity occurred over the internet outside of Illinois (subject to use tax). A portion of the resulting local sales tax was rebated to the internet-retailers.
- Plaintiff Municipalities (incl. Chicago, Skokie) claimed that the Defendant Municipalities received a greater share of tax revenue from the sales by receiving the entire statutory local sales tax distribution rather than the much smaller prorated share of the statutory use tax distribution.
- On March 21, 2019, the Illinois Supreme Court ruled the Department has exclusive authority to enforce tax collection and subsequent distribution. Plaintiff-Municipalities “are seeking to use the circuit court to conduct a full scale audit and redistribution of state taxes.”

Illinois Local Sales Tax Sourcing

Contingent Fee Audits – Local Government Revenue Recapture Act

- Sales tax order acceptance rule (at issue in the *Kankakee* lawsuits) struck down by the Illinois Supreme Court in *Hartney Fuel Oil. Co. v. Hammer*. New regulation promulgated to source local sales tax based on taxpayer's substantive connection with local jurisdiction. See Ill. Admin. Code 220.115(c) (imposing a multifactor test).
- On January 24, 2020, the Illinois legislature enacted the Local Government Revenue Recapture Act (P.A. 101-0628) (eff. Jun. 1, 2020) to ensure more accurate allocation of local sales tax revenues.
- The act authorizes local taxing authorities and third-party auditors to access and examine confidential sales tax data provided by taxpayers to the Illinois Department of Revenue.
- If the third-party auditor discovers local sales taxes have been misallocated or underpaid, the auditor may initiate an audit referral to the Illinois Department of Revenue.
- After the audit referral is initiated, the Department notifies the taxpayer that its local government contracted with a third party to review the taxpayer's sales and use tax payments.
- Taxpayers have two options: (1) consent to municipality's contingency-fee audit through a third party; or (2) hire an Illinois CPA to audit and certify local sales tax compliance / non-compliance.
- Localities agree to pay the third-party auditors a portion of the gross income generated from the audit (*i.e.*, up to 50% of the tax revenues collected).

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