



State & Local Tax **Alert**

Breaking state and local tax developments from Grant Thornton LLP

SALT Outlook, Trends and Predictions for 2017

Grant Thornton's 2017 Outlook, Trends and Predictions Alert focuses on how we believed 2016 would unfold from a SALT perspective, and how these predictions lined up with what actually happened. Also included are ten new predictions on critical SALT issues that, in our view, will be ripe for consideration in 2017.

As we have historically done, we take accountability for the predictions that we made in last year's Outlook alert. While our record was far from perfect, reflecting on what we thought would happen in 2016, and how reality differed from that initial perception, is crucial in developing insights on what may or may not occur this year. With respect to what's to come, readers should be forewarned that a particularly complex mix of geopolitical factors currently in play at the federal and state levels is likely to make the ability to predict what will happen in 2017 significantly more challenging than in most years.

As a starting point, we expect budgetary concerns in many states to continue to dominate the SALT landscape in 2017. According to a new report by The National Association of State Budget Officers, "softening state tax collections"¹ have become historically widespread, as general fund revenues for the 2017 fiscal year are below forecast in 24 states.² The reasons for the shortfalls are numerous. For example, Connecticut's budget deficit for the 2017 fiscal year is approximately \$1 billion, and is expected to be at \$1.5 billion by the 2018 fiscal year.³ Blame for this predicament has partly been placed at the door of Governor Dannel Malloy for "offering tax breaks to any corporation that threatened to move."⁴ Meanwhile, Michigan's budget outlook could turn on whether the U.S. Supreme Court will grant *certiorari* to a decision that upheld the retroactive repeal of the Multistate Tax Compact.⁵ A loss for the state could translate into a "stack of petitions

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¹ The National Association of State Budget Officers, *Summary: Fall 2016 Fiscal Survey of States* (Dec. 13, 2016).

² *Id.*

³ Adrienne Appel, *Connecticut Legislative Preview: Deficit Grows, Causes Worry*, BLOOMBERG BNA WEEKLY STATE TAX REPORT, Dec. 30, 2016.

⁴ *Id.*, quoting Prof. Richard Pomp, the Alva P. Loisel professor at the University of Connecticut School of Law. "Gov. Dannel Malloy (D) has contributed by 'offering tax breaks to any corporation that threatened to move. The legislature shares in the blame for a Christmas tree of special tax provisions.'"

⁵ Michael J. Bologna, *Michigan Legislative Preview: Tax Policy Hinges on High Court*, BLOOMBERG BNA WEEKLY STATE TAX REPORT, Dec. 30, 2016.

for tax refunds expected to total more than \$1 billion.”⁶ In addition, states that are heavily dependent on taxes derived from natural resources are finding themselves in a precarious financial position.

Many states are already poised to see legislative conflicts relating to the budget in 2017. In Washington, a Republican-controlled Senate is set to challenge a budget proposal from Democratic Governor Jay Inslee which, according to Republican chief budget writer Washington State Senator John Braun, contains “unbelievably unrealistic new tax increases.”⁷ In Illinois, the “political climate is so toxic” between Republican Governor Bruce Rauner and the Democrat-controlled House and Senate that many questioned whether a “swift resolution” for the budget is possible.⁸ However, progress is in motion as a legislative package has been introduced, through bipartisan cooperation, which contains a corporate income tax and personal income tax increase, a tax on sugary drinks and a two-year property tax freeze.⁹

Adding to the fiscal and political challenges already faced by states will be tax uncertainty at the federal level that may have a trickle-down effect. President-elect Donald Trump and House Republicans campaigned on “ambitious tax reform platforms.”¹⁰ While Trump has not yet released many details for his tax reform plans, potential key proposals include a corporate tax rate reduction, a repeal of many significant business incentives and a repeal of the estate and gift tax.¹¹ Meanwhile, on the judicial side, the eventual nomination and confirmation of a new U.S. Supreme Court Justice will have a significant impact on whether any state and local tax cases will be heard by the Court and if so, potentially the outcome in each case.

2016 Predictions – A Review

- *The impact of business pressure on tax policy.* In 2015, Connecticut launched a full-scale effort to stop GE from moving its headquarters out-of-state, a move that ultimately proved unsuccessful. We predicted that while states would learn from Connecticut’s mistakes and exercise caution in following a similar blueprint for retaining corporate operations within a state, at least one other state would provide relief to a defined class of taxpayers through the use of a different apportionment formula than the formula generally required to be used. This prediction verified as Delaware enacted the Delaware Competes Act, which will gradually phase in single sales factor apportionment, but exclude a narrowly

⁶ *Id.*

⁷ Paul Shukovsky, *Washington Legislative Preview: Capital Gains, Carbon Taxes*, BLOOMBERG BNA WEEKLY STATE TAX REPORT, Dec. 30, 2016.

⁸ Michael J. Bologna, *Illinois Legislative Preview: Fiscal Crisis Drives Tax Policy*, BLOOMBERG BNA WEEKLY STATE TAX REPORT, Dec. 30, 2016.

⁹ Maria Koklanaris, *Illinois Senate Leaders Agree on Package of Tax Increases, Reforms*, TAX ANALYSTS STATE TAX NOTES, Jan. 11, 2017. “The 99th Illinois General Assembly adjourned on January 10. The 100th General Assembly begins January 11, and both leaders said they would reintroduce all the bills and then move them immediately to the appropriate committees for action. [Senate Republican Leader Christine] Radogno said she was hoping for floor votes by February 1.”

¹⁰ For an in-depth look at the changes that might take place under President-elect Donald Trump, see [GT Insights: Republican Sweep Creates Potential for Major Tax Changes](#).

¹¹ *Id.*

defined class of taxpayers that are defined as telecommunications corporations or worldwide headquarters corporations.¹² Instead, these corporations may make an annual election to use either a three-factor apportionment formula or a single sales factor.¹³ Shortly after its enactment, DuPont indicated that its new agriculture company will be headquartered in Delaware.¹⁴ Although the Act “was not created for DuPont,” it played a role in keeping the company in Delaware.¹⁵ It should be noted that in the wake of the events in Connecticut, states appear to be reassessing the cost of providing such breaks. A recent report by the Massachusetts Budget and Policy Center shows that special business tax breaks will cost Massachusetts \$1 billion in 2017.¹⁶ Included among these tax breaks in the report are single sales factor apportionment for manufacturing companies and mutual fund companies.¹⁷

- *The future of the MTC.* The California Supreme Court’s decision in *Gillette Co. v. Franchise Tax Board* led some state tax practitioners to question the future of the Multistate Tax Commission.¹⁸ However, we went against this school of thought to some extent, and predicted that at least one state would become a member of the MTC in 2016, based on a reassessment of the risks of membership following litigation supporting state-specific legislation over the terms of the Multistate Tax Compact. Our prediction did not materialize. However, Virginia prefiled a bill that would have required the tax commissioner to take the steps necessary for Virginia to become an associate member of the MTC if it had been approved by the legislature.¹⁹
- *The fate of the Nevada commerce tax.* Given the strong opposition facing the Nevada commerce tax, we predicted that the tax would be repealed in its first year. Contrary to our prediction, the Nevada commerce tax remained in effect, and withstood efforts that were designed to give voters an opportunity to repeal the

¹² H.B. 235, Laws 2016.

¹³ For more information on the Delaware Competes Act, see [GT SALT Alert: Delaware Enacts Legislation Adopting Single Sales Factor Apportionment](#).

¹⁴ Stephanie Cumings, *DuPont Announces Delaware Headquarters Following Passage of Single Sales Factor*, TAX ANALYSTS STATE TAX NOTES, Feb. 23, 2016.

¹⁵ *Id.*, quoting Delaware House Majority Leader Valerie Longhurst, who sponsored the bill, “[w]hile the Delaware Competes Act was not created for DuPont, it was one piece of the puzzle in keeping DuPont here in Delaware.”

¹⁶ Kurt Wise, *The Growing Cost of Special Business Tax Break Spending*, Massachusetts Policy and Budget Center, Oct. 6, 2016.

¹⁷ *Id.*

¹⁸ In 2016, Multistate Tax Compact litigation continued to suffer a series of setbacks as the U.S. Supreme Court denied petitions for *certiorari* in both *The Gillette Co. v. Franchise Tax Board*, 363 P.3d 94 (Cal. 2015), *cert. denied*, 137 S. Ct. 294 (2016), and *Kimberly-Clark Corp. v. Commissioner of Revenue*, 880 N.W.2d 844 (Minn. 2016), *cert. denied*, 85 U.S.L.W. 3287 (2016). Additionally, taxpayers saw a series of losses in 2015 and 2016 as courts in Minnesota, Oregon and Texas rejected taxpayers’ arguments that they could make the Compact election. For a discussion of the *Kimberly-Clark* case, see [GT SALT Alert: Minnesota Supreme Court Denies Use of Multistate Tax Compact’s Equally-Weighted Three-Factor Apportionment Election](#).

¹⁹ H.B. 359, prefiled Jan. 5, 2016. The bill was stricken from the docket by the Committee on Finance by voice vote on February 1, 2016.

tax on the November 8, 2016 election ballot.²⁰ However, the tax may face additional challenges in 2017, as a bill to repeal the tax has been filed in the Nevada Assembly. While the future of the bill is in question as both the Democratic legislative majorities and Republican Governor Brian Sandoval support the tax,²¹ there may be further efforts to get the repeal on the ballot in 2017 if the legislation to repeal the tax is not enacted.²²

- *Alaska considers implementing a state income tax.* In 2016, Alaska Governor Bill Walker sought to impose an income tax on the state's residents that was necessitated by a combination of falling oil prices and falling oil production.²³ The state was "facing an Alaska-size shortfall," with a \$5.2 billion state budget for which two-thirds of the revenue "cannot be collected."²⁴ The proposed income tax would have been the first in 35 years in Alaska. Given the fiscal troubles facing the state, we predicted that Alaska would enact a personal income tax in 2016. This prediction did not come to pass. Governor Walker's proposal was "dismissed" by lawmakers who "refused to advance it to the floor for a vote in both the House and Senate."²⁵ However, this defeat does not rule out the possibility that a personal income tax proposal could be resurrected in the near future, as oil prices and production continue to lag. The November elections saw a shift in the composition of the Alaska State House of Representatives from a Republican majority to one comprised of Democrats, moderate Republicans, and independents that have expressed an interest in an income tax.²⁶
- *Remote seller nexus legislation.* We predicted that 2016 would see continued action at the state level on remote seller nexus legislation with at least three additional states enacting click-through nexus and/or affiliate nexus provisions. This prediction partially verified in 2016. As far as what happened at the state level on nexus provisions, states were extraordinarily active in introducing bills on the subject, with 42 sales tax nexus bills being introduced in 16 states as of August 23, 2016.²⁷ While several states enacted notice and reporting requirements similar to those

²⁰ *Coalition for Nevada's Future v. RIP Commerce Tax, Inc.*, Nevada Supreme Court, No. 69501, May 11, 2016. The Nevada Supreme Court determined that the referendum submitted by RIP Commerce Tax, Inc. was invalid because it failed to establish that there would be a significant impact on the balanced budget, as mandated by Nevada law. While a revised version was later approved by a Nevada district court, RIP did not think it feasible to obtain the necessary signatures needed before the deadline. See Metisse Lutz, *Top 5 Things to Know About the Nevada Commerce Tax*, TAX ANALYSTS STATE TAX TODAY, June 20, 2016.

²¹ *Id.*

²² Paul Jones, *New Democratic Nevada Legislature Likely to Focus on Modest Tax Reforms*, TAX ANALYSTS STATE TAX TODAY, Dec. 29, 2016.

²³ Kirk Johnson, *As Oil Money Melts, Alaska Mulls First Income Tax in 35 Years*, THE NEW YORK TIMES, Dec. 25, 2015.

²⁴ *Id.*

²⁵ Nathaniel Herz, *Alaska Gov. Walker Proposes Statewide Sales Tax, Oil Tax Increases to Kick Off Special Session*, adn.com, updated Aug. 25, 2016.

²⁶ Paul Jones, *Alaska Governor Again Calls for Fuel Tax Increase, Revenue Reform*, TAX ANALYSTS STATE TAX TODAY, Dec. 23, 2016.

²⁷ Liz Malm and Ryan Maness, *Sales Tax Nexus Legislation Was One of the Biggest Trends in State Legislatures This Year*, MULTISTATE INSIDER, Aug. 23, 2016.

enacted by Colorado,²⁸ only one state, Louisiana, enacted click-through and affiliate nexus provisions requirements in 2016.²⁹

- *Alabama litigation challenging Quill.* Our prediction that 2016 would see a lawsuit filed in court challenging Alabama's regulation³⁰ requiring out-of-state sellers to collect and remit sales tax in the absence of a physical presence in the state³¹ materialized. Litigation challenging the regulation was filed in the Alabama Tax Tribunal.³² However, we were incorrect in our prediction that states would adopt a wait-and-see approach on this issue in 2016. South Dakota enacted legislation in 2016 requiring certain remote sellers that do not have a physical presence in South Dakota to collect sales tax on sales made in the state.³³ Prior to the May 1, 2016 scheduled effective date of the legislation, the state filed a declaratory judgment action asserting that the legislation is valid³⁴ and remote retailers filed litigation challenging the facial constitutionality of the legislation.³⁵ Also, Tennessee promulgated a rule requiring that certain remote sellers that do not have a physical presence in the state collect sales tax.³⁶
- *More states will look to legalizing marijuana as a new source of revenue income.* Given the substantial amounts of revenue Colorado and Washington generated through the legalization and taxation of marijuana,³⁷ we correctly predicted that at least one other state would legalize the sale of marijuana (either medical or recreational) in 2016 and impose a tax equivalent to the level of tax imposed in Colorado. In 2016, five states put the question of legalizing and taxing recreational marijuana to voters: Arizona, California, Maine, Massachusetts and Nevada.³⁸ Voters in

²⁸ The U.S. Court of Appeals for the Tenth Circuit upheld the constitutionality of Colorado's notice and reporting requirements in *Direct Marketing Ass'n v. Brohl*, 814 F.3d 1129 (10th Cir. 2016), *cert. denied*, 85 U.S.L.W. 3287 (2016). For a discussion of this case, see [GT SALT Alert: Federal Court of Appeals Upholds Colorado's Sales and Use Tax Notice and Reporting Requirements](#). In 2016, Louisiana (H.B. 1121), Oklahoma (H.B. 2531) and Vermont (H. 873) each adopted notice and reporting requirements.

²⁹ Act 22 (H.B. 30), Laws 2016 (First Extraordinary Session). See also [GT SALT Alert: Louisiana Enacts Broad Range of Tax Increases During Recent Special Session](#).

³⁰ ALA. ADMIN. CODE r. 810-6-2-.90.03.

³¹ For further information on this regulation, see [GT SALT Alert: New Alabama Regulation to Require Out-of-State Sellers to Collect Sales and Use Tax Contrary to Supreme Court Precedent](#).

³² *Newegg, Inc. v. Alabama Department of Revenue*, Alabama Tax Tribunal, No. S. 16-613, filed June 8, 2016.

³³ S.B. 106, Laws 2016.

³⁴ Due to this litigation being filed, the collection and remittance requirements were automatically enjoined. *South Dakota v. Wayfair, Inc.*, No. 32CIV16-000092 (S.D. 6th Cir. Ct.), filed April 28, 2016. The remote retailers removed this case to the U.S. District Court for the District of South Dakota. *South Dakota v. Wayfair, Inc.*, D.S.D., No. 3:16-CV-03019. On December 8, 2016, the U.S. District Court held oral arguments on whether the case should be remanded to state court.

³⁵ *American Catalog Mailers Ass'n v. Gerlach*, No. 32CIV16-000096 (S.D. 6th Cir. Ct.), filed April 29, 2016.

³⁶ TENN. COMP. R. & REGS. 1320-05-02-.129.

³⁷ Debra Borchardt, *Colorado Now Reaping More Tax Revenue From Pot Than From Alcohol*, FORBES.COM, Sept. 16, 2015; Jareen Imam, *Pot Money Changing Hearts in Washington*, CNN.COM, updated July 11, 2015.

³⁸ Arizona Proposition 205, California Proposition 64, Maine Question 1, Massachusetts Question 4, and Nevada Question 2. For additional information on these ballot initiatives, see [GT SALT Alert: State Efforts to Raise Revenue Find Success with Voters on Some Ballot Initiatives](#).

Nevada, California, Maine and Massachusetts each approved the measures with Arizona being the only state to see its initiative fail. California will legalize marijuana and impose a state excise tax of 15 percent on retail sales of marijuana.³⁹ Maine will impose a sales tax of 10 percent,⁴⁰ while Massachusetts will subject sales of marijuana and marijuana products to the state sales tax of 6.25 percent as well as an additional excise tax of 3.75 percent.⁴¹ Additionally, a city or town can impose a separate tax of up to 2 percent.⁴² Finally, Nevada will impose a 15 percent excise tax on wholesale sales of marijuana.⁴³ Colorado subjects retail marijuana to the 10 percent state marijuana sales tax, the 2.9 percent state sales tax plus any local sales taxes.⁴⁴

- *Increased scrutiny of property tax exemptions for hospitals.* We correctly predicted that 2016 would see continued heightened scrutiny of property tax exemptions provided to hospitals with another state court decision being reached on this issue. In early 2016, the Illinois Appellate Court, Fourth District, held in *Carle Foundation v. Cunningham Township*⁴⁵ that a statutory exemption, contained in Section 15-86⁴⁶ of the Illinois Property Tax Code, for hospital property based on the value of the charitable services the hospital provided was unconstitutional because the exemption violated constitutional language limiting the available exemption from property tax to property used exclusively for charitable purposes. Additionally, at the end of 2016, the Illinois Appellate Court, First District, in *Oswald v. Hamer*,⁴⁷ upheld the constitutionality of Section 15-86, directly contradicting the holding in *Carle*. The *Carle* decision has been appealed to the Illinois Supreme Court and oral hearings were held last week.
- *Conformity to PATH Act.* On December 18, 2015, President Obama signed the Protecting Americans from Tax Hikes Act of 2015 (PATH Act),⁴⁸ which, among other things, extended the bonus depreciation for five years (50 percent rate for 2015-2017; 40 percent in 2018; and 30 percent in 2019).⁴⁹ Our prediction that states that historically have conformed to federal bonus depreciation provisions will continue to do so and not decouple as a result of the PATH Act verified in 2016.
- *Market-based sourcing.* Given the strength of the movement towards market-based sourcing, we predicted that at least two states that use the cost of performance approach would transition to market-based sourcing through legislation enacted in

³⁹ California Secretary of State, California General Election Tuesday, Nov. 8, 2016, Official Voter Information Guide (Nov. 2016).

⁴⁰ Maine Secretary of State, Maine Citizen's Guide to the Referendum Election (2016).

⁴¹ Secretary of the Commonwealth of Massachusetts, 2016 Information for Voters (2016).

⁴² *Id.*

⁴³ Nevada Secretary of State, Statewide Ballot Questions 2016 (2016).

⁴⁴ Colorado Department of Revenue, Web Publication: *Marijuana Taxes – Quick Answers*.

⁴⁵ 45 N.E.3d 1173 (Ill. App. Ct. 2016). For a discussion of this case, see [GT SALT Alert: Illinois Appellate Court Finds Hospital Property Tax Exemption Unconstitutional](#).

⁴⁶ 35 ILL. COMP. STAT. 200/15-86.

⁴⁷ Illinois Appellate Court, First District, No. 1-15-2691, Dec. 22, 2016.

⁴⁸ P.L. 114-113.

⁴⁹ See [GT Tax Legislative Update](#).

2016. This prediction verified as both Connecticut⁵⁰ and Louisiana⁵¹ enacted legislation in 2016 that transitioned the states to market-based sourcing.⁵²

Our 2017 Predictions

1. IRC Section 385 regulations

The issuance by the U.S. Department of the Treasury and the Internal Revenue Service of the final and temporary regulations under IRC Section 385 was a significant development in 2016.⁵³ The Section 385 regulations govern the potential reclassification of certain types of intercompany debt transactions as equity and were intended to deter certain “earnings stripping transactions” often used as domestic, international or state and local tax planning strategies. While tax practitioners have issued a wealth of articles on the uncertainty surrounding the impact of these regulations at the state level,⁵⁴ and whether states will conform to the federal regulations, states have yet to issue any guidance responding to the Section 385 regulations.⁵⁵ **Given the potential impact of the federal Section 385 regulations, we predict that at least two states will issue specific guidance related to conformity with the IRC Section 385 regulations.**

2. *Wynne* hypotheticals

In *Wynne*,⁵⁶ the U.S. Supreme Court held that state provisions allowing credits for income taxes paid to other states but denying credits for income taxes paid to the localities violated the Commerce Clause. Specifically, the Court held that Maryland’s personal income tax statutes violated the internal consistency test because double taxation would exist if each state imposed the same tax structure, as portrayed in an elaborate hypothetical example.⁵⁷ As 2016 got underway, two decisions emerged that utilized the *Wynne*

⁵⁰ Public Act No. 16-3 (S.B. 502), Laws 2016. For a detailed look at this legislation, see [GT SALT Alert: Connecticut Enacts Legislation Shifting State to Market-Based Sourcing](#).

⁵¹ Act 8 (H.B. 20), Laws 2016 (Second Extraordinary Session). For a discussion of this legislation, see [GT SALT Alert: Louisiana Enacts Various Tax Provisions During Second Special Session, Including Market-Based Sourcing](#).

⁵² While North Carolina has not formally adopted market-based sourcing, it continued its steady progress toward a market-based sourcing regime in 2016. See [GT SALT Alert: North Carolina Mandates Informational Reporting of Market-Based Sourcing Apportionment Calculation](#) and [GT SALT Alert: North Carolina Enacts Significant Tax Legislation and Proposes Market-Based Sourcing Provisions](#).

⁵³ T.D. 9790. See also [GT SALT Alert: SALT Top Stories of 2016](#).

⁵⁴ See Jamie C. Yesnowitz, Chuck Jones, Lori Stolly and Priya D. Nair, *The Impact of the Section 385 Regulations on States*, TAX ANALYSTS STATE TAX NOTES, Jan. 9, 2017.

⁵⁵ However, Louisiana did recently issue proposed regulations related to the state’s addback provision and indicated that they are reviewing the regulations to determine if “further clarification to Louisiana’s addback provision” is needed as a result. Nushin Huq, *Louisiana Releases Draft Rules Aimed at Corporate Taxes*, BLOOMBERG BNA WEEKLY STATE TAX REPORT, Oct. 21, 2016.

⁵⁶ *Comptroller of the Treasury v. Wynne*, 135 S. Ct. 1787 (2015). For a detailed discussion of this case, see [GT SALT Alert: U.S. Supreme Court Holds Lack of County Personal Income Tax Credit for Taxes Paid to Other States Violates Commerce Clause](#).

⁵⁷ For an analysis of the potential effect and applications of *Wynne*, see Vito Cosmo Jr., Matthew Melinson and Patrick Skeeahan, *Supreme Court Delivers Blow to Some State and Local Tax Regimes*, CPA JOURNAL (Vol. 86, Issue 4, Winter 2016).

hypothetical analysis. In *First Marblehead Corp. v. Commissioner of Revenue*,⁵⁸ the Massachusetts Supreme Judicial Court applied the internal consistency test and determined that the application of the financial institution excise tax apportionment statute did not actually subject the taxpayer to double taxation. The U.S. Supreme Court vacated this judgment and remanded the case for further consideration in light of *Wynne*.⁵⁹ On remand, the Massachusetts Supreme Judicial Court applied a more comprehensive internal consistency test by examining whether there hypothetically would be double taxation if each state imposed the same tax structure.⁶⁰ In West Virginia, the Supreme Court of Appeals held that use tax credits are applicable to sales taxes paid to both states and their local subdivisions on purchases of locomotive fuel.⁶¹ The Court found that not applying the credit for taxes paid to municipalities would violate the Commerce Clause of the U.S. Constitution. In its analysis, the Court used a hypothetical to illustrate that a taxpayer would be subject to additional tax unless the sales tax credit applied to taxes paid to states and taxes paid to local governments. **We predict that *Wynne* hypotheticals will play a role in at least two state supreme court decisions in 2017.**

3. States look for budget shortfall solutions

As of the beginning of January 2017, 31 states are projected to have budget shortfalls for the 2017 fiscal year.⁶² As a result, many states looking for ways to fill their budget gaps may consider income and sales tax measures. On the income tax side, raising corporate income tax rates could become a viable option. This reaction would counteract the recent inclination of states to reduce corporate income tax rates,⁶³ and ironically, may be most likely in states that followed the tax rate reduction trend over the last few years to the extent budget gaps can be traced to such reduction. New Mexico, for example, is set to reduce its corporate tax rate from 6.6 percent to 6.2 percent on January 1,⁶⁴ but is facing a \$69 million budget shortfall for the current fiscal year despite spending cuts.⁶⁵ With respect to the sales tax, the expansion of the base is likely to be targeted in numerous states. In 2016, we saw one state succeed in its efforts to expand its sales tax base and one state fail. Voters in Missouri approved an amendment to the state's constitution that

⁵⁸ *First Marblehead Corp. v. Commissioner of Revenue*, 23 N.E.3d 892 (Mass. 2015).

⁵⁹ *The First Marblehead Corp. v. Commissioner of Revenue*, 136 S. Ct. 317 (2015). For further discussion, see [GT SALT Alert: U.S. Supreme Court Vacates and Remands Massachusetts Case for Further Consideration Based on *Wynne*](#).

⁶⁰ *The First Marblehead Corp. v. Commissioner of Revenue*, 56 N.E.3d 132 (Mass. 2016). For a discussion of this case, see [GT SALT Alert: Massachusetts Supreme Judicial Court Upholds Constitutionality of Financial Institution Excise Tax Apportionment Rules](#). The First Marblehead Corporation and GATE Holdings, Inc. filed a petition for *certiorari* with the U.S. Supreme Court on December 15, 2016.

⁶¹ *Matkovich v. CSX Transportation, Inc.*, West Virginia Supreme Court of Appeals, No. 15-0935, Nov. 16, 2016. For a detailed discussion of this case, see [GT SALT Alert: West Virginia Supreme Court Extends *Wynne* to Sales and Use Tax Credits of Municipal Taxes](#).

⁶² Ryan Maness, *Thirty-One States Face Revenue Shortfalls for the 2017 Fiscal Year*, MULTISTATE INSIDER, Jan. 3, 2017.

⁶³ In 2017, five states will reduce their corporate income tax rates and, since 2008, 15 states have reduced their rates. Scott Drenkard, *Several States Will Start 2017 with Corporate Tax Reductions*, TAX FOUNDATION, Dec. 30, 2016.

⁶⁴ *Id.*

⁶⁵ Ryan Maness, *Thirty-One States Face Revenue Shortfalls for the 2017 Fiscal Year*, MULTISTATE INSIDER, Jan. 3, 2017.

would prohibit a new state or local sales, use or other similar tax on any service or transaction that was not subject to such a tax as of January 1, 2015.⁶⁶ On the other hand, Pennsylvania was able to significantly expand its sales and use tax base to include a host of digital products.⁶⁷ **We predict that at least three states facing budget difficulties will try to solve their issues by expanding their sales tax base, and at least one state will raise corporate income tax rates.**

4. *Remote retailer notice requirements*

Colorado's notice and reporting regime scored a victory in the last weeks of December as the U.S. Supreme Court denied *certiorari* in *Direct Marketing Association v. Brohl*.⁶⁸ Several other states looked to notice and reporting requirements in 2016 as a means of tackling the remote seller issue. Louisiana,⁶⁹ Oklahoma⁷⁰ and Vermont⁷¹ all enacted legislation in 2016 imposing such requirements on remote sellers. **We predict that the U.S. Supreme Court's denial of *certiorari* in *DMA* will encourage at least three more states to enact sales tax remote retailer notice requirements.**

5. *Continuing scrutiny of property tax exemptions for non-profits*

In 2016, as discussed above, two separate districts of the Illinois Appellate Court considered the constitutionality of Section 15-86 of the Illinois Property Tax Code,⁷² which added a new category of charitable exemption for hospitals. In *Carle Foundation v. Cunningham Township*,⁷³ the Illinois Appellate Court, Fourth District, held that Section 15-86 is facially unconstitutional and unenforceable. In contrast, the First District of the Illinois Appellate Court issued a decision in *Oswald v. Hamer*⁷⁴ upholding the constitutionality of Section 15-86, directly contradicting the *Carle* decision. In addition to the uncertainty regarding whether the rule of law as stated in *Carle* or *Oswald* will ultimately prevail, there is heightened scrutiny over property tax exemptions outside the realm of

⁶⁶ Missouri Secretary of State, 2016 Ballot Measures (2016). For a discussion of this development, see [GT SALT Alert: State Efforts to Raise Revenue Find Success with Voters on Some Ballot Initiatives](#).

⁶⁷ Act 84 (H.B. 1198), Laws 2016. For a detailed look at this legislation, see [GT SALT Alert: Pennsylvania Enacts Budget Legislation Expanding Sales Tax Base, Establishing Tax Amnesty Program](#).

⁶⁸ *Direct Marketing Ass'n v. Brohl*, 814 F.3d 1129 (10th Cir. 2016). In *DMA*, the U.S. Court of Appeals for the Tenth Circuit upheld the constitutionality of Colorado's notice and reporting requirements imposed on out-of-state retailers that do not collect sales tax in the state. For a discussion of this case, see [GT SALT Alert: Federal Court of Appeals Upholds Colorado's Sales and Use Tax Notice and Reporting Requirements](#).

⁶⁹ Act 569 (H.B. 1121), Laws 2016. See also [GT SALT Alert: Louisiana Enacts Sales and Use Tax Notice Requirements on Remote Retailers](#).

⁷⁰ H.B. 2531, Laws 2016 (enacted on May 17, 2016), adding OKLA. STAT. tit. 68, § 1406.2.A. See also [GT SALT Alert: Oklahoma Enacts Budget Package with Tax Provisions, Including Expansion of Sales Tax Nexus and Notice Requirements](#).

⁷¹ Act 134 (H. 873), Laws 2016. For a discussion of the Vermont legislation, see [GT SALT Alert: Vermont Legislation Enacts Prospective Notice Requirements on Noncollecting Vendors and Potential Expansion of Remote Seller Nexus](#).

⁷² 35 ILL. COMP. STAT. 200/15-86.

⁷³ 45 N.E.3d 1173 (Ill. App. Ct. 2016).

⁷⁴ Illinois Appellate Court, First District, No. 1-15-2691, Dec. 22, 2016.

hospitals, as many are questioning the wisdom of giving property tax exemptions to non-profits in general.⁷⁵ The Center for Non-Profits has predicted that a recent settlement by Princeton University in a lawsuit challenging its property tax exemption will set in motion other challenges to higher education institutions and other non-profits in New Jersey and beyond.⁷⁶ **We predict that the Illinois Supreme Court will affirm *Carle*, and that we will see increased scrutiny of property tax exemptions for other non-profits.**

6. *States consider tackling revenue fluctuations through gross receipts taxes*

Corporate income taxes have long been known for their revenue volatility.⁷⁷ Given the unpredictability of corporate income tax revenue streams, Ohio, Texas and Nevada all have turned to gross receipts taxes as a more predictable source of revenue.⁷⁸ **Given this trend, we predict that at least one state will introduce legislation to move from a corporate income tax to a non-income tax regime as a means to dampen revenue fluctuations.**

7. *The anti-Quill movement*

In 2016, states continued to challenge *Quill*'s⁷⁹ physical presence requirement through the legislative and judicial process. South Dakota enacted legislation in 2016⁸⁰ requiring certain remote sellers that lack a physical presence in the state to collect sales tax on in-state sales and a challenge to this legislation has already been filed.⁸¹ Meanwhile, litigation has been filed with the Alabama Tax Tribunal challenging a regulation requiring certain out-of-state sellers making retail sales into Alabama to collect and remit sales and use tax in the absence of a physical presence in the state.⁸² **Against this backdrop, we predict that anti-*Quill* legislation will continue to flourish in 2017, with at least two states adopting provisions. On the litigation front, we predict that the outlook will remain inconclusive in 2017 due to the deliberate nature of the judicial process in Alabama and questions of venue in the South Dakota challenge.**

⁷⁵ Jennifer Carr, *The Growing Fight Over Hospital Tax Exemptions*, TAX ANALYSTS STATE TAX TODAY, Sept. 12, 2016. "As New Hampshire state Rep. David Hess (R) noted: 'Hospitals and private universities are big businesses. . . . I think we need to start a conversation about why we are carving out a special exception for them.'"

⁷⁶ Center for Non-Profits, *Princeton University Settles Property Tax Exemption Lawsuit*, posted Oct. 17, 2016. "Given how closely this case was being watched throughout the country, the settlement will likely spur additional claims against other higher education institutions and other non-profits throughout New Jersey and elsewhere."

⁷⁷ The Pew Charitable Trusts, *Fiscal 50: State Trends and Analysis* (Nov. 1, 2016).

⁷⁸ Jared Walczak, TRENDS IN STATE TAX POLICY, Tax Foundation, Dec. 5, 2016.

⁷⁹ *Quill v. North Dakota*, 504 U.S. 298 (1992).

⁸⁰ S.B. 106, Laws 2016. For a discussion of the South Dakota legislation, see [GT SALT Alert: South Dakota Enacts Legislation Challenging Quill's Physical Presence Requirement](#).

⁸¹ *South Dakota v. Wayfair, Inc.*, D.S.D., No. 3:16-CV-03019; *American Catalog Mailers Ass'n v. Gerlach*, No. 32CIV16-000096 (S.D. 6th Cir. Ct.), filed April 29, 2016.

⁸² *Newegg, Inc. v. Alabama Department of Revenue*, Alabama Tax Tribunal, No. S. 16-613, filed June 8, 2016.

8. *Retroactive tax legislation*

In 1994, the U.S. Supreme Court issued its decision in *United States v. Carlton*,⁸³ a case that set the standard for testing the constitutionality of retroactive tax legislation. However, since that decision, the limits of retroactive tax legislation have been tested⁸⁴ and state legislatures have compounded this issue by using retroactive legislation as a mechanism to rewrite tax statutes and “to reverse unfavorable outcomes in tax litigation.”⁸⁵ In 2016, petitions for *certiorari* were filed with the U.S. Supreme Court in two retroactive tax legislation cases. In *Gillette Commercial Operations NA & Subsidiaries v. Michigan Department of Treasury*,⁸⁶ taxpayers are challenging the constitutionality of a Michigan law that retroactively repealed the Multistate Tax Compact. In *Dot Foods, Inc. v. Department of Revenue*,⁸⁷ taxpayers are challenging a law that retroactively narrowed a Washington Business and Occupation (B&O) tax exemption. **We predict that the U.S. Supreme Court will grant *certiorari* in at least one of the retroactive legislation cases.**

9. *Taxes on soft drinks and sugary items*

Fueled by health concerns and revenue generation, a trend of taxing soft drinks and sugary items is gaining traction in cities across the U.S. Philadelphia recently enacted the “Sugar-Sweetened Beverage Tax,” an ordinance that imposes a 1.5 cent per ounce tax on sugar-based drinks starting on January 1, 2017.⁸⁸ The tax, which has withstood a challenge by consumers, retailers, distributors and trade associations,⁸⁹ is estimated to generate \$91 million in its first year, and will make Philadelphia the “first major U.S. city to enact a soda tax.”⁹⁰ Other states are mulling similar taxes. In New York, the Greater New York Hospital Association is calling for a soda tax to “combat obesity and diabetes” and “help reduce the fiscal impact on hospitals if the federal Affordable Care Act is repealed.”⁹¹ In Illinois, Cook County approved a penny-per-fluid-ounce tax on sweetened beverages sold in the county.⁹² The tax, which is scheduled to take effect on July 1, 2017, is expected to generate \$73.7 million in 2017.⁹³ In California, voters in San Francisco, Oakland and

⁸³ 512 U.S. 26 (1994).

⁸⁴ Council on State Taxation, *Amicus Curiae of Council on State Taxation (COST) in Support of Petitioner*, Oct. 11, 2016.

⁸⁵ *Id.*

⁸⁶ 880 N.W.2d 230 (Mich. 2016). In its petition for a writ of *certiorari*, the taxpayer stated that its petition “should be held pending the disposition of *Goodyear Tire & Rubber Co. v. Michigan Department of Revenue*,” because the *Gillette* decision “is substantively identical to that challenged by the petition for *certiorari* in *Goodyear Tire & Rubber Co. v. Michigan Department of Revenue*.”

⁸⁷ 372 P.3d 747 (Wash. 2016). For a discussion of this decision, see [GT SALT Alert: Washington Supreme Court Upholds Retroactive Application of Amendment to B&O Tax Exemption](#).

⁸⁸ PHILA. CODE §§ 19-4100 to 19-4108, enacted by Bill No. 160176, June 20, 2016.

⁸⁹ *Williams v. City of Philadelphia*, Court of Common Pleas of Philadelphia County, First Judicial District, No. 1452, Dec. 19, 2016. See [GT SALT Alert: Philadelphia’s New Soda Tax Is Being Challenged](#).

⁹⁰ Paige Jones, *Judge Dismisses Soda Lawsuit Against Philadelphia*, TAX ANALYSTS STATE TAX NOTES, Dec. 20, 2016.

⁹¹ Paige Jones, *Group May Push for Soda Tax in New York*, TAX ANALYSTS STATE TAX NOTES, Dec. 29, 2016.

⁹² Cook County Government, *FY 2017 Budget Approved by Cook County Board of Commissioners* (Nov. 15, 2016).

⁹³ *Id.*

Albany all approved measures to tax sugary drinks.⁹⁴ Voters in Boulder, Colorado also approved a sugar-sweetened beverage product distribution tax⁹⁵ that is expected to generate \$3.8 million a year.⁹⁶ **Given this emerging trend, we predict that at least two more major municipalities will impose a soft drinks/sugary items tax.**

10. *States may be faced with groundbreaking federal conformity choices*

The election of Donald Trump as the country's new president and the Republican sweep of the House and Senate set the stage for significant tax legislation at the federal level.⁹⁷ During the campaign process, both Trump and House Republicans promised tax reform, including cutting tax rates on business income. While Trump has not offered many details on his tax plan, key proposals include reducing the corporate tax rate, repealing all business incentives except the R&D tax credit, repatriation of foreign earnings at a special tax rate, and repealing the estate and gift tax. Meanwhile, House Republicans have proposed a "destination-based cash flow tax" under which the tax would be "border-adjusted by exempting exports and excluding any deduction for the cost of imports."⁹⁸ Each of these proposals could be considered groundbreaking, and the cumulative effect of adopting several components of these proposals would be staggering, with a tremendous impact on the calculation of the state income tax base. **We predict that if a groundbreaking federal income tax change occurs in 2017, several states will work in concert to address whether, and if so, how to conform to the federal change by the end of the year.**

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⁹⁴ Kathleen K. Wright, *Looking Back: 2016 and California Election Results*, TAX ANALYSTS STATE TAX TODAY, Jan. 4, 2017. "Several local tax measures were passed by cities and counties in California, but one measure has attracted national interest. That is the soda tax on sugary drinks that passed in three California cities and in Boulder, Colorado. Voters in four U.S. cities approved special taxes on sugary drinks. The penny-per-ounce taxes in three San Francisco Bay Area cities (San Francisco, Oakland, and Albany) will apply to energy, sweetened tea, and sports drinks, but not to diet sodas or naturally sweetened drinks. In California, San Francisco's Measure V passed with 61.87 percent of the vote, Oakland's Measure HH received 60.75 percent of the vote, and Albany's Measure O1 was approved with 70.67 percent support. All three California measures will tax sugary drinks at a penny per ounce."

⁹⁵ Boulder County, *2016 General Election Official Results* (last updated Nov. 22, 2016).

⁹⁶ Nancy Fink Huehnergarth, *Bay Area and Boulder Soda Taxes Would Save Lives, Lower Healthcare Costs, Says Harvard*, FORBES.COM, Oct. 27, 2016.

⁹⁷ For an in-depth look at the changes that might take place under President-elect Donald Trump, see [GT Insights: Republican Sweep Creates Potential for Major Tax Changes](#).

⁹⁸ Dan R. Bucks, *Is the Profit-Shifting Jig Finally Up?*, TAX ANALYSTS STATE TAX NOTES, Jan. 4, 2017.

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