

CCH State Tax Advisory Board**Board Discusses Tax Incentives, Developments in the Legislatures and Courts, Jobs Act Conformity, the SSTP, and More at 2005 Roundtable**

Cronin: Bruce has an interesting announcement for everybody, assuming you're ready to make it.

New MTC Director

Johnson: I certainly am. First of all, I'd like to take this opportunity to express appreciation to Dan Bucks for his excellent service over 17 years as the Executive Director of the Multistate Tax Commission [MTC]. As I'm sure you all know, he resigned at the end of last year to take over a position at the Montana Department of Revenue. He was indefatigable in defending states' rights and was a worthy adversary to many of you, and I'm sure he'll continue to aggressively defend the rights of the states in his new role in Montana and we look forward to his continued association at the Multistate Tax Commission in that role.

We also have a new Executive Director, Joe Huddleston, former head of the Department of Revenue in Tennessee. He'll be starting August 1, and we're very excited about moving forward with Joe. We will also be changing the chair and Joan Wagnon of Kansas will be assuming the chair role at MTC after our annual meeting in July.

Cronin: Joe's a wonderful man, always enjoyed being with him. He's very personable and I certainly wish him well. I think it's important to have a strong Multistate Tax Commission that presents the opposite view on a lot of these issues. It's a healthy thing and I think Joe will do that well, if not better, than anybody I know.

State Revenues

Cronin: I noticed an article just within the last week or so in *The Wall Street Journal* about unprecedented escalations in state revenue, whereas a year or two ago, we had budget shortfalls. Any comments?

Duncan: Revenues have shown some surprising strength recently—April and May have been very good months. It's just because of the time of the year, but most of the strength has been in individual income tax and the final payments that came in with returns. We had about 20 states respond to a survey. The increase in payments with returns averaged about 30% above the year prior. Estimated payments for first quarter are up by about 20%.

It's hard to know what's causing it. You had some appreciation in the stock market. Of course, the housing market has done very well and there are some people cashing that out. The other thing that could be influencing it is that people have used up losses from the 2001-2002 time frame.

What states need to avoid is doing what they did a little bit in the late '90s—considering that they're going to get that sizable a bump every year. So, I think you'll see a lot of people be very cautious with it.

The other thing is that corporate income tax remains strong. It will be interesting to watch. Normally, profits run well when you come out of a recession, with the cost-cutting and the like, but there hasn't been a lot of business investment recently. We're starting to see investment and employment growth. So, then, does that kick in incentives and begin to reduce the corporate liabilities in future years?

Property tax assessments are going up and there are any number of states in which there are proposals to cap the assessment increase or roll it back. There's an editorial in *The Wall Street Journal* today about representatives of 20 states who are trying to pass a TABOR-like bill, a revenue and expenditure cap, like the one in Colorado.

Tatarowicz: What about rainy day funds, Harley? Given that we just came through this period, are states going to try to put a little bit more away this time rebuilding those funds?

Duncan: I think you'll see them try to rebuild. We had a piece at our annual meeting the other day where, at the end of this year even with the bumps and the like, they will be at about half the level they were in 2001. I think the lesson we've learned on rainy day funds is, you need them, but you can never have them big enough. You just can't overtax enough to put it away such that it would really ease the pressure of a large shortfall.

The other thing out there is that you get all sorts of expenditure pressures. Pressure for increased education and Medicaid spending are incredibly intense right now. Revenue growth is strong. But it's not easy to make a budget yet, because there are a number of expenditure demands and we're still paying for some of those one-time maneuvers that we used. Illinois is going to have to contribute to their pension fund sometime, presumably.

Cronin: Part of it also, I think, is the way government is accounting for things. They obviously don't account for things the way businesses do and I've always thought that's a problem.

Tatarowicz: One thing I hope that does happen though—once this pendulum swings back a little bit and the pressure is off—I hope that we reduce the rhetoric that has existed between the state departments of revenue and corporate taxpayers. The [2003] MTC study that came out about corporate tax shelters was more inflammatory than it needed to be at that time.

I hope we achieve a new balance and approach these things with a little bit more thoughtfulness, rather than with a

visceral reaction. Maybe that visceral reaction came out of a lot of frustration. But it just seems to me that over the last two or three years—with the corporate tax shelter regimes that have come up and states pointing fingers at corporate taxpayers claiming they aren't paying their fair share—I hope that some of that gets scaled back and we can go back to having a good healthy respect for one another.

Gillis: Harley, it looked like on the Rockefeller Institute numbers that corporate income tax revenues have risen basically double-digit every quarter year-over-year for the last ten quarters now.

Duncan: That's about right.

Gillis: Can you address why we're seeing more states go to alternative minimum assessments either in proposed legislation or in passed legislation?

Cronin: You mean similar to New Jersey?

Gillis: Based on gross receipts, right, or gross profits, depending on how they're structured.

Duncan: I think there's probably three policy reasons the states are doing it. One is to add stability to that particular source of revenue. While it's not large in the overall scheme of things, it is particularly volatile. If you go back and you look at when revenues came in short in 2001 and 2002, corporate tax preceded the slowdown in individual and sales by about a year, and at the trough it was 30% below the previous year. Even if it's 7%, 8%, 9% of your revenues, if it's dropping by 30% and everything else is slow, you want to improve the stability of that, because it really causes budgetary difficulty.

The second reason, I think, that you're seeing the alternative minimum assessment approach is really a "fairness argument," and you can put that in quotes if you'd like. But when you look at the numbers in the corporate tax you will find that certain sectors pay quite a high corporate tax burden and other sectors pay very little corporate tax burden. We just had some electronic conversation going on

among research people about what's the proportion of your corporate taxpayer population that pays zero, or whatever the minimum tax is, and it's like 70-75% on average that are paying zero. Now, there are reasons for some of that, but there's this fairness issue that's out there.

Then I think the third policy argument is that some of the approaches, particularly the add-back legislation and the like, are addressed at what is perceived to be abusive or aggressive use of a tax planning technique that ends up with an inappropriate result, and that is a retail sector that is making significant sales with zero liability in a state.

They take a look at these three things and they say, "We need to do something to shore up this tax and broaden it." So they do addbacks or the alternative minimum assessment in New Jersey and Kentucky. Ohio has another approach.

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There's also another feature of it. In some cases, states are, at the same time, trying to bring down the rate. Pennsylvania and Ohio are trying to phase the thing out entirely. Kentucky is bringing down their rate. But they're trying to figure out something that is not net income, so you can address those three objectives and end up with a better tax that's just more stable in your system.

Rosen: The fairness issue I find troubling to some extent. Remember that corporations pay a lot of other taxes—property taxes, for example, or they help with withholding taxes. Obviously, they pay a huge amount of sales and use taxes on their own consumption and on much of their asset base. To focus on the income tax only, which is supposed to be based on income—the success of a business—and saying it's unfair because companies that are not profitable aren't paying tax on profit, seems to be a *non sequitur*.

It seems to me that this whole idea—of the unfairness of corporations that aren't making profit not paying tax—is based on state legislative activity, which really is not right. It reminds me of the reason, sorry to be philosophical, that we don't have a democracy in this country. I think the Founding Fathers learned that pure democracy doesn't work. You get very political, very emotional responses. That's why we have a representative democracy in our country. We have people who are leaders and people who think and are rational in making the ultimate decisions on what laws are enacted.

A pure democracy is very scary when people just react instead of thinking things through on a rational basis. I think we'll talk about this a little bit later in the agenda, but maybe that's why so many parties are turning to the federal government. I think they have more faith in Congress to make sure things are done in a better, more rational way than is being done by some of the state lawmakers.

Frankel: Did you just arrive in this country?

Gall: I think he's running for office. [Laughter]

Frankel: Harley, our property taxes are soaring. Is there any hope of a California Prop 13 enactment around the country to stop rising taxes?

Duncan: I would certainly hope not. This idea of capping assessments is just an awful one in my estimation. The minute you do that, and then you begin to catch up with that assessment on transfer, you lose any semblance of equity in the property tax. We've got to be smarter than that and figure out a way to get relief to those that need it. There are a variety of things that can be done.

My local friends wouldn't like this, but I think states could impose some restrictions on local governments in terms of assessments. If you're going to exceed a constant yield levy, you've got to have public hearings and those sorts of things. I think we could use circuit breakers; New Jersey is doing this. It's not really much graduated by income

but you can graduate it by income. I would hope we don't get into a Prop 13 arrangement where we start messing with the base because the property tax is supposed to be a wealth tax and if you don't have a common base that measures it the same, you're just going to lose the basics of the tax.

Cronin: I happen to agree with you, at least in terms of California. But if you look around the country—New York State, New York City is very much a classified system. What is it, 30 different classifications in Minnesota? And in Pennsylvania they're talking about going to locally driven income taxes. Give me a break! I think you'd want to wake up in the morning and shoot yourself if you had to deal with something like that. Can you imagine that? Dealing with 70 different jurisdictions?

Duncan: My hands aren't clean in the classified property tax, but I think you need to be concerned about the base. One thing we need to do is look at the structure and numbers of local governments and what they have to do when they set the tax rate. A second thing is we could start pumping some more state money in where you've got it from more acceptable bases and buy down that property tax. Then we would be better off.

Cronin: I think that's what is going to happen in New Jersey. Not sure where they get the revenue from.

Tatarowicz: Going back to Harley's response to Tim's question why more of these alternative minimum tax structures are coming up, John Shannon at the ACIR [Advisory Commission on Intergovernmental Relations] gives the best explanation I have heard in terms of why this is a problem that's never going to be solved in our lifetime. John analogized it to asking the question: Why were there so many heroes at the Alamo? The reason: There was no back door. At the federal level, you've got the power of turning on the press. You can print more money. You can hedge this matching of expenses with revenues and all the other things.

What I find curious though, Harley, is—I heard your explanation and I agree that's the traditional line of thinking. Those were probably the three most salient points that Michigan advanced when they abandoned their income tax and went with their SBT [Single Business Tax]. Now they're backpedaling again, going back to the income tax. I'm not sure where the answer is.

It's unfortunate, though, because it seems that economic theory is virtually unanimous—I'm not sure if I've seen anything that would disagree with it—that gross receipts taxes typically are terrible. They don't match to those that have the ability to pay. Absent a group reporting mechanism, they can result in the pyramiding of taxes and, thus, may force integration of vertically separated entities to avoid multiplication of taxes. Yet here we are going back to what, probably from economic theory, many would agree is less than the "ideal" type of tax.

Congress has the power to clear up this area. A bill has been introduced into Congress and it has widespread support.

Cuno and Tax Incentives

Cronin: Let's talk about *Cuno* [386 F.3d 738 (6th Cir. 2004)]. I think it's nuts if you take what has happened in the City of Toledo and you assume that it's happening everywhere. I'd have to imagine hundreds of jurisdictions in the United States have similar provisions. So what's wrong with somebody competing for 4,200 employees?

Tatarowicz: Moving it away from the Commerce Clause argument—because that's a double-edged sword—I thought Paul Frankel did a great job in submitting his brief in *A&F Trademark* [605 S.E.2d 187 (N.C. Ct. App. 2004), *petition for cert. filed* June 2, 2005] that we're going to talk about later. He gives a lot of strong reasons why that should be overturned as a regulation of commerce that's impermissible.

But it is clear that Congress has the power to clear up this area. A bill has been introduced into Congress and it has widespread support. Giving credit where credit is due, Harley and the FTA [Federation of Tax Administrators] endorsed the bill that was introduced earlier this week by Senator Voinovich and Rep. Chandler [S. 1066 and H.R. 2471]. I think that no matter what the Court does, the quickest way to deal with this and not create a tremendous expense for both the state and taxpayers is through federal legislation. [CCH Note: On Sept. 27, the Court agreed to review *Cuno*.]

Frankel: Do you have a timeline, Phil?

Tatarowicz: Paul, everyone remains optimistic, but I'm not sure that the process itself has even been finalized at this point. It's been referred to Finance on the Senate side. There have already been some hearings on the House side and it's gathering more support every day. The question of what vehicle the bill will follow is currently being considered at the congressional level.

Frankel: How would you explain what the bill protects and what it doesn't protect?

Tatarowicz: The bill protects fiscal federalism in the area that is carved out by this bill. It starts with a broad grant of authorization to the states to use tax incentives for economic development purposes. Then it narrows the broad authorization to align it with the basis in which the *Cuno* decision was decided. It only pertains to the discrimination prong under the *Complete Auto Transit* [430 U.S. 274 (1977)] test, and then there's a series of limitations that are grafted on that, within the framework of this bill, protect the safeguards that taxpayers have fought for and won at the U.S. Supreme Court.

Cronin: Phil, can I go with that for a second. It says, "results in loss of a compensating tax system, because the tax on interstate commerce exceeds the tax on intrastate commerce." Now, the only true compensating tax that I know of is the sales and use tax.

Tatarowicz: That's if you're taking a snapshot today. Amy gets tremendous

credit for this whole bill and she insisted the “compensating tax system” section be included. It provides that when you have a situation that the courts will treat as a compensating tax—you’ve got two taxes that they say, in effect, offset one another—you cannot use a tax incentive to vitiate that counterbalancing effect and, thus, the state has to offer the incentive to both sides. If it’s a sales and use tax, the incentive has to be offered equally to the sales tax base as it is to the use tax base.

Paul Hartman in talking about the compensatory tax doctrine claimed it was the greatest accordion concept the courts ever came up with and, if you look back over time, the accordion has been expanded where the court wants to find a compensating tax. At other times it’s been contracted. At this moment in time, sales and use taxes are certainly the quintessential example and the accordion is somewhat contracted. This bill builds in the ability for it to flex with the courts in a way that you don’t have to go running back to Congress every time something changes. That’s the thought process behind it.

Eisenstadt: Or even more simply, to the extent that a state doesn’t use “sales and use tax” to describe what essentially is a sales and use tax, there isn’t an issue about whether or not that would be covered by the bill.

Tatarowicz: An example could include where we’re currently sitting: Illinois’ Retailer Occupation Tax. It’s not called a sales tax, but everybody knows that’s what it is.

Frankel: Would that include gross receipts taxes which are similar to sales taxes?

Tatarowicz: To the extent that it is involved with the compensatory scheme, yes. New Mexico’s gross receipts tax, for instance, is treated as a sales tax. That certainly would be covered.

Frankel: The B&O [business and occupation] taxes?

Tatarowicz: Those typically are not compensatory *per se*. They’re source taxes.

It’s where the goods are ultimately rendered or similar determination. If a court for some reason found a gross receipts tax was compensatory to some other tax—if they changed what they look at today—it would be covered. It is flexible.

Gall: I understand compensating sales and use taxes. There’s a lot of law there. But what is it going to do with respect to the Washington B&O tax?

Tatarowicz: Probably nothing. This is not a compensatory tax.

Cronin: Wasn’t the compensating tax argument rendered in West Virginia and it failed in *Armco* [467 U.S. 638 (1984)]?

Tatarowicz: Yes, because they held they weren’t imposed on substantially equivalent events, which is part of the current standard that the Court employs in evaluating what constitutes a compensating tax.

Certainly, if nothing happens to *Cuno* there’s going to be a lot of litigation.

To offer an example, let’s assume Illinois wants to provide an incentive for builders of prefabricated housing and they say, “If you set up a plant here in Illinois to manufacture prefabricated housing, we’re going to offer you an incentive against the sales tax due for new jobs created.” Now, by the authorization provision of this bill—but for this type of limitation—Illinois would be empowered to do that, in effect removing it from the Court’s jurisdiction to review.

If you were an out-of-state builder of prefabricated housing in Ohio and, for whatever reason, you wanted to sell your buildings in Illinois and you wanted the ability to have an equivalent base, Illinois wouldn’t have to honor that. They would not have to honor it on the out-of-state side for operations coming in and they could have disparity in those bases.

Now, flip it around. Classical theory is, if you’re paying a higher amount coming in on a use tax than the in-state residents on a sales tax, that’s classic discrimi-

nation. The only reason that the use tax has been found valid is because the sales tax was deemed to be a compensatory tax to equal the burden, but they have to be on the same base, same rates, etc. That’s simply what this bill says—that has to remain in place.

Gall: It seems like it’s going to create a lot of mischief.

Tatarowicz: But for this limitation you’d have tremendous mischief. You could do whatever you wanted.

Gall: With this limitation.

Tatarowicz: I think the mischief is the other way around, *i.e.* there’s plenty of potential for mischief without this limitation.

Johnson: I think that is the concern, though. There’s broad support for what the bill is trying to do, certainly among the states, but a lot of us are very concerned about the Sec. 3 limitations and exactly how they’re going to be interpreted in practice, and that could generate a lot of litigation.

If you go back and you’re on all fours with the case on

which the limitation was based, you know you’re okay. But if you depart from that too far one way or the other, it’s very uncertain to me how some of these are going to be applied. So I hope Phil is right that it really does reduce litigation and, certainly, if nothing happens to *Cuno* there’s going to be a lot of litigation.

Tatarowicz: But remember what this bill does. This bill simply says that with regards to incentives that match the parameters of the bill, that those incentives are authorized; they’re congressionally authorized. Those that are not authorized are not struck down. They’re not invalid. They simply remain where they are today.

Gall: You have the *Morton Building* [607 A.2d 424 (Conn. 1992)] situation which is whether or not it’s ever subject to tax. In some states, when you buy materials and you do prefabricated housing, modular housing, whatever you want to call it, that’s a consumable to the construction contractor. So I’m not sure that that’s the best example.

Tatarowicz: But what does that have to do with incentives?

Rosen: *Morton Building* cases around the country are based on the statutory construct of what was the “use” in the state. What this bill is addressing is that if a state wants to offer an incentive for one-half of a compensatory tax scheme, it must offer the same incentive for the other half of the compensatory tax system. That’s all it’s saying.

Gall: What if the Illinois and Ohio tax schemes themselves don’t ever line up on the same facts?

Rosen: It’s not a targeted incentive.

Tatarowicz: It’s not an incentive. That’s not what is being targeted. They’re looking to Illinois and goods coming in from out-of-state versus goods manufactured in Illinois.

Frankel: Phil, would job credit bills be protected under this legislation?

Tatarowicz: Those would be authorized. A taxpayer could not challenge them in court as long as they don’t violate one of those limitations. So, in that example that you just gave, if it’s just simply based upon the activities taking place within the jurisdiction, yes, it would be authorized.

Cronin: Two things. I think we’re all going to be very interested when we see the brief that Daimler files. Second, I would think that part of the mindset at the Supreme Court level—to accept cert or not accept cert—is going to be the prospect of federal legislation. I mean, why wouldn’t they just let Congress decide it? If there’s a shot at Congress deciding it, why wouldn’t they do that?

Tatarowicz: The Court? They may not. But the point is, even if the Court doesn’t take it, you’ve got this. If the Court does take it, it still wouldn’t resolve or clear up this area.

Cronin: So ultimately the area will be resolved with federal legislation.

Denmen: In Sec. 3(7) it says, “[the] tax incentive earned with respect to one tax can only be used to reduce a tax burden for or provide a benefit against any other

tax that is not imposed on apportioned interstate activities.” I’m not sure I know what that means.

Tatarowicz: It’s a term of art defined in Sec. 4(3).

Denmen: Right, and when I get that “imposed on apportioned interstate activities,” I think that doesn’t include the property tax and other such taxes. So does that mean I can’t have incentives that affect the property tax?

Tatarowicz: No, this particular limitation was informed by cases such as *Maryland v. Louisiana* [451 U.S. 725 (1981)]. As you may recall, in that case Louisiana imposed the first use tax on gas that was being extracted from the outer continental shelf and coming into Louisiana—which was fine, it was fairly imposed at

There are other cases popping up around the country that challenge credits and incentives in other states.

that point. But then Louisiana went one step further and they said, “Okay, for the tax that you pay under this particular levy, you can offset that against certain specified Louisiana severance taxes.” The only ones who could offset it against a Louisiana severance tax are those that had invested in Louisiana and were extracting these resources from within the state’s boundaries.

In effect what this is saying is, let’s assume that the state enacted a tax incentive measured by what you’re paying for real property taxes in the state and the benefit of that incentive can only be used to offset the corporate income tax. No problem with this limitation. That would be authorized because it’s measured and generated by what you pay in real property taxes, but it can be offset by anybody who is subject to a fairly apportioned interstate tax.

Let’s flip it around now. The state says, “We’re going to offer you an incentive measured by what you paid in corporate income tax but you can only use the ben-

efit of that incentive to reduce what you’re paying in real property taxes to the state.” That would not be authorized under this bill. Does that mean it’s invalid? No. It means somebody can challenge it, take it to court, argue *Maryland v. Louisiana*, have the court possibly throw it out, if they want to go that route. The bill simply doesn’t authorize it.

The first one, though, a properly measured benefit against the corporate income would be authorized. No one could take that into court and challenge it. That situation is protected because Congress has delegated that power, that authorization, to the states.

Kranz: There are other cases popping up around the country that challenge credits and incentives in other states.

Frankel: Can you list them?

Kranz: There’s litigation pending challenging the Minnesota Jobz Creation Act. And litigation in Nebraska, Oklahoma, and North Carolina.

Eisenstadt: And some of these cases aren’t under the

Commerce Clause. Or even if they include Commerce Clause in their arguments, they’re also making arguments under the state constitutional provisions, which would not be impacted by this bill.

Tatarowicz: Additional limitations, yes.

Eisenstadt: That’s correct. For example, North Carolina had a case challenging its incentives under a provision of the state constitution. In *Maready v. City of Winston-Salem* [467 S.E.2d 615 (N.C. 1996)], the court held that grants of funds to private companies did not violate the requirement that taxation is to be used only for public purposes.

Tatarowicz: Amy makes a very good point. Going back to what does this bill do: One, it respects fiscal federalism to the extent that it pertains to what’s been authorized here.

Two, it does not tell the states that they have to offer incentives. It leaves that judgment to the states. The states can choose to offer incentives or not. It, in effect, recognizes that the states are in the

best position to make that decision based upon facts and circumstances unique to their own operations.

Finally, it makes very clear that this federal bill does not supersede any other federal laws that may exist protecting multistate taxpayers' interests. So it's very intentionally designed to be an island onto itself focused only at select incentives.

Kranz: In terms of the drafting, it's easy for people to sit around and try and pick the language apart, but keep in mind the difficult job that is accomplished here between drafting a bill that allows the incentives we all love and want, but doesn't allow the discrimination that we hate.

Cronin: I agree, and I think just simply picking up the bill and reading it cold as I did . . .

Tatarowicz: That's cruel and unusual punishment for most people.

Eisenstadt: It's cruel and unusual punishment to make me help write it. [Laughter]

Kranz: Amy and Phil and Diann Smith [COST] and Jeff Friedman [Sutherland, Asbill & Brennan, LLP] and a lot of bright minds put a lot of time into this and came up with a product that works.

Cronin: It seems obvious that they have, after discussing these pieces. Hopefully the CCH readership is going to get a big benefit here. Obviously, if this case goes forward—if the Court takes it—I would see a very rapid enactment of this legislation. I can't imagine that Congress wouldn't jump in here. There's just too much involved.

Kranz: This is one bill that we're all singing "kumbayah" over, right Harley?

Duncan: Nothing happens rapidly in Congress, but our people took a lot of comfort from the way it's structured—in terms of the authorization, the limitations, the types of incentives that are not authorized but that are not *per se* invalid. It's a challenge, and that provided a lot of comfort to a number of administrators that I dealt with.

Rosen: One last comment. Steve and Harley were talking about how, to a very

large extent, the business community and the state revenue departments are working together and are very supportive of this. One might think that that automatically means it's going to sail through Congress pretty quickly. That would be a mistake. As we've all learned, members of Congress have their own minds and their own constituents to consider. So although there is large agreement of the parties we normally deal with, it does not mean it's going to be enacted tomorrow.

Frankel: Do you see opposition, Art?

Rosen: We had thought there might be from one certain sector of society, but so far they've been very quiet and apparently they're not going to object.

There's a very short amnesty period. January 1, 2006, until February 16, 2006—you've got six weeks to get into Columbus, Ohio.

Eisenstadt: Certainly there will be groups out there that aren't supportive. But it is an unusually broad coalition on this between the states, the companies, the local government authorities, even certain union groups, I believe.

Cronin: It actually means jobs, or loss of jobs.

Eisenstadt: Exactly.

Legislative Developments

Cronin: Let's talk about some legislative developments here real quick. There's a lot of stuff going on, Maryann.

Ohio

Gall: The Ohio legislation, as of last week on double-sided paper, was a foot thick—literally a foot thick—so there's a lot going on in Ohio. For the historians in the group, you will be happy to learn that the 1% "temporary" sales tax increase is going to be codified permanently at 5.5%. It went from 5% to 6%, but it was a temporary increase—it was going to disappear. Well, it's disappearing only to one-half a percent.

We are going to enact in Ohio, effective July 1, 2005, a commercial activity

tax—more popularly known in Columbus as the CAT tax—an excise tax on the privilege of doing business in Ohio levied on gross receipts, instead of the current corporate franchise tax which has been around since the early '20s and was levied for a long time on net worth and then became a dual-based tax—the greater of net worth or net income.

The rate will be \$100 on the first \$1 million in taxable gross receipts. Then 0.26% of the taxable gross receipts of more than \$1 million. Taxpayers subject to the tax will file the first return May 15, 2006.

A "taxpayer" is any legal person that has more than \$150,000 in annual gross receipts—that means corporations, partnerships, LLCs, S corps, sole proprietors, business trusts—whatever is a legal person. Excluded, because there are other Ohio taxes on them that have been around for a long time, are banks and financial institutions, bank holding companies,

savings and loans, financial service companies subject to federal or state supervision, insurance companies, public utilities and, our very personal favorite, dealers-in-intangibles—one of the more obscure taxes. Someday we're going to put dealers-in-intangibles on this agenda.

Frankel: Are REITs [real estate investment trusts] in or out?

Gall: I think they'd be in, wouldn't you?

Rosen: It's a legal person.

Gall: Yes, it's a legal person—good question. The situs of total gross receipts—this will be a lot of fun—will situs to Ohio subjects such as receipts from the sale, exchange, or other disposition of tangible personal property; receipts from the performance of services; receipts from rentals, leases, or any other use of tangible personal property. There will be a bad debt deduction. There will be a ton of exclusions, all of which make sense, like proceeds from the issuance of a taxpayer's stock, tax refunds, etc.

The one I was hoping that Rick Pomp would be here on is consolidation—you can elect to consolidate. Ohio has never

been a mandatory unitary state. It's a single return or an elective combination. You can force a combination in Ohio, but nobody ever did that. Otherwise taxable receipts between related members will be eliminated, even if there is no substantial nexus for the out-of-state entities that want to elect in. So, I don't know, I think I read that as saying, unless you elect into a consolidated return, they're going to tax everything, or subject to the taxable gross receipts.

A couple of other very quick things. The corporate franchise tax, which currently exists, is going to be phased out over five years beginning in tax year 2006—one-fifth each year. So for franchise tax year 2006, the taxpayer will pay 4/5 of the franchise tax, while this new stuff is coming in. The inventory and furniture-and-fixture tax is going to be phased out over five years—that's real important to manufacturers and retailers in Ohio.

A favorite old, old, old and very important exclusion from the property tax for jigs, dies, and drawings is going to end December 31, 2005. That really is a lot of money.

And then there's to be a very short amnesty period. January 1, 2006, until February 16, 2006—you've got six weeks to get into Columbus, Ohio. It would be a waiver of penalties and half of the interest, and it excludes any assessed tax, audit conducted, or audit pending. So that will be a very brief amnesty.

Cronin: Now, this is moving.

Gall: This is going. [CCH Note: H.B. 66 was signed into law by Governor Bob Taft on June 30, 2005.]

Pennsylvania

Cronin: Unlike Pennsylvania, Harley.

Duncan: The Pennsylvania Legislature goes on for some time, so they haven't finally disposed of the bill yet, although they do have a budget year that ends June 30. The proposal came out of the Governor's business tax reform commission that the Governor then put forward to the Legislature.

It has a variety of features. I think the three most important for this group would be the following. It would bring down the corporate net income rate from something close to 10 to something a little less than eight. It would remove a cap on the ability to use NOLs—I think it's now capped at \$2 million a year. And, then, it would impose a mandatory combined reporting regime in Pennsylvania.

That came out of this tax reform commission, has been introduced, but hasn't been disposed of in either house to my understanding. There's somewhat better support in the Senate than in the House, I think is what was reported to us by the Secretary of Revenue last week.

Rosen: What we've heard, which may be something new from a political viewpoint, is that the local tax issues are go-

It's mandatory, and I don't believe you can do mandatory nexus consolidation.

ing to take everybody's attention this year and the initial enthusiasm in support of the corporate tax reform has waned. I think people don't really expect that to happen this year. It might, but that's not really what people are expecting any more.

Duncan: The Pennsylvania program also includes moving to a single sales factor and some changes in their administrative procedures.

Frankel: They've got a good tribunal provision in this bill. I hope it is enacted.

Kentucky and Combined Reporting

Cronin: And then Kentucky?

Duncan: Kentucky has passed their reform and it had a variety of features. [CCH Note: H.B. 272 was signed into law by Governor Ernie Fletcher on March 18, 2005.] If you think Pennsylvania taxes are arcane, Kentucky has some nuances to theirs as well. Big pieces of the reform go like this. There's a reduction in the rate and there's the institution of something that looks a lot like the New Jersey alter-

native minimum assessment. You will compute your net income according to the law. You will then compute an alternative tax that is either based on gross receipts or, I believe, they even have the gross profits piece to it. And you'll pay the greater of the two. It had something on combined reporting as well.

Gillis: Mandatory nexus consolidation—which is an interesting issue to talk about, since I believe that's the only state . . .

Eisenstadt: It's the only state where it's mandatory.

Frankel: And the intangibles tax is gone?

Gillis: Yes, they're getting rid of it.

Cronin: Doesn't Virginia have a nexus combined?

Gillis: There are elective nexus consolidations.

Rosen: Many states have elective.

Cronin: So this is the first mandatory nexus combined?

Gillis: It's mandatory, and I don't believe you can do mandatory nexus consolidation.

Frankel: If they enact a statute, can't they do it?

Gillis: It doesn't adhere to the unitary principle for one.

Rosen: If it's all state-related income under *Allied Signal* [504 U.S. 768 (1992)], it would seem to me that you might have fair apportionment issues. But if they're taxpayers, then it's okay. Remember the question is what's included in the tax base. Whether you look at *Mobil* [445 U.S. 425 (1980)], *ASARCO* [458 U.S. 307 (1982)], *Woolworth* [458 U.S. 354 (1982)], the only likely issue would be apportionment concerns. Other than that, I'm not sure where you'd find constitutional infirmities.

Gillis: Although it conditions the filing requirement on the basis of some interstate element.

Cronin: But the apportionment is where that's all at. If you limit it to nexus companies . . .

Tatarowicz: That are unitary. You're saying "because of the unitary principle."

Is Kentucky just silent on that provision, or how does the bill read?

Gillis: I didn't see it in the provision. Of course, it's another one of these 300-page bills.

Tatarowicz: But that's an implied limitation anyway. Why couldn't they impose it as long as the nexus entities' operations were unitary?

Denmen: But they're talking about a consolidation as opposed to a unitary combination.

Tatarowicz: But those words are used interchangeably.

Denmen: I understand. But if you're talking about a company that already has nexus, meets their doing business standard, could be taxed individually—why would it be unconstitutional to simply consolidate them?

Kranz: On a single return.

Tatarowicz: That was my question.

Rosen: Other than fair apportionment.

Eisenstadt: Fair appointment is a big issue. You're not going to have the whole unitary group.

Rosen: Right, it depends on how it's applied. And then you get to the old question: Do taxpayers have a right, perhaps under the due process fair apportionment requirement, to force the state to accept a combined return if they're unitary? Maybe if you include others, again, that's fair apportionment as opposed to what you normally think about requiring combined returns.

Tatarowicz: It's probably a silly requirement because if you've got an out-of-state entity that lacks nexus and it would be beneficial to bring it into the group, you can create nexus to bring that entity into the group.

Gillis: One of the problems, though, is that even if you create some type of minimal level of nexus, then they say they have the right to disregard that.

Tatarowicz: Okay, fine, so more than a filing cabinet.

Rosen: You have the Alabama case about five years ago where a taxpayer wanted to have nexus. They said it was

de minimis, so they didn't worry about the whole issue.

Cronin: Part of the loose cannon associated with a state going to combined reporting is the uncertainty around what it does to the tax base. Is this a way to kind of guarantee, if you will, that you get it, but there's no question about what you're going to lose? One of the reasons why you haven't seen combined reporting in New Jersey is because of a very solid fear that it's going to turn out to be a loser. And I think it would, personally, but it's hard to quantify that.

Gillis: It's just interesting since it's the first, as far as I can tell. I haven't been able to find another jurisdiction.

Cronin: I've never heard of it.

Eisenstadt: It does not go as far as the Connecticut proposed combination

The single sales factor seems to be popping up in a lot of places.

which surely was combination without unitary.

Frankel: The Pomp proposal is combination without a unitary relationship?

Eisenstadt: Yes.

Frankel: Is that going anywhere?

Eisenstadt: No, they dropped that one and put in an add-back provision instead.

Denmen: This is the second time they brought it up.

Cronin: Phil, do you know of any other states?

Tatarowicz: I'm thinking about that in terms of the mandatory aspect.

Eisenstadt: I don't think there is.

Tatarowicz: Hawaii used to require mandatory combination—but you had to be 100% in the state, so it might have been a totally intrastate operation in the islands. D.C. used to have it if you had two entities that were 100% within the District, but I can't recall if that was mandatory or just permissible. Indiana used to have that with their supplemental income tax, as I recall.

Wethekam: Yes, but that wasn't mandatory.

Tatarowicz: Normally, it was always a benefit and the state would allow you to do it. Taxpayers filed that way if it was beneficial and didn't if it was not.

Duncan: Kentucky had *GTE* [889 S.W.2d 788 (Ky. 1994)], the case where they tried to prevent somebody.

Frankel: *GTE*, which Scott Clark, Bruce Clark and I tried, is exactly what Jack said. Kentucky was a net loser under its original combination law. So Kentucky said, "It's going to be a one-way street. If we think we should combine you, we're going to combine you, and you can't combine." In *GTE* the Kentucky Supreme Court held that, "It's a two-way street." That was phase one. In phase two, we're still in court trying to get refunds for several companies.

Tatarowicz: The curious feature about a nexus return—any kind of group reporting tied to a nexus requirement—is that the same reason you would bring an entity into the state, assuming more than a *de minimis* contact,

is the same reason that you would carve out pieces and make sure that it's not related to an entity that has nexus.

It's curious. Was this just a political compromise? It doesn't seem very thoughtful in terms of what Rick Pomp and the others push for in terms of combined reporting and getting away from separate return problems, because nexus combined reporting or a nexus group reporting mechanism typically would not move you away from the problems that most argue is inherent in a separate return regime.

Single Sales Factor

Cronin: Let's move on to the single sales factor. That seems to be popping up in a lot of places, Bruce.

Johnson: I can tell you what we did in Utah. The prior Governor's tax reform advisers, of which I was one, looked at the franchise tax, the corporate income tax, and—for a lot of the reasons that Harley talked about earlier—we said it's not a good revenue source for education. And, so, our recommendation was to do away with it.

Frankel: Do away with the corporate income tax?

Johnson: Just do away with the corporate income tax. But we wanted to be revenue-neutral, so we said, "You've got to raise property taxes \$100 million to do that."

"In the alternative, if you're not willing to go that far," we said, "go to a double-weighted sales factor," not because we thought the double-weighted sales factor was at all superior to the three-factor formula—in fact, I don't think it is—but there's something to be said for the fact that, even if you just use file drawers as the way to apportion, if everybody uses it, it's got some benefit.

We just thought the train had left the station on that when everybody was moving to at least double-weighted, if not further. So in order to be more uniform, we recommended double-weighted. [CCH Note: Ch. 226 (H.B. 78), Laws 2005, allows taxpayers to elect to use a double-weighted sales factor for taxable years after 2005.]

Now, there is a move in the state to go even further, go to single-weighted. I think that's even worse policy, but I think there's certainly a lot of momentum around the country to move that way.

Frankel: What's the rough count now on single-weight, double-weight, and standard three factors?

Johnson: Certainly a lot more than half are double-weighted or single-weighted.

Rosen: You still hear rumblings around the country, people wondering about the constitutionality of single factor sales. So far all you hear is rumblings because most taxpayers find it very helpful in certain states.

Frankel: Are there many single factor states?

Rosen: Yes, as you know it's growing. Used to be states were going to heavy-weighting sales. Now, either for certain industries or for all businesses, the formula is going to single factor sales.

Cronin: It results in a definite industry bias. It works to the disfavor of retail

service businesses. I think it typically works to the favor of manufacturers who are more interstate or multinational. No question it's an industry bias.

Johnson: One of the points that I wanted to make earlier when Harley was talking about the unfairness of the corporate income tax is that it's not so much unfairness as to corporations *vis-a-vis* individuals—because those are just different kinds of entities that have different statutory schemes—but the corporate franchise tax really, at least in our experience, operates very unequally and unfairly among businesses. You can say it's based on taxable income and that's a great leveler, but frankly that's not the way it works in practice.

More and more states are getting sensitive to different economic models in which different industries operate in trying to mold certain apportionment schemes to match those industries.

Rosen: That's going to happen whenever you have a uniform apportionment formula based on ratios, for example, because certain businesses are obviously a lot more capital intensive and, therefore, the property factor might be more significant. Other businesses are purely services and have just a little bit of property. Given that, in the classic situation a third of the weight really does not reflect how those businesses operate. So that's why I think you see more and more states are getting sensitive to different economic models in which different industries operate in trying to mold certain apportionment schemes to match those industries.

Wethekam: I'm not sure, though, when they go to a single sales factor—and this is the problem when Illinois went to it—that they took into consideration that it's fine if you're selling tangible personal property and you're doing it on a destination basis. However, when you look at the cost-to-performance standards in all the states, and no two are really the same, I don't think that's been taken into con-

sideration on some of these single sales factors.

You could skew it in either direction. At least in Illinois, it was the capital intensive industries that went to a single sales factor because they exported their liability.

Rosen: We are also seeing a number of states focusing on changing the receipts factor for services to be market-based, as opposed to cost-of-performance. And you see that move in legislative bodies—initially as economic development—the legislators are told that to have a cost-of-performance, you're really double-weighting payroll and perhaps double-weighting property where the company is located. You've seen on the East Coast with the financial services industries first, and I've seen this spreading around the country, focusing on sourcing receipts for services to where the market is, as opposed to cost-of-performance.

Cronin: You mean the customer.

Rosen: Yes.

Wethekam: It's more difficult to get to that.

Rosen: Absolutely more difficult.

Johnson: It's more difficult, and that's why they kind of just "copped out" a little bit when they did UDITPA [Uniform Division of Income for Tax Purposes Act] the first time around and said, services are too difficult to deal with. But I think conceptually you're absolutely right, that to have the sales factor based on cost-of-performance does just duplicate payroll.

Cronin: It does, absolutely.

Dennen: You were saying, Art, that the states are becoming more cognizant of the different industry needs within their state. But as that is happening, don't you think that they're also becoming less cognizant of what the state services are to support those kind of industries? So that you wind up saying to your manufacturers, who cause the greatest number of dollars to be spent for services—police, fire, all of these types of services related to plants and property—"Oh, you can

pay less, even though we're providing you more." That's part of, I think, the basic unfairness Bruce is talking about.

Rosen: What I've seen policymakers focus on is jobs in the state. Every elected official's primary responsibility, I think, is to increase the number of jobs and make them more economically profitable.

Certain sectors of manufacturing we've seen employ a certain level of employees that are resident in the state. Because the policymakers think it's important, which it probably is, to make sure those people are well-employed, they will give that industry breaks, even though that industry requires more government services. Yet the workers there are the ones who are being benefited through the compensation. So there are two sides of that scale that have to be balanced.

Tatarowicz: From an efficiency standpoint, I think common sense will tell you to integrate the system and just get rid of the corporate income tax, and tax it at the shareholder level—just let it flow through. As long as you're going to keep a corporate income tax, for whatever reason, then these will just be continual issues.

Paul, when are you going to challenge all these single factor sales formulas as violations of external consistency?

Frankel: If everyone had one, we should have uniformity. That would take away the advantage.

Tatarowicz: It doesn't mean it's externally consistent, though. It means it's internally consistent, but that doesn't mean it's externally consistent.

Frankel: I agree.

Jobs Act Conformity

Cronin: Shall we move on to the [American Jobs Creation Act of 2004] P.L. 108-357?

Duncan: There are a few things in there of interest from a conformity standpoint. The biggest was this phased-in deduction for qualified production activity income, or what euphemistically is referred to as domestic manufacturing. The states have

pretty much gone through their exercise of whether they're going to conform or not. There are a variety of legislatures still in session. We did a piece just recently and found 19 states, I believe, that either do not conform to that qualified production activity income or are expected not to conform, so that you'll have to add that back in those 19 states.

Cronin: Are there major states involved in the nonconformity?

Duncan: Yes, California would be the biggest. They will not be picking it up.

Tatarowicz: To give Harley a plug, on the FTA website there is a great study on not only this particular topic but on taxation of services, which the FTA just recently released. Very well done. Thank you, Harley. Everybody in the readership should know that, so they can look for it.

It's got to be very complex for compliance purposes, but this is three or four years in a row that states are being confronted with a federal bill that's going to reduce their tax base.

Johnson: And, Harley, don't go characterizing Utah as a minor state.

Tatarowicz: He said mining state, not minor state. [Laughter]

Duncan: I forgot that both Utah and Idaho did go ahead and conform.

Cronin: I think this is a major thing.

Duncan: It is, and it's a continuing pattern. The American Jobs Creation Act also, I think, continued some increased expensing under [IRC] Sec. 179 in the small business area. To my amazement, there are probably a dozen states that don't conform on that. You know where we are on the bonus depreciation—in a 12- to 15-state range that aren't conforming.

It's got to be very complex for compliance purposes, but this is three or four years in a row that states are being confronted, at some point in their budget cycle, with a federal bill that's going to reduce their tax base. And once they make a decision not to conform, it becomes very easy not to conform to the next one, and

not to conform to the next one, and some of these are easier to deal with than others.

Cronin: What about taxing the dividend, though?

Frankel: The foreign income?

Duncan: There are two potential constitutional issues that have been raised about this, and I'll have to turn to you, but one is a question of whether the states can get by with granting this deduction for domestic activities under *Kraft* [505 U.S. 71 (1992)]. There has also been an issue raised over the repatriated dividend. I'm not sure how that one really plays because dividends-received deductions vary so much.

Frankel: Is this a big issue in some states?

Duncan: Everything's a big issue when you're trying to make the budget fit. The Center on Budget and Policy Priorities did some work on this. It phases in, so the next year it is just 3% and then it goes up to 9%. I think they had it in the couple of billion dollar range across the country.

Rosen: We're trying to think how a state could possibly, under *Kraft*, discriminate against the foreign dividends, and we can't. Maybe the states are still trying to figure out a way, but I haven't heard of any states developing any approaches to violate *Kraft*. I'm sure they're trying.

Wethekam: I don't think that's as big of an issue as [IRC] Sec. 199 [CCH Note: IRC Sec. 199 creates the deduction for qualified production activity income.]

Dennen: Isn't there a question of footnote 23 still, so that you'd have unitary states saying that if you have domestic combination and they're not included in the return you can tax the dividend?

Frankel: Footnote 23 in *Kraft*? That's an issue that we intend to win.

Rosen: Right, it still hasn't been resolved.

Frankel: It's not over.

Dennen: I didn't think it was.

Frankel: On *Kraft*, Jack and I had the *Intel* case [931 P.2d 730 (N.M. 1996)],

which held that *Kraft* should not be narrowly construed.

Rosen: I certainly hope that's the case.

Gillis: Harley, I think we're going to find out after the fact that complexity is going to be a real problem for the compliance side in shops. I'm not sure how a company with limited resources is supposed to keep up with a system where we are now not only nonconforming with the federal, but also there's no uniformity among the states.

Even once you get within the states, then you have all of these complex income tax calculations, followed on the back side by alternative minimum tax computations. I don't know if anyone has really thought about that, but I think the compliance issues are going to be substantial.

Eisenstadt: Not to mention the interest add-back provision.

Gillis: Right, which if you look at Ohio for a moment and the CAT—that to some extent may be interpreted by some as saying that expense disallowance provisions really weren't that helpful anyway, since they had them for years.

Eisenstadt: That's right.

Johnson: I think people have thought about it. The QPAI [qualified production activities income] thing is a little harder to deal with, but if you go back to the bonus depreciation, the states, I think, made it very clear—and Harley has better information on this than I do—but the states made it very clear to the people that would listen at the federal level that, "Look, if you do this, you're going to have a lot of states that are going to be hurt by this."

If you do an investment tax credit of about one-half percent—because it didn't sound good they didn't want to do that—but if you do the investment tax credit at the federal level, you can accomplish exactly the same thing and leave the state tax basis untouched, and it has exactly the same economic effect.

Simply nobody was interested in listening to that. Partly, I think, because the amount of the credit when you put it that

way was so small that it didn't have the political impact. The fact is that the federal policymakers just weren't interested.

Gillis: That's fair, but on the state side now, Bruce, we have seven or eight different ways of computing depreciation. And keeping track of basis on your assets and getting IT to focus on fixed asset system doesn't happen very often.

Johnson: I agree, but my point is that if the business community and the states would go together to the federal government and say, "Look, if you're going to legislate on this, do it this way and it won't create all these problems for us on the state level"—that would have been a preferable result.

On the state side now we have seven or eight different ways of computing depreciation.

Now, I don't know if you could do something similar on the QPAI. I don't understand the intricacies of it well enough to know if there's anything you could do that would accomplish the results that Congress wanted without affecting the states. But certainly on the bonus depreciation, it's something that should have had more attention.

Tatarowicz: The lunch speaker at the ABA meeting indicated during his speech that they were very in tune to the states' concerns but, I think you're right Bruce, they needed so much bang for the buck. And, at the end of the day, it just didn't become a major concern for the feds under their tax policy.

It's not that they didn't listen or didn't understand. They simply chose not to act. They felt they had to go in the direction that they did, but he made it sound like it was a very conscious decision.

Johnson: I think it was conscious. I guess that's partly my point. It was brought to their attention and they chose to do it because they viewed it as a problem for the states, rather than a problem for the taxpayers.

Tatarowicz: I thought you were suggesting that they weren't listening.

Johnson: We told them and I don't think they cared.

Duncan: Bruce's point is that the complexity rolls downhill and it stops with you—with the corporate taxpayer. Then we'll have to come in and do the audit work. Somehow we need to strike a better relationship in dealing with these things at the federal level.

Johnson: The states for years have talked about the difficulties of administration and that simply falls on deaf ears, and I don't care that it falls on deaf ears. The problems of state administration are not that big a deal. The fact is, though, the problems of state administration are also problems of taxpayer compliance, and that is a big deal. Because if you're spending more money complying with your taxes than you're paying, that's a real deadweight loss to the economy.

I think states have done a disservice in the past by harping on costs of administration. They ought to be focusing on costs of compliance and they ought to be marching arm-and-arm with the taxpayers on that point.

Frankel: Well said.

SSTP

Cronin: Let's segue into our next topic, which is the SSTP [Streamlined Sales Tax Project].

Kranz: By the time the transcript comes out we will know the results of the vote that is taking place July 1. [CCH Note: The votes resulted in petitions for membership from 18 states being accepted. As a consequence of these votes, the SST Agreement will come into effect on October 1, 2005, with a Governing Board of 18 states.]

Johnson: I hope it's not "Dewey Wins." [Laughter]

Frankel: Steve, who's voting on what?

Kranz: There are 18 petitioning states that will be voting on each other as members of the Governing Board, which will come into existence October 1, assuming that the vote goes well. I think everyone is confident that there will not be any

major problems with the vote July 1. We will have some number of states that are full members, who have done everything required by the Agreement.

We'll have some states that have done everything, but have delayed effective dates, they will be associate members. And then there will be states, and hopefully a small number, that are associate members because they have failed to do a couple of things required by the Agreement. They will be given two years during which everyone anticipates that they will go home and try and fix those problems.

There were three states that did not petition. I think that was a surprise. Vermont, Texas, and Washington did not petition for membership. They could petition at some point in the future, should they have the appetite to do so. Wisconsin did not get their bill through. Politically it just was not something they could accomplish this year, so they may be joining the group next year.

Frankel: What will the 18 do July 1?

Kranz: July 1, they will vote on each other. That will give rise to the Governing Board. The Governing Board will then sign contracts with certified service providers and get the administrative mechanism in place to administer the Streamlined Sales and Use Tax Agreement.

Cronin: At what point does it trigger federal legislation?

Kranz: They're two separate beings. The state-level agreement is a voluntary system that can exist on its own without the federal legislation. The federal legislation could pass and become effective, but not grant any authority to the states for years. It will trigger when the states have met the minimum standards established by the federal bill and the thresholds in it for membership, which they will not have done yet.

Cronin: Then if it was the discriminatory part of *Quill* [504 U.S. 298 (1992)] that caused the Court to decide in favor of *Quill*, the complexity of that issue goes away?

Kranz: Much of the complexity goes away under this Agreement. It's not a perfect system. But the federal bill has not yet been introduced. There are, in my mind, two issues that are being debated in that federal bill that have prevented it from being introduced.

One is whether or not it will cover telecommunications transaction taxes. The second one is a battle between Amazon and eBay regarding the small seller exception—which small businesses should be carved out from a *Quill*-overtake in the federal bill, were Congress to pass those bills.

Cronin: Is my buddy, Rich Prem, trying to carve out Amazon? Is that what is going on?

Some of the changes that will be required between now and January 1, 2008, could have a major impact on the administration of certain companies.

Kranz: Just the opposite. Amazon is on the record as wanting a very low small-seller exception. They want to level the online playing field. They're willing to support this bill to level the playing field between Main Street retailers and the online community. They just don't want to be left holding the bag collecting from their customers when eBay sellers are not collecting from their customers.

Frankel: And what's going to happen in October? Will companies start collecting use tax on a go-forward basis?

Kranz: Yes. Probably the most significant thing to companies out there is that October is the beginning of the 12-month amnesty window. Companies that have questionable nexus need to give this a look: Are they willing to voluntarily begin collecting tax from their customers to take advantage of that amnesty offering?

Frankel: They get all the old years waived?

Kranz: No lookback.

Rosen: A couple of comments. One thing that's troubling to those of us who

have been involved in that is there are so many businesses out there that still are not paying attention to a lot of the law changes that already occurred. A lot of people are thinking that this whole process is only connected with the federal legislative activity when, in fact, we've already seen numerous state law changes.

Some of the changes that will be required between now and January 1, 2008, could have a major impact on the administration of certain companies. For instance, there will be some major changes in exemption administration in a number of states. It should make life a lot easier for taxpayers around the country.

Eisenstadt: For all taxpayers, whether or not they were remote sellers.

Frankel: Whether they sign up or not? Whether Congress acts or not? It just happens?

Eisenstadt: Exactly. Every one will be impacted.

Rosen: The second comment concerns recent developments around the country with destination sourcing for local tax. It's

been a real political problem in a number of states, derailing a lot of states from conforming totally or encouraging states to put off the effective date. Those who were very supportive of federal SSTP legislation were hoping that there would be so much conformity that you'd have a lot of momentum and be able to go to Congress and get Congress to enact the bill.

Now that there's been this problem of local sourcing, you can take the opposite optimistic view, if you support SSTP, and maybe those who support it can go to Congress now and say, "Look, Congress, we need you to do this in order to get every state back on the train." So I'm not sure if things are better or worse as far as what's going to happen in Congress.

Kranz: I think it diminishes the chances, but it does point out that the locals are the problem.

Eisenstadt: They were historically.

Cronin: They always have been and they always will be.

Rosen: Remember the Bumpers bill? [CCH Note: In the late 1990s, former U.S.

Senator Dale Bumpers (D-Ark.) introduced legislation, which was never enacted, to require use tax collection by remote sellers.] There you had the localities, and the AARP, who were fighting the most. Not until the very last session of Congress in which it was pending did the localities say, "Okay, we'll go along with it." But then it was too late to get it enacted.

Johnson: I'm not prepared to say at this point that *Quill* was rightly decided, but the fact that you have state legislators saying it's an intolerable burden to require our local merchants to keep track of a dozen different sales tax rates—it does inform a reading of *Quill*, I think.

Tatarowicz: Sounds to me like an endorsement for the *Quill* decision. [Laughter]

Duncan: I started this job in 1988 and one of my first tasks was trying to negotiate the Bumpers bill with local governments.

Frankel: A hard job?

Duncan: At least I'm alive, but no success.

COST Telecom Study

Cronin: You're on a roll, Steve. Do you want to tell us about the COST telecom study?

Kranz: Well, again, the locals are the problem. [Laughter]

Cronin: And there's a lot of those.

Kranz: There are. It was shocking. This is the fourth time we've done the telecom study. It was published by CCH this time and we thank them for putting out a wonderful product. On the sales tax side, general businesses file 7,500 returns a year, if you're a nationwide business. A telecom company files 48,000 returns a year, 170 returns per day! It's unbelievable. And the locals are the problem. They are resistant to change.

There's an effort to get simplification language in the federal sales tax bill. There's also discussion about going to Congress and asking Congress to prevent discriminatory taxation of telecom services. If you look beyond the administra-

tive burden, there is a rate differential. Telecom services are taxed at more than double the average rate of the sales tax.

Cronin: It would be interesting to go to these locals and ask for a copy of the law that gives them the authority to enforce the tax. I'd be willing to bet you that you would have a significant number of them that wouldn't have it.

Gall: In Ohio they don't answer the phone, so you will never get that. You've got to drive over to Steubenville and say, "I'm here. I want it."

Rosen: Often it's difficult to actually find the ordinance or law and, when you do, they have no procedures there for refunds or challenging the tax. You don't know whether you go to common remedies, or you try to mirror what the state tax remedies are. It's very difficult.

A telecom company files 48,000 returns a year, 170 returns per day! It's unbelievable.

As to the compliance burden for telecom—this is a true story. When I was at AT&T, the manager who worked for me who signed the returns would come in on Saturdays with an Ace bandage around his forearm, because he had to sign so many returns. Honestly, he would actually wear that Ace bandage every Saturday when he came in the office. It's a real burden.

Eisenstadt: And Art didn't offer to help out and sign half of them. [Laughter]

Kranz: There were five states that made improvements in their administrative burden and, thanks to Bruce Johnson, Utah was one. Illinois, Florida, Ohio, and Tennessee also reduced the number of returns that they require telecom providers to submit. Although it was a nice reduction from 68,000 returns a year down to 48,000 returns a year, we still face an incredible burden.

Johnson: 48,000 is a lot of returns, but 20,000 in four years is a significant reduction and if we can get a few more states to pick away at that . . .

Frankel: Another 20,000?

Johnson: Obviously the numbers are driven by Florida, probably Illinois, Ohio.

Developments in the Courts

Cronin: Counselor, can I assume that Louisiana doesn't like REITs?

Autozone (Louisiana)

Frankel: We've all read this opinion [*Autozone*, 900 So.2d 784 (La. 2005)]. It seems confused. Louisiana has a procedure where, after they sue you, you file a declinatory exception, which is like a motion to dismiss, on due process grounds. We know from *Quill* that the due process-nexus argument is hard for taxpayers.

The Supreme Court of Louisiana said, "They waived their Commerce Clause argument." They never waived anything. This is a preliminary motion. When that motion is denied, the case goes back to the trial court for other issues, including the Commerce Clause issue.

The idea of going after REITs, without dividing them between publicly traded investment REITs and planning REITs, is also wrong.

Tatarowicz: I think the House in Louisiana just introduced a bill to deny the deduction to the REITs in terms of trying to correct this problem and move forward. [CCH Note: Act 396 (H.B. 888), Laws 2005, was enacted on June 30, 2005.]

Frankel: I think they're trying to divide it between the publicly traded investment REITs and the others.

Rosen: On the substance of the opinion, not only do they forget about the two different tests, Due Process Clause and Commerce Clause, but also the substance of the argument is very scary—that a shareholder is subject to tax wherever the corporation is. Those kind of decisions are the kind of decisions that will likely be helpful as people argue in favor of H.R. 1956 in Congress.

Frankel: The BAT [business activity nexus] bill—no taxation with some physical presence.

Rosen: And having states doing these crazy things like what happened in Louisiana—as recognized even by the Chief Justice of that state who, as you know, after the decision was written, realized how wrong he was—it shows the need for some type of federal legislation.

Cronin: They're calling it a trust.

Rosen: There are corporate REITs and trust REITs. This happened to be a corporate REIT, I believe, in Louisiana.

Cronin: But they're calling it a pass-through, flow-through entity.

Rosen: It's really not a pass-through. That's a little error many people make—that it's really a deduction that the REIT gets for dividends paid. It's not a pass-through entity at all, and that's a big distinction conceptually from a partnership or an LLP.

Cronin: Where I'm going here is, does this get you to where the difference between a limited liability company and a partnership will have to ultimately be resolved?

Rosen: No, because the court made it clear that this was a corporation and so that was not the issue at all, the distinction between a pass-through entity and a corporation.

Cronin: But I'm talking about it from the perspective of a shareholder. In other words, a partner having nexus by virtue of a partnership interest, a REIT shareholder having nexus by virtue of a REIT interest, an LLC member having nexus by virtue of an interest in an LLC.

Rosen: I think not, because ever since the *American Bell* decision in 1870 . . .

Tatarowicz: Before my time. [Laughter]

Frankel: Was the American Bell telephone company in existence in 1870?

Rosen: Yes, it was. 1876 was the first telephone call, as a matter of fact. There have been a slew of cases and virtually every state has had decisions recognizing that a corporation, for jurisdictional purposes, is separate and distinct from the shareholders. That's why this case is really out in left field. It's really solid law in the United States, in every state and at

the federal level, that a shareholder is not where the corporation is.

Tatarowicz: Art, what about *Kulick* out of Oregon [7 Or. Tax 471 (Or. T.C. 1978), *aff'd*, 624 P.2d 93 (Or. 1981)]? This was an Oregon Tax Court decision and my recollection is that the Oregon court held that they could impose their tax on the S-corp shareholders because they had jurisdiction over them. Also, I think it was in the *Autozone* decision, they make reference to an SBE decision out of California that had talked about it in a different context. It may have been a partnership.

Rosen: Other states have recognized that they have no jurisdiction over the S-corp shareholder. That's why they take one of three approaches. Either the non-resident shareholders must concede tax-

violation of the taxpayer bill of rights might not void an assessment, a state department of revenue cannot use its failure to do something as a reason to impose a harsh result on a taxpayer. So there is some hope out there. There is some light at the end of the tunnel.

Johnson: Of course, your contemporary, Judge Cardozo, said that the prisoner should not go free because the constable erred.

Tatarowicz: This case was just remanded back to the lower court, right?

Rosen: For the substantive nexus issue, right.

Tatarowicz: So this just says that the refund claim was timely filed.

Rosen: Yes. I think the lesson to taxpayers around the country, and practitioners, is to look at taxpayer bills of rights. We always tell people to think about the administrative procedure act when they have an issue in a state: "Don't forget that. You might find some relief there." The same thing with tax-

payer bills of rights. Don't just look at the tax statute. Other areas might be helpful.

Eisenstadt: But in this case it was important that the taxpayer bill of rights was enacted after the corporate tax provision. So they said that trumped it.

Wethekam: There was a recent case in Pennsylvania addressing an issue about the taxpayer bill of rights and the application of that to something that occurred before its enactment that was subsequently litigated.

Kranz: Many of the taxpayer bills of rights are not enacted statutorily. They're essentially mission statements of the Department of Revenue and not worth the paper that they're written on. This one was, unusually, interpreted to have substantive meaning.

Rosen: New Jersey and Alabama have decisions also on the same lines giving the statute actual force and effect.

Johnson: But it is worthy of note that the notice the taxpayer received in this case did set out their appeal procedures.

Rosen: But not their refund procedures.

The lesson to taxpayers around the country, and practitioners, is to look at taxpayer bills of rights.

ability, withholding is required at the corporation level, or they put a franchise tax on the corporation to the extent of non-resident shareholders. So states have mostly recognized that they don't have jurisdiction over the shareholders.

MBNA

Cronin: You're on a roll, Art. How about the *MBNA* case [694 N.W.2d 778 (Minn. 2005)]? Did somebody blow a statute here?

Rosen: The focus here was the bill of rights. Many states have enacted a good-sounding bill of rights, yet there's often a clause in those laws that says, for example, "However, if the Department of Revenue violates this, it does not invalidate an assessment." That's troublesome because, again to sound a little philosophical, a lot of people think the law should apply to government operations as well as to citizens and taxpayers.

Three states, Alabama, New Jersey, and now Minnesota, have recognized that the law has to have some teeth in it to have any meaning at all. And, although a

Borders Online

Cronin: Maryann, as the successful litigator of *SFA Folio* [652 N.E.2d 693 (Ohio 1995)] and *Bloomingtondale's By Mail* [567 A.2d 773 (Pa Commw. Ct. 1989), *aff'd*, 591 A.2d 1047 (Pa. 1991)], what's happening with *Borders Online* [29 Cal. Rptr. 3d 176 (Ct. App. 2005)]?

Frankel: Does the returned product to stores defeat you?

Gall: Pretty much, yes. California has said that if you have an in-state agent acting on behalf of an out-of-state seller and there are the usual indicia of nexus by agency—that's the *Scholastic Book* case [255 Cal. Rptr. 77 (Ct. App. 1989)]. That's old law in California, where a school book company mail ordered catalogues and flyers to school teachers in California.

Cronin: That's pre-*Quill*.

Gall: Yes. This is really an application, I think, of old law in California to a more contemporary fact situation.

Frankel: Is it cases where affiliates take returns that create problems?

Gall: That is a real problem.

Kranz: Here they not only took returns, but they didn't even charge back the online seller for the credit.

Rosen: I have a number of clients in mail-order businesses that also have affiliates that are bricks-and-mortar, and I think almost all my clients in that business, over the last two years, have decided to voluntarily register and collect so they don't have to worry about what they call "seamless marketing." And I think the government administrators know that and think that's a smart thing for everybody to do.

Cronin: The issue really has always been more of a competitive issue. If Barnes & Noble or Borders want to be competitive with Amazon—and to be honest with you, I don't even know if Amazon collects tax.

Wethekam: They do on anything I've ever bought in Illinois.

Johnson: Some places they do, some places they don't. They provide services for some companies where they collect everywhere.

Cronin: Well, they have the capability, I know that. I would assume that Borders is going to drop this soon.

Frankel: Is it over?

Rosen: As of last week, when I spoke to their counsel, they hadn't decided. [CCH Note: Subsequent to this discussion, the time for filing an appeal passed and none was filed.]

Whistleblower Litigation

Wethekam: The *qui tam* cases in Illinois are a result of having done the same thing—where someone has purchased something online and taken it back to the bricks-and-mortar side of it. There's now 60 of those. In some cases, they didn't even have bricks-and-mortars. We've taken the concept one step further.

There's now 60 [whistleblower suits in Illinois]. In some cases, they didn't even have bricks-and-mortars.

Gall: Marilyn, what exactly is going on in those? Those are pretty important cases in terms of tax enforcement, I think, on the private side.

Wethekam: It is my understanding that three of the bricks-and-mortar have settled with the Department of Revenue. Those cases are over.

There was a case in the Illinois Supreme Court with respect to whether or not the whistleblower statute in Illinois was constitutional unto itself. [*Scachitti v. UBS Financial Services*, No. 97023, 2005 Ill. LEXIS 949 (Ill. June 3, 2005)] The case is not a tax case. The court reversed the Circuit Court of Cook County and held the whistleblower statute to be constitutional. I think there was some hope by the counsels who represent all the taxpayers in these *qui tam* cases that the court would have affirmed and that would have resolved the cases.

There was an interlocutory appeal taken on a procedural issue, out of the Circuit Court to the Appellate Court, which the Appellate Court chose not to take. A writ has been filed in the Illinois

Supreme Court. [*Illinois ex rel. Beeler Schad & Diamond, P.C. v. Ritz Camera Centers, Inc.*, Illinois Supreme Court, No. 1-05-1059, *petition for leave to appeal filed* June 27, 2005.]

Tatarowicz: That appeal is for what issue?

Wethekam: It's on a really procedural issue as to whether some of the cases were brought properly under the whistleblower act.

Rosen: Marilyn, would you recommend to clients that have return policies that people can return goods they get from mail-order sellers, but not to friends or relatives of class action lawyers? [Laughter]

Wethekam: In some cases, Art, some of the businesses in these *qui tam* cases don't have a bricks-and-mortar affiliate—1-800-FLOWERS, for example.

Frankel: Well, if they don't, why don't they move to dismiss under *Quill*?

Wethekam: I think that one is dismissed. There was also another one that I think has been dismissed where it was a mail-order hardware store without a bricks-and-mortar.

Lanco and A&F Trademark

Cronin: Okay, Paul, I think the next topics are yours—*Lanco* [21 N.J. Tax 200 (2003), *rev'd*, No. A-3285-03T1 (N.J. Super. Ct. App. Div. Aug. 24, 2005)] and *A&F* [605 S.E.2d 187 (N.C. Ct. App. 2004), *petition for cert. filed* June 2, 2005].

Frankel: I argued *Lanco* at the New Jersey Appellate Division on March 3. I'm optimistic that the great opinion by Judge Pizzuto of the Tax Court will be affirmed. It should come down any day. We'll see. [CCH Note: Subsequent to this discussion, the Appellate Division reversed the Tax Court decision.]

Gall: What is the New Jersey Division doing in the meantime?

Frankel: The New Jersey Division of Taxation has a form agreement for people willing to be bound by *Lanco*. I hope that the U.S. Supreme Court takes *A&F*. We filed our petition in June and we empha-

sized that many states have opinions on both sides of the issue.

Gillis: Very nice job.

Frankel: Thank you. The states are divided now. A group of states are on one side and a group are on the other side. The Supreme Court seems interested when things like that are happening.

Rosen: Do you know whether any *amicus* has definitely decided to attempt filing a brief? [CCH Note: Subsequent to this discussion, on July 6, 2005, the International Franchise Association filed an *amicus* brief in support of the petition for certiorari in *A&F Trademark*.]

Frankel: I haven't heard, but I'd like to urge everyone at this table to file an *amicus*—FTA, MTC. I think it's in all of our interest to get the U.S. Supreme Court to rule on this issue: whether *Quill* applies to all taxes or it doesn't apply to all taxes. It's been 13 years since *Quill* came down. So Harley, Bruce, let's get some briefs in there. It's really important.

I want you to follow the great Governor of California. I don't know if everybody at this table saw it, but when the gross proceeds and related issues were rising—and there are many cases out there now—Governor Schwarzenegger wrote a one-page letter to the California Supreme Court. "This case is very important, please take it."

Kranz: And they did, but I think they took it because COST sent a letter. [Laughter]

Frankel: That's right, there was also a COST letter saying the same thing: "It's very important, please take it."

Tatarowicz: Paul, two questions on this. Rick Pomp testified that use of economic presence, or the economic nexus concept, might actually result in lower tax revenue for the state of North Carolina. Where was that coming from? In terms of sourcing income outside the state or what?

Frankel: Rick concluded that because there's one Commerce Clause, *Quill* should apply to all cases, and physical presence is the bright-line test. He noted that companies in North Carolina could

be hurt because they could be taxed all over the country, without having physical presence.

Tatarowicz: And they would have income sourced outside, that's where they would lose it. That's what I thought.

Frankel: That was his point, that the North Carolina companies that are 100% in North Carolina could be allowed to apportion.

Tatarowicz: Second thing, you make the point here, if the Court accepts this and does not uphold this decision, this could stand for the proposition that a state could tax shareholders of corporations on their dividends. Is there anything between economic nexus, and the concept that we were just talking about earlier, that wouldn't lead to that conclusion?

Our group is worried about the *Autozone* concept, that if people can be taxed without being there, there's a lot of things that can be taxed out there. Multiple taxation could be everywhere.

Frankel: Our group is worried about the *Autozone* concept, about the issues that Art was just talking about, that if people can be taxed without being there, there's a lot of things that can be taxed out there. It's not just royalties and it's not just interest. It's almost anything. Multiple taxation could be everywhere.

Tatarowicz: I understand that, if you took it to its very far conclusion. In this case you actually had licensing of some intangibles in the state.

Frankel: We did.

Tatarowicz: So if someone buys a share of stock in IBM, now New York also can tax him on the dividends that they've earned from that.

Frankel: One thing we've all seen is some tax collectors are not like our friends at this table. If the budget pressure is hard, they push hard. And who knows what will happen without a bright line.

Rosen: The court could say that having property, including intangible property of a specific nature—where you're

getting a specific stream of income from specific property, like royalties from a license—is distinct from having an undivided interest in a corporation. You're right, that could be a decision.

Kmart

Cronin: How about *Kmart* [New Mexico Court of Appeals, No. 21,140, November 27, 2001; *appeal docketed*, No. 27,269, New Mexico Supreme Court; *motion to quash certiorari filed* July 1, 2005]?

Frankel: *Kmart* has been sitting there for years. What's happening?

Rosen: My partner argued that months ago. We're hoping for a decision from the Supreme Court on the gross receipts tax, the sales tax. The taxpayer is very optimistic on the sales tax case, even under the state statute. There might be a victory there. On the corporate income tax case, that's still being held in abeyance.

Frankel: And how about *Sonic* [11 P.3d 1219 (N.M. App. Ct. 2000); *appeal docketed*, No. 26,447, New Mexico Supreme Court] and *Long John Silver* [New Mexico Court of Appeals, No. 19,372, August 10, 2000, *certiorari quashed*]? Are they still sitting there?

Wethekam: They've been argued for two, two-and-a-half years.

Rosen: Still waiting.

Gall: Why is that?

Frankel: I don't know. The New Mexico Supreme Court is thinking about this.

Rosen: The ways of judges work mysteriously.

U.S. Bancorp

Cronin: Steve, you want to tell us about *U.S. Bancorp* [103 P.3d 85 (Ore. 2004), *petition for cert. filed* April 29, 2005]?

Kranz: The petition for cert was filed from the Oregon Supreme Court in a case where the Oregon Department of Revenue changed a legislative regulation dealing with their apportionment formula and applied it retroactively. We all thought the Due Process Clause and the U.S. Supreme Court's decision in *Carlton*

[512 U.S. 26 (1994)] meant something about retroactive application. But, in Oregon anyhow, it doesn't prevent the state from going back eight years. There was an eight-year retroactive application of this changed apportionment formula.

They have sought review and the Court will decide whether or not it's going to take the case during the fall term. COST filed an *amicus* brief encouraging them to take the case. Under any interpretation of the Due Process Clause, an eight year retroactive lookback is too far. We need more certainty in our tax system than that.

Compliance Initiatives

Cronin: Marilyn, do you want to spend a couple of minutes talking about these tax evasion\ tax planning initiatives?

Wethekam: I asked to have this on the agenda because there's just been a growth of tax amnesty programs, as well as these tax shelter programs. Some have taken the form of legislation, some have been done by administrative rules, and others have been handled by merely putting out a bulletin and requesting information.

I don't know, Harley, if this is part of the reason that revenues are up. But in a number of these, and California jumps to mind immediately, where you have had significant revenue collections—not done under amnesty but done before amnesty so you would not get hit with the additional penalties—some of those monies are going to be refunded.

Frankel: Not much.

Wethekam: Well, we'll give California the benefit of the doubt that they'll take the high road and, to the extent they should be refunded, they will be refunded.

Frankel: Right.

Johnson: The answer is still not much. [Laughter]

Wethekam: It seems to be that they've done nothing more than accelerate their receivables.

Frankel: Marilyn, we just analyzed all this and wrote an article called, *Hammers Disguised as Amnesties*. Particularly Cali-

fornia, particularly North Carolina—I think what they did in the early part of this year is outrageous.

Pay up anything you might ever owe or else you get huge penalties. California at least lets you file a claim for refund, so you have the hope for a refund. In North Carolina you can't even file a claim for a refund, even though our *A&F* case is still alive. They just said, "Pay or you get this 60% penalty."

Wethekam: One of the other problems with some of these is that they picked up federal audit adjustments. Anyone who has tried to guess what the Service is going to do to them in the next 20 years—that's going to be a problem. I think the statutes were not drafted very carefully. When you say "anything due and owing or probably due and owing," and you roll in RARs [Revenue Agent's Reports] that haven't been finalized yet—it is a problem.

I think what they did in the early part of this year is outrageous. Pay up anything you might ever owe or else you get huge penalties.

Now in Illinois the suggestion was that you pay those and that was going to be the only item that would be refunded. The Department's current position is that if you didn't file that claim within a year of the date of payment, even though we have an RAR statute in this state that allows a refund if you timely file your RARs, there may be an issue here with respect to whether a taxpayer will receive a refund.

Tatarowicz: Paul, going back to your piece, I assume on the penalties, to the extent that you don't voluntarily comply, they can be retroactively applied. Actually one of my students at Georgetown, who just finished as a COST intern, wrote a paper on this. I thought she made a very good case why the retroactivity provisions that potentially apply in the tax area don't have the same application when you're talking about penalties. Which sets it up nicely for the right taxpayer to come along and challenge that.

Frankel: It sure sounds *ex post facto*.

Tatarowicz: Yes, it sure does. The other thing is that some of these amnesty programs are imposing standards on advisers, regarding levels of assurance that they need to offer to abate penalties. In New York, for example, the standard imposed for what's deemed to be a reportable transaction under these structures is higher than the standard that exists at the federal level.

So a "substantial authority" will abate a penalty on the tax adviser under the federal rules. New York, I believe, has gone to a "more likely than not" standard, which sets up a real problem. Does that mean that, if you're providing these types of services, you can sign a federal return but you can't sign a state return? They're out of kilter now. The first time I could think of where actually the state level of standard is higher than the federal.

Wethekam: California was adopting the federal bill that was introduced several years ago and was never enacted at the federal level. I think they picked up portions of that bill when they did their tax shelter legislation.

Tatarowicz: I know New York was aware of this because Jeff Gottlinger [of Ernst & Young LLP] and Peter Faber [of McDermott Will & Emery], among others, had alerted them to this potential problem, but they still went ahead and enacted this level of assurance on tax advisers that's higher than what's required federally.

Frankel: We're challenging this in the New Jersey Tax Court. If you didn't take their amnesty they put an extra 5% penalty on you. If you have a good-faith position, why do you have to take their amnesty?

Johnson: Just as a matter of theory, what if they said, "We're keeping the interest rate the way it's always been but, if you want to pay it pursuant to an amnesty, we'll drop your interest rate by half." Do you have the same issue?

Frankel: That's an incentive for you to pay something you might not owe, to bring money in the door.

Johnson: I'm not asking the question with an answer in mind.

Frankel: I don't think it's the same issue. I think you then make a voluntary decision and you weigh that in your hazard of litigation. I don't think they've got a right, if you don't want to settle, to tell you that if you don't settle, you owe more.

Rosen: There's one company—this is public information, I think it was mentioned in a congressional hearing—whose truck got stopped in New Jersey and they explained Public Law 86-272 but the enforcement officer did not understand it. They were forced to pay the money; they had perishable goods on the truck. Finally, a few months later the state sent back a check with an apology. The same company's trucks were stopped again a few months ago and they had to go through the exact same thing, same company.

Frankel: Is it just budget pressure, Art?

Rosen: I think it's an attitude thing we see throughout the revenue departments in the country. We started this discussion two hours ago with Phil talking about rhetoric, and people really acting in an overwrought manner. They're so upset about what they think are abuses, often in situations that really aren't abusive, that they become paranoid, and they're overreacting in a lot of situations.

MTC Proposals

Cronin: Bruce, is there anything you want to add on your MTC proposals?

Johnson: I'll just tell you really briefly that the affiliate nexus statute is out to the states for a survey that basically says, "If there's any chance that any of you will adopt it, we'll go forward with it."

Frankel: Would this statute say that if I have an affiliate that's there, I'm there?

Johnson: It's for sales tax.

Rosen: For sales tax only.

Frankel: Can this be constitutional?

Gillis: *Cannon Manufacturing* [267 U.S. 333 (1925)]—No. Footnote 13 in *Keeton v. Hustler Magazine* [465 U.S. 770 (1984)]—No.

Cronin: And the MTC has that [National Nexus Program Bulletin] 95-1

which essentially says that any third party that you use . . .

Johnson: I think 95-1 was withdrawn, was it not?

Rosen: There was a difference. 95-1 you had the in-state people fulfilling contractual obligations of an out-of-state seller.

Frankel: So there may have been a representative there.

Rosen: So there is some argument there—of course the states have lost those two cases so far against Dell—but this is different. This thing automatically, irrespective of any agency relationship . . .

Frankel: The affiliate is there, so you're there.

Johnson: Well, it's got two requirements. First, the out-of-state vendor and

If a state is going to adopt an affiliate-nexus statute, and a lot of states are moving that way, why not have one model instead of 45 different ones?

the in-state business must be related parties. Second, the out-of-state vendor and the in-state business must use an identical or substantially similar name, trademark, etc., to develop, promote, or maintain sales, or the in-state business must provide services to, or that inure to the benefit of, the out-of-state business related to developing, promoting, or maintaining the in-state market. It's pretty simple.

Frankel: You should withdraw the proposed statute.

Rosen: If it was a presumption of agency, that might be different. But it's not, right?

Johnson: It goes a little bit to Tim's point and Phil's point. If a state is going to adopt an affiliate-nexus statute, and a lot of states are moving that way, why not have one model instead of 45 different ones?

Rosen: Because it's the wrong one.

Johnson: Well, you can argue that this is not a good statute and this statute ought

to be changed but, from the MTC's point of view, if you've got a lot of states moving in this direction, let's have statutes out there that look the same.

Frankel: So when we beat it in court, it's down.

Johnson: Then it's down.

Frankel: By the way, Bruce, I don't know if anybody at this table noticed that in *Borders* the court said that because they had common directors, it was unitary.

Eisenstadt: I did see that.

Rosen: That was one of the factors.

Frankel: Can that be serious?

Rosen: They didn't say exactly which factor, of course. They just went through all the commonalities. So you never know which was important and which wasn't.

Johnson: The reportable transaction statute is going to public hearing. The same issue—I know you all hate that statute, but is it better to have 45 different approaches?

Frankel: This is the California/New York approach that's going to be an MTC statute?

Johnson: We hope we've taken the best of those.

Tatarowicz: When is that hearing, Bruce?

Johnson: I think it was just approved to go to public hearing, so I don't think the public hearing has been scheduled yet. [CCH Note: Subsequent to this discussion, the hearing on this proposal was set for September 27, 2005.] But the public hearings are not *pro forma*. The combined reporting statute that was adopted was substantially changed as a result of good public comment. I would encourage you to make your comments.

Kranz: Although COST made many public comments that were rejected.

Johnson: We didn't adopt them all, but it's certainly an improved proposal.

Frankel: They've got you busy with these statutes.

Johnson: Then the expense add-back legislation. There's a public hearing scheduled on that for July 18.

Cronin: Thanks to everyone for a lively discussion. ■