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Tax News and Developments
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Congress, Treasury, Paycheck Protection Program and Employee Retention Credit

On March 27, 2020, President Donald Trump signed the Coronavirus Aid, Relief and Economic Security Act ("CARES Act") into law. A Client Alert discussed the tax provisions contained in the act. This article discusses two of the provisions in the act that are the subject of Congress's continuing interest: the Paycheck Protection Program ("PPP") and the Employee Retention Credit ("ERC").

Both provisions are intended to incentivize and aid employers in retaining the employees they had before the coronavirus pandemic. The PPP does this by providing forgivable loans to aid small businesses impacted by the coronavirus pandemic. The ERC does this by creating a refundable tax credit for employers of up to $5,000 per employee. As discussed below, the eligibility requirements for the PPP and ERC are different, with the ERC generally being available to a broader group of employers affected by the coronavirus pandemic. However, a business that receives a PPP loan is not eligible to claim an ERC even where the eligibility requirements are otherwise met.

Paycheck Protection Program

The CARES Act authorized the Small Business Administration ("SBA") to temporarily guarantee loans under a new section 7(a) loan program titled the "Paycheck Protection Program." Loans under the PPP are 100 percent guaranteed by SBA, and the loans may qualify for loan forgiveness. SBA is authorized to guarantee loans under the PPP through June 30, 2020. Congress authorized a program level of $349 billion; however, such funding was exhausted on April 16.

On April 24, President Trump signed the Paycheck Protection Program and Health Care Enhancement Act into law, which included $310 billion of additional funding to restart the PPP. As of June 6, approximately $130 billion of the additional PPP funds remain.

Treasury Actions Limit the Paycheck Protection Program

Treasury and the SBA issued numerous interim and final regulations, as well as frequently asked questions, to interpret the PPP. As discussed below, some of these interpretations have limited which businesses can receive PPP loans, how those funds can be spent, and what deductions are available to businesses that have PPP loans forgiven. Further, Treasury limited the PPP by setting an arbitrary requirement that at least 75 percent of amounts to be forgiven must be

Upcoming Tax Events

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Healthcare
►July 21, 2020

Tax Policy
►August 4, 2020

Tax Dispute Resolution
►September 1, 2020

Financial Institutions
►September 15, 2020

Consumer Goods & Retail
►September 29, 2020

VAT
►October 13, 2020

International VAT Conference Webinar Series

Audits and Disputes
►September 9, 2020

Financial Services
►October 7, 2020

E-Commerce
►October 28, 2020

VAT Around the World
Part I
►November 18, 2020

VAT Around the World
Part II
►December 2, 2020

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spent on payroll. This caused many borrowers to return PPP funds because of the uncertainty of the guidance.

On April 24, Treasury issued an interim final rule that bars hedge funds, private equity firms, and publicly traded businesses from taking loans under the PPP. This rule is intended to address concerns that certain "big fish" might receive money intended to aid small businesses in a time of crisis.

In Notice 2020-32, the IRS ruled that no deduction is allowed for an otherwise deductible expense if the payment of that otherwise deductible expense results in the forgiveness of the PPP loan. The IRS reasoned that Code Section 265 denies an otherwise allowable deduction where the amount is incurred to earn or produce a class of exempt income. Because section 1106(i) of the Cares Act excludes from gross income the amount of the covered loan forgiven under the PPP, the proceeds are therefore a "class of exempt income." Accordingly, the IRS ruled that based on precedent and its interpretation of section 265, the deduction is denied.

Congress Watching the Paycheck Protection Program

Congress has kept a watchful eye on the PPP. Less than a week after the IRS issued Notice 2020-32, on May 5, Senate Finance Committee Chairman Charles Grassley (R-IA), Ranking Member Ron Wyden (D-OR), and House Ways and Means Committee Chairman Richard Neal (D-MA) wrote to Treasury Secretary Steven Mnuchin urging reversal of the position in the notice -- such expenses should be deductible in accordance with Congressional intent. The next day, Senators Grassley, Wyden, John Cornyn (R-TX), Marco Rubio (R-FL), and Thomas Carper (D-DE) introduced bipartisan legislation, the Small Business Expense Protection Act of 2020, to reverse Notice 2020-32. Companion legislation was introduced in the House. Last week, Senator Cornyn attempted to hotline (fast track) the bill but was met by resistance from several senators.

On June 5, President Trump signed the Paycheck Protection Program Flexibility Act of 2020 into law after overwhelming support for the bill in the House (417-1) and the Senate (unanimous consent). The act gives businesses 24 weeks — instead of eight — to use PPP loan money and still qualify for loan forgiveness. It also reduces the threshold for the amount of loan money required to be spent on payroll from 75 percent to 60 percent.

Senator Rubio noted that the new 60 percent threshold created a cliff effect such that if a business spent "59.9 percent of payroll, you're going to get zero forgiveness on the whole thing." On June 8, Secretary Mnuchin and SBA Administrator Jovita Carranza issued a joint statement addressing Senator Rubio's concern: "If a borrower uses less than 60 percent of the loan amount for payroll costs during the forgiveness covered period, the borrower will continue to be eligible for partial loan forgiveness, subject to at least 60 percent of the loan forgiveness amount having been used for payroll costs."

Employee Retention Credit

The ERC is a fully refundable tax credit for employers equal to 50 percent of qualified wages (including allocable qualified health plan expenses) that eligible employers pay their employees. The ERC applies to qualified wages paid after March 12, 2020, and before January 1, 2021. The maximum amount of qualified wages taken into account with respect to each employee for all calendar quarters is $10,000, so that the maximum credit for an eligible employer for qualified wages paid to any employee is $5,000.

Congress Watching the Employee Retention Credit

Like the PPP, Congress seems to be keeping an eye on the ERC. In April, the IRS released Frequently Asked Question ("FAQ") numbers 64 and 65, which generally provided that if an eligible employer does not pay employees wages for the time they are not working, the employer may not treat any portion of the health plan expenses as qualified wages for purposes of the ERC because no portion of the health plan expenses would be allocable to wages paid to the employees.

Shortly thereafter, on May 4, Chairmen Grassley and Neal and Ranking Member Wyden wrote to Secretary Mnuchin expressing disagreement with the determination that employers who continue providing qualified health benefits to their employees do not qualify for the ERC unless they continue paying other qualifying wages. The Chairmen and Ranking Member noted that Treasury and the IRS's interpretation "runs directly counter to congressional intent."

On May 7, Treasury responded to Chairmen Grassley and Neal and Ranking Member Wyden writing that "[t]he Department has taken your views under consideration and will be revising the applicable guidance." That same day, the IRS posted updated FAQ numbers 64 and 65, generally providing that eligible employers that averaged 100 or fewer employees may treat health plan expenses allocable to the applicable periods as qualified wages even if the employees are not working and do not receive any wages from the eligible employer for the time they are not working. A similar rule with respect to health plan expenses was provided for an eligible employer that averaged more than 100 employees.

Treasury Provides Guidance for the Employee Retention Credit

On May 8, the IRS released a series of FAQs addressing the ERC under the CARES Act. The FAQs address a number of issues that have given some employers pause in claiming the credit and where getting it wrong could subject an employer to a 15 percent employment tax penalty. A few notable issues addressed in these FAQs include clarifying that:

- the entire controlled group of corporations is treated as one taxpayer for purposes of determining whether the corporation is subject to a full or partial suspension of its trade or business due to government orders related to COVID-19;
- an essential business that is otherwise not subject to a government order may still qualify as being subject to a full or partial suspension if it is unable to source critical goods or materials from suppliers that are themselves subject to a government order; and
- for those employers with more than 100 full-time employees, an employer may use any reasonable method to estimate the hours that an hourly employee is not providing services, with the IRS suggesting in particular that the employer could look to its approach under the Family Medical Leave Act or its Families First Coronavirus Response Act sick leave policy.

The effect of these FAQs is not wholly taxpayer favorable. For example, treating the entire controlled group as a single entity helps a controlled group qualify as "partially suspended" where it is subject to governmental orders in only the location of one of its member corporations, but it can make it harder for an employer to meet the test for a significant decline in gross receipts.

By: Christopher Hanna, Dallas, Josh Odintz and Alexandra Minkovich, Washington, DC, and Amanda Swartz and Matt Mauney, Houston

Business Leagues for One? Beware of the "Line of Business" Factor

Certain companies have frequently and - even more so now - are currently looking for ways to assist stakeholders navigate business hurdles and continually share knowledge, best practices, and expertise. These could be related to providing other financial assistance and other resources, cooperating with companies within their respective supply chain to offer better payment terms or flexible logistical solutions, introduction to customers, creating communities for discussions of best practices, or, in today's challenging times, by gathering information on Covid-19 related government assistance and relaying it where most needed, etc. Forming a tax exempt organization with the purpose of assisting stakeholders overcome the economic impact of Covid-19 would appear to be a tax-efficient way to accomplish just that - if possible. Franchise companies could be prime candidates for such structure, considering the number of franchisees they may have, the broad impact that such assistance would bring, and the relative ease of leveraging the existing network franchisees already form. However, although the idea sounds simple enough, keeping them eligible for tax exempt status is, unfortunately, much more complicated.

Background

On April 24, 2020, the IRS issued an adverse determination through Private Letter Ruling ("PLR") 202017028. It concluded that a taxpayer, a membership organization, did not qualify for tax-exempt status under Code Section 501(c)(6) because the taxpayer's activities furthered the private interests of its members rather than promote the improvement of business conditions of one or more lines of business. Although the "line of business" requirement highlighted in PLR 202017028 is not the only requirement needed to qualify for tax exemption under Code Section 501(c)(6), the IRS has made it clear that not meeting it would be determinative.

Business League

Under Code Section 501(c)(6), business leagues, chambers of commerce, real estate boards, boards of trade, and professional football leagues that (1) are not organized for profit, and (2) have net earnings which do not inure to the benefit of any private shareholder or individual, are exempt from federal income tax. Under Treas. Reg. Section 1.501(c)(6)-1, and as specifically listed under PLR 201347022, an organization must satisfy the following factors to benefit from tax exemption under Code Section 501(c)(6):

1. Be an association of persons having some common business interest, and its purpose must be to promote this common business interest;
2. Not be organized for profit;
3. Be a membership organization and have a meaningful extent of membership support;
4. No part of its net earnings may inure to the benefit of any private shareholder or individual;
5. Its activities must be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons;
6. Its purpose must not be to engage in a regular business of a kind ordinarily carried on for profit, even if the business is operated on a cooperative basis or produces only sufficient income to be self-sustaining;
7. It must be primarily engaged in activities or functions constituting the basis for its exemption; and
8. Its primary activity cannot be performing particular services for members.

In *ABA Retirement Funds v. United States*, 2013-1 USTC (N.D. Ill. 2013), *aff'd*, 749 F.3d 718 (7th Cir. 2014), it is stated a taxpayer must satisfy all the above-mentioned requirements to qualify as a business league. The eight-factor test has also been shortened to a six-factor test. *See, e.g., Bluetooth SIG Inc. v. United States,* 611 F.3d 617, 622 (9th Cir. 2010), *aff'g* 2008-1 USTC ¶ 50,177 (W.D.Wash. 2008). The "*reduced*" six-factor test requires that the group be an association (1) of persons having a common business interest; (2) whose purpose is to promote the common business interest; (3) not organized for profit; (4) that does not engage in a business ordinarily conducted for profit; (5) whose activities are directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons; and (6) of the same general class as a chamber of commerce or a board of trade.

The Line of Business Test

Code Section 501(c)(6) focuses on eight factors, but PLR 202017028 appears to focus on one: the "line of business" test. The "line of business" test imposes two separate but interrelated requirements: (1) taxpayer must represent one or more lines of business, and (2) it must not primarily be directed to performing particular services for individual persons.

The term "line of business" has traditionally been interpreted as referring to either an entire industry or all components of an industry within a geographical area. *See e.g.,* GCM 39062 (Nov. 22, 1983). In practice and shown through several of the IRS's decisions, associations representing all companies at every level in a business (i.e., an entire industry) are not the norm, rather, most trade associations are comprised of only one specific part of an industry. For example, in Rev. Rul. 67-334, an association, comprised of companies that manufacture a particular type of packaging material, promoting the use of that packaging material through the advertising and featuring of brand names of the manufacturers' product was determined to be tax exempt under Code Section 501(c)(6). Additionally, in Rev. Rul. 55-444, the IRS granted tax exempt status under Code Section 501(c)(6) to an association of retail dealers whose membership was open only to dealers engaged in retailing certain products and equipment. Lastly, in Rev. Rul. 73-567, a board formed to administer a certification program to physicians practicing in a particular medical specialty meant to improve the quality of health care and maintain high standards of excellence, was approved as an exempt business league. The aforementioned examples serve to illustrate that the IRS's application of the "line of business" test does not align with the idea that an organization must represent an entire industry to qualify for tax exempt status under Code Section 501(c)(6), rather the organization may represent only a subset of that industry.

Although the IRS does not require a taxpayer to represent an entire industry to qualify for tax exemption status under Code Section 501(c)(6), the IRS has made it clear that organizations with too narrow of a scope would not satisfy the "line of business" requirement either. For example, in Rev. Rul. 73-411, the IRS concluded that a shopping center merchants' association whose membership was restricted to, and required of, the tenants of a one-owner shopping center did not qualify for tax exemption status under Code Section 501(c)(6) because it did not serve the common business interests of "the kind of public business community contemplated by the statute." Following the same line of argument, under PLR 201906014, the IRS denied tax exempt status to an organization that was composed only of insurance agents from a specific insurance company, ruling that the organization did not improve conditions for the insurance agent industry outside of its membership. As such, although the "line of business" test should not be seen as requiring form an organization to represent an entire industry, focusing only on stakeholders of one business will likely be seen as too narrow of a scope by the IRS.

Finally, under PLR 201150032, the IRS denied tax exemption status under Code Section 501(c)(6) because the taxpayer's primary purpose and activity was to promote a single brand of inter-connection technology, rather than the improvement of business conditions of one or more lines of business. It should be noted that even though the board was open to any company in any industry, because the board of director of the organization had to approve all members, the IRS ruled that the organization lacked the voluntary and openness standard generally applicable to all potential members under Code Section 501(c)(6), citing Rev. Rul. 73-411. As such, it is important to not only have articles of incorporations and bylaws that encompass a large enough subset of an industry, but the organization must, in practice, be representing that subset.

Decision in PLR 202017028

In the present case, the IRS determined that the organization's goals were (1) fostering knowledge via the information sharing, (2) uniting franchise owners, (3) providing a forum of open and productive communication, and (4) promoting profitability and improving business conditions for franchise owners. The IRS ruled that taxpayer's activities only benefited and promoted interests of franchise owners of a specific organization rather than an industry as a whole, similar to the organization in Rev. Ruling 58-294. In that ruling, an association of licensed dealers did not qualify as a business league because the association held the controlling interest in a corporation that held the basic patent of a product it sold. More precisely, the IRS ruled that the association, which was engaged in furthering the business interests of its member dealers, did not qualify as a business league because the association did not benefit businesses that manufactured competing product of the same type covered by the patent. As such, and as provided above, the scope of the organization must be broad enough to encompass a subset of an industry to meet the requirement of the "line of business" test.

Here, the IRS determined that the association failed the test because the taxpayer advised its members in the operation of their individual businesses and helped them network with vendors and, therefore, provided a service to taxpayer's members, rather than merely promoting or improving a line of business. In Rev. Rul. 66-338, an organization formed to promote the interests of a particular retail trade did not qualify as tax exempt because the organization advised its members in the operation of their individual businesses. As such, it is important to consider that the activities and mission of the organization must not be self-serving but must foster the betterment of an entire line or lines of business - even benefiting competitors where applicable. *See also National Muffler Dealers Association. Inc. v. United States*, 440 U.S. 472 (1979), Rev. Rul 67-295 (citing luncheon meetings as key to benefitting the industry as a whole versus a specific product), Rev. Rul. 68-182 (citing and stating the IRS would not follow *Pepsi-Cola Bottlers' Association, Inc. v. United States*, 369 F.2d 250 (1966) where the Court held the association was tax exempt even though it focused only on a single product within an industry).

The "line of business" test does not actually require an organization to represent an entire industry, but it must represent a portion of the industry (including competitors) and cannot be excessively narrow in scope.

Conclusion

In conclusion, to be exempt from federal income tax under Code Section 501(c)(6), taxpayers must be aware and ensure that all eight factors (or the reduced six-factor test provided above) are carefully reviewed, analyzed, and met, and pay particular attention to the "line of business" requirements. On the one hand, although the term is broadly defined, it does not necessarily require taxpayers to serve an entire industry or all components of an industry within a geographical area. On the other hand, serving only the members of a single franchise or business interest should be seen as excessively narrow by the IRS. It may be possible for an organization to be limited to a subset of a profession, provided that the services it provides broadly benefit that subset. Lastly, in the event an organization does not qualify for tax exemption under Code Section 501(c)(6), the organization may still be able to meet and explore the other tax exempt organization requirements of other subsection in Code Section 501(c).

By: Jason Graham and Etienne Couret, Dallas

Online Trading Platform for Partnership Interests is a Qualified Matching Service

In private letter ruling ("PLR") released on April 24, 2020, the IRS concluded that a limited liability company that provides a venue for buying and selling of limited partnership interests using a web-based trading platform (the "Platform") satisfies the requirements as a qualifying matching service, as described in Treas. Reg. § 1.7704-1(g) and not an established securities market as described in Treas. Reg. § 1.7704-1(b) for purposes of section 7704(b) and Treas. Reg.§ 1.7704-1 [PLR 202017008].

Law

Code Section 7704 and its related regulations address certain publicly traded partnerships treated as corporations. It requires a multi-layered approach for determining whether a limited liability company ("LLC") is publicly traded, and, if so, whether such LLC will be taxed as a corporation. A corporate tax status will apply to an LLC only if ownership interests of the LLC are either (i) publicly traded on an established securities market (*See* Treas. Reg. § 1.7704-1(g)) or (ii) readily tradable on a secondary market (or its substantial equivalent), as described in IRC § 7704(b)(2)).

An established securities market is defined in Treas. Reg. § 1.7704-1(b). If interests are not tradable on an established securities market, they might be tradable on a secondary market or its substantial equivalent. Those partnership interests are defined as interests that, taking into account all of the facts and circumstances, the partners are readily able to buy, sell, or exchange their partnership interests in a manner that is comparable, economically, to trading on an established securities market. Treas. Reg. § 1 .7704-1(c)(1).

Alternatively, a transfer of a partnership interest may be completed through a qualified matching service. Treas. Reg. § 1.7704-1(g). This way the transfer will be disregarded in determining whether interests in the partnership are readily tradable on a secondary market or the substantial equivalent thereof. However, a transfer will meet the requirements of a qualified matching service only if all the conditions of the Treas. Reg. § 1.7704-1(g)(2) are satisfied.

Summary of Facts

A limited liability company X ("X") formed under the laws of State plans to provide the buying and selling of limited partnership interests through Platform. The web-based trading Platform will allow qualified prospective buyers and sellers to trade partnerships interests by allowing the sellers of interests to list those interests for sale on the Platform and potential buyers to view the offered interests and indicate their interest in purchasing, either by including the exact price they will be willing to pay or without including one. If the buyer and seller are matched through this process, X will provide a purchase agreement and an assignment to complete the transfer of the limited partnership interest. If requested by the parties, X will contact the general partner of the partnership to obtain its consent to transfer.

Specifically, X makes the following factual representations about the Platform:

(1) The Platform will consist of a computerized or printed listing system that will list customer's bids and/or ask quotes in order to match partners

who want to sell their interests in partnerships with persons who want to buy those interests;

(2) Matching will occur either by matching the list of interested buyers with the list of interested sellers or through a bid and ask process that allows interested buyers to bid on the listed interest;

(3) The selling partner will not be able to enter into a binding agreement to sell the interest until the 15th calendar day after the date information regarding the offering of the partnership interest for sale is made available to potential buyer. X will maintain the records at a central location to evidence such period;

(4) The closing of the sale effected by virtue of the Platform will not occur prior to the 45th calendar day after the date information regarding the offering of the partnership interest for sale is made available to potential buyers. X will maintain the records at a central location to evidence such period;

(5) The Platform will display only quotes that do not commit any person to buy or sell a partnership interest at the quoted price (non-form price quotes), or quotes that express interest in a partnership interest without an accompanying price (nonbinding indications of interest). The Platform will not display quotes at which any person is committed to buy or sell a partnership interest at the quoted price (firm quotes);

(6) The selling partner's information will be removed from the Platform within 120 calendar days after the date information regarding the offering of the partnership interest for sale became available. Following any removal of the selling partner's information from the Platform, other than by reason of sale of any part of such interest, no offer to sell an interest in the partnership will be entered into the Platform by the selling partner for at least 60 days; and

(7) X will notify the general partners of partnerships in which interests are sold over the Platform about the sale. The general partners will be responsible for ensuring that those transactions executed through the Platform when combined with any other transactions through the Platform or other venue do not add up to greater than ten percent (10%) of the total interest in the partnership.

X asserts that the intended Platform does not constitute an established securities market as defined in Treas. Reg. § 1.7704-1(g), but instead satisfies the requirements of a qualified matching service, based on the factual representations made above.

IRS Ruling

Based solely on the facts and representations submitted by X, the IRS ruled that the Platform met all the requirements of a qualified matching service of Treas. Reg. § 1.7704-1(g)(2) and, as such, is not an established securities market described in Treas. Reg. § 1.7704-1(b) for purposes of IRC § 7704. Moreover, IRS ruled that a partnership, whose interests become available on the Platform will not be considered publicly traded just because its interests are being offered on the Platform and may rely on the ruling as long as: (a) the ruling is not revoked; (b) the sum of partnership interests transferred during the taxable year of the partnership (other than in private transfers not involving trading (see Treas. Reg. §1.7704-1(e)) does not exceed ten percent (10%) of the total interests in partnership's capital or profits determined as provided in Treas. Reg. § 1.7704-1(k) and (c) the Platform continues to operate in a manner consistent with the facts as represented. However, it will remain the responsibility of the partnership whose interest is being traded and not of X to maintain the information required to permit a partnership to make the calculations, and the actual making of the calculations relating to qualification for any applicable safe harbor available under Treas. Reg. § 1.7704-1.

Finally, the IRS did not express or imply an opinion on the federal tax consequences of the transaction under any other provisions of the Code.

Looking Forward and Planning Ahead

In partnerships where transfers are made through a "qualified matching service," up to 10% of the interests can be transferred during the partnership's taxable year without resulting in the partnership being classified as a public traded partnership ("PTP").

The PTP classification comes with various adverse tax consequences for the partnerships and its investors. For partnerships organized under US law, the classification may result in the imposition of US corporate income tax filing and payment obligations on its worldwide taxable income. Moreover, PTP classification would make it impossible for the investors to benefit from the pass-through treatment of the partnership's items of income and loss.

Although a PLR cannot be relied upon by taxpayers other than those who request it, such nonprecedential guidance nevertheless indicates the position of the IRS and can be used for certain penalty protection purposes. In addition, a similar conclusion was reached by the IRS in 2018 in PLR 201840006 when a platform operated by a corporation, which was intended to match potential buyers and sellers of partnership interests through non-public online listings at non-firm prices, was ruled to be a qualified matching service and not an "established securities market" under Treas. Reg. § 1.7704-1(b). Therefore, this appears to be the current view of the IRS on such platforms, and the beneficial treatment of such arrangements is welcome news for affected taxpayers. As always, however, such favorable treatment is heavily dependent on the facts, and even a slight deviation from the published rulings may result in a completely different outcome (at least in the eyes of the IRS).

By: Ida Varshavsky, Zurich

DAC6 Possible Six-Month Deferral to Reporting

The EU Mandatory Disclosure directive, also known as “DAC 6” has by now been introduced and implemented in most EU Member States. Due to COVID-19, a directive is expected to be approved later this month granting Member States the option to defer the reporting deadlines by six months. As the deferment is optional, intermediaries and taxpayers may have to deal with a range of different reporting deadlines in the various Member States. For the first reporting period (reportable transactions between June 25, 2018 and June 30, 2020), reporting deadlines can range between August 31, 2020 and February 28, 2021. Reporting deadlines for reportable transactions after July 1, 2020 can range between August 1, 2020 and February 1, 2021. As the deferment is not approved yet and as reporting deadlines may not be deferred in the relevant Member States, we recommend not delaying preparations for mandatory disclosure. We refer to our tax alert for a more detailed explanation of the possible deferment and its implications, “*DAC6: Possible Six-Month Deferral to DAC6 Reporting*.”

By: Megan Ruigrok, Chicago

Texas Court Delivers a *Sirius* Change to Sourcing Methodology for Services

In a recent decision, the Texas Court of Appeals applied market-based sourcing for services, despite the state’s statute that requires the sourcing of receipts to the location where the service is performed. In *Hegar v. Sirius XM Radio Inc.*, No. 03-18-00573-CV (Tex. App. Austin, 2020), the court did not account for traditional cost-of-performance indicia, such as the time and resources that go into the production and distribution of a service, and instead only considered the final act that gets the service to the customer. In short, the court applied a cost-of-performance sourcing rule to produce a market-based sourcing result.

For more information on these and other recent state and local tax updates, please see "*Texas Court Delivers a Sirius Change to Sourcing Methodology for Services*" on the SALT Savvy blog, available at www.saltsavvy.com.

By: Trevor Mauck, New York

Texas Comptroller's Office Implements New Sourcing Rule for Internet Sales and Announces End of Internet Access Tax

First, the Texas Comptroller has adopted amended regulations under 34 Tex. Admin. Code § 3.34 relating to the local portion of the sales tax for internet orders. This rule change has the potential to impact a great number of internet sellers as well as most local Texas jurisdictions. Previously, when an order was placed over the internet and the seller fulfilled that order at a location at a place of business in Texas, the sale was considered to be consummated at that place where the order was fulfilled, and local sales tax was sourced to that fulfillment location. However, under the newly-enacted regulation, those internet orders are now considered to be sourced at the purchaser's address, which means that the local portion of the sales tax is due to the jurisdiction of the purchaser's address. This change is crucial because it is likely to shift revenue from jurisdictions that contain one or more fulfillment centers to jurisdictions where no such fulfillment centers are located. This change may also affect internet retailers who have entered into incentive agreements with Texas jurisdictions, because those incentive agreements could rely on the jurisdiction's ability to receive the additional local sales tax revenue generated by the fulfillment centers. This revenue shift is even more important in light of the current COVID-19 pandemic and resulting revenue shortfall. The rule change has been extremely contentious, spanning many pages of comments in the Texas Register and an opinion column by Comptroller Hegar in the Dallas Morning News. The new rule is not due to take effect until October 2021 so the Texas Legislature has a chance to weigh in on the rule in the 2021 legislative session.

The Texas Comptroller's Office has also announced that, starting July 1, 2020, it is no longer imposing sales tax on separately stated internet access charges because that tax is no longer permitted by the Internet Tax Freedom Act's grandfather clause. As a result, Texas will no longer be able to tax internet services unless those services are part of a bundle in which no reasonable allocation may be made. In Comptroller Hegar's 2020-2021 Biennial Revenue Estimate, the Comptroller's Office estimated that lost revenue from the internet access tax will be approximately $500 million per year, so it will be interesting to see how the Texas Comptroller's Office accounts for the lost revenue."

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For more information on these and other recent state and local tax updates, please see "*Texas Comptroller's Office Implements New Sourcing Rule for Internet Sales and Announces End of Internet Access Tax*" on the SALT Sawy blog, available at www.saltsawy.com.

By: Jimmy Lucas, Dallas

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