Current Federal Tax Developments

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Section: State Tax
Supreme Court Will Hear South Dakota Challenge to Quill

Citation: State of South Dakota v. Wayfair, SD SC, Case No. 28160, 9/14/17, Petition for Writ of Certiorari, 10/2/17, Cert Granted 1/12/18

The most public challenge to *Quill* will be heard by the U.S. Supreme Court, as the court's granted South Dakota's request to hear the case (Order Granting Certiorari, 1/12/18). The South Dakota Supreme Court in the case of *State of South Dakota v. Wayfair*, SD SC, Case No. 28160 ruled South Dakota's tests for when an out of state seller must collect and remit sales tax unconstitutional.

The State of South Dakota is hoping the Supreme Court believes now is the time to get rid of the physical presence test that was left in place in the *Quill* case. The Supreme Court's opinion in *Quill* gave, at best, lukewarm support for keeping the test in place, doing so largely because that's what had been decided before. The opinion suggested that if there had not been prior case law the Court would not have imposed this test and, as well, left open the door to reconsidering the issue later.

As we have discussed in other articles, this is one of three broad methods being used by states to attempt to increase collections of sales and use taxes by having out of state sellers, especially internet based ones, collect more sales tax. Other states have attempted to claim a very broad definition of "physical presence" to include the use of affiliates sellers in the state and the like (see Massachusetts) to simply "chip away" at the impact of *Quill*, while others have enacted "tattletale" laws that require sellers not to collect and remit the tax, but rather to report names and addresses of buyers in the state.

The latter two options have, to date, fared reasonably well in the federal courts, most significantly when the Tenth Circuit in *Direct Marketing Association v. Brohl* upheld Colorado's tattletale law, a holding the Supreme Court declined to review on appeal. The appellate panel held that because there was no tax collection required, *Quill* was not relevant to a determination of whether a state could impose this requirement on out of state businesses.

But South Dakota is looking to render the need to use those two methods unnecessary by getting the Supreme Court to revisit the entire concept of the physical presence test. The South Dakota Legislature enacted a law (S.B. 106) that clearly violated *Quill* and was meant as a vehicle to get the issue before the Supreme Court again. For that reason, the state is not necessarily upset that it lost at the state level, knowing the goal was to get the Supreme Court to hear the case.

As the South Dakota Supreme Court opinion described South Dakota's law:

> Senate Bill 106 was introduced during the session as: "An Act to provide for the collection of sales taxes from certain remote sellers, to establish certain Legislative findings, and to declare an emergency." S.B. 106, 2016 Legis. Assemb., 91st Sess. (S.D. 2016). The Act provided that any sellers of "tangible personal property" in South Dakota without a "physical presence in the state . . . shall remit" sales tax according to the same procedures as sellers with "a physical presence[.]" Id. § 1. However, the Act limited this obligation to sellers with "gross revenue" from sales in South Dakota of over $100,000 per calendar year or with 200 or more "separate transactions" in the state within the same time frame. Id. §§ 1-2. The Act authorized the State to bring a

> declaratory judgment action in circuit court against any person believed to meet the Act's criteria "to establish that the obligation to remit sales tax is applicable and valid under state and federal law." Id. § 2. The Act further authorized a motion to dismiss or a motion for summary judgment in the action. Id. It also provided that the filing of the action "operates as an injunction during the pendency of the" suit prohibiting the State from enforcing the Act's obligations. Id. § 3. Other sections of the Act prohibited retroactive application of the obligation to remit sales tax and made the obligation prospective only from the date of dissolution or lifting of an injunction provided for by the Act. Id. §§ 5-6.

The state filed suit shortly after the bill took effect, triggering the legislative injunction against any enforcement but allowing the challenge to move forward.

One of the reasons the state believed the time was ripe to attempt to get the Supreme Court to hear this case related to the *Brohl* case mentioned earlier. Initially the question arose whether the federal courts had the right to hear the challenge to Colorado's law, a question that was finally resolved by the United States Supreme Court. As the South Dakota Supreme Court opinion describes the matter:

> In 2015, the Supreme Court reviewed a Colorado law that instead of imposing the obligation to collect and remit use tax on sellers with no physical presence in that state, imposed the obligation "to notify . . . customers of their use-tax liability and to report" sales information back to the state. *Direct Marketing*, __ U.S. at __, 135 S. Ct. at 1127. The issue before the Supreme Court was whether the United States District Court had jurisdiction under the Tax Injunction Act (28 U.S.C. § 1341) over a suit challenging the new law on Commerce Clause grounds. Justice Kennedy, however, took the opportunity to write a concurrence questioning the advisability of continuing to follow *Bellas Hess* and *Quill* in light of later Commerce Clause jurisprudence and "in view of the dramatic technological and social changes that [have] taken place in our increasingly interconnected economy." *Id.* at __, 135 S. Ct. at 1135 (Kennedy, J., concurring). Despite noting the "startling revenue shortfall in many States" due to Bellas Hess and Quill, Justice Kennedy observed that Direct Marketing did not raise reconsideration of those decisions "in a manner appropriate for the Court to address it." *Id.* Nevertheless, he concluded that *Direct Marketing* provided "the means to note the importance of reconsidering doubtful authority." Id. He invited "[t]he legal system [to] find an appropriate case for [the Supreme] Court to reexamine *Quill* and *Bellas Hess*." *Id.*

The State Supreme Court, in deciding for the out of state sellers, found that the requirements imposed violated the physical presence test of *Quill*. Consider the law was designed to challenge *Quill*, the finding that there was no inherent reason why internet sellers should be treated differently than the mail order seller that was the subject of the *Quill* case is likely one that South Dakota is happy with.

The South Dakota Supreme Court concluded simply that the question of whether *Quill* should be overturned is one that only the U.S. Supreme Court could answer affirmatively. As the opinion states:

> However persuasive the State's arguments on the merits of revisiting the issue, Quill has not been overruled. Quill remains the controlling precedent on the issue of Commerce Clause limitations on interstate collection of sales and use taxes. We are mindful of the Supreme Court's directive to follow its precedent when it "has direct

> application in a case" and to leave to that Court "the prerogative of overruling its own decisions." *Rodriguez de Quijas v. Shearson/American Exp., Inc.,* 490 U.S. 477, 484, 109 S. Ct. 1917, 1921-22, 104 L. Ed. 2d 526 (1989). Therefore, we affirm.

On October 2, 2017 the state of South Dakota formally filed its request for the United States Supreme Court to hear the appeal of this case, claiming in the petition that "Quill clearly needs to go." The next step after that filing is to wait to see if the Supreme Court decides to hear this case or rather denies the request to hear this case.

Section: GAAP
SEC Issues Interpretative Bulletin on Applying ASC 740 in Light of TCJA, FASB Issues Additional Guidance

Citation: Staff Accounting Bulletin No. 118, 12/26/17

It's not often we talk about financial reporting issues in this venue, but the enactment of the *Tax Cuts and Jobs Act* creates issues for financial reporting involving accounting for income taxes under Accounting Standards Codification (ASC) 740. Under ASC 740-10-35-4 an entity must take into account the impact of a change in tax law on the entity's deferred tax liabilities, assets and valuation allowances. ASC 740-10-55-62 makes clear this takes place in the period that includes the date of enactment of the revised law.

The *Tax Cuts and Jobs Act* (TCJA) was signed into law on December 22, 2017, which makes that the date of enactment of the law. Given the complex changes that are part of this law, it may not be possible to complete an evaluation of the impact of this law on an entity's deferred tax liabilities, assets and valuation allowances in time for reporting activity for the period ended December 31, 2017.

In recognition of this issue, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 118. The bulletin allows registrants to make a reasonable estimate of the effects of TCJA and report that as a provisional amount during the "measurement period."

The measurement period is defined as:

> *The measurement period begins in the reporting period that includes the Act's enactment date and ends when an entity has obtained, prepared, and analyzed the information that was needed in order to complete the accounting requirements under ASC Topic 740. During the measurement period, the staff expects that entities will be acting in good faith to complete the accounting under ASC Topic 740. The staff believes that in no circumstances should the measurement period extend beyond one year from the enactment date.*

If it is not possible for an entity to make a reasonable estimate of the effects at the time a statement is issued, the bulletin provides the following guidance:

> *An entity may not have the necessary information available, prepared, or analyzed (including computations) for certain income tax effects of the Act in order to determine a reasonable estimate to be included as provisional amounts. The staff would expect no related provisional amounts would be included in an entity's financial statements for those specific income tax effects for which a reasonable estimate cannot be determined. In circumstances in which provisional amounts cannot be prepared, the staff believes an entity should continue to apply ASC Topic 740 (e.g., when recognizing and measuring current and deferred taxes) based on the provisions of the tax laws that were in effect immediately prior*

> *to the Act being enacted. That is, the staff does not believe an entity should adjust its current or deferred taxes for those tax effects of the Act until a reasonable estimate can be determined.*

Reporting for the provisional amounts and subsequent adjustments to those amounts are to be handled as follows:

> *Any provisional amounts or adjustments to provisional amounts included in an entity's financial statements during the measurement period should be included in income from continuing operations as an adjustment to tax expense or benefit in the reporting period the amounts are determined.*

The bulletin also provides disclosures that should be made while the determination of proper accounting for TCJA under ASC 740 is incomplete. Those disclosures are:

- Qualitative disclosures of the income tax effects of the Act for which the accounting is incomplete;
- Disclosures of items reported as provisional amounts;
- Disclosures of existing current or deferred tax amounts for which the income tax effects of the Act have not been completed;
- The reason why the initial accounting is incomplete;
- The additional information that is needed to be obtained, prepared, or analyzed in order to complete the accounting requirements under ASC Topic 740;
- The nature and amount of any measurement period adjustments recognized during the reporting period;
- The effect of measurement period adjustments on the effective tax rate; and
- When the accounting for the income tax effects of the Act has been completed. [Staff Bulletin 118, Question 2]

The Financial Accounting Standards Board met on January 10, 2018 to discuss other implications of TCJA on reporting and measurement for deferred taxes under ASC 740. Ken Tysiac of the *Journal of Accountancy* posted a report of that meeting on the *Journal's* website ("FASB Addresses Financial Reporting Impacts of New Tax Law", January 10, 2018[1]).

The board addressed five implementation issues and decided to issue a proposal to address another issue. The *Journal of Accountancy* reported that FASB will formally communicate the implementation issues via a set of FAQs on its website.

The Board first decided to allow private companies and not-for profits to apply SEC Staff Accounting Bulletin No. 118 to their financial statements. The board will permit this despite the that SEC bulletins are generally no applicable to private companies or not-for-profit organizations.

The FASB has published a Staff Q&A, *Whether Private Companies and Not-For-Profit Entities Can Apply SAB 118*, that gives the full position of the staff. The document does require private and

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[1] https://www.journalofaccountancy.com/news/2018/jan/fasb-addresses-tax-reform-implications-201818180.html

not-for-profit entities electing to apply SAB 118 to give all disclosures required in that bulletin, noting:

> *The FASB staff believes, however, that if a private company or a not-for-profit entity applies SAB 118, it should apply all relevant aspects of the SAB in its entirety. This would include the disclosures listed in SAB 118. The FASB staff also believes that a private company or a not-for-profit entity that applies SAB 118 should disclose its accounting policy of applying SAB 118 in accordance with paragraphs 235-10-50-1 through 50-3 of the Accounting Standards Codification.*[2]

The board decided that any tax to be due over up to eight years for deemed repatriation should not be discounted, nor should there be discounting of any minimum tax credit refund that a corporation will receive over several years.

The board ruled that, even though a lower base-erosion and anti-abuse tax (BEAT) might eventually apply to an entity's income, deferred tax assets and liabilities should be measured at the regular tax rate and not at the potentially lower BEAT rate.

TCJA also imposed a special tax on global intangible low-taxed income (GILTI) in IRC §250. The tax is imposed on foreign income in excess of a deemed rate of return on intangible assets of the foreign corporation.

A question arose about whether deferred tax assets and liabilities should be recognized for basis differences that will eventually reverse related to GILTI income, or if the effects of GILTI should be recognized only the period the tax is imposed.

In this case, FASB decided to allow entities to select either method of accounting for this item.

Finally, FASB is going to issue an exposure draft with a 15-day comment period to address "stranded tax effects" that exist in accumulated other comprehensive income. The American Bankers Association, among others, had raised concerns about the current treatment, which would cause the changes to flow through net income, would have impacts on both income and regulatory capital.

As was noted in a January 4, 2018 article posted on the ABA Banking Journal website:

> *In the letter, ABA pointed out that, under current tax accounting, the reduction of deferred tax assets and liabilities are recorded entirely within net income, including those applying to items in accumulated other comprehensive income such as unrealized gains and losses on available for sale securities. As a result, not only are net income and regulatory capital distorted, but this treatment also creates onerous operational burdens to track the related amounts in the future. Since ABA first expressed its concerns to FASB, other trade groups representing insurers have expressed support for the association's letter.*[3]

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[2] http://fasb.org/cs/ContentServer?c=FASBContent_C&cid=1176169777449&d=&pagename=FASB%2FFASBContent_C%2FGeneralContentDisplay, January 12, 2018

[3] "*FASB to Meet on Tax Reform Accounting Issue Raised by ABA,*" ABA Banking Journal Website, https://bankingjournal.aba.com/2018/01/fasb-to-meet-on-tax-reform-accounting-issue-raised-by-aba/, January 4, 2018

FASB is proposing to allow a one-time reclassification from accumulated other comprehensive income to retained earnings solely for the difference between the historical 35% federal rate and the new 21% state rate. Any other changes would continue to be treated under current guidance.

The *Journal of Accountancy* describes the proposed guidance as follows:

> *The guidance would be applied to each period in which the effect of the Tax Cuts and Jobs Act (or portion thereof) is recorded, which may be retrospectively to the December 2017 enactment date in some cases. If the proposal is approved, entities would disclose the following in the period in which a reclassification adjustment is made:*
>
> - *The nature and reason for the change.*
> - *A description of the prior-period information that has been retrospectively adjusted.*
> - *The effect of the change on affected financial statement line items.*[4]

As this exists now as only a proposed standard, it is subject to change based on the comments and must be finally adopted by the Board before it may be used.

Section: Various
List of Expired and Expiring Federal Tax Provisions from 2016-2027 Released by Joint Committee on Taxation

Citation: List of Expiring Federal Tax Provisions 2016-2027, JCX-1-18, Joint Committee on Taxation, 1/9/18

The Joint Committee on Taxation has issued its annual report on expiring tax provisions (*List of Expiring Federal Tax Provisions 2017-2027, JCX-1-18*).

This document provides a detailed list by year of expiring and expired provisions. The list of most immediate interest contains the provisions that expired in 2016. Such now expired provisions include, among others:

- Credits for certain nonbusiness energy property (IRC §25C(g)) and residential energy property (IRC §25D(g))
- Indian employment credit (IRC §45A(f))
- Exclusion for discharge of indebtedness on principal residence for individuals (IRC §108(a)(1)(E)
- Premiums for mortgage insurance deductible as mortgage interest (IRC §163(h)(3))
- Domestic production deduction for activities in Puerto Rico (IRC §199(d)(8)
- Medical expense deduction AGI limit remaining at 7.5% for individuals over 65 (IRC §213(f))
- Deduction for qualified tuition and related expenses (IRC §222(e))

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[4] Ken Tysiac, *"FASB Addresses Financial Reporting Impacts of New Tax Law"*, *Journal of Accountancy* website, https://www.journalofaccountancy.com/news/2018/jan/fasb-addresses-tax-reform-implications-201818180.html, January 10, 2018

A bill introduced in late December 2016 by Senator Hatch to deal with extending some of these provisions but to date the bill has not been passed by either chamber of Congress.

Another long list of expiring provisions are the various provisions that were adopted as part of PL 115-97, the law generally known as the Tax Cuts and Jobs Act, although some of these "expirations" are actually ending the disallowance of various deductions.

A full list of expired provisions can be found in the Joint Committee's report.

Section: 461
Current Deduction Allowed Where Fuel Rewards Program Entitled Customer to an Amount of Fuel at No Additional Cust

Citation: FAA 20180101F, 1/6/17

The IRS again looked at fuel rewards in Field Attorney Advice FAA 20180101F. The topic had come up before with a slightly different program that ended up in the court (*Giant Eagle Inc. v. Commissioner*, Case No. 14-3961, CA3, reversing TC Memo 2014-146, 5/6/16) with the IRS losing and formally issuing a non-acquiescence on the decision (AOD 2016-03, 10/2/16).

But in this case the IRS decided that, unlike their view with regard to *Giant Eagle*, that this particular fuel rewards program did allow the taxpayer to claim a current deduction for issued but not yet redeemed rewards at the end of the taxpayer's tax year.

In Giant Eagle the taxpayer qualified for a discount on future fuel purchased, but only if the taxpayer purchased additional fuel by a particular date. However, in this case the program was rather different and the IRS determined a different regulation applied.

The program in question worked as follows per the FAA:

> *Taxpayer is a * * * located in X. The company consists of A grocery stores operating under the name Y. The company offers a fuel reward program to its customers. Under the fuel reward program, the customer signs up for a free Y fuel reward card at an Y grocery store. Each week, Y will have up to B products throughout the store with fuel money linked to them. Fuel rewards will range anywhere from C to D in fuel. The reward amount will depend on the actual item purchased. The money earned (fuel reward) is electronically loaded to an enrolled customer's fuel card and can be redeemed for gas at any participating Q, an unrelated company. Unlike at some grocery stores, the customers do not earn money off a gallon of gas. Rather, Y customers are entitled to free fuel up to the amount of money loaded on the card. Basically, a customer inserts the fuel card just like any credit card, and the pump goes off when the total amount of money loaded on the card is reached, or sooner if the customer stops pumping gas. If the customer desires to purchase more gas than the amount loaded on the fuel reward card, the process of purchasing gas starts over, i.e., either cash or a credit card. Q will honor the fuel card without condition.*

The taxpayer recognized the fuel rewards as an expense when they were issued for both book and tax purposes.

Reg. §1.451-4(a)(1) provides a special "trading stamps" rule for accruing expenses.[5] The relevant portion reads:

> *(a)In general -*
>
> *(1)Subtraction from receipts.*
>
> *If an accrual method taxpayer issues trading stamps or premium coupons with sales, or an accrual method taxpayer is engaged in the business of selling trading stamps or premium coupons, and such stamps or coupons are redeemable by such taxpayer in merchandise, cash, or other property, the taxpayer should, in computing the income from such sales, subtract from gross receipts with respect to sales of such stamps or coupons (or from gross receipts with respect to sales with which trading stamps or coupons are issued) an amount equal to -*
>
> > *(i) The cost to the taxpayer of merchandise, cash, and other property used for redemptions in the taxable year,*
> >
> > *(ii) Plus the net addition to the provision for future redemptions during the taxable year (or less the net subtraction from the provision for future redemptions during the taxable year).*

This regulation does not apply to discount coupons where a taxpayer gets a discount on the purchase of future merchandise—rather it must be able to directly obtain the merchandise without an additional purchase. (Rev. Rul. 78-212) Unlike the program in *Giant Eagle*, which offered fuel at a discount, this program simply allowed the customer to obtain fuel up to the amount the taxpayer had loaded on the customer's fuel reward card.

The FAA notes:

> *In the subject case, the customers earned fuel rewards that were redeemable for gas. The money earned is electronically loaded to an enrolled customer's fuel card and can be redeemed for gas at any participating Q. The customer inserts the fuel card just like any credit card, and the pump goes off when the total amount of money loaded on the card is reached, or sooner if the customer stops pumping gas. We do not find this to be a discount. Rather, we believe that the rewards are redeemable for other property: specifically, gas purchased by Y from Q.*

The FAA concludes allowing the deduction is consistent with the purpose of Reg. §1.451-4. The document notes:

> *Moreover, in line with both Rev. Rul. 78-212 and the Tax Court in Giant Eagle, applying § 1.451-4 in this case would be consistent with the section's purpose to match sales revenues with expenses incurred to generate those revenues. Here, clearly, Taxpayer initiated the reward program to increase sales of its products; not to increase gas sales at Q, a third-party. Notable, this case is distinguishable from Giant Eagle where the Tax Court disallowed the current deduction with respect to discounts conditioned on an additional purchase of gas from the taxpayer.*

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[5] For those too young to remember them, some stores used to give "trading stamps" (S & H Green Stamps were the most well-known) a customer would collect, filling up books or cards. Once enough stamps were collected, the customer could go to a third-party store where the stamp books could be exchanged for merchandise.

Note that the author of this FAA (Mark Shapiro, Senior Attorney (Cleveland), LB&I Division) is the attorney who authored the ruling issued recently that found an educational institution did not, in his view, qualify for a current deduction for discounts given to students who had to attend two weeks in the following semester (FAA 20174901F).

Section: 3401
IRS Issues Early Withholding Tables to Take Into Account TCJA Changes

Citation: Notice 1036, Early Release Copies of the 2018 Percentage Method Tables for Income Tax Withholding, 1/11/18

The IRS has issued Notice 1036, *Early Release Copies of the 2018 Percentage Method Tables for Income Tax Withholding*. These new tables take into account the changes made in P.L.115-97, better known as the Tax Cuts and Jobs Act (TCJA), which reduced individual income tax rates and made other changes.

As the IRS had indicated, the new tables continue to use withholding allowances in the computation of tax to be withheld, something often referred to as "exemptions" or "dependents" by many employees. The amount has not actually just related to exemptions for years, so the fact that TCJA removed personal exemptions doesn't mean that these allowances can no longer be used.

The publication contains 8 sets of tables based on the term of the payroll period, with each setting having both a "Single" and a "Married" component.

The guide also notes a change in rates for withholding on supplemental wages. The general rate drops to 22% from its previous 25%, and the rate for supplemental wages in excess of $1 million for the year is decreased from 39.6% to 37% (the new top individual tax rate).

The IRS suggests that employers use these tables as soon as possible, but in any event no later than February 15.