

Multistate Tax Update: November 12, 2015



David M. Kall | Thursday, November 12, 2015

Midterm elections guide tax issues in various states

Last week, we wrote about Ohio's failed marijuana legalization initiative, voted down by 64.14 percent of those casting a ballot. A handful of other states also had tax-related issues on their ballots; here is a rundown of those measures:

TEXAS

In the Lone Star State, voters approved of two homestead exemption propositions and a tax-based highway funding plan.

Passed by large majorities, Propositions 1 and 2 (Prop 1 and Prop 2), the Texas Homestead Exemption for School District Property Taxes Amendment and the Property Tax Exemption for Surviving Spouses of Disabled Veterans Amendment, respectively, help homeowners.

Approximately 86 percent of voters approved of Prop 1, which increases the homeowner's exemption from \$15,000 to \$25,000. This means that homeowners will save, on average, between \$120 and \$130 per year, depending on where they live. Prop 1 would have cost Texas about \$1.2 billion in tax revenue for school districts over two years, but other legislation makes this up by entitling school districts to additional state aid from the Foundation School Fund. This fund is made up of revenue from land property rights income and fuel taxes.

Prop 2 corrected previous legislation that granted a homestead exemption to surviving spouses of deceased veterans, but which inadvertently left out spouses whose partners died before Jan. 1, 2010, the date that the enabling legislation for Prop 2 went into effect.

Texas law defines a homestead as a structure, manufactured home, or condominium that the individual living in the home owns. Texas currently has five types of homestead exemptions:

1. School taxes
2. County taxes
3. Age 65 or older and disabled exemptions
4. Optional percentage exemptions
5. Optional age 65 or older or disabled exemptions

With respect to highway funding, 83.7 percent of voters approved of Proposition 7 (Prop 7), the Texas Sales and Use Tax Revenue for Transportation Amendment. Prop 7 allows revenues from sales and use taxes, and state motor vehicle sales and rental tax, to be funneled into the State Highway Fund when Texas collects more than \$28 billion of sales and use tax revenue in one year. These funds can only be used to build, maintain, and restore non-tolled public roads, and to repay transportation-related debt.

Prop 7 also gives lawmakers the flexibility to respond to changes in funding needs. It does so by way of a provision that authorizes them to reduce the amount of revenue that is put into the State Highway Fund by up to 50 percent per fiscal year in the event of an economic downturn or some other change.

Approval of Prop 7 constitutes the largest single increase in transportation funding in Texas history.

COLORADO

Approximately 69 percent of voting Coloradans gave the state permission to keep the marijuana tax revenues that have been collected this fiscal year, via Proposition PP (Prop PP). As we explained in September, a constitutional quirk stemming from Colorado's Taxpayer Bill of Rights obligated the state to refund taxes if the amount raised exceeded estimates, in the absence of voter approval allowing the state to keep the revenues.

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The ballot language sought voters' permission to use the \$66 million marijuana revenue windfall to "provide \$40 million for public school building construction and for other needs, such as law enforcement, youth programs, and marijuana education and prevention programs, instead of refunding these revenues to retail marijuana cultivation facilities, retail marijuana purchasers, and other taxpayers."

The state estimated \$12.08 billion of total revenue, but it came in slightly higher at \$12.35 billion. In light of the overage, Prop PP requires \$40 million to be used for school construction, and \$12 million on youth programs, marijuana education and prevention programs, law enforcement services, substance abuse programs, poison control services, and the local government retail marijuana impact grant program. The remainder will likely go into the General Fund.

WASHINGTON

Washingtonians had the chance to vote on five unrelated measures last week. For the first one, Initiative 1366, 52.95 percent voted yes, thus forcing lawmakers to decide whether to let a sales tax decrease take effect, or to stop it by changing how taxes are approved through a ballot amendment. The amendment would ask voters whether it should take a two-thirds vote in the legislature, or voter approval, to raise taxes. The result of Initiative 1366's approval is that the sales tax will drop from 6.5 to 5.5 percent on April 15, 2016, costing the state \$1 billion in tax revenues, if the legislature declines to act.

The remaining ballot questions were advisories, pursuant to which the public's votes hold no legally binding effects. Instead, the results advise lawmakers on how the public feels about the tax matter at hand.

The 50.04 percent "no vote" for the second measure, Advisory 10, means that voters approved repealing the oil response and oil spill administration taxes imposed on crude oil or petroleum products transported by railroad. The transport tax was initially implemented after the 2013 shale oil boom in North Dakota, which led to the conveyance of nearly 700 million gallons of oil through Washington's rail system. The tax was created to ensure that oil is transported safely through the state, and its repeal would cost \$17 million for government spending.

Advisory 11's language asked voters whether they wanted to repeal or maintain the marijuana excise tax on medical marijuana that lawmakers imposed without voter approval. The tax was in the form of a \$1 fee for each initial and renewal marijuana recognition card. Voters passed the repeal.

Voters also advised that they wanted to repeal a gas tax increase of 11.9 cents, by way of Advisory 12. The gas tax was estimated to bring in \$3.7 billion in the first 10 years.

In another repeal vote, 64.82 percent of voters said they did not want to expand the business and occupation tax to copyrights, patents, licenses, franchises, trademarks, and the like, along with sales of goods that originate outside of Washington. According to the ballot language contained in Advisory 13, "[t]he legislature increased business and occupation tax revenues, and excluded certain software manufacturers from a retail sales tax exemption, without a vote of the people, costing \$1,449,000,000 for government spending."

MISSISSIPPI

Finally, two competing Mississippi Public School Support Amendments, Initiative 42 and Alternative 42, asked voters first to choose between "either measure" or "neither measure" becoming law, and then to weigh in on each measure individually.

With respect to the first question, 52 percent voted for neither measure. This majority position means that neither Initiative 42 nor Alternative 42 became law.

Voting for Initiative 42 would have required the state government to establish, maintain, and support "an adequate and efficient system of free public schools," enforced by the state's judicial system. The amendment's stated purpose was "to protect each child's fundamental right to educational opportunity."

Voting for Alternative 42 would have required the state legislature to establish, maintain, and support "an effective system of free public schools" at the legislature's own discretion. On the other hand, Alternative 42 would not have empowered the judiciary to enforce the amendment's mandate, provide for an adequate and efficient system of free public schools, or inscribe a fundamental right to educational opportunity for each child in the Mississippi Constitution.

Michigan: Lawmakers and the Treasury Department address various tax matters

EDUCATION SAVINGS ACCOUNTS

Lawmakers made it easier to save money for college by way of SB360, which addresses 529 College Savings Plans and takes effect Jan. 26, 2016. SB360 amends the Michigan Education Savings Program Act by increasing the maximum permitted account balance for all education savings accounts that name any one individual as the designated beneficiary from \$235,000 to \$500,000. The fiscal impact is unknown at this time due to the uncertainty of the number of individuals that will be affected, though it could be significant.

In the November 2015 Treasury Update, the Tax Policy Division of the Michigan Department of Treasury (Department) explains several current tax topics that are relevant to taxpayers. These include the state's Offer in Compromise program, cloud computing, nexus, and identity theft.

OFFER IN COMPROMISE

The Department defines an Offer in Compromise as a request by a taxpayer that it compromise an assessed tax liability, including the tax itself and related interest and penalties, for less than the full amount.

As of Jan. 1, 2015, the Department's Offer in Compromise program allows a taxpayer to submit an offer to compromise his or her tax debt based on one or more of the following grounds:

1. The taxpayer has received an accepted federal offer in compromise from the Internal Revenue Service (IRS).
2. The taxpayer can demonstrate that there is a doubt as to the collectability of the tax debt.
3. The taxpayer can demonstrate that there is a doubt as to the taxpayer's liability for the tax debt even though the appeal rights have lapsed.

The offer is only applicable for tax debt attributed to individual income tax or corporate income tax under Part 1 or Part 2 of the Michigan Income Tax Act, for the same tax years as the federal offer in compromise accepted by the IRS. In addition, a taxpayer is not eligible if he or she is in bankruptcy, or currently contesting its tax liability in court.

A taxpayer submitting an offer in compromise based on doubt as to collectability must show the following:

1. That the amount offered is the most that can be expected to be paid or collected from the taxpayer's present assets and sources of income.
2. That the taxpayer does not have reasonable prospects for acquiring more income or assets within a reasonable period of time that would enable him or her to pay a greater amount of the tax debt than the amount offered.
3. That the taxpayer would have prevailed in a contested case if he or she had, in fact, appealed the assessment.

When filing the offer, the taxpayer must also submit a non-refundable initial payment of \$100, or 20 percent of the amount of the offer, whichever is greater.

CLOUD COMPUTING

The Department uses the phrase "cloud computing" to refer to a variety of Internet-based delivery models, from the storage of data to the delivery of software products to customers, whether by electronic download or remote access, to the outsourcing of a customer's information technology department.

Whether any given transaction is subject to Michigan's 6 percent sales and use tax depends on the individual facts and circumstances of the situation. Generally, custom software, defined as software that is designed for the exclusive use and special needs of a single purchaser, is exempt from both sales tax and use tax. This is different from prewritten computer software. Either way, if a transaction involves a fee (license or subscription) for the use of prewritten computer software, the transaction would be considered a taxable use of prewritten computer software. How such prewritten computer software is delivered is not relevant.

NEXUS

Under Department definitions, a remote seller has nexus with Michigan and is subject to certain taxes, including sales and use tax, if the person:

1. Is physically present in the state for more than one day.
2. Actively solicits sales in Michigan and has gross receipts of \$350,000 or more sourced to Michigan.
3. Has an ownership or beneficial interest in a flow-through entity, directly or indirectly through one or more flow-through entities, that has nexus in the state.

The legislature has established a new law, effective Oct. 1, 2015, that creates certain presumptions that the seller is engaged in the business of making retail sales in Michigan and has nexus with Michigan for sales and use tax purposes. The presumptions are rebuttable on a showing that the activity is not or was not significantly associated with the seller's ability to establish or maintain a market in Michigan.

The first presumption of nexus arises when the seller or an affiliated person engages in or performs certain sales-related activities in the state.

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Sales-related activities include the following:

- Selling a similar line of products as the seller under the same or a similar name.
- Using a place of business in Michigan to facilitate the delivery or sale of goods sold by the seller to purchasers in Michigan.
- Facilitating sales to Michigan purchasers by allowing them to pick up or return goods sold by the seller at a place of business maintained in Michigan.
- Delivering, installing, assembling, or performing maintenance or repair services for the seller's purchasers in Michigan.
- Sharing management, business systems or practices, or employees with the seller or, in the case of an affiliated person, engaging in intercompany transactions related to the establishment or maintenance of the seller's market in Michigan.
- Conducting any other activities in Michigan that are significantly associated with the seller's ability to establish and maintain a market in Michigan.

Another presumption emerges when a seller enters into agreements with one or more Michigan residents, under which the resident refers potential purchasers to the seller in return for something of value. It does not matter whether that referral is via a link on a website, an in-person presentation, or otherwise.

This presumption only stands if the seller has more than \$10,000 in gross receipts in the previous 12 months from sales to Michigan purchasers referred to the seller by residents of Michigan with agreements with the seller, and the seller's total cumulative gross receipts from sales to Michigan purchasers exceed \$50,000 for the preceding 12 months.

Mere advertising will not give rise to the presumption unless the revenue paid to the person is based on commissions or other value tied to completed sales of goods in Michigan.

Revenue Administrative Bulletin 2015-22, released on Nov. 3, 2015, also addressed nexus standards for out-of-state sellers and provides several examples applying the rules.

FIGHTING TAX-RELATED IDENTITY THEFT

In an effort to combat identity theft, the Department selects tens of thousands of tax returns for verification. The process starts with a Letter of Inquiry, containing an envelope with the return address "PO Box 30771."

In addition, in the coming months, the Department will begin asking taxpayers who have been selected for identity verification to use MILogin. This is a Michigan-wide service that will eventually be used by other departments as well.

The Department emphasizes that it does not initiate requests for information via email, telephone, text, or fax. It only utilizes these methods to communicate when following up, *after* having sent the initial Letter of Inquiry.

In addition, the Department will not use a social security number in any letter that it sends, nor will it ask a taxpayer to provide a copy of his or her social security card via U.S. mail.

Finally, if a taxpayer did not file a return and receives a Letter of Inquiry, that taxpayer's identity may have been stolen. While the Department cannot confirm whether a return was filed, it will provide information regarding how to take precautions and what steps to take in order to file a return.

North Carolina: Revenue department announces changes in privilege tax, withholding rates, and filing requirements

The North Carolina Department of Revenue (Department) has made changes to the privilege tax imposed on banks, as well as withholding laws and filing requirements for those that withhold state income tax.

PRIVILEGE TAX

Per North Carolina statute, the state imposes an annual privilege tax on banks, banking associations, and similar organizations. The tax on these firms, levied for the privilege of "carrying on the business...on a statewide basis," is \$30 for each \$1 million, or part thereof, of total assets held. The statute prohibits further taxation by cities and counties.

This is about to change. In a recent important notice, the Excise Tax Division announced that effective July 1, 2016, North Carolina will no longer impose the privilege tax on banks.

WITHHOLDING AND RELATED CHANGES FOR TAX YEARS 2016 AND 2017

In a separate notice, the North Carolina Department of Revenue explained recent changes for employers, pension payers, and others who withhold the state income tax from wages. New legislation now requires the following for tax year 2016:

- A withholding rate on wages of 5.85 percent, effective for taxable years beginning on or after Jan. 1, 2016. This is derived from the mandate that North Carolina income tax to be withheld from wages at a rate that is 0.1 percent higher than the individual income tax rate, which remains at 5.75 percent for tax year 2016.
- Increases in the standard deduction:
 - For those married, filing jointly/surviving spouse, the deduction increased from \$15,000 to \$15,500.
 - For heads of household, the deduction increased from \$12,000 to \$12,400.
 - For singles, the deduction increased from \$7,500 to \$7,750.
 - For married filing separately, the deduction increased from \$7,500 to \$7,750.
- There is a new penalty of \$50 for failure to file an informational return by the due date. However, for tax year 2016, the penalty only applies to informational returns required to be filed in 2017.

As for changes for the 2017 tax year, because lawmakers reduced the individual income tax rate from 5.75 percent to 5.499 percent beginning on or after January 2017, the new withholding tax rate will be 5.599 percent.

CHANGES IN SUBMISSION METHOD

In an effort to combat tax fraud, the Department requires Form NC-3 and copies of withholding statements to be filed in an electronic format on or before Jan. 31 of the succeeding year. A taxpayer may apply for a waiver of the electronic submission requirement upon a showing of good cause.

The Department is currently developing three new electronic filing (eNC3) options for taxpayers: File upload, bulk transmittal, and online entry. These new methods will replace the current options of filing via CD or paper.

The Department has established a web page to provide information about the electronic filing of Form NC-3 and the Department's copies of withholding statements.



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