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Top Ten Income Tax Cases
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OUT OF SIGHT, OUT OF MIND

The Buckeye Institute v. Kilgore, Columbus City Auditor, 10th Dist. Franklin No. 20-CV-4301 (Apr. 27, 2021).

- The Franklin County of Common Pleas dismissed the claim brought by The Buckeye Institute challenging Ohio legislation.
- In March 2020, Sec 29 HB 197 required work performed at home to be treated as if performed at the workplace for municipal income tax purposes.
- The Buckeye Institute filed for declaratory and injunctive relief, claiming violation of due process under the U.S. and Ohio Constitutions, as there was neither nexus nor a "fiscal relation" between the City and the income they sought to tax.

Buckeye Institute, cont'd

- Alleges that the City seeks to compel the Institute to engage in extraterritorial taxation by withholding taxes from its employees.
  - The Ohio Chamber of Commerce filed a brief in support of the City, noting reliance by the City on the revenue stream.
- In dismissing the action, the Court took refuge behind broad doctrines rather than address the merits: "every enactment of the General Assembly enjoys a presumption of constitutionality" and that "the General Assembly enjoys broad powers of intrastate taxation."
  - Stated that Plaintiff's reliance on Commerce Clause case law applicable to interstate tax cases was misplaced.

Buckeye Institute, cont'd

- The biennial budget bill, signed into law by Governor DeWine on July 1, 2021, extends the temporary municipal income tax withholding rule for employers under section 29 of H.B. 197 through December 31, 2021.
- However, the bill amends section 29 to provide that an individual employee's tax liability for wages earned from January 1, 2021 to December 31, 2021 will no longer automatically be deemed to be the employee's principal place of work.
- While employers will still be required to withhold taxes based on an employee's principal place of work, an individual employee's income tax liabilities will generally be determined and allocated between jurisdictions based, in part, on where the employee actually works each day, pursuant to Chapter 718 of the Ohio Revised Code.

IT AIN'T EASY BEING CHEESY

PepsiCo Inc. & Affiliates v. Illinois Dep't of Revenue, Ill. Indep. Tax Trib., Nos. 16 TT 82, 17 TT 16 (April 13, 2021).

- Illinois is one of 16 states that excludes U.S. companies with 80% foreign property and payroll from water's edge combined returns.
- PepsiCo reorganized in 2010 and created FLNA to hold the intangible property for its domestic snack business; Transferred salaries of various PepsiCo expatriate employees to FLNA to meet 80% foreign employees test.
- PepsiCo argued that the legislature intended the 80/20 test to be a mathematical calculation that the agency is bound to accept.
- Tribunal holds that expatriate employees were not truly FLNA employees under common law and holds economic substance doctrine applies in determining foreign operating company status.
- Case is still pending before the Tribunal on other matters.

WE THE PEOPLE…

VAS Holdings & Investments LLC v. Comm'r of Revenue, Mass. App. Tax Board, Nos. C332269, C332270 (Oct. 23, 2020).

- The taxpayer, on a bypass application, is appealing a decision of the Massachusetts Appellate Tax Board which upheld tax imposed on the capital gain from a nonresident S-corp's sale of a 50% interest in a multi-member LLC doing business in Massachusetts.
  - The S-corp owners were non-residents and had a variety of holdings throughout the U.S. and Canada.

VAS Holdings, cont'd

- The state uses an "investee" apportionment method and requires nonresident individuals to compute their tax on gain from the sale of a partnership/LLC interest on an apportioned basis based solely on the payroll and property factors of the partnership, not of the investor.
- The taxpayer challenged the constitutional authority of the state to impose tax on a nonresident, as it was not engaged in a unitary business with the LLC. The Appellate Tax Board agreed with the lack of unity.
- However, the ATB found that the lack of unity did not preclude the imposition of the investee apportionment method, which resulted in 100% of the gain being taxed in Massachusetts.
- Note, the Department did not oppose the bypass application and concurs that the case "raises significant constitutional issues of first impression."

Verisign Inc. v Director of Revenue, Delaware Superior Court, N19C-08-093-JRJ (12/17/20)

- After filing an appeal at the Appellate Tax Board from the denial of its protest of an assessment, Verisign removed the matter to the Delaware Superior Court.
- Delaware imposes a limitation on the amount of NOLs that can be claimed, and limits the NOL to the amount claimed on the federal consolidated return.
- Delaware required separate company filings. The NOL that can be claimed by a company cannot exceed the NOL claimed for federal tax purposes on the consolidated return.

Verisign cont'd

- On stipulated facts, the NOL amount on the federal return was less than Verisign's NOL, due to a restructuring transaction and the use of NOLs for federal tax purposes.
- The court, relying exclusively on the challenge to the limitation under the Uniformity Clause of the Delaware Constitution, found the limitation was unconstitutional.

Verisign cont'd

- The court found that the Delaware regime discriminated between corporations that filed a federal consolidated return vis-a-vis corporations that filed federal separate company returns.
- The court found such classification regime was not reasonable and declined to defer to the Department's interpretation.

Ferrellgas Partners, LP v. Dir., Div. of Taxation, No. A-3904-18T-1 (N.J. App. Div. 2021).

- Upholds New Jersey's $150 administrative fee for each out of state partner of partnerships doing business in state.
- Ferrellgas, a publicly traded partnership, had 67,000 partners, and owed the maximum $250,000 fee.
- Court held that the fee does not unreasonably burden interstate commerce nor discriminate against commerce;
- Court found that apportionment was not required since fee represents wholly intra-state activity, i.e., processing returns;

Ferrellgas Partners, LP

- Relied on *American Trucking Assoc., Inc. v. Michigan Public Service Comm'n*, 545 U.S. 429 (2005) (doing business in multiple states may increase compliance costs; additional costs are not the same as un-apportioned flat tax).
- 67,000 K-1's processed at a cost of $4 per return: is there a better way to handle partnership informational reporting?

WHAT WILL BE THE CORRECT ALTERNATIVE?

Vectren Infrastructure Servs. v. Dep't of Treasury, 953 N.W.2d 213 (Mich. Ct. App. 2020).

- The Michigan Court of Appeals had found that the taxpayer had substantiated gross distortion from the application of the standard sales factor formula, and that an alternative apportionment formula was necessary to avoid extraterritorial taxation.
- The Department sought leave to appeal to the Michigan Supreme Court, which in lieu of leave, vacated the judgement and remanded to the Court of Appeals to address the taxpayer's arguments regarding the proper application of the statutory method.
- The Court of Appeals in turn, remanded back to the Court of Claims, which had never addressed certain arguments at the trial level.

Vectren Infrastructure Services, cont'd

- In its remand, which was limited to only those claims not previously addressed, the Court of Appeals retained jurisdiction, directed that the remand should be given priority, and requested copies of all papers filed on remand, as well as any orders/opinions issued by the Court of Claims.
- On May 25, 2021, the Court of Claims issued its Opinion and Order finding that the Department was entitled to judgment on the claims it had not originally addressed.
  - The taxpayer challenged the exclusion of assets sold in the normal course of business from the factor denominator, and
  - The taxpayer challenged the inclusion of gain as business income, yet its exclusion from the sales factor denominator.

Vectren Infrastructure Services, cont'd

- On September 30, 2021, the Court of Appeals issued a published decision, adopting the Court of Claims findings as to the application of the statutory challenges, and reaffirmed their prior holding that the application of the standard method, as applied to the Taxpayer, resulted in impermissible unconstitutional taxation.
- In a footnote, the Court addressed the Plaintiff's additional argument "that including the sale of the business in the tax base, but not in the sales factor, is impermissibly inconsistent, that is a large contributing factor, at least in the context of this case, to our conclusion that this represents a constitutional violation."
- This may open the statute to a factor representation challenge.

NO WHINE BEFORE IT'S TIME

Council on State Taxation v. Nebraska Dept. of Revenue, No CI 20-4124 (Neb. Dist. Ct. June 17, 2021).

- Nebraska issued guidance letter announcing its position that IRC 965(a) repatriated income is properly included in state tax base.
- COST filed declaratory judgment asserting repatriation is an exempt "deemed dividend."
- District Court holds that the letter was merely guidance, not a rule, so declaratory suit was premature; DOR "could still change its mind."
- Compare: *CIC Services, LLC v. IRS,* No. 19-930 (U.S. May 17, 2021): Anti-Tax Injunction Act did not apply to require tax promoter to commit criminal violation in order to challenge validity of IRS Notice 2016-66 on captive insurance company reporting.

DON'T COUNT YOUR CHICKENS JUST YET

***Delaware v. Pennsylvania and Wisconsin*, Nos. 145 &146, [DRAFT] First Interim Report of the Special Master (U.S. May 20, 2021).**

- In an action brought under the original jurisdiction of the U.S. Supreme Court, 30 states disputed Delaware's entitlement to escheat the unclaimed proceeds of certain "Official Checks" issued by MoneyGram.
- A Special Master appointed by the Supreme Court concluded that the instruments were either "money orders" or similar instruments, and therefore, under a federal statute, escheated not to Delaware (where MoneyGram was incorporated) but to the states where they were purchased.

Delaware v. Pennsylvania and Wisconsin, con't

- The Special Master conducted a detailed review of the legislative history of the federal statute and found that it had been passed in direct response to – and to depart from – the Supreme Court decision in *Pennsylvania v. New* York, which held that traveler's checks and money orders should escheat to the commercial domicile of the vendor.
- The Special Master found that, according to the legislative history, Congress acted because the decision had made "more severe" the problem of escheat acting "as a windfall" to the state of incorporation and deprived of revenue the 49 other states where purchasers of travelers' checks and money orders actually resided.

Delaware v. Pennsylvania and Wisconsin, cont'd

- The Special Master reviewed the arguments made by Delaware, which relied on technical differences between actual "money orders" and the Official Checks in issue and rejected all of Delaware's arguments.
- He recommended that the Supreme Court deny Delaware's motion for summary judgment and award summary judgment to the rest of the states.
- If adopted by the Supreme Court, this will be the first Supreme Court decision on unclaimed property in over 25 years and will be a significant restraint on Delaware's ability to escheat unclaimed property.

R.O.P. Aviation, Inc. v. Dir., Div. of Tax'n, No. 001323-2018 (N.J. Tax, May 27, 2021).

- The NJ Tax Court, in a published opinion, held the Division of Taxation cannot eliminate a company's NOL carryforwards during an audit of open years because the years in which the NOLs arose were closed under the statute of limitations, and granted the taxpayer partial summary judgment on the issue.
- R.O.P. Aviation, engaged in the business of leasing aircraft, filed returns for the tax years 2007-2011, which were accepted as filed and not audited. These years were closed by statute by the time an audit was conducted for the 2012-2015 years.
- During the audit, Taxation eliminated R.O.P.'s NOL carryforwards from the closed years, arguing that certain intercompany leases were not at arm's length prices, and that R.O.P. should have reported a larger profit in those older years.

R.O.P. Aviation, Inc. cont'd

- By increasing income in the closed years and eliminating NOL carryforwards, the state increased income in the audit years.
- The Tax Court found that the statute of limitations to conduct an audit is governed by the same four-year statute applicable to tax assessments. The Tax Court concluded that the audit must be conducted in the same period in which as assessment must be made.
- It found that permitting an adjustment of the NOL in the closed years would be an indirect assessment of tax, allowing Taxation to do "indirectly what the statute does not permit directly."
- The Tax Court also declined to follow IRS audit guidelines, which both parties had agreed would allow the IRS to adjust the NOLS in closed years and assess tax in open years, determining that it was not bound by IRS audit procedures or the IRS's interpretation of its own authority.

MEASURE TWICE CUT ONCE

Tractor Supply Co. v. S.C. Dep't of Revenue, S.C. Admin. Law Ct. No. 1 9-ALJ- I 7-041 6-CC

- South Carolina claims authority to force combined reporting under *Media General Communications, Inc. v. South Carolina Department of Revenue*, 694 S.E.2d 525 (2010).
- DOR issued "alternative apportionment" regulation in 2015 outlining how combined reporting would be implemented;
- *CarMax Auto Superstores West Coast, Inc. v. S.C. Dep't of Revenue*, 767 S.E.2d 195 (2014) placed burden of proof on party seeking alternative apportionment;
- *Rent-A-Center West, Inc. v. S.C. Dep't of Revenue*, 792 S.E.2d 260 (Ct. App. 2016) concurred, but did not explain how to meet the burden.
- *Tractor Supply* one of three pending Admin. Law Ct. cases testing the DOR's authority.

Thank You!

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