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Multistate Tax Update: October 1, 2015

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Ohio: Department of Taxation explains residency requirements

The Ohio Department of Taxation (ODOT) recently issued Information Release IT 2015-02, which discusses how ODOT imposes Ohio personal income tax on resident and nonresident individuals, for taxable years ending after March 23, 2015. The release addresses who is subject to Ohio personal income tax, residency, and related details.

WHO IS SUBJECT TO THE OHIO PERSONAL INCOME TAX?

As a general rule, the state imposes income tax on anyone who lives in Ohio or has earned or received income (including from the lottery or as a prize) in Ohio, though there are limited exceptions. In addition, nonresidents whose federal adjusted gross income includes any income earned or received in Ohio by a pass-through entity must also pay Ohio income tax, unless the entity files a composite Ohio return on behalf of its nonresident owner.

THE DEFINITION OF "RESIDENT"

The release defines a "resident," for the purposes of the Ohio income tax, as "an individual who is domiciled in this state." In order to be domiciled, one must have at least 212 contact periods with the state. A contact period is different from a day; one has a contact period when he "is away overnight from his abode located outside this state, and while away overnight from [that] abode, spends at least some portion, however minimal, of two consecutive days in [Ohio]."

One is irrebuttably presumed to be *not* domiciled in Ohio if the individual has fewer than 213 contact periods with Ohio and meets all of these conditions:

1. The individual did not change domicile to or from Ohio during the taxable year.
2. The individual files an affidavit of non-Ohio domicile by May 30 of the immediately succeeding calendar year.
3. In the affidavit, the individual verifies that she/he was not domiciled in Ohio pursuant to generally accepted common law notions of domicile.
4. In the affidavit, the individual verifies at least one abode outside Ohio during the entire taxable year.
5. The affidavit does not contain any false statements.

On the other hand, one is rebuttably presumed to be domiciled in Ohio when:

1. The individual has fewer than 213 contact periods in Ohio during the taxable year but does not meet any one of the criteria listed above or does not file the affidavit of non-Ohio domicile.
2. The individual had at least 213 contact periods in Ohio during the taxable year and is not a part-year resident. One may rebut the presumption of full-year Ohio domicile by proving, by clear and convincing evidence, that the individual was not domiciled in Ohio for all or part of the year.

A taxpayer can only have one domicile at any given point in time. While the tax law does not specifically define who is domiciled in this state, there is substantial guidance in case law on the determination of "domicile" for tax and other purposes.

One such recent case is *Cunningham v. Testa*, in which the Ohio Supreme Court noted that the issue of domicile is one of intent determined by the facts of the individual case. Factors include the acts and declarations of the person and the totality of accompanying circumstances, including the filing of federal income tax returns, voting, car registration, or location of one's spouse and children.

State law establishes certain factors that may not be considered when determining domicile, which include the location of one's physicians, veterinarians, lawyers, accountants, burial plots, insurance companies, brokers, investment facilities, institutional lenders with which the individual has a relationship, and financial institutions in which one has checking or other accounts.

In light of the *Cunningham* case, the ODOT revised a previous Information Release IT 2007-08, and incorporated the Ohio Supreme Court's tests for domicile determination for the taxable years beginning after Dec. 31, 2006, but prior to March 23, 2015.

New Jersey: Report says corporate tax subsidies have hurt

In a report titled "Corporate Subsidy Overhaul Taking New Jersey Further Down a Dangerous Path," the New Jersey Policy Perspective (NJPP) argues that the 2013 corporate tax subsidies contained in the Economic Opportunity Act of 2013 are doing nothing but "further cramping New Jersey's ability to invest in schools, transportation, and other areas known to be greater drivers of job creation."

Gov. Chris Christie signed the act into law in September 2013. Its purpose was to give New Jersey a competitive edge in the global economy by creating economic development incentive programs for projects that met certain goals, like enhancing business attraction, retention, and job creation efforts. In order to actually receive the incentives, the Act requires approved projects to generate new tax revenue, complete capital investments, and/or hire or retain employees.

A few months into the initiative, NJSpotlight opined that the act was off to a good start because new businesses were coming to New Jersey's "battered cities and aging suburban office parks." Real estate attorneys, brokers, and development professionals who supported the Act described a "dramatic sea change," in part because, as of March 2014, there were already 63 approved projects.

Before implementation of the act, NJSpotlight conceded that New York's and Pennsylvania's attraction and retention efforts had "crippled" those in New Jersey. This triggered the broad objective of making New Jersey more business friendly by doing the following:

- Increasing tax incentives for companies to set up shop in New Jersey.
- Lowering the minimum investment and job creation thresholds.
- Creating dozens of special zones and conditions that help companies qualify for additional rewards.

One of the act's authors, a real estate attorney, characterized it as "a really exciting elixir for suburban mayors." And the president and COO of the New Jersey Economic Development Authority declared the Act "zero risk," promising that revenues taken in would exceed the incentives paid out.

Zero risk is a tall order. Indeed, the program only works if prospective employees are excited enough by the schools, transportation, and recreation options and other positive lifestyle contributions that they put themselves in the same locations as the employers.

The NJPP report contends that two years in, the state is neglecting critical assets in favor of ineffective tax breaks. Since December 2013, New Jersey has approved $3.5 billion in tax subsidies, bringing the total since January 2010 to $6.5 billion. But so far in 2015, each job is actually *costing* taxpayers $108,362, and half of those jobs were already in New Jersey.

State and local taxes make up less than 5 percent of the cost of doing business, the report continues. Consequently, tax levels play only a minor part in business location decisions. What is more, tax breaks are not proven to grow a state's economy, unlike investments in public assets, like schools, transportation, and higher education.

To rein in the damage being done, NJPP offers two solutions:

1. Restore annual spending caps on the total amount of available subsidies, which would increase the legislature's oversight role and force it to be more selective in application approval.
2. Revise the net benefits test used to vet subsidy deals. As it currently stands, taxpayer benefits are estimated for up to 35 years, while corporations' contributions are only calculated for 15 years, at most. These time horizons should match, making the calculations more realistic, while also making it harder for firms to "take the money and run," leaving taxpayers in the lurch.

Finally, NJPP notes that businesses will often accept a tax break, but rarely choose a location solely because of one. As a result, the act has made it harder, not easier, for New Jersey to succeed.

Kentucky: Board of Tax Appeals concludes Netflix is not subject to certain taxes

At the end of August, there was chatter in the business community about the somewhat recent practice of taxing cloud computing and entertainment services. As *Fortune* observed, this uptick stems, in part, from the difficulty some states have tracking the Internet sales of businesses that have no physical presence in the state where the sales are made. This, in turn, makes it difficult—if not impossible—to collect sales taxes.

According to *Fortune*, the numbers tell the story of the rise of e-Commerce and subsequent slowdown in the growth of sales tax revenue: 10 years ago, sales tax revenue grew at 3.1 percent annually, whereas now the rate is only 1.3 percent.

More particularly, in the entertainment business, sales and rentals of DVD and Blu-ray discs have fallen from a peak of $20.2 billion less than a decade ago, to slightly more than only $10 billion now, according to a *Dow Jones Business News* article citing data from the Digital Entertainment Group. Similarly, CD sales in 2000 amounted to $13.2 billion, a figure that plummeted to $1.9 billion last year. From just these three products, states have lost approximately $1 billion of tax revenues annually.

While sales of these more traditional entertainment products drop, more and more consumers are paying for subscriptions to Netflix, and others, that stream their content. This has lead to a patchwork of taxation schemes, which jurisdictions have implemented to capture the otherwise lost tax revenue. For example, in early September, we described a pair of rulings by the Chicago Department of Revenue, resulting in the taxation of both the sale of technology to the consumer, and the consumer's purchase of it. These rulings will likely create litigation for the Windy City.

THE NETFLIX CHALLENGE

In Kentucky, Netflix challenged the tax scheme that subjects its new technologies to old tax rules. The laws at issue involve two sections of the Multichannel Video Programming and Communications Services rule (the gross revenues tax and the excise tax), and a third section pertaining to the Utility Gross Receipts License Tax for Schools.

Kentucky imposed these taxes on Netflix' streaming services, which are defined as "a subscription based service that streams digital movie or television content over the public Internet for viewing on either a television or an electronic device."

The Kentucky Board of Tax Appeals asserted that Netflix' streaming services are "comparable to programming provided by a television broadcast station." Netflix disagreed, contending that what it provides is different from the multichannel video programming services at issue in all three laws. Thus, one key question was whether the programming that Netflix engages in is comparable to that provided by a television broadcast station.

In its opinion, the board referred to the state's definition of multichannel video programming services as "programming provided by or generally considered comparable to programming provided by a television broadcast station and shall include but not be limited to cable, satellite broadcast and wireless cable services, and Internet protocol television provided through wireline facilities without regard to delivery technology."

The board concluded that there are enough differences between streaming services and a television broadcast station's multichannel video programming services that Netflix' streaming services cannot be considered to be comparable. For instance, Netflix does not provide any live programming, like sports, news, or award shows. Another difference is that Netflix is only available on the Internet after transmission to stand-alone devices, like computers and tablets. In contrast, programming for broadcast television involves the use of a television, on which programming is immediately available.

The board also determined that Netflix' services do not constitute "cable services," largely because Netflix does not transmit its programming over "facilities" that it owns or operates.

For these reasons, among others, Netflix is entitled to refunds for the taxes it paid under the three Kentucky statutes. The board has 30 days to appeal.

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Team member bio