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Top Ten Sales & Use Tax Developments

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Agenda

- Nexus
- Characterization
- ITFA Preemption
- Other Cases of Interest
- Sales Price
- Manufacturing Exemption

Nexus

U.S. Auto Parts Network, Inc. v. Comm'r of Revenue, (Mass. SJC 12/22/2022)

- Issue: Whether pre-Wayfair, placement of cookies and applications on customers' computers and phones, and use of third-party "content delivery networks" ("CDNs") which expedited access to its website via the CDNs' servers, creates substantial nexus.

- Background: U.S. Auto Parts sold products to customers via the Internet. On September 22, 2017, the Massachusetts Department of Revenue promulgated a regulation stating that cookies and applications distributed or stored on computers or other devices inside the state established physical presence for sales tax purposes.

U.S. Auto Parts Network, Inc. v. Comm'r of Revenue, (cont'd)

- Holding: The Supreme Judicial Court of Massachusetts (the State's high court) held that "cookies" and other electrons did not constitute taxable nexus for periods prior to the U.S. Supreme Court's decision in South Dakota v. Wayfair, 138 S. Ct. 2080 (2018).

Quad Graphics Inc. v. N.C. Department of Revenue, (12/16/2022)

- The North Carolina Business Court held that Quad 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.
- Quad had a salesperson located in NC for the period in question. Under the contracts between Quad and its customers, title and possession to the sold products transferred outside NC.
- The Court agreed with Quad that the U.S. Supreme Court's 1944 holding in *McLeod v. J.E. Dilworth Co.* applied, meaning NC 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.

Quad Graphics Inc. v. N.C. Department of Revenue, (cont'd.)

- NC Supreme Court implicitly overturned Dilworth by finding that sales tax applied to an out of state sale (as opposed to a use tax). Dilworth precluded sales tax liability in cases where out-of-state goods were delivered by a common carrier into a state and title and possession to the goods transferred to the purchasers outside the taxing state.

- MTC filed an amicus brief in support of NC arguing that *Dilworth* was overruled by *Complete Auto's* four-part test and its express rejection of the *Spector* case that rests on the same formalism as *Dilworth*.
- 21 states filed an amicus brief in support of NC.
- Many observers (including COST and Prof. Pomp, in a joint amicus brief) felt the decision violated ***Rodriguez,*** which says that only the Supreme Court can overrule its own precedents.

Characterization

ADP, LLC v. Ariz. Dept. of Rev., et al., Ariz. Ct. App., Dkt. No. 1 CA-TX 21-0009, 01/31/2023

- The Arizona Court of Appeals affirmed summary judgment against the taxpayer, a human resource services provider to Maricopa County. The taxpayer licensed its software for its customers' direct use, which allowed clients' employees to login and enter employment data. All the taxpayers' customers used the same software code and servers, which were maintained outside of Arizona, but the software was configured to each customer's individual needs.
- The Arizona Department of Revenue (DOR) and the City of Phoenix (City) collected transaction privilege tax (TPT) from revenues received from leasing the software to Maricopa County, and the taxpayer requested a refund. The refund claims were denied, the taxpayer appealed to the superior court, which granted the DOR's and the City's motions for summary judgment, and the taxpayer appealed.
- Citing precedent, the appeals court found that TPT did apply because the software did constitute tangible personal property. While the taxpayer may have once been offering human resources services, it had changed to renting human resources software.

ADP, LLC v. Ariz. Dept. of Rev., et al., Ariz. Ct. App., Dkt. No. 1 CA-TX 21-0009, 01/31/2023

- The taxpayer argued because all its customers accessed the same computer servers and none of its customers had exclusive use of the software, that the contract could not constitute a rental. The court however, found that the contract was not for access to the servers, but for the interface with the software, and at that level, the use was exclusive, and that each customer's access to the software was configured to fit their particular needs and thus was a rental.
- The taxpayer also argued that the contract was primarily for a service, and any property involved was incidental to the transaction and therefore not taxable, but the court found that the services provided, e.g., "hosting services" were separately stated and secondary to the taxable component of the transaction, i.e., the fees charged for the county's use of software. Lastly, the court found the software was subject to TPT under Phoenix's city code because the code expressly included “prewritten computer programs that are held or exist for general or repeated sale, lease, or license.” Accordingly, the summary judgment was affirmed.

Landis+GYR Midwest Inc. v. Washington Dep't of Revenue, Case No. 56877-2-II, Wash. Ct. App. 2d (March 28, 2023)

- Automated meter reading service involved pulling raw data from meters multiple times a day, sending it out of state to a data center where the hundreds of data items per meter were converted into one read per meter per day
- DOR argued primary purpose was collection and transmission of data, not processing
- TP argued that the primary purpose was the extraction and conversion of data
- TP lost at Thurston County, but was victorious at the Court of Appeals

ITFA Preemption

Apple Inc. v. Hegar, Travis County District Court (D-1-GN-20-004108)

- On August 7, 2020, Apple filed an action seeking a refund of tax and interest erroneously assessed and collected on Apple's sales of iCloud and iTunes Match services (Jan. 2013 – Feb. 2016).
- On April 16, 2021, Apple filed a second action seeking a refund of tax and interest erroneously assessed and collected on Apple's sales of iCloud and iTunes Match services for subsequent periods (March 2016 – May 2020).
- Both cases allege:
  - Texas's application of the sales tax is preempted by ITFA;
  - "Internet access" includes "personal electronic storage capacity . . . provided independently or not packaged with Internet access."
  - Also, "discriminatory tax on electronic commerce" because the Comptroller does not assess sales tax on offline providers that offer services similar to iCloud/Match.
  - Apple's services do not constitute "data processing services" within the meaning of the sales tax statute;
  - Apple's services do not constitute "data processing services" within the meaning of the Comptroller's regulation; and
  - The essence of Apple's transaction with its customers is not the provision of data processing services.

Apple Inc. v. Hegar, Travis County District Court (D-1-GN-20-004108)

- Comptroller argues:
  - Tax on Data Processing Services turns on use of computer, not use of internet.
  - Data storage is data processing, and iTunes Match/iCloud provide data storage.
  - If court finds ITFA applies, it should be struck down as interfering with states' rights and/or violating the anti-commandeering doctrine
    - "ITFA is a direct order to state gov'ts to refrain from taxing internet transactions. ITFA is unconstitutional."
- District Court Decision issued 6/16/22: both parties' MSJs denied; trial date being scheduled for later this year.
- Comptroller estimates potential $500M annual loss in Texas tax revenue.

Apple Inc. v. Samuel, Dkt. No. L01283 (La. Bd. Tax App. Jan. 12, 2023).

- The City of New Orleans assessed Apple for City Sales tax and French Quarter Economic Development District sales/use tax based on Apple's sales of iCloud subscriptions to customers in the parish.
- Apple argued that sales of iCloud subscriptions are sales of "Internet Access" under ITFA and therefore are not taxable by the state of Louisiana. Apple further argued that its iCloud service meets the definition of Internet Access under the ITFA because it provides storage plan subscribers with "personal electronic storage capacity."
- The Louisiana Board of Tax Appeals granted Apple's Motion for Partial Summary Judgment, stating that the transactions at issue fit within the ordinary meaning of the language employed and that personal electronic storage services are not listed as taxable services under Louisiana or parish law.
- The Board held that the assessment of the sales tax as to iCloud storage plans was barred by ITFA as the sale of "internet access."
- Focused on Prong 2 of ITFA (internet access)

Other Cases of Interest

State of Arizona ex rel. Arizona Dept. of Rev. v. Peter A. Tunkey, et al. CV-22-0128-PR

- From 2005 through 2015, Peter Tunkey was a manager of KT McClintock, LLC ("KT"), which did business as Silver Mine Subs in Arizona. KT charged customers to cover its transaction privilege taxes ("TPT") and reported the TPT to ADOR but failed to pay ADOR the amounts due. The taxpayer's business, a sandwich shop, had collected taxes from its customers and filed returns with the Department of Revenue, but failed to pay the taxes owed.
- In 2019, ADOR filed a complaint in tax court against KT and the Tunkeys seeking judgment for the TPT liability, penalties and interest. ADOR claimed the Tunkeys were personally liable for the TPT pursuant to A.R.S. § 42-5028, although ADOR did not issue an assessment of the taxes against the Tunkeys prior to filing the complaint.
- ADOR and the Tunkeys filed separate summary judgment motions, each asking the tax court to determine whether the Tunkeys were jointly and severally liable for the unpaid TPT.
- Affirming the Tax Court, the Court of Appeals held that the Department of Revenue was not required to assess the taxpayers personally before it could bring a collection action against them for unpaid transaction privilege taxes incurred in the taxpayer's operation of their business. The Court of Appeals concluded that under the standard set by Ariz. Dep't of Revenue v. Action Marine, Inc., 218 Ariz. 141 (2008), the Department of Revenue could initiate a collections action pursuant to A.R.S. §§ 42-5028 and 42-1108 against corporate officers or directors of a business that collected but did not remit tax without issuing a deficiency notice because the business had admitted collecting and owing the taxed by filing monthly transaction privilege tax returns.

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Maryland Digital Advertising Tax Litigation

State Court Case: *Comcast et al. v. Comptroller*

- Seeking declaratory judgment that the tax:
  - Violates ITFA; Violates the Due Process Clause; Violates the Commerce Clause's fair apportionment requirement and discriminates against interstate commerce; and Improperly delegates taxing authority to Comptroller.
- Summary judgment granted in favor of Plaintiffs striking down the DAT on grounds that it violates the Supremacy Clause, Commerce Clause, First Amendment and ITFA.
- Comptroller filed motion to stay; on Jan. 4, 2023, Plaintiffs opposed the motion to stay on the basis that the Comptroller failed to satisfy the requisite standards of relief by showing (1) that the S. Ct. of MD will likely reverse lower court's decision, and (2) that a denial of the stay would result in irreparable harm. The companies argue that the lower court's declaratory judgment does not prevent the Comptroller from assessing the DAT on or after the upcoming annual filing deadline (April 17, 2023).
- Maryland Supreme Court granted cert on Jan. 20, 2023 and on May 9, 2023 ruled that the state circuit court lacked jurisdiction to hear the constitutional challenge to the DAT because the appellees failed to first exhaust their administrative remedies (purely procedural victory).

Maryland Digital Advertising Tax Litigation

Federal Court Case: *US Chamber of Commerce et al. v. Comptroller*

- Seeking injunctive and declaratory relief on similar grounds as the state case.
- Dec. 2, 2022 U.S. Dist. Ct. decision, which dismissed the case without prejudice on the basis that the state circuit court's declaratory judgment rendered the Plaintiffs' case moot. Plaintiffs have appealed the decision to the Fourth Circuit, where it is currently pending. The case will likely be argued sometime during Fall 2023.

Sales Price

John G. Myers v. Commonwealth of Pennsylvania, (2/22/2023)

- Appellee petitioned the BOA, seeking a refund of 38 cents, the difference of the sales tax paid on the full purchase price versus the discounted purchase price.
- Issue: Does 61 Pa. Code § 33.2(b)(2) require that a vendor's register receipt indicate precisely to which taxable item the coupon relates in order to charge and remit sales tax on less than the original, non-discounted price of the item?
- Applying the plain language of Section 33.2(b) to this case, none of the receipts Appellee presented satisfy subsection 33.2(b)(2)'s description requirement. The first receipt, dated June 13, 2013, shows that Appellee purchased six taxable items and redeemed five coupons. While the six items are described, all five coupons are listed as "SCANNED COUP." Similarly, the second and third receipts, dated August 22, 2014, and August 25, 2014, reflect Appellee purchased a single item and redeemed a single coupon. Again, the items are described, but the coupons are recorded as "SCANNED COUP.
- Thus, the coupons on all three receipts are identified as coupons but not described. Without a description of the coupons, it is impossible to determine whether any of the coupons were of the type that subsection 33.2(b)(2) authorizes to establish a new purchase price. Because it was Appellee's burden to prove that he was entitled to a refund of sales tax, he did not meet his burden.

Manufacturing Exemption

Akamai Technologies, Inc. v. Commissioner of Revenue MA Appellate Tax Board Dkt. No. C332360 (12/10/2022)

- The Massachusetts Department of Revenue has issued its position on the Appellate Tax Board decision in *Akamai Technologies, Inc. v. Commissioner of Revenue* , Dkt. No. C332360, 12/10/2022. The Department states that the determination of whether a corporation is selling services or standardized software depends upon facts and circumstances of each case.
- Corporations that develop and sell access to software that allows customers to input their own information, manipulate the software, and run reports without interaction with the corporation or its employees, are engaged in the manufacture and sale of tangible personal property. Therefore, such corporations are entitled to be classified as manufacturing corporations under Mass. Gen. L. Ch. 58 § 2 and must file as manufacturing corporations under Mass. Gen. L. Ch. 63 § 38 and Mass. Gen. L. Ch. 63 § 42B.
- A corporation classified as a manufacturing corporation is entitled to a local property tax exemption on its machinery and other benefits such as the investment tax credit and certain sales tax exemptions if it otherwise meets the requirements for those exemptions. And a corporation treated as a manufacturing corporation is required to apportion its income using a single-factor formula based entirely on sales. (Massachusetts Technical Information Release No. 23-8, 07/12/2023.)

Questions?