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THE NEXT FRONTIER, THE PESKY LOCALS

- *Apex Laboratories International v. City of Detroit, (January 2020).*
 - At issue is whether Detroit's physical presence rule for imposition of its income tax still is applicable post Wayfair
 - Originally Tax Tribunal and Court of Appeals held Apex was NOT subject to Detroit's Income Tax due to lack of physical presence.
 - Court of Appeals remanded case back to Tribunal to address the impact of Wayfair and the overruling of Quill and National Belles Hess.

THE NEXT FRONTIER, THE PESKY LOCALS

- *Normand V. Wal-Mart.com USA LLC, (January 2020) Rehearing denied*
 - At issue is whether Walmart.com is responsible, pre-Wayfair, for the Jefferson Parish Local Tax on sales of third-party vendors through its own marketplace.
 - Definition of a “Dealer” who is responsible for collection, reporting and remitting purposes is quite broad and includes anyone regularly or systematically soliciting in Louisiana.
 - LA Supreme Court in a 4-3 decision reversed the Appellate Court and found Walmart.com was not a “dealer” for third party sellers.
 - Decision was 4-3 with 2 of the dissents concerned about a procedural matter related to an expedited tax recovery procedure
 - Adoption of a marketplace facilitator law will remedy tax collection on third party sales.

THE LOCAL TAX CONUNDRUM

- Does acquiring economic nexus at the state level automatically result in economic nexus at the local level?
- States are divided, but generally economic nexus at the state level results in economic nexus at the local level for local taxes administered by the state tax agency.
- Physical presence in a state generally creates nexus for local sales taxes.

BUT I LEFT THE STATE

- *Willacy v. Cleveland Bd. of Income Tax Rev.*, Slip Opinion No. 2020-Ohio-314
- Taxpayer was employed at Sherwin-Williams in Cleveland for 29 years.
- During her employment, she was compensated in part with stock-options
- After she retired, she moved to Florida and exercised the options
- Ohio Supreme Court said that the Taxpayer was subject to Cleveland income tax on the income she earned from exercising the options
- The court noted that because Taxpayer received the stock options while she was working and living in Cleveland, the stock options qualified as compensation and can be taxed by Cleveland.

ADD BACK OF ROYALTIES? THAT STINKS

- The Tax Appeals Tribunal *In the Matter of the Petition of The Walt Disney Company* (August 2020) affirmed an administrative law judge's decision that the taxpayer's foreign affiliate payments were royalty payments under former N.Y. Tax Law § 208(9)(o) and were required to be added back to the taxpayer's entire net income.
- The payments the taxpayer received from its foreign affiliates were for the use of copyrights. The taxpayer was required to add these royalty payment amounts to its entire net income because the addback and exclusion provisions under the former law operated to ensure royalty payments between related members were taxed once and did not escape taxation altogether.
- The Tribunal also rejected the taxpayer's argument that the statute was discriminatory holding that the provisions were only triggered if the royalty payments involved related parties, and that the law did not provide New York taxpayers with an advantage over other taxpayers, nor did the law burden interstate or foreign commerce.

FRANCHISE TAX WIN IN MISSISSIPPI

- Comcast, in *Mississippi Department of Revenue v. Comcast of Georgia/Virginia Inc.* (August 2020) convinced the Mississippi Supreme Court that the company could use an alternative apportionment formula that excluded capital from subsidiaries that didn't engage in any in-state activities.
- Comcast's subsidiaries that it excluded from its tax base had no connection to the company's business in Mississippi, and therefore it would be erroneous to include investments in them in the company's franchise tax base, the justices said.

WHOSE ROYALTIES ARE WE TALKING ABOUT

- *In Microsoft V. Wisconsin Department of Revenue (October 2019)* the Wisconsin Court of Appeals held that the licensors of the Microsoft software were the computer manufacturers that sold the hardware (with software included) to the sublicensees (end-users) in Wisconsin. There was no ‘direct relationship’ between Microsoft and the end-users.
- The issue is whether the royalties Microsoft received through software licensing agreements with out-of-state hardware manufacturers whose products were used in Wisconsin were subject to tax in Wisconsin.
- Sales of intangibles are taxable in Wisconsin if the income-producing activity occurs in Wisconsin.
- The software licensing agreements allowed the computer hardware manufacturers to install Microsoft’s software on their computers, with sublicenses sold to “end-users” in retail stores such as Best Buy. In this case, the end-users were located in Wisconsin.

MEDICAL EXAMS ARE A PAIN

- *ARUP Labs., Inc. v. Dep't of Revenue*, No. 52349-3-II, 2020 Wash. App. LEXIS 307 (Ct. App. Feb. 11, 2020).
- ARUP Labs is a pathology lab located in Utah that performs tests of bodily fluid and tissue samples from medical providers in all 50 states and transmits the results through the internet.
- Washington's B&O Tax is based on where a customer receives the benefit of the taxpayer's service.
- In this case, the Court focused on where ARUP's customers "receive the helpful or useful effects of its services."
- The Court concluded the benefit was received in Washington if the customer was in Washington because Arup's customers (medical providers) could not diagnose their patients until they received the results of the tests ordered from ARUP

DO YOU FEEL SECURE?

- *Defender Security v. McClain*, Ohio Supreme Court, No. 2019-0531
- Taxpayer is a security company that sells home and business security systems to Ohio customers
- After the systems are installed, taxpayer sells security service contracts to ADT that performs the security and monitoring services
- ADT is not located in Ohio
- For CAT purposes, receipts are sourced to where a purchaser receives the benefit of a transaction.
- The court said that ADT – taxpayer’s customer - received the benefits at its out-of-state offices and not in Ohio where the security service users are located

PIZZA (GAINS) FOR EVERYONE

- *State Tax Assessor v. Kraft Foods Group, Inc.* (June 2020). The Maine Supreme Judicial Court affirmed a Maine Business and Consumer Court's ruling that a taxpayer was not entitled to use alternative apportionment in determining its tax on the sale of its frozen pizza business.
- Kraft Foods Group, Inc. manufactured and sold various food products throughout the United States, including Maine, during the periods at issue. Over several years, Kraft developed a frozen pizza product line that was manufactured, sold, and distributed through Kraft Pizza Company (KPC), its subsidiary. On March 1, 2010, Kraft sold its frozen pizza product line assets for roughly \$3.7 billion, most of which was paid to KPC, with some proceeds paid to other Kraft affiliates.

PIZZA (GAINS) FOR EVERYONE

- The Court also vacated the lower court's decision to partially abate substantial underpayment penalties assessed.
- Finally, the Court ruled that a separate assessment by the Maine State Tax Assessor (Assessor) for the same period at issue was not barred by the statute of limitations, as the taxpayer did not provide substantial authority for its original reporting of the gain.

NON-BUSINESS BUSINESS INCOME?

- The Court of Appeals reversed the Court of Claims in *Vectren Infrastructure Services Corp. v. Department of Treasury* (March 2020), holding the statutory apportionment formula applied by the Department resulted in business activity being sourced to Michigan out of all appropriate proportion to the company's Michigan business activities. The Court remanded the matter back to the Department to develop an alternative apportionment method.
- MLI was headquartered in Minnesota and engaged in the business of constructing, maintaining and repairing oil and gas pipelines. The company had no Michigan business location nor permanent employees in the state. The company was retained to clean up a pipeline spill in Michigan. While the project was going on MLI sold all of its assets to Vectren. MLI included the gain in its apportionable Michigan income and the denominator of the sales factor. On audit the Department removed the gain from the factor. The result was approximately 70% of the gain being apportioned to Michigan.

NON-BUSINESS BUSINESS INCOME?

- MLI argued the receipts should be treated as a sale and sourced to Minnesota for apportionment purposes. The Department denied MLI the use of an alternative apportionment method stating it had not overcome the presumption that the statutory formula did not fairly represent MLI's activity in Michigan.
- The Appellate Court looked to whether the statutory formula was fair. It concluded that the value of the business assets was built up over time and was attributable to activity in a number of states. Furthermore, much of that activity had no connection to Michigan. Applied to MLI the apportionment formula led to an unconstitutional result. The court declined to set forth an alternative method.

BENEFIT RECEIVED DEFINED!

- The Washington Appellate Court in *LendingTree, LLC v. State of Washington Department of Revenue* (March 2020) reversed and remanded, finding that the benefit of LendingTree's services was received at the lender's place of business.
- LendingTree provides consumers with the ability to connect with multiple lenders for a number of financial products. Lenders pay LendingTree a fee for each of the referrals. If the referral results in a loan an additional fee is paid to LendingTree. The Department took the position that LendingTree should have allocated income based on the location of the borrower, not the lender.

BENEFIT RECEIVED DEFINED!

- Receipts are sourced to Washington based on where the customer received the benefit. The receipts should be sourced to the state where the lenders conduct their business activity that most directly relates to the services performed by LendingTree. Lenders receive no value from the services until they receive the referrals identifying the potential customers.
- The referral is the service that provides value to the lenders. Lending Tree's customers accrue the benefit of the services at the location where they receive and utilize the referrals, e.g. their business location.

EACH OF YOU ARE SPECIAL

- The North Carolina Supreme Court affirmed in *Railroad Friction Products Corp. v. North Carolina Department of Revenue*, (April 2020) the Superior Court decision holding that Railroad Friction could not use a single factor to apportion its income.
- Railroad Friction operates a North Carolina facility that manufactures brake shoes and disc pads for locomotives, freight cars and mass transit cars. The company requested a refund arguing it was a public utility and could apportion income using the single-factor apportionment authorized by the statute.
- The court determined that Railroad Friction did not meet the definition set forth in the statute of a public utility. The company did not own or operate any plant or equipment for the transportation of goods or persons.
- The court rejected the argument that the company owns the brake products for public use stating that when they are owned the company is not using them to transport goods or persons. The statute is intended to apply to those who provide public services.

AREN'T WORDS IMPORTANT IN A STATUTE?

- The Michigan Supreme Court, in *Honigman Miller Schwartz and Cohn, LLP. v. City of Detroit* (May 2020), reversed the Appellate Court holding that when sourcing the revenue from services one looks to the where the service was performed not where the service was delivered. In so holding, the court concluded the term “rendered” as used in the sales factor of the apportionment formula means to provide a service for another and the Legislature adopted an origin test rather than the market-based approach adopted by the Appellate Court.

AREN'T WORDS IMPORTANT IN A STATUTE?

- Honigman computed the revenue factor for services rendered in Detroit by excluding from the computation revenues from services performed in Detroit but delivered outside the city. The city on audit revised the revenue factor to include revenue from services performed in Detroit.
- The court interpreted the term “services rendered in the city” in light of the overall statute. That analysis served as the basis for the court’s conclusion that the apportionment of gross revenue under the revenue factor must be determined on the basis of the location where the business activity, which would include legal services, takes place. Thus, “services rendered” under the revenue factor encompasses revenue for all services done or carried on with in the City even if those services are performed for out-of-state clients.

AREN'T WORDS IMPORTANT IN A STATUTE?

- In reaching its conclusion, the court rejected the argument by Honigman that there is a distinction between “rendered” and “performed”. Specifically, relying on the computation of the payroll factor Honigman argued “rendered” relates to the location where the services were delivered. The terms generally have similar meanings and are effectively equivalent in their relative purposes within the statute.

I WANT MY MTV (OR SATELLITE RADIO)

- *In Hegar v. Sirius XM Radio, Inc.* (May 2020) the Appellate Court reversed the District Court concluding that the receipts from subscription services should be apportioned to Texas based on the location of where the satellite transmissions were received by the subscribers.
- SiriusXM provides subscription-based satellite radio services throughout the United States. During the 2010 and 2011 tax years the company's transmission equipment and production studios were almost exclusively outside of Texas. The primary source of revenue was the subscription fees for the satellite radio services. SiriusXM apportioned its reported subscription service revenue based on the location of where the programming was produced. On audit the Comptroller determined the service was the unscrambling of the radio signal and that the service occurred at the radio receiver. As such the apportionment factor was adjusted to reflect the percentage of subscribers in Texas.

I WANT MY MTV (OR SATELLITE RADIO)

- The Appellate Court analyzed the statutory phrase “services performed in this state” and concluded it means the act is done in this state, *e.g.* the receipt producing end-product act is done in Texas. Applying the analysis to the facts the court concluded that the services that a subscriber contracted for was the receipt of the programming. The receipt could only occur where the enabled satellite radio was located. The location could reasonably be presumed to be where the customer resided, *e.g.*, subscriber’s address because subscription revenue was not traced on a state-by-state basis.
- Thus, apportioning the revenue using the ratio of the cost of production activities within Texas to total production costs was not a fair value of the services performed in Texas.

I DON'T CARE ABOUT YOU. ITS ABOUT ME.

- The New Jersey Appellate Division affirmed in *Xpedite Systems Inc. v. Director Division of Taxation* (January 2020) the Tax Court's finding that the Director of Taxation had broad discretion to utilize an alternative apportionment method.
- Xpedite is a broadcast fax service headquartered in New Jersey. Customers send their customer lists, customer contact information, to the New Jersey location. Once received Xpedite uses proprietary software to send out large volumes of faxes, emails and/or voice mails. The messages go out through a multistate network of leased phone lines and some owned switching hardware. Xpedite receives virtually all of its order at its New Jersey location. However, New Jersey customers made up less than 10% of the total users. Xpedite calculated its New Jersey apportionment based on the billing location of its customers.

I DON'T CARE ABOUT YOU. ITS ABOUT ME.

- The auditor determined the sourcing method did not accurately reflect the trade or business practice or the economic realities of the generation of the charges for the services. The auditor suggested three alternative sourcing methods: (1) 100% because New Jersey is the origination point of all of the transmission; (2) 98% because approximately 98% of the telecom services originate in New Jersey; and (3) 89.83% because 59% of the switching devices are located in New Jersey and transmissions destined for New Jersey are almost always routed through equipment located outside the state.
- The Appellate Court adopted the reasoning of the Tax Court, which rejected the argument that the economic realities of the way the receipts are generated are similar to a long-distance telephone service. Further, the Tax Court found that Xpedite's allocation based on its cost of performance analysis inadequately represented the receipts allocated to the state. The Division's methodology was not unreasonable or arbitrary.

SHOULDN'T THEY BE ON THE SAME SIDE

- The Pennsylvania Commonwealth Court in *Synthes USA HQ Inc. v. Commonwealth of Pennsylvania* (July 2020) overturned a State Board of Finance and Revenue decision denying Synthes a \$2.1 million refund, holding that State law permitted the company to apportion its receipts to where its customers received the benefits. The court rejected arguments from the Attorney General's Office, which took an unusual approach in breaking ranks with the Department of Revenue and contended that while the refund should be denied, the tax agency's interpretation of the sourcing statute, under which Synthes sought the refund, was incorrect.

Synthes originally filed its taxes using the cost-of-performance method, which is an origin-based approach, but later petitioned the department for a refund under the benefits-received method, which is a market-oriented approach.

- Synthes, located in West Chester, argued it was entitled to the refund because the department had consistently interpreted the state law to source services to where customers were located. The department, however, denied the refund, saying the company failed to establish where the sales occurred, and the board affirmed that decision.

WAIT, SALES TAX AND INCOME TAX SITUSING ARE THE SAME?

- In Revenue Ruling 2020-01ST, issued April 2020, the Indiana Department of Revenue ruled that for Indiana sales and income tax purposes an Indiana pool maker should source its sales to out-of-state dealers to the state where the pool is delivered.
- The Indiana pool maker should source sales to Indiana if the sales are made at its Indiana location or if the pool is delivered within Indiana and pay the applicable sales tax, including that on transportation fees.
- The department added that the company can rely on certain documents provided by dealers to avoid collecting or remitting sales tax on its transactions, such as Indiana or streamlined sales tax exemption certificates and Indiana direct pay permits.

TRAILING NEXUS ON STEROIDS?

- Arkansas Revenue Legal Counsel Opinion No. 20200203, 02/20/2020.
- The taxpayer is a systems analyst for an Arkansas company who moved to Washington state from Arkansas.
- She continued to work for the company, doing the exact same work, but now working remotely from her home in Washington state.
- Arkansas DOR determined that taxpayer was still subject to tax in Arkansas because she was “carrying on an occupation in Arkansas.”

YOU ARE THE OBJECT OF MY AFFECTION

- *Citrix Sys., Inc. v. Comm'r of Revenue*, 484 Mass. 87 (2020).
- Citrix is software company which has subscriptions to GoToMeeting, GoToAssist and GoToMyPC.
- These subscriptions permit its users to remotely access or connect to third party computers.
- The court ruled that these subscriptions are transfers of rights to use software installed on a remote server and thus are subject to Massachusetts sales tax under a 2006 regulation.
- The court found Citrix's customers acquired access and use of Citrix's products, each of which constitutes standardized computer software.
- The court rejected Citrix's argument that the "true object" of its offerings was the provision of a remote connection service