

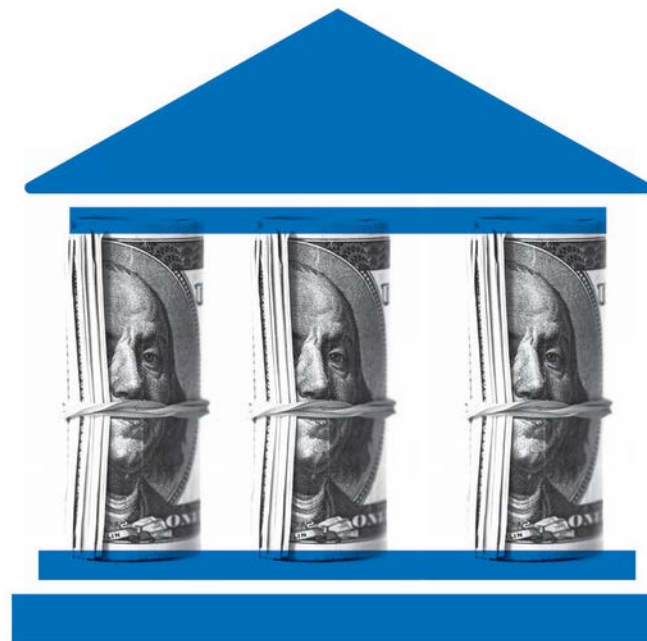
TEI New York Chapter 57th Annual Tax Symposium

Unmasking 2021— Judicial and Legislative Outlook

December 9, 2020

Jeff Friedman
Partner

Nikki Dobay
Partner



Agenda

- 2020 in Review: It's almost over
- Hello 2021!
 - Key legislative trends to have on your radar
 - Controversies to watch



2020 in Review: It's Almost Over



State responses to COVID-19

Overview

- Substantial reduction in economic activity and tax collections
- Unprecedented pressure on state unemployment insurance trust funds
- States scrambling to find alternative funding, including federal assistance

COVID-19 State Budget Shortfalls Could Be Largest on Record

Total state budget shortfall in each fiscal year, in billions of 2020 dollars



* Estimated based on CBPP calculations

Source: Pre 2014: CBPP survey; 2020 and following: CBPP calculations

CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

State responses to COVID-19

Overview

State 2020 Budgets

- States looking for ways to cut expenses and get cash in the door
- Postponing tax payment deadlines adds to the loss of current cash flow
- Use of rainy-day fund or other reserve balance to fill in budget holes
- Reliance on federal aid

Federal Relief Bill

- Carryback of taxpayers' net operating losses
- 163(j) changes
- Rhode Island estimates that conformity with the CARES Act could cost the state \$17.5 million over two years

Recouping Lost Revenues

- Increasing tax rates, broadening the tax base, eliminating tax exemptions, and/or enacting new taxes or fees
- Adoption of Gross Receipts Taxes
- Tax Amnesty Programs
- NOL Suspension

Impacts of the Election: Biden tax plan

Businesses

- Raising the corporate tax rate to 28 percent
- Imposing a 21 percent minimum tax “on all foreign earnings of U.S. companies located overseas”
 - Double the current 10.5 percent GILTI rate
 - Compute GILTI tax (and related foreign tax credits) on a country-by-country basis rather than a worldwide average*
- Instituting a “tax penalty” on “corporations that ship jobs overseas in order to sell products back to America”
- Imposing a 15 percent minimum tax on book income
- Eliminating Section 1031 exchanges and the ability to offset real estate losses against other income under the passive activity loss rules*

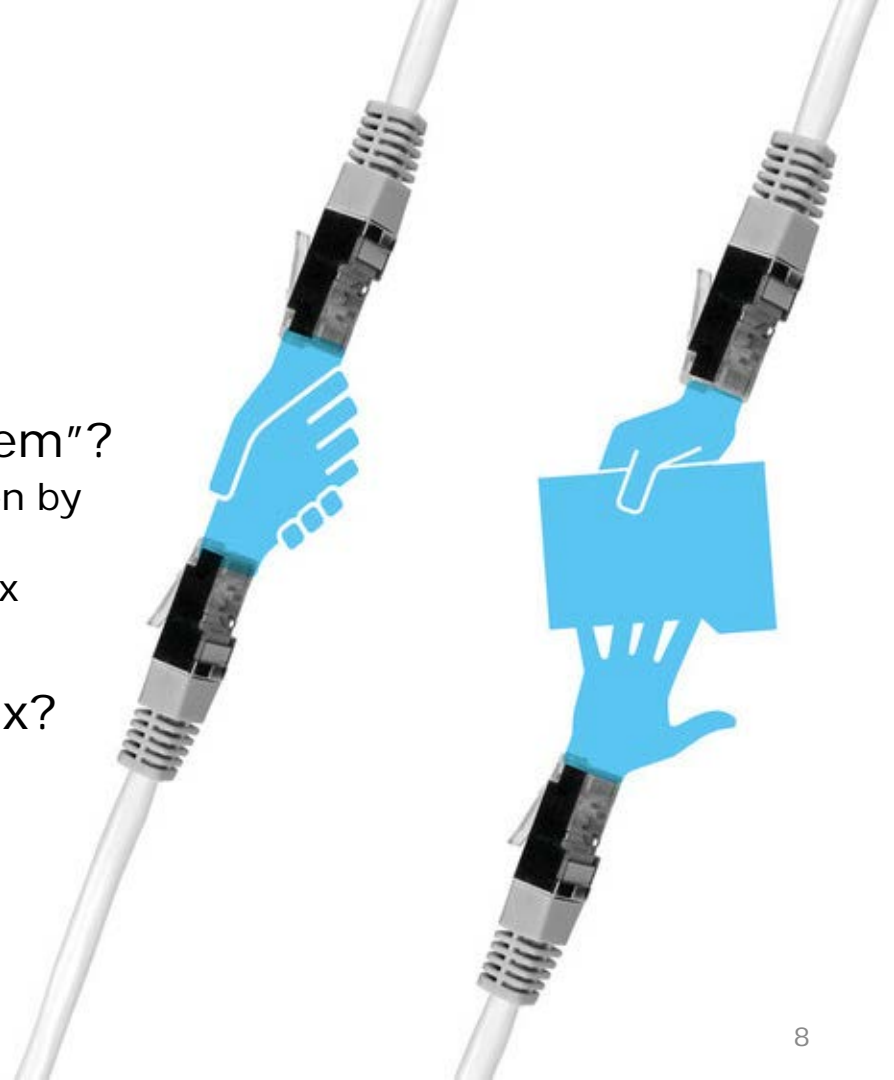
** Reported in media but not present on official campaign website on Election Day.*

**Hello 2021! Key
legislative trends to
have on your radar**



Digital Advertising Taxes

- Background
 - Prior attempts by States to tax advertising
 - Constitutional challenges
 - European approaches
- Different Approaches, Same “Problem”?
 - Maryland bill is akin to the approaches taken by France, UK, and Italy
 - A Nebraska bill simply expands the sales tax base to include digital advertisements
- Potential for a “model” digital ad tax?
 - Click-through provisions
 - South Dakota thresholds
 - Streamlined digital goods



Zombie Digital Ad Tax Bill

Maryland HB 732

- Would create a new digital advertising gross revenues tax separate from, and in addition to, the existing Maryland sales tax
 - The current Maryland sales tax is narrow, though attempts have been made to “modernize” the base
 - Tax imposed on a person’s annual gross revenues derived from digital advertising services in Maryland
 - HB 732 would take effect July 1, 2020, and the new tax would apply to all taxable years beginning after December 31, 2020
- Vetoed by Governor Hogan on May 7 after widespread opposition
- Legislature could override with a 3/5 vote of both chambers’ members in 2021
 - Similar proposal was defeated in D.C. this year

Other Digital Advertising Tax Bills

NY S 8056 – Digital Advertising Tax	NY S 8166 – Sales Tax on Digital Ad Services	NY A 9112 – GRT on “Individual Data” Income	NE LB 989 – Sales Tax on Digital Advertisements
<ul style="list-style-type: none">• Would establish a tax on a digital advertiser’s annual gross revenues derived from digital advertisements in the state• Unlike the proposed Maryland tax, this New York bill would only impose the digital advertising tax on targeted advertisements	<ul style="list-style-type: none">• Would expand the sales tax base to digital advertising services• Unlike S 8056, the sales tax expansion would not be limited to advertisements “that use personal information about the people the ads are being served to.”• Rather, the tax base is advertisements that “market” or “promote” a particular good, service, or political candidate or message” (similar to NE)	<ul style="list-style-type: none">• Imposes a 5% tax on gross income upon every corporation which derives income from the data individuals of this state share with such corporations• A similar bill was introduced in the Senate in May 2019 (SB 6102)	<ul style="list-style-type: none">• Expands the Nebraska sales and use tax to tax digital advertisements• “Digital advertisement” means an “advertising message delivered over the Internet that markets or promotes a particular good, service, or political candidate or message”

Digital Goods and Services

Florida

- Pair of bills proposed to change what streaming and similar services are subject to the state's communication services tax
- Both bills died in committee

Georgia

- Bill sought to expand sales and use tax to encompass certain digital goods and services transactions
- Failed to pass in 2020

Kansas

- Pair of bills propose to impose sales tax on digital property and subscription services
- Both bills failed to pass in 2020

Maryland

- HB 932 would subject certain digital products to Maryland sales and use tax
- Governor Hogan vetoed; Legislature could override with 3/5 vote of both chambers' members

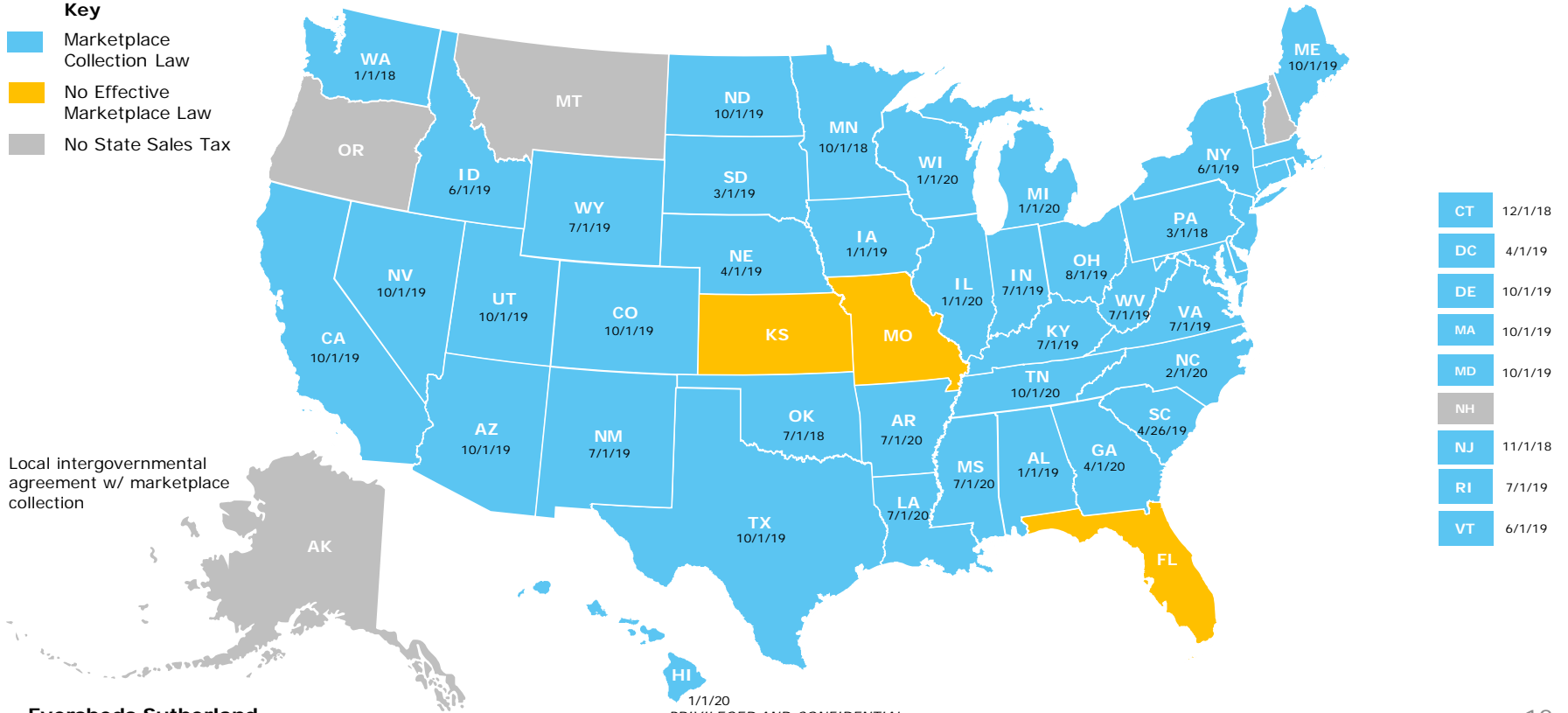
Utah

- Bill passed in January 2020 which repeals a bill passed during December 2019's special session on tax reform
- The 2019 bill would have expanded the sales tax base to include certain services including streaming media

Marketplace Collection Laws & Effective Dates (2020)

Key

- Marketplace Collection Law
- No Effective Marketplace Law
- No State Sales Tax



Local intergovernmental agreement w/ marketplace collection

Failed Marketplace Legislation

Expect these to reemerge in 2021



Florida HB 159/SB 126

- On March 14 both bills died in Committee



Missouri HB 1700/SB 529

- Legislative session has adjourned without passing either bill
- Several other bills introduced in 2020



Kansas HB 2657/SB 266

- Legislative session has adjourned without passing either bill
- Several other bills introduced in 2020

Marketplace Collections Go Local

What to expect

- Local administration of sales taxes and fees poses unique compliance challenges for marketplace facilitators
- Trend toward state-run online sales tax reporting portals
 - Alaska, Alabama, Colorado, Louisiana
- Expect laws and ordinances to address collection of other taxes and fees
 - Hotel and restaurant taxes, resort area fees, plastic bag taxes, soda taxes, and more!



Credits and Incentives

Tax Incentive Compact Proposals

- Interstate Compact to Phase Out Corporate Giveaways
- Prohibits a signatory state “from offering or providing any company-specific tax incentive or company-specific grant to any entity for a corporate headquarters, manufacturing facility, office space, or other real estate development to relocate to the offering member state.”
- “Bipartisan effort to phase-out corporate tax incentives”



Federal Tax Reform Reactions

— **Nebraska LB 1203**

- Clarifies that Nebraska's statutory subtraction for "dividends and deemed dividends" applies to § 965 deemed repatriation and GILTI
- Bill indefinitely postponed on August 13

— **Utah SB 53**

- Decouples Utah from GILTI
- Utah currently a water's edge combined reporting state, nonetheless requires taxpayers to include approximately 50% of GILTI in the tax base, yet does not provide a foreign tax credit
- Failed to pass in 2020

— **Virginia HB 1716**

- Increases the deduction for business interest expense disallowed under IRC § 163(j) from 20% to 35% starting January 1, 2021
- Failed to pass in 2020

New Jersey's Trapped Dividend Exclusion

- The New Jersey Division of Taxation issued a notice on November 5th solving the “trapped dividend exclusion” issue faced by many taxpayers as they prepared to file their first New Jersey combined Corporate Business Tax (CBT) returns for the 2019 year
- The issue arose due to New Jersey's adoption of combined reporting and its proposed method for calculating the dividend received exclusion
 - Specifically, a combined group that includes a member with a zero allocation factor would not be able to utilize that member's dividend exclusion
 - Followed immediately after enactment of AB 4809, a technical correction bill, which among other things, amended the definition of “taxpayer” to include “any combined group filing a mandatory or elective New Jersey combined return”



Mandatory Unitary Combined Reporting

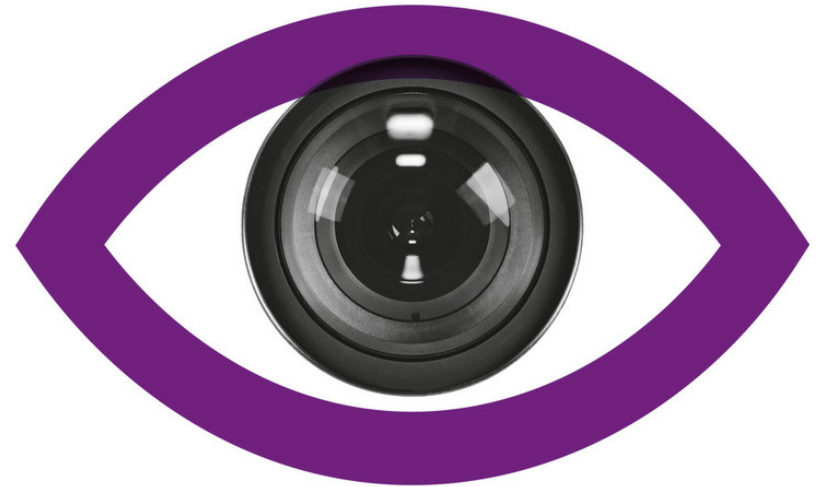
Virginia HB 739 HB 1109 SB 756	<ul style="list-style-type: none">• Binding 10-year water's edge election, but certain foreign income still would be included in the water's edge report• HB 1109 also included a public disclosure provision for public corporations that, even though "redacted," would make the following information available to the public: gross receipts, gross profits, excess or carried-forward credits, apportionable income, and Virginia taxable income• All bills carried over to the 2021 session
Maryland SB 311 HB 473	<ul style="list-style-type: none">• Both bills failed to pass this session
Pennsylvania SB 1032	<ul style="list-style-type: none">• Hearing on January 29 that included discussion of MUCR, held by the Pennsylvania Senate Democratic Policy Committee• Pending in Finance Committee since March 3
Florida SB 1596	<ul style="list-style-type: none">• Died in Committee on March 14

False Claims Act

D.C. B23-35, the D.C. False Claims Amendment Act of 2020

- Despite strong opposition by the business community, the D.C. Council on Dec. 1 voted to expand the reach of the District's False Claims Act to tax matters
- States that take this action historically experience a proliferation of nuisance *qui tam* lawsuits
 - Illinois, New York
- California saw a similar proposal in 2020

Hello 2021: Controversies to watch



WFH withholding battles

State of New Hampshire v. Commonwealth of Massachusetts

- New Hampshire filed a complaint in the U.S. Supreme Court challenging the constitutionality of a Massachusetts's regulation imposing income tax on non-resident remote workers
- Massachusetts adopted a regulation, 830 CMR 62.5A.3, on October 16, 2020, which allows the state to source and tax income of non-resident remote workers telecommuting due COVID-19 when they previously worked within the state
- New Hampshire, which has no income tax, immediately responded filing the instant complaint contending that:
 - This action is a “direct attack on a defining feature of the State of New Hampshire's sovereignty”
 - The regulation violates the Commerce Clause and Due Process Clause

WFH withholding battles

Local Taxes

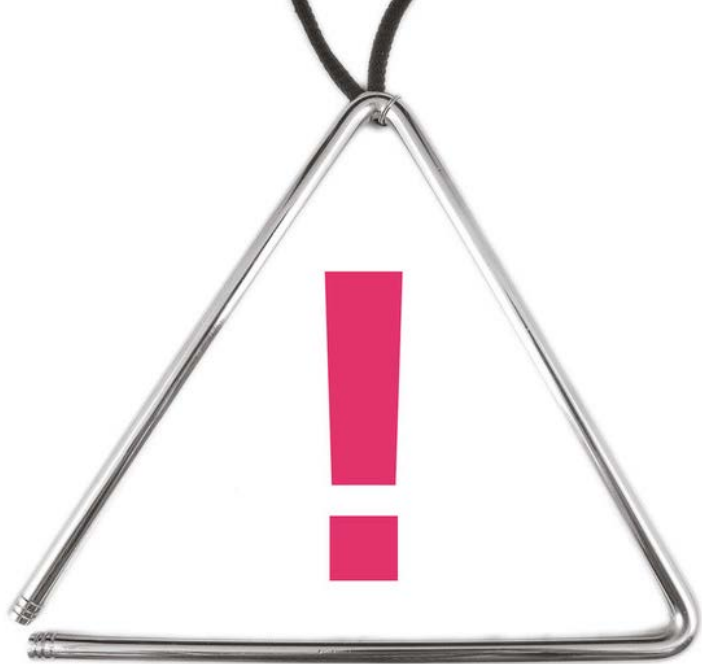
- Ohio HB 197, passed in March, keeps status quo for municipal income taxes based on pre-pandemic work locations until 30 days after the expiration of the emergency stay-at-home order
 - Republican lawmakers introduced a set of bills to repeal this measure (SB 352 and HB 754)
- New Portland area personal income taxes
 - Metro 1% PIT
 - Multnomah County 1.5% and 3% PIT



California voter initiative litigation

- A recent wave of local tax initiatives passed by simple majority vote in cities and counties across California has resulted in either court validation actions or challenges under the state constitution
 - Article XIII C, Section 2(d) of the California Constitution provides that “[n]o local government may impose, extend, or increase any special tax unless and until that tax is submitted to the electorate and approved by a two-thirds vote”
- Thus far, trial courts have split as to whether this provision applies to voter-initiated local taxes, and one appellate court already has concluded it does not
- Many of these cases are now on appeal





Watch out for the locals

- State budget issues have and will continue to put pressure on localities
 - Portland-area: New business profits tax and two new personal income taxes
 - San Francisco: 4 new tax measures voted in November 3, including a CEO-to-average wage ratio tax
 - Seattle: New payroll tax
- Increases in the number and impact of local taxes are likely to create challenges
 - Constitutional issues: nexus, due process & commerce clause
 - Jurisdictions authority to impose taxes

FCA and *Qui tam* actions aren't going away

- *State of Nevada Ex Rel Mark Fierro vs. Orbitz Worldwide, LLC*, No. A-20-814111-C (Nv. 8th Jud. Dist. Ct.)
 - *Qui tam* lawsuit brought against more than 20 online travel companies (OTCs) for back taxes that they say should have been paid to Nevada based on hotel room rate
- *New York v. Sotheby's Inc.* (N.Y. Sup. Ct. N.Y. Cty.)
 - On Nov. 6, New York alleged that Sotheby's allowed \$27 million of art to be purchased tax-free by Porsal Equities, which is controlled by the shipping company owner, even though the auction house knew the client wasn't an art dealer but was instead a collector buying for his personal use

Apportionment battles

Synthes USA HQ Inc. v. Commonwealth of Pennsylvania (July 2020)

- The Pennsylvania Legislature amended an apportionment statute to provide for market-based sourcing effective with 2014 tax year
- Nevertheless, the Commonwealth Court upheld the DOR's position that under the state's prior apportionment statute, service providers were required to apportion their sales factor receipts based on where customers received the benefits of the service, rather than where the taxpayer incurred the costs of performing the service
- The court rejected the AG's position that the DOR's benefits-received interpretation was inconsistent with the statute, and ordered the DOR to issue a refund to the taxpayer after determining that the benefit of the service was received outside of Pennsylvania

Sourcing receipts

Defender Security v. McClain, Ohio Supreme Court, No. 2019-0531

- Taxpayer is a security company that sells home and business security systems to Ohio customers
 - After the systems are installed, taxpayer sells security service contracts to ADT that performs the security and monitoring services
 - ADT has no presence in Ohio
- For CAT purposes, receipts are sourced to where a purchaser receives the benefit of a transaction
- The court said that ADT – the taxpayer’s customer – received the benefits at its out-of-state offices and not in Ohio where the security service users are located



Trailing nexus

Willacy v. Cleveland Bd. of Income Tax Rev., Slip Opinion No. 2020-Ohio-314

- Taxpayer was employed at Sherwin-Williams in Cleveland for 29 years
- During her employment, she was compensated in part with stock-options, which she exercised after retiring to Florida
- Ohio Supreme Court said that the Taxpayer was subject to Cleveland income tax on the income she earned from exercising the options
 - The court noted that because Taxpayer received the stock options while she was working and living in Cleveland, the stock options qualified as compensation – rather than an independent intangible – and can thus be taxed by Cleveland
 - Federal law (PL 104-95 [4 U.S. Code sec.114]) presumably did not protect her because the options were not “qualified” under that statute



Franchise tax win

Comcast, in Mississippi Department of Revenue v. Comcast of Georgia/Virginia Inc. (August 2020)

- Comcast convinced the Mississippi Supreme Court that the company could use an alternative apportionment formula that excluded capital from subsidiaries that didn't engage in any in-state activities
- Comcast's subsidiaries that it excluded from its tax base had no connection to the company's business in Mississippi, and therefore it would be erroneous to include investments in them in the company's franchise tax base, the justices said



[eversheds-sutherland.com](https://www.eversheds-sutherland.com)

© 2020 Eversheds Sutherland (US) LLP

All rights reserved.

PRIVILEGED AND CONFIDENTIAL. This communication cannot be used for the purpose of avoiding any penalties that may be imposed under federal, state or local tax law.

Contact Us

Jeffrey A. Friedman

Partner

Eversheds Sutherland (US) LLP

202.383.0718

jeffriedman@eversheds-sutherland.com

Nikki Dobay

Partner

Eversheds Sutherland (US) LLP

916.302.9527

NikkiDobay@eversheds-sutherland.us

Rev. 12/4/2020