"Shaking things up in state and local tax"

SUTHERLAND SALT SHAKER

FORECAST
Tax audits are hot, humid and sticky. Cold front approaching.

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Totally Cool: Tennessee Class Action Lawsuit Smoked

In a case that may limit the ability of consumers to file class action lawsuits regarding Tennessee taxes, the Tennessee Court of Appeals ruled that a taxpayer is precluded from bringing a class action suit to reclaim improperly paid taxes. In *Wicker v. Commissioner*, Tenn. Department of Revenue, No. M2009-02305-COA-R9-CV (Tenn. Ct. App. June 23, 2010), two plaintiffs had been assessed tax on "unauthorized substances and illicit alcoholic beverages," otherwise known as the "Drug Tax." The plaintiffs filed a lawsuit after the Tennessee Department of Revenue ("Department") failed to take any action on their refund claims. The plaintiffs filed a petition individually and "on behalf of all others similarly situated" seeking tax refunds. After the Drug Tax was declared unconstitutional by the Tennessee Supreme Court in *Waters v. Farr*, 291 S.W.3d 873, 908-13 (Tenn. 2009), the Department attempted to issue refund checks to the two plaintiffs. Despite this attempted refund by the Department, the plaintiffs proceeded to file a "Motion to Certify Class." The class was certified by the lower court, and the Department appealed that certification to the Court of Appeals.

The Court of Appeals based its decision to overturn the certification on narrow statutory and constitutional provisions — a law known as the "Taxpayer Remedies Statute," and the sovereign immunity provision of Article I, Section 17 of the Tennessee Constitution. The court

Continued on Page 2

New Hampshire Interest and Dividends Tax: Who's Taxable Now?

On June 10, 2010, New Hampshire Governor John Lynch signed Special Session House Bill 1 into law, which repeals a significant 2009 amendment. The 2009 amendment related to the Interest and Dividends Tax Law (Rev. Stat. Ann. Chapter 77) and made distributions from limited liability companies, partnerships, and associations with non-transferable shares subject to the Interest and Dividends Tax and exempted these entities from the tax. The repeal reverses course and now exempts these distributions from the tax but restores the tax on interest and dividends received by limited liability companies, partnerships, and associations with non-transferable shares. The repeal applies to taxable periods ending on or after December 31, 2010.

On June 28, 2010, the New Hampshire Department of Revenue ("DOR") issued technical information release No. 2010-006 that clarifies that the legislation does not retroactively repeal the 2009 amendment. Thus, taxpayers that paid tax on the distributions from limited liability companies, partnerships, and associations with non-transferable shares for the 2009 tax period cannot claim a refund. Limited liability companies, partnerships, and associations with non-transferable shares will be subject to the tax for taxable periods ending on or after December 31, 2010, with respect to income from interest and dividends.

South Carolina Goes Off the TRAC

The South Carolina Taxation Realignment Commission ("TRAC") issued its sales and use tax draft report ("draft report") on June 28, 2010. The South Carolina General Assembly created TRAC to study the state's current tax structure and to make recommendations to change that structure.

Among other recommendations, TRAC proposes to expand the definition of tangible personal property to include data processing, electronically delivered software, and digital products. TRAC also proposes the repeal of a number of sales and use tax exemptions, including several exemptions related to transactions involving the generation or sale of electricity. Interestingly, South Carolina was one of the first states to publish guidance indicating that charges for access to software hosted by an application service provider were taxable. The draft report now recommends that South Carolina also tax software downloaded to a purchaser's computer. In addition, TRAC recommends taxing electronically transferred "digital products," which include downloadable items such as "digital audio-visual works" (movies), "digital audio works" (songs), and "digital books."

In addition to sales tax base expansion, the draft report includes two use tax nexus provisions. First, the draft report contains a "click-through" nexus rebuttable presumption similar to laws in New York, North Carolina, and Rhode Island. Under the proposal, an out-of-state retailer would be presumed to have South Carolina nexus sufficient to collect use tax if it has sales in South Carolina in excess of $10,000 and has a contractual agreement with a South Carolina resident to refer business to the out-of-state retailer. The presumption may be rebutted with proof that the resident did not engage in any solicitation in the state on behalf of the out-of-state retailer. The second provision adopts an affiliate nexus standard by imposing a use tax collection obligation on an out-of-state company that is affiliated with a company in South Carolina, if the in-state affiliate helps the out-of-state company maintain a market in the state.

Continued from Page 1

Totally Cool: Tennessee Class Action Lawsuit Smoked *(cont.)*

first reviewed Article I, Section 17 of the Tennessee Constitution, which provides that "[s]uits may be brought against the state in such manner and in such courts as the Legislature may by law direct." The court, citing prior case law, noted that this provision requires that any statute allowing for suits against the state must be strictly construed, and "suits for tax refunds are actually against the State and can be maintained only in the manner and upon the conditions consented to by the State."

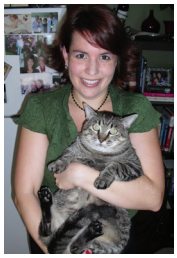
The Taxpayer Remedies Statute provides that "[t]he procedure established by this part is the sole and exclusive jurisdiction for determining liability for all taxes collected or administered by the commissioner of revenue." T.C.A. § 67-1-1804. Thus, by strictly construing the Taxpayer Remedies Statute as required by Article I, Section 17 of the Tennessee Constitution, the taxpayer is precluded from filing a class action because the law "simply does not contemplate maintenance of a generalized class action." Although this ruling appears to cover any type of tax collected and administered by the commissioner of revenue, its application to consumers collectively challenging a company's improper collection of sales and use taxes through a class action suit is unclear. Article I, Section 17 only restricts suits against the State, and thus a court may not "strictly construe" the law in a class action against a retailer. However, a court may, under this ruling, still require that plaintiffs in such an action follow the procedural requirements laid out in the Taxpayer Remedies Statute, which does not provide for class actions against any party.

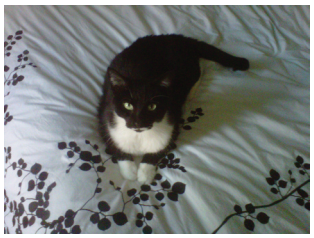
Valuation, Revaluation, and Ohio Property Tax

An Ohio Court of Appeals determined that a sale and repurchase of real property by the taxpayer did not reflect arm's-length pricing. In this case, *Wellington Square, LLC v. Auditor of Clark County*, 2010 Ohio 2928 (Ohio Ct. App. 2010), a County Board of Revision proposed to increase the valuation of the property after the local board of education filed a complaint requesting an increase in the valuation based upon two sales of the property. In valuing property, county auditors are statutorily required to decide the true value of property from the best information available. The auditor is only required to consider the sales price of a parcel to be the true value if the sale of the parcel was at arm's length between a willing seller and a willing buyer within a reasonable length of time. Although the parties involved in this case were found to be willing, the appeals court upheld the determination that the sales were not at arm's length because the property was not offered on the open market, and the taxpayer was not acting in its own financial self-interest in the sale and repurchase transactions. Once the trial court rejected the County Board of Revision's valuation, the trial court assigned a value to the property using the auditor's initial assessed value. Under an abuse of discretion standard, the appellate court upheld this valuation.

SALT PET(S) OF THE MONTH

Dylan and Skittles





Dylan and Skittles were rescued by Sutherland SALT Admin Extraordinaire, Becca Menso, in her college days – Dylan from an irresponsible roommate and Skittles from an irresponsible neighbor. All three being suburban Maryland natives (and Maryland Terrapin fans!), they recently made their big move to the Logan Circle neighborhood in the District of Columbia and are loving city life.

Dylan, lean and sleek, is the more curious of the two. His favorite activities include investigating strangers, hunting spiders, and drinking from the toilet on hot summer days. Dylan is content to watch television with Mom on the couch and is loyal beyond belief.

Skittles, chubby and hungry, is less active (not that Dylan is working hard…). He is excited that his new apartment does not have stairs. "Fat falls fast!" is his slogan. He enjoys hiding from guests and meowing loudly after a long day of sitting and staring out of the window. Skittles is also a sports fan and loves the Kitty Half-Time Show during the Puppy Bowl and is an expert at Ultimate Daydreaming.

Introduction of Federal Streamlined Sales Tax Legislation

On July 1, 2010, Representative Bill Delahunt (Mass.) introduced the Main Street Fairness Act (H.R. 5660) (the "Act"). As with prior versions of this federal streamlined sales tax legislation, the Act would negate, in some respects, the physical presence nexus standard articulated in *National Bellas Hess v. Department of Revenue of Illinois* and *Quill v. North Dakota*. Subject to certain requirements and limitations, the Act authorizes "member states" of the Streamlined Sales and Use Tax Agreement (the "Agreement") to impose a use tax collection obligation on remote sellers even though they have not established a physical presence. The Act is similar to previous versions of the federal streamlined sales tax legislation that have been introduced over the years, with two major exceptions noted below.

The Act incorporates provisions of the Agreement by requiring a state to adopt the simplification requirements established by the Agreement before the state is granted authority to impose a use tax collection obligation on non-physically present sellers. In addition to granting states the right to extend their sales and use tax collection obligations to non-physically present sellers, the Act would:

- Require the Agreement, the Streamlined Governing Board, and/or member states to meet three "authorization requirements" and meet 19 "minimum simplification requirements" in order for member states to retain the collection authority to collect sales tax on remote sales;
- Limit the grant of collection authority to sales and use taxes; member states cannot use the Act's principles to impose franchise taxes, income taxes, or licensing requirements on companies that do not otherwise have nexus; and

Continued on Page 4

Recently Seen and Heard

June 16, 2010
Sutherland Tax Education Series VIII
Sutherland Office – Atlanta, GA
Eric Tresh on Announcement 2010-9 and Schedule UTP - Requests for Tax Accrual Workpapers and the Reporting of Uncertain Tax Positions on Tax Returns
Diann Smith on Section 7701(o) – The Newly Codified Economic Substance Doctrine

June 17, 2010
COST Pacific Northwest Regional State Tax Seminar
Seattle, WA
Michele Borens, Jeff Friedman and **Steve Kranz** on Latest & Greatest State Tax Litigation
Steve Kranz on Digital Age SALT Issues – Applying Old Rules to New Technology
Michele Borens and **Jeff Friedman** on Evolving Combined Reporting Issues

June 21, 2010
Interstate Tax Corporation Interstate Tax Planning Conference
Jolly Madison Towers – New York, NY
Jeff Friedman on How the Interstate Tax System Works/Jurisdiction & Nexus and The Unitary Concept

June 27-30, 2010
IPT 34th Annual Conference
Marriott Desert Ridge – Phoenix, AZ
Steve Kranz on The Taxation of Digital Goods – Equality or Desperation
Marc Simonetti on Protecting FIN 48 Workpapers: Best Practices Following Textron

Wisconsin Court of Appeals Holds that Advertiser's Access to Wisconsin Population Is Income-Producing Activity

The Wisconsin Court of Appeals recently held that sales of telephone directory advertising by Ameritech Publishing, Inc. ("API") occurred in Wisconsin because Wisconsin is where advertisements reached their intended audience, regardless of where API's costs-of-performance were incurred. *AmeriTech Publishing, Inc. v. Wisconsin Dep't of Rev.*, No. 2009AP445 (Wis. Ct. App. June 24, 2010).

In this case, API maintained offices located in and outside Wisconsin where API sold local and national advertising in various telephone directories, including directories reaching Wisconsin residents. The Tax Appeals Commission concluded that the advertising was the sale of a service and would be sourced to Wisconsin because all the income from the performance of the services constituted income-producing activities in Wisconsin. Section 71.25(9) of the Wisconsin Statutes provides that sales of services and other non-tangible property performed both within and outside Wisconsin are subject to the costs-of-performance method of sourcing. API argued that the income-producing activity should be defined by its actual costs of performance. API performed a variety of activities ultimately leading up to the placement of the advertisement in the telephone directories, including solicitation and advertisement design – which occurred in and outside of Wisconsin. API argued that the Commission looked only to the last step in the process – the distribution of the advertising to the Wisconsin consumers – rather than to the location where API's costs were incurred in providing the advertising services.

The Wisconsin Court of Appeals held that access to Wisconsin residents was the primary income-producing activity that API offered to its customers. The Court stated: "API's customers may appreciate API's assistance in producing their advertisement(s), or in providing other services, but they pay for the unique access to a local market that advertising in its Ameritech Yellow Pages offers." Therefore, API's income-producing activity, defined as access to the Wisconsin population, occurred solely within Wisconsin. Contrary to Wisconsin law, the Court did not consider where API incurred its costs of performance.

Continued from Page 3

Introduction of Federal Streamlined Sales Tax Legislation *(cont.)*

- Provide for federal judicial review of certain disputes related to the Agreement.

The Act includes placeholders (i.e., does not address) instead of resolving the two most hotly debated issues recently confronting the Streamlined Governing Board, member states and the business community. First, a placeholder exists with respect to vendor compensation. Notably, the placeholder in the Act, as opposed to previous versions of the federal streamlined sales tax legislation, specifies that vendor compensation will be provided to "all sellers." Second, the Act includes a placeholder for simplification of taxes on communications services. In contrast to prior versions of the legislation, which included detailed requirements for the simplification of taxes on communications services, the Act simply states that state and local governments must simplify their sales and use taxes on communications services.

The Act's future is difficult to predict given competing business concerns and state and local government sovereignty issues. While congressional action is not likely until after the November election, it is possible that the Act could move forward before the end of the year – assuming that efforts to resolve the placeholder issues are able to produce consensus language. Finally, it is difficult to predict the effect of certain state sales and use tax collection practices, including Colorado's extensive information reporting and notice requirements on the states' support for Streamlined.

Multistate Tax Commission Update

Sales Tax

Project to Draft Model Sales and Use Tax Notice and Reporting Statute: On June 21, 2010, the Multistate Tax Commission's Sales & Use Tax Uniformity Subcommittee held a meeting by teleconference to continue its discussions on the Policy Checklist to be used to draft a proposed model sales tax notice and reporting statute. This project is intended to create a model statute similar to the notice and reporting regime recently adopted by Colorado. Colorado's regime, which is the subject of at least one lawsuit, requires vendors with no physical presence in a taxing state to provide notices to Colorado customers and the Department of Revenue, including a detailed description of purchasing history. The Policy Checklist that the Subcommittee is using to guide its drafting of the Model Statute is available at: http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Sales%20and%20Use%20Tax%20Reporting%20Policy%20Checklist%20_6-11-10_%20_2_.pdf.

Income and Franchise Tax

On June 22, 2010, the MTC's Income & Franchise Tax Uniformity Subcommittee held a meeting by teleconference to discuss several of the subcommittee's pending projects.

Project to Revise the Multistate Tax Compact Article IV.17 (Costs-of-Performance): The MTC seems bound and determined to eradicate sourcing based on costs of performance. The MTC is seeking to create a rule for receipts from services and intangible property that sources such receipts to the "market." States that have adopted market-based sourcing have defined market differently. In a bout of creativity that even Lady Gaga would envy, the MTC intends to source receipts from the sale of services to a state "if and to the extent the service is delivered to a location in [the] state." Notably, the proposal espouses a concept of market that no other state has adopted. And, the Subcommittee added that "if such location [the actual destination of the service] cannot be determined, then the delivery location should be 'reasonably approximated.'"

Project to Draft Model Mobile Workforce Statute: The MTC continued its belated efforts to stave off federal legislation to minimize the problems associated with employees working in several states and the differing requirements for withholding and personal income tax liability. The MTC proposal waters down the proposed federal legislation that has been extensively negotiated between the business community and the states by providing just a 20 workday threshold before both withholding and personal income tax liability applies. Dan Bucks, Director of the Montana Department of Revenue (and former MTC Executive Director), proposes that the Model only provide relief from withholding and not from tax liability – which is a sea change. Mr. Bucks explained that Montana is creating a computer program that will allow individuals traveling to Montana and other states to input the number of days they spend working in every applicable state and to receive an explanation of their state tax liability in each state.

43rd Annual Conference and Committee Meetings: The MTC is holding its Annual Conference and Committee Meetings July 25-29 in Hood River, Oregon. The agendas are available at http://www.mtc.gov/Events.aspx?id=4710. Interested members of the public who cannot attend in person can listen to or participate in the MTC committee meetings by teleconference; the dial-in information is available on the agenda for each meeting.

Corporate Officer Held Personally Liable for Bankrupt Corporation's Unpaid Sales Taxes

In an interesting twist on a run-of-the-mill case regarding the personal liability of a corporate officer for unremitted sales taxes, the New York State Division of Tax Appeals held an owner ("Petitioner") personally liable for sales tax even though the corporation was in Chapter 11 bankruptcy and was being run by a bankruptcy court-approved management company. *In re Eugene Dinino*, Docket Nos. 822605, 822606, 822607, 822608, 822609, 822610 (N.Y.S. Div. of Tax App. June 24, 2010). The threshold question reviewed by the administrative law judge ("ALJ") was whether the Petitioner had, or could have had, sufficient authority and control over the affairs of the corporation to be considered a person having a duty to collect and remit unpaid taxes.

During its bankruptcy, the corporation entered into an agreement with a third-party management company ("Manager"), giving the Manager complete and exclusive control over the daily management, finances, and operation of the corporation. The Manager was responsible for ensuring that the corporation paid all of its tax obligations. The Petitioner continued to receive a salary and retained certain rights to be involved in the operations of the corporation. The corporation retained the power to terminate the agreement if the Manager committed a material breach, and, as debtor in possession, the corporation remained a fiduciary of the estate.

A debtor in possession has the same duties as a trustee under section 1107 of the Bankruptcy Code, which include filing returns for pre-petition periods and filing returns and paying state and local tax liabilities for post-petitions periods on behalf of the debtor. The ALJ reasoned that these provisions effectively charged the corporation with the responsibility of filing sales tax returns for all periods after the bankruptcy petition was filed.

The ALJ found the Petitioner liable for the tax because the Petitioner was a corporate official who had a fiduciary responsibility and could not absolve himself by disregarding his duty and leaving it for someone else to do. His failure to inquire about the payment of taxes owed by the corporation was deemed unreasonable by the ALJ, and the Petitioner was consequently held personally liable for the unpaid taxes of the corporation.

California Amended Regulation Includes Independent Contractor Activities in Costs of Performance

Recent amendments to California regulation 18 CCR 25136, effective July 17, 2010, specifically provide for the inclusion of activities performed on behalf of a taxpayer by an independent contractor in determining the costs of performance for sourcing sales other than sales of tangible personal property. This amendment reflects the California Franchise Tax Board's view that the inclusion of independent contractor activities will result in a more accurate assignment of sales. These amendments are applicable to tax years beginning on or after January 1, 2008.

Currently in California, business income of multistate taxpayers is apportioned to California using a property, payroll, and double-weighted sales factor formula. Effective January 1, 2011, taxpayers may make an annual election to use a single sales factor apportionment formula; however, in November California voters will decide whether to repeal this single sales factor election as part of Proposition 24, the Repeal Corporate Tax Loopholes Act.

In determining the sales factor for sales other than sales of tangible personal property, when an income-producing activity is performed both inside and outside California, gross receipts are assigned to California if the greater costs of performance in connection with the income-producing activity are incurred in California compared to any other state. Prior to the amendments, California regulations defined "income producing activity" as transactions and activity *directly* engaged in by the taxpayer, and specifically stated that activities performed on behalf of a taxpayer by an independent contractor were not included. The amended regulation reverses this rule, allowing for activities performed on behalf of the taxpayer to be included when measuring costs of performance. The amendments also include the addition of examples to aid in determining where to assign activities performed on behalf of the taxpayer. These changes follow similar amendments made to the Multistate Tax Commission's model regulation.

Effective January 1, 2011, a change in California law will go into effect that effectively repeals costs-of-performance sourcing and replaces it with a market-based method. An interested parties meeting regarding the draft regulatory amendments instituting this change will be held on July 19.

Come See Us

July 11-14, 2010
Southeastern Association of Tax Administrators Annual Conference
Little Rock, AR
Steve Kranz moderating the Commissioner's Roundtable
Scott Wright on Questioning Authority: Presumptions in Property Tax Cases

July 12-16, 2010
TEI State & Local Tax Course
Indiana University/Purdue University Campus – Indianapolis, IN
Diann Smith and **Pilar Mata** on Introduction to State Franchise and New Worth Taxes; Managing Protests; and a Mock State Appellate Hearing

July 15, 2010
BNA Webinar
Steve Kranz on Colorado's Sales and Use Tax Reporting Requirements: A Model for Other States?

July 22-25, 2010
TEI 2010 Region VII Conference
Westin Hilton Head Resort – Hilton Head Island, SC
Jeff Friedman and **Eric Tresh** on State Tax Roundtable – Planning and Techniques

July 25-29, 2010
Multistate Tax Commission 43rd Annual Conference
Best Western Hood River Inn – Hood River, Oregon
Jeff Friedman on Transparency and State Tax Administration: What Taxpayer Information Is and Should be Transparent
Steve Kranz on Telecommunications Tax Reform

August 13, 2010
Manufacturers' Education Council 2010 Annual Ohio Tax Course
Granville, OH
Diann Smith on Major Trends & Multistate Tax Issues including Aggressive State Tax Actions

August 17, 2010
Stafford Webinar
Pilar Mata on Corporate Income Tax: Compiling and Maintaining Audit Files

September 23-25, 2010
ABA Section of Taxation Fall Meeting
Toronto, Canada
Steve Kranz on New Breed of Amazon "Taxes" – Colorado's Clever Twist

September 26-29, 2010
IPT Sales and Use Tax Symposium
Indian Wells, CA
Michele Borens on Join the Penny Pinchers – Learn How to Lower Your Tax Costs Through Proper Contracting Language
Steve Kranz on The Organized Chaos of State Tax Legislation

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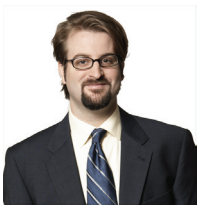

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