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77th Annual Conference
Scottsdale, AZ

Around the States – Everything You Need to Know About the Top State and Local Tax Issues

October 24, 2022

5:00 - 6:00 PM

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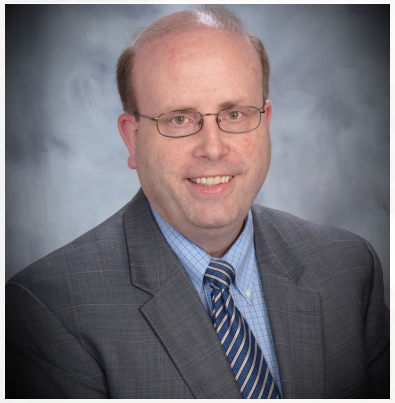
Moderator



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Agenda

- Apportionment
  - Sourcing
  - Alternative Apportionment
- *Wayfair* – Not Done Yet
- Gross Receipts Taxes
- P.L. 86-272

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Apportionment – Sourcing

Apportionment – Sourcing

Hegar v. Sirius XM Radio, Inc.

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Synthes USA HQ Inc. v. Pennsylvania

- "Income producing activities" statutes interpreted to reach what some call a market-based result.
- Both lower court decisions (DOR-favorable) pending at the respective state supreme courts.

Defender Security Co. v. McClain

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LendingTree v. Dep't of Revenue

- Market sourcing provisions interpreted by DORs to reach customers' customer, even though statute looks to "customer."

Apportionment – Sourcing

NASCAR Holdings, Inc., et al. v. Jeffrey A. McClain, Tax Commissioner of Ohio, et al., Case No. 2021-0578 (Ohio Supreme Court)

- The Ohio Board of Tax Appeals upheld the Department of Taxation's CAT assessment that used a viewership-based apportionment method to apportion revenue from licensing intellectual property, such as broadcast rights.
- NASCAR argued that its revenue from intangibles, such as intellectual property license agreements, should be sourced to the location of its licensees (i.e. location of the "purchaser's benefit").
- This matter is on appeal to the Ohio Supreme Court.
  - Oral arguments Jan. 25, 2022.

Apportionment – Sourcing

Express Scripts Inc. v. Indiana Department of State Revenue, Dkt. No. 19T-TA-00018 (Ind. Tax Ct. May 14, 2021)

- The Indiana Tax Court upheld a pharmacy benefit management company's sourcing of its receipts under Indiana's costs of performance rules applicable to receipts from services.
- The court rejected the Department of Revenue's position that the receipts should instead be sourced according to the rules for sales of tangible personal property.
- Based on the taxpayer's designated affidavits and contracts stating that its clients engage it and pay for the provision of services and that it does not purchase any drugs for resale or ever acquire possession or title of any drugs sold to its insurer client's members, the tax court found that the taxpayer properly apportioned its income as a service provider and granted summary judgment in favor of the taxpayer.

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Alternative Apportionment

Alternative Apportionment

Vectren Infrastructure Services Corp. v. Department of Treasury, Dkt. No. 17-000107-MT (Mich. Ct. App. Sept. 30, 2021)

- On remand from the Michigan Supreme Court, the Michigan Court of Appeals reaffirmed its March 2020 decision that application of the state's statutory apportionment formula was unconstitutionally distortive as applied to a taxpayer's Michigan Business Tax (MBT) liability for the sale of an entire business.
- The Court of Appeals previously upheld the trial court's decision that the taxpayer could not include the sale of the business in the sales factor denominator.
- The Department now seeks an appeal to the Michigan Supreme Court again and the Michigan Supreme Court granted review on March 23, 2022.

Alternative Apportionment

- South Carolina Forced Combination
  - *AutoZone Investment Corp. v. DOR*
  - *Belk Inc. v. DOR*
  - *Michael's Stores Inc. v. DOR*
  - *Tractor Supply Co. v. DOR*
- Arkansas Services Apportionment Rules
  - An ALJ with the Arkansas Department of Finance and Administration's Office of Hearings and Appeals upheld the Department's decision that a taxpayer must use an alternative apportionment method – deviating from the state's services apportionment rules.
    - September 12, 2022; Docket no. 22-457 (2014)

Wayfair – Not Done Yet…

Wayfair – Not Done Yet…

Wayfair, LLC vs. City of Lakewood, Colorado, Case No. 2022CV30710

- Wayfair LLC, is challenging a Lakewood, Colorado's imposition of sales tax on its sales, arguing that the city's sales tax violates the U.S. Constitution by unduly burdening and discriminating against interstate commerce
- Years at issue are May 2018 through May 2020
- Wayfair also argues that it was not "engaged in business" in the city under Colorado case law or the city's ordinance in effect prior to its adoption of the Colorado Municipal League's model ordinance on economic nexus on January 16, 2021

Wayfair – Not Done Yet…

National Pork Producers Council v. Ross, No. 21-468.

- This non-tax case presents a challenge to a California law (Proposition 12) that bans the sale of pork in California unless the treatment of animals meets certain standards, including providing pigs with a proscribed minimum amount of living space
- Application of Pike Balancing is at the center of the case
  - *Wayfair*: two "primary principles":
    - state laws may not discriminate against interstate commerce; and
    - state laws that regulate even-handedly to achieve a legitimate local purpose will be upheld unless the burden they impose is clearly excessive in relation to the purported local benefits
      - The second principle is known as "Pike Balancing" *Pike v. Bruce Church, Inc.*, 397 U. S. 137, 142 (1970)
- Oral argument at the US Supreme Court was held on October 11

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Gross Receipts Taxes

Gross Receipts Taxes

Intercompany Charges

- Washington DOR aggressively auditing intercompany charges for B&O tax purposes.
- The Washington Administrative Review and Hearings Division (the Division) of the Department of Revenue held that payments between affiliated entities could not be deducted from receipts subject to the business and occupation tax (B&O Tax). Det. No. 19-0201, 40 WTD 242 (2021).
  - Each of the taxpayers, three affiliated entities falling under the same parent company umbrella with each providing investment management services (the Taxpayers), sought to offset revenue received pursuant to customer contracts by deducting payments made to affiliated entities that performed some of the services provided under the contract.
  - The Division, citing RCW 82.04.220 and RCW 82.04.290, stated that the B&O Tax is a gross receipts tax that includes gross proceeds from sales without any deduction for expenses. The Division found that there is no specific authority in Washington that allows a transfer pricing deduction.
  - The Division further determined that the Taxpayers provided no evidence to show that an agency relationship was in place, which could have qualified the payments as advances or reimbursements that are excludable from the gross income computation.

Gross Receipts Taxes

Intercompany Charges

- Ohio CAT on agency receipts
  - *Apple, Inc. v. Jeffrey A. McClain, Tax Commission of Ohio*, Case No. 2021-1243, Ohio Board of Tax Appeals.
    - Apple appealed an Ohio CAT assessment that was based on Ohio treating its app store sales as taxable intercompany transactions.
    - Apple noted that Ohio law offers a gross receipts exclusion for receipts in excess of an agent's "commission, fee or other remuneration."
    - Apple argued that 70% of its receipts from sales of e-books and apps should be excluded in determining its CAT liability for the relevant period, highlighting contractual language that established the company as an agent of the developers and stated that Apple received a 30% commission on all prices paid by purchasers.

Gross Receipts Taxes

Discriminatory Local Gross Receipts Taxes

- *Sound Inpatient Physicians v. City of Tacoma*
  - Held: A Washington superior court improperly refunded local business and occupation (B&O) taxes for a company that has almost no customer contacts in Tacoma, because most of the business's income-producing services did not require customer contacts.
  - The city uses an apportionment method that applies market-based sourcing for sales to in-city customers, and COP for sales to out of city customers.

Gross Receipts Taxes

Discriminatory & Unapportioned Local Gross Receipts Taxes

- **Missouri and Illinois**: Municipalities claim that local GRTs – applicable to the provision of utility services within the local jurisdiction - apply to **all** gross receipts, including **all** receipts from sales to customers located outside the state.
  - Different sourcing depending on customer location:
    - Out-of-state consumers are subject to tax in the state of origin.
    - In-state consumers are subject to tax in the locality where the consumer is located, i.e., destination-based.
  - Violation of dormant Commerce Clause of U.S. Constitution?
    - No fair apportionment.
    - Use of various sourcing methods violates internal consistency test.

Gross Receipts Taxes

Discriminatory & Unapportioned Local Gross Receipts Taxes

- **Pennsylvania**: *7-Eleven, Inc. v. Upper Moreland Twp.*, No. 144 C.D. 2016 (Pa. Commw. Ct. Apr. 13, 2017)
  - Pennsylvania Commonwealth Court held township's application of its local privilege tax on 100% of 7-Eleven's receipts from franchise stores in the state violated the fair apportionment prong (i.e., external consistency) of the Complete Auto test.
- **Mississippi**: Mississippi cities claim that local GRT – applicable to receipts of communications companies on local business from customers within the corporate limits of a city – applies to intrastate and interstate services as well as sales to customers located outside the city/state.

Gross Receipts Taxes

ITFA Challenges - Virginia

- Four Virginia circuit courts concluded that ITFA prohibits the imposition of the local business, professional, and occupational license ("BPOL") tax on receipts from Internet access.
  - *Fairfax County, et. al v. Coxcom, LLC*, CL-2019-5800 (Fairfax Cir. Ct. Feb. 14, 2020); *Mugler v. Cellco Partnership*, CL 18-1409 (Hampton Cir. Ct. Jul. 13, 2020); *Cox Communications Hampton Roads LLC v. Norfolk*, CL19-4764 (Norfolk Cir. Ct. Aug. 3, 2020); *Cox Communications Hampton Roads LLC v. King*, CL19-3711 (Chesapeake Cir. Ct. Aug. 14, 2020).
- Grandfather Clause exemption for prohibited taxes on Internet Access that were "generally imposed and actually enforced" prior to October 1, 1998 is a factual question for trial.
  - Grandfather Clause exemption expired on June 30, 2020
  - Hampton: The city prevailed based on the court's conclusion that Hampton had "generally collected" the BPOL tax prior to October 1, 1998, but the decision did not describe any evidence.
    - Settled on undisclosed terms, so no appeal
- Cox had trials in Fairfax County and the City of Norfolk 2021

Gross Receipts Taxes

ITFA Challenges – Virginia (cont'd)

- Fairfax County ruled:
  - The County had the burden to prove it was grandfathered
  - Evidence did not prove the County's BPOL tax was generally collected prior to October 1, 1998, even though there was evidence that AOL paid something.
  - The court found that an ISP had a "reasonable opportunity to know," based on a "rule or other public proclamation" by the "appropriate administrative agency" that the tax applied to Internet access services.
  - Based on the County's BPOL tax ordinance that contained the example of "on line computer services" since 1994.
- Norfolk Court ruled:
  - Cox bore the burden to prove that Norfolk did not "generally collect" the BPOL tax prior to October 1, 1998.
  - Court concluded based on circumstantial evidence about one company that had generally collected.
  - Court also held that tax for 1998 "collected" in 1999 was somehow collected before October 1, 1998.
- Petitions for both cases are pending at the Virginia Supreme Court.
  - Appeals of circuit courts are discretionary to the Virginia Supreme Court.*

*Effective 2022, VA changed their appeal process, and BPOL tax appeals will go to the Court of Appeals as of right

Gross Receipts Taxes

ITFA Challenges – Pennsylvania, Oregon, Missouri

- Upper Moreland, PA
  - For purposes of its local business privilege tax, Upper Moreland is taking the position that its local tax is grandfathered under ITFA for periods before June 30, 2020 because they have collected on all gross receipts, including receipts from the sale of internet access, since the inception of the tax in the late 1960s.
  - For periods after June 30, 2020, the township is taking the position that the sunsetting of the grandfather provision does not apply, because its local business privilege tax is not a direct tax on internet access.
- Beaverton and Eugene, OR
  - Cities imposing license taxes on Internet access service charges; claiming those taxes are fees and not subject to ITFA.
- Missouri local jurisdictions asserting they are grandfathered under ITFA.

Gross Receipts Taxes

Digital Services/Data Tax—Overview

- Legislation proposing new taxes targeting “big tech” has been introduced in over a dozen states.
- Four categories of tax proposals:
  - Gross revenue/receipts taxes on digital advertising services;
  - Gross revenue/receipts taxes on social media advertising revenue;
  - Expansion of sales tax base to reach “digital advertising services”; and
  - Severance-style taxes on companies selling personal information and data.

Gross Receipts Taxes

Maryland Digital Advertising Gross Receipts Tax

- *Comcast of California/Maryland/Pennsylvania/Virginia/West Virginia, LLC, et al. v. Comptroller of the Treasury of Maryland*, Case No. C-02-cv-21-000509 (Oct. 20, 2022), ruled that:
  - Maryland's digital ad tax "violates the Supremacy Clause of the United States Constitution and the Internet Tax Freedom Act because the Tax constitutes a discriminatory tax";
  - That the tax "violates the Commerce Clause of the United States Constitution because the Tax discriminates against interstate commerce"; and
  - The tax "violates the First and Fourteenth Amendments to the United States Constitution because it singles out the Plaintiffs for selective taxation and is not content-neutral."

P.L. 86-272

P.L. 86-272

MTC P.L. 86-272 Statement and California TAM 2022-01

- The Multistate Tax Commission P.L. 86-272 Work Group released a proposed revision to its P.L. 86-272 Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States on Feb. 20, 2020.
- The California Franchise Tax Board issued TAM 2022-01 on Feb. 14, 2022, which reflects the MTC statement and lists fact patterns "common in the current economy due to technological advancements."
- Both documents cite *Wayfair* regarding "meaningful" presences without physical presence.

P.L. 86-272

California TAM 2022-01

- Online activities not protected by P.L. 86-272
  - Telecommuting employee not involved in soliciting sales
  - Post-sale assistance via chat or email links
  - Soliciting, receiving on-line applications for branded credit card
  - Inviting website viewers to apply for non-sales positions
  - Placing cookies on California customer devices to gather production, inventory information
  - Remotely providing fixes, upgrades
  - Selling extended warranties
  - Contracting with marketplace facilitator
  - Contracting with California customers for streaming services

P.L. 86-272

California TAM 2022-01

- Online activities protected by P.L. 86-272
  - Providing post-sale assistance to California customers by posting static FAQs.
  - Placing cookies to remind customers of shopping cart items and gather inventory, production information.
  - Allowing customers to search, purchase, and select delivery methods.

P.L. 86-272

New Jersey

- *Procacci Bros. Sales Corp. v. Div. of Taxation*, N.J. Tax Ct. Dkt. No. 015626-2014 (May 25, 2021).
  - N.J. Tax Court ruled that the in-state activities of an out-of-state wholesale produce distributor were protected under P.L. 86-272
    - Taxpayer took the position that it was not subject to New Jersey Corporation Business Tax (CBT).
    - It had no offices, property, employees or inventory in New Jersey.
    - It delivered produce to customers within the state primarily using third-party trucks.
  - The court held that the taxpayer's practice of delivering produce to in-state customers and accepting returns of rejected produce upon delivery and prior to acceptance was "ancillary to solicitation of sales" and thus was protected.

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Questions?