

myStateTaxOffice *Quarterly*

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MyStateTaxOffice Quarterly is prepared by PwC – Washington National Tax Services SALT team. Our objective is to provide a quick reference to our recently issued key developments.

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SALT Perspective **2012 trends in sales and use tax nexus expansion**

*Authored by: Amy St. Clair,
February 10, 2012*

Since January 1, 2012, sixteen bills have been introduced in various state legislatures specifically addressing the expansion of sales and use tax nexus. Although many states are modelling their legislative language after bills previously enacted in New York, Oklahoma and Colorado, there are many variations built upon these prior enactments and several new nuances.

Continuing the 2011 trend, sales and use tax nexus expansion in 2012 includes some common themes: click-through nexus, affiliate nexus, and reporting notices. Further, both prior to 2012 and in many of the 2012 proposed bills, many states are considering whether the use of affiliated or unrelated distribution warehouses in a state creates nexus. Finally, many states are tying their nexus expansion effective dates to the enactment, or lack of enactment, of federal legislation addressing remote sales tax collection.

Click-through nexus

In 2008, New York enacted the first click-through nexus law. Since then, many variations of click-through nexus have been enacted or proposed. In general, click-through nexus laws require out-of-state retailers operating "affiliate programs" in the state to register to collect and remit sales taxes. To accomplish this, legislation often amends the term "vendor" or "retailer" to include a person making retail sales of tangible personal property or services facilitated by an agreement with an in-state resident (an "affiliate")

who, directly or indirectly, refers potential customers by a link on an internet website to the seller for a commission or other consideration.

This position usually can be rebutted. It should be noted that New York's law is currently being challenged in the courts.

Since New York's enactment in 2008, multiple states have introduced similar legislation with seven states having enacted click-through statutes by the end of 2011. (Pennsylvania did not enact legislation, but instead issued a Department of Revenue bulletin stating that Pennsylvania's current nexus statutes are broad enough to include click-through transactions.) In keeping with this trend, since January 1, 2012, click-through legislation has been introduced in the following states: Florida (two separate bills), Hawaii, Indiana, Maryland, Minnesota, Missouri, and Vermont.

Affiliate or agency nexus

In addition to or instead of enacting click-through nexus laws, many states have enacted affiliate nexus statutes (The term "affiliate" in this instance is different from the "affiliates" in the affiliate programs described above.). Affiliate nexus laws consider the ownership relationships between in-state and out of state entities when determining nexus. Colorado and Oklahoma enacted this type of nexus expansion legislation in 2010. In general, such provisions state that any retailer that is part of a controlled group of corporations that has a component retailer member engaged in business in-state will be presumed to have sales and use tax nexus in the state. The presumption generally may be rebutted. Since 2010, many states have proposed similar legislation, with five states enacting such provisions.

Further, seven states have introduced affiliate nexus legislation since January 1, 2012, including: Florida (two separate bills), Hawaii, Indiana, Missouri, New Jersey, Vermont and Virginia.

Taking this one step further, Oklahoma enacted a deemed nexus presumption that is not rebuttable. Several other states soon followed suit. Under these statutes, nexus is deemed to exist when an out-of-state retailer holds a substantial ownership interest in, or is owned in whole or substantial part by, a retailer maintaining a place of business in the state, and:

- the out-of-state retailer sells the same or a substantially similar line of products as the related in-state retailer and does so under the same or a substantially similar business name;
- the in-state facilities or employees of the related in-state retailer advertise, promote, or facilitate sales by the out-of-state retailer to consumers; or
- a distribution house, sales house, warehouse or similar place of business in the state delivers property sold by the out-of-state retailer to consumers.

Continuing in 2012, the trend has been to expand the list of nexus creating activities performed on the out-of-state retailer's behalf and, in some cases, to remove the substantial ownership requirement. For example, Florida [Senate Bill 7206](#) provides that a dealer making mail order sales is subject to sales/use tax if a person, other than a person acting in the capacity of a common carrier, has substantial nexus with this state and that person:

1. Sells a similar line of products as the dealer and does so under the same or a similar business name;
2. Maintains an office, distribution facility, warehouse, storage place, or similar place of business in this state to facilitate the delivery of property or services sold by the dealer to the dealer's customers;
3. Uses trademarks, service marks, or trade names in this state which are the same or substantially similar to those used by the dealer;
4. Delivers, installs, assembles, or performs maintenance services for the dealer's customers in this state;
5. Facilitates the dealer's delivery of property to customers in this state by allowing the dealer's customers to pick up property sold by the dealer at an office, distribution facility, warehouse, storage place, or similar place of business maintained by the person in this state; or
6. Conducts any other activities in this state which are significantly associated with the dealer's ability to establish and maintain a market in this state for the dealer's sales.

Since January 1, 2012, five states have introduced similar nexus expansion legislation: Florida (two separate bills), Indiana, Missouri, New Jersey and Vermont.

Out-of-state retailer notification requirements

Though not nexus expansion provisions per se, out-of-state retailer notification requirements were first introduced by Colorado in 2010 in conjunction with its affiliate nexus provisions to

encourage use tax reporting among in-state purchasers. Such statutes generally provide that an out-of-state remote seller who makes sales into a state but who is not required to collect and remit sales and use tax under the state's nexus provisions must provide a prominent notice to its in-state purchasers that they owe use tax since sales tax is not being collected and remitted on their behalf. Although Colorado's provisions are currently not effective due to a federal injunction, four states have enacted similar, but less aggressive, legislation. Since January 1, 2012, Florida and Virginia have introduced bills with notice reporting provisions.

In-state distribution center

In addition to the above three nexus expansion tactics, the use of a warehouse or distribution center in state has moved to center stage in state nexus legislation. Prior to 2012, a handful of states, California, South Carolina and Tennessee, entered agreements with online retailers regarding in-state distribution centers. These agreements generally allow an online retailer to postpone the collection and remittance of sales tax in exchange for job creation from the building of an in-state warehouse.

Rather than entering into deals with online retailers, in 2012, it appears that legislatures are more likely to include the use of in-state distribution centers as a nexus creating activity within their statutes. For example, the following introduced bills illustrate this position:

1. Arizona [S.B. 1338](#)- A "retailer" includes any company that has warehouses or distribution centers in the state;
2. Oklahoma [H.B. 2586](#)- "Maintaining a place of business in state" includes utilizing or

maintaining a warehouse, whether by the taxpayer or an agent;

3. Tennessee [H.B. 2370/S.B. 2232](#)- The legislation provides a list of activities that do, as well as activities that do not, create a nexus relationship for affiliates/third parties. The bill defines an affiliate relationship as one that involves placing a distribution center in Tennessee with accompanying capital investment and job creation requirements;
4. Virginia [S.B. 597](#)- A dealer is presumed to have sufficient activity within the Commonwealth to require registration (unless the presumption is rebutted) if any commonly controlled person maintains a distribution center, warehouse, fulfillment center, office, or similar location within the Commonwealth that facilitates the delivery of tangible personal property sold by the dealer to its customers;
5. Vermont [H.B. 639](#)- The "vendor" definition is expanded to include taxpayers, or their agents, using a distribution type facility or selling, delivering, installing, assembling, or taking orders for any tangible personal property.

Remote sale collection effective dates

Another common trend is to tie the effective date of sales tax nexus expansion legislation to the enactment of federal legislation addressing remote seller collection responsibilities. For example, California [A.B. 155](#) introduced this trend in 2011 with the following caveats in its law:

1. If a federal law is enacted that allows states to mandate use tax collection for online retailers by

July 31, 2012 and California does not enact the federal law, nexus expansion provisions become effective January 1, 2013.

2. If a federal law that allows states to mandate use tax collection for online retailers is not enacted by July 31, 2012, nexus expansion provisions become effective September 15, 2012.

Following that trend, Vermont and Washington have introduced legislation that contains effective date provisions based on federal enactments. Further, in a unique nuance, the Washington proposed legislation, [S.B. 6474](#), provides that, effective January 1, 2014, origin-based sourcing will become effective unless Congress enacts legislation requiring remote sellers to collect tax before then.

Outside of legislative methods, in 2011, Tennessee reached an agreement with a large out-of-state Internet retailer to postpone the imposition of sales tax until January 1, 2014 unless a national solution is addressed before that time. Following that trend, on January 9, 2012, the Indiana Department of Revenue announced an agreement with the same Internet retailer in which the out-of-state retailer will voluntarily collect and remit sales tax beginning January 1, 2014 or 90 days from the enactment of federal legislation, whichever is earlier.

PwC Observes

Susan Haffield, PwC Partner in Minneapolis remarks that "although these proposed bills appear to be aimed at Internet retailers, many more unsuspecting businesses will be impacted. Any out-of-state retailer, even if it is not an Internet retailer or mail order business, but that meets the *di minimis* thresholds and ships into a state that has these types of laws may

unknowingly be subject to additional filing and reporting requirements."

Jennifer Jensen, PwC Director in Washington, DC notes, "It appears that states are scrutinizing sister states' legislation for successes and failures. In order to ensure a greater possibility of increased revenue streams, states are crafting legislation that is even more all-encompassing. The states' efforts to expand the reach of these bills and the mere volume increase of introduced bills will most likely increase national attention to this topic."

Prospects are varied for 2012 combined reporting legislative proposals

*Authored by: Kate Thurber,
February 24, 2012*

With the 2012 legislative season well under way, legislators in at least eight states have introduced bills that would implement combined or consolidated reporting. Outlined below are the most recent proposals and an analysis of potential future actions.

Alabama

Introduced on February 2, 2012, Alabama [H.B. 199](#) would define "unitary business" and would require taxpayers that are part of a unitary business to file a combined return. For purposes of Alabama law, "unitary business" would be defined as "a single economic enterprise that is made up either of separate parts of a single business entity or of a commonly controlled group of business entities that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that

produces a sharing or exchange of value among them and a significant flow of value to the separate parts." This definition is identical to the one included in the [Multistate Tax Commission's model statute for combined reporting](#). In addition, Alabama's definition of unitary business would be "interpreted broadly, limited only by the boundaries imposed by the U.S. Constitution."

In Alabama, the combined report would also include those members of the unitary business "commercially domiciled in a non-U.S. jurisdiction designated a tax haven by the Organization for Economic Cooperation and Development." Alabama taxpayers included in a combined report would calculate their Alabama taxable income by "apportioning the combined group's income to Alabama using a formula that measures the taxpayer's Alabama source apportionment data relative to the combined group's apportionment data from all sources."

The legislation does not address the election to file an Alabama consolidated return that is available to Alabama affiliated groups filing a federal consolidated return.

Ultimately, the legislation leaves the task of fully developing the combined reporting regime to the commissioner.

"This is the fourth consecutive year that a combined reporting bill has been introduced in Alabama," notes Kelly Smith, PwC SALT Partner in Atlanta, GA. "Historical evidence would suggest this bill does not have a good chance of passage. Nonetheless, taxpayers who would be adversely affected by the legislation would be wise to stay close to it, and the fact that the bill also includes partial decoupling provisions for bonus depreciation and the 199

deduction may affect its likelihood of passage. What will be most interesting is how accurate any fiscal note would be given that Alabama only recently increased the weighting of the sales factor and implemented market based sourcing effective in 2011."

Florida

Citing the "competitive disadvantage" Florida corporations experience as a result of a "separate accounting system," the Florida Senate introduced legislation, [S.B. 1590](#), on January 12, 2012, that would adopt a "combined system of income tax reporting."

The proposed legislation would modify the definition of taxpayer to include all corporations "that are members of a water's edge group" and would define water's edge group as "a group of corporations related through common ownership whose business activities are integrated with, dependent upon, or contribute to a flow of value among members of the group."

The proposed legislation also lays out rules for determining the members of the water's edge group and provides detailed requirements for using the water's edge reporting method to determine the group's taxable business profits. The legislation further provides that a water's edge group will be required to file a domestic disclosure spreadsheet in addition to its return. If enacted, the legislation would require the filing of a combined return for tax years beginning on or after January 1, 2013.

However, as Jay Koren, PwC SALT Partner in Miami, FL notes, "similar legislation is introduced each legislative session. With a Republican House and Senate, combined reporting would be perceived as an overall increase in taxes and so the likelihood of this legislation

passing this session is slim. Instead, the focus is on tax relief, as last year the Governor proposed to eliminate the income tax and this year he is proposing to increase the corporate exemption from \$25,000 to \$50,000, which would drop the tax rolls by several thousand taxpayers."

Kentucky

Kentucky first adopted nexus consolidation filing requirements in 2005. [H.B. 162](#), introduced on January 3, 2012, would repeal these requirements for tax years beginning on or after January 1, 2012.

"This legislation would take Kentucky back to the filing requirements that were in place prior to the Tax Modernization Act of 2005, which brought about the mandatory nexus consolidation rules," observes Chris Gilbert, PwC Director in Louisville, KY. "It is very unlikely that this legislation will find any support, especially since the Governor has recently established a special committee to look at tax reform options for Kentucky. The committee's report is not expected until late 2012, so any significant legislation is unlikely until after that report is issued and considered."

Maryland

Introduced on February 2, 2012, Maryland [H.B. 941](#) would require "an affiliated group of corporations engaged in a unitary business to file a combined income tax return reflecting the aggregate income tax liability of all the members of the affiliated group that are engaged in a unitary business." The proposed legislation would default to a worldwide unitary group, and provide for a water's edge election, the terms and conditions of which would be set out in regulations promulgated by the comptroller.

Interestingly, the proposed legislation states that "the regulations adopted by the comptroller shall be consistent with the 'Principles for Determining the Existence of a Unitary Business' (Reg. IV.1.(B)) adopted by the Multistate Tax Commission."

"An ongoing study, conducted for a number of years, shows that combined reporting would likely cost Maryland money," notes John Majowka, PwC SALT Director in Tyson's Corner, VA. "And while the study may be flawed, opponents of combined reporting still rely on it."

"Similar legislation has been introduced in prior years, but did not pass," adds Renee Padousis, PwC SALT Director in Tyson's Corner, VA. "In addition, this bill does not have the support of the Maryland Chamber of Commerce, which makes it even less likely to pass."

Missouri

On February 14, 2012, [H.B. 1727](#) was introduced in the Missouri House of Representatives. The legislation would require a water's edge combined report for any corporation that is doing business in the state and that is a member of a unitary group. The proposed legislation would define "unitary group" as "a group of corporations that: are related through common ownership; and by a preponderance of the evidence as determined by a court of competent jurisdiction or the director, are economically interdependent with one another as demonstrated by the following factors: centralized management; functional integration; and economies of scale."

"In each legislative session we see a proposal to raise taxes through modification of the tax code, including

proposals for combined reporting," notes Jeff Dardick, PwC SALT Partner in St. Louis, MO, "but almost all tax legislation enacted in Missouri over the last few years has been focused on reducing the state corporate tax burden (e.g., elimination of the Missouri Franchise Tax). This proposed legislation is particularly counter to this trend as it also includes proposals to negate conformity to federal legislation enacted since 2004, including bonus depreciation and NOL carryforwards, and makes other changes to Missouri's elective single sales factor apportionment rules."

New Mexico

Introduced on December 15, 2011, and as further amended prior to passage by narrow votes in the legislature, [S.B. 9](#) would require that "a unitary corporation that provides retail sales in a facility of more than thirty thousand square feet under one roof" file a combined return with other unitary corporations. If enacted, the effective date of the legislation would be January 1, 2013.

Governor Martinez is expected to veto the legislation, based on prior statements in opposition to combined reporting.

Oklahoma

For taxable years beginning on or after January 1, 2013, [S.B. 1562](#), introduced on February 6, 2012, would require "all entities that are part of an affiliated group engaged in a unitary business" to file a combined report "based on the combined group's business." The proposed legislation would define "unitary business" in the same manner as the Multistate Tax Commission's model statute.

Virginia

Introduced on January 20, 2012, [H.B. 1267](#) would require combined reporting for any taxpayer engaged in a unitary business with one or more other corporations. The combined group would be determined on a worldwide basis; however, the proposed legislation would provide a water's edge election. The election would be binding for ten years.

The proposed legislation also addresses the sharing of tax credits and provides that "any credit earned by one member of the group, but not fully used by or allowed to that member, may be used in whole or in part by another member of the group or applied in whole or in part against the total income of the combined group." Other tax attributes, including net operating losses and post-apportionment deductions, may not be shared among combined group members under the proposed legislation.

If enacted, combined reporting would be required in Virginia for taxable years beginning on or after January 1, 2013. However, on February 10, the House Finance Committee voted to continue the legislation to 2013.

"As noted, the bill has been pushed back to 2013 and even then, passage is unlikely," states John Majowka, PwC SALT Director in Tyson's Corner, VA.

PwC Observes

"Businesses want certainty," notes Bryan Mayster, PwC Managing Director in Washington, DC. "States looking to attract business should also want certainty in their tax code. Combined reporting will not bring certainty to a state. It will most likely have a negative impact on attracting business and may not bring in any additional revenue. So with that in mind, it is not surprising

that many of these proposals will not make it out of committee."

Key State Developments

Michigan addresses unitary flow-through entities under the income tax, and disregarded entities under the MBT

Enacted Michigan legislation amends provisions relating to the sales factor of the apportionment formula for a taxpayer that is unitary with a flow-through entity for purposes of the corporate income tax. Other enacted measures address the treatment of disregarded entities under the Corporate Income Tax and the Michigan Business Tax. [[S.B. 807](#), [S.B. 673](#), [S.B. 369](#), [S.B. 653](#), [S.B. 678](#), enacted 12/27/11]

Corporate income tax - treatment of flow-through entities and disregarded entities

As originally enacted, for a taxpayer that has an ownership or beneficial interest in a flow-through entity, business income that is directly attributable to the business activity of the flow-through entity is apportioned to the state under the single-sales factor based on the business activity of the flow-through entity. Under [S.B. 807](#), if the taxpayer is unitary with the flow-through entity, this provision does not apply.

Under [S.B. 673](#), the sales factor numerator must include a taxpayer's proportionate share of the total sales in the state of a flow-through entity that is unitary with the taxpayer, and the denominator must include the

taxpayer's proportionate share of the total sales everywhere of the unitary flow-through entity. In determining whether a flow-through entity is deemed unitary with a taxpayer, the legislation establishes a 50 percent ownership or control threshold by the taxpayer, and requires that the business activities or operations result in a flow of value between the taxpayer and the flow-through entity (or between the flow-through entity and another flow-through entity unitary with the taxpayer), or the business activities or operations of the taxpayer and entity are integrated with, are dependent upon, or contribute to each other. In addition, the legislation requires the elimination from the sales factor of sales between a taxpayer and a unitary flow-through entity, and of sales between flow-through entities unitary with the taxpayer.

Under [S.B. 678](#), a disregarded entity for federal income tax purposes is treated as a disregarded entity for corporate income tax and for withholding tax regimes. [Senate Bill 653](#) provides that a flow-through entity does not include a disregarded entity under S.B. 678.

These bills took immediate effect upon the signature of the Governor.

Michigan business tax - treatment of disregarded entities

Under [S.B. 369](#), a person that is a disregarded entity under the I.R.C. for federal income tax purposes must be classified as a disregarded entity under the Michigan Business Tax. However, a disregarded entity under the I.R.C. that was treated for MBT purposes as a person separate from its owner on an originally filed return prior to January 1, 2012 or on an amended return prior to December 1, 2011 is not required to file an amended return with its owner as a disregarded entity. In addition, if

such a disregarded entity was treated as a person separate from its owner for MBT purposes for its first tax year that begins after December 31, 2009, the entity may be treated as a person separate from its owner for its tax year that begins after December 31, 2010 and ends before January 1, 2012

This legislation is retroactive to taxes levied after January 1, 2008.

PwC Observes

"Despite the language of Senate Bill 678, under which a federally disregarded entity must be treated as a disregarded entity for corporate income tax purposes, uncertainty remains regarding the treatment of foreign disregarded entities," explains Eric Burkheiser, PwC SALT partner in Detroit. "As enacted, the corporate income tax is imposed on a 'foreign person,' meaning a person formed under the laws of a foreign country or a political subdivision of a foreign country, whether or not the person is subject to taxation under the I.R.C. Thus, it's not clear if a foreign disregarded entity is disregarded for corporate income tax purposes."

"Senate Bill 369 provides the Department with the confirmation that disregarded entities must be treated the same as they are federally for MBT purposes, as well as providing filing relief for such entities and their owners," says Jim Manley, PwC Managing Director in Detroit.

State Tax Practitioner Tip

Your local PwC state tax specialists may assist you with participation in these on-going or up-coming state tax amnesties:

- Ohio
- Texas

Enacted legislation, issued court decisions and administrative guidance

Note: The parenthetical date is the MySTO published date for the development

Income/Franchise Tax

Arizona

[Arizona enacts limited market sourcing election; proposed legislation would increase NOL carryforward period](#) (March 1, 2012)

District of Columbia

[D.C. Office of Tax and Revenue issues proposed combined reporting regulations](#) (January 20, 2012)

Illinois

[Illinois Appeals Court finds taxpayer not liable for double interest penalty](#) (March 16, 2012)

Indiana

[Indiana Supreme Court reverses Tax Court, sets procedure in forced combination cases](#) (March 16, 2012)

Louisiana

[Louisiana High Court declines to review ruling that foreign limited partner lacked nexus](#) (March 8, 2012)

Massachusetts

[Massachusetts proposed budget provides for market sourcing, addresses certain non-insurance income, delays FAS 109 fix, makes other changes](#) (January 27, 2012)

New Jersey

[New Jersey Division of Taxation inclined to respect taxpayer-IRS advance pricing agreement](#) (February 23, 2012)

[New Jersey Superior Court affirms corporation business tax assessment against foreign corporation with one telecommuting employee in state](#) (March 9, 2012)

New Mexico

[New Mexico: Overpayments from one period deemed paid against deficiencies in another period](#) (February 16, 2012)

Oregon

[Oregon Tax Court includes stock sale gains constituting business income in sales factor denominator](#) (January 27, 2012)

South Carolina

[South Carolina Court of Appeals: Department bears burden of proof in alternative apportionment case](#) (March 16, 2012)

Virginia

[Virginia proposals would remove penalties for manufacturers, amend](#)

[apportionment for retailers and allow full deduction under I.R.C. Sec. 199](#) (February 23, 2012)

Sales & Use Tax

Connecticut

[Connecticut Supreme Court determines out-of-state bookseller is liable for sales and use tax](#) (March 23, 2012)

Tennessee

[Tennessee Appeals Court holds out-of-state book distributor had sufficient nexus, liable for sales and use taxes](#) (February 3, 2012)

Other

New Jersey

[U.S. Circuit Court affirms District Court ruling, provides limited relief from New Jersey's stored value card AUP requirements](#) (January 6, 2012)

Texas

[Texas announces details of summer amnesty - penalties for non-participants](#) (March 16, 2012)

For more information on PricewaterhouseCoopers' state legislative tracking service, [click here](#).

MyStateTaxOffice Quarterly is prepared by PwC – Washington National Tax Services. We welcome your comments and suggestions – please contact any member of the Washington National Tax Services SALT Team:

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