Goodman v. Pomp

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Agenda

- Nexus
- Tax Base
- Sourcing
- Procedural and Other Interesting Issues

NEXUS

Death By A Thousand Lashes

- On August 4, 2021, the Multistate Tax Commission (MTC) approved its revised "Model Statement of Information Concerning Practices of Multistate Commission and Supporting States Under Public Law 86-272," which addresses the application of Public Law 86-272 to business activity conducted by an Internet seller.
- This statement was last updated in 2001.
- Under the revised statement, if a business interacts with a customer via the business's website or app, the business is generally considered to be engaged in a business activity within the customer's state.
- If the activity conducted through the website or app is not limited to solicitation of sales of tangible personal property or ancillary activities, then per the revised statement, the business is not eligible for Public Law 86-272 protection.

And Yet It Still Lives!

- Procacci Brothers Sales Corp. v. Division of Taxation, Dkt. No. 015626-2014 (N.J. Tax Ct. May 25, 2021).
- The New Jersey Tax Court ruled that the in-state activities of an out-of-state wholesale produce distributor were protected from the corporation business tax under P.L. 86-272.
- The taxpayer had no offices, property, or employees in New Jersey and delivered produce to in-state customers primarily using third-party trucks.
- The court found that the produce deliveries and returns before produce acceptance were “ancillary to solicitation of sales” and protected under P.L. 86-272.
- However, the taxpayer’s practice of sending its own trucks into the state to pick up returned produce after delivery and the customer’s acceptance was not protected unless de minimus.

And Is Even Getting Stronger

- A repealed New Jersey tax assessed on businesses that weren't subject to the state's corporate business tax violated the U.S. Constitution's supremacy clause by circumventing federal protections for businesses with minimal in-state nexus, the state Tax Court recently ruled.
- The New Jersey Tax Court, in Stanislaus Food Products Co. v. Director, Division of Taxation, docket number 011050-2017 agreed with California-based Stanislaus Food Products Co. that the state's alternative minimum assessment was "an end-run around" the Interstate Income Act , a 1959 federal law that insulates businesses without sufficient nexus in a state from corporate income tax. New Jersey repealed the assessment last year under a law that made significant changes to its tax code.

And Is Even Getting Stronger

- The court found that New Jersey used the assessment, which was based on a company's gross receipts or profits, as a de facto corporate income tax since July 1, 2006, when the assessment only applied to companies that claimed the act's protections. The assessment was "an attempt to eviscerate the properly expressed will of Congress enacted pursuant to the affirmative words of the commerce clause," Judge Mark Cimino said in a 35-page opinion that repeatedly chastised the state Division of Taxation.
- The Tax Court rejected the state Division of Taxation director's argument that the assessment was permitted because a taxpayer that consented to paying the corporation business tax reduced its assessment liability to zero, calling that stance "disingenuous" and "a clear obstacle to the will of Congress."

I Will Take No Nexus for $1,000

- In Robinson v. Jeopardy Productions Inc., 2020 WL 6162836 (La. Ct. App. 2020) (unpublished) the Louisiana Court of Appeal dismissed the Department of Revenue's petition to collect corporate and franchise taxes on royalties from a nonresident television production company.

- The taxpayer earned royalties from Louisiana between 2011 and 2014 through agreements to distribute its television show to television stations and other agreements to use its trademarks on gaming machines.

I Will Take No Nexus for $1,000

- The DOR filed suit to collect franchise and corporate taxes on that income. The taxpayer asserted the state lacked personal jurisdiction because the taxpayer did not transact any business in Louisiana and its contacts through unrelated third parties do not rise to the level of minimum contacts.

- The court concluded that the "random, fortuitous, and attenuated contacts" with Louisiana, initiated by the independent activities of third parties, were not sufficient to establish personal jurisdiction over the taxpayer.

California Redefines De Minimus

- The California Office of Tax Appeals (OTA) ruled in the Matter of LA Hotel Investments #3 LLC and Matter of LA Hotel Investments #2 LLC (OTA Case Nos. 18083638, 19014240 that two out-of-state limited liability companies were subject to the annual $800 LLC tax LLC tax because they were doing business in the state based on the property threshold.
- The LLC's argued that they were not doing business in California under section 23101(a) and the California Court of Appeal's 2017 decision in Swart Enterprises Inc. v. Franchise Tax Board.

California Redefines De Minimis

- The Franchise Tax Board argued on appeal that the LLCs were doing business in the state under section 23101(b) that provides in part that "a taxpayer is doing business in this state for a taxable year if . . . the real property and tangible personal property of the taxpayer in this state exceed the lesser of fifty thousand ($50,000) or 25 percent of the taxpayer's total real property and tangible personal property."
- The OTA distinguished the LA Hotel cases from Swart Enterprises, noting that Swart Enterprises addressed the taxpayer's 2010 tax year, while section 23101(b) went into effect for tax years 2011 and after. The OTA stated that "subdivisions (a) and (b) of R&TC section 23101 contain two alternative tests for doing business, and the satisfaction of either test leads to a nexus finding." Concluding that the out-of-state LLCs' distributive share of the California LLCs' property exceeded the threshold, the OTA held that the out-of-state LLCs were not entitled to refunds of the tax. The taxpayer in)

Got To Give Chicago Props!

- The city of Chicago has provided guidance for economic nexus thresholds and safe harbor nexus provisions effective July 1, 2021, with respect to Chicago's amusement tax and personal property lease transaction tax.

Got To Give Chicago Props!

- Effective July 1, 2021, out-of-state businesses making sales subject to Chicago's amusement tax and personal property lease transaction tax will establish economic nexus with the city and a responsibility to collect and remit the taxes if revenue from Chicago customers from the most recent four consecutive calendar quarters reaches $100,000. If during the most recent consecutive four calendar quarters an out-of-state business has received less than $100,000 in revenue from Chicago customers from sales subject to the amusement tax or lease transaction tax, the out-of-state business will not be responsible to collect such taxes under the following parameters:
  - The entity cannot have any other significant contacts with Chicago (please see below).
  - The safe harbor will apply beginning July 1, 2021 without any refunds or credits for taxes paid or remitted before that date.

Got To Give Chicago Props!

- The safe harbor will apply beginning July 1, 2021 without any refunds or credits for taxes paid or remitted before that date.
  - Once the out-of-state business falls outside the safe harbor by meeting the $100,000 threshold, the business must within:
  - 60 days - register with the city's Department of Finance within 60 days, and
  - 90 days - collect Chicago taxes for at least 12 months (even if it falls back within the safe harbor during that period).
  - Other Significant Contacts
  - agreements that the entity has with other businesses in Chicago;
  - activities that the entity's employees or other agents perform on the entity's behalf in Chicago;
  - any physical presence that the entity has in Chicago;
  - advertising directed at Chicago customers; and
  - any other facts that support or oppose the conclusion that the entity has purposefully availed itself of the privilege of carrying on business in Chicago.

It's Alive! (The Transactional Nexus Test)

- The North Carolina Wake County Superior Court held Quad Graphics Inc. v. North Carolina Department of Revenue, case number 20-CVS-7449 that Quad Graphics does not have the required nexus to impose sales and use tax on its book and catalog sales to North Carolina customers because title to the items transferred outside the state.
- Under the contracts between Quad Graphics and its customers, title and possession to the sold products transferred outside North Carolina, according to the court. This meant that under the U.S. Supreme Court's 1944 holding in McLeod v. J.E. Dilworth Co. , North Carolina did not have sufficient transactional nexus — the nexus between a state and the activity being taxed — to the disputed sales under the U.S. Constitution's commerce clause, the court said. Dilworth precluded sales tax liability in cases where out-of-state goods were delivered by a common carrier into a state and the goods' purchasers were transferred title and possession outside the taxing state.

It's Alive! (The Transactional Nexus Test)

- The court agreed with Quad Graphics that the holdings in Dilworth remain good law, saying that the Supreme Court's 2018 decision in South Dakota v. Wayfair Inc. did not overrule Dilworth formalism.

TAX BASE

Sometimes You Win and Lose

- The Arkansas Supreme Court issued an opinion in American Honda Motor Co. v. Walther (2020 Ark. 349, 2020) affirming the order of the circuit court granting summary judgment in favor of Arkansas Department of Finance and Administration (DFA).
- Here, the taxpayer argued that the gain on the sale of federal fuel credits that were generated by its regular business was not "disposed of" in its regular course of business.
- More importantly, the Arkansas Supreme Court specifically limited the power of administrative agencies to interpret statutory law. The Court rejected the state agency's interpretation of "business income," stating that "Simply put, we will determine what the statute means by construing it just as it reads, giving the words their ordinary and usually accepted meaning in common language."

Closed Means Closed

- The New Jersey Tax Court held in R.O.P. Aviation Inc. v. Division of Taxation, Dkt. No. 001323-2018 (N.J. Tax Ct. May 27, 2021) that the Division of Taxation could not eliminate a taxpayer’s NOLs generated during years beyond the statute of limitations.
- The division’s proposed reduction in the taxpayer’s NOL carryforward was based on a transfer pricing adjustment between related entities for years never audited by the division and otherwise closed under the applicable statute of limitations.
- The tax court held that although the division had broad authority to determine the proper tax amount due from available information, this mandate did not permit the division to audit closed years to reduce an NOL carryforward. The tax court also held that permitting the division to audit and adjust the taxpayer’s NOL carryforward from these closed years would be tantamount to an adjustment of the income reported in those years and thus constitute an impermissible audit of closed years.

A Discount By Any Other Name…

- The Pennsylvania Commonwealth Court determine in Myers v. Commw., Pa. Commw. Ct., Dkt. No. 274 F.R. 2016, 08/06/2021) that the taxpayer is entitled to the sale tax refunds he seeks for three specific transactions involving a discount.
- In the first two transactions, the taxpayer's purchase receipt reflected that he bought a single item designated as taxable and received a discount from the purchase price by applying a coupon. In the third transaction, the taxpayer purchased six items, all of which were taxable, and received discounts by using five coupons.

A Discount By Any Other Name…

- At issue was whether every kind of coupon discount is excludable from sales tax, such as percentage reductions of entire purchases, specific dollar-amount discounts from a minimum purchase amount, discounts for shopping on a specific day, and other discounts not limited to specific items purchased. Since these types of discounts cannot be linked to specific discounted items, the commonwealth and the wholesale club reasoned that such discounts would not qualify for sales tax refunds.
- The commonwealth court held that percentage reductions of entire purchases, specific dollar amount discounts from a minimum purchase amount, discounts for shopping on a specific day, and other such discounts may not be linked to specific items purchased, but they still constitute on-the-spot cash discounts; and, therefore, they qualify for exclusion from sales tax under the plain language of the regulation.

Next Thing You Know, They Will Be Taxing Air

- In July, Fort Scott, a Kansas town of about 8,000, filed a class action lawsuit against streaming giants Netflix and Hulu in state district court, claiming that the companies failed to get authorization to use public rights of way, such as internet facilities, to deliver their services and failed to pay a required local franchise fee.
- Kansas law requires "competitive video service providers," as well as utilities, to pay up to 5 percent of gross revenue received from local customers for "the provision of services in that city" — a model that has long applied to cable providers in the state that rely on the public rights of way to deliver services to customers.
- The suit alleges that Netflix and Hulu have failed to comply with Kansas law because they haven't paid the fee to Fort Scott and other Kansas cities.
- Similar challenges have cropped up in other states in the last three years, including in Arkansas, Georgia, Missouri, Nevada, Ohio, Tennessee, and Texas.

Making Something Out Of Nothing

- *VAS Holdings & Investment LLC v. Commissioner of* Revenue, MA Appellate Tax Board, Dkt. Nos. C332269 & C332270 (October 23, 2020) Appeal pending.
  - The Massachusetts Appellate Tax Board ruled that capital gain recognized on a Florida S corporation's sale of its subsidiary a Massachusetts LLC was subject to corporate excise tax and nonresident composite tax.
  - The S corporation did not have any activities in Massachusetts, and none of its shareholders were Massachusetts residents. The taxpayer contended that the Due Process and Commerce Clauses prohibited Massachusetts from taxing the income because the LLC's sale did not involve a minimum connection to Massachusetts or the availment of the protections and benefits of Massachusetts law.

Making Something Out Of Nothing

- The Board concluded that the increase in value of the subsidiary was “inextricably connected to and in large measure derived from property and business activities in Massachusetts,” which included improved management and staffing of a call center business.
- The Board ruled that these business activities “necessarily involved availment of the protection, opportunities and benefits given by Massachusetts” and these facets “supplied the requisite connection between Massachusetts and business activities that resulted in the” capital gain

SOURCING

No Taxation Without Representation?

- A Utah administrative law judge (ALJ) denied a taxpayer’s appeal that requested that the proceeds from the sale of its subsidiary should be included in the denominator of the sales factor.
- The Auditing Division during the audit removed from the sales denominator the income from the sale of subsidiary-1 that had been attributed to goodwill and intangibles. In response, the taxpayer amended its returns to claim the gain was non-business income.
- The Division maintained that the subsidiary was unitary with the taxpayer, as demonstrated by the taxpayer’s history of unitary filings for all of the years that it had owned the subsidiary, and thus its sale was subject to Utah tax.

No Taxation Without Representation?

- Upon review of the evidence, the ALJ concluded that the Utah administrative rules provide that where business income from intangible property cannot readily be attributed to any particular income producing activity of the taxpayer, the income cannot be assigned to the numerator of the sales factor for any state and will be excluded from the denominator of the sales factor.
- The ALJ noted that if the taxpayer were able to identify which percentage of the proceeds from the intangibles could be attributed to Utah, that portion could be included in the numerator and then the proceeds from the intangibles could be included in the denominator. However, the taxpayer did not calculate out that percentage, because it maintained that because 100% could be attributed to its state of commercial domicile. Since the taxpayer did not meet its burden of proof for its position, the ALJ determined that the apportionment fraction should remain as calculated by the Division.

Hey Now

- One Technologies LLC, a Texas company that sells consumer credit report service, is asking a California Court to invalidate a 2012 ballot measure that established income tax rules for more than 100,000 corporations that sell goods or services in the state. The challenge is based on how parts of the measure were bundled together., The California Franchise Tax Board is asking the court to dismiss the complaint, alleging One Technologies has failed to state a valid cause of action. A hearing is scheduled Dec. 8 in Los Angeles County Superior Court.
- One Technology is alleging that Proposition 39 violates the single-subject rule in the California Constitution. Proposition 39 had two other elements along with the single-sales formula: It earmarked $550 million of the estimated $1 billion in annual revenue for five years to energy efficiency projects like retrofitting schools and government buildings, and it gave cable television companies a permanent carve-out, allowing them to assign half their sales of intangibles based on market rules and half based on cost of performance rules.

Hey Now

- Before 2013, companies could choose between the single-sales formula and the three-factor formula, which double-weights California sales. If they chose single-sales factor apportionment they used market-based sourcing. If they chose the three-factor formula, they assigned income from sales of intangibles to the location where the company incurred the costs to perform the services. One Technologies wants to use the three-factor formula and cost of performance, which would keep more of its income in Texas, where its offices and employees are located.
- One Technologies alleges that those three elements aren't sufficiently related to one another in two different ways. Either the single-sales factor rules are germane to the funding for clean energy jobs, leaving the cable tax carve-out unrelated; or single-sales factor and the cable carve-out are germane, leaving the clean energy jobs fund unrelated.

Apportioning Transaction Taxes; What a Concept

- The Massachusetts Supreme Judicial Court held decision in Oracle USA, Inc. v. Commissioner of Revenue, 487 Mass. 518 (2021 that software vendors have a statutory right to apportion tax on the sale of prewritten computer software purchased for use in multiple states and that they may do so through the Commonwealth's general tax abatement process. The court's) confirms that the ability to apportion tax on software is not contingent on strict compliance with the administrative procedures set forth in the Massachusetts Commissioner of Revenue's apportionment regulation. The tax abatement process is an acceptable mechanism for taxpayers to seek tax apportionment with respect to software purchased for use in multiple jurisdictions.

Apportioning Transaction Taxes; What a Concept

- Oracle concerned transfers of prewritten computer software to Hologic, Inc., a Massachusetts-based company. The vendors, Oracle and Microsoft, charged Massachusetts sales tax on the full value of the transactions. Hologic later notified the vendors that its employees located in and outside Massachusetts were using the software. The vendors filed applications for abatement and refunds, through the general tax abatement process, for the portion of the taxes they remitted on software transferred for use outside the Commonwealth. The Commissioner denied the vendors' applications on the grounds that, having failed to comply with the procedures set forth in the regulation, the vendors were precluded from apportioning tax. The Massachusetts Appellate Tax Board (ATB) sided with the vendors, finding that they had a statutory right to apportionment notwithstanding their failure to comply with the Commissioner's regulation.

Apportioning Transaction Taxes; What a Concept

- On appeal, the Massachusetts Supreme Judicial Court confirmed that the vendors had a statutory right to apportion sales tax because the software in question was transferred for use in multiple jurisdictions. The court rejected the Commissioner's argument that, in using the term "may" in G. L. c. 64H, § 1, the Massachusetts Legislature delegated to the Commissioner the authority to decide whether to allow apportionment of sales tax on software. The court observed that the Commissioner's argument raised separation of powers concerns because the decision whether to allow apportionment of sales tax on software "represents a fundamental policy decision that cannot be delegated," and the Massachusetts Legislature had intended to permit sales tax apportionment when software is transferred for use in multiple jurisdictions.

Apportioning Transaction Taxes; What a Concept

- The court also held that the vendors were entitled to use the general abatement process to seek apportionment. The court analogized a purchaser that fails to provide an MPU exemption certificate to a purchaser that fails to provide a resale certificate in respect of a nontaxable sale. In the latter case, the vendor may seek a refund of excessive taxes paid through the general abatement process. The court saw no reason to deny similar treatment to a vendor when the purchaser fails to provide an MPU exemption certificate.

Apportioning Transaction Taxes; What a Concept

- Oracle stands for the proposition that the administrative procedures set forth in the 830 Code Mass. Regs. § 64H.1.3(15) are not the exclusive means of seeking apportionment of sales tax on software purchased for use in multiple jurisdictions. If a taxpayer wishes to pay only the apportioned tax when the tax is due, it must comply with the regulation. Otherwise, the vendor may pay tax on the entire transaction and apply for an abatement and refund through the general abatement process.

First Cookie Nexus, Now Cookie Apportionment?

- Maryland has issued guidance that advises companies to use IP addresses, geolocation data and cookies to determine the location of devices for the apportionment formula applicable to the state's tax on digital advertising. In proposed regulations the Maryland comptroller said the numerator for the apportionment formula would be the number of devices accessing digital services from Maryland. The denominator would be the number of devices accessing digital services from any location.

First Cookie Nexus, Now Cookie Apportionment?

- The guidance said that each company would use "information within their possession or control which most reliably identifies a device's location." It gave ways to identify where the device is, including internet protocol, which is commonly known as the IP address; geolocation data, the place the device is registered to; and any cookies, or pieces of identifying data, on the device. It also said "any other comparable information" could be used to decide where the device is located.

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Illinois Wants To Do What?

- Starting Jan. 1, 2021, marketplace facilitators and remote sellers will be responsible for the retailers' occupation tax, which is levied at different rates in cities and counties on top of the state's 6.25% tax rate.
- The law change requires remote sellers and marketplace facilitators without a physical presence in Illinois to employ destination sourcing for the retailers' occupation tax. However, the tax is determined on an origin-basis for in-state sellers or for sales fulfilled from in-state inventory.
- Out-of-state sellers with a physical presence in Illinois may also incur a state use tax obligation, according to the law.

PROCEDURAL ISSUES AND OTHER FUN STUFF

Does This Work Both Ways?

- The Minnesota Supreme Court held in Olson v. Commissioner of Revenue (A20-1048, Dec 30, 2021) that a tax order assessing sales and use tax sent by regular mail instead of certified mail satisfies the constitutional requirement for due process.
- Jeffrey Olson operates a farming and heavy construction business as a sole proprietorship, and the business address is also Olson's home address. The DOR sent letters to Olson's home address alerting him that his business had been selected for an audit and scheduling audit conferences, but the department received no response. Olson failed to appear for the audit conferences, and the DOR sent a preliminary audit report showing unpaid sales and use taxes of roughly $120,000. When Olson again failed to respond, the DOR sent him a tax order in September 2017 assessing the sales and use tax and more than $30,000 in penalties and interest by regular, non-certified mail.

Does This Work Both Ways?

- Olson claimed that he either did not receive it or overlooked it and did not learn about the order until his bank account was levied in January 2018. Olson appealed the order, arguing that regular mail was not sufficient notice to satisfy due process under the federal or state constitutions.
- The state supreme court concluded that Olson's arguments focus on why certified mail is a better policy choice than regular mail and not why regular mail is constitutionally deficient.

Comity Is No Comedy

- A federal judge dismissed an Illinois business' attempt to claim a sales tax refund from California for money seized to collect owed taxes on sales made through Amazon, finding the Tax Injunction Act bars it from federal court.
- Illinois U.S. District Judge Edmond Chang rejected a preliminary injunction request sought by Illinois-based IJR Corp. and its owner, Isabel Rubinas, against the California Department of Tax and Fee Administration. The court found it doesn't have jurisdiction because of the federal Tax Injunction Act , which prohibits federal courts from hearing challenges to state tax laws when a plain, speedy and efficient remedy exists in state courts.

Comity Is No Comedy

- Judge Chang said the case "presents challenging questions of tax law and fundamental fairness," but California's state court system, and "ultimately the United States Supreme Court," is where Rubinas must fight for her claims. "California does offer a plain, speedy and efficient remedy, so the Tax Injunction Act prevents this court from issuing the relief that Rubinas seeks," the judge wrote.
- The court also noted that even if the court did have jurisdiction, California's sovereign immunity "would preclude the return of the already-seized funds."

Maybe Its Never Too Late

- The California Office of Tax Appeals (OTA) in Appeal of Cornerstone Compounding Pharmacy, Inc., Cal. Office of Tax Appeals, 2021-OTA-196P, 04/07/2021 reversed the Franchise Tax Board's (FTB) determination denying a California corporation's (appellant) claim for refund, because the OTA concluded that the appellant's filing of the refund claim during the period when its corporate status was suspended could be retroactively validated upon revivor since that revivor occurred before the expiration of the statute of limitations for the filing of the refund claim.

Maybe Its Never Too Late

- The appellant was suspended by the FTB on August 1, 2017 and revived on December 6, 2018 with an issuance by the FTB of a Certificate of Revivor. During its period of suspension, it filed its amended return claiming the refund on November 7, 2018. There was no dispute that the appellant filed its amended return (claim for refund) before the statute of limitations expired on September 15, 2019.
- However, the FTB, relying on a FTB legal ruling, denied the refund claim because the appellant was suspended at the time the claim for refund was filed and it was, therefore, invalid.

In Your Face!

- *New York v. B&H Foto and Electronics Corp*, Dkt. NO 452106/2019 (September 21, 2021).
  - The New York Supreme Court granted B&H's motion to dismiss the New York AG's complaint regarding a purported False Claims Act violation. The court held the AG incorrectly alleged that B&H made a false claim on its tax return when they did not collect sales tax on "instant savings," a type of vendor funding where a manufacturer reduces B&H's purchase price of a particular item based on each retail sale of such item.
  - In granting the motion, the court held that B&H did not violate the FCA and that "instant savings" are not subject to sales tax. The court rejected the AG's argument that instant savings were akin to manufacturer's coupons.
  - The AG argued that B&H's instant savings were part of the total consideration paid to B&H by the customer and compared the program to manufacturer's coupons, which are generally subject to sales tax in New York. In contrast, B&H argued that instant savings function as a discount from the manufacturer to B&H and are included in B&H's costs of goods sold.
  - In support of its motion to dismiss, B&H cited to administrative guidance that held analogous savings were not subject to the New York sales tax, highlighted that Generally Accepted Accounting Principles treat instant savings as a costs of goods sold reduction, and pointed to B&H's treatment being consistent with the industry standard.

QUESTIONS?