

# Transparency and Taxation – The Good, The Bad, The Gray

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## Agenda

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- Transparency in State Taxation
- Freedom of Information Act (FOIA) Requests
- Multistate Tax Commission – 51-State Spreadsheet
- Disclosure of Taxpayer Filing Positions
- Disclosure with Returns
- Financial Statement Disclosures
- Information Sharing Among State Tax Authorities
- Disclosure in Litigation

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## Background

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- Growing trend by State Tax Authorities to request information not contained in a standard corporate income tax return
- Increased disclosure of information in tax filings
- Information requested:
  - May not affect tax liability as shown on the return
  - Increases compliance burden
- Permit analysis of the state tax system

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## State Transparency: FOIA Requests

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- Common Law right
- Broad Scope
- Federal Freedom of Information Act
- Scope
  - Applies to executive branch public bodies
    - Local governments
  - Does not apply to legislative bodies and courts
- Purpose
  - Request documents not provided by state during audit
  - Review state contracts with 3<sup>rd</sup> party auditors and collectors

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## State Transparency: FOIA Requests

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- States vary drastically in scope of open records law
  - 2002 study ranked states
    - Best states (B grade): Nebraska, New Jersey
    - Worst states (F grade): Tennessee, Montana, Arizona, Wyoming, Alaska, Pennsylvania, Alabama, South Dakota.
- Who can make request
  - Nonresidents?
  - Corporations?
- Documents Covered
  - “public writing”
  - computerized information
  - drafts
- Timing of public body response
- Notification of reasons for denial

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## Taxpayer Transparency: MTC's 51-State Spreadsheet

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- Compilation of State Tax Return Data Model Statute
  - This model statute requires taxpayers to report certain data as it was filed in the other states in which the taxpayer does business “51 State Spreadsheet”
  - This “51 state spreadsheet” includes:
    - filings, business income, nonbusiness income, apportionment factors, composition of the combined group
  - “In lieu” of exception – may file copies of all state tax returns in each state

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## Taxpayer Transparency: MTC's 51- State Spreadsheet

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### Why is the 51-state spreadsheet meeting taxpayer resistance?

- Spreadsheet attempts to compare taxpayer positions and filings in each state
- Each state's laws are different
- Taxpayers contend that this spreadsheet will not give states useful information, but will create confusion and result in additional compliance burden and “rabbit hole” audit questions

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## Taxpayer Transparency: Disclosure of Inconsistent Filing Positions

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- Massachusetts
  - 2007 regulation change which requires disclosure of an inconsistent filing position (“IFP”)
  - A taxpayer must disclose any IFP as part of its corporate tax filing beginning December 8, 2005
  - If such IFP is not disclosed, the taxpayer will be subject to a penalty equal to the amount of tax attributable to the inconsistency

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## Taxpayer Transparency: Disclosure of Inconsistent Filing Positions

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- Massachusetts
  - A taxpayer is deemed to have taken an IFP when
    - (i) the taxpayer pays less tax in MA based upon an interpretation of MA law that differs from the position taken by the taxpayer in another state where the taxpayer files a return, **and**
    - (ii) the governing law in that other state is the same in all material respects as the MA law

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## Taxpayer Transparency: Disclosure of Inconsistent Filing Positions

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### Example 1:

A foreign corporation doing business in MA sells the stock of a subsidiary. The corporation's commercial domicile is in another state. The corporation claims there was no unitary business relationship between it and the subsidiary and therefore does not apportion the gain from the sale in reporting income for MA corporate tax purposes. Rather, the corporation allocates the gain from the sale of the subsidiary to its state of commercial domicile, and it reports the gain in a consistent manner in its state of commercial domicile. The corporation **is not** subject to the penalty for an **inconsistent filing position**.

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## Taxpayer Transparency: Disclosure of Inconsistent Filing Positions

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### Example 2:

The facts are the same as in Example 1 except that the corporation treats the gain from the sale of its subsidiary as apportionable income in its state of commercial domicile and does not report the inconsistency in reporting income for MA corporate tax purposes. The law in the corporation's state of commercial domicile is the same in all material respects. The corporation **is** subject to the penalty for an ***inconsistent filing position***.

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## Taxpayer Transparency: Legislation

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- Connecticut Proposed House Bill 5337
  - Business corporation tax returns and supporting documentation are public information under FOIA if:
    - Taxpayer reports more than \$10 million in total sales for the tax year; or
    - Taxpayer receives more than \$50,000 in Connecticut tax credits in a tax year
  - Status
    - Failed to obtain “favorable” recommendation from Jt. Comm. on Finance, Revenue and Bonding by April 17, 2009 deadline

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## Taxpayer Transparency: Legislation

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- Florida Senate Bill 2270
  - “Domestic Disclosure Spreadsheet”
    - Income reported to each state;
    - State tax liability;
    - Apportionment and allocation methods for each state; and
    - “Other information required by the department by rule in order to determine the proper amount of tax due to each state and to identify the water’s edge group”
  - Part of failed combined reporting bill
  - Also included in prior sessions’ (failed) combined reporting legislation, e.g., SB 2766/HB 1237 (2008)

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## Taxpayer Transparency: Corporate Reporting Disclosure Requirements

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- Maryland
  - Maryland corporate taxpayers that are members of a “corporate group” are required to report a pro forma water’s edge return to Maryland as if Maryland was a unitary reporting state
  - Purpose of information reporting is to allow Maryland to “study” combined reporting
  - Separate state reporting still mandated under state law
  - Penalties may be imposed for failure to comply
  - ***Viewed as requiring the business community to provide state revenue estimates***

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## Taxpayer Transparency: Federal Increased Disclosure

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- The IRS has developed alternative methods by required disclosure of certain information
  - Schedule M-3 requires detailed reconciliation
  - M-3 also requires expense items reconcile between GAAP & federal tax

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## Taxpayer Transparency: CALIFORNIA!!!

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- California
  - Schedule M-3
    - State specific schedule M-3 requires detailed reconciliation and state specific adjustments
  - DISA Reporting
    - Reporting of deferred intercompany stock account balances
    - Taxpayers required to file amended schedules with balances for prior 7 years (2001-2007)
    - Taxpayers that fail to file are required to file complete amended returns
  - Amnesty
    - Taxpayers required to file amended returns with detailed disclosure of each uncertain tax positions by May 31, 2009
    - Failure to file may result in imposition of 20% penalty

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## Taxpayer Transparency: Disclosure of Financial Statement Workpapers

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- IRS officials have stated that FIN 48 workpapers are tax accrual workpapers
- State and local tax agencies have not expressed an IRS-like policy of restraint with respect to tax accrual workpapers
- State tax auditors are requesting FIN 48 workpapers before the company has even prepared them
- Multistate Tax Commission has expressed interest in understanding FIN 48 workpapers and the disclosure requirements
- Information-sharing agreements between tax agencies may inadvertently circumvent any restraint policy

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## Taxpayer Transparency: Disclosure of FIN 48 Workpapers

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- Issues with Disclosure of FIN 48 Workpapers
  - ***Number 1 Issue – Why should a taxpayer be forced to disclose its “level of comfort” with a tax position and the surrounding analysis?***

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## Taxpayer Transparency: Disclosure of FIN 48 Workpapers

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- Montana
  - Request for FIN 48 workpapers sent to certain large corporations
  - Appears Montana is seeking out companies with significant FIN 48 amounts
  - Results?

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## Taxpayer Transparency: State Information Sharing

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- Uniform Exchange of Information Agreement was executed in 1993
- Currently all states (except New Mexico and Nevada), New York City and DC are signatories to the Agreement
- Multistate Tax Commission is also a signatory

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## Taxpayer Transparency: State Information Sharing

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- **Statutes and Regulations**
  - State statutes typically follow IRC § 6103, with possible exceptions (e.g., tax incentives) and/or considerations for state constitutional provisions.
  - Statutory similarities:
    - Exception to general taxpayer confidentiality rule,
    - Other state's representative must be "authorized",
    - Reciprocity, and/or
    - "Tax purposes" only.
  - Examples
    - New York: N.Y. Tax Law § 202(3).
    - North Carolina: N.C. Gen. Stat. § 105-259(b)(3).
    - Florida: Fla. Stat. §§ 213.053(7)(j), 213.0535; Fla. Admin. Code 12-22.007.
    - New Jersey: N.J. Rev. Stat. § 54:50-9(f).

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## Taxpayer Transparency: State Information Sharing

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- **Statutes Often Define The Types Of Information A State May Share With Other States.**
- **Examples**
  - Typical information includes: tax returns/reports, registration applications, information obtained through audit, filing/non-filing status, and/or taxpayer's name, address, FEIN.
  - Other states permit more broad disclosure.
    - For example, Washington defines "tax information" as including "the nature, source, or amount of the taxpayer's income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability deficiencies, over assessments, or tax payments, whether taken from the taxpayer's books and records or any other source." R.C.W. § 82.32.330(1)(c).

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## Taxpayer Transparency: IRS & MTC Sharing

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- IRS Executed a Memorandum of Understanding with State Tax Authorities
- IRS Executed a Memorandum of Understanding with the MTC

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## Taxpayer Transparency: Disclosure in Litigation

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- The Oregon Dep't of Revenue requested business records in order to determine if Harley-Davidson was protected from taxation under P.L. 86-272. *Harley-Davidson, Inc. v. Dep't of Revenue*, No. TC MD0408097A (Or. Tax 2006)
  - Harley did not want information about trade secrets, customer lists and employees to become public
  - The Department indicated it would, if asked, share the requested information with other states and the MTC
- The Tax Court denied Harley's motion for protection stating that the request would not cause annoyance, embarrassment or oppression

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## Taxpayer Transparency: Disclosure in Litigation

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- North Carolina
  - Wal-Mart was involved in corporate income tax litigation with North Carolina over the treatment of payments to a REIT
  - Wal-Mart filed motion for a protective order to seal all future filings after embarrassing materials were disclosed (i.e., E&Y state tax planning promotional materials)
  - Court did not grant the motion to seal the record

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## State Transparency: State Guidance

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- Taxpayers have had difficulty at times getting State Tax Authorities to provide guidance on specific legal issues through letter rulings
  - Some states will not issue rulings on nexus issues (e.g., Georgia, California)
  - Some states will not rule on issues of fact (e.g., Colorado, Georgia)
  - Some states do not issue any rulings (e.g., District of Columbia)
- States vary in whether they will allow taxpayers to request anonymous rulings and whether such rulings are binding
  - Certain states will only issue rulings to taxpayers that disclose their identity (e.g., Georgia)
  - Generally, anonymous rulings are not binding on the state
- States may charge taxpayers a fee to response to a letter ruling (e.g. Colorado)
- Taxpayers have had to resort to Freedom of Information Act Requests to attempt to identify State Tax Authorities' positions on tax technical issues

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## State Transparency: Discovery of State Tax Authority's Information

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- States often do not provide taxpayers with guidance on how they administer and apply state law
- In current litigation in North Carolina, *Delhaize America, Inc. vs. Hinton, Secretary of Revenue of the State of North Carolina*, Plaintiff asserted that North Carolina had secret laws regarding its rules, regulations and policies on when a forced combined return would be required to be filed by the state
- Plaintiff uncovered emails and other communication within the Department of Revenue that indicated that the Department did not want to disclose its policies on forced combination to taxpayers or auditors for fear that taxpayers would plan around such rules

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