

TRENDS IN STATE AND LOCAL TAXATION OF NEW TECHNOLOGIES

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Overview

- It's all about the Tubmans! ***States and Localities need \$\$.***
- Streaming and digital goods
- The “Cloud”
- Remote Sellers
- Qui Tam Actions / State False Claims Acts
- Class Action / Consumer Fraud
Exposure for Over-Collection

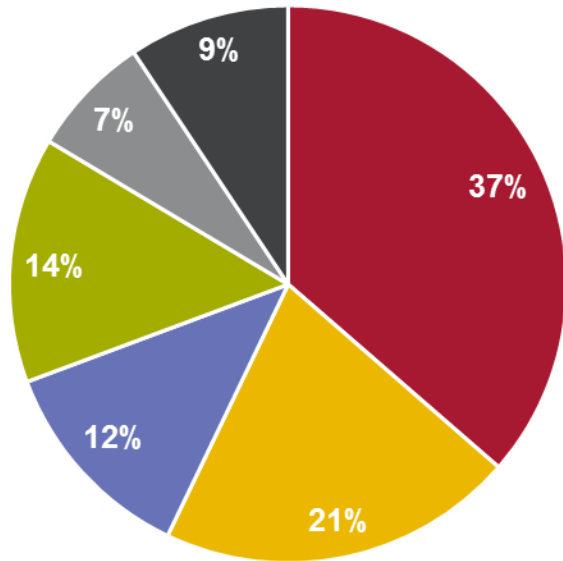


State Fiscal Conditions and Policy Implications

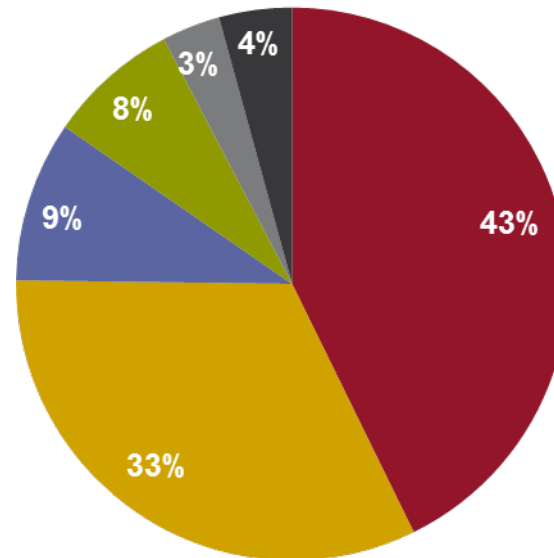
Relative share of total state and local business taxes for FY2014

COST/EY Study, *Total state and local business taxes: State-by-state estimates for fiscal year 2014*, November 2015; \$688.7 billion paid by business – 2.2% increase from FY 2013 – 45% of all state and local taxes

United States



Arizona



■ Property ■ Sales ■ Excise ■ Income ■ Unemployment ■ License

Streaming Services

- **Alabama**

- Proposed Regulations issued Feb. 2015 that would have expanded the definition of tangible personal property under the rental tax to include streaming services.
 - Opposition by legislators and business community. DOR ultimately withdrew regulation, but signaled they would interpret the tax as applying to streaming products regardless of the regulation or statute.
 - Early 2016 – DOR revoked prior rulings on taxing technology; DOR applying rental tax to streaming services

- **Kentucky** - *Netflix, Inc. v. Finance and Administration Cabinet Dep't of Revenue*, Order No. K-24900 (Bd. Tax App. Sept. 23, 2015)

- Netflix's streaming services provided did not meet the definition of "multichannel video programming services").

- **Connecticut** - Conn. Dep't of Revenue Services Ruling No. 2015-5 (Nov. 3, 2015)

- Streaming services subject to sales and use tax because characterized as taxable "computer and data processing services."

Digital Goods: City of Chicago

- **Revised Ruling #5 (Perpetual Licenses – Computer Software)**
 - Effective September 1, 2013 – Revised Ruling #5 provides that the transfer of computer software is subject to the City’s Personal Property Lease Transaction Tax if such transfer qualifies as a non-taxable lease for Illinois sales tax purposes.
 - Can it be challenged?
 - Does the broad application go beyond the City’s own ordinance?
- **Ruling # 12 – Nonpossessory Computer Leases**
 - Adopted June 9, 2015 – City of Chicago issues Ruling #12, effective July 1, 2015 (Enforcement was pushed back to January 1, 2016).
 - Property leased or rented in the city or leased and rented outside the city but used in the city.
 - Access to an interactive web site that provides an ability to search for information (e.g., financial information website) will be considered taxable even though most of the information provided is of a “transitory and fleeting” nature.
- **Hertz Case**
 - Rental of car up to 3 miles outside of the City of Chicago still subject to the Chicago Lease Transaction Tax.

Digital Goods: City of Chicago

– City of Chicago, Amusement Tax, Ruling #5

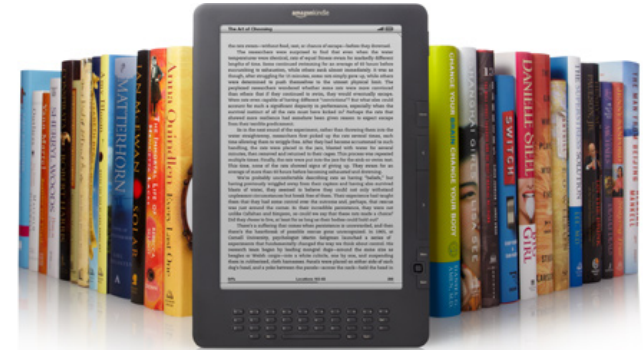
- The Chicago amusement tax is imposed at a 9% rate on the privilege of witnessing or viewing any taxable amusement.
- Ruling #5 applies the tax to amusements which are delivered electronically (e.g., charges for streaming or renting shows, movies, videos, music, and games). The Ruling was effective September 1, 2015.
- The tax applies to customers whose residential street address or primary business address is in Chicago.
- The permanent download of music or movies is not taxable.

E-Delivered Software vs. Downloadables vs. Streaming

- Taxability NOT always the same

- Examples:

- Illinois (*but be careful of Chicago*)
- Michigan
- New Jersey
- Pennsylvania



Non-Traditional Case Study: Taxation of In-Vehicle Technology

- **Telematics**

- **Sales of telematics value-add services (telecom? Info svcs?)**
 - **Pennsylvania**
 - **Illinois**
 - **New York**
 - **Texas**
 - **Others**
 - **Purchases of telecom to provide telematics**
 - **Resale**
 - **Sourcing**
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Non-Traditional Case Study: Taxation of In-Vehicle Technology

- **Downloading apps and content to vehicle**
- **Streaming using technology built into car**
- **Sourcing issues: cars are mobile**



Federal Legislation

Digital Goods and Services Tax Fairness Act of 2015

- S. 851 was introduced by **Senator John Thune (R-SD)** on **3/24/2015**.
- **H.R. 1643** was introduced by **Lamar Smith (R-TX)** on **3/26/2015**.
- **Reported out of committee in June of 2015, but no report has been issued.**
 - Bill would prevent multiple and discriminatory taxes on digital goods or services.
 - Provides specific sourcing mechanism based on “customer address” which is hierarchical and similar to the sourcing under the SSUTA.
 - Requires states to have “reasonable” direct pay procedure for qualified customers to self remit tax.

Remote Seller Developments

- **Alabama**

- 2015 - Adopted economic nexus regulation (\$250k sales + “doing business”)
- Assessments issued & appeals pending

- **South Dakota**

- 2016 – legislation adopted (SB 106) (\$100k or 200 transactions)
- Effective May 1, 2016
- Lawsuits filed immediately
- Enforcement now stayed pending litigation

- **Oklahoma**

- April 2016 - state Senate passed bill that would impose new reporting requirements on out-of-state (HB 2531)
 - out-of-state retailers would need to send Oklahoma customers annual summary of purchases; inform them use tax may be due
 - Reports would not be shared with state tax authorities (unlike CO).
 - Back in OK House.

Other Important Opportunities (often overlooked)

Pennsylvania

- Processing = producing mobile telecommunications services
 - DOR asserts SUT exemption is only for voice usage
 - Bandwidth vs. Time
 - 100% usage in voice transmission?
 - How to measure time
 - What if less than 50%? Electricity vs. Equipment
 - Exemption still works after 2010!!
- USF distributions exempt from GRT

Other Important Opportunities (often overlooked)

Massachusetts

- “Object of the transaction” test
 - Taxability of web-accessed software as a service—*Brainshark*
 - Taxability of software and services through downloaded applet—*Citrix*
 - Cloud computing? Conflicting guidance
- *J2 Communications: Taxability of eFax services*
- Sourcing: Multiple points of use
 - Software downloaded in Massachusetts and used in other states
 - *Oracle / Microsoft Licensing* litigation
- Early termination fees
 - Taxable? Even if written off?

State False Claims Acts

- Approximately 30 jurisdictions have False Claims Acts
 - Some states restrict their FCA provisions to Medicaid and/or contractor/type “frauds”.
 - A number of state FCA statutes contain explicit “tax bars” prohibiting *qui tam* actions for allegedly false tax claims (e.g., CA, DC, HI, MA, NM, NYC, NC, TN, VA). Some states impose a tax bar only with respect to income tax matters (e.g., IL, IN, RI).
 - A number of states do not appear to restrict the action to a particular subject matter (e.g., DE, FL, VT, NH, NJ).
 - In 2010, New York became the first state to explicitly authorize the application of its FCA to tax claims.
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Types of *Qui Tam* Actions

- Traditional False Claims Actions
 - False claims for payment *from the state*
 - Reverse False Claims Actions
 - False statements to avoid or reduce payments *to the state*
 - Reverse false claims actions give rise to *Qui Tam* actions for tax.
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Other Noteworthy *Qui Tam* Updates

- *New York ex rel. Danon v. Vanguard Group Inc.*
 - The Supreme Court did not address the substance of the suit, but granted Vanguard’s motion to dismiss based on the relator’s violations of the New York State attorney code of conduct (disclosing confidential client information).
- *New York ex rel. Eric Rasmussen v. Citigroup, Inc.*
 - Lawsuit alleges Citigroup owes more than \$2 billion in taxes and penalties. Claims Citigroup improperly followed IRS guidance pertaining to NOL deductions claimed in connection with the federal government’s efforts to save the banks.

Other Noteworthy *Qui Tam* Updates

- *National Qui Tam/Direct suits for 911 fee undercollection*
 - More cases popping up each day in major jurisdictions: PA, IL, TN, GA, AL, DC, etc.
 - Complaints allege that telecommunications providers have undercollected and underreported the 911 fees due to a jurisdiction
 - Many complaints allege the undercollection and underreporting is intentional
 - Allege that telecommunications providers either:
 - Intentionally understated the number of lines/customers in the jurisdiction; or
 - In states that impose different fees on different types of technology (VoIP for example), intentionally misclassified their services as one type of technology vs. another

Other Noteworthy *Qui Tam* Updates

- *National Qui Tam/Direct suits for 911 fee undercollection*
 - *Qui Tam vs. Direct Suits*
 - Case Study: Pennsylvania
 - Allegheny County: *Phone Recovery Services, LLC v. Verizon Pennsylvania, Inc., et al.*
 - Suit brought by PRS on behalf of Allegheny County alleging undercollection
 - Defendants filed preliminary objections to dismiss complaint alleging, among other claims, that PRS was not a proper *qui tam* plaintiff
 - Defendant’s objections based on public disclosure bar
 - Defendant’s also argue no “false statement” was made that triggered Allegheny County’s False Claims Act
 - Delaware County: *Delaware County v. Verizon Pennsylvania, Inc., et al.*
 - Direct suit by County against telecommunications providers with lines in the county
 - Delaware County does not have a false claims act ordinance
 - Similar direct suits subsequently filed in at least 11 other PA counties....and counting.

Other Noteworthy State Tax Cases – Consumer Fraud/Class Actions

- *Walmart & Sam’s Club Cases*
 - Pennsylvania
 - Named plaintiff bought two cans of shaving gel with a buy one get one free coupon. Total purchase \$2.97.
 - Alleges Walmart overcharges sales tax in PA stores and Internet sales and has “misappropriated millions of dollars...”
 - Ohio
 - Retailer shortchanged customers who returned items to different stores by applying lower sales tax rates.
 - Breach of contract – violates terms of sale by refunding less than the original purchase price.
 - Walmart seeks to remove to State Tax Commission from federal court since they are exclusive arbiter of state tax refund claims.

False Claims Act

- Should FCAs be Applied to Tax?
 - Upends protections for taxpayer rights, including historical right to privacy in tax matters.
 - May discourage use of voluntary disclosure programs.
 - Incentivizes collection of transaction taxes, which may expose taxpayers to class-action consumer fraud lawsuits.
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False Claims Act

- Should FCAs be Applied to Tax? (Cont'd)
 - Removes tax administration decisions from taxing authorities.
 - Leads to disparate treatment among taxpayers.
 - Contravenes well-established procedures designed to ensure efficient resolution of tax disputes.
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Recent Class Action Suits (Municipality Suits)

- *Village of Bedford Park et al. v. Expedia WA et al.*, 1:13-cv-05633 (filed August 7, 2013) (Northern Illinois).
 - More than 150 municipalities filed a class action against online travel companies accusing such companies of underpaying hotel taxes.
 - U.S. District Judge denied class certification.
 - Municipalities and defendants continue to settle individually.
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Tax Collection Liability Litigation

- Class actions can be brought against the government jurisdiction:
 - *Arizona Department of Revenue v. Bernard J. Dougherty*, 29 P.3d 862: class action lawsuits against the State were permitted in Tax Court.
 - *Granados v. County of Los Angeles*, CA Court of Appeal, Second District, No. B200812 (March 28, 2012): a taxpayer can file a class action claim for refund of CA local telephone users taxes paid. Before filing the claim the plaintiff must first file a claim that contains the information required by the Government.
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False Advertising Violations?

- *Yabsley v. Cingular Wireless LLC*, 176 Cal.App.4th 1156
 - Did Cingular violate the CA False Advertising Law when it advertised it would collect sales tax reimbursement on sales of cellular phones?
 - Under Regulation 1585, the retailer must pay sales tax (and may collect sales tax reimbursement) on the full unbundled price of the phone when it sells a cell phone bundled with a service contract
 - Court of Appeals agreed with the trial court that regulations provide the same safe harbor for suits under the UCL that statutes do. The class action was thus dismissed.
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Questions?

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