SALT Experts Discuss ‘Kill Quill’ Cases, Future of Transfer Pricing Litigation
by Eric Yauch

Whether taxpayers are obligated to follow “unconstitutional” state tax laws and what the future could hold for transfer pricing litigation in light of recent state court rulings are some of the challenges states face, panelists said during a March 21 discussion.

Speaking at the 2017 American Bar Association and Institute for Professionals in Taxation conference in New Orleans, Jordan Goodman of Horwood Marcus & Berk Chtd. asked fellow panelists whether taxpayers are required to follow “unconstitutional” state laws, like those challenging the physical presence standard in Quill Corp. v. North Dakota.

The ruling in Quill “is Supreme Court precedent — we follow it,” University of Connecticut law professor Richard Pomp said.

Helen Hecht of the Multistate Tax Commission said there are various schools of thought on what to make of the direct challenges to Quill, but acknowledged that states are frustrated. “To use a word that is probably overused now, this is fraught to say that we’re going to disregard what is the law to bring a challenge to this case,” Hecht said. “We could’ve continued to sort of whittle away at it over time, but I think that states took Justice [Anthony M.] Kennedy at his word and said, ‘You want a case, we’ll bring you a case.’”

The panel’s discussion then turned to transfer pricing in light of recent state court rulings in Rent-A-Center East Inc. v. Department of Revenue in Indiana and See’s Candies Inc. v. Utah Tax Commission.

Hecht said there has been a series of cases on whether intercompany transactions require economic substance before a state has the power to change the allocation and loss between the companies for tax purposes.

“I think the states have gotten themselves into a little bit of a cul-de-sac, where we’ve been arguing essentially what are economic substance arguments when, in fact, we ought to be arguing about what do we all agree is the right result and does this look like that?” Hecht said. “The federal government has its own way of doing this, and it’s got its own system in which it does it. And saying to states ‘look, you have to do it exactly like the federal government does’ doesn’t work.”

Hecht said the states struggle with making economic substance arguments, when in reality the issue is more about income distortion.

One way to tackle the transfer pricing issue — and the issue of tax havens — is for states to adopt combined reporting, Pomp said.

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During a later discussion on the rise of use tax notice and reporting requirements after the Tenth Circuit’s ruling in Direct Marketing Association v. Brohl was allowed to stand when the U.S. Supreme Court denied cert, Pomp said another thing to keep an eye on is a provision in a New York budget proposal. “Right now, in a version of the [New York] budget is the following: If you sell on the Amazon platform, Amazon has to collect New York use tax,” Pomp said. “That is a game changer, should it be upheld and passed.”
Revenue Commissioners Discuss *Quill*, Federal Tax Reform

by Eric Yauch

Federal tax reform’s impact on states and state challenges to the *Quill* physical presence standard were among the issues state tax administrators discussed on a March 22 panel.

Speaking in New Orleans at the 2017 American Bar Association and Institute for Professionals in Taxation conference, Iowa Revenue Director Courtney Kay-Decker said that because her state is one of the few that allows a state deduction for federal taxes paid, any decrease in federal taxes could result in an increase in state revenue.

Alabama Revenue Commissioner Julie Magee said her office has been in contact with federal lawmakers and will continue to remind them of the effects the proposed federal reforms could have on states. “It is daunting to think about the crimp in cash flow that they could possibly cause any of our states,” Magee said. “So the best part about it is, for the first time in my six years, the National Governors Association has a seat at the table.” However, she said, one challenge is that not all the states want the same thing.

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When asked by moderator Breen Schiller of Horwood Marcus & Berk Chtd. his firm’s thoughts on *Quill*, the tax administrators answered that states are basically throwing everything at the wall and seeing what sticks.

“I would like to drill in everybody’s head, and I’ve told Congress this and I’ve told the National Governors Association this: It’s too late. The door is shut,” Magee said. Congress should have acted three years ago when the U.S. Senate passed the Marketplace Fairness Act, but the House failed to act, she said.

“But lo and behold . . . our dear friend [Rep. Bob Goodlatte, R-Va.] made nothing happen,” Magee said. “He [came] out with an asinine solution last year known as an origin-sourcing solution — give me a break, that is just a non-starter.” She said she doesn’t believe federal remote seller legislation will pass as long as Goodlatte is on the House Judiciary Committee.

Regarding what states are doing to address uniformity issues related to sales tax collection for out-of-state sellers, Kay-Decker said that while states talk to each other in an effort to be consistent, it’s ultimately up to legislators.

Schiller said that with states facing large budget deficits, some revenue departments have expanded tax collection efforts without new legislation supporting that expansion — often disguised as a clarification to existing law.

Magee said that under Alabama law, anything perceptible to the senses is taxable. Based on that language, she said, the Department of Revenue in 2015 proposed a regulation to tax streaming video services such as Netflix. However, lobbyists got involved and warned DirecTV customers that their bills would go up, she said, resulting in state lawmakers intervening and asking the DOR to pull the proposed reg. Magee said that when the Alabama Legislature returns from its break, she plans to work with lawmakers to introduce legislation that would allow the state to tax streaming services.

In Iowa, Kay-Decker said, the DOR is required by law to review its regulations every five years and update them as necessary to reflect current conditions. “So because that’s our duty, we need to look at the world as it stands now, and not necessarily how it existed then,” she said.

Schiller asked Louisiana DOR Deputy Secretary Kevin Richard whether there was any traction to the rumor that Louisiana was considering a move to a commercial activity tax (CAT). Richard said that Gov. John Bel Edwards (D) is believed to be on board with a CAT because it would bring an amount of certainty to the state’s budgeting process. Income tax deductions are hard to forecast year to year because the market changes, he said.

Richard said that the administration is looking at repealing the state franchise tax and possibly phasing out the corporate income tax. “The CAT has components of both the franchise tax [and the corporate income tax] in that there is a minimum component of it that every business would pay
this tax, and it also would expand the base in that it would apply to all businesses, even sole proprietorships,” he said.

Schiller's last question to the panelists was on some states' refusal to release their audit manuals and other guidance.

Kay-Decker answered that Iowa's audit manuals have not been released because most taxpayers wouldn't understand what the department is saying in the manuals, so they wouldn't be helpful.

“But if they're not helpful, why not just release it?” Schiller asked. The manuals would cause more confusion instead of helping taxpayers, Kay-Decker responded. The DOR is working on releasing guidance that is written for the majority of taxpayers that are not as well versed in taxes, she added.

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