

SALT SHAKER

Shaking things up in state and local tax.



California FTB Takes Harley-Davidson for a Ride: Securitization Subsidiaries Are Financial Corporations with Nexus in California

By Shane Lord and Andrew Appleby

The California Superior Court ruled that certain special purpose entities (SPEs) owned by Harley-Davidson, Inc. had nexus in California. The taxpayer formed the SPEs as securitization subsidiaries, which the court held were subject to California income taxation because the SPEs: (1) were “financial corporations” under California law; and (2) had substantial nexus with California because the SPEs had agents in the state. The court determined that independent dealerships and the SPEs’ parent and sister corporations were agents of the SPEs. The taxpayer argued that the SPEs were not “financial corporations” because the SPEs were bankruptcy remote subsidiaries of the taxpayer and were not in substantial competition with national banks, as required by Cal. Code Regs. tit. 18, § 23183. The court did not address the implications of the SPEs constituting bankruptcy remote subsidiaries. The court ultimately held that the SPEs were in substantial competition with national banks because the SPEs and national banks conducted the same activities of bundling loans and selling securities backed by those loans. In addition to the above issues, the court sustained a demurrer early in the case, dismissing the taxpayer’s two other causes of actions: (1) the Franchise Tax Board discriminated against the taxpayer by not allowing it to file separate returns; and (2) the taxpayer was entitled to use an equal-weighted three-factor apportionment formula (see *Gillette Co. v. Franchise Tax Bd.*, 147 Cal. Rptr. 3d 603 (Cal. Ct. App. Oct. 2, 2012)). *Harley-Davidson, Inc. & Subs. v. Franchise Tax Bd.*, No. 37-2011-00100846-CU-MC-CTL (San Diego Super. Ct. May 1, 2013).

“Tut-Tut,” Long Beach: California Supreme Court Permits Taxpayers to File Class Action Suit to Recover Telephone User Taxes

By Sahang-Hee Hahn and Pilar Mata

The California Supreme Court held that taxpayers may file a class action lawsuit to claim a refund of local telephone user taxes (TUT) paid to the City of Long Beach. The taxpayer class alleged that the City unlawfully collected the TUT on services that were determined to be nontaxable under the Federal Excise Tax (and therefore were not subject to the TUT), and that the City had not properly obtained voter approval to amend its TUT ordinance as required by Proposition 218. The City filed a demurrer to dismiss the taxpayers’ complaint, arguing primarily that Long Beach’s municipal code expressly disallows class claims for refund. The City appealed the Court of Appeals’ denial of the demurrer, arguing that this case was distinguishable from the California Supreme Court’s recent decision in *Ardon v. City of Los Angeles*, 52 Cal.4th 241 (2011). *Ardon* held that the Government Claims Act permits class action claims for refund against a local government entity “in the absence of a specific tax refund procedure set forth in an applicable governing claims statute.” The City argued that the Long Beach municipal code constituted a “statute” for this purpose. The California Supreme Court rejected this argument, ruling the taxpayers could file a class action suit against the City, even though the local ordinance directly prohibits such claims. *McWilliams v. City of Long Beach*, Case No. S202037 (Ca. 2013).

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California Court of Appeal Lends Judicial Support for Declining Term of Possessory Interests and for Authoritativeness of Assessors' Handbooks

By Douglas Mo

The California Court of Appeal ruled that the County of Los Angeles illegally assessed the possessory interest of the lessee of a building owned by the California State Teachers' Retirement System. The possessory interest was valued pursuant to a special statute that only applied to property owned by a state public retirement system, which allowed the inclusion of the value of the tax-exempt reversion in the value of the possessory interest. In reversing the trial court's decision, the Court of Appeal stated that the Los Angeles County Assessor should have declined the value of the possessory interest with each successive assessment to recognize the declining remaining term of the possessory interest. This is a significant and beneficial point to taxpayers owning possessory interests in California, because a declining

term causes the value of the possessory interest to decrease as a function of time. Further, the Court of Appeal cited language in the California State Board of Equalization Handbook (AH 510) to support its decision. This decision is the second in the last four months (the other being *Sky River LLC v. Kern County*, 214 Cal. App. 4th 720 (2013)) to give judicial credence to the Assessors' Handbooks. When there is helpful language in Assessors' Handbooks to support taxpayer positions, Assessors can be inclined to ignore the guidance contained in these Handbooks. *California State Teachers' Retirement System v. County of Los Angeles*, B225245, Court of Appeal, Second Appellate District (May 7, 2013).



SALT PET OF THE MONTH

Tessa



Meet Tessa, the cuddly Shih Tzu of Sutherland SALT's Tim Gustafson and his wife, Emily. Twelve-year-old Tessa has lived quite an exciting life. After whisking her (and Tim's wife, to whom Tessa belonged) away from Bakersfield, California, Tim smuggled the pup – ironically – *into* Amsterdam and transported her to the southernmost part of the Kingdom of the Netherlands where he was stationed with the U.S. Army. Over the next two years, she marked her territory in the Netherlands, Germany, France, Belgium and Luxembourg. She even met her doppelganger on the streets of Heidelberg. Tessa is happy to be back in the States, however, far from the insufferable pretentiousness of those European yappers. Now, she enjoys long naps on the couch, chasing squirrels, long naps on her bed, chasing skunks, long naps on Tim's bed, and scrounging for "people food." Tessa would thank us for being featured as the May Pet of the Month, but she is no doubt taking a long nap.



SALT Pet of the Month: It's Your Turn!!

In response to many requests, the Sutherland SALT practice invites you to submit your pet (or pets) as candidates for SALT Pet of the Month. Please send us a short description of why your pet is worthy of such an honor, along with a picture or two. Submissions should be directed to Katie O'Brien Schrack at katie.schrack@sutherland.com.

Enterprise Portfolio Management: The Next Generation of New York Nontaxable Products

By David Pope and Jack Trachtenberg

The New York State Department of Taxation and Finance has determined that a financial services firm is not subject to the New York State sales and use tax because the product being sold by the taxpayer constitutes a single, integrated, nontaxable service. The taxpayer provides its clients with investment management and risk management services and sells a product that consists of a comprehensive enterprise portfolio management support service for financial institutions and investment managers. The product includes numerous components, including a customized platform to manage information, customized investment analysis services, data control and operations services, customized trade management workflow services, compliance evaluation and reporting services, daily support, and a desktop analytical calculator. In determining the taxability of the product, the Department considered whether it represents a transaction that bundles taxable and nontaxable components for a single price or a “single integrated product.” The Department noted that, when considered separately, some components of the taxpayer’s

product seem to qualify as taxable (e.g., the web interface for the product is built on taxable prewritten software). Ultimately, however, the Department determined that the product was a single integrated product—specifically a nontaxable operations and management contract service for portfolio investment managers—because: (i) the product does not come in multiple variants; (ii) customers may use different components of the product in different proportions without incurring extra charges; and (iii) the different components of the product are highly synergistic. Although nuanced, the Department’s opinion follows prior guidance and case law that distinguishes between bundled transactions and single integrated products. The opinion also provides a good analysis of the factors that taxpayers may want to consider in determining whether a particular transaction is subject to sales and use tax. [N.Y. Advisory Opinion TSB-A-13\(12\)S](#) (Apr. 23, 2013).

MTC Three-Factor Election Falls Flat in Texas

By Zachary Atkins and Prentiss Willson

A Texas administrative law judge ruled that a taxpayer was not entitled to make an alternative three-factor apportionment election under Article IV of the Multistate Tax Compact (Compact) for Texas franchise tax purposes. The Texas Tax Code requires taxpayers to use a single gross receipts factor to apportion taxable margin to Texas. The taxpayer filed refund claims in which it asserted its right to use the alternative three-factor apportionment formula set forth in the Compact to determine its franchise tax liability. Despite being a full member of the Multistate Tax Commission established by the Compact, Texas has taken

the position that the three-factor apportionment election is not available to taxpayers because the franchise tax is not an income tax. Without addressing that argument, the administrative law judge concluded that Texas law governs and requires taxpayers to use the single gross receipts factor formula, affirming the Comptroller’s denial of the taxpayer’s refund claims. The Comptroller adopted the administrative law judge’s decision as written. Docket Nos. [304-13-1314.13](#), [304-13-1315.13](#) (Tex. State Office of Admin. Hearings, Apr. 9, 2013).

Come See Us

June 9-12, 2013

TEI Region VIII Conference

Hyatt Regency Mission Bay – San Diego, CA

Michele Borens and **Jeff Friedman** on State Tax Update

June 9-12, 2013

Federation of Tax Administrators Annual Meeting

Hyatt Regency – Albuquerque, NM

Prentiss Willson on Multistate Issues

June 13, 2013

The 17th Annual Multistate Tax Institute

Country Springs Hotel – Waukesha, WI

Jeff Friedman on Hot Topics in State Income Tax

June 17, 2013

UC Davis Summer Tax Institute

UC Davis – Davis, CA

Prentiss Willson on Constitutional Limits on State Taxation

June 19-21, 2013

Interstate Tax Corporation Interstate Tax Planning Conference

Courtyard Upper East Side – New York, NY

Michele Borens and **Jeff Friedman** on How the Interstate Tax System Works/ Jurisdiction & Nexus

Michele Borens on The Unitary Concept

June 26-30, 2013

TEI Region VII Conference

Westin – Hilton Head, SC

Jeff Friedman and **Eric Tresh** on State Tax Roundtable – Planning and Techniques

Recently Seen and Heard

May 7, 2013

Los Angeles County Bar Association Tax Practitioners Conference

Westin Bonaventure – Los Angeles, CA

Prentiss Willson on Recent Developments in SALT Litigation

May 7, 2013

NYSBA 17th Annual New York State and City Tax Institute

Concierge Conference Center – New York, NY

Marc Simonetti and **Jack Trachtenberg** on Ethical Dilemmas

May 8, 2013

TEI Houston Chapter 25th Annual Tax School

Hyatt Regency-Downtown – Houston, TX

Andrew Appleby and **Timothy Gustafson** on Transaction and Property Tax Planning in Asset Acquisitions

May 9-11, 2013

ABA Section of Taxation May 2013 Meeting

Grand Hyatt – Washington, DC

Marc Simonetti on Because I Said So: Forced Combination, Alternative Apportionment and Taxpayer Transparency Concerns

May 16-17, 2013

Media Industry Tax Conference

Wild Dunes Resort – Isle of Palms, SC

Jeff Friedman and **Eric Tresh** on State and Local Tax Watch List

May 17, 2013

TEI New Jersey Chapter Meeting

Meadow Wood Manor – Randolph, NJ

Marc Simonetti and **Andrew Appleby** on Latest and Greatest State Tax Litigation

May 20-22, 2013

COST Spring Audit Session/ Income Tax Conference

Ritz-Carlton – New Orleans, LA

Carley Roberts on Top 10 State Income/Franchise Tax Cases and Issues to Watch in 2013

Marc Simonetti on The Art of Settlement: Reaching a Win/Win with Tax Administrators

May 21-23, 2013

Telestrategies Communications Taxation 2013

Peabody Hotel – Orlando, FL

Todd Lard and **Eric Tresh** on Telecommunications Tax Controversies...the Good, the Bad and the Ugly

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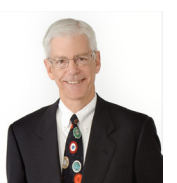
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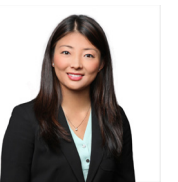
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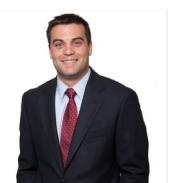
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