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PAUL J. HARTMAN
STATE AND LOCAL TAX FORUM

Pomp v. Goodman

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Agenda

- Income Tax
 - Nexus
 - Income Sourcing, Apportionment and Combined Reporting

- Sales Tax

Polling Question 1

Pomp can levitate birds. Goodman was the salutatorian of his high school class, but he was home schooled. Who deserves more respect?

- A. Pomp
- B. Goodman
- C. Rodney Dangerfield
- D. None of the above

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Income Tax

MTC Proposed Regulations

- MTC 2021 revised policy statement takes the position that selected activities conducted via the internet cause PL 86-272 protection to be lost.
- Example: text chatting over website with in-state users causes PL 86-272 protection to be lost.
- Several states adopted the revised policy statement as regulations or via informal guidance.
- American Catalog Mailers Association (“ACMA”) filed a challenge to New York regulations mirroring the MTC’s revised policy statement.

P.L 86.272 Under Assault

American Catalog Mailers Ass'n., v. FTB:

- The Superior Court granted American Catalog Mailers Association's ("ACMA") Motion for Summary Judgment holding the Technical Advice Memorandum No. 2022-01 ("TAM") and FTB Publication 1050 ("Publication 1050") invalid as underground regulations because the Franchise Tax Board failed to comply with the California Administrative Procedure Act, Gov. Code §§ 11340-11361 ("APA").
- The FTB issued guidance conforming to the Multistate Tax Commission's advisory statement on P.L. 86-272. The guidance expanded the scope of activities that would not be protected by P.L. 86-272.
- The Superior Court denied FTB's Motion to Vacate and Modify Judgement.
- In a separate February 13, 2024, order, the Court affirmed that ACMA is the prevailing party and the FTB is obligated to pay ACMA's attorney's fees.

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.

Polling Question 2

When Pomp quit smoking at 10 years old, his parents called him a quitter.

When Goodman was 10, his parents moved, but he found them a year later. Who had a more difficult childhood?

- A. Pomp
- B. Goodman
- C. Their Parents

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Income Sourcing, Apportionment and Combined Reporting

Minnesota – Apportionment Factor Calculation of Manipulation

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.” See Pomp, *The Case Against Excluding Gross Receipts from the Sales Factor* 42 J. of State Taxation 29 (2024).

South Carolina – Income-Producing Activity...The Chicken or the Egg?

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 – Sourcing Intangible Property...The Egg or the Egg?

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.

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.

At Peace. Final Destination

VVF Intervest LLC v. Harris:

- The Ohio Board of Tax Appeals reversed the Commissioners decision to deny taxpayer's CAT refund request in part because the "ultimate delivery" of the products at issue were outside of Ohio.
 - A portion of the amount was affirmed because the taxpayer failed to show any non-hearsay evidence to corroborate whether the ultimate destination was outside of Ohio.
- Taxpayer is a soap manufacturer who housed large amounts of product for a client within a warehouse in Ohio
 - Client would then coordinate 3rd-party trucking to deliver soap to the final customer.
 - The dispute primarily stems from the taxpayer not knowing precisely where Client's ultimate destination was, because the Client coordinated subsequent shipping processes.
- Commissioner argued that taxpayer's shipment to Ohio and subsequent storage constituted a taxable transaction
 - Taxpayer argued that its storage in Ohio was merely one leg of the Client's transportation and continuous delivery process.

Still Restless. Final Destination,

Jones Apparel Group / Nine West Holdings v. McClain:

- The Ohio Board of Tax Appeals ruled that the taxpayer was not entitled to a CAT refund on products it could not prove were received outside of Ohio from 2010 to 2016.
- The Department of Taxation determined that refunds were owned in transactions where a corresponding out-of-state “mark-for” address was included with the shipment when initially shipped to Ohio distribution centers.
- However, if a given shipment did not include this feature, CAT tax was owed.

Another Blow for COP. A Market-Based Victory For Taxpayer

Solix Inc. v. NJ Division of Taxation:

- The New Jersey Tax Court ruled that Solix's market-based approach to income allocation better reflected the business's economic reality and rejected the Division of Taxation's attempt to utilize cost-of-performance allocation instead.
- Solix is a DE corporation with HQ in NJ that helps mostly out-of-state gov. entities manage federal subsidy programs for their residents
 - Around one-third of its 900 employees and its main computer server are in NJ, and all executive functions are performed in NJ.
 - Assigned receipts from sales to the state where customers were located for apportionment purposes
 - Nearly all clients were outside of NJ
 - Majority of employees performed duties outside NJ
- The Court ruled that Solix's compensation for its services was not attributable work from New Jersey.
 - Solix effectuated governmental functions through its hands-on interactions with, and assistance to, non-New Jersey subsidy recipients.

MASSIVE Win for Microsoft in CA...Or is it?

In re: Microsoft Corp. and Subsidiaries:

- The California Office of Tax Appeals held Microsoft may include 100% of repatriated dividends in its sales factor denominator.
- Microsoft filed a waters-edge combined report for 2018, including 25% of repatriated dividends as apportionable income after applying California's 75% dividends received deduction.
- Although only 25% of the dividends were treated as apportionable income, Microsoft, on amended returns, included 100% of the dividends in the sales factor denominator.
- The FTB, argued the "matching principle" should apply so only 25% of the dividends included in the sales factor denominator.
 - OTA rejected the FTB's arguments
 - CA law did not preclude including the dividends that qualified for the California deduction as "gross receipts" in the sales factor.
 - FTB did not demonstrate a qualitative difference or quantitative distortion that warrants use of an alternative apportionment methodology.

Pick A Number. Transfer Pricing Woes

Tractor Supply Co. v. SC Dept. of Rev.:

- The Administrative Law Court issued an order upholding the use by the Department of Revenue (DOR) of combined reporting under an alternative apportionment theory.
- The Chief Administrative Law Judge (ALJ), although recognizing that the DOR's expert did not conduct a transfer pricing study to determine the appropriate transfer price, nevertheless agreed with his opinion that:
 - (1) the intercompany transactions were not at arm's length and;
 - (2) that "combined unitary reporting would achieve something very close to implementing a reasonable transfer price."
- The ALJ indicated that the holding should not apply to all taxpayers, stating that the DOR "cannot choose an alternative method simply because separate reporting leads to lower taxes," and "if there was a way to fix the artificial dilution of the business activity in South Carolina through fixing the transfer price and utilizing separate reporting, then I would rule in that direction."

Polling Question 3

During Covid, Pomp did not leave his house for 393 days. During the same period, Goodman continuously drove his RV, dressed in a Hazmet suit. Both came down with Covid.

Who had it rougher?

- A. Pomp
- B. Goodman
- C. Pomp's wife
- D. Goodman's wife

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Sales Tax

Use Tax...All or Nothing?

Willingson 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.

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.”
- Does Perrier now have a marketing problem?

Bundling may Save Time, but not Money...

Bekkerman v. CA Dept. of Tax. & Fee Admin.:

- A California administrative court ruled that sales tax could be levied on the full price of smartphones when purchased as part of bundled phone and service packages, despite their “discounted” prices in such bundles.
- The taxpayers challenged this practice, detailed in long-standing guidance from the CA Department of Taxation & Fee Administration (CDTFA), arguing that it was improperly promulgated under the California Administrative Procedure Act (CA APA).
- The court found that the taxpayers were not truly receiving discounted prices on the smartphones unless they also agreed to a wireless service contract at the time of sale.
 - Furthermore, the public hearing offered during the adoption of the CDTFA guidance was sufficient for CA APA purposes.

Huh? We Had To Litigate This?

Walmart Starco LLC v. MO Director of Revenue:

- The Missouri Department of Revenue assessed Walmart Starco \$8 million in use tax, interest, and penalties for tax periods from Sept. 30, 2012, through June 20, 2015.
 - Assessed on IT equipment stored in Missouri that was resold to Walmart and its affiliates.
- The Missouri Supreme Court affirmed the Missouri Administrative Hearing Commission (AHC) decision finding that the IT equipment purchased by Starco qualified for the resale exemption because the goods were purchased solely for the purpose of reselling them to other subsidiaries, and the subsidiaries to which the equipment was resold paid use tax in those jurisdictions.
- The court, relying on the plain wording of the statute, rejected the Department of Revenue's argument that the company did not hold equipment for resale, because of the installation of software and hardware, testing, and repackaging for delivery.

Good Faith can be Taxing (Literally)

Toolpushers Supply Co. v. MS Dept. of Rev.:

- The Supreme Court of Mississippi ruled that Toolpushers failed to take the necessary separate and additional good-faith steps to verify its customers were wholesalers with no intention to use the products purchased directly.
- Toolpushers is a Wyoming-based company that sells supplies to energy companies from a retail location in Mississippi.
- Purchasers presented exemption certificates, but the taxpayer took no further, good-faith actions to confirm that the purchaser was, in fact, a retailer who intended to resell the purchased products.

Polling Question 4

Did you enjoy Pomp v Goodman? (Define enjoy...)

1. No, it is like the Harlem Globetrotters beating up on the Washington Generals every time.
2. Yes, it is entertaining despite it being so one sided.
3. No, because I can't tell if Pomp and Goodman actually like each other.
4. All of the above.
5. None of the above.

Any last thoughts?

Questions?

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