National Conference of State Tax Judges 42nd Annual Meeting

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AGENDA

- Nexus
- Addback of deductions
- Gain apportionability
- Apportionment
- Transaction taxes
- Miscellaneous

Nexus

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Nexus

On remand from the Michigan Court of Appeals, the Michigan Tax Tribunal found that the taxpayer did not have nexus with the City of Detroit and so was not required to pay city income tax for the 2010 and 2012 tax years. The Tribunal was directed to determine whether the U.S. Supreme Court's decision in *South Dakota v. Wayfair, Inc.* (2018) would have changed the result of this Tribunal's previous determination that was decided prior to *Wayfair* and was based on the "physical presence" standard enunciated in *Quill Corp. v. North Dakota*, (1992).

The Tribunal noted that in wake of *Wayfair*, while the physical nexus is still good law, the U.S. Supreme Court ruled that a business could acquire an economic nexus regardless of where the business, employees or warehouses are located. If the sales, or "economic activity" in that particular state are substantial enough, tax liability would ensue.

In the case at hand, the Tribunal found that the taxpayer's activities as a passive holding company were by design minimal. The Tribunal rejected the city's reliance on both the "commercial domicile" concept as well as finding that the city's reliance on the unitary business concept was misplaced as the City Income Tax does not include that concept, nor is there any language that would allow a unitary business to create a nexus link to a corporation.

(*Apex Laboratories International Inc. v. City of Detroit*, Mich. Tax Tribunal, Dkt. No. 16-000724-R, 08/19/2022.)

Nexus

Every state with a sales tax now has both remote seller and marketplace facilitator rules.

What will a successful challenge to these rules look like?

Ooma Inc. v. Dep't of Rev., No. 52; SC S067581 (Or. 12/23/2021)

The taxpayer contended that *Wayfair* requires both "economic and virtual contacts" with a state to require tax collection. Because it did not have a website or any virtual contacts with the state, it argued that simply meeting the $100,000 economic nexus threshold was not sufficient to create nexus

The Oregon Supreme Court disagreed, stating that the Supreme Court did not articulate virtual contacts as a requirement when nexus is "otherwise established through sales, marketing, and service delivery efforts."

The taxpayer has filed a petition for cert with the U.S. Supreme Court.

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Nexus

Wayfair LLC, v. City of Lakewood (Case No. 2022CV30710) (2022)

Wayfair LLC, has sued Lakewood, Colorado, over its complex sales tax reporting requirements. Wayfair alleges that during the period from 2018 to 2021, Lakewood's decentralized sales tax system unconstitutionally violated the company's right to engage in interstate commerce, which would be a direct violation of the Commerce Clause of the United States.

Colorado's sales tax reporting requirements are more complex than just about any other state's due to the fact that about half of Colorado's cities are "home rule" cities which oftentimes require separate sales tax permits, and sales tax filings, in each local jurisdiction. This means that online retailers who have sales tax nexus in Colorado could be subject to filing hundreds of pages of sales tax returns each month in order to stay compliant.

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Nexus

Halstead Bead Inc. v. Richard (Civil Action No. 2:21-cv-02106) (May, 2022)

Days after voters rejected a constitutional change that would have centralized tax collection, an out-of-state business sued Louisiana and several parishes in Federal Court to challenge the state's patchwork approach to collecting taxes.

Halstead Bead, an Arizona-based business that sells jewelry-making supplies online, says that Louisiana's parish-by-parish registration and reporting system violates the federal due process and commerce clauses.

The Defendant's Motion for Summary Judgement was granted on the issue of comity. The court also noted that it was unlikely the case would have survived a Tax Injunction Act challenge as well.

Nexus

Online Merchants Guild v. Hassell (Case No. 179 MD 2021) (September 2022)

The Pennsylvania Department of Revenue cannot pursue back taxes from certain third-party sellers that had inventory housed in Pennsylvania through participation in an Amazon sellers' program, a state court held Friday.

A seven-judge panel for the Pennsylvania Commonwealth Court unanimously blocked the department from seeking sales and income taxes from sellers that had goods stored in the state as part of the fulfillment by Amazon, or FBA, program, in which Amazon would control the flow of inventory the retailers sold. The court held in a precedential opinion that because the third-party sellers didn't control the placement of their goods after Amazon received them, they didn't have nexus with Pennsylvania.

The court also held that the Department did not have the right to inquire into the remote seller's business activities in Pennsylvania without some other connections to the state.

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Nexus

MTC Uniformity Committee Revised Statement on PL 86-272

- Purports to interpret the limits of PL 86-272 in the context of current technology
- Expands the list of unprotected activities to include:
  - A business has an employee that telecommutes on a regular basis unless the activities are limited to the solicitation of orders for tangible personal property.
  - The company provides post-sale assistance to customers via either electronic chat or email that is accessed through a link on the company's website.
  - The company solicits and receives on-line applications for its branded credit cards via the company's website.
  - The company contracts with a marketplace facilitator, whose marketplace offers for sale the company's products via a website. The marketplace maintains inventory, including the company's products, at fulfillment centers around the country.
  - The company (a) inserts Internet "cookies" into the computers or other electronic devices of customers who access the company's website and (b) uses customer search information gathered by its cookies to adjust production schedules and inventory amounts, develop new products, or identify new items to offer for sale.
  - The company remotely fixes products via the Internet and WIFI.
  - The business sells extended warranty plans via a website to customers who purchase the company's products.
  - The company streams videos and music to electronic devices for a charge.

Nexus

On August 24, 2022, the ACMA (American Catalog Mailers Association) filed a complaint in the Superior Court in San Francisco challenging the California Franchise Tax Board's adoption of comprising TAM 2022-01 and FTB Publication 1050.

The Complaint states that the California memo would effectively remove PL 86-272 long-time protection from liability for the California income tax for many remote sellers. The Case is American Catalog Mailers Assn. v. Franchise Tax Board.

New York has also adopted a version of the MTC's statement, while Oregon has taken a pass….for now.

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Addback of Deductions

Addback of Deduction

Pfizer, Inc. v. Alabama Dep't of Revenue (Ala. Tax Trib. 2022)

Pfizer paid $658 million in interest to Pfizer Transactions Ireland ("PTI") and did not add back that payment in calculating its Alabama corporate income tax.

The DOR challenged the applicability of the exception because, while PTI included the payment as income on its Irish tax return, it deducted large amounts of interest payments to affiliates and accordingly had a trading profit of just $10,000.

Alabama's statute generally requires the add back of interest and intangible expenses paid to an affiliate, but there is an exception for when corresponding item of income was "subject to" a tax based on the related member's net income by a foreign nation which has in force an income tax treaty with the United States, "even if no actual taxes are paid on such item of income in the taxing jurisdiction by reason of deductions or otherwise." Ala. Code § 40-18-35(b).

Alabama Tax Tribunal held that a corporation is not required to add back interest paid to a related entity as the recipient was subject to tax on that income in Ireland.

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Addback of Deduction

In the Matter of the Petition of Nordstrom, Inc. and Combined Affiliates (N.Y. Div. of Tax App. 2022)

The taxpayer, Nordstrom, is a fashion retailer and the parent company of a number of subsidiaries. Taxpayer took a bad debt deduction totaling approximately $119 million on its federal tax return for the fiscal year ending Jan. 31, 2009.

Division of Taxation asserted that the taxpayer was the wrong entity to take the bad debt deduction, and thus, the taxpayer should not have included the bad debt expense in federal taxable income.

The ALJ disagreed, finding that the IRS had audited the deduction and allowed it, and that "the outcome of the federal audit is determinative for purposes of the bad debt deduction.“

Accordingly, the ALJ reversed the disallowance of the taxpayer's bad debt expenses.

Gain Apportionability

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Gain Apportionability

VAS Holdings & Investment LLC v. Commissioner of Revenue, No. SJC-13139 (Massachusetts Supreme Judicial Court, 5/27/2022)

The court held that Massachusetts could constitutionally impose tax on the sale of a capital gain without applying unitary business principles, but Massachusetts law required the unitary business principal to apply

VAS was an Illinois (and subsequently a Florida) corporation that merged with a Massachusetts LLC in 2011. After the merger, VAS sold its interest in another LLC and realized a substantial gain

Because VAS was not unitary with the subsidiary, Massachusetts could not tax the gain even though the subsidiary had a substantial Massachusetts presence

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Gain Apportionability

In the Matter of Goldman Sachs Petershill Fund Offshore Holdings (Del.) Corp., v. N.Y.C. Tax Appeals Tribunal et al., No. 2022-02361 (Supreme Court of New York, First Department, N.Y. App. Div., Apr. 12, 2022)

The court held that NYC could tax the gain on a foreign corporation's sale of a minority interest in an investment management company doing business in NYC despite there being no unitary relationship between the foreign corporation and the investment management company

The foreign corporation contended that although the investment management company was doing business in NYC, it was not, and upon earing the gain, the question should be whether the foreign corporation had nexus with NYC

See also Ohio HB 515

Expands the definition of business income to include the sale of an equity or ownership interest in a business

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Gain Apportionability

2009 Metropoulos Family Trust v. Franchise Tax Board, Super. Ct. No. 37-2020-00011877-CU-MC-CTL, D078790 (Cal. App., May 27, 2022)

The California Court of Appeal held that nonresident trust shareholders were subject to California tax on their gain from the sale of an S corporation's stock in a subsidiary

The taxpayers argued that the sourcing rules for intangibles under the personal income tax rules should apply

The Court determined that because the S corporation sold the interest, the sourcing rules for corporations applied

Apportionment

Virginia Dep't of Taxation v. R.J. Reynolds Tobacco Co. 868 S.E.2d 429 (Va. 2022)

Under Virginia law, the numerator of the property factor includes real and tangible property owned and used in Virginia

The taxpayer aged tobacco in warehouses in Virginia

This storage did not constitute “use” under Virginia law, as consequently was excluded from the factor

Apportionment

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Akamai Technologies. Inc. v. Commissioner of Revenue, Mass App. Tax Bd. 2021

In Massachusetts, a manufacturing corporation must use single sales factor apportionment formula, instead of the standard three factor formula.

The Massachusetts Appellate Tax Board held that because the company and sold standardized computer software, which operated almost automatically without employee intervention, the company qualified as a manufacturing corporation.

On May 9, 2022, the Commissioner appealed the decision to the Massachusetts intermediate appellate court.

19

Apportionment

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Sirius XM Radio, Inc v. Hegar, TX S. Ct. No. 20-0462 (March 25, 2022)

- The Texas Supreme Court held Sirius XM's receipts from Texas subscribers are apportioned to the state based on where the company's personnel or equipment performing the service is physically located, not where the satellite-enabled radio is located.
- In so doing, the court reversed the Appellate Court. The Appellate Court held the company's service receipts should be sourced where the "receipt-producing end-product act" of decrypting the radio signal occurred. The supreme court rejected that argument and concluded that a service is performed in Texas "if the labor for the benefit of another is done in Texas."
- The court recognized the disagreement was "largely one of statutory interpretation," and found there was no reason to depart from the straightforward understanding of the words used in the statute.
    - The statutory language supports locating the performance of the service at the place where the taxpayer's personnel or equipment is physically doing useful work for the customer.
    - The receipt-producing end-product act test, as originally used in an administrative hearing decision, "aimed to tell the Comptroller *what* qualifies as the 'service performed". The court found that the test was used in this case to determine the location of the service, which is not consistent with the statute.
    - The court concluded that the focus should be on the words in the statute themselves.

20

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Apportionment

Vesta Corporation v. Department of Revenue, OR Tax Court Magistrate Division Dkt. TC-MD 200019G (March 28, 2022)

Vesta processes payments for prepaid wireless services for telecommunications companies including AT&T Mobility LLC, Sprint, and T-Mobile. Vesta submits card transactions to First National Bank of Omaha and JP Morgan Chase Bank NA payment acquirers.

On its 2010 and 2011 tax returns, Vesta took the position that its fees were primarily earned for work performed outside of Oregon because the fees paid to payment acquirers were direct costs of performance. The Department found the fees weren't direct costs of performance.

The Magistrate granted partial summary judgment to the Department finding that the payment acquirers didn't act on behalf of Vesta but provided it a service when the banks processed payments for Vesta's customers. Therefore, Vesta incurred those costs in Oregon and can't reduce its taxable income by excluding the receipts from the numerator of the sales factor in the apportionment equation.

Apportionment

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Synthes USA HQ, Inc. v. Commonwealth of Pennsylvania, Commw. Ct. 2020

At issue was how to apportion sales of services.

The taxpayer originally used the costs-of-performance method for determining its sales factor in the apportionment formula and subsequently sought a refund on the basis that the Department had consistently applied the benefits-received method.

On appeal, the Commonwealth Court rejected an argument by the Attorney General that the refund should be denied because the Department's interpretation was in error.The Court noted that the Department has consistently applied the benefits-received method for many years and that the legislature acquiesced in that interpretation.

Therefore, the Court upheld the use of the benefits-received method of calculating the sales factor. The case is now on appeal at the Pennsylvania Supreme Court.

22

Transaction Taxes

Transaction Taxes

Cincinnati Federal Savings & Loan Co. v. McClain, slip op. No. 2022-Ohio-725 (Ohio Mar. 15, 2022)

The taxpayer, a bank, purchased computer services from a vendor. It claimed a refund on the sales tax it paid, contending that these constituted non-taxable professional services

The Tax Commissioner denied the refund, claiming that the services were taxable "automatic data processing and computer services," and the Board of Tax Appeals agreed

However, the vendor also performed software customization services, which were not taxable

The Supreme Court of Ohio remanded the case in part because the BTA failed to employ the "true object" test on service charges related to the customization of software

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Transaction Taxes

Martin v. Comm'r of Rev., Dkt. No. 9499-S (Minn. 4/25/2022)

A vacation rental operator-imposed surcharges for credit card processing fees

However, the taxpayer did not engage in extending credit, financing, or carrying charges. These were all conducted by a third party

The Minnesota Tax Court held that the taxpayer could not reduce the tax base on the vacation rentals by separately stating the credit card processing fee

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Transaction Taxes

Books-A-Million Inc. v. South Carolina Department of Revenue, 844 S.E.2d 399 (SC September 2022).

Books-A-Million ("BAM") is a book seller that offers an annual membership loyalty program to its customers, which entitles members to additional discounts and free shipping on online orders.

BAM did not charge sales tax on its membership fees in South Carolina because the memberships are not tangible personal property.

Upon audit, the Department of Revenue determined that the membership fees are subject to sales taxes and issued an assessment.

The Supreme Court upheld the Department's assessment because the membership program depended on providing discounts to customers for sales of tangible personal property, making them related to the business of selling tangible personal property at retail and subject to South Carolina sales tax.

Transaction Taxes

Kentucky HB 8, effective January 1, 2023

Kentucky historically has taxed a number of services like lodging rentals, landscaping services, telecommunications services, pet services, and laundry services

Effective January 1, 2023, the list of enumerated taxable services will more than triple

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Transaction Taxes

Quad Graphics Inc. v. North Carolina Department of Revenue, Dkt. No. 20-CVS-7449 (June 23, 2021)

The North Carolina Superior Court held that Quad Graphics does not have the required nexus to impose sales and use tax on its book and catalog sales to North Carolina customers because title to the items transferred outside the state

Under the contracts between Quad Graphics and its customers, title and possession to the sold products transferred outside North Carolina, according to the court. This meant that under the U.S. Supreme Court's 1944 holding in *McLeod v. J.E. Dilworth Co*., North Carolina did not have sufficient transactional nexus — the nexus between a state and the activity being taxed — to the disputed sales under the U.S. Constitution's commerce clause, the court said. *Dilworth* precluded sales tax liability in cases where out-of-state goods were delivered by a common carrier into a state and title and possession to the goods transferred to the purchasers outside the taxing state.

The court agreed with Quad Graphics that the holdings in *Dilworth* remain good law, saying that the Supreme Court's 2018 decision in *South Dakota v. Wayfair Inc*. did not overrule Dilworth formalism.

The case was argued before the North Carolina Supreme Court in August 2022.

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Transaction Taxes

Apple Inc. v. Tax Appeals Tribunal, 2022 NY Slip Op 02459 (NY 4/14/2022)

The taxpayer had a promotion where qualified purchases received a $100 gift card. When a customer bought a qualified item, the taxpayer would reduce the sales tax base on that item by the amount of the gift card

A customer buys a $1,000 laptop and receives a $100 gift card. Apple considered that a $100 discount, and only collected and remitted tax on the $900 purportedly paid for the laptop

The court determined that these promotion giveaways were not in fact discounts and could not reduce the tax base on the sale. The taxpayer thus had under collected sales tax

Miscellaneous

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Miscellaneous

The U.S. Supreme Court has scheduled Oct. 3 oral arguments in Delaware v. Pennsylvania et al. and Arkansas (Case No. 22o145 and 22o146) in a long-standing dispute between Delaware and 30 other states, led by Pennsylvania, over who can lay claim to abandoned MoneyGram checks.

The justices had the option to accept a report by a special master they appointed or to hear arguments who found against Delaware by stating that the abandoned checks are governed by federal unclaimed property law, which provides that the state where they were purchased should lay claim to them.

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Miscellaneous

Zilka v. Tax Review Board of Philadelphia (Pa. 2022)

The Pennsylvania Supreme Court agreed to hear a Philadelphia resident's claims that the city unconstitutionally subjected her to double taxation by refusing to credit her Delaware state income taxes paid against her city wage tax liabilities.

The state's justices granted a petition from Diane Zilka challenging a Pennsylvania Commonwealth Court finding that the city wasn't required to refund wage taxes to offset the remainder of her Delaware state income tax liability after Pennsylvania credited her for taxes paid to Delaware.

Zilka had alleged in a petition in February that the unanimous seven-judge panel of the Commonwealth Court misapplied the U.S. Supreme Court's 2015 Comptroller v. Wynne ruling, which held that Maryland violated the Constitution's commerce clause by not providing a credit for other state taxes paid against a county tax. Wynne, she said, required that state and local taxes "must be considered as one" rather than analyzed individually. The case is Diane Zilka v. City of Philadelphia, case number 20 EAP 2022, in the Pennsylvania Supreme Court.

Miscellaneous

Effective March 16, 2021, Washington D.C. expanded its False Claims Act to repeal the tax bar and cover tax fraud. This expanded law will enlist whistleblowers to do their own investigations and bring suit on behalf of the District in tax controversies. And it didn't take long to get a large lawsuit filed.

In August 2022, Washington, D.C.'s attorney general announced a whistleblower lawsuit accusing Michael Saylor of evading $25 million in district income taxes by fraudulently claiming to live in Florida and alleging the company he co-founded falsified tax documents for years.

District Attorney General Karl Racine alleged that Saylor had illegally avoided filing income tax returns in the district since 2005 through a scheme that attempted to establish residency in Virginia and income-tax-free Florida.

Questions?

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