

# What the L?

Don't forget the L in SALT –  
Local tax issues

**PAUL J. HARTMAN**  
STATE AND LOCAL TAX FORUM

VANDERBILT UNIVERSITY LAW SCHOOL

**Eric M. Anderson**

Managing Director  
Andersen  
333 Bush Street, Suite 1700  
San Francisco, CA 94104  
[eric.m.anderson@Andersen.com](mailto:eric.m.anderson@Andersen.com)  
(Office) 415.764.2766  
(Mobile) 415.595.7842  
[Andersen.com](http://Andersen.com)

**Maria Eberle**

Partner, Tax  
Baker & McKenzie LLP  
452 Fifth Avenue  
New York, NY 10018  
United States  
Direct: 212 626 4414  
Direct Fax: 212 310 1728  
[maria.eberle@bakermckenzie.com](mailto:maria.eberle@bakermckenzie.com)

**Amy F. Nogid**

Alston & Bird LLP  
90 Park Avenue, New York, NY  
10016  
Email: [amy.nogid@alston.com](mailto:amy.nogid@alston.com)  
Direct: (212) 210-9413  
Mobile: (470) 316-8478

**Maria Todorova**

**Partner**  
Eversheds Sutherland (US) LLP  
999 Peachtree Street, NE,  
Suite 2300  
Atlanta, GA 30309-3996, US  
T: +1.404.853.8214  
C: +1.678.644.1383

# Agenda

- Overview of local taxes (other than sales taxes)
- Some quirky things about local taxes
- Authority to impose local taxes
- Some constitutional limitations applicable to local taxes
- Sampling of local taxes
- COVID-19 and local taxes
- Recent litigation regarding local taxes
- Local taxes: The Future

## Poll Question # 1

How much of your time in an average month do you spend on local tax issues?

- a) Most of my time
- b) About one quarter to one third
- c) As little as I can – state tax issues fill my days
- d) There are local taxes?

# Overview

- Local impositions include:
  - Sales taxes
  - Gross receipts taxes
  - Income taxes
  - Licensing taxes
  - Occupation taxes
  - Property taxes
  - Other taxes
- Local tax jurisdictions include:
  - Counties/Parishes
  - Cities/Municipalities
  - School Boards
  - Special Taxing Districts
- Local taxes can either be administered by states or the localities themselves

# Overview

- Local taxes are widespread
  - As of 2018, there were 19,495 incorporated cities, towns and villages in the United States.
    - Source: <https://worldpopulationreview.com/us-city-rankings/how-many-cities-are-in-the-us>
  - Reportedly
    - 57% of cities have a business tax based on economic activity
    - 11.2% of cities have a flat tax
    - 30.4% of cities have a tax on gross receipts
    - 20.1% of cities determine tax based on number of employees or payroll
    - 6.5% of cities impose a property tax on square footage
    - 3.9% of cities tax profits
    - Many cities impose taxes on multiple bases
      - Source: Charles Swenson, City Business Taxes: More than You Think, State Tax Notes Dec. 16, 2016 at 762

# Some Quirky Things About Local taxes

- Statute of limitations
- Time to appeal / protest
- Third-party contingent fee auditors
- No advance notice of tax law changes
- Separate registration for local taxes
- Successor liability / bulk sale reporting
- Tax incentives

# Authority to Impose

- Dillon's Rule v. Home Rule
  - Dillon's Rule provides that localities can only exercise those powers that are explicitly granted by the state or those powers that are necessarily implied to effectuate the express powers residing in the localities.
    - Based on two 1868 opinions written by Iowa Supreme Court Justice John Dillon.
  - Home Rule provisions authorize local governments to pass ordinances if they are consistent with state laws and the state constitution.
    - Authorization in state constitution (may require enabling legislation or be self-executing) or by statute, and may be restricted to jurisdictions of a particular size (e.g., cities with populations of 2,000+)
  - Some states apply both the Dillon's Rule and Home Rule

# Authority to Impose

- Tax vs. Fee
  - Tax vs. fee distinction can be critical in determining whether a particular charge will sustain constitutional scrutiny.
  - Several state constitutions impose supermajority or direct voting (i.e., ballot measure) requirements for new taxes, which may not apply to the enactment of fees.
  - Determination:
    - Taxes are means to raise money to be used for any appropriate governmental purpose.
    - Fees are imposed for a specific purpose, on persons or activities that receive a benefit.
    - Tax disguised as a fee may be outside the scope of the local government's authority.

# State Constitutional Limitations

- State constitutions may impose limits or prohibitions on local taxes:
  - Income tax prohibitions, e.g., Texas' Bullock Amendment (cannot tax net incomes of natural persons)
  - Occupation prohibitions
  - Limits on ability to expand tax base
  - Uniformity provisions
  - Voting requirements
  - Fair apportionment

# Sampling of Local Taxes

- Real estate transfer and mortgage recording taxes
  - Controlling interests transfer taxes
- Business taxes
- Unincorporated business taxes
- Occupation taxes
- Payroll taxes
- Commercial rent taxes
- “Sin” taxes, e.g., tobacco, soda and plastic bags
- Taxes and surcharges on CEO compensation

## Poll Question # 2

Which Local Jurisdiction has given you the most grief?

- a) The Big Apple is a big pain in the...
- b) A City in California
- c) A City in Colorado
- d) A Parish in Louisiana
- e) There are too many to choose from!

28th ANNUAL

PAUL J. HARTMAN  
STATE AND LOCAL TAX FORUM

VANDERBILT UNIVERSITY LAW SCHOOL

# Direct Taxes: Select Cities



## New York Unincorporated Business Tax

- “Unincorporated Businesses” include: trades, professions, and certain occupations of an individual, partnership, limited liability company, fiduciary, association, estate or trust
- Tax is 4% of net income allocated to the City
- Professional and other service organizations are large taxpayers: hedge funds, private equity, law firms, accounting firms, consulting firms, advertising agencies, and others



## NYC: Unincorporated Business Tax

- Allocation formula:
  - $\text{Services performed in NYC} / \text{Services performed everywhere} = \text{NYC allocation \%}$
- An estimated 2 million people commute into Manhattan every day
- Work performed at home in CT, NJ, Upstate, and Long Island is not work performed in NYC
- The City has provided no guidance related to telecommuting employees due to COVID



## San Francisco Business Tax

- Applies to all persons doing business in the City
- Three primary components:
  - Gross receipts tax depends upon NAICS category up to 0.65%
  - Homelessness gross receipts tax up to 0.69%
  - Payroll expense tax 0.38%
- The % of payroll in SF for most businesses used to determine half or all of the taxable gross receipts



## San Francisco Business Tax

- Payroll includes all W-2 compensation of employees plus “pass-through” compensation from flow-through entities
- Payroll allocation based upon:
  - **Percentage of working hours in San Francisco**
  - **Percentage of business transacted in San Francisco**
  - **Based upon a reasonable method given facts and circumstances**
- **No prescribed method to determine hours worked in San Francisco - audits are... inconsistent**



## Los Angeles Business Tax

- Applies to all persons doing business in the City
- Tax depends upon business activity up to .45% of gross receipts for “professions and occupations” businesses
- Taxable gross receipts measured by “work performed in the City”



## Los Angeles Business Tax

- Allocation provided by City Clerk Ruling No. 15
  - Receipts “directly attributable” to services
  - Allocation based upon cost
  - Default assumption that 20% of work performed outside of Los Angeles deemed gross receipts from within the City
- Little guidance on application of these rules but City has recognized pre-COVID telecommuting workers outside of Los Angeles may reduce the percentage of taxable gross receipts



## COVID-19 and State and Local Taxes

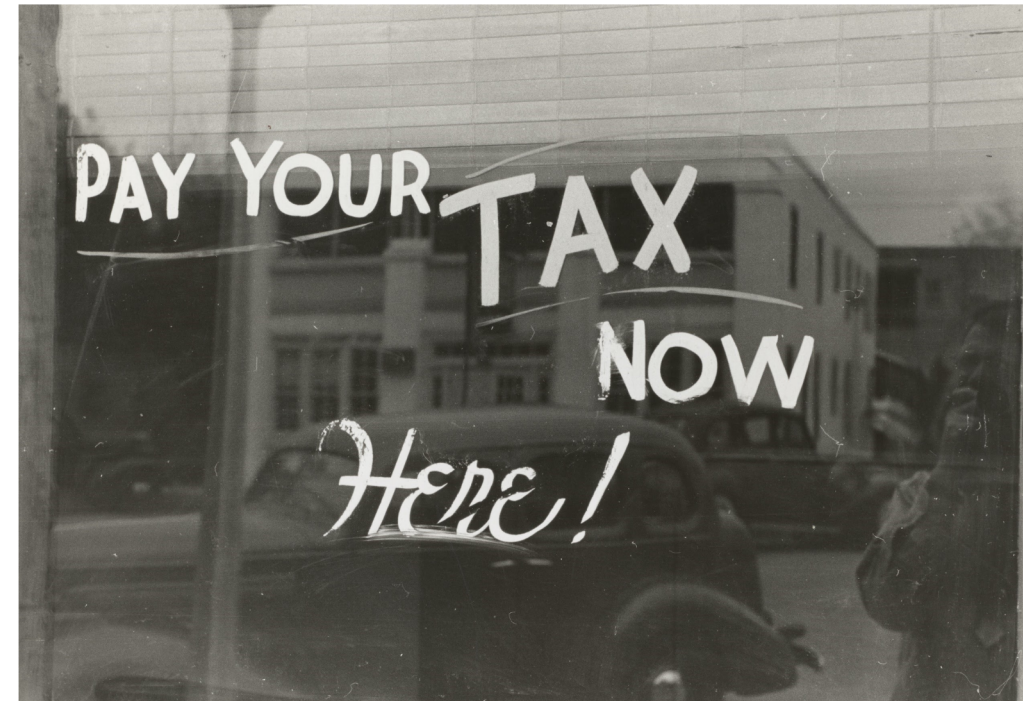
- Pandemic has had monstrous impact on State taxes, especially in major metropolitan areas
  - Residency issues: migration to Hamptons, CT, FL, NV etc.
  - Home office work: employee taxation and the “Convenience Rule”
  - And rates will likely go up
- Many local tax measures are based on where services are performed, including NYC’s Unincorporated Business Tax, SF’s Gross Receipt Tax and many others!
- How do we maximize tax savings?

# How Can Remote Work Save \$\$

	New York City	San Francisco	Total
Gross Receipts			200,000,000
Payroll Expenses	50,000,000	50,000,000	100,000,000
Other expenses	20,000,000	20,000,000	40,000,000
Net Income			60,000,000
Payroll %	50%	50%	
Tax			
UBT	1,200,000		
Payroll Expense		380,000	
Gross Receipts		555,650	
Total Tax	1,200,000	935,650	2,135,650
<hr/>			
Telecommuting Employees			Savings
20%	240,000	187,130	427,130
50%	600,000	467,825	1,067,825

## Other State and City Issues

- May consider impact in states and localities that apportion based upon where work performed
- Beware \$\$ grabs due to budget deficits - Philadelphia is considering temporary telecommuting employees as performing services in the City if the primary work location is in the City
- Substantiation may be the key to determining and realizing tax benefits



## COVID-19 and Local Tax Litigation

- The Ohio Municipal Income Tax Trilogy
  - Background: 20-Day Rule and HB 197, Section 29
  - *Morsy v. Dumas [City of Cleveland]* (and others)
  - HB 110 “fix”
- *Boles, et al v. City of St. Louis*
  - St. Louis issued Covid-19 guidance that provides days worked outside the city while teleworking will be deemed worked at the nonresident employees’ primary work location within the city
  - Failed legislation, SB 604 and HB 688, would have prohibited cities from taxing remote workers

# Local Tax Litigation

VANDERBILT UNIVERSITY LAW SCHOOL

- *Mack-Cali Realty Corp. v. N.J.*, 466 N.J. Super. 402 (N.J. Super. Ct. 2021)
  - Businesses and trade associations challenged Jersey City’s adoption of ordinance “to establish a payroll tax on the payrolls of Non-Jersey City residents for the benefit of Jersey City schools.” Court held that the ordinance violated the Dormant Commerce Clause; remanded to determine remedy.

# Local Tax Litigation

VANDERBILT UNIVERSITY LAW SCHOOL

- *City of Athens v. McClain*, 163 Ohio St. 3d 61 (2020)
  - Cities and villages that impose net-profits tax challenged enactment of law to centralize collection and administration of those taxes by the state and retention of 0.5% of the tax by the state.
  - Ohio Supreme Court held that it was within the legislature's constitutional authority to provide for the centralized administration of the tax, but the state's retention of 0.5% of the tax "cannot be seen as a legitimate exercise of the General Assembly's power to limit or restrict municipal taxation."

# Local Tax Litigation

VANDERBILT UNIVERSITY LAW SCHOOL

- *Apex Laboratories International, Inc. v. City of Detroit*, No. 338218, 2020 WL 34298 (Mich. Ct. App. Jan. 2, 2020)
  - The Michigan Court of Appeals remanded a case on whether Detroit may impose its income tax on an out of state taxpayer, in light of the US Supreme Court’s *Wayfair* ruling.
  - The Michigan Court of Appeals previously upheld the Tax Tribunal’s decision that the taxpayer lacked sufficient nexus with Detroit to be subject to its income tax because the taxpayer did not have a physical presence in Detroit and therefore was not doing business within the City.
  - On appeal, the Michigan Supreme Court remanded the case back to the Court of Appeals in light of *Wayfair*.
  - The Court of Appeals declined to rule and further remanded the case to the Tax Tribunal. On remand, the Tax Tribunal will consider whether to extend the US Supreme Court’s decision in *Wayfair* beyond sales and use tax.

# Local Tax Litigation

VANDERBILT UNIVERSITY LAW SCHOOL

- *Saban Rent-a-Car LLC v. Arizona Dep't of Revenue*, 434 P.3d 1168 (Ariz. 2019) (U.S. Supreme Court denied certiorari)
  - Maricopa County imposes a surcharge on car rental agencies to fund a stadium and other sports and tourism-related ventures.
    - The Arizona Supreme Court held that the surcharge did not violate the dormant Commerce Clause or the anti-diversion provision of the Arizona Constitution.
    - Remanded to Tax Court to enter summary judgment for DOR
  - Commerce Clause: The court found no discriminatory intent against out-of-staters despite them paying most of the surcharges.
  - Anti-Diversion Provision: The provision limits tax revenues related to the use or operation of vehicles on roads to only highway and street purposes. But the court held that the provision does not apply to the surcharge on car rental agencies.

# Local Tax Litigation

- *Honigman Miller Schwartz and Cohn LLP v. City of Detroit*, No. 157522 (Mich. May 18, 2020)
  - The Michigan Supreme Court ruled in favor of the city of Detroit in holding that, for purposes of the Uniform City Income Tax, revenue for services rendered in the city should be calculated on the basis of where the services are performed, not on where the client that received those services is located.
  - The Michigan Supreme Court's opinion reversed the Court of Appeal's published opinion from January of 2018, which had ruled in favor of the Honigman law firm (taxpayer).

# Local Tax Litigation

- *Expansion of Utility Users Taxes in California*
  - The City of Los Angeles claims its communications user tax, imposed on utility services, applies to communications providers' leases of equipment.

# Local Tax Litigation

VANDERBILT UNIVERSITY LAW SCHOOL

- *Local taxes on unapportioned gross receipts*
  - Class action lawsuits alleging that local taxes apply to unapportioned gross receipts (MO, GA, IN, TX, MS)
  - *Upper Moreland Township v. 7-Eleven Inc.*, 160 A.3d 921 (Pa. Commw. Ct. 2017)
    - The Pennsylvania Commonwealth Court held that the township's application of its local privilege tax on 100% of 7-Eleven's receipts from franchise stores in the state violated the fair apportionment prong (i.e., external consistency) of the *Complete Auto* test
  - *Shell Energy North America (US) LP v. Pennsylvania Dep't of Revenue*, 1814772 (BF&R 2020)
    - The BF&R ruled that proceeds from sales of electricity to customers located outside Pennsylvania for resale were not subject to the gross receipts tax because those sales do not have nexus with the state.

# Local Tax Litigation

VANDERBILT UNIVERSITY LAW SCHOOL

- Four Virginia circuit courts concluded that ITFA prohibits the imposition of the local business, professional, and occupational license (“BPOL”) tax on receipts from Internet access.
  - *Fairfax County, et. al v. Coxcom, LLC*, CL-2019-5800 (Fairfax Cir. Ct. Feb. 14, 2020); *Mugler v. Cellco Partnership*, CL 18-1409 (Hampton Cir. Ct. Jul. 13, 2020); *Cox Communications Hampton Roads LLC v. Norfolk*, CL19-4764 (Norfolk Cir. Ct. Aug. 3, 2020); *Cox Communications Hampton Roads LLC v. King*, CL19-3711 (Chesapeake Cir. Ct. Aug. 14, 2020).

# Local Tax Litigation

VANDERBILT UNIVERSITY LAW SCHOOL

- *Clear Channel Outdoor LLC v. Raymond*, Md. Ct. App No. 9 (Mar. 15, 2021)
  - In March 2021, Maryland’s highest court rejected Clear Channel’s constitutional challenge of a City of Baltimore billboard tax on First Amendment grounds. “[D]ifferential taxation of media is subject to heightened scrutiny under the First Amendment when a tax suppresses or threatens to suppress particular ideas or viewpoints by (1) singling out the press, (2) targeting a small group of speakers, or (3) discriminating on the basis of the content of taxpayer speech. The Ordinance at issue in this case does not do so and thus is not subject to heightened scrutiny under the First Amendment.”
  - Clear Channel is currently seeking cert for SCOTUS to review Maryland’s highest court’s decision.
  - Most recently, on September 16, 2021, the Ohio Supreme Court came out the opposite way and struck down a similar Cincinnati billboard tax on the basis that it infringed on First Amendment rights to free speech and a free press. *Lamar Advantage GP Co. LLC v. Cincinnati*, Slip Op. No. 2021-Ohio-3155 (Ohio S.Ct. Sept. 16, 2021).

# Local Tax Litigation

VANDERBILT UNIVERSITY LAW SCHOOL

- *Wendella Sightseeing Co. v. City of Chicago*, Cook Cty. Cir. Ct. No. 19 CH 03022 (June 24, 2021)
  - Wendella operates boat tours on the Chicago River and Lake Michigan. Chicago had previously attempted to levy its Amusement Tax on Wendella’s business, but the Illinois Appellate Court upheld that this tax was pre-empted by the Maritime Transportation Security Act of 2002 (33 U.S.C. s. 5(b)), which prohibits taxes on “any vessel or water craft” or on “its passengers or crew.”
  - Chicago then created a new “Tour Boat Operator Tax” that it claimed did not impose a tax on vessels directly, but on “tour boat operators,” i.e., a tax on the business itself, not the boats. Wendella filed a complaint against the new tax, seeking a declaratory judgment that the new tax was unenforceable on the same federal preemption grounds.
  - The Cook County Circuit Court held for Wendella, stating that a tax on the “representatives” of the vessel was equally prohibited and preempted as a tax on the vessel itself. Nevertheless, slightly different taxes (mostly general business taxes and landing fees) on boat operators have been successful in Hawaii, California, and New York.

# The Future

- Expansion of local taxation due to revenue needs and desire for some autonomy
- “Netflix” and new technology taxes
- Imposition of additional “sin” taxes



Questions????

28th ANNUAL

# PAUL J. HARTMAN

STATE AND LOCAL TAX FORUM

VANDERBILT UNIVERSITY LAW SCHOOL

