30th ANNUAL
PAUL J. HARTMAN
STATE AND LOCAL TAX FORUM

Here a Local Tax – There a Local Tax – Everywhere a Local Tax!

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Agenda

- Local Tax Basics
- Nexus Considerations
- Case Law Developments
- Specific Local Tax Considerations
- Benefits and Burdens

Local Tax Basics

Local Tax Basics

- How many localities across the U.S. impose some type of tax on companies?
- What types of taxes are imposed by localities?
- What is the nexus standard for these taxes?
- How do these localities enforce compliance?
- How do companies effectively deal with all these taxes and their various complexities?

Local Tax Basics, cont.

- Types of taxes imposed by localities may include:
  - Income taxes
  - Gross receipts taxes
  - Licensing taxes
  - Occupation taxes
  - Sales taxes
  - Property taxes
  - Transfer taxes
  - Others
- Type of localities that impose taxes may include:
  - Cities and municipalities
  - Counties and parishes
  - School board
  - Special taxing districts

Local Tax Basics, cont.

- Issues:
  - Statute of limitations
  - Time to appeal / protest
  - Third-party contingent fee auditors
  - No advance notice of tax law changes
  - Availability of information
  - Difficulties with administration of taxes

Nexus Considerations

Nexus Considerations

- Physical presence versus economic nexus
- Hybrid/remote workers
- P.L. 86-272 considerations
- Entity classification
- Sourcing
- Recent developments

Case Law Developments

Lakewood, Colorado – Nexus

Wayfair LLC v. City of Lakewood et al., No. 2022CV30710 (Jefferson County Dist. Ct., Aug. 5, 2022)

- The City of Lakewood issued a notice of deficiency for sales tax to Wayfair LLC.
- The City rules required out-of-state businesses that exceeded economic nexus thresholds to register in the City.
- Wayfair LLC asserted that the City was requiring out-of-state sellers to register in circumstances where in-state businesses did not have the same obligation.
- Wayfair LLC also asserted that the State's decentralized sales tax system unconstitutionally violated the company's right to engage in interstate commerce, a direct violation of the Commerce Clause of the United States, by creating a burden on out-of-state sellers.
- Colorado's sales tax reporting requirements are more complex than just about any other state's due to the fact that about half of Colorado's cities are "home rule" cities which oftentimes require separate sales tax permits, and sales tax filings, in each local jurisdiction.
- This means that online retailers that have sales tax nexus in Colorado could be subject to filing hundreds of pages of sales tax returns each month in order to stay compliant.
- The 2018 *Wayfair* ruling allows states to impose economic nexus as long as it does not discriminate against out-of-state sellers, or cause an undue burden on taxpayers.
- This case is currently pending.

Detroit, Michigan – Nexus

Apex Laboratories International Inc. v. City of Detroit, Dkt. No. 16-000724-R (Mich. Tax Trib., Aug. 19, 2022)

- On remand from the Michigan Court of Appeals, the Michigan Tax Tribunal found that the taxpayer did not have nexus with the City of Detroit and was not required to pay City Income Tax for the 2010 and 2012 tax years.
- The Tribunal was directed to determine whether the U.S. Supreme Court's decision in *Wayfair* would have changed the result of the Tribunal's previous determination that was decided prior to *Wayfair* and was based on the "physical presence" standard enunciated in *Quill*.
- The Tribunal noted that in the wake of *Wayfair*, while physical presence nexus is still good law, the U.S. Supreme Court ruled that a business could acquire an economic nexus regardless of where the business, employees or warehouses are located. If the sales or "economic activity" in that particular state are substantial enough, tax liability would ensue.
- In the case at hand, the Tribunal found that the taxpayer's activities as a passive holding company were by design minimal.
- The Tribunal rejected the City's reliance on both the "commercial domicile" concept as well as finding that the City's reliance on the unitary business concept was misplaced as the City Income Tax does not include that concept, nor is there any language that would allow a unitary business to create a nexus link to a corporation.
- The City has filed an appeal in the Michigan Court of Appeals.

Fairfax County, Virginia – ITFA

Coxcom, LLC v. Fairfax County, et al., Dkt. No. 210568 (Va. S. Ct., July 14, 2022)

- Coxcom, L.L.C. ("Cox") sought a refund of the Fairfax County Business and Professional Occupational License ("BPOL"), arguing that the Internet Tax Freedom Act ("IFTA") preempted the County from collecting tax on the sale of internet access services.
- The IFTA prohibits state and local taxes on internet access services.
- The Circuit Court held for the County, concluding that the IFTA's grandfather clause permitted the imposition of the tax.
- The grandfather clause permitted taxes (authorized by statute) on internet access services where service providers "had a reasonable opportunity to know, by virtue of a rule or other public proclamation made by the appropriate administrative agency of the State or political subdivision thereof, that such agency has interpreted and applied such tax to Internet access services."
- The County argued that the publishing of the ordinance itself satisfied this requirement.
- The Virginia Supreme Court disagreed, holding that the Department of Tax Administration, not the County or Board of Supervisors of Fairfax County, was the appropriate administrative agency.
- Further, the Court held that the ordinance's publication alone does not satisfy the County's notice requirement because the ordinance did not clearly state that the BPOL tax would apply to internet access services like those provided by Cox.

Seattle, Washington – Payroll Tax

Greater Seattle Chamber of Commerce v. Seattle, No. 20-2-17576-5 SEA (Wash. Sup. Ct., June 7, 2021), (No. 82830-4-1, June 21, 2022)

- On July 6, 2020, the City of Seattle passed Ordinance No. 126108, imposing a payroll expense tax applicable to certain entities engaging in business within Seattle.
- The tax is based on compensation paid to employees in Seattle.
  - Businesses with payroll expense in the prior calendar year of less than $7 million – as well as a variety of specifically-named types of businesses – are exempt.
- In response to the ordinance, the Seattle Chamber brought an action in court alleging the tax violated the state constitution.
- The City asserted that the payroll expense tax is a constitutionally permissible excise tax on the privilege of doing business, while the Seattle Chamber argued that the tax is a tax on employers' payment of compensation to employees and was, therefore, an impermissible tax on an employee's act of earning a living.
- Highlighting the facts that the tax is levied on businesses based on their aggregate payroll expense and businesses are expressly prohibited from passing the expense of the tax on to employees in the form of wage deductions, the Superior Court of Washington for King County concluded that there is no burden on employees.
- Accordingly, the Court granted the City's motion for summary judgment, ruling as a matter of law that the City's payroll expense tax is a valid excise tax on business under the taxing authority granted to cities by the Washington State Constitution and statutes.
- On June 17, 2021, the Washington State Court of Appeals upheld the tax, concluding that the tax is an excise tax that is within the City's power to impose.

St. James, Louisiana – Procedure

Nucor Steel La., LLC v. St. James Parish School Board, et al. (La. S. Ct., 2022)

- Louisiana law provides that if a locality fails to act on a refund claim, an appeal is time-barred if not filed within 18 months of the date of the refund claim.
- The locality acknowledged the refund claim, requested additional information, entered into prescription suspension agreements, and represented to the company that it could appeal the refund denial within 90 days of the notice of denial.
- The lower court rejected the locality's argument that the appeal was time-barred finding that it acted on the refund claim during that timeframe by conducting a "thorough and extensive investigation" of the refund claim, and the company's appeal was filed within 90 days of the locality's notice of refund claim denial.
- The Louisiana Supreme Court held that the *act* required of the collector is to "render a decision" and "mail a notice of disallowance."
- Because the collector did not act within one year of the claim, the 180-day appeal period commenced on the 1-year anniversary of the filing. As the taxpayer appealed to the BTA ten months later, it was untimely.

Specific Local Tax Issues/Considerations

San Francisco

- In 2012, San Francisco voters passed Proposition E which was intended to replace the payroll expense tax with a gross receipts tax
- Beginning in 2013, the gross receipts tax was phased in (10% in 2013, 25% in 2014, 50% in 2016, 75% in 2017, and 100% in 2018) while the payroll expense tax was phased out
- Beginning in 2019, San Francisco added the Homelessness Gross Receipts Tax which effectively doubles the tax rate in the city
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San Francisco, cont.

- The gross receipts tax is imposed on every “person” “engaging in business within the City”
  - San Francisco Business and Tax Regulations Code Sections 6.2-15, 6.2-12
- “Engaging in business in the within the City” is very broad
  - For example, a company meets this definition if one or more of the person’s employees or representatives performs work or renders services in the city for all or part of any seven days during a tax year
- Companies that file combined returns for California purposes, must file a combined City return as well

San Francisco, cont.

- The gross receipts tax is measured by the person's "gross receipts from all taxable business activities attributable to the City." Section 953
- The amount of receipts attributable to the City is calculated differently, depending on what kind of business is being operated
- The kind of business is determined based on the North American Industry Classification System ("NAICS") code for that business

San Francisco, cont.

- For each category, the amount of gross receipts attributable to the City is determined using an apportionment, allocation, or combined method
- Apportionment:
  - Gross Receipts x (Employees of the Combined Group in SF/Total World-Wide or Waters-Edge Employees of the Combined Group) = Apportioned Gross Receipts
    - Section 956.2
- Allocation:
  - Direct sales in the City, or property located in the City
    - Section 956.1
- As if that was not confusing enough, there are separate tax rates for each category, and those rates are graduated

San Francisco, cont.

Administrative Office Tax

- Imposed on any company engaging in business within the City as an “administrative office” in lieu of the gross receipts tax. Section 953.8
- “Administrative Office” means:
  - 50% of total combined payroll expense in the City associated with providing administrative or management services
  - More than 1000 employees in the US
  - Total US gross receipts of more than $1 billion

San Francisco, cont.

Overpaid Executive Tax (also referred to as the Overpaid Executive Gross Receipts Tax)

- Approved by San Francisco voters on November 3, 2020 and became effective on January 1, 2022.
- Generally, imposes an additional gross receipts tax on taxable gross receipts from businesses in which the highest-paid managerial employee, within or outside of San Francisco, earns more than 100 times the median compensation of employees based in San Francisco.

San Francisco, cont.

Issues to Keep in Mind

- NAICS Classification Issues
  - Are you properly classified? Will the City agree?
- Combined Return Issues
  - Do you have a small presence in the City but large gross receipts that may be pulled into the City under the rules?
- Proper Apportionment Calculation
  - Are you calculating using the proper payroll fact? Are you properly accounting for all employee activity in the City?
- Constitutional Concerns
  - Is this scheme constitutional?

California: Local Streaming Taxes

- Application of utility users taxes to streaming services?
- Prior Attempts
  - Pasadena’s “Netflix Tax” (2016)
  - MuniServices draft “ruling” (2016)
- Union City’s New UUT
  - Measure WW – 5% UUT on electricity, gas, video and telecom services
  - Passed in 2020 with 57% of the vote

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California: Utility Users Taxes

- More and more localities applying a broad reading of UUT ordinances
- “Integrated” services?
  - Stockton Mun. Code § 3.100.020
    - “Telecommunications service” includes “video and/or data services that are functionally integrated with ‘telecommunication services.’”
    - “Video services” includes services “that are functionally integrated with ‘video services.’”
  - Security services? Anything using the Internet?

California: Utility Users Taxes

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    - “Video services” includes services “that are functionally integrated with ‘video services.’”
  - Security services? Anything using the Internet?
- “Ancillary” services?
  - San Fran. Bus. & Tax Reg. Code Art. 10 § 701(a):

    “Ancillary Telephone Communications Services” means “services associated with or incidental to the provision, use or enjoyment of telephone communications services”
- Software? Anything related to text messaging?

Tennessee Business Tax

- Tennessee imposes a gross receipts tax known as the business tax.
- The business tax has a state component and a local component.
- Activities subject to the business tax
  - Sales of tangible personal property and sales of services
- Business location
  - Establishing a business location in the state
  - Tax imposed twice if sourced to location in the state
- Sourcing of receipts for purposes of the business tax
  - Where product or service is delivered
- Limited exemptions

Portland, Oregon Local Taxes

- The City of Portland Revenue Division administers three local income taxes:
  - Metro Supportive Housing Services (SHS) Business Income Tax
  - Multnomah County Business Income Tax
  - City of Portland Business License Tax, which includes Portland Business License Tax is the Clean Energy Surcharge
- Considerations
  - Compliance issues
  - Sourcing
  - Appeals (Oregon Tax Court hears appeals after administrative process is exhausted)

Benefits and Burdens

Benefits and Burdens

- Potential benefits
  - Entity level filings
  - Sourcing
  - Supporting local community
- Potential burdens
  - Separate registrations, payments, and returns in each locality
  - Differing laws, rates, and deadlines in each locality
  - Audit issues
  - Impact of noncompliance

Questions?

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