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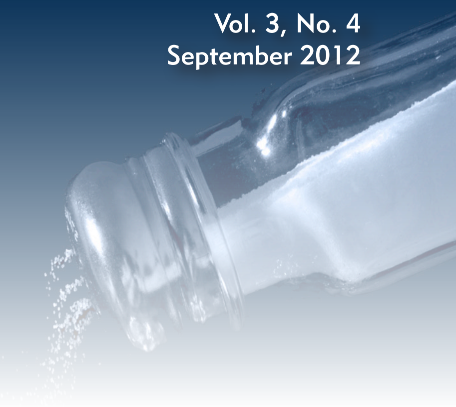

SUTHERLAND SALT SHAKER

Shaking things up in state and local tax.

Oregon DOR Out of Luck on SOL

In a significant taxpayer victory, the Oregon Tax Court held that changes or corrections made by other states' taxing authorities will not hold open the Oregon statute of limitations. *Dep't of Revenue v. Washington Federal, Inc.,* TC 5010 (Or. Tax Ct., June 29, 2012). The taxpayer, a multistate federal savings and loan corporation, timely filed its Oregon corporate excise tax returns for tax years 1999 through 2002. Arizona and Idaho state taxing authorities assessed the taxpayer in 2003 and 2006, respectively. In 2008, after the expiration of the standard Oregon statute of limitations for assessment (generally three years from the date the return was filed), the Oregon Department of Revenue (the "Department") issued assessments for the tax years 1999 through 2002. The issue before the court was whether the Department's assessments were timely.

The statute at issue, ORS 314.410(3)(b)(A), provides that if the IRS or "an authorized officer of another state's taxing authority makes" certain "changes or corrections" for which an assessment or refund may be issued under the Internal Revenue Code or relevant state law, then a notice of deficiency may be issued under Oregon law within two years after the Department is notified of the changes. One such "change or correction" that triggers the extended statute of limitations period is a change or correction to the taxpayer's income tax liability that causes a change in the taxpayer's Oregon taxable income. If triggered, the extended two-year assessment period applies regardless of whether the standard limitations period has already expired, and the assessments are not limited to the items changed or corrected by the IRS or other state.

The Department argued that the limitations period remains open whenever the IRS or another state proposes a change or correction which, if made by the Department, would change a taxpayer's Oregon tax liability. The Department contended that if the same changes that were made in Idaho, for example, were made in Oregon, the taxpayer's Oregon tax liability would be changed, and the limitations period would remain open.

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In This Issue

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The court held that a change by another state can only "directly result" in a change in a taxpayer's Oregon tax liability when there is connecting linkage between Oregon substantive law and the substantive law of that sister state. For example, Idaho's changes to a taxpayer's apportionment factors would not directly cause a change in that taxpayer's Oregon tax liability as Oregon's apportionment statutes are not linked to Idaho's. By contrast, IRS adjustments to a taxpayer's taxable income would directly cause a change in that taxpayer's Oregon tax liability, because Oregon tax law is linked to the IRC. The court noted that it was aware of only one substantive linkage between Oregon tax law and the tax laws of sister states—in the context of credits for taxes paid to other states by individuals. The court also found there to be a profound absence of legislative history supporting the Department's expansive view of the statute.

This is an important win for Oregon taxpayers because it reinforces the very limited nature of the Department's ability to hold open the statute of limitations for assessment. In addition, the court suggested that had it accepted the Department's position, it would have been forced to confront serious Commerce Clause issues because the Department's construction would give businesses operating in Oregon alone an advantage over businesses operating in, and subject to tax in, several states.

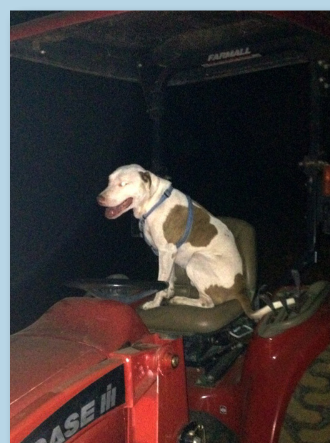
SALT PET OF THE MONTH

Dom

Meet Dom, the newest rescue pet of Sacramento partner Carley Roberts and her husband, Jeremy. You may remember the Roberts' other pets, which were featured as Pet of the Month on www.stateandlocaltax.com in March and in our April Fool's edition of the SALT Shaker.

Carley recently was heading home from work late in the evening, and as she entered the freeway, she came upon a large, Pit Bull-ish looking dog running at top speed in the lanes of traffic. Cars were whizzing by him without a care, so Carley rolled down her window, pulled to the side of him, and began talking to the clearly scared pup, hoping he might slow his stride. As the dog, who is now known as Dom, began slowing down, Carley swerved to protect him as another car impatiently tried to cut around her. She then drove ahead of Dom, continuing to swerve back and forth until all traffic was at a standstill. Once at a stop in the road, Carley opened her doors and encouraged Dom to hop in. As he approached, he stopped about 10 feet in front of her, lowered his head, and stared, showing no trace of emotion. Now eye-to-eye with what was clearly a 100-plus pound Pit Bull, for a split second Carley questioned the wisdom of her judgment, but knew she was doing the right thing and continued to sweetly encourage Dom to jump in her car. Thankfully he did, hopping into the driver's seat and then into the backseat.

As she drove away, Carley became acutely aware that she was 40 miles from home and had invited into her car a very large dog with unknown propensities (aside from the freshly sprayed skunk aroma that he donned!). As a safety measure in case Dom became aggressive in his unfamiliar surroundings, Carley stretched her right arm tightly over the passenger seat gripping the headrest with her hand in an effort to serve as a temporary barrier that would (hopefully) allow her enough time to pull safely to the side of the road in the event Dom became aggressive. Much to the contrary, Dom, still heaving from his running, shifted forward, resting his head on top of Carley's hand, revealing his sweet nature and longing for affection. Carley scratched his head the rest of the way home and assured Dom that he was going to be just fine.



Badly beat up from his life on the streets, Carley made sure Dom received medical attention after bringing him home and located the original owner, who had no interest in being reunited with Dom. Since then, Carley and Jeremy have welcomed Dom into their home and are absolutely smitten with the sweet pup. Despite his size and intimidating looks, the other animals are sure to remind Dom that he is still at the bottom of the pecking order as the newest addition to the family. Seven-pound miniature border collie, Tanq, who was previously the newest family member, especially enjoys bossing around the much-larger Dom. Dom is growing more comfortable with his home and new family every day, and he is thrilled to be the Pet of the Month!

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

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

To Be or Not to Be ASP: South Carolina's Treatment of Bundled Services

South Carolina applied the "true object" test to separate the taxability of Application Service Providers (ASPs) from the taxability of bundled services with ASP components. S.C. Priv. Ltr. Rul. No. 12-2 (June 11, 2012).

In this case, a medical practice purchased two services from one seller for one non-itemized price. The first service was a software product that was either transferred to the practice's server for a one-time fee, or was accessed by the practice from an ASP, for which it was charged periodically. The software allowed input of certain health information into the system so that it could be accessed in real time by all employees of the practice and streamlined the clinical, financial, and administrative functions of the practice.

The second service was a medical billing service. The practice would input information into the seller's system and the seller would use this data to manage the practice's billing functions. This billing service could not be purchased unless the practice also purchased the software product. However, the practice could purchase the software product but not the billing service. The taxability issue centered on whether the services, when sold together for one non-itemized price, were subject to sales tax in South Carolina.

The Department of Revenue determined that charges for the software when accessed from an ASP are subject to tax when sold separately from the billing service. However, the Department noted that data processing services are exempt from sales tax in South Carolina. In this case, the Department determined that the billing service was a nontaxable data processing service because it manipulated information input by the customer and converted it into useful billing information.

Finally, the Department examined whether sales of the software product and billing service, sold together for one non-itemized price, would be subject to sales tax. Relying on the "true object" test, the Department determined that, when bundled together, sales of the software and billing service were a nontaxable data processing service because the software was merely the vehicle for the practice to receive access to the seller's data processing service. Thus, the Department determined that the "true object" of the transaction was the data processing service. Accordingly, the entire bundled transaction was not subject to sales tax.

Administrative Convenience Justifies Inequality in Tax Forgiveness Program

The U.S. Supreme Court held in *Armour v. City of Indianapolis,* 132 S.Ct. 2073 (June 4, 2012), that a city's refusal to refund sewer taxes prepaid by some homeowners while relieving taxes paid by other homeowners who elected to pay the tax by installment did not violate the Equal Protection Clause. Applying a rational basis standard, the Court upheld the tax forgiveness scheme because it was rationally related to the city's legitimate interest of avoiding the administrative costs associated with issuing refunds.

The opinion reflects the difficulty of applying the Equal Protection Clause. The Court provided that laws treating similarly situated taxpayers differently are constitutional as long as there is a "plausible policy reason for the classification . . . and the relationship of the classification to its goal is not so attenuated so as to render the distinction arbitrary or irrational." The Court noted that the only instance where it has found a rational basis lacking in this context is where a state law requiring equal assessment was "dramatically violated" by gross disparity in assessments. Here, the sewer project financing assessments were equally distributed, as required by state law. Whether the tax should be forgiven and how such a tax forgiveness program should be implemented are separate questions which are not addressed by state law.

The dissent, written by Chief Justice John Roberts, viewed the majority opinion as an expansion of the administrative convenience concept. Chief Justice Roberts viewed the Court's prior decisions addressing administrative convenience as being limited to allowing a legislature to consider administrative concerns when creating classes of taxable entities that may be taxed differently. However, the dissent viewed the taxpayers in *Armour* as being in the same class pursuant to Indiana's tax scheme that had specifically provided that the costs of sewer projects were to be equally allocated. Further, the dissent took exception to the majority's conclusion that the case did not involve a gross disparity of treatment, pointing to the fact that homeowners who were refused refunds paid 10 to 30 times the tax that installment homeowners paid. The dissent called into question whether there was even an administrative burden at all. The dissent noted that the city had already produced records showing the exact amount of refunds due to each lump sum payor and that the total cost of issuing the refunds would be $300,000 (out of a $900 million budget).

Show Me the Refund (But Not the Money)

The Indiana Tax Court held that a retailer was permitted to seek sales and use tax refunds of tax collected from its customers before refunding the tax to its customers. In *Fresenius USA Marketing, Inc. v. Indiana Dep't of State Revenue,* No. 49T10-1008-TA45 (Ind. Tax Ct. 2012), a retailer sold dialysis equipment to customers and collected and remitted sales tax to the Indiana Department of Revenue. The retailer filed refund claims alleging that the equipment was exempt durable medical equipment but did not refund the tax to its customers. The Department denied the refund claim, and the retailer appealed to the Indiana Tax Court.

The refund statute at issue provided that "a retail merchant is not entitled to a refund of state gross retail or use tax *unless* the retail merchant refunds those taxes to the person from whom they were collected." Ind. Code 6-2.5-6-14.1 (emphasis added). The Department argued that the statute required that the merchant refund the claimed over-collected tax to its customers prior to seeking a refund. The court disagreed and found that the statute does not limit the merchant's ability to seek a refund, it only limits the merchant's ability to receive the refunded tax (if it is determined that the merchant is entitled to the refund). Therefore, the statute limiting the merchant's ability to receive the money (if the merchant is entitled to the money), does not limit a merchant's ability to seek a refund.

Efforts to Expand Economic Nexus Stall in West Virginia

The West Virginia Supreme Court of Appeals held that an out-of-state licensor of intangible property did not have nexus in West Virginia despite products bearing its intangible property being sold in the state. *Griffith v. ConAgra Brands, Inc.,* Dkt. No. 10-AA-02 (W. Va. May 24, 2012). The decision is an important taxpayer victory, particularly for licensors of intangible property.

ConAgra Foods, Inc., a food products company, established and transferred to a wholly owned subsidiary, ConAgra Brands (CA Brands), numerous trademarks and trade names. CA Brands also acquired intangibles from unrelated third parties. CA Brands licensed the intangibles to related and unrelated parties in return for royalty payments. The licensed food products were manufactured by the licensees outside of West Virginia and were sold or distributed to wholesalers and retailers in several states, including West Virginia. CA Brands had no physical presence in West Virginia, and it did not control how the licensees distributed the products bearing the CA Brands' intangibles.

The court held that CA Brands did not have nexus with West Virginia because it lacked both "purposeful direction" under the Due Process Clause and "substantial nexus" under the Commerce Clause. The court distinguished its prior decision in *Tax Comm'r v. MBNA America Bank,* 640 S.E.2d 226 (W. Va. 2006), *cert. denied,* 551 U.S. 1141 (2007), in which it held that an out-of-state bank that issued credit cards to West Virginia customers had income tax nexus based on its "significant economic presence" in the state. While the court reiterated that physical presence is not required for Commerce Clause purposes, it nonetheless distinguished *MBNA*. Unlike MBNA, CA Brands did not "continuously and systematically" engage in direct mail and telephone solicitation and promotion in West Virginia. The court also noted that CA Brands did not dictate how the licensees distributed the licensed food products.

It is interesting to compare the holding in *ConAgra* to the holding in *Jack Daniels Props, Inc. v. Iowa Dep't of Revenue,* Dkt. No. 09DORFC002 (Iowa Dept. Inspects. and Appeals July 28, 2011), where a taxpayer without physical presence was found to have nexus because it received royalties based on the sales of licensed products in the state.

Federal Court Schmears Taxpayer's Bankruptcy Claim

The U.S. Court of Appeals for the Third Circuit took a bite out of a bagel store's bankruptcy petition by holding that sales taxes are non-dischargeable "trust fund" taxes rather than excise taxes. *In Re: Michael Calabrese, Jr.,* No. 11-3793 (3d. Cir. July 20, 2012). After not having enough dough to pay their debts, Don's What a Bagel, Inc. and its individual owner both filed for bankruptcy protection.

The court boiled the issue down to whether sales taxes owed by the owner were considered "trust fund" or "excise" taxes under the Bankruptcy Code. Under the Bankruptcy Code, trust fund taxes are always non-dischargeable, while excise taxes are non-dischargeable only if they are less than three years old. The court found that third-party sales taxes more closely resemble trust fund taxes. These third-party sales taxes are paid by the debtor's customer and are held by the debtor, rather than paid by the debtor.

The Third Circuit now follows the holdings of the Second Circuit, Seventh Circuit, and Ninth Circuits on this issue. To avoid being toasted, corporate officers should take these decisions into consideration prior to a bankruptcy filing.

Oregon Tax Court Excludes Goodwill Proceeds From Sales Factor

The Oregon Tax Court ruled that receipts from the sale of goodwill are not includable in the Oregon sales factor because the goodwill could not readily be attributed to a particular income producing activity of the taxpayer. *Tektronix, Inc. v. Dep't of Revenue,* T.C. 4951 (Or. Tax Ct. June 5, 2012). The court found that the goodwill at issue was generated by the taxpayer's business activities around the world, rather than in Oregon alone, and occurred over a substantial period of time.

Tektronix sold a division to Xerox in 2000 and recognized taxable gain of almost $590 million related to the sale of goodwill. Tektronix and the Department of Revenue agreed that gain from the goodwill was apportionable business income but disagreed on the inclusion of the gain in the taxpayer's Oregon sales factor.

Despite a lengthy discussion of the occasional sale exclusion from the Oregon sales factor, the Tax Court did not decide the case on that basis. Rather, the court relied on the Department's rule for sourcing gain from sales of intangible assets based on the location of the "income producing activity" but only if the income producing activity "can be readily identified." If income producing activity cannot be readily identified, the Department's rule requires that the gain be excluded from the calculation of the sales factor altogether. Importantly, the court noted that goodwill is, in essence, the aggregate value of a business's assets and activities and that in Tektronix's case, those activities occurred around the world and over a significant period of time. Thus, the gain from the sale of the goodwill could not readily be attributed to any particular income producing activity and was excludable from the Oregon sales factor.

We expect the Department to appeal the Tax Court's decision to the Oregon Supreme Court or, alternatively, to amend OAR § 150-314.665(4)(3) to avoid similar results.

A Pupu Platter of a Case: Packaging and Filtration Businesses Held Unitary

In a somewhat troubling decision, an Illinois Appellate Court held that a taxpayer's parent company and its subsidiaries engaged in two lines of business—consumer packaging manufacturing and filtration product manufacturing—were unitary and had to file a combined Illinois return. *Clarcor, Inc. v. Hamer,* 2012 WL 1719518 (Ill. App. 1st May 11, 2012). The Taxpayer contended that there was a lack of unity between the entities because: (1) the subsidiary groups lacked horizontal integration as required by the Seventh Circuit's holding in *In re Envirodyne Industries, Inc.,* 354 F.3d 646 (2004), and (2) even if horizontal integration is not required, there was insufficient vertical integration between the parent and the subsidiary groups to support a unitary finding.

The court rejected both of the taxpayer's arguments. First, the court held that the taxpayer's subsidiaries were horizontally integrated because the subsidiaries participated in a centralized cash management system operated by the parent, shared common employee benefit plans, and compensated their officers based on the performance of the whole group rather than just the subsidiary. Second, the court rejected the taxpayer's argument that the parent is only unitary with the filtration subsidiary group and not the packaging subsidiary group. In rejecting the taxpayer's argument, the court cautioned that: "The tax code does not create a pupu platter from which a parent selects the subsidiaries that provide the best tax treatment and then leave the others on the plate."

In our view, the court's opinion is troubling, less for its outcome and more for its failure to focus on the classic unitary business indicia—functional integration, centralized management, and economies of scale. The court's decision suggests that the presence of minimal stewardship and administrative functions, such as a centralized cash management system, may be sufficient to support a unitary finding because it allows the subsidiaries to receive money "essentially from each other." While a cash management system may be one indicator of a unitary business, the U.S. Supreme Court made clear in *F.W. Woolworth* and other cases that a flow of *cash* among companies is not the same as a flow of value. The court also failed to distinguish between the mere *ability* of a parent to control a subsidiary, which is almost always present and does not create a unitary relationship, and the actual exertion of control, which is required for a unitary relationship to exist.

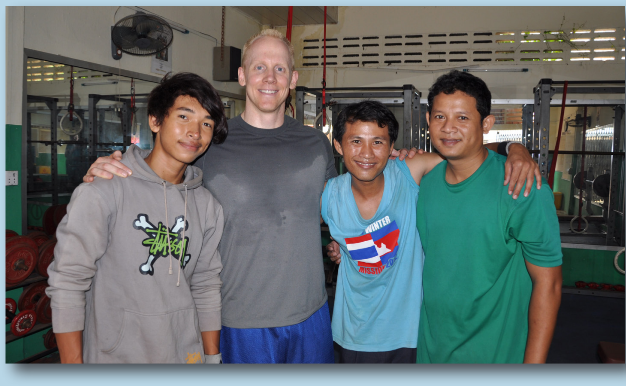
The SALT Scene: Working to Rebuild a Broken Community in Cambodia

Two years ago, Sutherland SALT associate Tim Gustafson took a life-changing trip to Cambodia. Earlier this summer, he returned once again to Svay Pak, Cambodia, where he volunteered with Agape International Missions (AIM), an organization dedicated to fighting child sex trafficking, and Svay Pak is an international hub for the trafficking of young girls.

AIM began its efforts in Svay Pak in 2006, when founders Don and Bridget Brewster opened the Agape Restoration Center, a safe haven that provides rehabilitation and support to rescued girls. In its first year, the center rescued and assisted 52 young girls. Since then, AIM's community has expanded to include multiple Rehab's House community centers, which offer community members healthcare, education and necessary goods, and children a safe place to play. AIM also provides anti-trafficking training in Cambodia and in the U.S.

During his two-week stay in Cambodia, Tim primarily volunteered at The Lord's Gym, which offers outreach to prevent trafficking. The kickboxing training facilities and coaching offered by the Gym attract young men in the area, where kickboxing and mixed martial arts are very popular. While Tim was volunteering at the Gym, there was a Strong Man competition wich lasted four days. Through its kickboxing teams and similar events, AIM volunteers build trust with local men who train there and are able to teach the men about the Christian faith and educate them about the evils of the sex trade.

The most impactful part of Tim's trip was his visit to the Agape Restoration Center, a highly secure facility where rescued girls receive full-time education and counseling until the age of 18. Tim said, "It was powerful to say the least. Each one of those girls was a victory." As testament to its commitment to the girls it assists, ARC offers life-long support to these women after they move on from the facility.



Tim and members of his team also visited the local brick factories, where some of the poorest Cambodians live and work. Families who work in the factories are effectively enslaved, making roughly 75 cents for each 13-hour shift, but paying $20-25 each month to the factory owner to rent a "house" that consists of one tiny room. Workers take out loans for basic expenses, and the owners charge astronomical interest rates so that the debts can never be repaid. The AIM team traveled to the factories each day at lunch to distribute essential goods such as rice, soap, and first aid kits, and AIM and the local church also provide food, education, and medical treatment at the factories when possible. Children from the factories attend AIM's Kids Club, where the children around them play and sing; however, the factory children are often so exhausted that they curl up and fall asleep.

Tim was once again moved by his trip to Cambodia and plans to continue to volunteer with AIM.

For more information about AIM, visit http://agapewebsite.org/. A recently released documentary shown at international film festivals provides a glimpse into life at Svay Pak; the trailer is available at http://www.thepinkroommovie.com/trailer.

CALIFORNIA SHAKING

California Supreme Court Considers Case to Allow Property Tax on Intangible Assets

For the first time in 50 years, the California Supreme Court is revisiting the issue of the proper application of the property tax to intangible assets. In *Elk Hills Power, LLC v. California State Board of Equalization,* Case No. S194121, the court will address whether the California State Board of Equalization (the Board) may assess Elk Hills' intangible Emission Reduction Credits (ERCs). In *Elk Hills,* the Board treated the ERCs as "necessary" to put a power plant to "beneficial or productive use" and thus taxable for property tax purposes. Because many businesses use intangible assets that are "necessary" to the conduct of their businesses (e.g., trademarks, trade names, franchises, licenses, customer relationships, patents, and copyrights), the case has attracted attention across a broad spectrum of the California business community.

The trial court in this case initially agreed with the Board's finding that the ERCs were "necessary" to construct Elk Hills' power plant, and therefore were an attribute of taxable real property under Revenue and Taxation Code section 110(f). The Court of Appeal affirmed the lower court but on different grounds. *Elk Hills Power, LLC v. Board of Equalization,* 195 Cal. App. 4th 289 (2011). First, the Court of Appeal held that ERCs are an intangible asset or right, and thus not subject to property tax. However, under the language of Revenue and Taxation Code section 110(e), the court reasoned that the full value of those intangible ERCs may be added to the value of the taxable property—Elk Hills' power plant—because they were "necessary" to put the power plant to "beneficial or productive use." *Id.* at 293.

The Court of Appeal's decision potentially overturns several California Supreme Court decisions affirming the nontaxability of intangible assets or rights. It further calls into question several aspects of the Board's appraisal guidance.

Amicus briefs have been filed by, among others, the Council On State Taxation (COST), the Institute for Professionals in Taxation (IPT), the Broadband Tax Institute, the California Taxpayers Association (CalTax), joined by the California Manufacturers & Technology Association and the Silicon Valley Leadership Group, and the California Cable and Telecommunications Association. Taxpayers should monitor this California Supreme Court case because it could have significant implications with respect to the taxation of intangible property in California.

California Court of Appeal's Motion on Election

On July 24, 2012, the California Court of Appeal issued its decision in *The Gillette Company, et al. v. Franchise Tax Board,* No. A130803, confirming that the Multistate Tax Compact is an enforceable multistate compact and that its apportionment election provision is binding on California until the state withdraws from the Compact by enacting a repealing statute. In fact, the California legislature passed Senate Bill 1015 on June 27, 2012, prospectively repealing the Multistate Tax Compact and codifying the "doctrine of elections." Both sections of Senate Bill 1015 were aimed at limiting the potentially huge revenue fallout that otherwise would have resulted from a taxpayer victory in *Gillette.* While the legislation was slated as revenue neutral and passed by a simple majority vote, the holding in *Gillette* has raised a legitimate question as to whether Senate Bill 1015 was in fact a tax increase under the law prior to its passage, and thus subject to the two-thirds super majority vote requirement.

On August 9, 2012, however, on its own motion, the California Court of Appeal ordered a rehearing in *Gillette* and vacated its July 24 decision and opinion. The court's order came one day after the Franchise Tax Board filed a petition for rehearing. With a rehearing pending, the impact of the *Gillette* case and Senate Bill 1015 in California remains to be seen. One issue is whether the doctrine of elections applies only to taxpayers that make an election on an original return and then try to revoke it on a subsequently filed amended return. Another issue is whether the doctrine of elections will apply to prohibit taxpayers from making the apportionment election on an amended return altogether. Retroactively prohibiting taxpayers from making the Compact election on amended returns may raise due process concerns.

Taxpayers in other Compact election states potentially could make the election and argue that the state is limited to complete withdrawal from the Compact and cannot unilaterally change or repeal individual provisions.

Stay tuned for Sutherland SALT's coverage of this closely watched case.

California Dreaming: Major Tax Bills Die as Initiatives Loom, BOE Transparency Passes

State Board of Equalization Transparency

Although the most significant tax legislation to pass the California Legislature this year was SB 1015 (discussed in “California State Court of Appeal’s Motion on Election,” on page 7), another major tax bill to reach the Governor’s desk also could have far-reaching impact. AB 2323 requires the State Board of Equalization (BOE) to issue written opinions in cases where the amount in controversy exceeds $500,000. AB 2323 passed the Senate on August 21 and awaits the Governor’s signature.

AB 2323 will be a major step forward in promoting transparency at the BOE and in rebuilding taxpayer confidence by requiring the BOE to publish written opinions and decisions. The BOE is the nation’s only elected tax appeals board. It serves as a quasi-judicial appellate body that hears and decides California tax disputes that arise in the context of both the tax and fee programs administered by the BOE and Franchise Tax Board (FTB) determinations of corporate and personal income tax matters. Despite this significant quasi-judicial role in the heart of California’s tax community, for well over a decade now there have been few written BOE decisions.

The current lack of transparency at the BOE and related lack of taxpayer confidence were addressed in a recent decision by the California Court of Appeal, Second Appellate District. In City of Palmdale v. Board of Equalization, 206 Cal.App.4th 329 (2012), the BOE was criticized for the performance of its decision-making authority and appellate function.

AB 2323 leaves the BOE with ultimate authority on the precedential value of its decisions. However, the legislation would require the BOE to fully explain the basis for its decisions even in non-precedential summary decisions. More specifically, the BOE would be required to set forth its findings of fact, the legal issue(s) presented, the applicable law, analysis, disposition, and names of adopting board members. This required practice would yield consistency in the BOE’s decision-making authority with respect to the appeals it decides and over time will restore the taxpayer confidence that has been missing for so many years.

Rule 5452 of the BOE’s Rules for Tax Appeals sets forth criteria that are comparable to the California Court of Appeal’s rules regarding when an appellate decision should be published, including whether the decision would resolve or create an apparent conflict in the law or would involve a legal issue of continuing public interest. See 18 Cal. Code Regs. § 5452(e). In just the last few years, the BOE has addressed scores of cases that fit the criteria in Rule 5452 for issuing a published Formal Opinion, and yet the BOE has remained reluctant to publish opinions upon which California’s tax enforcement agencies and taxpayers alike can rely.

Mandatory Single Sales Factor:

California’s two-year legislative session ended in the wee hours of September 1 with no further significant tax changes, despite a last-ditch effort to impose a mandatory single sales factor apportionment formula. AB 1500 would have removed the ability to use California’s standard apportionment formula consisting of property, payroll, and double-weighted sales. Requiring a two-thirds vote for passage, the bill failed in the Senate by a vote of 22-15, with three senators not voting. AB 1500 joins other tax bills that will not see the light of day this year.

Other Failed Anti-Corporate Taxpayer Bills

Several other anti-corporate taxpayer bills did not pass the California Legislature. AB 2439, which would have required the FTB to disclose the name, tax liability, charitable contributions, and apportionment formula of the 500 largest publicly traded corporate taxpayers (measured by gross receipts, less returns and allowances), did not receive a vote in the Senate. SB 1208, mandating publicly traded corporations to disclose the compensation of their boards of directors and five highest paid retirees, failed passage in the Assembly by a vote of 32-36, with 12 members not voting. Finally, AB 2408, repealing the two-year net operating loss (NOL) carryback that is scheduled to take effect on January 1, 2013, remained in the Senate without a vote.

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Tax Propositions

Although the legislative session has ended, the campaigns to enact three significant tax initiatives have just begun. First, Proposition 39, an initiative that would mandate a single sales factor apportionment formula and allocate $550 million per year to "create energy efficiency and clean energy jobs" is slated to appear on the November 2012 general election ballot. A July Field Poll indicated voters favor the initiative 44% to 43%, with 13% undecided. A majority of voters must approve the initiative for it to become law.

Propositions 30 and 38 would increase personal income taxes. Proposition 30, sponsored by Governor Jerry Brown, creates three new tax brackets of 10.3%, 11.3%, and 12.3% for taxpayers with taxable incomes exceeding $250,000, $300,000, and $500,000, respectively. Proposition 30 also would increase sales taxes by 0.25% to a total of 7.5%. Proposition 38, sponsored by activist Molly Munger, increases income taxes on annual earnings over $7,316 using a sliding scale from 0.4% for lowest individual earners to 2.2% for individuals earning over $2.5 million. The July Field Poll indicates that that voters favor Proposition 30 54% to 38%, with 12% undecided. The same poll indicates that voters are divided on Proposition 38, with 46% of voters in favor and 46% against, and 8% undecided.

California Screaming: Regulatory Process Heats Up!

Although the Legislature ended its session, the tax agencies are pressing on in the regulatory process. The BOE is continuing a dialogue with interested parties regarding whether its technology transfer agreement (TTA) regulation, 18 Cal. Code Regs. § 1507, "should be amended to clarify when sales or purchases of software qualify as Technology Transfer Agreements and how tax applies to sales of qualifying software media." The TTA statutes exclude from the sale or purchase price the value of intangible property transferred under a TTA. Cal. Rev. and Tax. Code §§ 6011(c)(10), 6012(c)(10). At its interested parties meeting on July 17 and at the BOE's Business Taxes Committee meeting on August 21, stakeholders took issue with the BOE staff interpretation of the law governing TTAs and whether software is tangible personal property when it is transferred on tangible storage media. Other interested parties have proposed an optional percentage allocating the taxable and nontaxable values of tangible personal property transferred under a TTA. The BOE has decided to move the next interested parties meeting regarding the TTA regulation from November 13, 2012 to January 2013 to allow further discussion.

The FTB also has a full regulatory agenda. On September 5, the FTB moved proposed regulation 24465-3 to the formal regulatory process. The proposed regulation details the annual reporting requirement for corporations that transfer appreciated property to an insurer and defer gain under Cal. Rev. and Tax. Code § 24465(b).

An FTB interested parties meeting will be held on October 1 to discuss the development of a proposed regulation addressing procedures for handling defective credit assignment elections under Cal. Rev. and Tax. Code § 23663. Section 23663 authorizes corporations in a combined reporting group to assign tax credits within the group. However, credit assignments occasionally are invalid for failure to comply with the statute. Thus, the proposed regulation would attempt to specify appropriate procedures to correct defective elections.

In other FTB news, the agency is considering whether and to what extent to continue its involvement in the Multistate Tax Commission (MTC) after the passage of SB 1015, which withdrew California's participation in the MTC Compact. Even though California's membership in the MTC Compact has been withdrawn, the MTC permits states to participate in the MTC on either a dues or a fee basis. The FTB deferred a decision on the question of MTC participation at its September 5 meeting but likely will discuss the issue again at its meeting on December 5.

California Nexus: Not in My House!

In a non-precedential, summary decision released May 3, 2012, the California State Board of Equalization (the Board) held that a foreign corporation with only one employee in California was "doing business" in the state and thus was subject to California's corporation franchise tax. *Appeal of Warwick McKinley, Inc.,* Cal. Bd. of Equal., Jan. 11, 2012 (released May 3, 2012). While California recently expanded its statutory definition of "doing business" in California Revenue and Taxation Code (CRTC) section 23101(b) to include a factor presence nexus test, the Board in *Appeal of Warwick McKinley, Inc.* focused on CRTC section 23101(a), which defines "doing business" to mean "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit."

The taxpayer, a Massachusetts-based marketing and consulting services provider, neither maintained an office in California nor provided services for any California-based clients, but employed an individual who worked from her home in Venice, California. Appealing an adverse determination by the California Franchise Tax Board, the taxpayer contended that its lone California employee worked from a qualifying home office and engaged in activities that were protected under P.L. 86-272. The taxpayer further contended that this home office was not "publicly attributed" to the company and therefore did not create nexus for the taxpayer in California under current constitutional constraints.

The Board was precluded from determining whether a state statute was unconstitutional or unenforceable by virtue of federal law and noted that the taxpayer provided services rather than solicited sales of tangible personal property (rendering P.L. 86-272 inapplicable). Turning to whether the taxpayer was "doing business" in California, the Board found there was no dispute that the taxpayer engaged in transactions for a corporate business purpose through its California-based representative. Further, the Board noted that through its employee in California, the taxpayer received substantial benefit and protection from the state that allowed it to enhance its business. This, the Board reasoned, was enough to support a finding of substantial nexus and the imposition of California's corporation franchise tax pursuant to CRTC section 23151.

POLICY *WONK*

Illinois Senate President Wants Corporate Tax Liabilities on Internet

Illinois Senate President John Cullerton introduced a bill on May 9 that would require publicly traded corporations doing business in Illinois, and those that are at least 50% owned by a publicly traded company, to disclose certain income tax liability information for eventual publication on an Internet database. SB 282 would require the information, usually considered confidential, to be disclosed by corporations that are not obligated to file a corporate income tax return. The data would be publicly searchable, although the data would not be disclosed until two years after the relevant tax year. Although the General Assembly adjourned on May 31 without voting on the bill, Senator Cullerton plans to work on the bill over the summer with the intent of holding hearings before the November veto session.

The information that Illinois would require to be disclosed in an annual statement filed with the Secretary of State includes, among other items: (1) name and address of the corporation; (2) name and address of any corporation that owns 50% or more of the voting stock; (3) modified taxable income; (4) business and nonbusiness income; (5) apportioned income; (6) Illinois apportionment factor; (7) Illinois credits claimed; and (8) Illinois tax liability before and after credits.

Beyond requiring unprecedented levels of taxpayer disclosures, a corporation's obligation to file the annual statement is not based on the company having an income tax filing requirement, but whether it is "doing business" in the state. The doing business standard in the bill includes corporations making sales of tangible personal property to Illinois customers, earning income from intangible personal property with a situs in Illinois, or performing services for customers located in the state. Thus, some corporations that are *not subject to the corporate income tax,* such as companies protected by Public Law 86-272, will nonetheless have to file an annual disclosure statement. However, the bill does give these companies the option of electing to not provide a detailed statement but instead provide an explanation of why no tax return is required and a designation of the gross receipts in the state. The current version of the bill prescribes noncompliance penalties up to $100 per day for a corporation that is delinquent in filing the annual statement.

Senator Cullerton justifies this approach as a tool to evaluate the need for corporate tax breaks and to understand the impact tax incentives have on job creation and economic development. While understanding whether incentive programs achieve their intended purpose is admittedly important, SB 282 arguably goes beyond what is necessary to achieve that goal and places another administrative burden on already burdened companies. The relationship between the stated goal and providing such data to the public is unclear, including why only data from public companies is relevant to evaluating tax policy. And particularly worrisome is the bill's extension of the reporting requirement to corporations not subject to tax, and arguably corporations not even required to be registered with the Secretary of State. Further, the Illinois taxpayer confidentiality provision already allows taxpayer information to be shared with the Secretary of State, and a simple addition to that provision could serve the stated purpose of SB 282 without additional burdens on taxpayers.

Come See Us

September 19, 2012
TEI Seattle Chapter Meeting
Bellevue Club – Bellevue, WA
Jeff Friedman and **Michele Borens** on Significant State Tax Litigation Around the Country
Jeff Friedman and Tax Partner **Robb Chase** on Thinking Outside the Box – Legitimizing Corporate Structures
Michele Borens and **Robb Chase** on Taxpayer Confidential Information (Or Not-So-Confidential) – What the States and the Federal Government are Sharing
Marc Simonetti and **Scott Booth** on The Sutherland Bottom 10 – The Worst of the Worst in State Tax

September 20, 2012
TEI San Francisco Chapter Meeting
Golden Gate University – San Francisco, CA
Charlie Kearns with Tax Partners **Adam Cohen** and **Joe DePew** on Federal and State Tax Issues Related to Employment

September 28, 2012
ACI Emerging Payment Systems Conference
Marriott – Washington, DC
Marlys Bergstrom on State Roundtable: New Initiatives and Money Transmitter Issues in Emerging Payment Systems and Ensuring Compliance with the State Regulatory and Enforcement Framework

September 30-October 3, 2012
IPT Sales and Use Tax Symposium
Hyatt – Minneapolis, MN
Jack Trachtenberg on Settlements and Appeals and on Ask the Experts – New Jersey, New York, Pennsylvania
Steve Kranz on Cloud Computing

October 17, 2012
Entertainment Software Association GameLaw 2012
Westin St. Francis Hotel – San Francisco, CA
Steve Kranz will present on tax issues

October 21-24, 2012
Broadband Tax Institute Annual Conference
The Breakers – Palm Beach, FL
Eric Tresh and **Jack Trachtenberg** on False Claims Act: What Can You Do to Protect Your Company?
Jeff Friedman on Significant Court Decisions Impacting Our Industry and on Seeking State Tax Fairness: The Need for Federal Adjudication, a Taxpayers Bill of Rights, and Federal Preemption Legislation
Doug Mo on Significant Property Tax Developments and on Central Assessment and Intangibles – Elk Hills, Oregon and Other Significant Developments
Steve Kranz on State Tax Reform – UDITPA/ Digital/Contingent Fee Audits: How the BTI Membership is Working Together to Impact the Policy World
Maria Todorova on Emerging Transaction Tax Issues

October 24-26, 2012
COST 43rd Annual Meeting
Loews Portofino Hotel – Orlando, FL
Eric Tresh on Staying Out of Trouble – Due Diligence for Sales and Use and Employment Taxes Related to Mergers and Acquisitions
Carley Roberts on Monday Morning Quarterbacking: Strategic Lessons from the Top 10 Current State Tax Cases
Steve Kranz on Resolving State Tax Issues Through Congress – What's Cooking in Washington?

October 28-31, 2012
TEI Annual Conference
Westin Diplomat – Hollywood, FL
Michele Borens and **Marc Simonetti** on Practical Guide to Handling State Tax Controversies

November 1-3, 2012
2012 California Tax Policy Conference
Loews Coronado – San Diego, CA
Prentiss Willson delivering the keynote address, interviewing the Board of Equalization's new Executive Director, Cynthia Bridges
Jeff Friedman on A SALTy Countdown – the Top 10 Litigation Cases of 2012
Jack Trachtenberg on The Sales Factor – Finding a Method in the Madness
Tim Gustafson on Successfully Negotiating a State Tax Settlement – Even in This Economy

November 4-7, 2012
IPT Income Tax Symposium
Key Bridge Marriott – Arlington, VA
Diann Smith on Ask the Specialist!

November 8, 2012
MACPA/Maryland Bar Association Advanced Tax Institute
Martins West – Baltimore, MD
Jeff Friedman on National Developments and Trends in State Taxes – Point/Counterpoint Discussion

November 9, 2012
STARTUP State Tax Roundtable for Utilities and Power
Louisville Gas & Electric – Louisville, KY
Jeff Friedman on State Tax Aspects of Attorney Client Privilege and Work Product Doctrine

November 13, 2012
Wirleess Tax Group Meeting
Kansas City, KS
Eric Tresh and **Maria Todorova** on Hot State and Local Tax Topics for Communications Companies

Recently Seen and Heard

July 29-August 2, 2012
Annual Wichita Program on Appraisal for Ad Valorem Taxation
Wichita, KS
Doug Mo on What is a Possessory Interest and How is it Treated for Ad Valorem Taxation?

August 6, 2012
Georgetown University Law Center Advanced State and Local Tax Institute
Georgetown University Law Center – Washington, DC
Marc Simonetti on Alternative Apportionment – Sword or Shield?

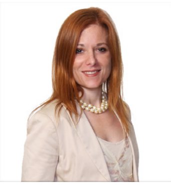
August 10, 2012
2012 Ohio Tax Course
Cherry Valley Lodge – Granville, OH
Diann Smith on Multistate Trends and Developments and on Nexus

August 30, 2012
COST Pacific Northwest Regional Seminar
Fairmont Hotel – San Jose, CA
Pilar Mata on Discussion of State Tax Cases and Issues to Watch in 2012 and Beyond
Andrew Appleby and **Jack Trachtenberg** on Hot Topics in New York State Tax
Carley Roberts and **Prentiss Willson** on Best Practices and Strategies for Winning California Income and Sales/Use Tax Cases

September 13, 2012
Wireless Tax Group Meeting
Kansas City, KS
Eric Tresh and **Maria Todorova** on Hot State and Local Tax Topics for Communications Companies

September 13-15, 2012
TEI Tri-Chapter Meeting
Westin Boston Waterfront – Boston, MA
Jack Trachtenberg on Cutting Edge Issues Regarding Manufacturing Exemptions from Sales and Use Tax
Diann Smith on DC Transfer Pricing Litigation

The Sutherland SALT Team



Michele Borens
202.383.0936
michele.borens@sutherland.com

Jonathan A. Feldman
404.853.8189
jonathan.feldman@sutherland.com

Jeffrey A. Friedman
202.383.0718
jeff.friedman@sutherland.com

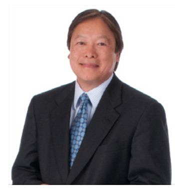
Stephen P. Kranz
202.383.0267
steve.kranz@sutherland.com

Carley A. Roberts
916.241.0502
carley.roberts@sutherland.com

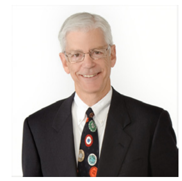
Marc A. Simonetti
212.389.5015
marc.simonetti@sutherland.com

Eric S. Tresh
404.853.8579
eric.tresh@sutherland.com

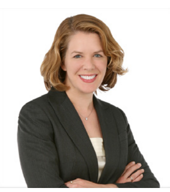
W. Scott Wright
404.853.8374
scott.wright@sutherland.com



Douglas Mo
916.241.0505
douglas.mo@sutherland.com



Prentiss Willson
916.241.0504
prentiss.willson@sutherland.com



Pilar Mata
202.383.0116
pilar.mata@sutherland.com

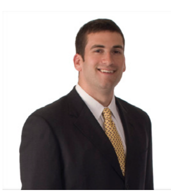
Michele L. Pielsticker
916.241.0506
michele.pielsticker@sutherland.com

Diann L. Smith
202.383.0884
diann.smith@sutherland.com

Jack Trachtenberg
212.389.5055
jack.trachtenberg@sutherland.com

Marlys A. Bergstrom
404.853.8177
marlys.bergstrom@sutherland.com

Andrew D. Appleby
212.389.5042
andrew.appleby@sutherland.com



Zachary T. Atkins
404.853.8312
zachary.atkins@sutherland.com

Madison J. Barnett
404.853.8191
madison.barnett@sutherland.com

Scott A. Booth
202.383.0256
scott.booth@sutherland.com

Christopher N. Chang
212.389.5068
christopher.chang@sutherland.com

Michael L. Colavito Jr.
202.383.0870
mike.colavito@sutherland.com

Miranda K. Davis
404.853.8242
miranda.davis@sutherland.com

Lisbeth A. Freeman
202.383.0251
beth.freeman@sutherland.com

Timothy A. Gustafson
916.241.0507
tim.gustafson@sutherland.com

Charles C. Kearns
202.383.0864
charlie.kearns@sutherland.com

Jessica L. Kerner
212.389.5009
jessica.kerner@sutherland.com

Suzanne M. Palms
404.853.8074
suzanne.palms@sutherland.com

Kathryn Pittman
202.383.0826
kathryn.pittman@sutherland.com

David A. Pope
212.389.5048
david.pope@sutherland.com

Maria M. Todorova
404.853.8214
maria.todorova@sutherland.com