Southeast State & Local Tax: Important Developments - October 2013

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The Williams Mullen Southeast State and Local Tax (SESALT) team is pleased to provide you with a comprehensive recap of recent legislation around the U.S.

VIRGINIA

EXECUTIVE ANNOUNCEMENTS

- **Virginia Governor Announces Four New Enterprise Zone Designations**. Governor Bob McDonnell announced four new Virginia Enterprise Zone ("VEZ") designations. The zones are for (i) the City of Portsmouth, (ii) the City of Winchester, (iii) Scott County and (iv) a joint zone between the City of Radford and Pulaski County. Each VEZ is entitled to state and local enterprise incentives intended to create jobs, promote private investment and support overall growth of the local economy. During a five-year period, qualified businesses can earn up to $200,000 in Real Property Investment Grants and up to $800 per position per year in Job Creation Grants. The VEZ program is administered by the Department of Housing and Community Development. Va. Governor's Press Release (Oct.17, 2013).

CORPORATE INCOME TAX

- **Nexus Created by Activities of Employee in Virginia**. The Department of Taxation ruled that an out-of-state taxpayer appeared to have nexus in Virginia because of the activities of its employee who lived in Virginia. The taxpayer did not have any customers in Virginia. The employee provided training services at customer facilities across the United States and developed "test methods" for customers from her home. P.L. 86-272 generally prohibits a state from imposing income tax on a company whose only contacts with a state constitute solicitation of tangible personal property. Unlike many states, Virginia extends P.L. 86-272 to service providers. The Department concluded that the preparation of the test methods likely would exceed the protections of P.L. 86-272 unless such activities were *de minimis*. However, due to inadequate information, the Department was unable to make a final determination. Va. P.D. 13-172.

SALES AND USE TAX

- **Virginia Issues Ruling on Cloud-Based Services**. The Department of Taxation ruled that the retail sales and use tax would not apply to certain cloud-based services described by the taxpayer. The taxpayer represented that the hardware and software used to provide the cloud-based services will be located outside of Virginia and maintained by employees outside of Virginia. Customers will be charged a monthly fee for accessing the hardware and software. Customers will not download or otherwise possess the software. Under these facts, the Department ruled that the cloud-based services will be exempt from sales and use tax because no tangible personal property will be transferred to the customers. However, depending on additional facts not provided, the Department noted that the cloud-based services may be subject to the communications tax under Va. Code § 58.1-649. Va. P.D. 13-182.

COLLECTIONS

- **Filing by IRS Does Not Prevent State from Pursuing Collections**. The Department of Taxation ruled that a lien or other filing by the Internal Revenue Service (the "IRS") does not prevent the Department from pursuing collection activities against a taxpayer. In the ruling, the Department concluded that a corporate officer was liable as a responsible officer for the unpaid taxes of a business under Va. Code § 58.1-1813(A). The taxpayer claimed that he was unable to pay the outstanding liability because he owed other secured debts to the IRS that had priority over the liability owed to Virginia. The Department ruled that the taxpayer's claim was without merit as the Department is not precluded from pursuing collection activities against a taxpayer due to any filing by the IRS. Va. P.D. 13-181.

LOCAL TAXES

- **Non-stock Cooperative Subject to BPOL and BTTP Taxes**. The Department of Taxation ruled that a taxpayer, a non-stock cooperative that operated a laundry facility, was subject to the business professional and occupational ("BPOL") and business tangible personal property ("BTPP") taxes. The taxpayer was formed by a group of non-profit hospitals and provided services to its members and other public and private non-profit entities within the city. The Department reasoned that the taxpayer was not a non-profit charitable organization and, therefore, did not qualify for the exemption to the BPOL tax provided under Va. Code § 58.1-3703(C)(18). The Department also held that the taxpayer was not exempt from the BPOL tax because all of its members were non-profit organizations. Regarding the BTTP tax, the taxpayer failed to show that its property was exempt under Chapter 36 of the Code of Virginia or that the city enacted an ordinance exempting such property. Va. P.D. 13-176.

- **Payroll May be Used to Situs Gross Receipts for BPOL Tax.** The Department of Taxation ruled that in certain cases, a service provider may situs its gross receipts for purposes of the BPOL tax based on its payroll. Under Va. Code § 58.1-3703.1(A)(4)(b), payroll apportionment is permitted if it is impossible or impractical to situs gross receipts from services to where the services are performed or directed and controlled. The Department remanded the case to the city to evaluate the taxpayer's method of situsing and to determine whether it was eligible for an out-of-state deduction for gross receipts derived from customers located in states in which the taxpayer filed a return for an income or income-like tax. Va. P.D. 13-170.

NORTH CAROLINA

- **Tax Filings for Same-Sex Marriages.** The Department of Revenue issued guidance on the impact of IRS Rev. Rul. 2013-17 for purposes of North Carolina personal income taxes. Pursuant to Rev. Rul. 2013-17, the IRS now allows same-sex spouses to file their federal income tax returns using the filing status of married filing jointly or married filing separately. North Carolina does not recognize a same-sex marriage as valid. Each individual will need to file a separate North Carolina personal income tax return on Form D-400 using the filing status of single or, if qualified, head of household or qualifying widow(er). N.C. P.D. 13-1.

DISTRICT OF COLUMBIA

- **Multistate Tax Compact and Combined Reporting.** Mayor Vincent Gray recently signed into law the "Fiscal Year 2014 Budget Support Congressional Review Emergency Act of 2013" (the "Act"). The Act repeals and reenacts the Multistate Tax Compact. The modified version of the compact does not include the Article III election provision or the Article IV apportionment formula. The Act also makes several changes to the combined reporting provisions. Among the changes, the Act amends the definition of a "unitary business" dealing with business conducted by a partnership. In addition, the Act repeals the provisions of D.C. Code Ann. § 47-1810.04(c)(2) dealing with apportioning income or loss when a member of a combined group owns an interest in a partnership which is not an unincorporated business. The Act is effective October 17, 2013 for a 90-day period that expires on January 15, 2014. L. 2013, Act 20-204.

MARYLAND

- **Local Tax Credit for Resident Owners of Pass-through Entities.** The Comptroller of the Treasury has petitioned the U.S. Supreme Court to review a Maryland Court of Appeals case holding that the federal dormant Commerce Clause is violated by Maryland's failure to allow a credit against the county tax for a Maryland resident taxpayer with respect to pass-through income of an S corporation arising from activities in another state. *Wynne v. Comptroller of the Treasury*, Md. Ct. App., Dkt. No. 107 Sept. Term 2011 (2013), cert. filed, U.S. S. Ct., Dkt. No. 13-485 (Oct. 13, 2013).

- **Corporate Income Tax – Withholding Guide for 2014.** The Maryland Comptroller recently issued a withholding guide for 2014 relating to information about filing employer withholding tax forms, reconciliation statements, and other employer withholding related forms. Md. Comptroller, Maryland Withholding Tax Facts January 2014.

SOUTH CAROLINA

- **Angel Investor Credit Form Revised.** The Department of Revenue recently revised Form TC-56A (Application for Angel Investor Credit). An angel investor is entitled to a non-refundable income tax credit of 35% of qualified investments made between 2013 and 2019 in a qualified business. Fifty percent of the credit may be applied to the angel investor's net income tax liability in the tax year when the qualified investment is made. The remaining 50% may be applied to the angel investor's net income tax liability in later tax years and carried forward up to 10 years. The total amount of credits allowed for all taxpayers for any one calendar year is $5 million. The application also contains instructions on taxpayer eligibility, limitations, and transferability. S.C. Form TC-56A.

AROUND THE NATION

- **Illinois – Click-Through Nexus Law Preempted.** The Illinois Supreme Court held that the state's click-through nexus provision in Illinois Public Act 96-1544 (the "Act") is void and unenforceable because it is preempted by the federal Internet Tax Freedom Act ("ITFA"). The Court did not review the plaintiff's second argument that the Act violates the Commerce Clause of the U.S. Constitution.*Performance Marketing Ass'n. v. Hamer,* No. 114496 (Ill. Oct. 18, 2013).

- **Illinois – Injunction of Cook County Non-Titled Personal Property Tax.** On October 8, 2013, Cook County Circuit Court Judge Robert Lopez Cepero issued a permanent injunction barring the county from imposing and enforcing the Non-Titled Personal Property Tax. Judge Cepero issued a preliminary injunction regarding the tax on August 1, 2013. A final order and written opinion are forthcoming. At that time, the county will have 30 days to appeal, which it is expected to do.

- **Indiana – Sourcing of Income by Service Provider**. The Department of Revenue ruled that a taxpayer's sale of information services to Indiana clients was subject to income tax in Indiana, even though some of the work in developing the product was performed outside of Indiana. The taxpayer (i) conducted financial research in Indiana, (ii) processed the data outside of Indiana and (iii) then sold the data to customers in Indiana. The Department ruled that, because the income-producing activity occurred within Indiana, the taxpayer was subject to Indiana income taxes on sales to customers within Indiana under a cost of performance analysis. Ind. Rev. Ltr. No. 02-20130238.

- **Massachusetts – Guidance for Vendors Affected By Recent Sales and Use Tax Repeal.** On September 27, 2013, Governor Deval Patrick signed legislation that repealed Massachusetts's controversial computer services tax. On September 30, 2013, the Department of Revenue issued guidance for taxpayers affected by the repeal. Mass. TIR 13-17.

- **New York – Guidance Issued Regarding Reciprocal Use Tax Credit.** The Department of Taxation and Finance issued a tax bulletin that explains the New York State and local reciprocal use tax credit that may be allowed for sales or use tax paid in another state or in another locality in

New York State. N.Y. State Tax Bulletin No. TB-ST-765.

- **Tennessee: Refund for Sales Tax Wrongfully Charged and Remitted.** The Tennessee Court of Appeals ruled that the taxpayer was entitled to a refund for sales tax that it wrongfully charged internet service providers and remitted to Tennessee. The court reasoned that the internet services were not "telecommunications" services because (i) the taxpayer did not own, control, or charge the end-users for the transmission lines and (ii) the end-users could not access the internet directly using the taxpayer's services. *Level 3 Communications v. Roberts*, No. M2012-01085-COA-R3-CV (2013).

- **Multistate – Tax Foundation Releases 2014 State Business Tax Climate Index.** The Tax Foundation recently released its 2014 State Business Tax Climate Index to enable business leaders, policymakers and taxpayers to gauge how their states' tax systems compare. The best 10 states in this year's index are Wyoming, South Dakota, Nevada, Alaska, Florida, Washington, Montana, New Hampshire, Utah, and Indiana. The 10 lowest ranked, or worst, states are Maryland, Connecticut, Wisconsin, North Carolina, Vermont, Rhode Island, Minnesota, California, New Jersey and New York. The Index notes that, once North Carolina's recent tax reforms become effective, it should move up to as high as number 17. 2014 State Business Tax Climate Index.

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