LOUISIANA STATE TAX DEVELOPMENTS

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I. INCOME/FRANCHISE TAXES

A. Legislative Developments

1. The **2007 Regular Session** of the Louisiana Legislature was a fiscal session, which means that there were tax-related bills aplenty. Many of the tax bills enacted during the 2007 Regular Session relate to various tax incentive provisions and continuing hurricane relief legislation. Selected legislation from the **2006 Regular Session**, the **2006 2nd Extraordinary Session**, and the **2007 Regular Session** are discussed below and in other sections of this outline.

2. **Act No. 153 (HB 203) of the 2006 Regular Session** enacts La. R.S. 12:1601-1606 to authorize any domestic limited liability company, business corporation, partnership in commendam, or partnership to convert to another type of domestic business entity by submitting a conversion application to the Louisiana Secretary of State. The Act also provides that if the tax classification is different for the converting and converted entities, tax liabilities for the converting entity will be calculated based on the method prescribed by current law for the converting entity's tax classification and will be a liability of the converted entity. Finally, the Act provides that short-period tax returns must be filed for the converting entity if the converted entity's tax classification is different from the converting entity's tax classification. This provision became effective on June 2, 2006.

3. **Act No. 170 (HB 352) of the 2006 Regular Session** amends La. R.S. 12:142.1(A) to provide for the dissolution of a corporation by filing an affidavit with the Louisiana Secretary of State if the corporation is not doing business, owes no debts, and owns no immovable property. This Act became effective on August 15, 2006.

[1] The author gratefully acknowledges the contributions provided by the following members of the Jones Walker State and Local Tax team: Louis S. Nunes III (Partner, New Orleans), Brandon A. Lagarde (Associate, Baton Rouge), Jonathan R. Katz (Associate, New Orleans) and Kathryn S. Friel (Associate, New Orleans).

4. **<u>Act No. 4 (HB 120) of the 2006 2nd Extraordinary Session</u>** enacts La. R.S. 47:6025, which authorizes a refundable credit against individual income, corporate income and fiduciary income taxes for the full amount of any surcharges, market equalization charges or assessments paid by a taxpayer during a taxable year as a result of the 2005 regular assessment or the emergency assessments levied by the Louisiana Citizens Property Insurance Corporation due to Hurricanes Katrina and Rita. For calendar year taxpayers, such assessments paid in 2006 will be a credit against 2006 income taxes. Such assessments paid after December 31, 2006, will be claimed on the income tax return filed for the year in which the payment was made.

5. **<u>Act No. 182 (HB 141) of the 2007 Regular Session</u>** amends Section 3 of Act No. 60 of the 2002 Regular Session, as amended by Act No. 12 of the 2004 1st Extraordinary Session, to extend the income and corporation franchise tax credits provided by La. R.S. 47:6019 for costs associated with rehabilitation of certain historic structures for all taxable periods ending prior to January 1, 2012. This Act became effective on August 15, 2007.

6. **<u>Act No. 247 (SB 32) of the 2007 Regular Session</u>** amends La. R.S. 47:293(10)[2] and enacts La. R.S. 47:287:738(G), 293(5)[3] and (9)(a)(i)[4] to provide an income tax deduction for Louisiana corporations and individuals for any funds received from a hurricane recovery entity if the income was required to be included on their federal income tax return. This Act became effective on July 6, 2007.

7. **<u>Act No. 271 (SB 250) of the 2007 Regular Session</u>** amends La. R.S. 51: 1787(A)(3) to authorize a business to receive a $2,500 enterprise zone credit if 35% of its employees are residents of any enterprise zone, not just an enterprise zone in the same parish as the business or an enterprise zone in a contiguous parish as that of the business. The provisions of this Act are effective for incentive contracts entered into on or after July 1, 2007.

8. **<u>Act No. 279 (SB 352) of the 2007 Regular Session</u>** amends La. R.S. 51: 1787(A)(3) to require that employees eligible for the Enterprise Zone job credits must be U.S. citizens and domiciled in Louisiana or establish domicile in Louisiana within 60 days of their employment. This Act became effective on July 6, 2007.

9. **<u>Act 298 No. (HB 359) of the 2007 Regular Session</u>** amends La. R.S. 47:297.6(A)(1) and (5), 6019(A)(1)(a) and (B)(1) to expand the tax credit

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for corporation income and franchise taxes to include eligible costs and expenses incurred during rehabilitation of an owner-occupied residential structure, owner-occupied mixed use structure, or an historic structure located in a cultural products district, and to increase the maximum amount of tax credits allowed to be granted in any calendar year from $1 million to $10 million. The provisions of this Act are effective for taxable years beginning January 1, 2008.

10. **Act No. 357 (HB 929) of the 2007 Regular Session** enacts La. R.S. 47:6028[5] to provide for a refundable income and corporation franchise tax credit for overpayments related to the inventory tax credit. To be eligible for the credit, a taxpayer must have gross receipts of $500,000 or less. The credit not previously claimed for 1999 through 2002 for income taxes and for 2000 through 2003 for corporation franchise taxes may be claimed on amended returns until December 31,2007. This Act became effective on August 15, 2007.

11. **Act No. 368 (SB 70) of the 2007 Regular Session** amends La. R.S. 47:6023 to extend the sound recording investor tax credit to January 1, 2010. The credit may be claimed against any state income tax and became effective on July 10, 2007.

12. **Act No. 371 (SB 90) of the 2007 Regular Session** creates two new tax credits.

    a. First, the Act enacts La. R.S. 47:6030[6] to create a refundable tax credit against individual and corporation income taxes for the cost of the purchase and installation of a wind energy system or solar energy system, or both, by a resident individual at their residence located in Louisiana or by the owner of a residential rental apartment project. The credit may be claimed if a resident individual purchases a new home with a system installed, a system is purchased and installed at an existing home, or a system is installed at a new or existing apartment project, and will be equal to 50% of the first $25,000 of the purchase and installation cost of wind or solar energy systems purchased and installed on or after January 1, 2008. The credit may be used in addition to any federal tax credits earned for the same system, except that a taxpayer may not receive any other state tax credit, exemption, exclusion, deduction, or any other tax benefit for property for which a tax credit has been received under this provision. *See* **Revenue Information Bulletin No. 07-025 (Sept. 13, 2007)** for a discussion of this new credit provision.

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b. The Act also enacts La. R.S. 47:297.7(A) to create a nonrefundable credit against individual income tax for tax year 2008 for 7% of the premiums paid by individuals on their primary residence for homeowners' insurance, condominium owners' insurance, or tenant homeowners' insurance. The Act provides that any Citizens property insurance assessment must be subtracted from the total premium paid before applying the 7% credit rate. **Act No. 447 of the 2007 Regular Session** also creates a nonrefundable credit against individual income tax equal to 7% of the premiums paid by individuals on their primary residence for homeowners' insurance, condominium owners' insurance, or tenant homeowners' insurance. There is a conflict between the two Acts because Act No. 371 limits the credit to tax year 2008, but Act No. 447 does not.

13. **Act No. 374 (SB 124) of the 2007 Regular Session** enacts La. R.S. 33: 130.731 et seq., the Louisiana Community Economic Development Act, and La. R.S. 47:6031[7], which authorizes a tax credit against corporation income and franchise taxes for 25% of the money donated, contributed or represented by a sale below cost by the taxpayer to a certified community development corporation or a certified community development financial institution. The credit must be approved by the Department of Economic Development and is limited to $500,000 per year per individual or $1 million per year per business and $1 million total per individual and $2 million total per business. The credit may be carried forward for five years. This Act is effective from July 10, 2007, to August 15, 2010.

14. **Act No. 379 (SB 188) of the 2007 Regular Session** amends La. RS. 47:6016 relative to the Louisiana New Markets Tax Credit to include the following: a $50 million cap on the entire credit; an increase in the applicable percentage, which allows for more of the credit to be taken up front; a reduction in the number of credit allowance dates; and a $15 million cap on the amount that can be issued by a single business. The Louisiana New Markets Tax Credit was designed to piggyback the Federal New Markets Tax credit, which encourages investors to invest in poor or under-developed regions of the country. If an allocation is received from the federal government, an investor also is entitled to claim the state new markets tax credits if funds were invested in a Louisiana low-income business. This Act became effective on July 1, 2007.

15. **Act No. 382 (SB 211) of the 2007 Regular Session** amends La. R.S. 47:6025(A)(3) to allow individual and corporate taxpayers to claim the Louisiana Citizens Property Insurance Corporation assessment after payment is made on a form provided by the Secretary of the Department. This Act is effective for assessments paid on or after January 1, 2007.

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16. **<u>Act No. 387 (SB 285) of the 2007 Regular Session</u>** amends the Louisiana Quality Jobs Program, La. R.S. 51:2453-2462, to change the requirements for an employer to qualify for a rebate under the program. The provisions of the Act apply to contracts entered into with the Department of Economic Development on or after June 30, 2007. No new contracts may be approved by the Department of Economic Development on or after January 1, 2012.

17. **<u>Act No. 392 (SB 339) of the 2007 Regular Session</u>** amends La. R.S. 47:6021 to allow for a credit for 15% of the total investment made in a voluntary remedial investigation and a credit for 50% of the total investment made in a voluntary remediation action at a state-certified site. The Act also makes the brownfields tax credit transferable and provides that no credit will be allowed for any expenditures for which a taxpayer receives a credit, rebate, or other tax incentive granted by the state under any other provision of law. These new provisions are effective for all taxable periods beginning on or after January 1, 2008.

18. **<u>Act No. 400 (HB 372) of the 2007 Regular Session</u>** amends La. R.S. 51:1787(A), (B), (I), and (J), La. R.S. 47:2456(B), and La. R.S. 47:2461(B) and repeals La. R.S. 51:1787(C), (D), and (H), all relative to the Enterprise Zone and Louisiana Quality Jobs Programs. The new provisions allow the taxpayer an option between the sales and use tax rebate and a refundable investment income tax credit equal to 1.5% of qualified expenditures. Qualified expenditures are defined as amounts classified as capital expenditures for federal income tax purposes plus exclusions from capitalization provided for in Internal Revenue Code Section 263(a)(1)(A) through (L), minus the capitalized cost of land, capitalized leases of land, capitalized interest, capitalized costs of manufacturing machinery and equipment to the extent the capitalized manufacturing machinery and equipment costs are excluded from sales and use tax pursuant to La. R.S. 47:301(3), and the capitalized cost for the purchase of an existing building. This Act became effective on July 10, 2007.

19. **<u>Act No. 401 (HB 408) of the 2007 Regular Session</u>** enacts La. R.S. 5l:2351-2356 to create the Technology and Commercialization Credit and Jobs Program to deter university professors from taking their research and leaving the state. Individuals and businesses that invest in the commercialization in Louisiana technology in Louisiana and/or create new direct jobs earn a refundable tax credit against their Louisiana corporation income and franchise taxes. The credits are earned and granted for a period of not less than five tax years. At least five new direct jobs paying at least $50,000 a year must be created. This credit is administered by the Department of Economic Development and became effective on July 10, 2007.

20. **Act No. 445 (HB 640) of the 2007 Regular Session** amends La. R.S. 47:6020. 1(A) and La. R.S. 6020.2(A)(1) relative the to Angel Investor Tax Credit Program to make the credit refundable. The credit may be claimed against any income or corporation franchise tax liability. This Act became effective on August 15, 2007.

21. **Act No. 472 (SB 332) of the 2007 Regular Session** enacts La. R.S. 47:6033[8] to provide that employers be allowed a nonrefundable apprenticeship tax credit against individual or corporation income and franchise taxes equal to one dollar for each hour of employment of each eligible apprentice, not to exceed 1,000 hours for each eligible apprentice. An eligible apprentice means a person who has entered into a written apprentice agreement with an employer or an association of employers pursuant to a registered apprenticeship program or a person who is enrolled in a training program accredited by the National Center for Construction Education and Research that has no less than four levels of training and no less than 500 hours of instruction. Any unused credit may be carried forward for ten years. The provisions of this Act became effective on July 11, 2007.

22. **Act No. 482 (SB 218) of the 2007 Regular Session** enacts La. R.S. 47:6034[9] to create a musical and theatrical production income tax credit, which grants a refundable income tax credit to musical or theatrical productions or musical or theatrical facility infrastructure projects. State-certified infrastructure projects are capped at $60 million per year with half of that amount reserved for projects in areas other than Jefferson and Orleans Parishes. The infrastructure credit expires January 1, 2014. The credits are available for expenditures for production, infrastructure, and transportation expenses, employment of Louisiana students, and employment of Louisiana residents made on or after July 19, 2007. This credit is not allowed if the Motion Picture Investment credit (La. R.S. 47:6007) or the Sound Recording credit (La. R.S. 47:6023) has been granted.

B. Judicial Developments

1. Oral reasons for judgment were rendered on January 19, 2007, in *Bridges v. Geoffrey, Inc*., No. 502,769 (19th J.D.C. filed 01/30/07). In this case, which is on appeal to the Louisiana First Circuit Court of Appeal, the trial judge held that Geoffrey, Inc. ("Geoffrey"), a Delaware Corporation, was subject to Louisiana corporate income tax on the royalties it earned from its affiliate's use of its trademarks and trade names. Geoffrey, as an intangible holding company for Toys-R-Us and other affiliates, had no

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physical presence within or contacts with Louisiana except those contacts established through its affiliate's use of the intangibles they were leased. Geoffrey argued that the Department's assessment of corporate income tax was in violation of the Commerce Clause of the U.S. Constitution. The court's decision came down to whether the court was going apply the U.S. Supreme Court's holding in *Quill v. North Dakota*, which concerned sales and use taxes, to Louisiana corporate income taxes. This court held that the Supreme Court's decision in *Quill* was limited to sales and use tax. The court proceeded to hold that Geoffrey's intangible property was used within the state in such a way as to become an integral part of a business carried on within Louisiana. As a result, the court held that Geoffrey's intangible property had acquired a business situs within the state that was subject to taxation. Since the court found that Geoffrey's income from the royalties was undoubtedly earned within Louisiana, the court concluded that the state had a constitutional right to tax that income.

2. Following the ruling in the Louisiana *Geoffrey* case and the recent refusal by the United States Supreme Court to review the decision in *Lanco, Inc. v. Director, Division of Taxation*, 908 A.2d 176 (N.J. 2006), *cert. denied*, 2007 WL 811146 (U.S. 6/18/07), the Department made blanket settlement offers in all "intangible holding company cases" that are pending in court. The Department has offered to settle these litigation matters on the following basis: (a) the taxpayer agrees to pay 100% of the amount of tax at issue; (b) the taxpayer agrees to pay interest on the tax at a rate of 12% per annum simple interest instead of the statutory rate of 15% per annum (14% beginning on January 1, 2007); (c) the Department will waive all penalties; and (d) the taxpayer will have to negotiate legal fees with the Department's outside counsel, if the case has been referred to outside counsel. It is expected that the Department also will extend the same offer to settle pending "intangible holding company cases" that are still in the field audit unit or the audit review unit, provided the taxpayer takes steps to "put the case in litigation." The Department apparently believes that a case has to be in the "litigation mode" before the Department can compromise any liability. Also, one outside counsel who is handling a number of these cases has offered to settle his firm's attorney fee claim by accepting attorneys fees of 8% of the amount of tax and interest due instead of the statutory 10% rate. The settlement offers remain in effect until there is either a decision in the Louisiana *Geoffrey* case or in another Louisiana case.

3. Expected Judicial Decisions.

Although *Geoffrey* was the only significant corporation income/franchise tax case that has been rendered in the last 12 months, there are a number of cases that are working their way through the lower courts. Issues involved in pending income/franchise tax cases include:

a. Does the Louisiana Department of Revenue have the power to "force" the use of combined reporting for purposes of computing Louisiana corporation income tax? The Department argues that it has such power pursuant to La. R.S. 47:287.480. Taxpayers feel differently.

b. For Louisiana corporation income/franchise tax purposes, the Department seems to be attempting to allocate or attribute virtually all offshore oil and gas revenues to Louisiana for receipts factor purposes on the theory that the "ultimate destination" of oil and gas produced in the Gulf of Mexico off the coast of Louisiana is in Louisiana. Although the facts vary from case to case, the Department's position appears to be suspect in many respects. These cases are in the very early stages of litigation.

c. Nexus cases continue to work their way through the lower courts. The issues come in a variety of "packages." There are a number of the lingering "*Geoffrey*-type" intangible holding company cases still pending. In addition, there are cases that will address whether a foreign corporation is subject to the Louisiana corporation franchise tax if the foreign corporation's only contact with Louisiana is its "passive" investment either as a member in a limited liability company that conducts business in Louisiana or as a limited partner in a limited partnership that conducts business in Louisiana.

C. Administrative Developments

1. Revenue Rulings

a. **Revenue Ruling 06-018 (Nov. 3, 2006) (Allocation and Apportionment Ratio Treatments Regarding Foreign Trade Zones)**. Property that is imported into the United States and located in Louisiana in a foreign trade zone is treated as located outside of Louisiana for corporate franchise tax purposes. The property is excluded from the numerators of the property revenue ratios for purposes of apportioning a corporation's franchise tax base. This treatment applies only to property imported into the United States.

Property that is located in Louisiana in a foreign trade zone is treated as located outside of Louisiana for corporate income tax purposes also. The property is excluded from the numerator of the property ratio and the numerator of the revenue ratio for purposes of apportioning a corporation's income tax base. Unlike the rule applicable to franchise taxes, however, this rule applies to any

property held in a foreign trade zone, and is not limited solely to property imported into the United States.

b. **<u>Revenue Ruling 06-016 (September 25, 2006) (Frequently Asked Questions Concerning the Motion Picture Investor Tax Credit</u>)**. The purpose of this Revenue Ruling is to provide guidance to persons seeking to earn, claim, or transfer the Motion Picture Investment Tax Credit earned by investment in a "motion picture production company" producing a "state-certified production." The ruling illustrates the use of the Investor Tax Credit by way of an example. In addition, the ruling answers several frequently asked questions regarding the Investment Tax Credit program.

2. Revenue Information Bulletins ("RIB")[10]

a. **<u>RIB No. 07-010 (March 23, 2007) (Implications of the Corporation Income Tax Exemptions for Dividends and Interest</u>)**. La. R.S. 47:287.738(F), enacted in 2005, exempts dividend and interest income from the corporate income tax. That statute also permits a corporation to elect to be taxed on interest income received from a subsidiary in which the corporation owns 50% or more. La. R.S. 47:287.81 disallows a deduction for any amount that is attributable to income that is not subject to the corporate income tax. With dividends and interest that are not subject to the corporate income tax under La. R.S. 47:287.738(F), this means that the expenses incurred by the recipient in the production of the non-taxable dividend and interest income are not deductible. The RIB notes that one item often affected by this disallowance is the interest expense. Therefore, the recipient's interest expense must be attributed to non-taxable interest income using the process described in LAC[11] 61:I.1130(B)(1). The RIB also clarifies that the exemption applies to all tax computed under the corporation income tax provisions; so that dividends and interest received by cooperatives, shipowners' protection and indemnity associations, political organizations, and homeowners associations who are subject to the corporation income tax.

With respect to partnerships that have a corporation as a partner, dividends and interest are exempt to the extent they are exempt for corporation income tax purposes and any expenses that would be

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[10] As used in this outline, a "RIB" is not something you eat with barbeque sauce. Instead, a "RIB" is a Revenue Information Bulletin, which is a policy document issued by the Louisiana Department of Revenue, which will be referred to herein as the "Department."

[11] References to the "LAC" are to the Louisiana Administrative Code.

disallowed for corporation income tax purposes will be disallowed in the partnership return calculation.

b. **RIB No. 07-006 (Feb. 9, 2007) (Corporations and Exempt Organizations Claiming the Credit for the Louisiana Citizens Property Insurance Corporation Assessments Paid in 2006)**. This RIB provides information regarding the refundable income tax credit for the Louisiana Citizens Property Insurance Corporation regular assessments, emergency assessments, insurance companies' regular assessment recoupment surcharge and market equalization charges that were a result of Hurricanes Katrina and Rita. The RIB describes the documents are needed to determine the amount of the refund, the documents that must be attached to the income tax return, and the forms that should be used to claim the credit. **Note:** For tax years beginning with 2007, RIB No. 07-006 is superseded by RIB 07-015, which incorporates changes to the Citizens credit made by **Act No. 382 of the 2007 Regular Session**, which is discussed above.

c. **RIB No. 06-036 (December 13, 2006) (Documentation Required for Ad Valorem Tax Payment Credits on Inventory)**. La. R.S. 47:6006 provides a credit against the Louisiana income and franchise taxes for local property taxes paid on inventory held by manufacturers, distributors, and retailers. This RIB explains how taxpayers should claim the credit and the documents that should be attached to the taxpayer's return to support the credit.

d. **RIB No. 06-034 (Oct. 16, 2006) (Computing the Federal Income Tax Deduction on 2005 Tax Returns)**. This RIB explains how a taxpayer whose income is not entirely attributed to Louisiana should treat the Disaster Relief Credits claimed on a 2005 federal income tax return for purposes of computing the Louisiana federal income tax deduction.

3. Private Letter Rulings ("PLR")

a. **PLR 07-001 (February 5, 2007) (Motion Picture Investor Tax Credit as Currently Amended)**. This PLR addresses the manner in which Louisiana Motion Picture Investor Tax Credits are allocated and claimed by investors in Louisiana state-certified motion picture productions. The ruling addresses how the credits are earned and by whom; how credits may be allocated among member of partnership LLC's; and how credits are claimed on an income tax return.

4. Adopted Rules

a. **<u>Adopted Rule LAC 61:I.1122 (March 1, 2007) (Taxes Not Deductible</u>)**. This Rule provides that federal alternative minimum tax attributable to tax preference items, such as, but not limited to, accelerated depreciation, depletion, and intangible drilling and development cost is not deductible for purposes of computing Louisiana corporate income tax liability. However, federal alternative minimum taxable net income from sources other than tax preference items is deductible to the extent that it is applicable to regular federal taxable income.

The Rule also provides that Federal income tax deducted from Louisiana net income in taxable periods to which a NOL is carried back must be computed to determine the amount of federal income tax attributable to net income that is taxed by the federal government but that is not taxed by Louisiana as a result of a NOL carry back. Federal income tax attributable to net income which is not taxed by Louisiana as a result of a NOL carry back is the excess of allowable federal income tax deducted from Louisiana net income before the NOL carry back over the allowable deduction after the NOL carry back. The federal income tax attributable to net income which is not taxed by Louisiana must be treated as a reduction to the NOL deduction. If the amount of the federal income tax attributable to the net income that is not taxed by Louisiana exceeds the Louisiana NOL deduction, such excess must be treated as income in the year of the transaction that gave rise to the excess.

b. **<u>Adopted Rule LAC 61:I.601 (October 20, 2006) (Presidential Disaster Relief Credits</u>)**. This Rule updates LAC 61:I.601 (April 20, 2006) to declare that the federal low-income housing tax credit and the federal new markets tax credit are disaster relief credits and to provide guidance regarding their applicability.

5. Notices of Intent to Adopt Rules

a. **<u>Proposed Rule LAC 61:I.1115 (April 02, 2007) (Withholding Tax at the Source)</u>.** ***NOTE: THIS PROPOSED RULE WAS WITHDRAWN BY THE DEPARTMENT APRIL 24, 2007***. This proposed rule was very controversial. It would have required any withholding agent to withhold and deposit income tax on the payment of an amount subject to withholding. Amounts subject to withholding included: (i) payments of non-employee compensation (i.e., any amount reported on IRS form 1099-Misc) to residents or non-resident persons and corporations; (ii) rents paid to a non-resident from movable or immovable property located in the state;

(iii) natural resource royalties paid to non-resident persons; and (iv) payments or royalties paid to non-resident persons for the right to use intellectual properties, intangibles or trademarks in the state.

This proposed rule would have imposed additional, administrative burdens on corporations and other entities doing business in Louisiana. After receiving a deluge of negative comments, the Department withdrew the proposed rule on April 24, 2007.

Taxpayers, however, should continue to monitor this issue for future developments from the Department. For example, Professor Susan Kalinka, apparently with the assistance from Mike Pearson, a Senior Tax Policy Analyst in the Tax Policy Services Division of the Department, along with others at the Department, has suggested that the Department should resubmit the proposed regulation with certain changes. *See* Kalinka, "Louisiana's Proposed Withholding Reg Should Have Been Adopted," 2007 *State Tax Notes* 162-1 (2007, Tax Analysts).

b. **Proposed Rule LAC 61:I.1140 (March 1, 2007) (Exemption From Tax on Corporations)**. This proposed rule notifies taxpayers of the Department's intent to begin enforcing La. R.S. 47:287.501, which requires tax-exempt organizations to pay income tax on unrelated business taxable income that is not exempt from the federal income tax. The Department will begin enforcing this rule for all taxable periods beginning on and after January 1, 2008. An organization claiming a total or partial exemption as an organization described in I.R.C. Section 401(a) or 501 is required to file an income tax return in the same manner as any other corporation. To claim a total exemption, the organization must submit a copy of the Internal Revenue Service ruling establishing its exempt status under I.R.C. Section 401(a) or 501 and include with its return a statement that none of its income was subject to federal income tax. To claim a partial exemption, the organization must submit a copy of the Internal Revenue Service ruling establishing its exempt status with its return, report any income subject to the federal income tax on its Louisiana return, and include with the return a statement that all income not reported on the Louisiana return is exempt from federal income tax under I.R.C. Section 401(a) or 501.

II. TRANSACTIONAL/SALES AND USE TAXES

A. Legislative Developments

1. **Act No. 1 (HB 633) of t[he 2007 Regular Session** makes two, unrelated changes to the sale tax law.

   a. First, Act 1 enacts La. R.S. 47:301(16)(m) to provide an exclusion from state sales and use taxes for machinery and equipment used by a motor vehicle manufacturer with a North American Industry Classification System (hereinafter, "NAICS") code beginning with 3361. The Act also authorizes political subdivisions, at their option, to provide the exclusion at the local level. As discussed in **RIB No. 07-029 (Sept. 20, 2007)**, the effect of the Act is to immediately make fully effective for motor vehicle manufacturers the state-level sales/use tax exclusion for manufacturing machinery and equipment that is being phased-in over several years for other eligible manufacturers.

   b. Act 1 also provides that tooling used in a compression mold process will be considered manufacturing machinery and equipment for purposes of the exclusion for manufacturing machinery and equipment.

   c. This Act became effective on May 31, 2007.

2. **Act No. 30 (HB 270) of the 2007 Regular Session** amends La. R.S. 51:1286(C)(1) and repeals La. R.S. 51:1286(C)(3), (5) and (6) to remove limitations on the amount of proceeds from the sales and use tax levied by the Louisiana Tourism Promotion District dedicated and pledged to tourism promotion. This Act became effective on July 1, 2007.

3. **Act No. 162 (SB 12) of the 2007 Regular Session** amends La. R.S. 47:301(8)(c) to require the Department to issue sales tax exemption identification numbers for political subdivisions when requested by the political subdivision. This Act became effective August 15, 2007.

4. **Act No. 173 (SB 272) of the 2007 Regular Session** makes several, unrelated changes to state and local sales/use tax statutes.

   a. First, the Act enacts La. R.S. 47:301(14)(g)(iii) to provide a sales/use tax exclusion for labor, materials, services and supplies used for repairing, renovating or converting any drilling rig, and machinery and equipment that are component parts of such rigs, used exclusively for the exploration or development of minerals outside the territorial limits of Louisiana in the Outer Continental Shelf waters. The term "drilling rig" is defined as any unit or structure, along with its component parts, that is used primarily for

drilling, workover, intervention or remediation of wells used for exploration or development of minerals. "Component parts" means any machinery or equipment necessary for a drilling rig to perform its exclusive function of exploration or development of minerals. This provision essentially converts an existing exemption from tax that has been in effect since July 11, 2005, to an exclusion from tax that no longer will be subject to any potential suspension of state sales tax exemptions. The Department provides information regarding the new exclusion and the old exemption in **RIB No. 07-026 (Sept. 20, 2007)** and **RIB No. 07-016 (May 22, 2007)**.

b. On the local sales tax level, Act 173 amends La. R.S. 47:301(14)(g)(i)(bb) relative to the sales tax exclusion on repair services rendered in Louisiana when the repaired property is delivered to the customer in another state. For many years, this exclusion has applied at the state level and has been optional at the local level. These provisions are continued in Act 173 with one exception at the local level. The exclusion is mandated for any parish with populations between 21,300 and 21,450 according to the most recent census. The only parish with this population range is East Feliciana Parish, which has been aggressive in asserting its local sales tax on repair services to items of tangible personal property that come from outside Louisiana and are delivered back to the customer outside the parish. This exclusion appears to legislatively override the decision in *WYESCO of Louisiana, L.L.C. v. East Feliciana Parish School Board*, 809 So.2d 401 (La. App. 1st Cir. 2001). *See also* **RIB No. 07-026 (Sept. 20, 2007)**.

c. The third provision of Act 173 is the enactment of La. R.S. 47:337.10(L) to allow parishes with populations between 45,000 and 48,250 to participate in annual sales tax holidays at the same time and in the same manner as the sales tax holiday authorized by Act No. 244 of the 2007 Regular Session, which is discussed below. The only parish that currently falls within these population parameters is St. Charles Parish.

d. The provisions of Act 173 became effective on June 27, 2007.

5. **Act No. 209 (HB 240) of the 2007 Regular Session** amends La. R.S. 47:305.50 to continue the exemption for certain trucks and trailers from state and local sales and use taxes. Language was added to the exemption to provide that the determination of whether a truck is used at least 80% of the time in interstate commerce is based solely on the actual mileage of each truck, and that no truck shall have more than 20% Louisiana intrastate mileage. The Act also authorizes the Secretary of the Department to promulgate rules and regulations to provide for the

administration of audits, audit procedures, and the documents a taxpayer must retain to substantiate the exemption. This Act became effective on June 29, 2007. For a discussion of Act No. 209, see **RIB No. 07-030 (Sept. 20,2007)**, which references **Rev. Rul. 05-004**. These policy documents will be utilized by the Department to determine what constitutes interstate commerce for purposes of the exemption.

6. **Act No. 244 (SB 3) of the 2007 Regular Session** amends La. R.S. 47:305.54 to establish a two-day, state-level sales tax holiday on the first consecutive Friday and Saturday of August each year. The holiday provides an exemption from state sales taxes on the first $2,500 of the purchase price of most individual items of tangible personal property. The exemption will apply statewide to all consumer purchases of tangible personal property, other than vehicles subject to license and title and meals furnished for consumption on the premises where purchased, including to-go orders, provided that the property is not for use in a business, trade, or profession. The Act became effective on July 6, 2007. *See also* **Act No. 173**, discussed above, which provides for a similar sales tax holiday in St. Charles Parish, and **Act No. 429**, discussed below, which provides for a state-level sales tax holiday for purchases of hurricane preparedness supplies.

7. **Act No. 291 (HB 231) of the 2007 Regular Session** amends La. R.S. 47:303(E)(1) and 304(A) and enacts La. R.S. 47:305.56 to provide an exemption from state sales and use taxes for the purchase of off-road vehicles to certain buyers domiciled in another state. To qualify for the exemption, the purchaser must submit proof that it is domiciled in another state and provide a signed affidavit that tax has been paid or will be paid on the off-road vehicle in the state in which it is domiciled within 60 days after the date of purchase or delivery, whichever is later. A valid out-of-state driver's license or state-issued picture identification card will be accepted as proof that the buyer is domiciled in another state. The exemption only applies if the state in which the buyer is domiciled also provides a similar exemption. At the present time, the only neighboring states that provide similar exemptions are Mississippi, Oklahoma and Tennessee. This new law is discussed by the Department in **RIB No. 07-024 (Sept. 17, 2007)**. This Act became effective on October 1, 2007.

8. **Act No. 298 (HB 359) of the 2007 Regular Session** enacts La. R.S. 47:305.57[12] to provide a state and local sales tax exemption for sales of original, one-of-a-kind works of art from an established location within the boundaries of a cultural product district. "Cultural product district" means a district designated by a local governing authority in accordance with law for the purpose of revitalizing a community by creating a hub of cultural activity, including affordable artist housing and workspace.

[12] Renumbered by the Louisiana State Law Institute.

"Works-of-art" mean visual arts and crafts including paintings, photographs, sculptures, pottery and traditional or fine crafts. This Act will become effective for taxable years beginning January 1, 2008.

9. **Act No. 339 (HB 757) of the 2007 Regular Session** makes two changes to the sales tax law.

   a. First, the Act enacts La. R.S. 47:301(3)(i)(ii)(aa)(I)(eee) and (bb)(III) to include certain machinery and equipment used primarily to produce a news publication within the phased-in, state-level sales/use tax exclusion for manufacturing machinery and equipment. To qualify for the exclusion, the newspaper manufacturer may not be required to register with the Louisiana Department of Labor for purposes of unemployment insurance, but would be assigned a NAICS code within the information Sector 51 or the manufacturing Sectors 511–511110.

   b. This Act also enacts La. R.S. 47:301(16)(n)[13] to provide a sales tax exclusion for machinery and equipment purchased by owners of certain radio stations.

   c. The provisions of Act 339 became effective on July 1, 2007.

10. **Act No. 358 (HB 935) of the 2007 Regular Session** amends La. R.S. 47:301(10)(v) and (w), and (16)(d), 321(A), 337.10(H)(1), and 6014(E)(1)(a), enacts La. R.S. 47:301(14)(i) and (29), 301.1, 302(C), and 331(C), and repeals La. R.S. 47:301(14)(i), 302(C), and 331(C), all relative to telecommunications services. The overall goal of these changes is to provide for definitions and rules for sourcing taxable telecommunication and ancillary services. The majority of the definitions provided in this Act are consistent with the Streamlined Sales Tax Project definitions that were approved by the implementing states. Many of the sourcing rules contained in this Act are consistent with the existing statute, but have been updated to reflect current, industry technology and terminology. This Act became effective on August 1, 2007.

11. **Act No. 393 (SB 360) of the 2007 Regular Session** amends La. R.S. 47:306(B)(1)(a) and (11) and La. R.S. 47:337.18(B)(1), enacts La. R.S. 47:306(A)(6) and (7) and La. R.S. 47:337.18(A)(6), and repeals La. R.S. 47:306(B) and (C) and 337.18(B)(2) and (3), all relative to the collection of state and local advance sales taxes from retail dealers. This is a major change that will make life easier for wholesale and retail businesses. The changes are discussed in **RIB No. 07-028 (Sept. 20, 2007)**. Effective January 1, 2008, the minimum annual sales volume required of dealers in order to qualify for an advance sales tax exemption on their purchases of

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[13] Renumbered by the Louisiana State Law Institute.

items of tangible personal property is reduced from $3 million to $500,000. In order to take advantage of the exemption, dealers must not be delinquent in the filing or payment of sales taxes. Effective January 1, 2009, the state and local advance sales tax provisions are repealed in their entirety. In addition, the authority to claim credit on sales tax returns for advance sales taxes paid on purchases of tangible personal property for resale expires on January 1, 2009.

12. **Act No. 419 (HB 916) of the 2007 Regular Session** enacts La. R.S. 47:301(7)(l) to provide for a state and local sales and use tax exclusion for leases or rentals of pallets that are used in packaging products produced by a manufacturer. The Act defines the term "manufacturer" to mean a person whose primary activity is manufacturing and who is assigned by the Louisiana Department of Labor a NAICS code within the manufacturing sectors 31–33 as they existed in 2002. This Act will become effective on July 1, 2008.

13. **Act No. 424 (HB 29) of the 2007 Regular Session** amends La. R.S. 47:302(R) and 321(H) and enacts La. R.S. 47:331(P)(3) to reinstate the exemptions from state sales and use taxes for certain livestock under La. R.S. 47:305(A)(2) and farm irrigation equipment under La. R.S. 47:305.25(A)(3). This Act became effective on July 1, 2007.

14. **Act No. 427 (HB 170) of the 2007 Regular Session** enacts La. R.S. 47:301(16)(o)(i) and (ii)[14] to provide for an exclusion from state sales and use tax for machinery and equipment purchased by certain utilities assigned NAICS codes for Sector 22111, electric power generation. This Act will become effective on July 1, 2008.

15. **Act No. 429 (HB 225) of the 2007 Regular Session** makes two, unrelated changes to state sales tax provisions.

    a. First, the Act enacts La. R.S. 47:305.58[15] to establish an annual sales tax holiday during the last weekend of May each year beginning at 12:01 a.m. on Saturday and ending at 11:59 p.m. on Sunday. The holiday provides an exemption from state sales and use tax on the first $1,500 of the purchase price of certain hurricane-preparedness items or supplies. The new sales tax holiday is discussed by the Department in **RIB No. 07-027 (Sept. 20, 2007)**.

    b. This Act also amends La. R.S. 47:301(3)(i)(ii)(bb)(I) to include certain recyclable material merchant wholesalers within the definition of "manufacturer" and therefore eligible for the phased-

[14] Renumbered by the Louisiana State Law Institute.

[15] Renumbered by the Louisiana State Law Institute.

in, state-level exclusion for manufacturing machinery and equipment.

c. The provisions of Act No. 429 became effective on June 30, 2007.

16. **Act No. 430 (HB 241) of the 2007 Regular Session** enacts two new exclusions/exemptions from state sales taxes.

a. First, the Act amends La. R.S. 47:301(10)(dd) to provide a state sales tax exclusion for purchases of food items for school lunch or breakfast programs by nonpublic elementary or secondary schools that participate in the National School Lunch and School Breakfast Programs or the purchase of food items by nonprofit corporations that serve students and participate in the national program.

b. Act No. 430 also enacts La. R.S. 47:305.59[16] to create a state sales/use tax exemption for the sale of construction materials to Habitat for Humanity affiliates located in Louisiana when the materials are intended for use in constructing new residential dwellings in Louisiana.

c. The provisions of this Act became effective on October 1, 2007.

17. **Act No. 439 (HB 464) of the 2007 Regular Session** amends La. R.S. 47:302(S), 321(I) and 331(Q) to protect the state and local sales tax exemption under La. R.S. 47:305.51 for purchases of utilities used by steelworks, blast furnaces, coke ovens and rolling mills for all taxable periods beginning on or after July 1, 2007. This Act became effective on July 1, 2007. **Act No. 480 (HB 386) of the 2007 Regular Session** also provides for the same exemption for these utilities.

18. **Act No. 457 (HB 944) of the 2007 Regular Session** enacts La. R.S. 47:305.60[17] and La. R.S. 337.9(D)(28) to provide a state and local sales/use tax exemption for certain water conservation equipment for use within the Sparta Groundwater Conservation District from July 1, 2007, through June 30, 2010. Prior to application for an exemption certificate, the applicant must receive certification from the Commissioner of Conservation that the equipment qualifies as water conservation equipment. The exemption is limited to a total of $1 million in state sales taxes. The Department is authorized to promulgate rules and regulations for the implementation of this Act. The exemption became effective on July 1, 2007, and expires on June 30, 2010. **Act No. 471 (SB 331) of the 2007 Regular Session** provides a similar exemption for water conservation equipment for use within the Sparta Groundwater

[16] Renumbered by the Louisiana State Law Institute.

[17] Renumbered by the Louisiana State Law Institute.

Conservation District. However, Act No. 471 does not provide the $1 million cap or an expiration date. Since Act No. 457 was subject to later legislative action than Act No. 471, the provisions of Act No. 457 appear to be controlling.

19. **Act No. 462 (SB 37) of the 2007 Regular Session** enacts La. R.S. 47:301(10)(ee)[18] and (18)(o) to provide an exclusion from state sales/use taxes for storm shutter devices. A storm shutter device is defined as materials and products manufactured, rated and marketed specifically for the purpose of preventing window damage from storms. The Department, in consultation with the Department of Insurance, must promulgate rules and regulations to carry out the provisions of the Act. The Act also enacts La. R.S. 47:337.10(M)[19], which provides that political subdivisions may by ordinance or resolution provide a local sales/use tax exemption for storm shutter devices. This Act became effective on July 1, 2007.

20. **Act No. 463 (SB 55) of the 2007 Regular Session** amends La. R.S. 47:305(D)(1)(k) to specifically include prescription eyeglasses and corrective lenses issued by physicians or optometrists as orthotic devices eligible for the state sales/use tax exemption. Prescription eyeglasses and corrective lenses have been considered exempt as orthotic devices since 1989 when the 19th Judicial District Court rendered its decision in *Secretary of the Department of Revenue and Taxation v. Ivan & Janot R.C. Montagne, dba Montagne Vision Clinic*. This Act became effective on July 1, 2007.

21. **Act No. 464 (SB 65) of the 2007 Regular Session** enacts La. R.S. 47:315.5, which authorizes an exemption in the form of a restricted refund of sales tax collected by a qualified charitable institution on the sale of donated tangible personal property or items made from donated property. The refund must be used exclusively in Louisiana for land acquisition, capital construction, or equipment, or related debt service or job training, job placement, employment, or other related community services and support program costs. The Department is authorized to audit the institutions receiving refunds. This Act will become effective on January 1, 2008.

22. **Act No. 471 (SB 331) of the 2007 Regular Session** amends La. R.S. 47:301(3)(j) and (13)(m) and repeals La. R.S. 47:302(T), 321(J) and 331(R) to provide a permanent sales/use tax exclusion for electric power or energy and natural gas used by paper or wood manufacturing facilities. This Act became effective on July 1, 2007.

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[18] Renumbered by the Louisiana State Law Institute.

[19] Renumbered by the Louisiana State Law Institute.

23. **Act No. 480 (HB 386) of the 2007 Regular Session** enacts La. R.S. 47:301(16)(p)[20] concerning the definition of the term "tangible personal property" to provide a state sales tax exclusion for newspaper sales. Newspaper sales are exempt at the local level as provided in La. R.S. 47:337. Although La. R.S. 47:305.14 exempts newspapers from state sales tax, that state-level exemption currently is suspended such that state sales tax is collected on sales of newspapers. Newspaper sales are exempt at the local level as provided in La. R.S. 47:337.9(C)(10). The new exclusion from state sales tax becomes effective on July 1, 2008.

24. **Other 2007 Regular Session Legislation Affecting Local Sales Taxes**

    a. **Act 245 (SB 26) of the 2007 Regular Session** amends La. R.S. 47:337.10(I) to expand the option of political subdivisions to exclude certain farm business related property from sales/use tax. This Act became effective on July 1, 2007.

    b. **Act 266 (SB 217) of the 2007 Regular Session** enacts La. R.S. 47:9038.59 to create the New Orleans City Park Taxing District as a tax increment financing district in the parish of Orleans. The Act only references local sales tax increments, but the referenced authority, La. R.S. 33:9038.34, also includes state sales tax increments. The New Orleans City Park Taxing District will have all authorities provided for in La. R.S. 33:9038.34 to implement sales tax increment financing. The boundaries of the proposed district will include the area known as "New Orleans City Park." This Act became effective on August 15, 2007.

25. **Act No. 41 (HB 1128) of the 2006 Regular Session** amends La. R.S. 47:301(16)(f) to provide that pharmaceuticals administered to livestock for agricultural purposes and not included in the term tangible personal property shall be registered with the Department of Agriculture and Forestry. Legend drugs administered to livestock for agricultural purposes are not required to be registered, but those drugs that are not registered will be considered tangible personal property. This provision became effective on August 15, 2006.

26. **Act No. 457 (SB 354) of the 2006 Regular Session** amends La. R.S. 306(E) and 337.18(D) to provide that the submission of state and local sales taxes by a licensed vehicle dealer may be extended for a period not to exceed 90 days, by approval form the Secretary of the Department if good cause is shown. Prior law required licensed vehicle dealers that sold a vehicle at retail to remit all taxes collected no later than 40 days from the date of sale. This provision became effective on June 15, 2006.

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[20] Renumbered by the Louisiana State Law Institute.

27. **<u>Act No. 765 (HB 594) of the 2006 Regular Session</u>** retrospectively amends Civil Code Article 466 relative to component parts of immovable property. The term "immovable" is replaced with the term "a building or other construction." The Act also provides that other things are considered to be permanently attached to a building or other construction if they cannot be removed without substantial damage to themselves or to the building or other construction or if, according to prevailing societal expectations, they are considered to be component parts of its component parts. This provision became effective retroactively on June 29, 2005.

28. **<u>Acts Nos. 411 and 608 (HB 1003 and SB 546, respectively) of the 2006 Regular Session</u>** each enacted La. R.S. 47:337.9(F) to exempt purchases of prescription drugs purchased pursuant to a Medicare Part B and D plan from local sales/use tax. These provisions became effective on July 1, 2006.

B. Judicial Developments

1. In *Kansas City Southern Railway Company v. Department of Revenue*, Docket No. 04-2547 (W.D. La. March 30, 2007), the federal district court for the Western District of Louisiana held that the imposition of Louisiana sales and use tax against a rail carrier engaged in the transportation of goods in interstate commerce was discriminatory because motor carriers and water carriers were exempt, but rail carriers were not.

Kansas City Southern Railway Company ("KCSR") is a carrier by rail engaged in the transportation of property in interstate commerce. KCSR purchased diesel fuel and imported diesel fuel into Louisiana to be used as transportation fuel to power KCSR's locomotives in their common carrier operations transporting property in interstate commerce. KCSR also owns its rights-of-way in Louisiana and builds, maintains and repairs its own track and roadway structures at its own expense.

After an audit of the company's books, the Department issued a proposed assessment against KCSR for additional tax due on its importation and purchase of diesel fuel in Louisiana and on its purchase of track and roadway materials, which it used to build, maintain and repair its track and roadway structure in Louisiana. KCSR sought to enjoin the assessment by the Department pursuant to 49 U.S.C. §11501 (the "4-R Act"), which grants federal district courts jurisdiction to enjoin state actions which "unreasonably burden and discriminate against interstate commerce."

The Department argued that the Court did not have jurisdiction to grant the relief sought because 49 U.S.C. 11501 does not apply to sales and use tax. The Court disagreed with the Department and noted that the 4-R Act forbids all forms of tax discrimination against railroads by states. The Court determined that the appropriate comparison group included water

carriers and motor carriers since they were the railroads' direct competitors. Diesel fuel used by motor carriers is exempt from Louisiana sales and use tax and transportation fuel used by water carriers that are engaged in foreign or interstate commerce is exempt from sales and use tax. Accordingly, the Court concluded that both water carriers and motor carriers were treated more favorably than rail carriers under the Louisiana sales and use tax structure. Thus, the Court held that the sales and use tax assessment proposed by the Department were discriminatory and prohibited by 49 U.S.C. §11501(b). It is interesting to note that the Court prohibited the Department from assessing sales and use tax on its purchases of tracks and other materials without explanation.

2. *St. Tammany Parish Tax Collector v. Barnesandnoble.com, LLC*, No. 05-5695 (E.D. La. Mar. 22, 2007). In this case, which presently is on appeal to the United States Fifth Circuit Court of Appeal, the federal district court for the Eastern District of Louisiana held that on-line book retailer, barnesandnoble.com, LLC ("Online"), did not have a substantial nexus with St. Tammany Parish, Louisiana (the "Parish"), as required by the dormant Commerce Clause, and was not required to collect and remit Parish sales/use taxes on its sales to customers in the Parish even though Online's affiliate, Barnes & Noble Booksellers, Inc. ("Booksellers"), operated a store in the Parish.

   Online is an internet retailer of books, movies, and music. It accepts orders from customers from across the country, including the Parish and fills the orders through a national distribution system. Online has no physical presence in Louisiana except for the use of common carriers to deliver merchandise. Online did not maintain a mailing address or telephone number in Louisiana and had no employees or tangible property in Louisiana. At various times during the taxable periods at issue, Barnes & Noble, Inc. owned, either directly or indirectly, 40%, 80% and 100% of Online. In addition, Barnes & Noble, Inc. also owned 100% of Booksellers, which owned and operated retail stores throughout the United States, including one store in the Parish. Although Online and Booksellers were commonly owned, they did not share management, employees, offices, and other important elements of their businesses.

   After a discussion of the substantial nexus requirements of the Commerce Clause, as articulated in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), and an analysis of the decisions in *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), and *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, 483 U.S. 232 (1987), as they relate to attributional nexus, the Court addressed the Parish's argument "… that the physical presence of Booksellers' store in Mandeville should be attributed to Online because Booksellers allegedly acted on Online's behalf within the taxing jurisdiction." The Parish cited five aspects of the

business relationship between Online and Booksellers to support its argument that a substantial nexus existed:

- A customer loyalty program run by Barnes & Noble, Inc. and from which Online derived revenues from annual membership fees
- A multi-retailer gift card program
- Online received commissions on merchandise ordered at Booksellers' retail stores, but shipped directly to the customer
- A cross-promotional advertising program
- Booksellers' stores gave preferential treatment to returns of merchandise purchased from Online.

The Court provided a detailed examination of each of the five characteristics.

With respect to the membership program, the Court noted that Online and several of its other affiliates participated in the customer loyalty program that was run by Barnes & Noble, Inc. Proceeds from the membership fees paid by customers were distributed on a pro rata basis according to the percentage overall discounts under the program awarded by each affiliate. Thus, Online did not receive revenue from sales made by Booksellers, and vice versa. Neither company, however, made sales or took orders for the other company. Both companies advertised the program and all participants in the program shared all member names and e mail addresses, which were used for direct marketing.

Online and Booksellers also participated in a multi retailer gift card program, which mirrored the membership program. Gift cards were available and redeemable at Booksellers' stores and at Online's website, as well as at other participating retailers. Promotional materials used by the program participants advertised that the gift cards were redeemable at Online's website. A separate affiliate, Marketing Services (Minnesota) Corp., Inc. ("Marketing"), administered the gift card program. A participating company remitted the proceeds from sales of gift cards to Marketing in return for a fee. When a gift card was redeemed, Marketing paid the retailer the face value of the gift card. Thus, a participating retailer interacted only with Marketing and the customer in fulfilling its obligations under the program.

As with the membership program, a participating retailer in the gift card program derived revenue only from selling gift cards directly to customers or from accepting gift cards as payment for items purchased from the retailer. Participants did not derive revenue from sales made by other participating retailers.

During the periods at issue, when a Booksellers' store did not carry an item requested by a customer, the customer could place an order with a clerk at the retail store and have the item shipped to the store for pickup or directly to the customer. The retail store would "source" the requested items on a computer system that would locate the item among various wholesalers and distribution centers, including Booksellers' own warehouses and those of third parties. Booksellers' stores were not able to choose a particular source through the system. In some cases, the computer system sourced the order to Online's distribution centers, which then shipped the item directly to the customer or to the Booksellers' store. In these situations, Online would charge Booksellers a wholesale price plus a commission for the purchase and Booksellers would resell the item to the customer. Booksellers collected and remitted applicable state and local sales/use taxes on its sales.

With respect to cross-promotional advertising, the Court noted that Online's website provided a "store locator" to identify nearby locations and information about events taking place at Booksellers' retail stores. The only evidence presented by the Parish that Booksellers promoted Online during the relevant taxable periods was in connection with advertising the multi retailer gift card and membership programs. According to testimony, store employees at Booksellers' store in the Parish would provide information about the website only if asked by a customer.

With respect to the return policy, Booksellers' stores accepted returns of merchandise carried by the stores regardless of where the merchandise was purchased. For example, a customer who had purchased an item from Online could return the item to a Booksellers' store and receive store credit upon showing a receipt for the amount paid to Online. Online advertised this return policy on its website. In contrast, customers who returned an item but did not show a receipt from Online received a store credit for the price of the item at the time in the Booksellers' store. Booksellers' accepted returns from other book stores to encourage customer satisfaction, entice new customers and as a source of income. Testimony also showed that Booksellers' managers had discretion as to whether to give a full refund to a customer who presented a receipt from a retailer other than Booksellers or Online.

Beginning its nexus analysis and relying on substantial precedent from other jurisdictions, the Court concluded that the relationship between Booksellers and Online did not create a substantial nexus for Online in the Parish. The Court concluded that the activities of Booksellers in the Parish on behalf of Online "…were not of the order of magnitude necessary to establish that Booksellers marketed Online's products on Online's behalf in the Parish." The Court also noted that the existence of a close corporate relationship did not mean that Booksellers' physical

presence could be imputed to Online. In essence, the Court concluded that the two entities should be respected as separate, legal entities even though they were closely related.

The Court further analyzed the nature and extent of the activities performed by Booksellers on behalf of Online and concluded that they were "…insufficient to treat Booksellers as acting as a marketing presence for Online in the Parish." Citing *SFA Folio Collections, Inc. v. Tracey*, *SFA Folio Collections, Inc. v. Bannon*, and *Bloomingdale's By Mail Ltd. v. Pennsylvania*, supra, the Court noted the significance of the fact that Booksellers had never taken or solicited orders on behalf of Online and did not provide facilities to place orders with Online. The Court also noted that the Parish had not demonstrated that participation in the gift and membership programs constituted a sufficient nexus upon which to base a tax collection obligation. The Court noted that neither program produced revenue to Online by virtue of sales made or orders taken by Booksellers at the retail store in the Parish. The Court also specifically noted that any benefit that Online may have derived from Booksellers' advertising of the programs was "…not sufficient to impute its presence to Online."

The Parish also relied on the fact that Online received commissions from in-store sales in support of its nexus argument. The Court dismissed this argument and noted that "…it is clear from the evidence that Online is in fact one of many wholesalers, including its competitors, from whom Booksellers sources items that it does not have in stock, to be shipped to the store or directly to the customer." The Court also noted that there was no evidence that Booksellers treated Online any differently from other third-party wholesalers in its computer-based sourcing system and that the evidence established that Booksellers treated this type of transaction as its own sale for which it collected and remitted applicable state and local sales/use taxes.

The Parish placed a great deal of weight on Booksellers' return policy, arguing that the policy was preferential to Online because Booksellers accepted Online's merchandise as if it were its own, but only gave store credit in the amount of the price of the item in Booksellers' store at the time for merchandise from other retailers. The Court agreed with the decisions of the Ohio and Pennsylvania courts referenced above in rejecting the argument that a preferential return policy established substantial nexus. The Court specifically noted that "[t]he policy of Booksellers to accept returns according to a slightly more generous policy than the one extended to other retailers is not comparable to an independent contractor making sales on behalf of the out-of-state retailer, such as was involved in *Scripto* and *Tyler Pipe*." The Court also noted that it was not comparable to the level of sales or sales support activity undertaken by in-state agents in other cases that have found nexus.

The Court concluded its nexus analysis by noting that Booksellers initiated the return policy to generate goodwill and to serve the convenience of its customers. The Court noted that *Borders Online v. State Board of Equalization*, 129 Cal. App. 4th 1179 (Cal. Ct. App. 2005), is the only case to rely on a comparable return policy to find nexus and that the court in that case "… implied that a [return] policy based on such considerations would not be indicative of the requisite nexus."

Considering all the evidence presented by the Parish, the Court concluded that a substantial nexus did not exist upon which to base tax collection liability.

This case represents another important development in the never-ending "substantial nexus" saga. The successful removal of the case to federal court is by itself an important development. Although a study of federal court jurisdiction is far beyond the scope of this outline, taxpayers that find themselves as defendants in a suit by a Louisiana local tax collecting authority for the collection of Louisiana local sales/use taxes should carefully consider the merits and benefits of removing the matter to federal court. A reading of Judge Vance's well-reasoned opinion provides a thorough and thoughtful analysis of the Commerce Clause nexus issue as it relates to online retailers and may provide helpful support for other taxpayers that are hailed into Louisiana courts by local taxing authorities.

3. In *DaimlerChrysler Financial Services of North America, L.L.C. v. Secretary, Department of Revenue*, Docket No. 2007 C.A. 0010 c/w No. 2007 C.A. 0011 (La. App. 1st Cir. 9/14/07), the Louisiana First Circuit Court of Appeal joined a growing list of state courts that have held that an assignee finance company is not entitled to a refund of the amount of state sales[21] taxes advanced for motor vehicle credit sales that ultimately prove to be uncollectible and are charged off of the company's federal tax returns as bad debts.

The taxpayer is engaged in the business of leasing motor vehicles, selling off-lease motor vehicles and purchasing installment sale contracts from Chrysler dealerships. The taxpayer is registered as a dealer for Louisiana sales/use tax purposes and files monthly Louisiana sales/use tax returns for rental receipts and off-lease motor vehicle sales.

In a typical transaction, an automotive dealership sold an automobile to a customer pursuant to an installment sale contract. The customer agreed to repay all or part of the purchase price, including a pro rata portion of the sales tax, on an installment basis. After the installment contract was signed, the automobile dealership would assign its rights under the installment contract to DaimlerChrysler without recourse. In exchange

[21] *See Hellerstein & Hellerstein,* State Taxation, §17.11[2][c] (2007 Cumulative Supp.).

DaimlerChrysler paid the dealership the full amount financed under the contract, including the full amount of sales taxes due. From this amount, the dealership remitted sales taxes due on the sales of the vehicles to the Louisiana Motor Vehicle Commissioner as required by Louisiana law.

If the customer defaulted on the installment contract, the vehicle was repossessed and sold with the proceeds applied to the outstanding debt. The remaining unpaid balance, including a pro rata amount of the financed sales tax, was written off by DaimlerChrysler for accounting and federal income tax purposes.

DaimlerChrysler filed refund claims with the Department seeking refunds of Louisiana sales taxes paid and ultimately charged off for federal income tax purposes. The Department denied DaimlerChrysler's claims. The Department's denial of the refund claims was upheld by the Louisiana Board of Tax Appeals and the 19th Judicial District Court. The court of appeal upheld the lower court's decision.

Like many state statutes, La. R.S. 47:315(B) provides for a reimbursement sales taxes previously paid by a dealer whenever the unpaid balance on an account due to the dealer on the purchase of tangible personal property has been found to be "bad" in accordance with Internal Revenue Code §166 and the amount actually has been charged off for federal income tax purposes. The term "dealer" is defined in La. R.S. 47:301(4)(b) as "[e]very person who sells at retain . . . tangible personal property." Neither the definition of "dealer" nor the definition of "person" includes an assignee.

On appeal, the Louisiana First Circuit Court of Appeal held that DaimlerChrysler was not a dealer for purposes of the refund provisions in La. R.S. 47:315(B). Even though DaimlerChrysler was a dealer with respect to sales of its off-lease motor vehicles, it was not a dealer with respect to the financing transactions at issue. The court also held that the reimbursement provided for in La. R.S. 47:315(B) is limited to the amount of sales taxes previously paid by the dealer. It was undisputed that DaimlerChrysler did not submit the motor vehicle sales tax to the vehicle commissioner. Instead, the automobile dealerships remitted the sales taxes due on the sales of the motor vehicle to the vehicles commissioner on behalf of their customers.

Alternatively, DaimlerChrysler argued that it was entitled to a refund under the Louisiana Bad Debt Statute because it was an assignee of the installment contracts. DaimlerChrysler relied on Louisiana Civil Code art. 1984, which provides that rights and obligations arising from a contract are heritable and assignable unless the law, the terms of the contract or its nature preclude such effects. The court noted that the Department's current regulations recognize that the right to seek a refund pursuant to La.

R.S. 47:315(B) may be transferred or assigned to a lending institution. However, those regulations provide that "[n]o refund is authorized on bad debts arising . . . on sales finance by lending intuitions . . . unless the lender has full recourse against the seller for any unpaid amounts." Louisiana Administrative Code 61:I.4369B.5 (June 2006). The installment contracts at issue were assigned to DaimlerChrysler without recourse. Accordingly, the court concluded that DaimlerChrysler was ineligible to receive a refund under the Civil Code provision.

Finally, the court noted the unique aspect of Louisiana's sales tax collection system with respect to Louisiana motor vehicles. According to the court, sales tax due on vehicles subject to the vehicle registration license tax is paid directly by the purchaser of the vehicle to the vehicle commissioner as the agent for the Department. The statutory duty of the automobile dealership/vendor is limited to providing the purchaser with notarized statement containing a full description of the vehicle and other information as specified by statute and regulations. Thus, for motor vehicle sales, the dealer has no statutory obligation to collect the sales tax from the buyer and the buyer cannot contractually assign the legislative obligation to collect and remit sales tax on motor vehicles to a third party. Thus, while it is undisputed that DaimlerChrysler was the source of funds used to pay the sales taxes due on the motor vehicle sales and that the dealerships remitted the taxes to the vehicle commissioner on behalf of their customers, neither DaimlerChrysler nor the dealerships had a statutory obligation to pay the sales/use taxes. Further, the dealerships could not transfer to DaimlerChrysler a statutory obligation and a related statutory benefit that they did not have. Thus, the court concluded that DaimlerChrysler was not entitled to refunds.

4. In *International Paper, Inc. v. Department of Revenue*, No. 42,023 (La. App. 2d Cir. 04/04/07), which presently is on appeal to the Louisiana Supreme Court, the Louisiana Court of Appeal for the Second Circuit held that purchases by International Paper, Inc. ("IP") of three chemicals (sodium chlorate, elemental oxygen, and hydrogen peroxide) used in the manufacture process of white paper were not excluded from Louisiana state sales and use taxes under the "further processing exclusion" because the "purpose" for which IP purchased the three chemicals was not for incorporation "into" the final product, but rather for use in the production process.

IP is a manufacturer of a variety of paper products. At its manufacturing facility in Bastrop, Louisiana, IP manufactures light-weight grades of paper for sale to its customers. The manufacturing process begins with raw timber and wood chips. The raw timber and wood chips are composed of fiber, which is composed of a number of elements including polymers, lignin, cellulose and hemicellulose. The timber and wood chips are converted into pulp using the Kraft process. Approximately 85% of

the lignin is removed from the timber and wood chips during the Kraft process. After the Kraft process, the lignin remaining in the pulp causes it to be brown and unsuitable for certain grades of paper. In order to remove the brown color from the pulp, IP uses a bleaching process (called "short sequence bleaching process") designed to remove most of the remaining lignin and to bleach whatever lignin remains in the pulp. The short sequence bleaching process involves two stages. First, the pulp is mixed with chlorine dioxide, which is created by the sodium chlorate, for the purpose of removing 50% - 75% of the remaining lignin from the pulp material. Some oxidation occurs at this stage of the process. Second, the hydrogen peroxide and elemental oxygen materials are added to the pulp to whiten the remaining lignin. Further oxidation occurs at this second stage of the process. The short sequence bleaching process causes oxygen atoms to be bonded to the remaining lignin.

The issue before the Second Circuit was whether IP's purchases of sodium chlorate, elemental oxygen, and hydrogen peroxide fell within the further processing exclusion contained in La. Rev. Stat. Ann. 47:301(10)(c)(i)(aa). The Court noted four requirements that had to be met for the further processing exclusion to apply: (1) the material must be processed into tangible personal property for sale at retail, (2) the material must become a recognizable, integral part of the end product, (3) the presence of the material as component of the end product must be of a benefit to the end product, and (4) the "primary purpose" for the purchase of the material must be to process it into the end product. The Court noted that the last requirement is a jurisprudential rule established in *Traigle v. PPG Industries, Inc.*, 332 So. 2d 777 (La. 1978), and *Vulcan Foundry, Inc. v. McNamara*, 414 So. 2d 1993 (La. 1982).

The Court determined that IP failed to meet the first and second requirements of the further processing exclusion because the oxygen atoms integrated into the final product were only partial elements of the chemicals in question. The Court also noted that IP failed to prove how much oxygen came from the chemicals in question. Because of this, the Court determined that the chemicals were largely consumed in the bleaching process and not passed along to the final product.

The Court ultimately concluded that the short sequence bleaching process and the chemicals used therein merely allowed the lignin to remain in the final product and IP purchased the chemicals at issue for the purpose of removing and modifying the lignin already in the wood and not for further processing into an article of tangible personal property.

5. In *Department of Revenue v. National Financial Systems, Inc.,* 2006-0957 (La. App. 1st Cir. 03/23/07), the court held that modular banking units leased to banks and other federally insured financial institutions were

corporeal movables ("tangible personal property") and the lease of such property was subject to Louisiana lease tax.

The taxpayer, National Finance Systems, Inc., was in the business of leasing modular banking units to banks and federally insured financial institutions desiring to open branch locations in rural and urban areas. The modular bank buildings ranged in size from 14 feet wide by 70 feet long, to 28 feet wide and 70 feet long and weigh several tons. The modular units were bolted onto a concrete slab foundation and drive-in lanes were built alongside the unit.

The lease agreements contained language that the modular units were "portable" and "temporary in nature." The trial court determined that the modular buildings were movables according to the foregoing terms of the lease. The Court agreed that the modular units were movable; however, it disagreed on how the trial court reached its conclusion. The Court stated that the designation in the lease that the modular units would remain "mobile" did not answer the question of whether the modular units were movable for tax purposes. The Court also noted that, in the context of this dispute, a contractual agreement cannot dictate the classification of a thing under the Civil Code.

Although the modular units had some degree of permanency once set in place (as noted above), the Court determined that they were not intended to be permanent. The Court concluded that the normal and intended use of the modular banking units was to be moved from place to place whenever the lease had run its course. Accordingly, the Court held that the modular banking units were corporeal movables and leases of such units were subject to lease tax.

6. In *Cajun Contractors v. St. Tammany Parish Tax Collector*, 2006-0443 (La. App. 1st Cir., 12/29/06), the court held that items purchased and used by Cajun Contractors ("Cajun") in the upgrade and construction of a sewerage system for the City of Slidell were subject to sales tax because the contractor was the ultimate consumer of the items. The Court based this conclusion on the finding that the items became component parts of an immovable and in performing a contract to construct an immovable; a contractor is the ultimate purchaser of materials incorporated into the immovable and can be taxed for governmental use.

Cajun argued that the plumbing installations were not component parts because they could be removed without substantial damage to either the items or the immovable. However, the Court disregarded this fact and applied the societal expectations test to determine that the installed items were clearly plumbing installations and, as such, fell within the first paragraph of Civil Code Art. 466, which provided "[t]hings permanently

attached to a building or other construction, such as plumbing, heating, cooling, electrical or other installations, are its component parts."

Interestingly, the Court noted that applying the component part test set out in *Willis-Knighton Medical Center v. Caddo Shreveport Sales and Use Tax Commission*, 903 So. 2d 1071 (La. 2005), would lead to a different result because, under that test, the plumbing installations would be considered component parts only if they could not be removed without substantial damage to the sewerage system or to the items. However, the Court concluded that the Louisiana Supreme Court's opinion in *Willis-Knighton* was inapplicable to the case because the current case began prior to the *Willis-Knighton* decision. Accordingly, the Court determined that the correct version of Article 466 was applied.

7. In *R & B Falcon Drilling v. Lafourche Parish School Board*, 2006-0064, (La. App. 1st Cir. 11/3/06), the court held that 2006 La. Act Nos., 1st Ex. Sess., No. 34, §1 ("Act 34"), which amended La. R.S. 47:305.1(B) to add "barges and drilling ships" within the exemption provided to operators of "ships and vessels" operating exclusively in foreign or interstate coastwise commerce, was only to be applied on a prospective basis.

The taxpayer, R & B Falcon Drilling USA, Inc. ("R & B"), conducts a drilling business off the coast of Lafourche Parish. The Lafourche Parish School Board ("Parish") issued an assessment against R & B for taxes resulting from such drilling activities from January 1, 1998 through December 31, 2001. The taxes were associated with R & B's drilling activities, including the purchase of drilling materials, supplies and equipment. R & B paid the tax under protest and filed a suit for redetermination and refund.

The question before the court was whether R & B was entitled to a tax exemption provided by La. R.S. 47:305.1(B). The trial court rendered a judgment in favor of R & B finding that it was entitled to the exemption. The Parish appealed the trial court's decision, asserting that the drilling rigs at issue are not considered "vessels," but rather are "barges," which are not entitled to the exemption under La. R.S. 47:305.1(B). R & B filed a motion to supplement the appellate record with La. R.S. 47:305.1(B) as amended by Act 34.

The Louisiana Court of Appeal for the First Circuit determined that Act 34 represented new substantive laws passed under the guise of interpretive legislation. Accordingly, the Court denied R & B's motion to supplement the appellate record because it held that Act 34 can only be applied prospectively and did not apply to the current case.

C. Administrative Developments

1. Revenue Rulings

a. **Revenue Ruling No. 07-005 (Sept. 19, 2007) (Sales and Use Taxation of Transactions Involving for the Furnishing of Scaffolding.** This revenue ruling discusses the sales/use tax aspects of transactions involving the furnishing of scaffolding. The Department opines that transactions for the furnishing of the possession or use of scaffolding without the transfer of title will be taxed as leases or rental of tangible personal property. According to the Department's understanding of the scaffolding business, "[s]caffolding is a type of property that, when set in place, does not require operation by human presence. The customer's possession and use of the scaffolding is the essence of the transaction, and is certainly not an inconsequential element of a service transaction." Therefore, the Department will apply sales tax to the daily or other periodic rate for the furnishing of scaffolding.

The Department also opines that at this time it will not apply sales tax to any separately stated charges for the delivery and pick up of leased or rented property, including scaffolding. Similarly, the Department will not apply sales tax to separately-stated, additional charges for the set-up and tear-down of the scaffolding and for the on-site presence of owner personnel who advise lessees in the proper and safe use of the scaffolding, provided that these additional services are optional to the customer and the periodic lease or rental rates for the scaffolding are not affected by the customer's decision to purchase or decline the additional,, optional services. If the additional services are included in a single charge for the furnishing of the scaffolding, or if the purchaser does not have the option of purchasing or declining the additional services, the entire charge to the customer will be considered a taxable lease or rental.

Scaffolding and other durable tangible personal property purchased by scaffolding providers for the exclusive purpose of leasing or renting the scaffolding as tangible personal property are excluded from sales/use tax as provided in La. R.S. 47:301(10(a)(iii).

Because of apparent uncertainty in the industry, the revenue ruling provides that the revenue ruling will be applied only on a prospective basis from the date of issuance for dealers "who have not collected the sales tax on these transactions, but who themselves paid the sale or use tax on the scaffolding as property being used in rendering non-taxable services …." Dealers that elect to apply the ruling on a prospective basis "…will not be

recognized as eligible to have made tax-free purchases or importations of scaffolding, as provided by La. Rev. Stat. Ann. §47:301(10)(a)(iii)." From the effective day forward, according to the Department, all dealers will be required to collect state sales/use tax on leases or rentals of scaffolding regardless whether the sales/use tax was paid on particular units of property that are leased or rented after the effective date of the ruling.

Taxpayers should read this revenue ruling together with **Revenue Ruling No. 06-012** (commercial trash containers and trash collection services) and **Revenue Ruling No. 06-013** (portable toilet facilities), which are discussed below.

b. **Revenue Ruling No. 07-002 (May 22, 2007) (Sales and Use Taxation of Airplanes).** This revenue ruling provides an extensive discussion of the Department's interpretation and application of *Word of Life Christian Center v. West*, 936 So.2d 1226 (La. 2006), in which the Louisiana Supreme Court held that an aircraft that was stored in Louisiana when not in use in interstate commerce was subject to use tax in Louisiana. The decision has the effect of narrowing the application of Louisiana's interstate commerce exclusion in La. R.S. 47:305(E). The ruling also provides insight into the Department's interpretation of the phrase "bona fide interstate commerce.

In the ruling, the Department adopted a narrow definition of bona fide interstate commerce that was used by the Louisiana Supreme Court. According to the Court, bona fide interstate commerce does not include the use of tangible personal property, such as an aircraft, to travel across state lines unless it is used exclusively in "the exchange of goods and services." Relying on this unusual interpretation of bona fide interstate commerce, the Department opined that Louisiana use tax can be avoided only if an aircraft that is purchased outside Louisiana is used in bona fide interstate commerce continuously and on an uninterrupted basis from the moment it is brought into Louisiana. If the continuous use of the aircraft in bona fide interstate commerce is interrupted at any time while the aircraft is in Louisiana, Louisiana use tax is due.

The ruling then gives some examples of how these murky rules apply. "Interstate commerce activity means the use of airplanes in the exchange of goods and services between states. The interstate exchange of goods and services includes not only the for-hire commercial transportation of passengers or property between states, but also the vendor delivery to customers of property sold or leased; the transportation of inventory, assets to be rented or leased, or other direct revenue-producing property to the locations

from where the property will be sold, leased, manufactured or fabricated for sale or lease, or deployed for use in rendering of commercial services; and the transportation of personnel and property across state lines to and from sites where the personnel and property will be used directly in commercial revenue-producing activities. Mileage to transport business owners, officers, or employees between states for purposes other than direct revenue production will not be considered bona fide interstate commerce for the airplanes used in such transportation."

The Department concluded by opining that an aircraft that enters Louisiana solely for the purpose of refueling, repair or dropping off or picking up passengers or cargo would not be subject to use tax because the aircraft would not "come to rest" in Louisiana. "However, an airplane that is indefinitely hangered in Louisiana and uses Louisiana as its base of operation for interstate travel is subject to the Louisiana use tax."

PRACTICE TIP: The Department notes that it will apply its interpretation of the *Word of Life* case from July 1, 2007. This apparently means that a taxpayer that purchased an aircraft outside Louisiana and brought it into Louisiana prior to July 1, 2007, and used the aircraft continuously in interstate commerce will not be subject to Louisiana use tax even though the aircraft is hangered in Louisiana or otherwise has its base of operations in Louisiana. Apparently, for periods prior to July 1, 2007, the Department will apply the provisions of La. R.S. 47:305(E) (the interstate commerce exclusion) in accordance with the taxpayer-friendly decisions *Shaw Group, Inc. v. Kennedy*, 767 So.2d 937 (La. App. 1st Cir. 2000), and *Tigator Inc. v. West Baton Rouge Police Jury*, 657 So.2d 221 (La. App. 1st Cir. 1995), *writ denied*, 663 So.2d 712 (La. 1994).

c. **Revenue Ruling No. 07-003 (Sept. 6, 2007) (Sales Tax Applicable to Long-term Occupancy of Hotel and Motel Rooms).** This revenue ruling addresses an issue that probably has been more prevalent in the wake of Hurricanes Katrina and Rita. This ruling also supersedes Revenue Ruling No. 03-007. The ruling provides that the taxability of hotel accommodations depends on the character of use and not the time or method of payment. According to the Department, if the use of accommodations is as a hotel, then the character of use is transient and not taxable. On the other hand, if the purpose of use is as a permanent resident, then the user is considered permanent. Further, the Department notes that fulfillment of several factors including, but not limited to physical presence, long term use, the contractual nature of the arrangement, and the permanency of the

habitation are essential components to establishing the character of the use as that of permanent residence or home. Only the use of a hotel as a permanent residence or home by a natural person is excluded from payment of sales tax. The ruling also reviews the regulations at LAC 61:I.4301(C)(b).

d. **Revenue Ruling No. 06-019 (Nov. 27, 2006) (Sales Taxability of Piano Tuning Services)**. The issue addressed in this revenue ruling is whether the service of tuning a piano is considered a "repair service" that is subject to the sales tax. The ruling describes tuning as follows: "Tuning involves changing the pitch of each string by increasing or decreasing the tension of that string…. The tuner will adjust the tension of each string to perfect pitch. The tuner may also repair any damaged parts of the piano if those parts are worn or broken."

The Department opined that the tuning services are taxable repair services because they are performed in order to "restore" the piano to the correct pitch and temperament as determined either by the standards of the piano owner or the tuner. The Department cited cases holding that "restorative" services are properly taxable as repairs. The Department noted that tuning is more than a "mere enhancement" to the piano because the primary purpose of having a piano is to produce a desired sound. The Department concluded that tuning is actually "fixing" the piano so that it performs as intended. Finally, the Department noted that it is not necessary that parts actually be replaced for the tuning to be a taxable repair, although any situation in which the replacement of parts is necessary also constitutes a taxable repair.

e. **Revenue Ruling No. 06-015 (September 19, 2006) (Taxability of Purchases for Marine Transportation Vessels, Drilling Barges, and Drilling Ships)**. This revenue ruling addresses changes made by Act No. 34 of the 2005 First Extraordinary Session, to the ships supplies exemption in La. R.S. 47:305.1(B), particularly with respect to purchases for drilling ships and drilling barges. In the Ruling, the Department concludes that the exemption, as amended, does not apply to "… purchases that are used for the operation of mineral exploration, drilling, or production barges in Louisiana waters." According to the Department, the exemption does not apply to these specific purchases because the types of barges at issue (i.e., drilling barges) are not operating exclusively in foreign or interstate coastwise commerce while they are operating in Louisiana waters.

The Department correctly noted that Act 34 did not change the very broad definition of "foreign or interstate coastwise

commerce" in La. R.S. 47:305.1(C)., but merely clarified that barges are specifically covered by the exemption in La. R.S. 47:305.1(B). The Department also noted that Act 34 did not expand the definition of the term "foreign or interstate coastwise commerce" to include petroleum drilling or producing activities. While true, the fact of the matter is that it probably was unnecessary to legislate such expansion because offshore drilling and production activities arguably are considered to be "foreign or interstate coastwise commerce" under La. R.S. 47:305.1(C) and prevailing U.S. Supreme Court cases.

La. R.S. 47:305.1(C)(1)(d) provides in pertinent part that for purposes of the exemption in La. R.S. 47:305.1(B), "the term 'foreign or interstate coastwise commerce' shall mean and included trade, traffic, transportation, or movement of passengers or property by, in, or on a ship, barge, or vessel, including a drilling ship: … (d) At a point in or between points in the same state when such trade, traffic, transportation, or movement of passengers or property is part of or consists of one or more segments of trade, traffic, transportation, or movement of passengers or property that either … (ii) precedes movement of the passengers or property from within the state to a point outside the territorial boundaries of such state, or (iii) is part of a stream of trade, traffic, transportation, or movement of passengers or property originating or termination outside the territorial boundaries of such state or otherwise in foreign or interstate coastwise commerce, as defined in this Subsection." This definition of "foreign or interstate coastwise commerce" seems to be broad enough to cover the activities of drilling barges.

Based on La. R.S. 47:305.1(C) and U.S. Supreme Court jurisprudence, it appears that drilling barges can be engaged in "foreign or interstate coastwise commerce." Thus, it certainly is possible that the legislature did not specifically address drilling barges in Act 34. Without any analysis of the specific provisions of La. R.S. 47:305.1(C) or U.S. Supreme Court jurisprudence, the Department concludes that the exemption in La. R.S. 47:305.1(B) does not apply to purchases of supplies, laundry services and repair services for "… use in Louisiana territorial waters aboard vessels used for such non-interstate commerce activities as mineral exploration, drilling, or production." The Department further concluded that "[a] drilling ship or mineral exploration, drilling, or production barge, while operating in Louisiana, is not operating in foreign or interstate coastwise commerce so as to be eligible for the sales tax exemption provided by La. R.S. 47:305.1(B)." The Department's reading of the applicable provisions of La. R.S. 47:305.1 is questionable when full consideration is given to the

nature of the oil and gas exploration and production industry, U.S. Supreme Court jurisprudence, La. R.S. 47:305.1(B) and (C), as amended, and the history of the ships' supplies exemption and Louisiana cases that have interpreted the exemption. Expect a challenge to the Department's interpretation.

f. **Revenue Ruling No. 06-014 (September 19, 2006) (Sales Taxability of Fees Paid for the Right to Use Eye Surgical Machine)**. The facts in this revenue ruling relate to a group of eye surgeons that purchased a machine to aid in surgical procedures. When the manufacturer sold the machine, the manufacture retained the intellectual property rights to the technology that is necessary for the operation of the machine. To operate the machine, the surgeons must pay to the manufacture patent and licensee fees for each use. Without the remittance of such fees, the machine cannot be used for its intended purpose. The Department held that the payments for intangible rights are included as part of the total purchase price of the tangible property when the two are inextricably associated. As a result, both the cost of the machine and the payments for the use of the machine are subject to Louisiana sales tax.

g. **Revenue Ruling No. 06-013 (September 19, 2006) (Furnishing Portable Toilet Facilities)**. In this revenue ruling, the Department concluded that transactions for the furnishing for a consideration of the temporary use of portable toilet facilities are taxable as leases or rentals of tangible personal property. The Department also ruled that the taxable base includes the charges for the lease or rental of the portable toilets and any charges for the cleaning and sanitation of the facilities, regardless whether the cleaning and sanitation charges are separately stated. Any separately-stated charges for the delivery and pick up of the facilities, however, are excluded for the taxable base on the lease or rental of the facilities. Because some taxpayers in the industry had considered the subject transactions as non-taxable services, the Department declared that it ruling would apply only on a prospective basis.

This revenue ruling should be read in conjunction with **Revenue Ruling No. 07-005** (scaffolding services), which is discussed above, and **Revenue Ruling No. 06-012** (commercial trash containers and trash services), which is discussed in the next paragraph.

h. **Revenue Ruling No. 06-012 (September 19, 2006) (Furnishing Commercial Trash Containers and Trash Collection Services)**. In this revenue ruling, the Department opined regarding the sales/use tax aspects of furnishing commercial trash containers and

trash collection services. The Department considered three fact scenarios: (i) the trash removal company contracts with customers for the regularly-scheduled, periodic disposal of the customers' trash and the invoices provide a single, lump-sum, periodic charge; (ii) same as scenario (i) except that charges for the furnishing of dumpsters and for trash removal are separately delineated on invoices; and (iii) the trash removal company furnishes dumpsters on an irregular basis and customers are charged separately for the delivery of the dumpsters, for the time the dumpsters are at the customers' facilities, and for the pick-up of the dumpsters and removal of waste.

The Department concluded that the true object of the transactions in scenarios (i) and (ii) is the furnishing of the trash removal service and that providing the customers with the dumpsters is done to facilitate the furnishing of the non-taxable services. Thus, for scenarios (i) and (ii), no sales/use taxes are due on the non-taxable service. With respect to scenario (iii), the Department concluded that the true object of the transaction is the customer's desire to have possession of a dumpster for an indeterminate period of time. The customer is charged based on how long it keeps the dumpster. In this scenario, the Department concluded that sales tax is due on the periodic charges for the customer's possession of the dumpster, but not on separately-stated charges for the trash pick-up.

At the end of this ruling, the Department attempted to reconcile its ruling regarding the furnishing of commercial trash containers and trash collection services with its ruling regarding the furnishing of portable toilet facilities (**Revenue Ruling No. 06-013**, discussed immediately above). The Department stated that the reason for the different rulings is "… that the 'true object' of the transactions for the dumpsters and trash pick-up is the trash removal service. In the case of the transactions for the portable toilet facilities, the 'true object' of the transactions is the furnishing of the facilities themselves."

To some, the distinction made by the Department has a funny odor to it and it is difficult to reconcile the two rulings. As discussed above, many in the portable toilet industry also apparently failed to see the distinction. The question is: Who will clean up this mess and will the clean-up be taxable?

This revenue ruling also should be read in conjunction with **Revenue Ruling No. 07-005** (scaffolding services), which is discussed above.

2. Revenue Information Bulletins

a. **RIB No. 07-004 (December 20, 2006) (Concerning Refinery Gas Taxable Values for Calendar 2007)**. This RIB declares that the taxable value for refinery gas for sales and use tax purposes for calendar year 2007 has been set at $1.137 per thousand cubic feet (MCF) in accordance with La. Rev. Stat. Ann. 47:301(3)(f) and (13)(d).

3. Private Letter Rulings

a. None to report.

4. Notices of Intent to Adopt Rules

a. **Proposed Rule LAC 61:I.4304 (Oct. 23, 2006) (Proposed Rule Concerning the Sales Tax Exemption on Purchased of Electricity and the Sales Tax Limitation on Purchases of Natural Gas by Paper and Wood Products Manufacturers)**. This proposed rule provides guidance to taxpayers concerning the sales tax exclusions provided by Act 48 of the 2005 First Extraordinary Session of the Louisiana Legislature. Act 48 amended the sales tax definitions of "cost price" and "sales price" to provide that paper and wood products manufacturers shall be liable for sales or use tax payment only on the first $6.20 per MMBtu of the "cost price" or "sales price" of their purchases of natural gas during the period July 1, 2006, through December 31, 2008. Act 48 also enacted La. R.S. 47:302(T), 321(J), and 331(R) to provide that paper or wood products manufacturing facilities shall not be liable for sales or use tax on their sales, purchases, or uses of electric power or energy during the same period. The proposed rule defines "paper manufacturing facility" and "wood products manufacturing facility" and provides for the application of the exclusion for facilities that engage in additional revenue-producing activities in the facility.

III. TAX PROCEDURES AND OTHER ADMINISTRATIVE DEVELOPMENTS

A. Legislative Developments

1. None

B. Judicial Developments

1. None

C. Administrative Developments

1. Revenue Information Bulletins

a. **RIB No. 07-011 (April 3, 2007) (Signatures Required to Execute Binding Agreements)**.[22] This RIB sets out rules regarding those persons who are authorized to execute agreements with the Department on behalf of non-individual taxpayers. With respect to corporate taxpayers, the following persons may execute such agreements: corporate officer; board member; or any other person having authority to bind the corporation. The corporation's name must be shown on the first signature line of the document. The signature name and title of the officer, board member or other authorized person must be shown on the second line. With respect to limited liability companies, a member must sign the agreement if the limited liability company is member managed, and a manager must sign the agreement if the limited liability company is manager managed.

By signing any agreement with the Department, the individual signing the agreement on behalf of the taxpayer is certifying that: (i) they are authorized to execute the agreement; (ii) they acknowledge that they are signing the agreement under penalties of perjury; and (iii) if it is later determined that the person signing was not properly authorized to execute the agreement, the individual, by signing, is acknowledging and agreeing to be held personally liable for the liability of the entity which he lacked authority to bind.

The highlighted language is a response to the decision in *Bridges v. X Communications, Inc.,* 861 So. 2d 592 (La. App. 5th Cir. 2003). In that case, the controller of a corporate taxpayer signed an agreement to waive prescription during the course of a sales tax audit. Subsequently, the corporate taxpayer argued that the agreement to waive the prescriptive period was invalid because the controller did not have the authority to bind the corporation. The court of appeals agreed and the assessment was dismissed because the time for assessing the taxes had prescribed. The highlighted language in the RIB would allow the Department to proceed directly against an individual who did not have authority to bind the corporation.

PRACTICE TIP: The Department is strictly enforcing all aspects of this RIB. Non-individual taxpayers should take the necessary steps to make sure that a person signing an agreement with the Department has the requisite authority to

[22] This RIB originally was issued on March 27, 2007, and was updated on April 3, 2007, to include the Voluntary Disclosure Coordinator as one of the Secretary's delegates who can sign agreements to bind the Department.

sign the agreement and bind the entity. This applies to settlement agreements, agreements to abide by pending cases and waivers of prescription, just to name a few.

b. **RIB No. 07-007 (January 29, 2007) (Offer in Compromise Program Revised)**. The Department has revised the offer in compromise application, Form R-20212, to implement major changes made to the offer in compromise (OIC) program. The revised form will replace Forms R-20211 (8/04) and R-20212 (11/99). These changes became effective for all offers received by the Department on or after February 1, 2007. The postmark date will determine when an offer is received.

An offer in compromise is an agreement between a taxpayer and the Department that resolves the taxpayer's state tax debt. Under the authority of La. R.S. 47:1578(4) and 47:295, the Secretary of the Department may compromise, waive, or reduce tax liabilities, including penalties and interest, by accepting less than full payment in certain circumstances. Under the new OIC program, taxpayers must include a non-refundable payment of at least 10 percent of the amount offered with their OIC application. Additionally, the new program limits taxpayers to only one approved offer in a 10-year period.

Revised Form R-20212 reflects all changes made to the OIC program, provides detailed instructions for requesting an OIC, and includes all required financial forms. The form is posted on the Department's website at http://www.revenue.louisiana.gov.

c. **RIB No. 07-002 (December 21, 2006) (2007 Judicial Interest Rate to Be Paid on Refunds)**. This RIB sets the interest rate to be paid on refunds and credits at 9.5% for the calendar year 2007.

d. **RIB No. 07-001 (December 21, 2006) (2007 Interest Rate Collected on Unpaid Taxes)**. This RIB sets the interest rate on unpaid taxes at 14.5% for the calendar year 2007.

2. Adopted Rules

a. **Adopted Rule LAC 61:I.5302 (May 20, 2007) (Issuance and Cancellation of a Lien; Fees)**. This rule clarifies when the Secretary of the Department may release certain property subject to a recorded lien. Additionally, this rule restricts taxpayers to only one approved offer-in-compromise in a 10-year period and requires offers in compromise applications to be accompanied by a nonrefundable payment of at least 10 percent of the amount offered.

b. **Adopted Rule LAC 61:III.2115 (Jan. 20, 2007) (Interest Abatement and Compromise)**. La. R.S. 47:1601(A)(2)(c) authorizes the Secretary of the Department to abate interest due to unreasonable errors or delays by the Department in performing ministerial or managerial acts. La. R.S. 47:1601(A)(2)(d) authorizes the Department to waive interest to promote the effective administration of the tax laws. This Rule provides regarding the circumstances under which interest will be abated or compromised.

The Rule defines a "Managerial Act" as an administrative act that occurs during the processing of a taxpayer's case involving the temporary or permanent loss of records or the exercise of judgment or discretion relating to management of personnel. A decision concerning the proper application of the law is not a managerial act. Further, a general administrative decision, such as the department's decision on how to organize the processing of tax returns or its delay in implementing an improved computer system, is not a managerial act for which interest can be abated.

The Rule defines a "Ministerial Act" as a procedural or mechanical act that does not involve the exercise of judgment or discretion, and that occurs during the processing of a taxpayer's case after all prerequisites, such as conferences and review by supervisors, have taken place. A decision concerning the proper application of the law is not a ministerial act.

The Rule gives the examples of situations that do not constitute an unreasonable error or delay by the Department: (i) interest accrues as a result of the taxpayer's failure to pay the tax liability he calculates for each period when due; (ii) interest accrues as a result of the taxpayer's failure to pay the entire balance owed once he and the department are in agreement as to the amount of the balance; (iii) interest accrues while the taxpayer waits for a determination of his refund claim in order to offset prior period underpayments; and (iv) interest accrues as a result of the taxpayer's failure to cooperate with Department personnel.

The Rule states that before the Secretary may consider compromising any amount of interest, the taxpayer must have paid all outstanding taxes. When determining whether or not to compromise interest for a taxpayer, the secretary will examine the taxpayer's filing and compliance history, any special circumstances that may exist, and the hazards of litigation. This list is not all-inclusive.

The Rule also states that interest may be compromised when the Department and the taxpayer interpret the law differently and there is no binding judicial decision regarding the issue. If interest is compromised with regard to an unresolved issue, the taxpayer will agree to thereafter operate under the Department's interpretation of the law. Interest may only be compromised for a specific taxpayer if the taxpayer has not had any interest compromised within the past five years. Interest may only be compromised for a specific taxpayer if neither the taxpayer, it affiliates, nor its related entities have ever had any interest compromised that arose from the same issue. The Secretary may compromise any portion of the total interest for which compromise is requested. The Rule also states that the following is a partial list of circumstances in which interest will not be compromised: (i) a taxpayer is party to a voluntary disclosure agreement for the period in which the interest accrued; (ii) interest accrues as a result of participation in an abusive tax avoidance transaction; and (iii) interest that accrues on trust taxes that the taxpayer has collected but not remitted.

c. **Proposed Rule LAC 61:I.1401 (March 1, 2007) (Partnerships Composite Returns and Payments)**. This proposed rule changes the requirement to withhold when the partner in a partnership is a partnership itself. This proposed change would prevent such partnerships from being included on composite returns.

d. **Proposed Rule LAC 61:III.1501 (August 23, 2007) (Compensated Tax Preparers to Submit Certain Returns Electronically)**. This proposed rule requires tax preparers to file certain individual income tax returns electronically beginning in 2008. Act 452 of the 2006 Regular Session of the Legislature amended La. R.S. 47:1520(A) to authorize the Secretary of the Department to require certain tax preparers to file returns electronically under certain circumstances and to require that the electronic filing requirements be implemented by administrative rule in accordance with the Administrative Procedure Act.

Individual income tax returns prepared by a tax preparer that prepares more than 100 Louisiana individual income tax returns during any calendar year are required to be filed electronically in accordance with the following requirements. For returns due on or after January 1, 2008, 30% of the authorized individual income tax returns must be file electronically. For returns due on or after January 1, 2010, 60% of the authorized individual income tax returns must be filed electronically. For returns due on or after January 1, 2012, 90% of the authorized individual income tax returns must be filed electronically.

IV. TRENDS/OUTLOOK FOR 2007/2008

A. Election Year

Elections for all statewide elected officials and many local officials will take place in the Fall of 2007. Because Governor Blanco will not run for reelection, Louisiana will elect a new governor. The new governor will be faced with continuing issues involving recovery of Louisiana in the wake of the storms of 2005. Taxes won't be too far from the forefront. The 2008 Regular Session of the Legislature, however, will be a non-fiscal session, which means that tax bills will be limited. If the new governor has a specific, state-level "tax agenda," he (there are no female candidates) will have to either pursue that agenda in a special session or wait until the 2009 Regular Session. The delay might prove to be an unacceptable delay, so keep your eyes open for a special session that could address specific tax issues.

Many current members of the Louisiana House of Representatives and the Louisiana Senate are facing term limits. Some will run for other elected positions. Others will ride the wave into retirement. Either way, both chambers will have new faces and new ideals when the Legislature next convenes. In addition, we will have a new governor. Without a doubt, it will be an interesting legislative arena in 2008.

B. Louisiana State and Local Taxpayers Bill of Rights

It has been several years since the business community sought to add some teeth to the taxpayers' bill of rights in Louisiana. Business taxpayers continue to grapple with rampart, arbitrary assessments by the Department and local tax collectors, law suits by the Department and local tax collectors even before an audit has began or been completed, multiple audits by multiple parishes using multiple contract audit firms, referrals of state and local tax cases to outside counsel who are entitled to attorneys' fees of up to 10% of the amount due if the government is successful, aggressive claims by tax collectors that have little basis in fact or law without the ability of a winning taxpayer to get a reimbursement for its attorneys' fees, just to name a few. It is time to reconsider an effort to seek the enactment of a state and local taxpayer's bill of rights with teeth!

C. "Loophole" Legislation

Unlike many states, the Louisiana Legislature has not been too aggressive in pushing for the so-called "loophole closing legislation" that we have seen in other states. Although the Louisiana Legislature previously has considered combined reporting, there seems to be no current initiative to enact combined reporting in Louisiana. Nevertheless, as discussed above, the Department continues its efforts to "force combination" in certain cases based on its perceived authority in La. R.S. 47:287.480. The scope of the Department's authority under current law will be tested in litigation.