State Tax Developments 2018-2019

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Agenda

- Nexus
- Apportionment
- Adjustments to the Base
- Wynne Revisited
- Miscellaneous But Fun Cases

Nexus

Do You "Trust" Nexus?

- North Carolina Dept. of Rev. v. The Kimberly Kaestner 1992 Family Trust, Dkt No. 18-457 (June 21, 2019)
- The presence of an in-state beneficiaries does not empower a state to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain to receive it.
- Also see Fielding v. Comr. of Rev. (MN SC 2018) where the Minnesota Supreme Court held that the domicile of the grantor at the time of the trusts creation is not a sufficient basis to tax all the income of the trust.

I Only Moved For My Spouse – Telecommuter Nexus

- Utah Private Letter Ruling No. 17-005, 08/23/2018, released 01/30/2019
- Taxpayer is a seller of nutritional supplements and health foods Online to Utah customers.
- Taxpayer incorporated and headquartered outside Utah regularly solicits orders in Utah through the Internet and catalogs and transports and delivers the products into Utah to the customers via common carrier.
- Taxpayer employs a research and development employee who is a resident of Utah and telecommutes from her home office.
- Here, the taxpayer "utilizes" in Utah an office or a place of business similar to an office by utilizing the Utah employee's in-home office when she regularly telecommutes from this location.
- This conclusion does not change even if the taxpayer does not hold out the in-home office to the public as a place of business for the business.

Economically Dependent Nexus – Really?

- ConAgra Foods RDM Inc. v Comptroller of the Treasury (Maryland Court of Appeals, June, 2019) See also *Staples Inc. v. Comptroller of the Treasury* (Maryland Court of Appeals, August 2018) On Appeal to USSC
- Maryland can tax a ConAgra IP holding subsidiary incorporated in Nebraska because its connections to its parent in MD provide sufficient nexus. ConAgra had no "real economic substance as a business entity separate from its parent." A portion of ConAgra's income was produced from the activity of the parent in MD.
- The court applied a substantial evidence test and held that the taxpayer depended on its parent and other subsidiaries for most of its income.
- There was circular flow of money albeit from the cash management program and not from dividends.
- The taxpayer relied heavily on its parent for core services
- Taxpayer lacked any meaningful substantive activity apart from its parent.

How Big Is That Exception?

- The California Office of Tax Appeals (OTA) has ruled that Jali, LLC, a foreign LLC was not doing business in California and is entitled to a refund of its $800 LLC tax.
- For the years at issue, Jali's sole connection with California was a capital interest that ranged from 1.12% to4.75% in an LLC that conducted business in California and was classified as a partnership for tax purposes.
- *See also In the Matter of the Appeal of Satview Broadband, Ltd*., CA OTA Case No. 18010756 (September 25, 2018), the California Office of Tax Appeals rejected the FTB's interpretation of "doing business" and the application of Swart.

Throwing Shade on PL 86-272?

- The MTC is currently involved in updating its interpretation of the Interstate Income Act of 1959 also known as PL 86-272.
- As part of that project the MTC was debating cloud computing transactions and other internet-based transactions to see if they exceed the protections of PL 86-272.

Meet Me At The Corner of Nexus and Sourcing!

- Greenscapes Home & Garden Prod. Inc. v Testa (Ohio Crt of App. 2019)
- A Georgia wholesaler made sales to big box retailers that took title and possession at taxpayer's facility in GA. Bill of lading prepared by taxpayer indicated that some shipments were going to OH. Those deliveries exceeded the CAT's nexus threshold of $500,000. Taxpayer had no other contacts with OH.
- OH has an "ultimate destination rule" that seems to come from the "dock sales" context.
- Dilworth was not applicable because that was pre Complete Auto, when interstate commerce could not be taxed.

Meet Me At The Corner of Nexus and Sourcing! Part 2

- Mia Shoes, Inc. v. McClain (BTA Case No. 2016-282 (August, 2019)
- The Ohio Board of Tax Appeals ruled that shoes shipped from outside the country to nationwide retailers' distribution centers located in Ohio should be sitused to Ohio for the CAT.
- The BTA held that the taxpayer did not provide evidence that the shoes were further shipped to the retail stores outside of Ohio.
- Ohio has an "ultimate destination" test for sourcing purposes.

But what if I watch it on my phone?

- Users of Netflix, Hulu and Spotify are challenging Chicago's Amusement Tax Ruling Number 5 that imposes a 9% tax on streaming services used in the city.
- The binge watchers are arguing that just using a billing address as the sole proof of use in the city is an improper exterritorial form of taxation.
- Tax Upheld on 9/30/19

Anything left to Discuss about Wayfair?

- Marketplace Nexus
- Income Tax Nexus
- Economic Nexus
- PL 86-272
- Gross Receipts Taxes
- Retroactivity
- Voluntary Disclosure Programs
- See the MTC VDA Program

Apportionment

Market Based or COP?
Nah, How About Something Different?

- In *Texas Comptroller of Public Accounts of the State of Texas v. Sirius XM Radio, Inc.*, Dkt. 03-18-00573-CV, the circuit court permitted the taxpayer to source receipts from subscribers to the state based on the fair value of services performed in the state, rather than on the "market" method used by the Comptroller that sourced receipts based on the location of the subscriber.
- The Taxpayer's headquarters, transmission equipment and production studios were predominantly located outside of Texas, and the production and transmission of radio audio content was conducted outside of Texas.
- The taxpayer had sourced receipts from the services provided to Texas subscribers based on location of the production activity.
- The Comptroller claimed that receipts should be sourced based on the location of the subscriber.
- For services performed in multiple locations, the statute apportions receipts based on "the fair value" of the services performed in the state. The statute is silent as when services are considered performed in the state.

Who Said It Couldn't Be Done

- Mississippi DOR v. Comcast of Georgia/Virginia, Inc. (Chancery Court, June 2019)
- The Taxpayer successfully excluded the capital of 10 of its passive investments from the base of the capital tax base under an alternative apportionment/holding company theory.
- The court stated that the Department failed to meet the standard established in Equifax of showing the Board of Tax Appeals decision was arbitrary and capricious.

Does It Matter How Much It Costs?

- On February 7, 2019, the Supreme Court of Virginia affirmed the Arlington Circuit Court's denial of a corporate taxpayer's request to use an alternative method of apportionment. *CEB v. Dept. of Taxation* (Dkt. 171627)
- The taxpayer had alleged that Virginia's statutory method of apportionment did not properly reflect its income from business and sources in the Commonwealth because under the costs of performance sourcing rule, all of the taxpayer's receipts from sales of services were sourced to Virginia even though 95 percent of its market was located outside of the Commonwealth.
- Despite the existence of substantial double taxation, the Court held that the statutory method of apportionment did not produce an unconstitutional or an inequitable apportionment of the taxpayer's income.

You Got To Count My Peeps!

- *In the Matter of the Protest of Discover Bank v. New Mexico Taxation and Revenue Department*, NM Administrative Hearings Office, D&O No. 18-44, (12/2018), the Administrative Hearings Office held the Department failed to carry its burden to show that eliminating the payroll factor from the apportionment formula for financial institutions was required to fairly apportion Discover Bank's income.
- Discover Bank does not have branches, work locations, offices or employees in New Mexico. 6% of Discover Bank's customers are located in New Mexico. Approximately, .6% of the company's revenue comes from the New Mexico customers. .2% of income apportioned to NM.
- The Department argued that the payroll factor denominator when compared to the apportionable income was below the de minimis threshold level. The Department believed that 1.69% payroll to apportionable income ratio was indicative that payroll was not significant contributor to Discover Banks's generation of income.
- The ALJ found that the Department had the burden to establish by clear and cogent evidence that the apportionment formula did not fairly represent Discover Bank's business activities. Mere ratio's were found not to be sufficient.

Against the Odds

- Abercrombie & Fitch Co v. CA FTB (Cal. Ct App., August 2019)
- A&F's refund claim was denied for failure to show a cure for the potentially discriminatory practice of allowing companies with strictly California business to file on a separate company basis while denying similar situated inter-state businesses the same option.
- Interestingly, A&F never alleged that the offending portion of the law be struck down.
- Rather, A&F wanted a refund of the difference in tax between filing as a unitary group versus separate accounting.

Adjustments To The Base

Lorillard Continues Its Hot Streak

- In *Lorillard Tobacco Co. v. Director, Division of Taxation*, N.J. Tax Court Dkt. No. 008305-2007, (2/2019), the New Jersey Tax Court held that Lorillard Tobacco was not required to add back any portion of the royalties that it paid to an affiliate under the unreasonable exception to the addback requirement. The licensor filed New Jersey Corporate Business Tax returns and included the royalties in its apportionable income base and allocated its income to New Jersey under its allocation factor.
- In reaching its conclusion, the Tax Court rejected the Division's argument that the payor was only entitled to a partial exception because its allocation factor was greater than the licensor's allocation factor. The Tax Court found the legislative concerns with shifting of income were allayed and the variations in the allocation factors without more did not establish that the payor was only entitled to a partial exception.

As Long As You Owe It

- At issue in *Daimler Investments US Corporation v. Director, Division of Taxation*, N.J. Tax Court Dkt. No. 008165-2016, (1/2019), is whether N.J.S.A. 54:10A-4 (k)(2) (C) requires the add-back of taxes attributable to a New Jersey Taxpayer's income in a non-separate reporting state.
- The Tax Court ruled that the New Jersey statute is independent of the "filing and payment requirements of other states", and that the statutory term, "taxes paid or accrued" is meant to refer to the tax liability of an entity and not to the payer of the tax. The Court held that the addback was to be computed by its pro-rata share of its parent's total tax obligation to those jurisdictions.
- The Tax Court rejected the Division's argument that payments made pursuant to a tax sharing agreement were tax payment that were required to be added back for New Jersey corporation business tax purposes.

A Rose By Any Other Name

- Deere & Company v. WI DOR (WI Tax App. Comm. August 2019)
- The TAC held that Deere was entitled to a dividends received deduction even though the payment came from a foreign limited partnership that made a “check-the-box” election to be treated as corporation for federal and Wisconsin purposes.
- Wisconsin has taken the position that any payments not from a regular corporation were not eligible for the dividends received deduction.

Wynne Revisited?

Foreign Commerce Clause Dismissed

- Steiner v. UT State Tax Comm. (UT SC, August, 2019)
- The Utah Supreme Court refused to extend protections of the foreign commerce clause to individuals.
- The Steiners own an S Corp. that does business on a worldwide basis. Because Utah does allow for a foreign tax credit, the Steiner's deducted their foreign income.
- The Court disallowed deductions holding that the deductions were not mandated by Dormant Commerce Clause or the Dormant Foreign Commerce Clause.

But Wait, There is More

- Edelman v. Department of Taxation and Chamberlain v. Department of Taxation (Writ of Cert. at USSC)
- As issue is whether New York's denial of a credit for taxes on intangible income paid to another state is discriminatory.
- Here, both taxpayers were domiciled in CT and paid CT taxes on intangible investment income.
- New York also taxed the income because both taxpayers had permanent places of abode in NY and spent more than 183 days in NY.

Now This is Getting Silly

- Obus v. Department of Taxation (ALJ Decision, August, 2019)
- The issue is whether meeting the definition of a statutory resident (permanent abode and 183 days in the state) is met with the purchase of a vacation house that is used a couple of weeks per year.
- New York is claiming that a rule is a rule and the taxpayer is subject to tax regardless of their state of residency and whether New York offers a credit for taxes paid elsewhere.

Miscellaneous But Fun Cases

It’s Not About The Money

- On February 28, 2019, Arizona initiated an action in the USSC against California to challenge the $800 “doing business tax.”
- Arizona is alleging that California’s doing business tax “tramples over state borders and flouts constitutional precedents.”
- Arizona argues that the California law violated the Due Process Commerce Clause along with the Fourteenth Amendment.

Let Me See That.

- *Department of Revenue, Finance and Administration Cabinet v. Sommer* (Supreme Court of Kentucky, November 2018)
- Kentucky refused to release final orders in contested cases if they were not appealed by the taxpayer.
- Took position that redactions would be unduly burdensome and taxpayer information was susceptible to release.
- However, DOR had itself used redacted copies of final rules to support its position in litigation concerning other taxpayers.
- Court of Appeals held that the Kentucky Bill of Rights guarantees taxpayers access to the final orders.
- Argued March 15, 2018.

If You Use It, You Will Owe

- Emery Electronics v MI DOT (February 2019)
- Cell phones given away with purchase of phone service contracts by a sell of wireless services were subject to use tax based on the amount paid by the seller to the wholesaler.

- Alamo National Building Management v. Hegar (2019)
- A hotel owner owed use tax on consumables (toothbrushes etc.) because they were not itemized on the bills and were advertised as being free.