ADVISING FOREIGN BUSINESSES ABOUT U.S. SUBNATIONAL TAXES

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Selected Articles and Presentations

1. "American State and Local Taxes for Businesses Headquartered Abroad: Know What You Do Not Know—'The Big Three'," *Daily Tax Report* (January 9, 2013). A short article for tax professionals describing three important principles.

2. "Advising Foreign Businesses on U.S. State and Local Taxation," *Tax Management International Journal* (April 12, 2013). A detailed article for tax advisers.

3. "Advising Foreign Businesses About American State and Local Taxation -- And a Few Words About Tax Haven Legislation," *Lecture to Georgetown University Law Center Graduate Tax Class* (October 24, 2018).

4. "Looking Back (Reflections on Wayfair) and Looking Forward (Sales Taxation of Services)," *Lecture to Duke Law School Graduate Tax Class* (October 16, 2018).

5. "Overview of State and Local Taxation," *Joint Presentation By Rimon P.C. and Wilkin and Guttenplan* (May 14, 2018) (recording available at https://www.youtube.com/watch?v=pfMqAGviVoc&t=32s).

6. "U.S. State and Local Sales and Use Taxes: Bad News, Good News and the Smoke from a Distant Fire," *Jerusalem Post* (July 7, 2015). A short article providing news regarding U.S. subnational taxes. Published in a daily newspaper.

7. "U.S. Operations: An Israeli Circular and a U.S. Indictment," *Jerusalem Post* (May 5, 2016). A short article highlighting the dangers of the "wait to see what happens" attitude of many foreign business people and tax professionals. Published in a daily newspaper.

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American State and Local Taxes for Businesses Headquartered Abroad: Know What You Do Not Know—'The Big Three'

BY DAVID A. FRUCHTMAN

European, Asian, and other foreign-based businesses selling goods and services in the United States seek to capture a part of the world's largest consumer market; however, these businesses need to be aware of the tax dangers presented by each of the 50 states.

Unfortunately, many foreign businesses do not know of these dangers.

Foreign-based businesses need to be aware of the tax dangers presented by each of the 50 states.

Based on experience, what follows are the three most important state tax unknowns.

The Lack of a Permanent Establishment Is Irrelevant

Many foreign business and foreign tax professionals believe that a business that does not have a permanent establishment in the United States is not subject to taxation in the United States. Unfortunately, they are wrong where state taxes are concerned.

The United States' tax treaties with other countries provide that a business must have a "permanent establishment" in a foreign country before the business is subject to that country's taxes on income or capital. These treaties define "permanent establishment" as requiring a "fixed place of business."[1]

However, the concept of a permanent establishment is irrelevant to state taxation (unless, as rarely occurs, the state chooses to apply such a standard).[2] For state tax purposes, if a business has an employee or representative in a state on company business—even if that presence is temporary—the business is likely to have tax presence in the state under the U.S. Constitution as interpreted and applied by the U.S. Supreme Court and state supreme courts.[3] If such a presence is established,

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[1] A typical definition provides that "the term permanent establishment means a fixed place of business of an enterprise through which the business is wholly or partially carried on." This or another definition also requiring a "fixed place of business" is contained in the United States' tax treaties with the United Kingdom, Germany, France, Russia, Israel, Japan, Korea, China, and other countries.

[2] See e.g., Florida Technical Assistance Advisement 03C1-003 (Sept. 3, 2003). See also *In the Matter of Westward Seafoods Inc.*, Alaska Office of Tax Appeals, 35-OTA-2000 (Jan. 6, 2004), and *In the Matter of the Appeal of Galvantech Inc.*, California State Board of Equalization Case No. 288289 (Feb. 1, 2006), both of which analyze tax presence in circumstances mirroring that being discussed in this article and reach their holdings without applying a permanent establishment standard. As noted in the text, the states can adopt a permanent establishment standard for taxation, but rarely do so. See e.g., Massachusetts, which uses a permanent establishment standard in limited circumstances relating to its corporate income tax. Mass. G.L. c. 63, Section 32B(c)(3)(iv); see also Massachusetts Technical Information Release No. 10-16 (April 4, 2011). Significantly, even if a state adopts a permanent establishment standard for its income tax, that standard does not necessarily apply to other taxes imposed by the state (e.g., sales and use taxes).

[3] See e.g., *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (holding that, for sales tax purposes at least, tax presence of a business in a state may exist only if the business has a physical presence in the state). An in-state physical presence need not be fixed or permanent, and state courts have held that tax presence can be created by the transitory presence of an employee who is attempting to make a market for the business's goods or services. See e.g., *Orvis Company Inc. v. Tax Appeals Tribunal*, 86 N.Y.2d 165 (1995). Moreover, tax presence can be created by the activities of non-employee representatives. See e.g., *Scripto Inc. v. Carson*, 362 U.S. 207 (1960). While the cases discussed above involve tax presence for sales

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the business will be subject to state and local income, franchise, sales, use, and other taxes. (An income tax exception might be available for businesses selling only tangible personal property.[4])

It is essential that foreign businesses understand that the points of contact required to establish state tax presence are far less substantial than those required under a permanent establishment threshold. Such points of contact include having in-state employees, agents, or representatives doing anything (even on a temporary basis) that creates a market for the business's goods or services. They also include repair or other service activities performed in a state on a business's behalf, or the business's ownership or rental of property located in the state.

It is essential that businesses avoid creating state tax presence accidently.

Of course, businesses exist to make sales and to make a profit, and they regularly conclude that the value of their activities in a state exceeds the cost of the state's taxes and tax compliance requirements. But, with state and local sales tax rates often exceeding 7.5 percent of gross sales, and with state income taxes as high as 10 percent of taxable income, it is essential that businesses avoid creating state tax presence accidently.

The Income Tax Treaty Between the U.S. And a Foreign Home Country Is Irrelevant

Many foreign business and tax professionals mistakenly believe that their resident country's income tax treaty with the United States, by which double taxation is to be avoided (or largely reduced), also protects them from American state and local taxation. It does not.

In fact, the treaties are limited to federal taxes.[5] Therefore, for businesses that have tax presence, the states may impose income, franchise, sales, use, and other taxes independent of the federal government's ability to impose its income tax. And, in general, the measure of state taxes due is not affected by international tax treaties.

For income tax purposes, a business entity that has tax presence in a state may be subject to tax on all of the business's worldwide income. Likewise, if a corporation has tax presence in a state, some or all of its affiliates worldwide might be included in the measure of state income taxes due.[6] This potentially includes foreign affiliates lacking any direct connection with the state, and it can occur even if foreign affiliates' resident country has a tax treaty with the United States.

When a business or corporate group is required to file on a worldwide basis, the income apportionment computation will include information about its worldwide property, payroll, and sales. Even if the resulting amount of state income taxes is small, the cost to gather and organize the information can be significant.[7] For obvious reasons, foreign businesses are likely to view a tax filing requirement in a state 3,000 to 15,000 miles away as an unjust burden.

Moreover, any state income tax due may be small in comparison to the foreign business's liability for uncollected sales and use taxes.

For these reasons and others, it is essential that foreign businesses not be lulled into thinking that all American taxes are covered by tax treaties with the United States.

Owners and Employees Can Be Personally Liable for a Business's State Taxes

There is a widely held belief that shareholders, partners, officers, managers, etc. of legitimate businesses cannot be held liable for the business's unpaid taxes. Unfortunately, that belief is incorrect. Likewise, a technique sometimes considered by business planners of terminating a company to eliminate exposure for state tax liabilities can damage the business's owners and management by shifting the liability for the business's unpaid state taxes to them personally.

When a business fails to pay sales taxes, use taxes, or other trust fund taxes (that is, taxes that the business is required to collect from another taxpayer and then remit to a state), state law frequently permits the collection of the taxes from individuals at the business who were in a position to know about and correct the business's failure to collect and remit such taxes.[8]

Research reveals that between January 2010 and July 2012, no fewer than 17 states litigated this issue against such responsible persons, and that several of the states issued more than one of these decisions. Moreover, the

tax purposes, it is very important to note that there is an even lower standard for a business to be taxable in a state for income tax purposes. See e.g., *Lanco Inc. v. Director, Division of Taxation*, 188 N.J. 380 (2006) (finding income tax presence from the generation of in-state revenues from licensed trademarks and other intangible property, and holding that ''We therefore affirm the Appellate Division's determination that the Director constitutionally may apply the Corporation Business Tax notwithstanding a taxpayer's lack of a physical presence in New Jersey'').

[4] Under federal Pub. L. No. 86-272 (15 U.S.C. Section 381(a)), a business will not be subject to a net income tax of a state in which it is not incorporated if its activities in the state are limited to the solicitation of the sale of tangible personal property, with acceptance or rejection of all orders occurring outside of the state and shipment or delivery of the property occurring from a point outside of the state.

[5] The treaties provide (with some variation in language) that ''The taxes which are the subject of this Convention are: In the case of the United States, the Federal income taxes imposed by the Internal Revenue Code . . . .''

[6] The constitutionality of worldwide combined reporting as applied to foreign entities was litigated at the U.S. Supreme Court in *Barclays Bank PLC v. California Franchise Tax Board*, 512 U.S. 298 (1994). The court held that the U.S. Constitution does not impede worldwide application of California's corporate franchise (income) tax.

[7] The U.S. Supreme Court rejected Barclays Bank's ''vigorous'' argument that the compliance burden and additional expense required by worldwide combined reporting made this reporting methodology unconstitutional. *Barclays* at 312-314.

[8] See e.g., California (Cal. Rev. & Tax. Cd. Section 6829 and Cal. Code Regs. 1702.5); Texas (Tex. Tax Code Ann. Section 111.0611); New York (N.Y. Tax Law Section 1133 and NYCRR 532.3); Florida (Fla. Stat. Section 213.29); and Illinois (35 ILCS 735/3-7).

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states usually won these cases. And, significantly, the reported decisions are a small minority of these collection actions; most disputes are resolved quietly.

Conclusion

All 50 of the United States impose tax on a business's income, sales of goods, or both. Unfortunately, state taxes involve rules different from the federal taxes administered by the Internal Revenue Service. This can result in state tax presence where there is no federal tax presence. And, without regard to any treaty restrictions on federal taxation, such tax presence can also result in an unsatisfied sales tax collection obligation in earlier periods and a liability for state income taxes (potentially determined on a worldwide basis).

If a business determines that it has a liability for prior periods' state sales, income, or other taxes, it is likely to need the assistance of tax counsel to correct the problem quickly and as quietly as possible. While a discussion of the possible approaches to such a resolution is beyond the scope of this article, some possible approaches are described in ''Nonlitigated Resolutions of Multistate Tax Disputes: Three Case Studies Show How Taxpayers, States Can Find Common Ground'' (42 DTR J-1, 3/3/11).

And, of course, businesses having an exposure for state taxes should undertake a tax planning program to reduce future periods' tax liabilities.

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Advising Foreign Businesses on U.S. State and Local Taxation

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Taxes imposed by states and localities in the United States can be a source of confusion for foreign business entities (hereinafter "foreign businesses") making sales in or into the United States, and for foreign tax professionals advising those businesses. The confusion arises because: (1) foreign businesses often do not have a permanent establishment in the United States and thus are generally not subject to U.S. federal income tax under a U.S. income tax treaty with the foreign business's home country; (2) the foreign business's home country typically has a tax treaty with the United States making the business's income taxable in its home country rather than by the U.S. government; and (3) there are thousands of state and local tax jurisdictions imposing many different types of taxes.

This article is divided into three parts, addressing the following matters:

I. First, for any tax, the threshold issue is whether a foreign business is subject to the jurisdiction of the taxing authority. This topic is important and complex; therefore, its principles are discussed at some length below. The reader is cautioned that tax presence standards can differ according to the tax at issue.

II. Second, several common state taxes are described, including some widely held misimpressions about the states' ability to impose these taxes on a foreign business.

III. Third, enforcement measures frequently used by the states are described, including both those directed at a foreign business and its officers and managers as well as those directed at purchasers of a foreign business's stock or assets. This part also includes a discussion of the protective measures available to a foreign business that self-identifies taxes with which it is not in compliance.

STATE JURISDICTION TO TAX FOREIGN BUSINESSES

Summary: State power to tax foreign businesses is not limited by the federal requirement of a permanent establishment. Instead, limitations are found primarily in the U.S. Constitution. The states may impose a corpo-

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rate income tax on a business that does not have a physical presence in the state, but are prohibited from imposing sales and use taxes on a business unless the business has a physical presence in the state.

Dispelling the Permanent Establishment Misunderstanding

It is common knowledge among foreign businesses and foreign tax professionals that, under their home country's tax treaty with the United States, foreign businesses generally must have a permanent establishment in the United States to be subject to U.S. taxes on income. Such treaties generally define a "permanent establishment" as requiring a "fixed place of business."[1]

Based on that knowledge, many foreign businesses and foreign tax professionals believe that foreign businesses that do not have a permanent establishment in the United States are not subject to taxation in the United States. Unfortunately, they are wrong where state and local taxes are concerned.

State authority to impose taxes even in circumstances in which the federal government cannot impose taxes is rooted in the Tenth Amendment to the U.S. Constitution, which states as follows:

> The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

These "powers" include the right to make independent judgments about whether to impose taxes on a foreign business that is not subject to U.S. federal income taxation.[2]

Dispelling the Delaware Incorporation Misunderstanding

In addition, there is a commonly held belief among foreign businesses and foreign tax professionals that incorporating in Delaware makes a foreign business "nontaxable" for state tax purposes. This belief is erroneous, and seems to be due to a misunderstanding of certain exemptions contained in Delaware law. Delaware Code Annotated §1902(b) provides the following exemptions from Delaware's corporation income tax:

> (6) A corporation maintaining a statutory corporate office in the State but not doing business within the State; (and). . .
>
> (8) Corporations whose activities within this State are confined to the maintenance and management of their intangible investments. . .

The first important observation about these corporation income tax exemptions is that, even where Delaware taxes are concerned, the exemptions are limited to the state's corporation income tax; they do not apply to other Delaware taxes. Therefore, even corporations qualifying for these income tax exemptions are subject to Delaware's franchise tax.[3]

In addition, notwithstanding Delaware's corporation income tax exemptions, every other state has the right to tax Delaware corporations to the same extent that they could tax corporations formed under any other state's laws. That is, any corporation that has tax presence in a state is subject to that state's income tax, franchise tax, sales tax, use tax, etc., without regard to the state of its incorporation.

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[1] A typical definition provides that "the term permanent establishment means a fixed place of business of an enterprise through which the business is wholly or partially carried on." This or another definition also requiring a "fixed place of business" is contained in the U.S.'s income tax treaties with China, France, Germany, Israel, Japan, Korea, Russia, and the United Kingdom.

[2] There may be room for argument over whether this result is compelled by the U.S. Constitution. This argument relies in part on the authority of the Supremacy Clause of the U.S. Constitution (Article VI, Clause 2):

> This Constitution, and the Laws of the United States which shall be made in pursuance thereof; and all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the constitution or laws of any state to the contrary notwithstanding.

Analysis of this issue is beyond the scope of this article. However, with the exception of the limitation provided by federal P.L. 86-272 (codified at 15 U.S.C. §381 *et seq.*), discussed below, it is clear that the federal government and state governments treat the states as having the right to impose income and many other taxes on foreign businesses without regard to the federal treatment of those businesses. Thus, on the Internal Revenue Service (IRS) Internet page listing U.S. income tax treaties, the IRS cautions:

> Many of the individual states of the United States tax income which is sourced in their states. Therefore, you should consult the tax authorities of the state from which you derive income to find out whether any state tax applies to any of your income. Some states of the United States do not honor the provisions of tax treaties.

http://www.irs.gov/Businesses/International-Businesses/United-States-Income-Tax-Treaties—A-to-Z. The same principle applies with respect to the ability of cities and other localities to impose income or other taxes on foreign businesses.

[3] Del. Code Title 8, Ch. 5.

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U.S. Supreme Court Interpretations of the U.S. Constitution Regarding Tax Presence Standards, and State Court Applications of Those Standards

Several clauses of the U.S. Constitution provide protection to foreign businesses that might be treated as having tax presence in a state. Foremost among these are the Due Process Clause (Amendment XIV, §1) and the Commerce Clause (Article I, §8, clause 3). The latter contains, in its various facets, the Interstate Commerce Clause, the Foreign Commerce Clause, and the implied "Dormant Commerce Clause."[4] The U.S. Supreme Court stated in a 2008 decision: "The Commerce Clause and the Due Process Clause impose distinct but parallel limitations on a State's power to tax out-of-state activities."[5] For a state to be able to tax the activities of a foreign business, the state's connection to both the business and activity to be taxed must be constitutional under the Due Process Clause and the Commerce Clause.

The Due Process Clause Receives New Life

The Supreme Court has provided several formulations of the protection of the Due Process Clause, the most widely repeated of which may be that from the 1954 case of *Miller Bros. Co. v. Maryland*,[6] holding that the Due Process Clause "requires some definite link, some minimum connection, between state and the person, property or transaction it seeks to tax." The Court subsequently clarified that minimum connections are required both between the state and the person or entity that the state seeks to tax, and also between the state and the activity it seeks to tax. *See, e.g., Allied-Signal, Inc. v. Director, Division of Taxation*:[7]

> But the Due Process Clause also underlies our decisions in this area. Although our modern due process jurisprudence rejects a rigid, formalistic definition of minimum connection, we have not abandoned the requirement that, in the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax, *see Quill Corp. v. North Dakota, ante*, at 306-308.

The language of the Supreme Court's decisions notwithstanding, over the years the significance of Due Process protections has been eroded. This was made clear in 1992, in the Court's decision in *Quill Corp. v. North Dakota*.[8] The case involved Quill, a Delaware corporation selling office supplies by mail order. Quill had warehouses in several states, but only "insignificant or nonexistent" tangible personal property in North Dakota and no employees, agents, or representatives in North Dakota. North Dakota's tax commissioner attempted to force Quill to collect North Dakota sales/use taxes on Quill's retail sales to customers in the state; Quill, however, refused, citing the protections of both the Due Process Clause and Commerce Clause.[9]

In *Quill*, the Supreme Court for the first time separated the analysis of Due Process Clause protections from Commerce Clause protections. Having made that separation, the Court overruled its precedents requiring a physical presence in the state for tax presence under the Due Process Clause. Instead, the Court held that the Due Process Clause requires only that Quill "purposefully directed" its activities at North Dakota customers, from wherever those activities originated. While the opinion involved a corporation incorporated and based in the United States, the Due Process Clause analysis should have equal application to foreign businesses.

After the *Quill* decision in 1992, the Due Process Clause did not seem to provide any meaningful protection for out-of-state businesses. In the world of tax jurisprudence, the lone voice arguing for meaningful Due Process protections was that of Chief Justice Calogero of the Louisiana Supreme Court, who issued a courageous concurring opinion in 2005.[10] That state of affairs finally changed in 2012, when two state Su-

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[4] In its entirety, Article I, Section 8, clause 3 provides that "[The Congress shall have Power To] regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

The Dormant Commerce Clause is derived from the affirmative assignment of power to Congress. That affirmative assignment supports an inference that the states do not possess the power to regulate foreign or interstate commerce.

[5] *MeadWestvaco Corporation v. Illinois Dept. of Revenue et al.*, 553 U.S. 16, 128 S. Ct. 1498 (4/5/08).

[6] 347 U.S. 340, 344–345.

[7] 504 U.S. 768 (1992).

[8] 504 U.S. 298.

[9] See below for analysis of the Commerce Clause issue.

[10] *Bridges v. Autozone*, 900 So. 2d 784 (La. S. Ct. 3/24/05), *reh'g denied* (5/13/05). In *Autozone*, all seven of the Louisiana Supreme Court's justices held that Due Process protections did not prevent the state from taxing an out-of-state entity that owned certain intangible property (an interest in an affiliated real estate investment trust) that it arguably used in the state. The taxpayer filed a petition for rehearing, which the court declined to hear because it was filed late. However, Louisiana Chief Justice Calogero filed a concurring opinion arguing strenuously that, in the *Autozone* decision handed down two months earlier, he and his fellow justices misunderstood the issue. He argued that the Due Process personal jurisdiction issue the court addressed in *Autozone* involved principles distinct from the question of a state's ability to impose an income tax on an out-of-state business. Notably, in his *Autozone* concurrence, Chief Justice Calogero was not joined by any of his colleagues. However, less than two months later, he was joined by two other justices in voting to accept a case that could have overturned *Autozone*'s Due Process holding. (The au-

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preme Courts held tax assessments violative of constitutional Due Process protections.

The first of those 2012 decisions involved an out-of-state corporation that licensed trademarks and other intellectual property to a related entity which in turn sublicensed the trademarks to a nationwide chain of restaurants. The licensor's royalties were determined as a percentage of the restaurants' gross sales, including the gross sales of restaurants in Oklahoma. The Oklahoma Supreme Court concluded that, under the facts of the case, the licensor did not have Due Process tax presence in Oklahoma. Therefore, the licensor's royalty income was not subject to Oklahoma corporation income taxation.[11] In the words of the court:

> Oklahoma simply has no connection or power to regulate the licensing agreement between (the licensor) and (its licensee). . .(The licensor) is not a shell entity and the licensing agreement. . .is not a sham obligation to support a deduction under Oklahoma law. . .The Oklahoma Tax Commission cannot summarily disregard the licensing agreement simply because it produces a deduction that the Commission does not like.[12]

The second of the 2012 state Supreme Court decisions involved an out-of-state corporation that licensed the use of trademarks and tradenames to related and third-party licensees. The licensees manufactured food products outside of West Virginia. The products were then sold throughout the United States, including in West Virginia. Each of these sales generated royalty income for the licensor. The West Virginia Supreme Court concluded that the licensor's involvement in the revenue-generating activity was merely passive, as contrasted with the licensees which determined where to sell the underlying goods. The court, therefore, concluded that the licensor did not have tax presence in West Virginia for Due Process Clause purposes.[13]

The reasoning of each of these state court decisions has equal application to foreign businesses. This is significant because it provides hope that, with tax planning and proper structuring, foreign businesses will again have a reasonable expectation of an ability to control their tax presence in U.S. states and localities.

The Commerce Clause: A Mixed Bag of Protections for Foreign Businesses

As indicated above, the U.S. Constitution's Commerce Clause (Article I, §8, clause 3) contains three aspects potentially impacting the constitutionality of a state's assertion of tax authority over remote businesses. In practice, however, the tax presence issues generally arise under the Dormant Commerce Clause, and it is this aspect of the Commerce Clause that is analyzed immediately below.[14]

The Commerce Clause: Physical Presence Required for Sales and Use Tax Purposes

Since at least 1824, the U.S. Supreme Court has known that the Commerce Clause contains a negative provision limiting state actions interfering with interstate commerce — the Dormant Commerce Clause.[15] In 1967, the Court held in *National Bellas Hess, Inc. v. Department of Revenue of Illinois*[16] that the state of Illinois could not require an out-of-state mail order company that had neither outlets nor sales representatives in the state to collect and remit a use tax on goods purchased by its customers for use in the state. As the Court later summarized in *Quill*, ''[in *Bellas Hess*] we ruled that 'a seller whose only contact with customers in the State is by common carrier or United States mail' lacked the requisite minimum contacts with the State.''[17] The Court in *Quill* rejected a request that it overrule *Bellas Hess*. Instead, it reaffirmed the requirement that a business must have ''substantial nexus'' with a state before it is treated as having tax presence in the state for sales and use tax purposes.

Therefore, Commerce Clause ''substantial nexus'' for sales and use tax purposes requires some type of physical presence. Decisions of the U.S. Supreme Court and the states' high courts provide guidance as to what types of physical presence result in substantial nexus:

- The presence can arise from the in-state presence of an employee, agent, or independent representa-

thor of this article was counsel in that second case.) That is, three of the state's seven justices were apparently willing to reconsider *Autozone*'s Due Process holding. It would be another seven years before a state Supreme Court finally acknowledged that the Due Process Clause provides meaningful protection for remote businesses that are being pursued by state departments of taxation.

[11] *Scioto Insurance Co. v. Oklahoma Tax Comm.*, 279 P.3d 782, 2012 OK 41 (2012).

[12] *Id.* at 784.

[13] *Griffith v. ConAgra Brands, Inc.*, 728 S.E.2d 74 (S. Ct. W. Va. 2012).

[14] Exercise of authority under the Interstate Commerce Clause requires an act of Congress, as is discussed below with regard to P.L. 86-272. Foreign Commerce Clause issues tend to arise in the context of the amount of income or value of movable property to be taxed. These issues are analyzed under ''State Taxes Imposed on Foreign Businesses,'' below.

[15] *Gibbons v. Ogden*, 22 U.S. 1 (1824), 9 Wheat. 1, 231–232, 239 (J. Johnson concurring).

[16] 386 U.S. 753 (1967).

[17] *Quill*, 504 U.S. at 298, quoting *Bellas Hess* at 758.

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tive making or exploiting a market for the business's goods or services.[18]

- An in-state office unrelated to the business's taxable sales activities is sufficient to create substantial nexus and tax collection and remittance obligations on those sales.[19]
- According to New York's highest court, ''substantial nexus'' requires some physical presence but not substantial physical presence. Rather, the physical presence must merely be more than *de minimis*.[20]
- Isolated or sporadic contacts in a state do not necessarily create substantial nexus. According to Kansas's highest court, 11 installations of card readers over a four-year period did not create tax presence because they qualified as being merely isolated and sporadic.[21]
- Sales of an out-of-state company's merchandise at a three-day seminar attended by two company officers were subject to sales and use tax, but sales into the state made throughout the remainder of the year were not taxable.[22]

The Commerce Clause: More About Physical Presence Through Business Relationships

In 2008, New York State pioneered an effort to bring the *Scripto* decision into the 21st century by adopting a law applying its principles to Internet-assisted sales. Under that law, a remote business (including a foreign business) can be treated as having sales tax presence in New York State if it has a certain amount of sales attributable to commission-based representatives ''resident'' in the state. Many other states adopted variations of this approach, and litigation over its constitutionality soon followed in state and federal courts. The state tax authority won in New York State (law ruled constitutional on its face)[23] but lost in Colorado (law ruled unconstitutional; case currently on appeal to the federal court of appeal)[24] and Illinois (law ruled unconstitutional; case currently on appeal to the Illinois Supreme Court).[25]

Significantly, a foreign business does not necessarily have tax presence in a state merely because one or more affiliated corporations conduct business in the state. However, that result might change if the in-state corporation acts on behalf of the foreign business. This can occur if, for example, the affiliate promotes the foreign company's Internet site, or accepts exchanges or returns for the foreign company. More generally, if the affiliate does anything that can be construed as aiding the foreign company in making or exploiting a market, it can be treated as creating tax presence for the foreign company.[26]

The Commerce Clause: Income Taxes and Other Non-Sales Taxes May Be Subject to Lower Thresholds of Tax Presence

It seems reasonable to believe that the direct cost of multistate taxes that a business pays from its own pocket has a greater adverse effect on the operation of interstate commerce than does the imposition of the administrative responsibility of collecting and remitting sales taxes that are paid by the business's customers. Under that real-world understanding, the extent of a business's contact with a state necessary to establish income tax presence should have to be greater than or equal to the contacts required to create sales and use tax presence.

Nevertheless, *Quill* is susceptible to an understanding that it applies to sales and use taxes only, and that it permits a finding of tax presence for income tax purposes even in the absence of a physical presence. Proponents of this understanding, many of whom are state revenue department employees, point to *Quill* language regarding the benefit of ''a bright line rule *in the area of sales and use taxes*.''[27] They also point to the following statement in *Quill*:

> In sum, although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-

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[18] *See, e.g., Scripto Inc. v. Carson*, 362 U.S. 207 (1960). *See also Scholastic Book Clubs, Inc. v. Comr.*, 304 Conn. 204 (2012), *cert. denied*, 133 S. Ct. 425 (2012) (discussed at length below, in ''Sales and Use Tax Planning'').

[19] *National Geographic Society v. California Board of Equalization*, 430 U.S. 551 (1977).

[20] *Orvis Company, Inc. v. Tax Appeals Tribunal*, 86 N.Y.2d 165, 654 N.E.2d 954, 630 N.Y.S.2d 680 (N.Y. Ct. App. 1995), *cert. denied*, 516 U.S. 989 (1995).

[21] *In the Matter of Intercard, Inc.*, 270 Kan. 346, 14 P.3d 1111 (Kan. Sup. Ct. 2000).

[22] *Dept. of Revenue v. Share Int'l Inc.*, 676 So. 2d 1362 (Fla. Sup. Ct. 1996), *cert. denied*, 519 U.S. 1056 (1997).

[23] *Amazon.com, LLC v. New York State Department of Taxation and Finance*; *Overstock.com, Inc. v. New York State Department of Taxation and Finance*, Decisions 34 and 33 (N.Y. Ct. App. 3/28/13).

[24] *The Direct Marketing Association v. Roxy Huber, in her capacity as Executive Director*, Colorado Dept. of Revenue, 10-cv-01546-REB-CBS (3/30/12).

[25] *Performance Marketing Association, Inc. v. Hamer*, Dkt. No. 2011-CH-26333, Ill. Cir. Ct. (Cook County) (5/11/12).

[26] For an example of this, see *Matter of Borders Online Inc.*, No. A105488 (Cal. Ct. App., 1st App. Dist. 5/31/05) (out-of-state online retailer had sales and use tax presence in California through the activities of its ''authorized representative,'' a brick-and-mortar affiliate that sold products similar to those sold by the online retailer. The out-of-state company therefore was held liable for use tax collection on goods purchased by its customers in California).

[27] *Quill*, 504 U.S. at 299 (emphasis supplied).

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> line, physical-presence requirement, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes.[28]

State revenue departments have taken advantage of the Supreme Court's language, and in some instances have received support from state courts. Thus, state courts have found income tax presence in a variety of circumstances in which the remote business did not have a physical presence in the state. For example, state courts have found businesses to have income tax presence, without having physical presence, from the licensing of intangibles (trademarks and tradenames)[29] and from having customers in the state.[30]

State legislatures likewise have created income tax presence statutes that look to ''economic presence'' rather than physical presence. While the statutes vary, California's economic presence law is instructive and holds that a remote business lacking any physical presence in the state can be treated as having tax presence in the state for income tax purposes if its annual sales exceed either $509,500 or 25% of the business's total sales.[31]

These low standards for tax presence are (or, at least, should be) worrying for management and advisors of foreign businesses that carefully avoid creating a permanent establishment in the United States. Unless business management is aware of the existence of state tax issues, they will not know (until an audit occurs or until, in the case of a start-up, they look to sell the company) that they likely have sales, use, and/or income tax liabilities in the states visited by their sales staff. They may be even more surprised to learn that a relatively modest amount of sales can create a presence for state income taxes, or that tax presence can arise from an affiliate or unrelated company doing business in a state if the affiliate or unrelated company represents the foreign business in a way that helps to create or exploit a market in the state for the foreign business.

Summary of Dormant Commerce Clause Tax Presence

As should be apparent from the examples above, it is difficult to predict whether a state revenue department or court will conclude that a foreign business's in-state presence is *de minimis* (so that the foreign business is not required to collect and remit state sales and use taxes) or substantial (therefore satisfying the Dormant Commerce Clause threshold for a state to require a business to collect sales and use taxes). Likewise, it is difficult to predict whether a revenue department or court will conclude that the duration of a contact:

(1) is sporadic and therefore inconsequential,[32]

(2) creates substantial nexus for the duration of the contact only,[33] or

(3) creates tax presence for the entire tax period (or longer).[34]

[28] *Id.* at 317.

[29] *See, e.g., Geoffrey, Inc. v. South Carolina Tax Comm.*, 313 S.C. 15 (7/6/93), *cert. denied*, 510 U.S. 992 (Delaware holding company that licenses its trademarks and trade names for use by its parent corporation (Toys 'R Us) throughout the United States, including South Carolina, has sufficient nexus under the Commerce Clause to subject it to the state's corporate income tax and corporate license fee); *K-Mart Properties, Inc. v. Tax'n and Revenue Dept.*, 139 N.M. 172 (12/29/05) (a New Mexico Supreme Court decision letting stand a New Mexico Appellate Court decision allowing New Mexico to impose gross receipts tax and corporate income tax on Kmart Properties, Incorporated (KPI), a Michigan affiliate holding trademarks developed by the Kmart Corporation. In its Commerce Clause analysis, the appellate court determined that *Quill*'s physical presence requirement does not apply to the state income tax. In any event, the appellate court determined that a trademark has a ''physical presence'' where it is put to tangible use, i.e., where the stores are located, and that Kmart employees in New Mexico were essentially representing KPI's interests); *and Lanco Inc. v. Director, Division of Taxation*, 188 N.J. 380 (2006) (finding income tax presence from the generation of in-state revenues from licensed trademarks and other intangible property, and holding, ''We therefore affirm the Appellate Division's determination that the Director constitutionally may apply the Corporation Business Tax notwithstanding a taxpayer's lack of a physical presence in New Jersey'').

[30] *See, e.g., Tax Comr. of West Virginia v. MBNA America Bank, N.A.*, 2006 W. Va. LEXIS 132 (2006), *aff'g* No. 04-AA-157 (W. Va. Cir. Ct. 6/27/05), *cert. denied*, 551 U.S. 1141 (2007) (income tax presence found from ''significant economic presence'' is measured by ''the frequency, quantity, and systematic nature of a taxpayer's economic contacts with a state) *and Capital One Bank v. Massachusetts Comr. of Rev.*, 899 N.E.2d 76 (Mass. 2009) (regarding Massachusetts Financial Institution Excise Tax, holding that ''[i]n addition to their consumer lending activities, the Capital banks were soliciting and conducting significant credit card business in the Commonwealth with hundreds of thousands of Massachusetts residents, generating millions of dollars in income for the Capital banks. In essence, the Capital banks were providing valuable financial services to Massachusetts consumers, for which the Capital banks were compensated in the form of interest payments, interchange fees, and finance charges.'').

[31] Cal. Rev. & Tax. Cd. §23101(b)(2). When the law was enacted in 2010, its annual sales threshold was $500,000. That threshold is adjusted each year for inflation. The current threshold was announced by the California Franchise Tax Board in its January 2013 edition of ''Tax News'' (''Index Brackets for Doing Business in California'').

[32] *See, e.g., Intercard*, above.

[33] *See, e.g., Share International*, above.

[34] *See, e.g.,* Texas Comptroller of Public Accounts sales tax rule 3.286(b)(2), under which an ''out-of-state seller who has been engaged in business in Texas continues to be responsible for collection of Texas use tax on sales made into Texas for 12 months after the seller ceases to be engaged in business in Texas.''

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For sales and use tax purposes in particular, the consequences of falling on one side of that line or the other can be great. Realistically, the business bears all of the downside risk for failing to collect tax from its customers — the parties who owe it. Therefore, as a matter of risk management, the business may be better served by collecting tax rather than relying on a tax presence argument alone.

The Interstate Commerce Clause: Congress Exercises Its Power to Create a Safe Haven for Remote Businesses

In the world of state and local taxation, foreign and other remote businesses derive almost all of their tax presence protection from the Due Process Clause and the Dormant Commerce Clause. A significant addition to the list of federal protections is a protective sphere created by the U.S. Congress in 1959 under its Interstate Commerce Clause powers (''The Congress shall have Power To regulate Commerce. . .among the several States. . .''). As mentioned above, this sphere exists under federal P.L. 86-272 (codified at 15 USC §381 *et seq.*).

Two notes of caution are in order before further describing the operation of this federal law:

- First, P.L. 86-272 applies only to net income taxes and franchise taxes based on net income. Therefore, it can be and often is the case that a business that is protected from state and local net income taxes under P.L. 86-272 will have an obligation to collect state and local sales and use taxes or comply with obligations arising under other taxes.
- Second, P.L. 86-272 applies to businesses selling tangible personal property only. Businesses selling services are not eligible for its protection.

P.L. 86-272 permits businesses to conduct in-person sales solicitation in a state relating to sales of tangible personal property without being subject to the state's net income tax, provided acceptance or rejection of the sales order occurs outside of the state, and the goods are shipped or delivered from outside of the state. Where those conditions are satisfied, the business will not be subject to the destination state's net income tax (or franchise tax based on net income).

The definition of ''solicitation'' was the subject of a U.S. Supreme Court case,[35] which resolved the matter by concluding that solicitation is limited to activities in which a business engages only for the purpose of requesting a sale. Providing product samples to customers is one example. The Court rejected a definition that attempted to draw a distinction between pre-sale activities and post-sale activities as being unworkable as applied to continuing business relationships.

Much more could be written about P.L. 86-272. Unfortunately, as the world has moved to a service-based economy, P.L. 86-272 has not kept pace, and the law has lost much of its relevance. The law needs an overhaul, with one possibility being the adoption of a permanent establishment standard.[36] Until such a change occurs, the best approach for a foreign business is to be aware of the federal statute and to consult state tax counsel when in doubt about its application.

The Due Process Clause and the Commerce Clause: To Be Taxed, Both the Transaction and the Entity Must Have Nexus with the State or Local Jurisdiction

In 2012, an Illinois circuit court ruled that the Chicago Department of Revenue acted unconstitutionally under both the Due Process Clause and the Commerce Clause when it attempted to impose Chicago's transaction tax on vehicle rentals entered into outside of Chicago.[37] (The City of Chicago has appealed the decision to the Appellate Court of Illinois.)

In issuing that decision, the Illinois court was following a long line of U.S. Supreme Court decisions requiring nexus between the tax jurisdiction and the transaction or activity it seeks to tax. For example, in *Complete Auto Transit, Inc. v. Brady*,[38] the Supreme Court stated:

> Appellee, in its turn, relies on decisions of this Court stating that ''[i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business,'' *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254 (1938). These decisions have considered not the formal language of the tax statute but rather its practical effect, and have sustained a tax against Commerce Clause challenge *when the tax is applied to an activity with a substantial nexus with the*

[35] *Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214 (1992).

[36] A perennial effort to update P.L. 86-272 is in large part an effort to counter the states' much more realistic efforts to revise the tax presence principles applicable to sales taxation. For more on the states' sales tax effort, see ''The Most Important Sales Tax Change in Almost 50 Years,'' at www.statetaxalert.us.

[37] *Enterprise Leasing Co. of Chicago, LLC, d/b/a Enterprise Rent-A-Car, Alamo Rent-A-Car and National Rent-A-Car v. The City of Chicago*, 11 L 50840; consolidated with 10 CH 51118 (9/27/12).

[38] 430 U.S. 274 (1977).

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> *taxing State*, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State. [Emphasis added.]

See also *Mobil Oil Corp. v. Comr. of Taxes of Vermont*,[39] stating:

> For a state to tax income generated by interstate as well as intrastate commerce, the Due Process Clause of the Fourteenth Amendment imposes two requirements: a ''minimal connection'' or ''nexus'' between the interstate activities and the taxing State, and ''a rational relationship between the income attributed to the State and the intrastate values of the enterprise.''

More recently, in *Allied-Signal, Inc. v. Director, Division of Taxation*,[40] the Supreme Court prohibited New Jersey from taxing a stock sale occurring outside of the state. The case opens with the following unequivocal statement:

> Among the limitations the Constitution sets on the power of a single State to tax the multistate income of a nondomicillary corporation are these: There must be ''a 'minimal connection' between the interstate activities and the taxing State,'' *Mobil Oil Corp. v. Commissioner of Taxes of Vt.*, 455 U.S. 425, 436-437 (1980) (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978)) and there must be a rational relation between the income attributed to the taxing State and the intrastate value of the corporate business. 445 U.S., at 437. . . A State may not tax a nondomiciliary corporation's income, however, if it is ''derive[d] from 'unrelated business activity' which constitutes a 'discrete business enterprise.' '' *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 224 (quoting *Mobil Oil*, above, at 442, 439).

In *Allied Signal*,[41] the Court explained that transactional nexus is required by the Commerce Clause: ''In a Union of 50 states, to permit each state to tax activities outside its borders would have drastic consequences for the national economy, as businesses could be subjected to severe multiple taxation.'' Immediately thereafter, the Court explained that transactional nexus also is required by the Due Process Clause. *See also MeadWestvaco Corp. v. Ill. Dept. of Revenue*.[42]

Some States Allow Additional Protections for Remote Businesses

In addition to the federal protections discussed above, states may add their own protections. In some instances, these are designed to support certain state industries. For example, Illinois provides a sale and use tax exemption allowing remote businesses to temporarily store in Illinois merchandise acquired outside of the state without being treated as having tax presence in the state.[43] As another example, New York State has a sales tax exemption allowing qualifying out-of-state businesses to use the services of in-state fulfillment companies (and to store goods at the fulfillment companies' in-state locations pending distribution) without creating tax presence for the out-of-state businesses.[44]

Alabama has an intrastate commerce exemption allowing a business to be present in one county of the state without necessarily being treated as having tax presence throughout the state.[45] An administrative law judge applied that regulation in 2013 to conclude that a business did not have tax presence in an Alabama county even though it had extensive tax presence in another Alabama county.[46]

STATE TAXES IMPOSED ON FOREIGN BUSINESSES

> *Summary: Foreign businesses having tax presence in the United States should be aware that: (1) states can require the inclusion of foreign entities in income tax returns, even if the entities lack tax presence in the*

[39] 445 U.S. 425, 436–437 (1980).

[40] 504 U.S. 768 (1992).

[41] 504 U.S., at 777–778.

[42] 533 U.S. 16, 24 (2008). For an analysis of extraterritorial taxation that does not reach constitutional issues, see *Town Fair Tire Centers, Inc. v. Comr. of Revenue*, 454 Mass 601 (8/25/09), rejecting the Massachusetts Department of Revenue's attempt to impose use tax on transactions occurring outside of the Commonwealth. In support of its tax assessment, the Department of Revenue argued that Massachusetts use tax was due when a company with extensive Massachusetts contacts sold tires to Massachusetts residents in New Hampshire. The court, however, refused to adopt the series of assumptions and inferences proposed by the Department of Revenue to ''demonstrate'' that the tires were used in Massachusetts.

[43] 35 ILCS §105/3-55(e) and 86 Ill. Adm. Code 150.310(a)(4).

[44] N.Y. Tax Law §§1101(b)(8)(H)(v)(A) and 1101(b)(18).

[45] *See* Alabama Department of Revenue regulation 810-6-3-.51(2).

[46] *Paris John Van Horn II v. State of Alabama Dept. of Revenue*, Dkt. No. S. 12-863, Ala. Dept. of Rev. Admin. Law Div. (3/3/13), relying on *Yelverton's Inc. v. Jefferson County, Alabama*, 742 So. 2d 1216 (Ala. Civ. App. 1997), *cert. denied*, 742 So. 2d 1224 (Ala. 1997).

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states; (2) a business that has tax presence in a state can help its income tax results by having employees and property outside of the state; (3) state sales tax planning focusing on the characterization of a transaction is often more effective than trying to avoid tax presence; and (4) foreign businesses can be required to comply with state requirements for other taxes, including real property transfer taxes, as well as unclaimed property remittance requirements.

Income Tax Treaties Are Generally Irrelevant to State and Local Income Taxation

Many foreign business and tax professionals mistakenly believe that their home country's income tax treaty with the United States, by which double taxation is to be avoided (or largely reduced), also protects them from American state and local taxes. To the contrary, the treaties rarely provide such protection.

In fact, these treaties generally are limited to federal taxes.[47] These treaties generally provide (with some variation in language) that ''The taxes which are the subject of this Convention are: In the case of the United States, the Federal income taxes imposed by the Internal Revenue Code . . .'' Therefore, for businesses that have tax presence, states and localities may impose income taxes (as well as franchise taxes, sales taxes, use taxes and other taxes) independent of the federal government's ability to impose its income tax. And, in general, the measure of a business's state taxes due is not affected by international tax treaties.

For all of these reasons, foreign businesses must not be lulled into thinking that state and local taxes are covered by their home country's tax treaty with the United States.

State and Local Income Taxes

For the reasons presented above, many foreign businesses mistakenly believe that they do not have income tax presence in a state or that, if they are present in a state, they do not have an income tax filing obligation or liability. To the contrary, states (and localities) may impose income taxes (as well as franchise taxes, sales taxes, use taxes, and other taxes) independently of the federal government's ability to impose its income tax. States have both direct and indirect approaches to including foreign businesses in annual income tax returns.

[47] *See Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 196 (1983) (''. . .the tax treaties into which the United States has entered do not generally cover the taxing activities of subnational governmental units such as States. . .'').

Direct Approach to Requiring Foreign Corporations to File State Income Tax Returns

The direct approach for a foreign corporation (or any other form of business entity) to be required to file a state income tax return is for the business to have tax presence in the state. Once tax presence is established — by having employees, representatives, property, etc., in the state — the business is required to comply with the state's income tax laws.

Indirect Approach to Requiring Foreign Corporations to Be Included in State Income Tax Returns

A foreign corporation (or other form of business) lacking tax presence in a state nevertheless may be required to be included in a state income tax return under the following circumstances:

1. A business has income tax presence in a state (discussed at length above) and is required to file an income tax return in that state; and
2. The business has one or more affiliates (including foreign corporations) with which it works closely as a single economic unit (a ''unitary business''); and
3. The business that has tax presence in the state is permitted or required by the state to file a ''combined return'' with its unitary affiliates.

Here, two points are in order. First, state tax professionals distinguish between: (1) entities that have tax presence and are directly subject to tax in combined reporting states; and (2) entities that do not have tax presence and are included in the combined return only for purposes of measuring the amount of tax owed by the affiliate that is directly subject to tax. However, business management is unlikely to be concerned with such nuances when the company is required to gather and provide information to jurisdictions that are as much as 15,000 miles away so that the states can properly measure their affiliate's income tax liabilities. Second, the states use a variety of multi-entity income tax reporting techniques. In general, these are known as combined returns (or combined reports) and consolidated returns (or consolidated reports). However, beyond some fundamental commonalities, there is great variation among the reporting techniques. Therefore, each state's filing rules must be separately analyzed.

As of January 1, 2013, 29 states permit or require the filing of combined (or consolidated) returns by unitary entities. Furthermore, there is a clear trend among the states to require such combined income tax filings, with seven states and the District of Columbia adopting combined filing since 2004. That trend makes it essential that foreign businesses' tax person-

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nel and their foreign tax advisors have sufficient familiarity with unitary business and combined reporting tax concepts so that they can obtain state tax expertise when needed.

Unitary Business Principle — Constitutionality and Some Specifics

For income tax purposes, a business entity that has tax presence in a state may be subject to tax on all of the business's worldwide income. (This is discussed below.) Likewise, as mentioned earlier, a unitary business can be required to include all of its unitary affiliates in a state income tax return even if some of those affiliates lack tax presence in a state.

A unitary business is a vertically or horizontally integrated economic unit of affiliated corporations (or other entities) that are treated, in effect, as a single taxpayer for income tax measurement purposes. According to the U.S. Supreme Court, the ''hallmarks'' of a unitary business are ''functional integration,'' ''centralized management,'' and ''economies of scale.''[48] The hallmarks test is applied to a business's mainline business activities (purchasing, manufacturing, marketing, distribution networks, etc.). These do not include accounting, legal, or other ''back office'' functions.

The tests are fact-based, with layers of administrative and judicial interpretations attached to each. Moreover, every state is entitled to add its own gloss to the interpretations and return filing requirements. For these reasons, further detail regarding the unitary business principle is beyond the scope of this article. For present purposes, it is most important to note that, under operation of the unitary business principle, if a corporation has tax presence in a state, some or all of its affiliates might be included in the measure of the corporation's state income tax liability.

Worldwide Combined Reporting

When a corporation is part of a unitary group, some states require it to file its income tax return with all of its unitary affiliates, wherever those affiliates are located. This is known as ''worldwide combined reporting,'' and it has been very unpopular outside of the United States.

The states vary in the amount of common ownership required for corporations to be included on a combined return, but a widely used standard requires more than 50% common ownership of the corporations. Some states require higher thresholds of common ownership for unitary treatment,[49] but no states permit the inclusion of corporations on the same income tax return with lesser percentages of common ownership.[50]

The constitutionality of worldwide combined reporting as applied to foreign corporations was litigated in the Supreme Court in *Barclays Bank PLC v. California Franchise Tax Board*.[51] (Worldwide combined reporting was previously held constitutional as applied to U.S. corporations.)[52] The *Barclays* litigation attracted international attention.

Barclays involved a corporate group of more than 220 corporations doing business in some 60 nations. Only two of those 220 corporations had tax presence in California for purposes of the state's franchise (income) tax. Nevertheless, because the corporations were a unitary business, California claimed the right to require Barclays to include the income (and voluminous apportionment factor information) of each of those 220 corporations on Barclays' California franchise tax combined return.

Barclays argued that California combined reporting rules cannot require the inclusion of all the income and apportionment factor information of its unitary affiliates worldwide (i.e., worldwide combined reporting). In support of its position, Barclays argued that worldwide combined reporting imposes excessive administrative burdens and interferes with Congress's right to set U.S. tax policy with other nations. Regarding the administrative burdens, even if the resulting amount of state income tax is small (as it was in *Barclays*), the cost to gather and organize the information could be significant.

The Court rejected Barclays' arguments. Instead, the Court concluded that California could require worldwide combined reporting for Barclays' entire unitary group even though the parent corporation was incorporated and headquartered abroad.

"Water's Edge" Reporting

Even though the states are permitted to use worldwide combined reporting, many limit the corporations includible in a combined reporting group to entities having a significant presence in the United States. Therefore, a common approach is to exclude a foreign corporation from its unitary group's combined return if more than 80% of the corporation's property and payroll is located outside of the United States.

New York State follows a different approach, prohibiting all foreign entities from being included in a

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[48] *Allied Signal*, 504 U.S., at 769.

[49] For example, New York State uses an 80%-stock-ownership threshold. N.Y. Tax Law, Art. 9-a, §211.4(a) and 20 NYCRR 6-2.2(a)(2).

[50] Non-corporate entities are subject to different rules, often without any required percentage of common ownership.

[51] 512 U.S. 298 (1994).

[52] *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983).

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combined report.[53] The law does not make exceptions for entities having a substantial presence in the United States. Similarly, North Dakota tax regulations prohibit foreign entities from being the parent of a combined group or included in a combined return.[54]

The approaches followed by the New York State legislature and the North Dakota Office of the State Tax Commissioner plainly distinguish between entities incorporated in the United States and those incorporated elsewhere. Such distinctions raise a suspicion that in some circumstances the provisions unconstitutionally discriminate against foreign commerce. To determine whether there is unconstitutional discrimination, it is necessary to evaluate the four-part test of *Complete Auto Transit* outlined above. In addition, because foreign commerce is involved, it is also necessary to analyze whether the provisions create a substantial risk of international multiple taxation and whether the provisions prevent the U.S. government from ''speaking with one voice when regulating commercial relations with foreign governments.''[55] Other Constitutional provisions might also apply.

Finally, some states permit unitary taxpayers to file on either a worldwide or water's-edge basis. California, for example, permits unitary taxpayers to elect whether to file their combined returns on a worldwide or water's-edge basis.[56] Once the California election is made, it is binding for 84 months (seven years).[57]

The Cumulative Effects of No Requirement of a Permanent Establishment, No Treaty Protection, and Worldwide Combined Reporting

Under state tax principles, a foreign corporation can be treated as having income tax presence in a state even if it lacks a permanent establishment. Moreover, under unitary business and combined reporting principles, the presence of that corporation in the state can create an obligation to include affiliated corporations in a combined return even if those affiliates do not have tax presence in the state. These can include foreign affiliates lacking any connection to the United States. Thus, it is possible for a group of affiliated corporations to be required to report extensive information to a state even if none of the corporations has a permanent establishment in the United States and only one of the corporations has tax presence in the state. While this might describe state income tax consequences on the aggressive end of the spectrum, there are many possible outcomes that, while less aggressive, are troublesome for foreign businesses that do not plan properly.

Computation of State Taxable Income: Denial of Deductions for Related-Party Interest and Royalties

In most states, the computation of a business's taxable income begins with the entity's federal taxable income. (Foreign businesses that are not required to file a federal income tax return must prepare a federal pro forma return.)[58]

The states require a variety of adjustments to the federal income figure. In the mid-1990s, many states enacted ''anti-passive investment company'' legislation in reaction to tax planning techniques in which operating companies transferred valuable intangible assets to affiliated intangible protection companies domiciled in foreign or domestic locations perceived to be tax havens. The holding companies licensed use of the intangibles (often trademarks or tradenames) to the operating companies, which then deducted the royalty payments in their computation of state apportionable income. Another arrangement involved loans from a corporation legally and commercially domiciled in a tax haven jurisdiction to a related operating company, thereby generating low-cost tax deductions. Some taxpayers used both of these tax planning techniques.[59]

To challenge these structures, the states seemed to be left with two expensive alternatives: case-by-case litigation alleging that the holding company had in-state tax presence[60] or case-by-case litigation alleging that the holding company was a sham and should be disregarded.[61] Faced with those choices, many states opted for a third alternative, one that is less expensive and more assured than the first two: denying the royalty or interest deduction to the operating company unless the holding company is located in a jurisdiction that taxes the royalties or interest at a rate close to the rate of tax in the state that is taxing the operating company.[62]

In recognition of the range of circumstances in which these related-party structures were used, the states added other exceptions in addition to the rate-of-tax exemption. Thus, New Jersey also has an ex-

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[53] N.Y. Tax Law Art. 9-A, §211.4(a)(5).

[54] N.D. Admin. Code 81-03-05.2-01.

[55] *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979).

[56] Cal. Rev. & Tax. Cd. §25110.

[57] *Id.*, §25113(c)(9).

[58] *See, e.g.,* North Dakota Cent. Code §57-38-32.

[59] *See, e.g., Aaron Rents, Inc. v. Collins*, Civil Action File D-96025 (Ga. Super. Ct. Fulton Cty. 6/27/94).

[60] *See, e.g., Geoffrey, Inc. v. South Carolina Tax Comm.*, 313 S.C. 15 (7/6/93), *cert. denied*, 510 U.S. 992 (1993).

[61] *See, e.g., Syms Corp. v. Comr. of Revenue*, 436 Mass 505 (Sup. Judicial Ct. of Mass. 4/10/02).

[62] *See, e.g.,* Mass. G.L. ch. 63, §31J(b) and 830 CMR 63.31.1(4)(a)1.a. The interpretation of these provisions is the subject of considerable litigation between taxpayers and the Massachusetts Department of Revenue.

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ception if the related-party recipient is a resident of "a foreign nation that has in effect a comprehensive income tax treaty with the United States."[63]

Apportionment of Income and an Easy Tax Planning Opportunity

When a corporation operates in more than one jurisdiction, its income is apportioned among the states in which the corporation does business. That is, each jurisdiction is entitled to tax only a portion of the corporation's income. The states have broad discretion in setting their apportionment formula,[64] but any apportionment formula must bear a rational relationship to how the income was earned.[65] The traditional apportionment formula follows a three-factor approach, comparing the business's (or unitary group's) in-state property, payroll, and sales to, respectively, its property, payroll, and sales everywhere.

Too often a profitable foreign business makes the mistake of having no property or payroll by, for example, depending on the property or payroll of an affiliate that is not included in a combined return. When this happens, the property and payroll factors are removed from the apportionment formula applied to the foreign business's income. A much better result is available if some of the affiliate's employees who are servicing the taxable business are transferred to the foreign business, along with property that is being used to service the business. The foreign business should then have meaningful levels of payroll and property abroad, while still having none in the apportioning state. When this occurs, "zero" factors (i.e., apportionment factors with nothing in their numerator) are used in apportioning income, therefore reducing the amount of income apportioned to the state, perhaps by as much as two-thirds.

The states are permitted to use apportionment formulae other than the three-factor formula described above, as long as the approach adopted satisfies the requirements of a minimal connection between the interstate activities and the taxing state and a rational relation between the income attributed to the taxing state and the intrastate value of the corporate business. Many states take advantage of that freedom by increasing the weight accorded to the sales factor, with 16 states apportioning income by a sales factor only.[66] These states' legislatures look to decrease (or eliminate) the weight assigned to the property and payroll factors because doing so removes a disincentive to locating facilities in state.[67] At the same time, profitable businesses located outside of such a state are required to pay a larger percentage of the state's income tax collections.

Pass-Through Entities Involve Special Issues

In general, state income tax treatment of general partnerships, limited partnerships, and limited liability companies conforms to the federal income tax treatment of those entities. Texas is the notable exception to this income tax conformity, as it taxes LLCs as corporations for purposes of its income-tax-like "margin tax."[68]

In general, state and local jurisdictions do not impose entity-level income taxes on entities that are treated as partnerships for federal income tax purposes. The most important exceptions are Illinois, Texas, New York City, and the District of Columbia. Other jurisdictions impose a variety of fees on these entities.

A common method of taxing the income earned by these entities, without taxing the entities themselves, is to require the entities to withhold and remit income taxes on nonresident partners' distributive shares. In general, nonresident partners that do not want income tax withheld can consent to be subject to the state's income tax.

State Sales and Use Taxation

Fundamentals of Sales and Use Taxation

Sales and use taxes are imposed on retail sales of goods and some services by 45 states and thousands of smaller units of government (e.g., cities and counties). Only Alaska, Delaware, Montana, New Hampshire, and Oregon do not impose these taxes. Sales and use taxes are long-established revenue sources for the states, permitting the collection of taxes on gross sales amounts with little protest from taxpayers. The states therefore are very protective of their ability to collect all of the taxes to which they believe they are entitled.

In general, sales and use taxes are imposed on transfers, for a consideration, of title or possession of

[63] N.J. Admin. Code 18:7-5.18(a)(3). A "comprehensive income tax treaty" is one that "allocates all categories of income and/or the withholding of tax on interest, dividends or royalties." N.J. Admin. Code 18:7-5.18(a)(4)(ii).

[64] *See, e.g., Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978).

[65] *Id.*

[66] Although the U.S. Supreme Court has addressed single-factor formulae in several contexts, the constitutionality of this approach under the Commerce Clause has never been fully adjudicated.

[67] The disincentive exists under the traditional three-factor formula because increasing employment and/or facilities in the state directly increases the portion of the company's income taxed by the state.

[68] Tex. Tax Code Ann. §171.0002 and Tex. Admin. Code 3.581(c).

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tangible personal property and some services to the end-user of the property or services. In some states, the taxes also apply to payments for the leasing of tangible personal property.[69] With rare exception, sales and use taxes are not imposed on sales or leases of real property.[70]

In general, for a transaction to be treated as nontaxable, the purchasing business must provide a resale certificate to the seller. By providing this certificate, the purchaser verifies that it is registered with the relevant state for sales tax purposes and represents that it is not making the purchase for its own consumption. A seller receiving such a certificate in good faith is relieved of responsibility for tax collection on the transaction. Likewise, sales of personal property to a registered business that will use the items in a manufacturing process generally qualify for a ''manufacturing exemption'' and are not subject to sales taxes. For the sale to be treated as nontaxable, the purchaser of these items should provide an exemption certificate to the seller. Both resale certificates and exemption certificates are available on the state revenue departments' Internet websites.

State sales taxes are often said to be ''destination'' taxes. This is because state sales taxes apply in the state where title or possession is transferred (as contrasted with the state where the order for the merchandise/service is placed, accepted, or fulfilled).[71] The states have long recognized that this creates an incentive for consumers to purchase items in a state that either does not tax the transaction or imposes tax at a lower rate, after which the purchasers personally transport the items to their home state. To eliminate that undesired incentive, states imposing sales taxes also enacted taxes on the in-state use of property purchased outside of the state. To reduce the possibility of unconstitutional, protectionist, taxation of items purchased remotely, these states provide a credit for sales taxes paid on the purchase of the item in any other state.

It is interesting that, while these taxes rarely have special provisions relating to foreign retailers, experience demonstrates that sales and use taxes are the most dangerous state taxes for foreign businesses. This is not due to anything inherent in the taxes so much as the lack of knowledge or lack of concern of foreign retailers. Unfortunately, many foreign retailers think of themselves as being too distant from the states to be of interest to the states' departments of revenue. The retailers therefore act (or, more accurately, fail to act) on the belief that they are ''flying below the radar screen'' and can ignore their tax collection and remittance obligations.

Such noncompliance is not tax planning. In truth, it is high-stakes gambling that puts the business at risk of having to pay an average of about 8% of its gross sales to state and local jurisdictions — an amount that it could and should have collected from the business's customers. Civil penalties are frequently imposed, and criminal penalties are possible if the seller knowingly failed to collect taxes or to file sales tax returns.

As discussed immediately below, much better approaches are available for remote businesses seeking to reduce or potentially eliminate their sales tax exposure.

Sales and Use Tax Planning

Sales and use tax planning tends to fall into one of two categories: tax presence planning and characterization planning.

Tax presence planning involves the Due Process Clause and Commerce Clause issues described above. Tax presence planning does not make the product or service nontaxable. Instead, its objective is merely to free the vendor from an obligation to collect and remit sales or use taxes to the target state and localities. If the purchased items are taxable, the customer (but not a retailer lacking tax presence) is obligated to file a tax return with the state, reporting the transaction and paying the taxes due on the sale.

Tax presence planning is hazardous for the vendor because of the state revenue departments' and courts' uncertain applications of constitutional principles, as discussed above. It also is hazardous because of the difficulty businesses encounter controlling the activities of their sales people and other representatives, and because of the unpredictability of how state departments of revenue or legal tribunals will view a retailer's relationships with non-employees who assist in a transaction.

A demonstration of the consequences of this uncertainty is available in the conflicting Connecticut and Michigan decisions involving Scholastic Books (Scholastic).[72] Scholastic sells books to schoolchildren throughout the United States, relying on teachers to circulate order forms in their classrooms. The students and their parents decide on the books to order. The teachers collect payments from the students, which they then forward to Scholastic. The teachers also distribute the ordered books to their students. The teachers are not compensated for their involvement,

[69] *See, e.g.,* New York State (N.Y. Tax Law §1101(b)(5) and 20 NYCRR 526.7).

[70] The sales and use tax of Florida is one such exception; it is imposed on certain leases of real property. Fla. Stat. §212.031.

[71] *See, e.g.,* Indiana Code §6-2.5-4-1(e).

[72] *Compare Scholastic Book Clubs, Inc. v. Comr.*, 304 Conn. 204 (Sup. Ct. of Conn. 2012), *cert. denied*, 133 S. Ct. 425 (2012), *with Scholastic Book Clubs, Inc. v. Dept. of Treasury*, 223 Mich. App. 576 (1997), *appeal denied*, 457 Mich. 880 (1998).

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although they are permitted to select classroom items from a list of items Scholastic makes available. Most important for present purposes, the facts in the Connecticut and Michigan cases were indistinguishable from each other, as Scholastic apparently followed the same business model throughout the United States.

Despite the indistinguishable facts, the state courts issued conflicting decisions, with the Connecticut court openly questioning the Michigan court's decision. The Michigan Court of Appeals held that Scholastic did not have an agency or other relationship with the teachers that created tax presence for the company, and therefore did not have sales and use tax presence in Michigan. By contrast, the Connecticut Supreme Court held that the teachers were Scholastic's representatives and created sales and use tax presence for Scholastic. Therefore, in Connecticut, Scholastic was liable for a tax assessment of $3,298,743 (plus interest and penalties) for the 10 years at issue (ending May 31, 2005), and apparently had a liability for uncollected sales taxes, interest, and penalties for the next seven years.

The downside of tax presence planning for sales and use taxes is not merely the uncertainty, possible litigation, and possible liability for significant amounts of taxes, interest, and penalties that the business should not have owed in the first place, but also includes the efforts the business must make to restrain its activities so that it can argue that it does not have sales tax presence in the state. This almost certainly suppresses its sales volume. Should litigation be necessary, one must also factor in the legal fees and unproductive internal time involved in working on tax litigation. Multiply those risks and costs by as many as 45 states, and one gets a sense of the financial hazards presented by tax presence planning.

For many businesses, sales tax characterization planning provides a more reliable alternative to tax presence planning. Characterization planning is based on the knowledge that states and localities treat some goods and services as nontaxable, or as taxable at lower rates. For example, many states do not impose sales or use taxes on the sale of unprepared foods or medical devices. It is often possible for tax advisors to obtain written guidance from the states confirming a desired characterization of a client's goods or service, thereby confirming that retail sales of the relevant items are not taxable. As a second example, the states generally do not impose sales tax on the sale of intangible rights. Therefore, if a business can demonstrate to state revenue departments that the essence of a transaction (sometimes called the purchaser's ''true object'') is the sale of intangible rights, rather than the sale of any tangible personal property transferred with the intangible rights, it is likely that the revenue departments will issue advisory opinions confirming that the sales are nontaxable.

Written guidance from the states is often available without charge and on a taxpayer-anonymous basis. In addition, there are several techniques available to multistate taxpayers that do not want to request 10, 20, or more letter rulings. These alternatives include requesting guidance from the Streamlined Sales Tax Governing Board, a group of more than 20 states that are working together to simplify their sales and use taxes by making them more uniform.

Real Property Transfer Taxes

Many foreign businesses create corporate affiliates or other entities to hold interests in U.S. real property. When the property is sold, or when a majority interest in the entity that holds the real property is sold, many states (and localities) will impose real property transfer taxes.[73] While these taxes are generally imposed at what appear to be low tax rates (e.g., New York State's tax is $2 per $500 of property transferred),[74] the taxes due on a transfer can be substantial and can affect the economics of the transaction.

States can be very assertive in claiming a right to tax a foreign resident or entity selling a direct or beneficial interest in U.S. real property. In *Matter of the Petition of Cafcor Trust Reg. Vaduz*,[75] a foreign resident owned a foreign trust that owned a foreign corporation that owned real property located in New York. The foreign trust transferred a controlling interest in the foreign corporation to another foreign corporation. The transaction was negotiated outside of the United States and the foreign trust lacked any New York contacts (other than the indirect ownership of real property in New York).

Based on New York law which imposes real property transfer tax on the transfer of a controlling interest in an entity that owns New York real property, the New York State Department of Taxation and Finance assessed tax on the foreign trust's transfer of the stock of the foreign corporation. The state Tax Appeals Tribunal affirmed that assessment of tax. The Tribunal concluded that because the tax was on the transfer of a beneficial interest in New York real property, not on the sale of stock through which the transfer occurred, the foreign trust's lack of tax presence was irrelevant.

This issue is not unique to New York. Many other states and localities claim a right to tax real property transfers when there is a direct or indirect sale of a controlling interest in real property.

Escheat of Unclaimed Property

All states have ''unclaimed'' property laws, and almost every business has liabilities for unclaimed

[73] *See, e.g.,* N.Y. Tax Law §1400 *et seq.*

[74] N.Y. Tax Law §1402.

[75] Dkt. Nos. 812682 and 812683, NYS Tax Tribunal (1997).

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property. These laws do not involve taxes; rather, they are state-imposed responsibilities on businesses holding assets belonging to others. Nevertheless, they are discussed here because of their effect on business profitability and because they often are the responsibility of businesses' tax departments.

In large part, the states' unclaimed property law is derived from the 1954, 1966, 1981, or 1995 Uniform Unclaimed Property Act. Under the states' laws, businesses holding unclaimed property are required to surrender custody of the property to the state. The state holds the property for the true owner until the true owner files a claim with the state and proves ownership of the property. Because the states use unclaimed property as a source of funds, and because unclaimed property remittances involve many millions of dollars annually, the states are very protective of their right to take custody of unclaimed property. Furthermore, because the states step into the shoes of the actual owner of the property, the states claim that they always have jurisdiction to pursue the company that is holding the property, wherever that company is located. That is, the states assert that they are not constrained by the holder's possible lack of tax presence in the state under the Due Process Clause and the Commerce Clause, discussed in ''State Jurisdiction to Tax Foreign Businesses,'' above.

Unclaimed property laws apply to all types of property, but the large-dollar issues involve intangible property — unclaimed payroll checks, customer overpayments, unreturned deposits, uncashed refund checks, unused gift certificates, etc. Ownership of the property always remains with the true owner, and no holder can take ownership of the property by its unilateral actions. Attempts by holders to use accounting entries to claim these unclaimed amounts as ''miscellaneous income'' are improper and leave holders exposed to substantial liabilities. The passage of time does not alter ownership. This principle is best demonstrated by an example involving tangible personal property:

> Mrs. B (''Owner'') asks Corporation X (''Holder'') to store her furniture for two months. Holder agrees to do so at a rate of $10 per month. Three years later, Owner still has not claimed her furniture. While Holder may charge Owner for the extra storage time, Owner at all times retains ownership of the furniture. Holder does not own the property and cannot legally claim it as its own. Holder cannot legally use the furniture. Of course, over time Holder might receive permission to sell the property to pay for the costs of storage. However, any excess amounts must be sent to the state for safekeeping until Owner claims her money.

To reduce battles between the states over entitlement to unclaimed property, the U.S. Supreme Court has established the following priority rules for determining the state to which the property is to be delivered:[76]

1. The first priority claim to the unclaimed property goes to the state of last known address of the apparent owner, as shown on the business records of the holder; and
2. If the apparent owner's address is unknown, or if the apparent owner resides in a state that does not claim the unclaimed property (or in a foreign country), the holder's state of corporate domicile (i.e., state of incorporation) or, in the case of a noncorporate holder, place of principal business has the next claim to the abandoned property.

The second priority rule has two consequences: First, Delaware is the most significant beneficiary of this rule because it is the state of choice for incorporating businesses, and it aggressively enforces its rights to unclaimed property. Second, foreign businesses that incorporate a U.S. affiliate in Delaware have established the affiliate's legal domicile in a state with an active unclaimed property audit practice.

Not all unclaimed property is escheatable. For example, many states have exemptions for property held by one business that is owed to another business. Other exemptions are available as well.

Noncompliance with unclaimed property laws is especially problematic for foreign businesses (and their domestic affiliates), as many states treat their ability to take custody of such businesses' unremitted unclaimed property as not being subject to any statute of limitations.

ENFORCEMENT AND COLLECTION OF TAXES

> *Summary: The states enforce their ability to collect taxes through information exchange and audit cooperation arrangements. In addition, the Securities and Exchange Commission can punish publicly traded companies having poor internal controls that lead to undisclosed state tax liabilities. Businesses*

[76] *Texas v. New Jersey*, 379 U.S. 674 (1965). In 2012, the Court of Appeals for the Third Circuit rejected New Jersey's attempt to add an intermediate priority rule, reasoning that it did not have the authority to contradict the U.S. Supreme Court's decision in *Texas v. New Jersey*. *Sidamon-Eristoff v. New Jersey Retail Merchants Association*, 669 F.3d 374 (3d Cir. 2012), *petition for certiorari denied*, 133 S. Ct. 528 (10/29/12).

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that become aware of their noncompliance with state taxes have several corrective measures from which to choose.

State Tax Audits and Interstate Cooperation

Every state has several relationships it can call upon to ensure that its taxes are collected at what it believes to be the proper amount. At the most basic level, the states need, and by a wide margin receive, taxpayers' cooperation. However, as with any tax program, that cooperation is reduced if taxpayers do not believe that they will be audited.

Unfortunately, state tax compliance by foreign businesses is too often lacking. Based on the author's experience, this appears to be the result of: (1) a lack of knowledge among foreign businesses and foreign tax professionals of the existence and significance of these taxes; and (2) a perceived lack of enforcement by the states. Regarding the former, it is hoped that this article has shed light on the fundamental differences between state taxes and federal taxes. Regarding enforcement by the states, there is no way of knowing when state auditors will become aware of the noncompliance of foreign businesses. Business management that bets on not being caught is risking a large liability for the business and for management personally.

The states have an assortment of enforcement tools at their disposal. Of course, each state has an audit staff and many states have offices in other regions in the United States that they have identified as likely sources of revenue. Furthermore, enforcement by the states is aided by the following potentially powerful resources:

1. Federal-State Information Sharing. Under §6103(d), the IRS shall disclose any ''returns and return information'' to any State agency that is charged with administering state tax laws to the extent necessary to administer those laws. The states place great reliance on the receipt of information from the federal government, as the Colorado Attorney General recently observed (''the [Colorado Department of Revenue] relies heavily upon its access to 'Federal Tax Information,' or 'FTI,' which is defined broadly to include any information gathered by the IRS with regard to a taxpayer's liability.'')[77] In addition, the states can treat the information they receive from the federal government as sufficient support for a *prima facie* correct assessment.[78]

2. Information Sharing Among the States. To increase compliance with corporate income taxes, sales taxes, and use taxes, the states participate in a variety of information exchange agreements. For example, in 1993 the Federation of Tax Administrators' ''Uniform Exchange of Information Agreement'' was adopted by 48 states, the District of Columbia, and New York City.[79] The agreement facilitates tax administration by providing for the exchanging of information among the participating states (and localities).

As another example, the Southeastern Association of Tax Administrators (SEATA) is a group of 12 states (Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, and West Virginia) that ''sponsors a program to exchange tax information among its member states to facilitate tax administration and compliance across state boundaries.''[80] SEATA maintains a use tax audit verification program in which ''Member states are collecting and exchanging audited sales and purchase information on behalf of other member states so that use tax can be properly collected from the customer. Customers of these businesses will be contacted for collection of use tax, penalty, and interest.''[81] There are numerous other agreements among the states.

3. Multistate Tax Commission/Unclaimed Property Contract Auditors. The states have concluded that if a taxpayer is noncompliant in one state, it also might be noncompliant in several other states. Therefore, the states have developed approaches to sharing the expenses of identifying and auditing noncompliant businesses. Among these is the Multistate Tax Commission (MTC) Joint Audit Program. Through the Joint Audit Program, 28 participating states pool their resources to select businesses for corporate income, sales and use, franchise, and gross receipts tax audits. The MTC reports that over the last five years the audit program has

[77] Colorado Attorney General Opinion 12-07, Dec. 12, 2012 (text to fn. 23).

[78] *See, e.g., Dept. of Revenue of the State of Illinois v. Jane Doe*, IT 13-01 (Dept. of Revenue Hearings, 2/4/13).

[79] Bloomberg BNA State Tax Library, 1730 T.M., *Managing State Tax Audits*, at 1730.02.

[80] SEATA Agreement Brochure, Oct. 2007.

[81] *Id.*

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completed "the equivalent of 1647 state income and sales tax audits."[82]

Similarly, states auditing businesses for noncompliance with unclaimed property laws frequently join in common audits conducted by outside ("contract") auditors. These audits are often performed on behalf of 15 or more states.

The MTC also maintains a "National Nexus Program" to foster "increased state tax compliance by business that is engaged in multijurisdictional commerce. . . [and] the identification of businesses involved in multijurisdictional commerce which are not now in compliance with applicable state tax laws. . . ."[83]

4. Securities and Exchange Commission. Companies that are publicly owned, or that are planning to be publicly owned, must know that the Securities and Exchange Commission (SEC) treats failures to properly account for state tax exposures as potentially material misstatements in financial statements. In 2011, the SEC fined a company $200,000 for paying state sales taxes instead of collecting the taxes from the business' customers, as was required by law. The SEC held that the reason for the company's payment was a failure of internal controls, with the result that the company's financial statements were materially misstated. The federal fine was in addition to $3.9 million in taxes that the business owed the states.[84] As a second example, in August 2012 Sprint Nextel Corp. disclosed that it is being investigated by the SEC for potentially improper state and local sales tax collection practices. Sprint stated that the SEC "investigation follows a filing by the New York Attorney General alleging Sprint did not collect the proper New York state taxes from Sprint's New York customers."[85]

5. Assessments Based on Lack of Cooperation. When a business does not cooperate with state tax agencies, the agencies are authorized to assess taxes on the best information available. While a state should not make the amount assessed punitive, it must make the assessment large enough to protect the state's claims. This can result in assessments that are large and, from the taxpayer's perspective, unreasonable.

Derivative Liability

In order to collect taxes due, states are empowered to impose tax liability beyond the entity that incurred the liability. In general, these liabilities are imposed for sales taxes, use taxes, income tax withholding, and other trust fund taxes (that is, taxes that the business is required to collect from another taxpayer and then remit to a state). There are two primary types of derivative liability: "Responsible person liability" and "Successor liability."

Responsible Person Liability

When a business fails to pay sales taxes, use taxes, or other trust fund taxes, state law frequently permits the collection of the taxes from individuals at the business who were in a position to know about and correct the business's failure to collect and remit such taxes.[86] From January 1, 2010, through June 30, 2012, no fewer than 17 states litigated this issue against such responsible persons, and several of the states litigated two or more responsible person cases. Moreover, the states usually won these cases. Significantly, the reported decisions represent a small minority of these collection actions; most disputes are resolved quietly.

Whether an individual is a responsible person must be determined on a case-by-case basis. Factors to be analyzed include: authorization to sign a business's checks, ability to hire and fire employees, management of day-to-day business activities, degree of responsibility for the maintenance of the business's books, authorization to sign tax returns, and ownership of the business's stock. Further, in some states responsible person liability can apply without any showing of the person's willfulness or intention to shortchange the state on its taxes. Even in states where a showing of willfulness is required, it can be made merely by showing that the business paid other liabilities while the responsible person knew or should have known that the taxes were owed. No showing of bad faith is required. Moreover, the burden of proof is typically on the alleged responsible person to prove that he was not responsible for the failure to remit tax.

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[82] MTC Internet page "About the MTC Audit Program," http://www.mtc.gov/Audit.aspx?id=578 (last visited 2/17/13).

[83] MTC Internet page "About the Nexus Program," http://www.mtc.gov/Nexus.aspx?id=526 (last visited 2/17/13).

[84] *In the Matter of Hudson Highland Group, Inc.*, Securities and Exchange Act of 1934 Release No. 63688 (1/10/11); Accounting and Auditing Enforcement Release No. 3226; Administrative Proceeding File No. 3-14182.

[85] *See* Sprint website at http://newsroom.sprint.com/article_display.cfm?article_id=2347.

[86] *See, e.g.,* California (Cal. Rev. & Tax. Cd. §6829 and 18 Cal. Code of Regs. 1702.5); Texas (Tex. Tax Code Ann. §111.0611); New York (N.Y. Tax Law §1133 and 20 NYCRR 532.3); Florida (Fla. Stat. §213.29); and Illinois (35 ILCS 735/3-7).

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Once one is determined to be a responsible person, he can be held liable for the business's unpaid taxes, sometimes without having an opportunity to challenge the amount of the alleged tax liability. In addition, the liability is not extinguished even if the business goes out of existence. Also, a business's failure to collect sales and use taxes on its taxable sales can cause a responsible person to be liable for a business's uncollected taxes as well as taxes that were collected but not remitted.

Successor Liability

Some foreign businesses follow a model of developing a start-up company to the point where it demonstrates viability in the United States and then selling the business. In other circumstances, a foreign business may seek to purchase an existing business as an entrance into the U.S. market. In both circumstances, the foreign business must be concerned about unpaid state taxes — the former because these taxes will damage salability and the latter because the taxes owed reduce the value of the purchased assets.

This, of course, is contrary to a commonly held belief that an acquiring business can avoid responsibility for the liabilities of an acquired business by purchasing its assets instead of its stock. Where unpaid state taxes are concerned, that belief is wrong. A purchaser's liabilities can arise as part of the transaction (that is, the transaction itself might be taxable) or because the purchaser is a successor to the purchased business.

The states' justification for imposing successor liability is that, while tangible assets are held by the prior owner, the states have liens and other mechanisms that they can use to enforce collection. However, after those assets are converted to cash and the business is closed, the prior owner can conceal the whereabouts of the funds or use the funds to pay other creditors. Moreover, the states provide a mechanism for an acquirer to learn of the prior owner's outstanding liabilities by requiring the acquirer to obtain a tax clearance certificate. The states, therefore, are not reluctant to impose successor liability on an acquirer that failed to protect itself. Unlike derivative liability for a responsible person, which generally applies only to trust fund taxes, successor liability can extend to any tax owed by a business, including income tax.

Further, the acquirer may be denied any meaningful opportunity to contest the amount of the tax, as demonstrated in a 2012 decision of the Wisconsin Tax Appeals Commission:[87]

> Finally, [the acquirer] has questioned the amounts due. Assessments made by the [Wisconsin Department of Revenue] are presumed correct and the burden is on the acquirer to prove by the greater weight of credible evidence in what respects [the Department of Revenue] erred in its determination. [The acquirer] has produced no documentation to support calculations other than those contained in the assessment.

Realistically, if the state is unable to obtain payment from the prior owner, and the acquirer cannot persuade the prior owner to pay its liabilities, the possibility of the acquirer obtaining helpful tax records from the prior owner is virtually nonexistent.

To avoid or at least reduce the risk of such liability, acquirers of substantial portions of a business's assets are generally required to file tax "bulk sale" notices with the relevant tax jurisdictions. These are different from bulk sale notices filed for Uniform Commercial Code purposes, and instead put the state tax authorities on notice of the planned asset sale so that any claim for tax liabilities can be asserted before the transaction occurs, i.e., at a time when the acquirer can hold the seller responsible for the tax. If the prior owner does not owe state taxes, the state will issue a tax clearance certificate.

Additional techniques for minimizing such exposure are available as well, although none of these other techniques can eliminate the acquirer's exposure for the prior owner's unpaid taxes.

When a Foreign Business Discovers a State Tax Liability

It frequently happens that a foreign business discovers an unpaid state tax liability. As long as this occurs before the company has been contacted by the jurisdiction involved, the company has several options available. These include filing the required return and paying the taxes due, making a voluntary disclosure through tax counsel, or participating in a tax amnesty with the assistance of tax counsel. In many cases, two or all three of these options are available, which means that care must be used in deciding on the approach to take.

Before deciding on the approach to take, the business must determine the periods of exposure and the reason for its failure to comply with the state's requirements. It also must consider whether it has a liability for other taxes imposed by the state, and whether it has a liability for taxes imposed by other states. Finally, it should consider whether it has overpaid taxes to another jurisdiction, which now should be the subject of a claim for refund.

If the periods of noncompliance are within the last three years, the business should consider simply filing the necessary returns and paying the taxes due. The

[87] *Villager Food Mart/Beer & Liquor v. Wisconsin Dept. of Revenue*, Dkt. No. 10-S-276 (Wis. Tax App. Comm. 4/4/12).

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state will bill the business for interest and penalties. The business can request a waiver of penalties but interest is rarely waived.

A second alternative is to seek a voluntary disclosure agreement with the state (or states). These are never entered into by the business contacting the state directly, as the business must remain anonymous until the terms of the agreement are established. Instead, the agreements are negotiated with the assistance of tax counsel, who contacts the state on behalf of his anonymous client. Engaging an attorney to communicate with the state is important because of the additional protection of the attorney-client privilege, as these contacts occasionally take unsatisfactory turns. In general, the terms of these agreements are negotiable, depending on the state and, of course, the reasonableness of the business's belief that it was not subject to the tax.

In most voluntary disclosure agreements, the most important term is the length of the period for which returns must be filed and tax paid (the ''look-back period''). For some states the look-back period to be used in their voluntary disclosure agreements is limited or pre-set by law or regulation. For example, Illinois provides that the maximum look-back period is four years, with a possibility of being less.[88] Unless state law specifies a look-back period, the states typically seek three years' back returns and payments. Without regard to the states' typical arrangements, when seeking voluntary disclosure, counsel should request prospective treatment, explaining the reason that this treatment is appropriate. Whatever the look-back period, the states will require the remittance of all trust fund taxes the business collected.

A third alternative for businesses that have identified an unpaid state tax is to participate in a state's tax amnesty program, if one is available for the tax at issue. The terms of these programs vary but generally involve a limited look-back period, waiver of interest, and/or waiver of penalties.

The three alternatives above apply to businesses that did not commit fraud or engage in other clearly improper conduct (e.g., collecting sales and use taxes from customers but not remitting the amounts to the states). Businesses that did engage in such conduct must make sure to disclose that information to their counsel so that counsel can develop an appropriate strategy for approaching the states.

The rules and strategy change if a business is contacted by a state before the business initiates contact. When this occurs, the business is no longer eligible for voluntary disclosure or tax amnesty. Instead, counsel's approach should be to cooperate with the state, providing the information requested, and, where possible, helping to shape information requests to make them less burdensome. Experience demonstrates that the states are willing to treat a business leniently if a good rapport with the state tax officer is established and the business's reason for noncompliance is reasonable.

When a business has been contacted by a state, it is very important that the business also determine whether it has exposure for unpaid taxes in other states. That review must be done quickly and thoroughly, as it is important to initiate the voluntary disclosure process in the relevant states before those states receive information about the company pursuant to an exchange of information agreement. Once the states have that information, they can contact the business at any time to inquire about its possible tax presence, at which point the business will be disqualified from making a voluntary disclosure or taking advantage of a tax amnesty in that state.

The methods described above are simplified versions of three fundamental tools available to assist a business that wants to eliminate an exposure for unpaid taxes. The actual approaches used must be tailored to the business's circumstance and states involved.[89]

CONCLUSION

Foreign businesses would not think of operating in their home country without obtaining tax advice and complying with their country's tax laws. Nor would they consider conducting business in the United States without first receiving expert tax advice on federal tax law and acting in accordance with the advice received. Regrettably, that diligence often does not extend to U.S. state and local taxes, even though the business's and business manager's liabilities for these taxes can be more substantial than for federal taxes. The reasons often given for that lack of attention — lack of awareness and lack of auditing — are not satisfactory.

Federal tax treaty protections and the federal concept of a permanent establishment have almost no relevance to state taxation. Rather, the states are concerned with tax presence principles that are established by the U.S. Constitution. The states also are focused on income computation, apportionment, and sales tax collection rules. Each of these concepts is complex. The information and strategies provided in this article are intended to help in-house tax profes-

[88] 86 Ill. Admin. Code 210.126(b)(2).

[89] For a fuller discussion of this topic and other approaches to avoiding litigation, see ''Nonlitigated Resolutions of Multistate Tax Disputes: Three Case Studies Show How Taxpayers, States Can Find Common Ground,'' 42 *Daily Tax Rep.* J-1 (3/3/11).

ISSN 0090-4600

sionals at foreign businesses, as well as their outside advisors, understand fundamental concepts of state taxation and appreciate why planning for these taxes is so important.

ISSN 0090-4600

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GEORGETOWN UNIVERSITY LAW CENTER

Advising Foreign Businesses About American State and Local Taxation -- And a Few Words About Tax Haven Legislation

October 24, 2018

Presented by David A. Fruchtman

RECOMMENDED READINGS FOR TODAY'S LECTURE

I. U.S. Supreme Court cases:

A. *Container Corp. of America v. FTB*, 463 U.S. 159 (1983)
B. *Kraft Gen'l Foods v. Iowa Dep't Rev*., 505 U.S. 71 (1992)
C. *Barclay's Bank PLC v. FTB*, 512 U.S. 298 (1994)

II. Articles (Available where cited and on my professional biography)

A. "Advising Foreign Businesses on U.S. State and Local Taxation" (Tax Management Int'l Journal, Apr. 12, 2013)
B. "Delaware: An Onshore Tax Haven" (Institute on Taxation and Economic Policy, December 2015) https://itep.org/delaware-an-onshore-tax-haven/
C. "US Operations: An Israeli Circular and a US Indictment" (Jerusalem Post, May 5, 2016)

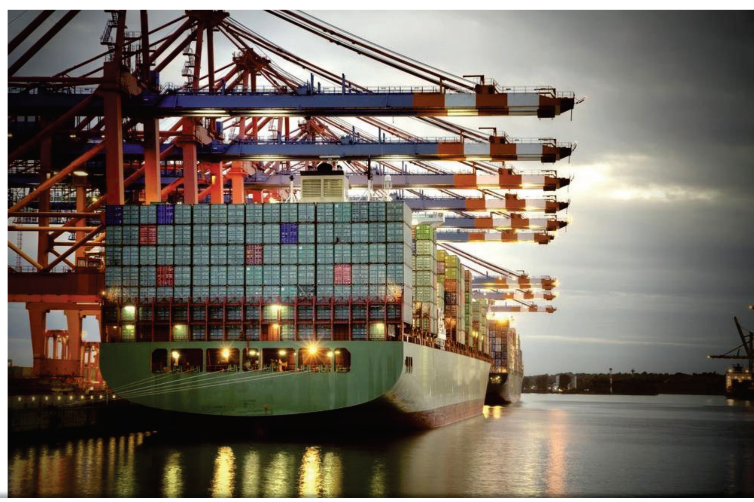
TODAY'S LECTURE

I. WHY IS THIS IMPORTANT?

Who is your potential client/taxpayer?

FOREIGN OPERATING COMPANIES

Entities incorporated abroad are often called
"Alien corporations"

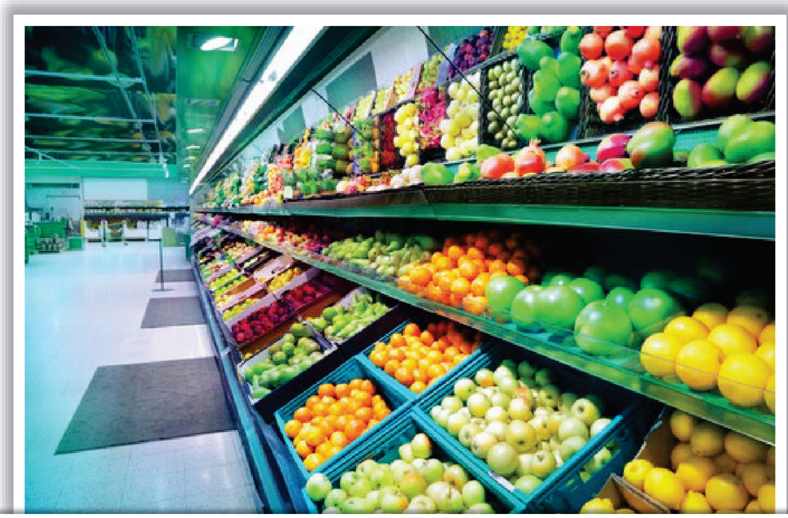


2017:

$2,903,349,000,000

in total imported goods and services

(U.S. INTERNATIONAL TRADE IN GOODS AND SERVICES (published September 2018)
https://www.census.gov/foreign-trade/Press-Release/current_press_release/ft900.pdf
(Part A, Exhibit 1)



2017:

$601,869,000,000

in imported consumer goods

(U.S. INTERNATIONAL TRADE IN GOODS AND SERVICES (published September 2018)
https://www.census.gov/foreign-trade/Press-Release/current_press_release/ft900.pdf
(Part A, Exhibit 6)

2017:

$509,838,000,000

in imported services

(U.S. INTERNATIONAL TRADE IN GOODS AND SERVICES (published September 2018)
https://www.census.gov/foreign-trade/Press-Release/current_press_release/ft900.pdf
(Part A, Exhibit 4)

What are "imported services"?
Largest: Travel, Transport, Insurance, IP, Telecommunications, Financial

(U.S. INTERNATIONAL TRADE IN GOODS AND SERVICES (published September 2018)
https://www.census.gov/foreign-trade/Press-Release/current_press_release/ft900.pdf
(Part A, Exhibit 4)

Dollar to foreign currency exchange rates:

USD per unit (at 09/01/xx)

	Euro	Pounds	Yen	Yuan	Shekel
2007	1.362955	2.017146	0.008638	0.132264	0.242511
2011	1.428255	1.617998	0.013017	0.156605	0.279874
2014	1.313031	1.661179	0.009590	0.162809	0.279628
2017	1.160655	1.295701	0.009001	0.146431	0.277080
Change to purchasing power 2007 to 2017	Down 15%	Down 36%	Up 4%	Up 11%	Up 14%

Source: http://www.xe.com/.

VERY SIMPLE ECONOMICS

A weak dollar

=

more expensive imports

=

reduced purchases of foreign goods

What will happen when the dollar strengthens...?

II. SUBSTANTIVE ISSUES

A. General Principles

Federal constitutional requirements

- Due process, equal protection and perhaps all federal constitutional protections available to domestic corporations
- Foreign Commerce Clause

Commerce Clause.

Article 1, Section 8, Clause 3 of the U.S. Constitution:

“The Congress shall have the power to…regulate commerce with foreign nations, and among the several states, and with the Indian tribes.”

Commerce Clause requirements for state taxation of domestic companies, as set forth in *Complete Auto Transit Inc. v. Brady,* 430 U.S. 274 (1977):

1. must be applied to an activity with a substantial nexus with the taxing state;
2. must be fairly apportioned;
3. must not discriminate against interstate commerce; and
4. must be fairly related to services provided by the taxing state

Foreign Commerce Clause adds two requirements for state taxation of foreign commerce:

5. must not create unconstitutional international multiple taxation;

6. must not impair federal uniformity in an area where federal uniformity is essential by preventing the United States from speaking with one voice in regulating foreign trade.

Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979)

What is foreign commerce? More than mere foreign incorporation?

See dissent in
Kraft General Foods Inc. v. Iowa Dept. of Revenue and Finance, 505 U.S. 71 (1992).

TAX PRESENCE

is <u>the</u> major stumbling block for foreign businesses.

TAX TREATIES

and the concept of a “permanent establishment”

P.E. is a

"fixed place of business."

CAUTION!

Tax treaties generally do not apply to states.

CAUTION!

P.E. is not a state tax concept

Tax presence for state tax purposes

"SUBSTANTIAL NEXUS"

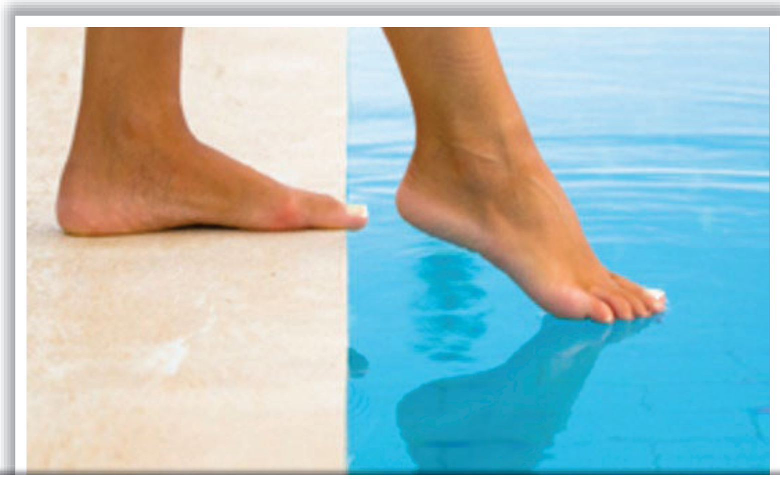
COMPARE:	P.E.?*	Substantial Nexus?
Maintaining a stock of goods belonging to the foreign business solely for the purpose of storage, display or delivery.	NO	YES
Maintaining a fixed place of business solely for the purpose of purchasing goods or collecting information for the foreign business.	NO	YES
Maintaining a stock of goods belonging to the foreign business solely for the purpose of processing by another enterprise.	NO	YES

*Per U.S. Model Income Tax Convention of November 15, 2006 (Art.5)

CAUTION!

Delaware corporations are not exempt from state tax.

This misconception is based on misunderstanding Delaware Code §§1902(b)(6) and (8), which provide exemptions from Delaware income tax.



De minimis **presence** is not a tax planning concept

B. Sales And Use Taxes

The most significant exposure for many foreign businesses

SALES AND USE TAX RISK

- Unknown tax presence and failure to collect
- Known tax presence and failure to collect proper amounts
- Known tax presence and tax collection, but failure to remit

When advising foreign businesses always discuss responsible person exposure

C. Income Taxes

INCOME TAX ISSUES

- Confusion over tax presence
- Will Base Erosion and Profit Shifting (BEPS) play a role?
- Federal conformity. How far does it go?
  - "Taxable Income"
  - What if conformity leads to discrimination against foreign commerce? *Kraft*

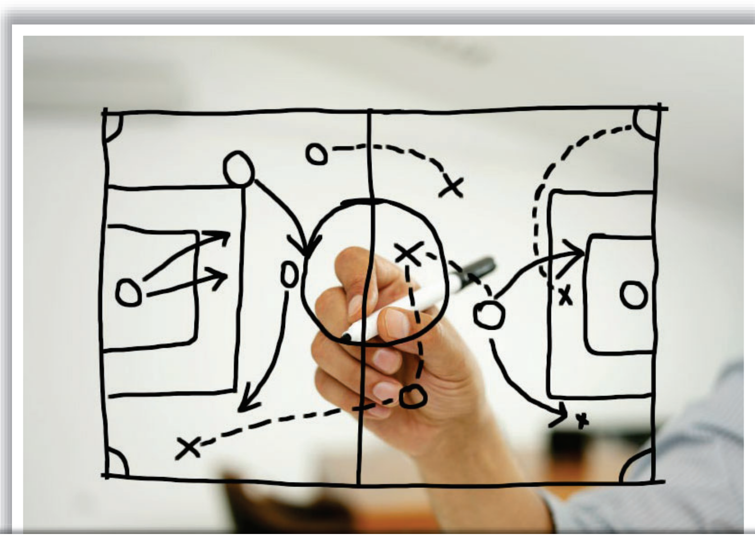
MORE INCOME TAX ISSUES

- Unitary Groups. Worldwide filing vs. water's-edge filing
- Water's-edge issues
  - Tax haven
  - Parent of group
- Consequences of market-based apportionment

D. LOOSE ENDS

- Some states -- for specific taxes -- protect activities beyond the tax presence requirements of the U.S. Constitution (E.g., Illinois use tax temporary storage exemption (35 ILCS 105/3-55(e)))
- Escheat of unclaimed property. Every state has these laws. However, even among tax compliant companies, there is little knowledge or compliance with escheat laws
  For a primer, *see* http://www.statetaxalert.us/articles/NYU02.pdf

III. PLANNING AND POLICY CONSIDERATIONS



A. Planning

1. Compliance Issues

Noncompliance is not planning.

Foreign compliance with state tax requirements is *weak*

WHY?

1. Lack of understanding
2. Lack of audits

Compliance Issues

Start-ups vs. Mid-sized companies vs. Large companies

2. Income tax planning in water's-edge states

Often better to have out-of-state (e.g., foreign) property and payroll than to be a pure holding company

Challenges to tax haven statutes

Two types of tax haven statutes

List specific countries, e.g., Montana (Mont. Code Ann. § 15-31-322(f))

List offending characteristics, e.g., Rhode Island (R.I. Gen. Laws §§ 44-11-1(8) and 44-11-4.1(d))

Do tax haven statutes violate the "Speaking with one voice" requirement?

May each state have its own foreign policy?

3. Sales and use tax planning

Tax presence planning is often possible… But often dangerous

What if Congress adopts remote vendor legislation?

- What if remote vendor legislation does not apply to businesses based abroad? Rep. Goodlatte's draft proposed online sales tax bill (released August 25, 2016)

- What if remote vendor legislation applies to services? *See generally* "Congress Should Exclude Sales of Services From Any Remote Vendor Tax Collection Legislation,"   Bloomberg BNA Daily Tax Report (August 14, 2015)

Characterization planning.

The same as for domestic companies.

4. The “Uh Oh” Moment…

WHEN A FOREIGN CORPORATION DISCOVERS A STATE TAX LIABILITY

Quantify

Strategize

Correct

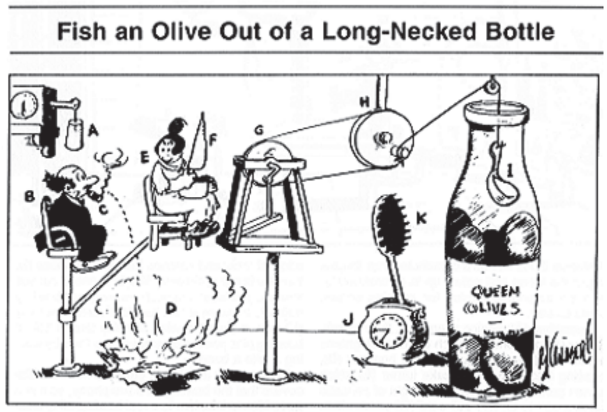
- Voluntary disclosure?
- Amnesty?
- Restructure?

… And remember to protect responsible persons in any agreement

B. Policy Considerations

1. Increase compliance

2. Reduce complexity of corporate income taxation



(…even though **Rube Goldberg** would love the states' current approaches)

INCREASE COMPLIANCE BY FOREIGN BUSINESSES BY

1. Educating foreign accountants about state tax requirements.

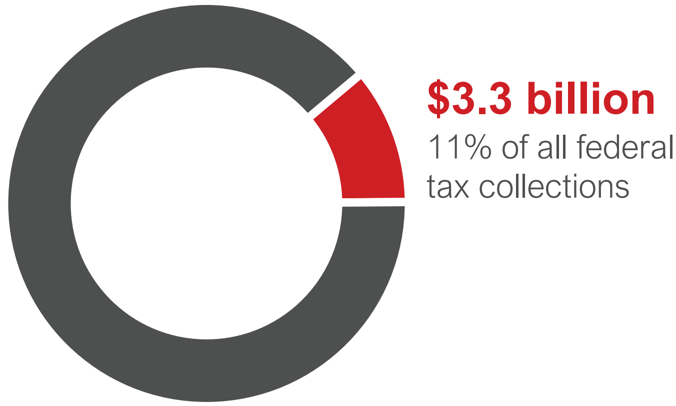
2. Other ways to increase compliance

Seems simple.

So why aren't the states doing this?

3. Right-Size Emphasis on Corporate Income Taxation

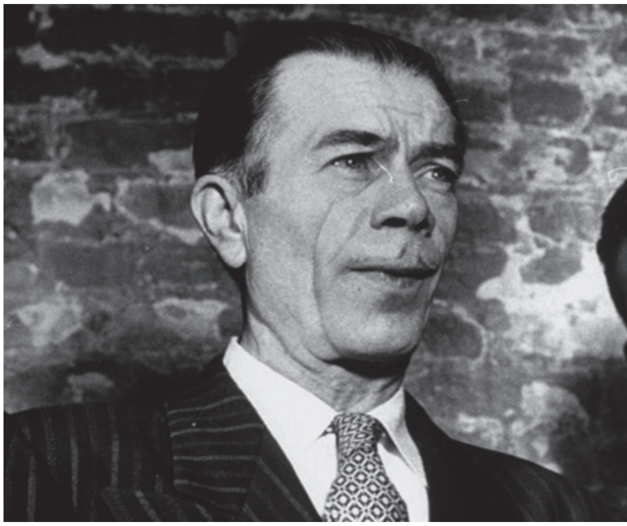
A partial explanation…



For 2014, the federal government collected some $3.3 billion in federal corporate income taxes -- 11% of all federal tax collections.

(“Where do federal tax revenues come from?” The Center on Budget and Policy Priorities, March 15, 2015)

(*See e.g.*, “Offshore Shell games 2015” U.S. Public Interest Research Group and Citizens for Tax Justice (October 2015))



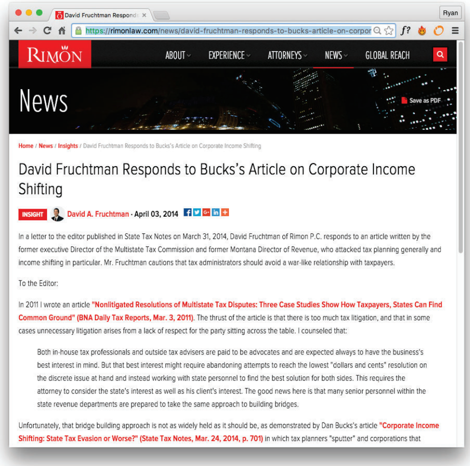
They are following
Willie Sutton's thinking:

"That's where the money is."

Likewise, DOR advocates tend to focus on corporate income tax issues.

See, e.g , "New report may spur passage of Massachusetts tax havens legislation" (State Tax Today, October 8, 2015), referencing the October 2015 report on federal tax avoidance.

See also, "Corporate Income Shifting: State Tax Evasion or Worse?" by Dan Bucks (State Tax Notes, March 24, 2014). Bucks was Montana Director of Revenue from 2005 through 2013. *And see* my response "Practitioner Responds to Bucks's Article on Corporate Income Shifting" (State Tax Notes, March 31, 2014)



David Fruchtman Responds
https://rimonlaw.com/news/david-fruchtman-responds-to-bucks-article-on-corpor

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David Fruchtman Responds to Bucks's Article on Corporate Income Shifting

INSIGHT David A. Fruchtman · April 03, 2014

In a letter to the editor published in State Tax Notes on March 31, 2014, David Fruchtman of Rimon P.C. responds to an article written by the former executive Director of the Multistate Tax Commission and former Montana Director of Revenue, who attacked tax planning generally and income shifting in particular. Mr. Fruchtman cautions that tax administrators should avoid a war-like relationship with taxpayers.

To the Editor:

In 2011 I wrote an article "Nonlitigated Resolutions of Multistate Tax Disputes: Three Case Studies Show How Taxpayers, States Can Find Common Ground" (BNA Daily Tax Reports, Mar. 3, 2011). The thrust of the article is that there is too much tax litigation, and that in some cases unnecessary litigation arises from a lack of respect for the party sitting across the table. I counseled that:

> Both in-house tax professionals and outside tax advisers are paid to be advocates and are expected always to have the business's best interest in mind. But that best interest might require abandoning attempts to reach the lowest "dollars and cents" resolution on the discrete issue at hand and instead working with state personnel to find the best solution for both sides. This requires the attorney to consider the state's interest as well as his client's interest. The good news here is that many senior personnel within the state revenue departments are prepared to take the same approach to building bridges.

Unfortunately, that bridge building approach is not as widely held as it should be, as demonstrated by Dan Bucks's article "Corporate Income Shifting: State Tax Evasion or Worse?" (State Tax Notes, Mar. 24, 2014, p. 701) in which tax planners "sputter" and corporations that

But there is a problem:

For the states, that's not where the money is.

9X

During 2014, the states collected nine times more tax revenue from sales and use taxes than from corporate income taxes. *See e.g.,* "State Government Tax Collections Summary Report: 2014," U.S. Department of Commerce (August 16, 2015). Corporate income taxes were 5.3% of state tax collections.

Email Correspondence

I. First Note (To A Large Group of State Tax Practitioners):
"Hi All!
Can anyone possibly cite for me any examples of a foreign (non U.S.) company that has run into trouble on click-thru nexus?"

II. Second Note:
"I will be interested in any responses you get…the state DORs have not been discharging their responsibilities in this area. Too busy fooling around attacking corporate income tax planning."

III. Third Note (one month later):
"Did you receive any responses to this inquiry?"

IV. Fourth Note:
"Nope - never rec'd any response."

IV. The Crystal Ball.

Where Are We Headed Over the Next Five to Ten Years?

- Federal sales tax legislation?
- More audits
- Responsible person liability
- And, ultimately, greater compliance

A Last Thought: Challenge Yourself

No. 17-494

In The
Supreme Court of the United States

SOUTH DAKOTA,

Petitioner,

v.

WAYFAIR, INC., OVERSTOCK.COM, INC.,
AND NEWEGG, INC.,

Respondents.

**On Writ Of Certiorari To The
Supreme Court Of South Dakota**

**BRIEF FOR DAVID A. FRUCHTMAN
AS *AMICUS CURIAE*
SUPPORTING NEITHER PARTY**

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March 5, 2018

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Questions????

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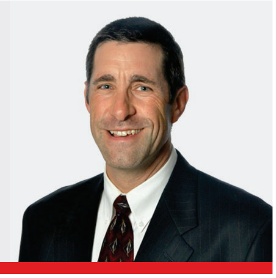

- Has advised clients regarding taxes in all 50 states.

- For Mr. Fruchtman's professional biography and links to more than 70 of his articles, outlines and newsletters, please go to www.rimonlaw.com

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Looking Back (Reflections on *Wayfair)* **and Looking Forward** (Sales Taxation of Services)

October 16, 2018

Lecture by David A. Fruchtman

RECOMMENDED READING FOR TODAY'S LECTURE

1 *South Dakota v. Wayfair, Inc., et al.*, 585 U.S. --- (June 21, 2018)

2 *Pike v. Bruce Church,* 397 U.S. 137 (1970)

3 *South Dakota v. Wayfair, Inc. et al.,* Brief for David A. Fruchtman as *Amicus Curiae* Supporting Neither Party (March 5, 2018)

4 *"How the Supreme Court's Sales Tax Case Could Affect Law Firms,"* National Law Journal, M. Coyle (April 16, 2018)

FYI: Digests of all amicus briefs filed in *Wayfair* are available in the booklet "Covering the Waterfront" (https://rimon.egnyte.com/dl/jQ7gbFoNFI)

PART I: LOOKING BACK

Reflections on *Wayfair*

Physical presence still matters

PART I: LOOKING BACK

Reflections on *Wayfair*

Physical presence still matters

Small vendors

PART I: LOOKING BACK

Reflections on *Wayfair*

Physical presence still matters

All other vendors

PART I: LOOKING BACK

Reflections on *Wayfair*

Important theoretical consideration:

It is not clear S. Ct. concluded that both thresholds are satisfactory (more than $100k in sales/200 or more transactions)

PART I: LOOKING BACK

Reflections on *Wayfair*

Important practical consideration:

What if a vendor falling below the thresholds sells on a platform with multiple vendors whose sales accumulate to amounts above the thresholds?

PART I: LOOKING BACK

Reflections on *Wayfair*

Two types of retroactivity

Initial

Annual

PART I: LOOKING BACK

Reflections on *Wayfair*

Tax presence is *not* always bad

- Sales tax nexus planning is high risk
- Sales tax nexus planning prevents characterization planning
- Income tax presence allows apportionment
- Income tax presence avoids throwback
- Income tax presence planning allows bringing in losses from earlier periods


Part II:
Looking Forward
(Sales Taxation of Services)


PART II: LOOKING FORWARD
Sales Taxation of Service
Service sector is LARGE…
and growing
12
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PART II: LOOKING FORWARD
Sales Taxation of Service

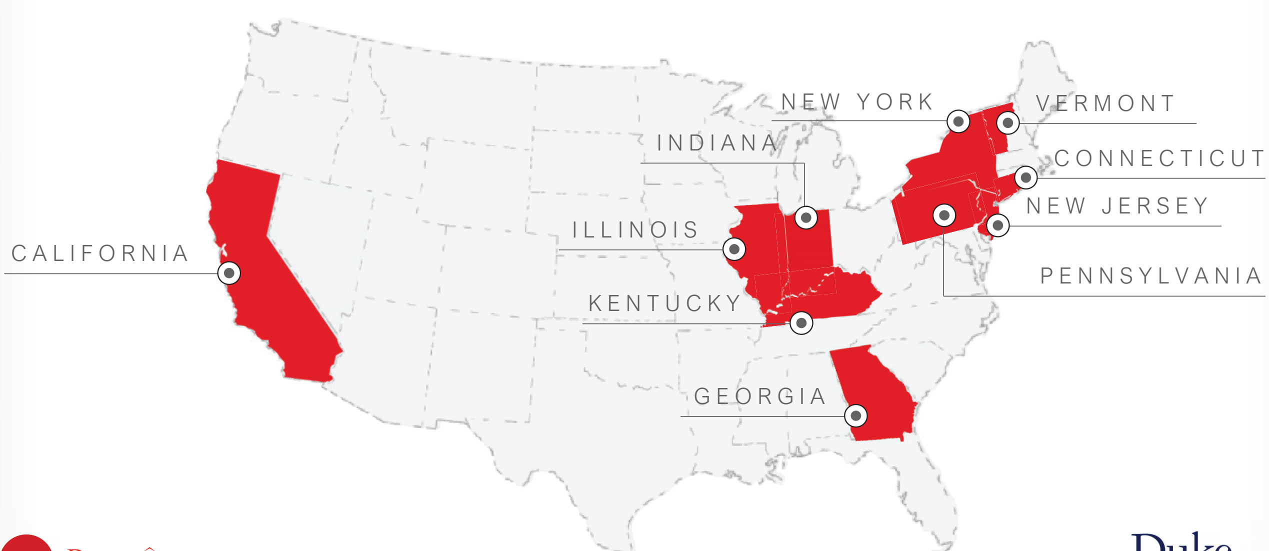
Sales taxation of services is limited….

for now

PART II: LOOKING FORWARD
Sales Taxation of Service

Broad sales taxation of services is coming.

Last five years: Proposals and studies
in the states highlighted below



PART II: LOOKING FORWARD

Sales Taxation of Service

Broad sales taxation of services is coming.

CA SBE estimated its state's annual collections from taxing services would be **1/7 of all taxes collected by all states.**

PART II: LOOKING FORWARD

Sales Taxation of Service

This is going to be messy

PART II: LOOKING FORWARD

Sales Taxation of Service

Prior attempts have failed.

See especially Florida. Also Massachusetts and Michigan

PART II: LOOKING FORWARD

Sales Taxation of Service

Problems with taxing services

a. Defining the service

b. Apportioning

c. Pyramiding

Might be avoidable if not imposed on B2B	But politically difficult not to impose on B2B

PART II: LOOKING FORWARD

Sales Taxation of Service

What should Congress do?

- My answer is in my brief
- What do you suggest?

Questions????

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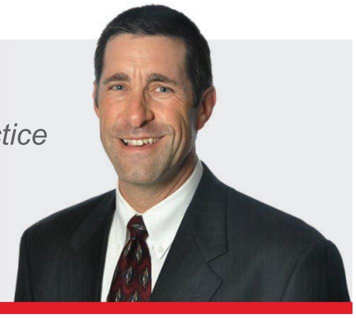

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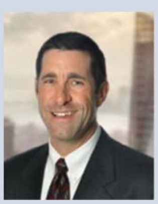
Overview of US State and Local Tax

May 14, 2018

Our Speakers



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Housekeeping

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- We will be polling our audience throughout the presentation. This will help us get a sense of the participants and their experience.
- In order to obtain CPE/CLE credit, please answer all polling questions and complete the survey that will be e-mailed after the presentation.
- This webinar is being recorded and will uploaded on to www.wgcpas.com.

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Agenda

- Introduction to State and Local Taxes (SALT)
- Common SALT Misconceptions
- Tax Presence Rules and International Principles
- Fundamentals of State and Local Taxes
- Planning Strategies
- Strategies for Fixing Noncompliance

Introduction to State And Local Taxes

Personal Income Tax * Corporate Income Tax * Franchise Tax * **Sales Tax** * Use Tax * Telecommunications Tax * Documentary Stamp Tax * Business and Occupation Tax * Escheat of Abandoned Property * **Rental Car Tax** * **Derivative Liability**

Common Principles

- Income Tax
  - Federal Conformity
  - Separate, Combined, or Consolidated Returns
  - UDITPA (Uniform Division of Income for Tax Purposes Act)
- Sales Tax
  - Destination Tax
  - Tangible Personal Property But Extending to Services
  - SSUTA (Streamlined Sales and Use Tax Act)

COMMON SALT MISCONCEPTIONS

Common SALT Misconceptions

- We're only subject to tax in the states we have locations
- Nexus is the same for sales and income taxes
- If I only sell online I don't have to collect any sales tax
- All states have the similar tax rules
- If the seller doesn't collect sales tax, no tax is due
- Once I determine if I have a filing obligation, I don't have to revisit SALT again
- Delaware corporations are exempt from state tax

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TAX PRESENCE RULES AND INTERNATIONAL PRINCIPLES

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How is Business Being Conducted in the US?

- Wholly-owned US Corporation
  - Full income subject to US federal tax
  - Full income subject to US state & local tax (generally)
  - Might inadvertently bring in foreign affiliates
  - Proper transfer pricing is critical
- Wholly-owned US Limited Liability Company
  - Ignored for US federal income tax purposes
  - As if foreign parent was operating in US directly
  - How is income subject to apportioned to states?

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Federal Safety Net

- Treaty Country: Permanent Establishment (PE)
  - "fixed place of business of an enterprise through which the business is wholly or partially carried on"
  - Generally, taxpayer favorable.
- Non-Treaty Country: Effectively Connected Income (ECI)
  - "all income from sources within the United States connected with the conduct of that trade or business is considered Effectively Connected Income."
  - Less protection than PE
  - More subjective in nature. Less taxpayer favorable.
- File protective Form 1120-F

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May a business have state tax presence even without having a permanent establishment in the United States?

Yes!

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13

Impact on State Taxation

- Many states have lower presence standard than PE
- Many states do not recognize US tax treaties
- Most states offer no benefit for foreign tax credit

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COMPARE:	P.E.?*	Substantial Nexus?
Maintaining a stock of goods belonging to the foreign business solely for the purpose of storage, display or delivery	NO	YES
Maintaining a fixed place of business solely for the purpose of purchasing goods or collecting information for the foreign business.	NO	YES
Maintaining a stock of goods belonging to the foreign business solely for the purpose of processing by another enterprise.	NO	YES

* Per U.S. Model Income Tax Convention of November 15, 2006 (Art. 5)

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Polling Question 1

Companies based outside the US must consider:

A. State sales tax
B. State income tax
C. Neither of the above
D. Both of the above

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Tax Presence

- Also known as "nexus"
- What is it?
  - General concept
  - Constitutional tests (Important Clauses: Due Process/ Commerce/Dormant Commerce/Foreign)
- Planning is possible--but requires discipline and vigilance

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Sales and Use Tax Presence

- First, a brief description of the difference between sales taxes and use taxes.
- Whichever tax potentially applies to vendors, what is at stake?
- May the vendor just advertise "tax included"? **Generally, no.**

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So What is Sales/Use Tax Presence?

- Physical Presence. Examples?
- "Ground hog" nexus? Cookie nexus?
- "Trailing" nexus? How long does nexus last?

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Presence for Other Taxes

- "Substantial" nexus
- Generally, does not require physical presence
- Economic Presence

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P.L. 86-272 (15 U.S. Code § 381)

- Safe Harbor for net income taxes only
- **No state**, or political subdivision thereof, shall have power to impose… a **net income tax** on the income derived within such State by any person from interstate commerce **if the only business activities** within such State by or on behalf of such person during such taxable year are … **the solicitation of orders** by such person or his representative, in such State **for sales of tangible personal property**, which orders are **sent outside the State for approval or rejection**, and, if approved, are filled by **shipment or delivery from a point outside the State**

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But Remember this Rule:

For all taxes, a corporation always has tax presence in the state in which it is incorporated.

There is no Delaware exception – although in certain circumstances the state will not impose its income tax.

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FUNDAMENTALS OF STATE AND LOCAL TAXES

Sales Tax

- Transactional tax
- Seller is responsible for collecting for sales taxes in states where it has tax presence
- General rules:
  - Sales of tangible property are subject to tax
  - Sales of services are not subject to sales tax
  - States have specific exceptions to the general rules
- Typically accrual method is required

Use Tax

- Applies to the use of taxable items/services
- Taxability rules are the same as sales tax
- Not applicable if sales tax was paid
- An area of focus for most tax exams

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Sales and Use Tax Exemptions

- Seller who receives exemption form in good faith generally is not required to collect tax
- Exemption form must be properly completed
- Common exemptions:
  - Resale
  - Manufacturing
  - Capital improvements
  - Exempt organizations

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Polling Question #2

A company which purchases office supplies from an online vendor which doesn't charge sales tax:

A. Need not do anything further. It is the vendor's responsibility
B. Must pay use tax with respect to the purchase

Income Tax

- Taxable income is subject to allocation & apportionment
  - Business vs nonbusiness income
- Corporate rules are often different from partnership/individual rules
- Common apportionment methods:
  - Three factor approach
  - Single sales factor
  - Double/triple weighted sales factor

Income Tax – Sales Factor

- Which sales are included for each state?
- Sales of tangible personal property
- Sales of services
  - Cost of performance
  - Market based sourcing

Franchise/Other Business Taxes

Measured on some basis other than net income

- Gross receipts
- Adjusted gross receipts
- Capital
- Minimum tax

Avoids Public Law 86-272 since tax not based on net income

Payroll Taxes

- Employee withholding
- Employer taxes
- Reciprocal Agreements
- Federal law to standardize rules?

Polling Question #3

A company which sells software support services in multiple states can use Public Law 86-272 to minimize:

A. Sales Tax
B. Income Tax
C. Franchise Tax
D. None of the above

PLANNING STRATEGIES

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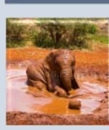
Bad Tax Planning

The always popular ostrich approach.

Playing the "audit lottery"
(p.s., no lawyer can advise you about this)



Muddying the water

Running with the "pack"

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Good Tax Planning

Tax presence planning. High reward but high risk

- Especially for sales/use taxes
- States generally will not give guidance

Characterization planning

- Especially for sales/use taxes
- States will give guidance

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STRATEGIES FOR FIXING NONCOMPLIANCE

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Risks Associated with Noncompliance

Statute of Limitations starts when tax return is filed. No tax return, no statute of limitations

Levels of liability - Income Tax - generally limited to business entity

Sales Tax - trustee type role. Often personal responsibility for responsible persons

Digital economy: taxation of SaaS, data processing services. P.L. 86-272 protection doesn't apply

Best Practice: File tax returns if any possibility of liability (to start statute of limitations)

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Sales Tax Remediation

Did customers pay use tax

Are exemption certificates available?

Does contract allow for back charging of sales tax?
(must consider business relationship)

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State Specific Amnesty Programs

- Currently in TX 
- Often when change in state leadership
- Federation of Tax Administrators maintains current list: https://www.taxadmin.org/state-tax-amnesty-programs
- Amnesty programs are good opportunities to check for 100% compliance

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Fixing the Problem

- **Best Approach:** Voluntary Disclosure
  - ANONYMOUS. Your representative approaches the state before they find you
  - State specific - most states have formal programs
  - Multistate Voluntary Disclosure Program. 38 state participate. Some high profile states which don't are CA and NY
  - Lookback period generally ranges from 3 to 5 years

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Fixing the Problem (Continued)

- Fix the problem going forward only: risk of past noncompliance being found
- Amend prior years (quiet disclosure)
  - Risk of additional penalties being imposed
  - State asking for more years going back
- Do nothing. Who's going to know:
  - Due Diligence by investor / buyer
  - State Tax Audit of vendor/customer
  - Certification required by customer in that state
  - Disgruntled employee / business partner
  - Problem will likely get worse with passage of time

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M&A Implications

Due to transferee liability, seller's state tax exposure is important to buyer even in an asset purchase

Buyer will take broad risk assessment due to short time frame usually for SALT DD

Potential exposure is often large for sales/income tax if nexus activities are not well defined.

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M&A Implications (Continued)

- Can be major setback to transaction
- Buyer will ask for escrow amounts to cover VDA filings post-closing
- Bulk sale provisions: mechanism in place, but not quick. Often doesn't work for M&A transaction.

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Polling Question #4

A business acquisition, structured as an asset purchase, provides insulation to the buyer for past SALT noncompliance by the seller.

A. True
B. False

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Any Questions?

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THE JERUSALEM POST

YOUR TAXES: U.S. state and local sales and use taxes: Bad news, good news

By DAVID A. FRUCHTMAN AND LEON HARRIS

07/07/2015

Photo by: REUTERS

Thousands of American subnational governmental units (states and localities) impose taxes. These taxes include "sales taxes," which are imposed on sales to end users of goods and certain services, and "use taxes," which are imposed on such purchases when sales tax applies but was not collected. Across the US, combined state and local tax rates are about 8 percent of the amount of a retail sale.

Sales and use taxes generate far more tax revenue for states and localities than do corporate income taxes. Businesses in the United States know that the subnational governments jealously guard their sales-tax base, and these businesses go out of their way to avoid the under-collection of these taxes. Recently, there have also been "whistle- blower" lawsuits brought by private parties against non-compliant businesses. The private parties are eligible for large financial rewards if taxes are collected as a result of their efforts.

Despite the risks of noncompliance, anecdotal evidence suggests that many businesses headquartered abroad are not complying with their obligations to collect sales taxes.

Some are not doing so because of a lack of understanding of the American tax system, others are hoping that the states will not notice them, and others (including very large businesses) are relying on the advice of local financial accountants who are not state tax experts.

Israeli businesses fall into each of these categories of noncompliance, and it is primarily to these businesses and their advisers that the remainder of this article is addressed.

First, the bad news: States treat vendors as being liable for collecting tax on their sales even if a tax treaty protects those businesses from having to file a federal income-tax return. For example, the temporary presence in a state of a vendor's employees, or even of independent contractors selling the vendor's goods, can be sufficient to require the vendor to collect sales tax. Failure to collect sales taxes exposes the vendor, as well as its management and financial employees ("responsible persons"), to liability for the uncollected taxes, interest and penalties. Make no mistake: Sales-tax noncompliance converts the small liabilities of a business's many customers into a large liability of the business itself.

And even worse news: Earlier this year, a US Supreme Court justice wrote that he is prepared to end a half-century's worth of precedent conditioning a requirement that vendors collect a state's sales tax on the vendor's physical presence in that state. Such a change will directly impact Israeli vendors (and their responsible persons), potentially including those with no property, employees or representatives in the US. Under current law, such vendors generally are not responsible for the collection of state and local sales taxes.

Now the good news: Twenty-four states are members of the Streamlined Sales Tax Governing Board, which provides uniform definitions for sales-tax concepts. These states' cooperation has simplified the process of determining taxability of sales of goods and services. And more good news: Currently, seven states have active or upcoming tax amnesty programs applicable to sales taxes, under which participating businesses will generally receive a waiver of liability for some back taxes, waiver of liability for all penalties and waiver of liability for some or all interest on the taxes and penalties. In addition, three other states are considering sales-tax amnesty programs.

Even more good news: Even states and localities that are not offering tax amnesty permit non-compliant taxpayers to come forward voluntarily and make special arrangements to become compliant. Such arrangements generally include the waiver of some back taxes and a waiver of all penalties. In some cases, it is possible to obtain a shorter period of back-tax liability than is available through the amnesty programs. In general, interest is not waivable when a business makes a voluntary disclosure.

Significantly, the voluntary disclosure process is a negotiation between a tax jurisdiction and a tax professional on behalf of his unidentified client. The client's identity is not disclosed until the terms of the voluntary disclosure are agreed upon.

And the best news: Ultimately, sales-tax responsibilities are dependent upon the characterization of what is being sold. Not all goods and services are taxable, nor (when they are taxable) are all goods and services taxed at the same rate. For example, items characterized as “medical devices” (a favorite merchandise category for Israel-based vendors) may be taxed at reduced rates in some states and exempted from sales tax in other states. Likewise, some states impose sales taxes on the sale of prepared foods but not on the sale of unprepared foods.

Moreover, looking to the “essence of a transaction” may reveal that what is being sold is a nontaxable service rather than taxable tangible personal property. A classic example is the purchase of legal services that involve drafting a will; while purchasers, of course, want the paper manifestation of the legal advice they received, their real desire is for legal advice. The difference in characterizations is significant because most states impose sales tax on sales of paper, but most do not impose sales tax on the sale of legal services.

Characterization planning has been and will continue to be the most highly valued sales-tax planning service that state tax lawyers provide.

The smoke from a distant fire Efforts are under way in several very populous states to greatly expand the types of services that are subject to sales taxation.

For example, Pennsylvania Gov. Tom Wolf has proposed an expansion of the state's sales tax to services, and on March 18, 2015, the Pennsylvania Department of Revenue issued a bulletin identifying types of services that will be newly subject to sales tax. These include accounting and legal services. And California is considering legislation that potentially makes sales of all types of services taxable in California.

Of course, identifying where the benefit of a service is received is difficult when the purchaser is a multistate or multinational enterprise. For example, because financial accounting and tax advice benefit an organization in its entirety, how would one determine where a benefit of such advice is received? Nevertheless, in April, the California State Board of Equalization (the state agency responsible for administering its sales tax) estimated that a tax on services would generate $122 billion for the state in 2016. Put in context, that figure is astounding considering that during 2014 all states combined collected a total of $866b. from all taxes. It is certain that the California Legislature will have difficulty restraining itself from tapping into such a revenue stream, as will the legislatures of other states.

Israeli businesses will be directly and significantly affected by the trend toward the taxation of services if the physical presence requirement is eliminated. For that reason, although the smoke from this fire is presently barely discernible, it merits vigilant monitoring.

Some closing remarks State and local tax liabilities matter. They may impact on a liquidity event, and the tax world is getting smaller and more transparent. The US-Israel tax treaty does not cover state taxes.

And the domestic foreign tax-credit rules in the Israeli Income Tax Ordinance only relate to income taxes, not sale and use taxes. So check it all out.

As always, consult experienced tax advisers in each country at an early stage in specific cases.

THE JERUSALEM POST

BUSINESS & INNOVATION

YOUR TAXES: US operations: An Israeli circular and a US indictment

By DAVID A. FRUCHTMAN, LEON HARRIS \ 05/04/2016

Two recent developments portend a shift in the states' attitudes and, consequently, require the maturation of Israeli businesses' tax planning and compliance.

It is an open secret that many Israeli businesses selling in or into the United States may not be fully complying with their US state and local (subnational) tax obligations – and certainly are not engaging in basic tax planning.

Anecdotal evidence suggests three reasons for this: bad tax advice; a yihiye b'seder (it'll be okay), fly-below-the-radar approach to tax management; and the failure of the states to defend their interests through audits and enforcement.

However, two recent developments portend a shift in the states' attitudes and, consequently, require the maturation of Israeli businesses' tax planning and compliance.

Comparison

In April, the Israel Tax Authority issued Circular 4/2016, which asserts tax jurisdiction over foreign businesses having a "significant digital presence" in Israel.

(The circular does not define "digital services.") In the United States, many states have been litigating similar jurisdictional concepts (and are regularly succeeding) under theories of the economic presence of the remote business or the presence of an Internet representative in the jurisdiction.

Until now, the states' efforts have been focused on businesses with significant physical presence somewhere in the US.

However, Circular 4/2016 plays directly into the states' hands by legitimizing arguments they have long made and by applying those arguments across international borders. Furthermore, Israel's initiative against US businesses can be expected to trigger a response in kind from the states in which those businesses are located.

That means state revenue departments can be expected to attempt to reach Israeli companies making remote sales into their state. This does not mean that the states will ignore similar businesses from other countries. However, given that many noncompliant Israeli companies already have actual physical presence in the states, an increased profile for Israeli sales into the US is bad news.

Recent example

Indeed, a month before the issuance of Circular 4/2016 (while the circular was still in draft form), the US federal government unsealed a grand-jury indictment against an Israeli businessman and arrested him.

The disputed business involved the sale of skin-care products in shopping malls.

The illegal activities alleged included tax evasion, employment of illegal workers and related conspiracy charges. The federal grand jury also indicted nine others, including at least six more Israelis, on two to 20 counts of criminal conduct.

It is likely that the federal indictments are just the start of the defendants' problems, as the business operated in at least seven states. Any or all of these states and other subnational jurisdictions may pursue audits and enforcement proceedings of their own, including for taxes other than those at issue federally. And because the indictment alleges the making of unreported payments to employees in cash, goods and gift cards, multistate tax issues may figure prominently in any additional criminal charges against these Israelis. Furthermore, civil enforcement (collection of taxes, interest and penalties) is at least as likely against both the business and the individuals who held managerial roles.

The aim

As always, a primary objective for federal and subnational tax jurisdictions is to shift tax obligations to nonvoters to the greatest extent possible. Among the most vulnerable nonvoters are foreign-based businesses whose only "planning" against tax liability is their presumed low profile.

Get protected

Israeli companies can and should take action to protect themselves. First, they should disregard "don't worry" advice from anyone lacking expertise in American federal, state and local taxation.

Second, the companies should obtain competent federal and state tax counsel to estimate the likelihood that the business is liable for prior periods' unpaid taxes, and then quantify the exposure.

The businesses will want expert advice on approaches for eliminating or at least reducing the exposure. Third, these businesses should structure their activities to reduce their federal and subnational tax obligations and liabilities.

This third point bears emphasizing, as the yihiye b'seder philosophy of businesses and advisers has kept Israeli businesses from doing actual, legitimate federal and subnational tax planning. With the issuance of Circular 4/2016 and the arrest of the Israeli national, one can only hope that the days of fly-below-the-radar tax management will end post-haste.

Who is held responsible?

For sales, use, withholding and certain other taxes, states and localities have the right to collect a business's unsatisfied obligations from the business's owners, management personnel and even nonmanagement employees who were involved in relevant finance or tax functions. This is known as "responsible party" liability. It is a tool regularly used in the US when a business has acted irresponsibly or when enforcing collection from the business is difficult.

A 2013 study found that over a prior 30-month period, no fewer than 17 states litigated responsible-person cases, and several states litigated two or more responsible- person cases. Moreover, the states usually won these cases. Significantly, the reported decisions undoubtedly represent a small minority of these collection actions. Most disputes are resolved quietly.

Obviously, no one wants to pay someone else's taxes. But a business that fails to tax plan risks being held responsible for taxes not paid by its customers and further risks having its management held personally responsible for the customers' unpaid taxes. Now, after the issuance of the Circular 4/2016 and the indictment described above, Israeli businesses must be aware of their increased profile in the US and act responsibly.

As always, consult experienced tax advisers in each country and state at an early stage in specific cases.

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PROFESSIONAL EXPERIENCE

David A. Fruchtman chairs Rimon's State and Local (Subnational) Taxation practice.

Mr. Fruchtman's clients include market-leading heavy equipment manufacturers, marketing companies, travel lodging providers and vehicle rental companies, as well as mid-sized retailers and other businesses. His clients are listed on the NYSE, on NASDAQ and are privately held.

Mr. Fruchtman has assisted clients on issues in all 50 states, on matters involving income taxes, franchise taxes, sales and use taxes, real property transfer taxes and a variety of other state and local taxes. His practice is equally divided between tax planning and tax controversy work.

His planning work includes tax efficient structuring of businesses and transactions, and frequently requires working with tax authorities to obtain favorable letter rulings. He enjoys advising foreign companies that are expanding into the United States, and in 2010 assisted an American affiliate of an Israeli company in one of Wall Street's most successful IPOs of the year.

EDUCATION

- Harvard University, J.D.
- University of Wisconsin, B.B.A with distinction

BARS & COURTS

- U.S. Supreme Court
- U.S. Tax Court
- New York
- Illinois

PREVIOUS EXPERIENCE

- Horwood Marcus & Berk (Of Counsel)
- Winston & Strawn LLP (Partner)
- McDermott Will & Emery (Partner)

In contested matters, Mr. Fruchtman's clients share his philosophy of working cooperatively with state revenue departments. They recognize that saving a few dollars today in exchange for a damaged relationship is not a sound approach. Mr. Fruchtman therefore looks to obtain excellent results while negotiating intelligently with taxing authorities. He prefers to become involved in tax disputes in the late stages of an audit rather than after an assessment has been issued. And, because negotiated resolutions are not always possible, he has successfully represented clients before courts and administrative tribunals across the country. In 2003, he was a Special Deputy Attorney General to the state of Hawaii.

Mr. Fruchtman is the author of "**Nonlitigated Resolutions of Multistate Tax Disputes: Three Case Studies Show How Taxpayers, States Can Find Common Ground**" (published in BNA Daily Tax Reports (March 3, 2011) and in two other tax publications), of the booklets "'**Covering the Waterfront' *Wayfair* Amicus Curiae Brief and Collected Articles**" and "**Advising Foreign Businesses About U.S. Subnational Taxes**", of the Hebrew language booklet "American State and Local Taxes: Risks and Opportunities -- What Israeli Businesses Must Know" (available upon request), and of many other tax articles and updates.

He lectured at NYU's Summer State and Local Tax Institute for 13 years (on **Constitutional issues**, **LLC and partnership taxation**, and **escheat of abandoned property issues**), was the chairman of the Income and Franchise Taxes Subcommittee of the American Bar Association's state tax committee, and has been co-author of the Illinois chapter of the ABA's Sales and Use Tax Deskbook for more than 20 years. He has lectured on state tax issues at Tax Executives Institutes, American Bar Association meetings, Chicago Tax Club, the Israel Export Institute, the Israel-America Chamber of Commerce, Duke Law School, Georgetown University Law Center, the University of South Carolina School of Law, ITT Chicago Kent Law School, the University of Wisconsin School of Business, and many seminars in the United States and Israel.

Mr. Fruchtman has been repeatedly recognized as a New York and Illinois Super Lawyer, an annual listing of 2-5% of the states' lawyers who have achieved significant professional accomplishment.

When not working, Mr. Fruchtman enjoys family time and running, and was the pitcher/commissioner/umpire/popcorn maker of the sandlot baseball league he formed with his daughters. In 2017, when he was old enough to know better, he ran twelve marathons in twelve weeks.

Mr. Fruchtman is a graduate of Harvard Law School and the University of Wisconsin. Before Rimon, Mr. Fruchtman was the partner in charge of State and Local taxation at Winston & Strawn LLP, a partner at McDermott Will & Emery and Of Counsel to Horwood Marcus & Berk.

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