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SALT Savvy: Coast-to-Coast Updates

Wednesday, August 5th, 2020 | 1:00 – 2:00 pm ET



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Agenda

SALT Savvy: Coast-to-Coast Updates

- 1. Transfer Pricing (SALT) Developments**
- 2. Receipts Sourcing Developments in PA, TX, and WA**
- 3. East Coast Updates**
- 4. Midwest Updates**
- 5. Southwest Updates**
- 6. West Coast Updates**
- 7. U.S. Senate Coronavirus Relief Bill (SALT Implications)**

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Transfer Pricing (SALT) Developments

State Tax Developments in Transfer Pricing

The Basics

- Pricing of related-party transactions (e.g., sale of goods, provision of services, licensing of IP) to prevent tax avoidance by requiring arm's-length terms.
- The IRS is authorized under IRC § 482 to allocate income or deductions between related entities where necessary to prevent tax avoidance or to ensure taxpayers clearly reflect the entities' income attributable to controlled transactions.
 - The goal of transfer pricing is to put related/"controlled" party transactions "on a tax parity" with unrelated/"uncontrolled" party transactions. Treas. Reg. § 1.482-1(a)(1).
 - "[T]he standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer." Treas. Reg. § 1.482-1(b)(1).

State Tax Developments in Transfer Pricing

Application to State Taxation

- States adopt statutes modeled off IRC § 482 (e.g., N.C. Gen. Stat. § 105-130.5(a)(9), Ind. Code Ann. § 6-3-2-2, Utah Code Ann. § 59-7-113, etc.).
- Major issue in separate return filing states because intercompany transactions are NOT eliminated (in contrast to combined return filing states). Also occurs in combined return states where certain affiliates are carved out of the combined group (e.g., insurance companies).
- Aggressive enforcement + lack of government transfer pricing sophistication = taxpayer victories.
 - *Utah State Tax Commission v. See's Candies, Inc.*, 435 P.3d 147 (Utah 2018).
 - *Rent-A-Center East, Inc. v. Indiana Dept. of State Revenue*, No. 49T10-0612-TA-00106 (Ind. Tax Court 2015); *Columbia Sportswear USA Corp. v. Indiana Dept. of State Revenue*, No. 49T10-1104-TA-00032 (Ind. Tax Court 2015).
 - *Microsoft Corp. v. D.C. Office of Tax & Revenue*, Case No. 2010-OTR-00012 (OAH 2012) (cf., *Hess Corp., et. al. v. D.C. Office of Tax & Revenue*, Case No. 2012-OTR-00027 (OAH 2018)).

State Tax Developments in Transfer Pricing

States Revamp Enforcement Efforts

- Historic initiatives:
 1. Engagement of third-party transfer pricing consultants (e.g., RoyaltyStat LLC/Ednaldo Silva, Chainbridge Software LLC, Economic Analysis Group LLP, etc.).
 2. Training sessions focused on IRC 482 instruction and transfer pricing.
 3. Special transfer pricing information exchange agreements.
- The Multistate Tax Commission's State Intercompany Transactions Advisory Service.
- New initiatives:
 - North Carolina: voluntary corporate transfer pricing resolution initiative.
 - Indiana: advance pricing agreement ("APA") program.

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Receipts Sourcing Developments

Cost of Performance Sourcing was Always Market

Synthes USA HQ, Inc. v. Commonwealth of Pennsylvania

- Pennsylvania moved from cost-of-performance sourcing to market-based sourcing for sales of services in 2014.
- Despite law change, the PA DOR interpreted the cost-of-performance rule to reach market-based results in years prior to 2014.
- Taxpayer Synthes, a PA-based corp., turned the PA DOR's interpretation against it to support its refund claim.
- PA DOR eventually agreed with the Taxpayer; however, Attorney General intervened and argued against the DOR's interpretation (and the taxpayer's argument).
- The Commonwealth Court of Pennsylvania deferred to the PA DOR's interpretation, finding:
 - The prior statute was ambiguous, warranting deference to the DOR's expertise.
 - The legislature "acquiesced" to the PA DOR's interpretation by not expressly repealing it.
- The Court sharply criticized the AG's decision to advocate for a position adverse to its client.

Update on *Sirius XM*

- Effectively makes Texas a market-based sourcing state
- Texas Taxpayers and Research Association and Council on State Taxation petition Texas Supreme Court for Review
- Tax Executives Institute also petitions for review
- Currently waiting to see if Texas Supreme Court accepts case

Washington DOR Response to *LendingTree*

- *LendingTree*
 - Online loan marketplace is paid by lenders to match with prospective borrowers
 - “[F]or a service-related business like *LendingTree*, ‘the benefit is received where the customer’s related business activities occur.’”
 - Court held the market is the location of lenders (taxpayer’s) customers and not the location of borrowers (customers’ customers)
 - See also, *ARUP Labs, Inc. v. WA DOR*
- **Washington DOR Response:**
 - “The dispute focused on how to apply Rule 19402(303)(c) to the specific facts of *LendingTree*.”
 - “The court’s opinion does not suggest that Washington must always attribute receipts to a customer’s business location,…”
 - “[F]or example, if a taxpayer provides marketing or advertising services to a customer engaging in selling goods or services, the customer’s most directly related activity is ‘selling’ and that activity occurs in the customer’s market and receipts will be attributed to that location.”

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East Coast Updates

D.C. Drops Digital Advertising Tax Proposal

- Council originally proposed a 3% tax on gross receipts from digital advertising services due to COVID-19 budget shortfall
 - Digital advertising services: “Advertising services related to advertisements displayed on a digital interface, including advertisements in the form of banner advertising, search engine advertising, interstitial advertising, or other comparable advertising”
 - Also taxed gross receipts from the sale of personal information
- Tax proposal formally dropped during July 28 vote

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Midwest Updates

Comerica, Inc. v. Mich. Dept. of Treasury

Michigan –Tax Credits Transfer to Successor Entity Following Merger

- The taxpayer was a bank holding corporation with numerous subsidiaries.
 - Taxpayer merged a subsidiary state-chartered bank regulated by Michigan with a Texas subsidiary.
 - After the merger, the Michigan subsidiary ceased to exist but transferred all property to the Texas subsidiary.
 - The taxpayer filed its Michigan Business Tax (“MBT”) returns for 2008-11, including the Texas subsidiary as part of its unitary business group, and claimed the Single Business Tax (“SBT”) credit earned by no longer existing Michigan subsidiary.
- The Michigan Tax Tribunal disallowed the carryforward of the SBT credit holding the credits were privileges that could only be transferred by assignment.
- The Michigan Court of Appeals reversed and held the SBT credit was property rather than a privilege and allowed the taxpayer to claim the credits because all property was transferred during the merger by operation of law.

Illinois Updates Marketplace Facilitator Laws

Legislation Creates Origin versus Destination Conundrum

- Late 2019 legislation attempted to fix discrepancies between sales tax (“ROT”) and use tax obligations.
 - Effective January 1, 2021, a marketplace facilitator generally must collect and remit state and local sales tax on sales of TPP made on its platform into Illinois.
 - Until 2021, marketplace facilitators are only required to collect and remit state use tax on sales of TPP into Illinois (6.25% origination rate), while remote retailers required to charge state/local rate (10.25% destination in Chicago).
- New law perpetuates marketplace origin versus destination conundrum.
 - Illinois retailers selling directly charge sales tax using an origin-based rate (as low as 6.25% where product is shipped).
 - Remote sellers and marketplace facilitators without physical presence in Illinois are required to collect and remit a destination-based sales tax (10.25% rate where customer takes possession in Chicago).
 - Constitutional challenge: Discriminates against interstate commerce?

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Southwest Updates

Other Texas Developments

- *Lockheed Martin Corp. v. Hegar*
- Projected budget shortfall of approximately \$4.6 billion
- Property Tax : Appraisal Review Board Hearings Now Underway
- COVID-19 Updates
 - Field offices remain closed, headquarters open for limited staff
 - As of 8/1/20, updated Texas Notification Results and Updated Refund letters mailed
 - 90 days instead 60 days

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West Coast Updates

Legislative/Regulatory Activity

- Newly enacted Seattle payroll tax
- Pending **California corporate disclosure bill**
- Upcoming Local Ballot Measures:
 - San Francisco Business Tax Reform Ballot Measure (eliminate payroll tax, increase GRT, authorize spending of measures currently in litigation)
 - Portland Payroll tax ballot measure

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U.S. Senate Coronavirus Relief Bill (SALT Implications)

U.S. Senate Coronavirus Relief Bill

- Senate Coronavirus relief bill includes the Remote and Mobile Worker Relief Act of 2020 (S. 3995)
 - Provides an annual 30-day safe harbor for non-residents working in any state
 - Prevents taxation on individuals and withholding requirements on employer
- Additional provisions specific to COVID-19 “covered period”
 - Threshold extended to 90 days
 - Covers localities
 - No nexus on employer
- Bill would exempt professional athletes, entertainers, and other highly-compensated public figures

Questions

The image features a dark blue background with a white speech bubble shape. The word "Questions" is written in a bold, dark blue font inside the white bubble. The background has a subtle pattern of small, light blue dots, resembling a starry night sky or a textured surface.

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