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State Tax Program

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South Dakota – Use Tax Apportionment

Ellingson Drainage, Inc. v. South Dakota Department of Revenue, 2024 S.D. 8 (2024)

- Taxpayer, a Minnesota company specializing in installing drain tile for farming and government applications worked in 20 different states during the audit period, including South Dakota. Taxpayer used 11 pieces of equipment in the state, including some for as little as one day.
  - After an audit, the DOR imposed the use tax on the entire fair market value of the equipment. The taxpayer did not pay the sale tax on the equipment so no credit was provided.
- On appeal, the South Dakota Supreme Court affirmed the tax, stating that even though it was not apportioned, it did not violate the Commerce or Due Process Clauses.
- In May, the taxpayer filed a cert petition with the U.S. Supreme Court, arguing that imposing the unapportioned use tax on its equipment violates the fair apportionment requirement of the Complete Auto test.

New Jersey – You Cannot Shoplift the Sales Tax

New Jersey v. Burnham, Docket No. A-3519-20 (N.J. Super. Ct. App. Div. Dec. 21, 2022)

- Defendant shoplifted an Xbox One, priced at $499.99. He was charged with third-degree shoplifting, which is for merchandise exceeding $500, because the sales tax was included with the price for purposes of determining the charge. Defendant contended that the charge should be amended to fourth-degree shoplifting because the shoplifting statute does not encompass the sales tax.
- The Appellate Division agreed, stating that the general theft statute does include the sales tax in the value of the amount involved in the crime, but the shoplifting statute does not. Thus, the plain language of the shoplifting statute does not permit for the inclusion of sales tax.
  - The court stated that this reading was supported by the fact that the purpose of the shoplifting statute is to prevent the loss of merchandise, but the sales tax is not part of a store's inventory. Therefore, "there is no basis for the State to include sales tax when grading a defendant's shoplifting charge."

California – P.L. 86-272 Workaround Struck Down

American Catalog Mailers Ass'n v. Franchise Tax Board, No. CGC22601363 (Super. Ct. Dec. 13, 2023)

- The FTB issued revised guidance regarding Internet activities and their impact on the protections under P.L. 86-272.
- The Association filed a lawsuit stating that the guidance is invalid because it contradicts P.L. 86-272. The lawsuit also stated that the rule was invalid because the FTB failed to follow the rulemaking process.
- The court granted the Association's motion for summary adjudication, stating that the guidance constituted "underground regulations" in violation of the California Administrative Procedure Act.

New York – It's Not a Black or White Cookie

American Catalog Mailers Association v. Dep't of Taxation and Finance, Case No. 903320-24 (N.Y. Sup. Ct. April 5, 2024)

- The Association filed a complaint in April 2024 challenging the Department's adoption of a rule stating that businesses engaging in certain internet-based activities inside the state – including providing residents with computer cookies - are not insulated from taxation under P.L. 86-272.
  - Despite the rule being adopted in December 2023, the Department plans to apply it retroactively to January 1, 2015.
- The Association is seeking a declaratory judgment that the rule is invalid because it conflicts with P.L. 86-272.
  - The complaint, in the alternative, seeks a declaratory judgment that the rule as applied to the time period before its publication date violates Due Process.

Pennsylvania – Sparkling Water Argument Fizzles

Montgomery v. Commonwealth, No. 336 F.R. 2020 (Pa. Commw. Ct. April 23, 2024)

- Taxpayer filed a sales tax refund claim for her purchases of two bottles of Perrier sparkling water arguing that water was exempt.
- The Department denied the refund stating that Perrier is carbonated water and thus falls within the definition of a “soft drink” which is taxable.
- The Commonwealth Court affirmed the refund denial because the record shows that Perrier contains carbonation and thus falls within the plain language of the definition of a “soft drink.”

California – Streaming Service Franchise Fees

Lancaster v. Netflix, No. B321481 (Cal. Ct. App. Feb. 22, 2024)

- In a proposed class action suit, a city claimed that streaming services, like Netflix, must obtain a franchise from the state's Public Utilities Commission and pay fees to local governments.
- The appellate court upheld the lower court's dismissal of the case, stating that the city was not authorized under the 2006 Video Competition Act to bring an action against a non-franchise holder to collect franchise fees.
  - The court stated that the city's claim was a "thinly veiled request" to order the Commission to issue franchises to streaming companies or institute an enforcement action.

Ohio – Remote Working

Schaad v. Alder, 2024-Ohio-525 (2024)

- Ohio General Assembly enacted emergency legislation during the pandemic that deemed any day that an employee worked from home to be a day worked at the employee's principal place of work.
- Taxpayer, a hybrid worker before the pandemic argued that the law violated the Due Process Clause because the law permits a municipality to tax nonresidents for work performed outside of their jurisdiction.
- The Ohio Supreme Court affirmed the appellate court's determination that the legislation was constitutional and that the state's taxing jurisdiction may be exercised over all of a resident's income based on the state's in personem jurisdiction over them.

Pennsylvania – Taxpayer's Argument Fails to Wynne

Zilka v. Tax Rev. Bd., 304 A.3d 1153 (Pa. 2023)

- For three years, the taxpayer had claimed a credit for Delaware tax to offset her Pennsylvania tax. She also claimed a credit for the Wilmington Tax (and the balance of her Delaware tax not utilized) to offset her Philadelphia Wage Tax.
- The taxpayer argued that there was double taxation since she was unable to offset her Philadelphia Wage Tax with the balance of her Delaware tax. The Commonwealth Court found that there was no basis for a claim of double taxation under the Commerce Clause or a violation of the internal consistency test.
- In a 3-2 decision, the Pennsylvania Supreme Court affirmed the lower court, stating that, unlike the Maryland county tax in Wynne, the Philadelphia tax was enacted by the city council and collected by the city department of revenue. The court rejected the taxpayer's argument that Wynne requires the aggregation of the Philadelphia tax with the Pennsylvania income tax in discerning whether it violates the dormant Commerce Clause.

New York – Internet Access Taxation

In re Verizon N.Y. Inc., N.Y. Tax App. Trib., No. 829240 (May 4, 2023)

- Taxpayer was assessed additional tax pursuant to N.Y. Tax Law § 184 on its gross earnings from sales of fiber broadband and other Internet access services to ISPs.
- In its appeal to the Division of Tax Appeals, taxpayer argued: (1) that its services were interstate telecommunications eligible for the 100% deduction from the 184 Tax; and (2) Internet Tax Freedom Act (ITFA) prohibited the imposition of the 184 Tax because it is a gross receipts tax on Internet access services.
- The Administrative Law Judge held that ITFA prohibited the imposition of the 184 Tax on the taxpayer's services.

Arkansas – Broad Application of Hotel Taxes Denied

Hotels.com, LP v. Pine Bluff Advert. & Promotion Comm'n, Case No. CV-23-416 (Ark. May 16, 2024)

- A group of online travel companies were sued by localities seeking to collect several types of unpaid hotel taxes between 1995 – 2019. The circuit court found in favor of the localities and entered a judgment totaling $34M in damages and $11.5M in attorneys' fees and costs. The court found that the companies fell within the entities subject to the taxes in the statutes because it was "any other provider of accommodations[.]"
- On appeal, the Arkansas Supreme Court reversed, stating that under the doctrine of ejusdem generis, when general words following specific words in a statute, only objects similar in nature to the specific words are included in the general words.
  - Here, the court found that the preceding specific words only list lodging establishments or entities that manage those establishments. However, the travel companies do not own, operate, or manage lodging establishments, instead they are accommodations intermediaries and thus do not fall within the statute.

New York – AI Surcharge Legislation

- AB 8179 (introduced in October 2023)
  - Imposes a surcharge for each employee who was displaced due to their position being replaced by "technology."
    - "Technology" includes, but is not limited to machinery, AI algorithms or computer applications.
  - The surcharge is the sum of any taxes or fees imposed by the state or any political subdivision that are computed based on an employee's wage for the employee's final year of employment (e.g., state income tax, state unemployment insurance, local occupational taxes, etc.)
- SB 9401 (introduced in May 2024)
  - Requires employers to conduct impact assessments if they use AI.
  - Includes two separate taxes (both are at a rate of 2% of the corporation's business income base)
    - One tax is a 2% surcharge on a company that terminates the employment or substantially reduces the hours of 15 or more employees due to AI.
    - The other tax is a 2% tax when a company uses AI for data mining purposes.

Indiana – Tax Base Addback

Penn Entertainment, Inc. v. Indiana Department of Revenue, Case No. 22T-TA-00015 (Ind. Tax Ct. Feb. 28, 2024)

- Taxpayer, which operates a casino in Indiana through a subsidiary, added back the value of income taxes paid to other states. After an audit, the DOR required that certain other payments made by the taxpayer to state governments had to be added back to the Indiana tax base.
- The taxpayer claimed, among other things, that it did not have to add back the other payments because they were unapportioned excise taxes, privilege fees and other non-tax payments that were not measured by income.
- The court rejected the taxpayer's argument stating that, based on a prior Indiana Supreme Court case, the legislature's use of the phrase "based on or measured by income" suggests a broader application than if the legislature had just said "taxes on income" should be added back.

Minnesota – Apportionment Factor Calculation

E.I. DuPont de Nemours and Company & Subsidiaries v. Commissioner, Docket No. 9485-R (Minn. Tax Ct. June 24, 2024)

- Taxpayer, a science and technology company, bought and sold forward exchange contracts to offset its foreign currency exchange exposure.
  - For the relevant tax years, the net income from these contracts was $60M, $650M, and $408M. However, the gross receipts were roughly $65B for two years and $50B for the third.
- The Commissioner sought to apply an alternative apportionment method that included the net income from the contracts but not the gross receipts in the sales factor denominator.
- The Tax Court agreed, stating that "including [the contract's] gross receipts in the calculation of the general apportionment factor does not accurately show to a full degree or extent, DuPont's income arising from its taxable business activities in Minnesota."

Ohio – Fashion Faux Pas

Jones Apparel Group, et al. v. McClain, Case Nos. 2020-53, 2020-54 (Ohio Bd. of Tax App. Sept. 13, 2023)

- Taxpayer, a designer, marketer, and wholesaler of apparel, shipped products to Ohio-based distribution centers of major retailers and paid the commercial activity tax (CAT) on all items shipped even those that were ultimately received by customers outside of Ohio.
  - Taxpayer applied for a refund for amounts relating to products that were ultimately shipped to locations outside of Ohio. As evidence, the taxpayer provided labels for some products showing where they would be ultimately delivered. The Department granted those refund claims, but denied the claims for products where the label did not show the ultimate destination.
- At the Board of Tax Appeals the taxpayer provided evidence in the form of a report showing the distribution of product throughout stores across the country. The Department argued that the taxpayer must have contemporaneous knowledge of the ultimate destination at the time the product was shipped.
- The Board rejected the Department's contemporaneous knowledge standard, it also rejected the taxpayer's appeal and report stating that the sampling method used was insufficient to prove that the situsing of the products to Ohio was not valid.

Federal – Transition Tax

Moore v. United States, 144 S. Ct. 1680 (2024)

- Case is a challenge to the constitutionality of the section 965 transition tax that was enacted in the Tax Cuts and Jobs Act of 2017.
- The taxpayers argued, inter alia, that the tax is a "direct tax" that violates the U.S. Constitution's Apportionment Clause and does not qualify as an income tax under the Sixteenth Amendment. The district court granted the government's motion to dismiss and the Ninth Circuit affirmed.
- The Court ruled 7-2 in favor of the government, stating that Congress had the power to tax shareholders on undistributed income realized by the entity which has been attributed to the shareholders and when the entity itself has not been taxed on the income.

Federal – Chevron Overturned, State Impact

Loper Bright Enterprises et al. v. Raimondo, 603 U.S. ___ (2024)

- In a 6-3 decision, the Supreme Court overruled Chevron, which directed courts to give deference to regulatory interpretations of ambiguous statutes (provided the interpretations were reasonable).
  - The Court stated that Chevron was "misguided because agencies have no special competence in resolving statutory ambiguities. Courts do."
  - Congress may still vest interpretation powers in agencies when it enacts a statute.
- While this case involved federal regulations, it may also impact how courts interpret state regulations.
  - States typically apply one of three standards of review: a de novo review (including a Skidmore-type rule), Chevron-type deference, or a hybrid standard.
- Congress may still vest interpretation powers in agencies when it enacts a statute, provided it is explicitly stated.

Federal – Chevron Overturned, State Impact

Loper Bright Enterprises et al. v. Raimondo, 603 U.S. ___ (2024)

- In Loper, the Court stated:
  - "The text of the APA means what it says. And a look at its history if anything only underscores that plain meaning. According to both the House and Senate Reports on the legislation, Section 706 "provide[d] that questions of law are for courts rather than agencies to decide in the last analysis." H. R. Rep. No. 1980, 79th Cong., 2d Sess., 44 (1946) (emphasis added)"
  - "Chevron is overruled. Courts must exercise their independent judgment in deciding whether an agency has acted within its statutory authority, as the APA requires. Careful attention to the judgment of the Executive Branch may help inform that inquiry. And when a particular statute delegates authority to an agency consistent with constitutional limits, courts must respect the delegation, while ensuring that the agency acts within it. But courts need not and under the APA may not defer to an agency interpretation of the law simply because a statute is ambiguous."

Federal – Chevron Overturned, State Impact (De Novo)

Loper Bright Enterprises et al. v. Raimondo, 603 U.S. ___ (2024)

- Many states apply a de novo review where a court does not apply any deference to a state agency when reviewing a regulation. In recent years, some states have shifted to this standard.
  - For example, in 2022, Tennessee enacted SB 2285 which required courts to "not defer to [an] agency's interpretation of [a] statute or rule." It also required a court, after applying all customary tools of interpretation, to exercise "any remaining doubt in favor of a reasonable interpretation that limits agency power and maximizes individual liberty."
  - In 2024, Idaho enacted HB 626 which required courts to review agency interpretation's on a de novo basis.
- A handful of states apply a Skidmore test, which is similar to a de novo review, but gives some weight (not deference) to agency expertise.

Federal – Chevron Overturned, State Impact (Chevron)

Loper Bright Enterprises et al. v. Raimondo, 603 U.S. ___ (2024)

- Other states have adopted similar standards of review as Chevron where courts provide a level of deference to state agencies.
  - For example, in Colorado, a court is only required to set aside an agency rule when the rule violates certain standards (e.g., it is arbitrary or capricious or it is a denial of a statutory right). Colo. Rev. Stat. Ann. § 24-4-106(7).
  - In the District of Columbia, courts explicitly "defer[s] to an agency's reasonable interpretation of the statute it administers." D.C. Appleseed Ctr. for L. & Just., Inc. v. D.C. Dep't of Ins., Sec. & Banking, 214 A.3d 978, 985 (D.C. 2019).
- Loper involved the statutory interpretation of the APA. Thus, state courts are not required to abandon any Chevron-type deference it currently provides.

Federal – Chevron Overturned, State Impact (Hybrid)

Loper Bright Enterprises et al. v. Raimondo, 603 U.S. ___ (2024)

- The final set of states apply a hybrid approach to review state agency regulations/rules. This approach can vary considerably.
  - For example, in Iowa, while interpretation of a statute is a matter of law for courts to consider, a court will given deference to an agency's interpretation when such interpretation has clearly been vested by a provision of law. State v. Pub. Empl. Rels. Bd., 744 N.W.2d 357, 360 (Iowa 2008). This hybrid approach is similar to what the Court said in Loper.
  - In New York, "[d]eference is generally accorded to an administrative agency's interpretation of statutes it enforces when the interpretation involves some type of specialized knowledge[.]" Belmonte v. Snashall, 2 N.Y.3d 560, 565 (N.Y. 2004).

Federal – Chevron Overturned, State Impact (Going Forward)

Loper Bright Enterprises et al. v. Raimondo, 603 U.S. ___ (2024)

- Courts are already examining the impact of *Loper* on pending cases.
  - In *3M Co. v. Commissioner*, the taxpayer challenged the allocation of income earned by a foreign subsidiary by the IRS to reflect proper arm's-length compensation. *3M Co. v. Commissioner*, Case No. 23-3772 (8th Cir. 2024)
    - The Eighth Circuit requested additional briefing on how several recent U.S. Supreme Court decisions, including *Loper*, would impact the transfer pricing dispute.
  - Less than a month after the *Loper* decision, the South Carolina Court of Appeals acknowledged the impact of the case.
    - We are cognizant of the recent United States Supreme Court decision in *Loper Bright Enterprises v. Raimondo*, which overruled precedent requiring a reviewing court "to defer to 'permissible' agency [interpretations of the statutes those agencies administered,]" even when a reviewing court might read the statute differently, if "the statute [was] silent or ambiguous with respect to the specific issue' at hand." The Court reminded us that "[t]he Framers appreciated that the laws judges would necessarily apply in resolving those disputes would not always be clear, but envisioned that the final 'interpretation of the laws' would be 'the proper and peculiar province of the courts.'" The Court overruled *Chevron*, which "demand[ed] that courts mechanically afford binding deference to agency interpretations." *Colonial Pipeline Co. v. S.C. Department of Revenue*, No. 6072 (S.C. Ct. App. July 17, 2024) (citations omitted).

South Carolina – Income-Producing Activity

MasterCard International Inc. v. S.C. Department of Revenue, Docket No. 20-ALJ-17-0008-CC (June 3, 2024)

- The case centered on South Carolina's income-producing activity test used to apportion receipts from services.
  - Taxpayer operates a network permitting cardholders to buy goods and services and withdraw money.
  - The DOR asserted that the taxpayer maintained, operated and regulated a network for cardholders in the state and thus should be taxed.
- The ALJ upheld the DOR's position, stating that the taxpayer's income-producing activity occurred in the state.
- The ALJ rejected the taxpayer's argument that its income-producing activities take place on out-of-state data centers.

South Carolina – Retroactive Marketplace

Amazon Services LLC v. S.C. Department of Revenue, 442 S.C. 313 (S.C. Ct. App. 2024)

- In 2019, South Carolina enacted a marketplace facilitator law. However, the DOR assessed the taxpayer for third-party sales made in the first quarter of 2016 under a separate law.
- The South Carolina Administrative Law Court and Court of Appeals upheld the assessment, stating that the taxpayer was liable for the tax.
- On October 3, the South Carolina Supreme Court granted the taxpayer's writ of certiorari to review the case.

Michigan – Undelivered Tax Exemption Application

ProQuest LLC v. Township of Ypsilanti, Case No. 166549 (Mich. June 14, 2024) (order denying review)

- On June 14, the Michigan Supreme Court upheld the denial of an exemption application because the application was not received by the deadline.
  - The application was timely mailed via certified mail, but the USPS sorting machine stripped the postage and USPS held the it for 38 days before returning it to the taxpayer.
- The court held that the combination of no receipt and no action by the taxing authority meant that no appeal was allowed. Taxpayer loses.
- In a concurring opinion, Ms. Justice Welch invited the legislature to change the law "… to avoid this type of inequitable result in the future" and to give taxpayers more statutory options for delivery than the USPS or providing for digital submissions.
- Interest parties are working towards a legislative change.

South Carolina – Sourcing Intangible Property

U.S. Bank National Association v. S.C. Department of Revenue, Docket No. 20-ALJ-17-0168-CC (June 25, 2024)

- Taxpayer, a bank, earned income from a variety of sources including interest from mortgages and loans and interest and fees from credit cards.
- After an audit, the DOR issued an assessment, determining that the taxpayer should have sourced mortgage loan and credit card receipts to the state because it was intangible property.
  - The taxpayer argued that the receipts were from services and use should be sourced to where the income-producing activity occurs (in this case, outside of the state).
- The ALJ ruled in favor of the DOR, noting that intangible property is defined as all property other than tangible property and the definition of tangible property specifically excludes evidences of debt which was broad enough to include the receipts from mortgages.
  - The ALJ also found that the credit card receipts were accounts receivables that fell within the definition of intangible property.

Nebraska: I.R.C. § 965 income is not a "deemed dividend"

Precision Castparts Corp. v. Nebraska Dept. of Rev., 317 Neb. 481, _____ N.W.3d _____ (Aug. 30, 2024)

- Taxpayer sought to deduct § 965 repatriation income from Nebraska taxable income as "dividends…deemed to be received" under Neb. Rev. Stat. § 77-2716(5).
- Applied the general rules of statutory interpretation and the standards specific to tax statutes (tax imposition strictly construed against government/exemptions strictly construed in favor of government)
- Cited extensively from *Moore v. U.S.* and held:

  "that the language of Section 965 does not deem the income included to be dividends, and we determine that Section 965 employs pass-through treatment to attribute earnings to shareholders without deeming a distribution to have been made to shareholders. We therefore conclude that income included in federal taxable income pursuant to Section 965 does not qualify for deduction as 'dividends…deemed received' under § 77-2716(5)."