



Congress Senses That Physical Presence Nexus IS the Standard!

Senate Bill 1147 became effective on March 31, 2010 and is important because its inclusion of a "sense of Congress" that physical presence is a viable nexus standard. Public Law No: 111-154, or the PACT Act ("Prevent All Cigarette Trafficking" Act of 2009 – a misnomer for the sake of a clever acronym because the bill covers smokeless tobacco as well as cigarettes) is aimed at reducing illegal remote tobacco sales to consumers. Amid menacing words like "al Qaeda" and underage smoking, Congress provides a rare federal acknowledgment of state tax nexus, both overtly and through a vocal silence on the issue.

First, the Bill specifically requires remote tobacco vendors, regardless of their presence in a state, to comply with state excise tax collection laws and reporting requirements "as if the delivery sales occurred entirely within the specific State." § 2A. Thus, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), is not an impediment to state enforcement of excise tax collection on remote tobacco vendors.

The Bill becomes of further interest to many multistate businesses because Congress explicitly notes that the removal of Commerce Clause nexus rules for remote tobacco sellers should not be interpreted to mean anything regarding the nexus issue in general. After 24-plus pages of tobacco selling regulatory minutia, Congress recognizes that broader nexus questions could be implicated by the law and squashes any argument for an implied broader meaning. That

Ouch! Georgia General Assembly Enacts 1.45% "Hospital Tax"

The Georgia General Assembly recently passed House Bill 1055, which includes a myriad of increased fees and a new temporary tax on revenue earned by hospitals. O.C.G.A. § 31-8-179. The tax, officially known as the "Provider Payment Agreement Act," but more commonly referred to as the "hospital tax" or "bed tax," imposes a 1.45% "provider payment" on "net patient revenue" earned by hospitals in the state and is imposed for the privilege of operating a hospital. "Net patient revenue" is defined to mean the total gross patient revenue of a hospital less certain items such as contractual adjustments, charity care, and indigent care. The term "hospitals" is defined broadly to include nursing homes and other specialty centers, but the term does not include some hospitals, such as "critical access hospitals" (as defined under Georgia law) and state owned or operated hospitals.

The tax – which some prefer to call a fee – is intended to be in effect for only three years and was passed in conjunction with other tax reductions

included within H.B. 1055 including a five year phase-out of the state portion (a quarter mill) of the property tax and the reduction of state tax on retirement income. The language of the Act is silent as to whether hospitals may pass this tax through to their patients and insurers, but it is anticipated that many hospitals will attempt to do so.

Other states have recently enacted or expanded similar "hospital taxes" including Colorado (H.B. 1293 – 2009), Maine (H.B. 1351 – 2004), Ohio (H.B. 1 – 2009), Oregon (H.B. 2116 – 2009), Wisconsin (S.B. 62 – 2009, A.B. 770 – 2010), and a tax is currently being proposed in Connecticut (S.B. 478 – 2010).

If enacted, the "hospital tax" would become effective on July 1, 2010 and would be scheduled to sunset on June 30, 2013. The Georgia House and Senate approved the bill on April 14, 2010, and it is currently awaiting Governor Sonny Perdue's signature or veto. The Governor is expected to sign the bill.

Colorado Zero Apportionment

Effective April 30, 2010, Colorado's Department of Revenue has amended its apportionment regulations in two material ways. First, an apportionment factor whose denominator is zero shall be excluded from the apportionment factor calcula-

tion. Second, amounts in any factor that do not materially contribute to the generation of business income shall be excluded from the factor. Both changes will be applied to produce higher, not lower, Colorado apportionment.

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Congress Senses That Physical Presence Nexus IS the Standard! (con't)

Congress was aware of the possibility of a broader meaning, and its decision to explicitly prevent one is curious evidence that Congress actually is paying attention to the nexus wars.

In Section 8, the final section of the Act, Congress includes a "Sense of Congress Concerning the Precedential Effect of This Act" that reads: "This Act is in no way meant to create a precedent regarding the collection of State sales or use taxes by, or the validity of efforts to impose other types of taxes on, out-of-State entities that do not have a physical presence within the taxing State."

In the Bill, Congress notes that it has been involved for at least 50 years (since the passage of the Jenkins Act) in urging compliance with state laws regulating remote sales of tobacco products. The Jenkins Act established reporting requirements for out-of-state companies that sell tobacco products to citizens of taxing states and provided federal level enforcement of the reporting requirements. The amendments expand on the record keeping and reporting requirements to include that: "Each delivery seller shall keep a record of any delivery sale, including all of the information described in [other sections of the Bill], organized by the State, and within the State, by the city or town and by zip code, into which the delivery sale is so made." If Congress felt it necessary to authorize such record keeping, perhaps the notice and reporting regime newly enacted by Colorado and being considered elsewhere similarly needs federal authorization.

Washington State Legislature Update

On April 23, 2010, Washington State Governor Chris Gregoire signed Senate Bill 6143 into law as a revenue package aimed at closing a projected budget shortfall. The Bill is supposed to add approximately \$794 million in new revenue. Reaching this agreement proved difficult, but key to the deal was the Senate's decision to drop a proposed sales tax rate increase. Although the increase would have been temporary, it proved a major sticking point in the negotiations. Rather than a rate increase, the Bill does include an expansion of the tax base. The package includes temporary measures that expire in 2013, including a new \$.02 tax per 12 ounces on soft drinks, a \$.50 per gallon excise tax on beer, and a Business and Occupation Tax (B&O Tax) surcharge for service-industry businesses. These temporary measures account for approximately \$342 million.

One of the most controversial parts of the Bill is a provision that allows the Department of Revenue (DOR) to attack businesses that engage in "tax avoidance transactions,"

which is projected to raise an estimated \$31 million. The DOR will consider several factors to determine whether a transaction is to be disregarded, including: whether the transaction changes the economic positions of the participants in a meaningful way, apart from tax effects; whether substantial nontax reasons exist for entering into the transaction; and whether the transaction is a reasonable means of accomplishing a substantial nontax purpose. Notably, the DOR is not required to prove the subjective intent of the taxpayer when making this determination.

Another significant addition is \$82 million in B&O Tax related to the adoption of a limited economic nexus standard. Out-of-state businesses engaged in service activities and with more than \$50,000 of payroll or property in the state, more than \$250,000 of in-state sales, or at least 25% of its total property, total payroll, or total receipts in the state will be liable for B&O Tax on any service activities or royalty income.

SALT PET OF THE MONTH

Michele's "Joe"



Joe Borens (aka Joe Joe and Chunky Chicken) is a special four-year-old English bulldog and loyal member of the Borens family. He is particularly loved for some of his unique characteristics, including his ability to sleep 23 hours a day, his wall-shaking snoring and his unwillingness to go outside (even for the most basic of reasons). Most importantly he loves to eat (rocks too!). While the facial characteristics of English Bulldogs can appear intimidating, Joe adores every-

one, including small children, and is excited to see strangers. He is a great companion to Michele's 9- and 10-year-old daughters who commented, "he snuggles very well." He has attempted (accidentally) on occasion to take a swim with Michele's daughters, but instead of doggy paddling, Joe just sinks. With spring passing by all too quickly, Joe is gearing up for a long, sleepy summer. He hates the heat, but maybe that will be incentive enough to take swimming lessons!

Arizona “Accessorizing” the Unitary Analysis

The Arizona Court of Appeals recently decided *R.R. Donnelley & Sons Co. v. Arizona Dep’t of Revenue*, No. 1 CA-TX 08-0007 (Ariz. Ct. App. April 29, 2010), holding that a commercial printing company’s subsidiaries, R.R. Donnelley Receivables Inc. (“Receivables”) and Caslon Inc. (“Caslon”), which provided accounts receivables and investment services respectively, performed “accessory” functions and thus were not unitary with the taxpayer’s commercial printing business. However, the court ruled that the taxpayer’s trademark holding subsidiary, Heritage Preservation Corp. (“Heritage”), provided “basic operations” and must be included in the taxpayer’s combined return.

Arizona law requires affiliated corporations that comprise a unitary business to file a combined Arizona income tax return. Following a lengthy audit, the Arizona Department of Revenue (the “Department”) concluded that all three of RR Donnelley & Sons’ subsidiaries were unitary with its commercial printing business and assessed additional tax. The taxpayer appealed, and the Arizona Tax Court found that Receivables and Caslon’s investment business were not unitary with the taxpayer’s commercial printing business and that Heritage, an intangible holding company, was unitary with the taxpayer. The Department appealed, and the taxpayer cross appealed.

The Arizona Court of Appeals began its analysis by emphasizing that in determining whether a business is unitary, a “key factor ... is the distinction between ‘basic operations’ and ‘accessory’ functions.” *Id.*

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Recently Seen and Heard

April 15, 2010

Strafford CPE/CLE Webinar

Eric Tresh on Apportioning Service Revenue in Corporate Tax Compliance – Navigating the Latest State Laws and Regulations

April 22, 2010

New York State Bar Association 2010

New York State and City

Tax Institute

Princeton Club – New York, NY

Marc Simonetti on Disclosure Developments

April 22, 2010

DC Bar Taxation Section/State and

Local Tax Committee Program

DC Bar Conference Center – Washington, DC

Pilar Mata on State and Local Tax Trends Every Practitioner Should Know

April 25-29, 2010

COST Intermediate/Advanced Sales Tax School

Georgia Tech Hotel & Conference Center – Atlanta, GA

Scott Wright and **Jonathan Feldman** on Manufacturing/Construction Sales & Use Tax Issues

April 25-29, 2010

COST Intermediate/Advanced State Income Tax School

Georgia Tech Hotel & Conference Center – Atlanta, GA

Jeff Friedman and **Michele Borens** on Determining the Corporate Income Tax Base

April 26, 2010

TEI Cincinnati Chapter Meeting

Cincinnati, OH

Marc Simonetti and **Maria Todorova** on State Tax Legislation and Litigation Update

Diann Smith and **Pilar Mata** on Nexus Evolution: Legislation, Regulation and Litigation, and The Dangers of Unreliable Intercompany Accounting

Marc Simonetti and **Pilar Mata** on The Dangers of Unreliable Intercompany Accounting

Diann Smith and **Maria Todorova** on Ohio CAT and Michigan SBT Developments

April 28, 2010

STARTUP Spring 2010 State Tax Roundtable for Utilities and Power

Charlotte, NC

Jeff Friedman and **Eric Tresh** on State Tax Trends: Revising Apportionment Methods, Aggressive Penalty Enforcement and Retroactive Taxation

April 29, 2010

TEI Nashville Chapter Spring Seminar

Nashville, TN

Jeff Friedman and **Pilar Mata** on The Dangers of Unreliable Intercompany Accounting

May 7, 2010

State Taxation – The Role of Congress in Developing Apportionment Standards

Sutherland’s Office – Washington, DC

Washington Bad Debt Law Change

Among the provisions of Washington Senate Bill 6143 (*discussed on page 2*) is a change to the rules governing bad debt credits for sales taxes. Washington was one of a few states that had case law permitting third parties to claim bad debt credits for debts that had been purchased from the original seller of taxable goods. *Puget Sound National Bank v. Department of Revenue*, 868 P.2d 127 (Wash. 1994). Under the

new legislation, third parties will no longer be able to claim bad debt credits after such an assignment. The legislation explicitly overturns the *Puget Sound* decision. The legislation also states that debts that have been assigned by a seller to a third party are no longer included in the definition of bad debts under the statute and that the right to claim a bad debt credit may not be assigned by a seller.

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Arizona “Accessorizing” the Unitary Analysis (*con’t*)

When services are accessory, they are “not embodied in the product or its delivery to the customers,” and “‘not so pervasive as to negate functional independence’ of the subsidiaries.” *Id.* The court then determined that the services performed by Receivables and Caslon did not create a unitary relationship because they were accessory services rather than basic operational components of the core business. The court explained that even though a significant part of Receivables’ factoring income came from R.R. Donnelley, it purchased the accounts without recourse, at fair market value and also earned revenue from third-party purchases. The court further found that Caslon’s property consisted of intangible personal property investment assets and that it did not share any centralized management or property with R.R. Donnelley.

On the other hand, the trademarks held and managed by Heritage were a core part of Donnelley’s operations in delivering the commercial printing materials it produced. The trademarks were fully operationally integrated with the delivery and distribution of Donnelley’s products and services to its customers.

Ultimately the court concluded that Heritage was functionally interdependent and must be included in Donnelley’s unitary group. The court further noted that although Arizona regulations identify a unitary business by a substantial transfer of tangible items, intangible items such as trademarks may be treated as tangible products under the unitary business standard.

Amazon Fights to Protect Disclosure of Customer Identities

On April 19, 2010, Amazon.com filed a complaint in U.S. District Court for the Western District of Washington seeking a declaration that North Carolina is not entitled to personal information regarding the identity of Amazon’s North Carolina customers. Amazon maintains that if it is forced to comply with the State’s demand for such information, the disclosure will invade its customers’ right to privacy, and violate the First Amendment and the federal Video Privacy Protection Act.

Amazon sets forth in its complaint that it has been under audit by the North Carolina Department of Revenue (“Department”) for sales and use tax purposes. As part of the audit and in response to the Department’s request for information, Amazon provided the following information regarding purchases made from North Carolina customers since 2003: the order ID number; the city, county and zip code to which the item was shipped; the total price paid; the date of the transaction; and the standard product code for each transaction. However, to protect customer privacy and decisions regarding purchases of expressive materials, Amazon did not provide the Department with personal identifiable information for any of its North Carolina customers as was specifically requested. The Department threatened to issue an administrative summons to force Amazon to provide such information, and Amazon filed suit. Amazon maintains that the infor-

mation provided is sufficient for North Carolina to conduct its audit and that linking this information to specific individuals is unnecessary and irrelevant. Furthermore, Amazon states that by requiring disclosure of customer purchasing habits, the State will chill the exercise of customer’s expressive choices and cause customers not to purchase certain items for fear of the disclosure of their choices to the government (e.g., Amazon notes that it has already provided the Department with information that shows that North Carolina customers purchased books on bipolar disorder, alcoholism and divorce). Amazon also notes that public figures who have purchased expressive works could be scrutinized, and such information could be used against them for political purposes.

Notably, Amazon.com filed its lawsuit in U.S. District Court in Seattle, Washington, where Amazon is headquartered. Amazon has no employees, property or physical presence in North Carolina and is not registered to do business with the North Carolina Secretary of State. Amazon maintains that venue is appropriate in Washington because the events at issue (i.e., the Department’s audit and demand for customer information) took place in the district, a substantial amount of property at issue is located in the district, and because Amazon’s compliance with the demands for customer data would largely occur within the district. This case is one to watch.

Come See Us

May 12, 2010

TEI Seattle

Seattle, WA

Michele Borens, Jeff Friedman and Steve Kranz on Apportionment – Sales Factor Sourcing of Services – What Is Your “Market”?; Digital Goods Update – Where Has It Been and Where Is It Going?; RAR Reporting – Pitfalls and Challenges; and Legislation and Litigation Update

May 17-19, 2010

COST Spring Audit Session/Income Tax Conference

Four Seasons Hotel – Austin, TX

Jeff Friedman on To Do or Not To Do: Participating in Amnesties and VDAs

May 18-19, 2010

Telestrategies Communications Taxation 2010

Navy Pier – Chicago, IL

Steve Kranz on Fighting the Good Fight – Communication Industry Efforts to Ensure Sound Tax Policy in a Deficit Environment

Eric Tresh on Send Lawyers, Guns and Money – A Review of This Year’s Significant State and Local Tax Controversies and What Taxpayers Are Doing to Fight Back

May 18-19, 2010

TEI 2010 IRS Audits & Appeals Seminar

Westin O’Hare Hotel – Rosemont, IL

Marc Simonetti on State Tax Consequences of Federal Tax Controversies

May 20, 2010

TEI Denver Chapter SALT Meeting

Lakewood Country Club – Denver, CO

Steve Kranz on State Legislative Scorecard

May 21, 2010

National Conference of State Legislatures Spring Executive Committee Meeting

Brown Palace Hotel – Denver, CO

Steve Kranz on State Taxation of Telecommunications and Electronic Commerce

May 21, 2010

Georgetown Law Center’s State and Local Tax Institute

Georgetown University Law Center – Washington, DC

Marc Simonetti on The Troubled Economy: Losses, Debt Restructuring, Cancellation of Indebtedness Income, Conformity – A State and Local Tax Perspective

May 24, 2010

TEI Baltimore/Washington Chapter Meeting

Hidden Creek Golf & Country Club – Reston, VA

Michele Borens, Steve Kranz and Pilar Mata on SALT Current Developments

June 6-9, 2010

Federation of Tax Administrators 2010 Annual Meeting

Grand Hyatt Buckhead – Atlanta, GA

Eric Tresh on Corporate Income Tax – Alternative Apportionment & Section 18 Issues

June 7, 2010

TEI Atlanta Chapter International Committee Meeting

Atlanta, GA

Scott Wright on State and Local Tax Considerations for Foreign-Owned Entities

June 17, 2010

COST Pacific Northwest Regional State Tax Seminar

Seattle, WA

Sutherland SALT Team on Latest & Great State Tax Litigation; Digital Age SALT Issues – Applying Old Rules to New Technology; and Evolving Combined Reporting Issues

June 21, 2010

Interstate Tax Corporation Interstate Tax Planning Conference

Jolly Madison Towers – New York, NY

Jeff Friedman on How the Interstate Tax System Works/Jurisdiction & Nexus and The Unitary Concept

June 27-30, 2010

IPT 34th Annual Conference

Marriott Desert Ridge – Phoenix, AZ

Steve Kranz on The Taxation of Digital Goods – Equality or Desperation

Marc Simonetti on Protecting FIN 48 Workpapers: Best Practices Following Textron

Eric Tresh on Convergence in the Communication Industry & Impact on Asset Valuation

July 15, 2010

TEI State & Local Tax Course

Indiana University/Purdue University Campus – Indianapolis, IN

Eric Tresh on Introduction to State Franchise and New Worth Taxes

Diann Smith and Pilar Mata on Managing Protests and a Mock State Appellate Hearing

July 22-25, 2010

TEI 2010 Region VII Conference

Westin Hilton Head Resort – Hilton Head Island, SC

Jeff Friedman and Eric Tresh on State Tax Roundtable – Planning and Techniques

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