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TEI Denver

SALT Litigation Update

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Agenda

- Combined reporting and apportionment
- Marketplace collection
- Uniformity
- More noteworthy cases

Learning Objectives

- Provide an overview of combined reporting and apportionment.
- Analyze current and pending marketplace collection laws at the state and local level.
- Review uniformity litigation and other noteworthy cases.

Polling Question

What is your favorite beverage to start the day?

A. Coffee

B. Tea

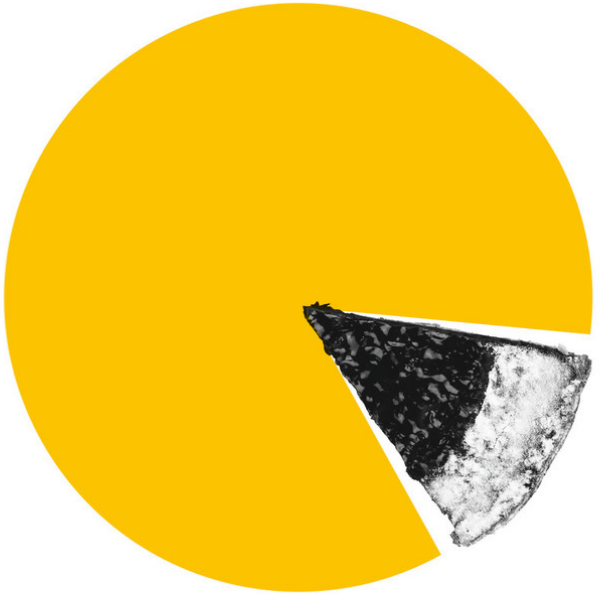
C. Water

D. Soda

E. Juice

F. Other

Combined reporting and apportionment



Polling Question

How closely is your tax team monitoring combined reporting and apportionment issues?

A. Closely

B. Somewhat regularly

C. Not as much as we should

D. Not at all

Massachusetts – litigation proceeds

Synqor, Inc. v. Comm'r of Revenue, No. 19-P-1695 (Mass. Ct. App. 2021)

- Taxpayer was a manufacturer or power converters and systems
- Taxpayer won a patent infringement lawsuit against Texas competitors
- Massachusetts took the position that litigation proceeds (including damages, settlement payments, and royalty payments) were attributable to the state for corporate excise tax apportionment purposes
- The court held that the net income statute does not include an exhaustive list of income producing activities
  - Moreover, because the taxpayer was not in the business of licensing, its royalty income was attributable to Massachusetts as the proceeds from the enforcement of legal rights

Michigan – sourcing service receipts

Honigman Miller Schwartz and Cohn LLP v. City of Detroit, 505 Mich. 284 (Mich. 2020)

- The Michigan Supreme Court ruled in favor of the city of Detroit in holding that, for purposes of the Uniform City Income Tax, revenue for services rendered in the city should be calculated on the basis of where the services are performed, not on where the client that received those services is located
  - The taxpayer alleged that the city was exceeding its authority under the Uniform City Income Tax Ordinance (UCITO)
- The Michigan Supreme Court's opinion reversed the Court of Appeal's published opinion from January of 2018, which had ruled in favor of the Honigman law firm (taxpayer)

Mississippi – alternative apportionment win

Comcast, in Mississippi Department of Revenue v. Comcast of Georgia/Virginia Inc., 300 So.3d 532 (Miss. 2020)

- A taxpayer convinced the Mississippi Supreme Court that the company could use an alternative apportionment formula that excluded capital from subsidiaries that didn't engage in any in-state activities
- The taxpayer's subsidiaries that it excluded from its tax base had no connection to the company's business in Mississippi, and therefore it would be erroneous to include investments in them in the company's franchise tax base, the justices said
- The MDOR sought to tax more than 340% out-of-state value than allowed, and MDOR's assessment disregarded the receipts and property of taxpayer's subsidiaries from the computation of taxpayer's apportionment, even though those subsidiaries comprised between 77% and 80% of taxpayer's total assets during the years at issue

New Mexico – mileage method

In re United Parcel Service Inc. (Ohio) & Affiliates, No. 19-27 (N.M. Admin. Hearings Office 2019)

- A delivery company could depart from the statutory apportionment method for trucking companies, based on mileage driven in the state, because it produced a result that bears no rational relationship to its New Mexico business activity
- The mileage method was grossly distortive because it resulted in a more than ten-fold increase in sales attributed to New Mexico compared to actual revenue from New Mexico customers
- In place of the statutory method, the company was permitted to use the "state-to-state volume method," which instead assigned half of the receipts from a sale to the state of origination and the remaining half to the destination state

New York – broker dealers

In the Matter of BTG Pactual NY Corporation,
DTA No. 827577 (2019)

- A corporate member of a disregarded limited liability company was not permitted to use a special apportionment rule for broker-dealers even though the disregarded entity was a registered broker-dealer
- The company owned two single member LLCs, one of which was a registered broker-dealer, the other was not
- Although the company was deemed a broker-dealer through its ownership of the LLC, this status could not carryover to the non-broker dealer receipts earned by the second LLC
- The ALJ also rejected the taxpayer's Due Process, Equal Protection and Commerce Clause claims, noting that states were entitled to treat classes of entities differently

North Carolina – public utilities

Railroad Friction Prods. Corp. v. North Carolina Dep't Revenue, No. 278A19 (N.C. 2020)

- The court held that a manufacturer of brake pads used by railroads did not qualify for an exception to the state's standard three-factor apportionment formula that allows "public utilities" to instead apportion their income using a single-sales factor formula

- The manufacturer did not meet the statutory test for a public utility because it:
  1. was not regulated my specified entities and,
  2. did own property used for the transmission of communications or the transportation of goods or persons

- Notwithstanding the NC Supreme Court's decision, the issue of whether companies that are subject to some forms of regulations, e.g., federal versus state regulation, is a recurring issue and can have significant impacts on how taxpayers apportion their income

Oregon – commodity hedging

Chevron U.S.A. Inc. v. Dep't of Revenue, TC-MD 190031N (Or. Tax Ct. Apr. 14, 2021)

- Cross motions for summary judgment in a involving the inclusion of receipts from commodity hedging activities in the taxpayer's sales apportionment factor
  - The Department concluded that the gross hedging receipts were not includable in the taxpayer's sales apportionment factor because they arose from the sale of intangible assets and were not derived from Chevron's primary business activity
- The tax court held in favor of the Department with respect to the characterization of the hedging receipts as receipts from intangible assets, despite the fact that the assets are treated as ordinary rather than capital assets under federal tax law, finding that the composition of the sales factor is a matter of state, not federal law
  - On the second issue as to whether the hedging receipts were derived from Chevron's primary business activity, the tax court held that summary judgment was not appropriate given the fact-dependent nature of the analysis

Marketplace collection

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Louisiana – applying existing tax definitions to marketplace transactions

Normand v. Wal-Mart.com USA LLC, No. 2019-C-00263 (La. Jan. 29, 2020)

- Louisiana attempted to apply its existing sales tax definitions to marketplace transactions
- Louisiana Supreme Court ruled in favor of Wal-Mart.com, overturning the court of appeals and trial court decisions
- The court held that Walmart.com marketplace was not *the* "dealer" in third-party sales made through the platform
- An online marketplace is not a party to the underlying transaction between the third party retailers and their customers. Rather, the online marketplace is a facilitator of the sale

Polling Question

How would you characterize Louisiana's approach to taxing marketplace transactions prior to the enactment of its marketplace law?

A. Highly unfair to taxpayer

B. A stretch, but not that unfair

C. Clever way to raise revenue

Maryland – looking at legislative intent

Travelocity.com v. Comptroller of Maryland, No. 14 Sept. Term (Md. Ct. App. 2020)

- Holding that an online travel booking company did not qualify as a "vendor" for purposes of sales and use tax for years prior to a 2015 law change
- In 2015, the Maryland General Assembly expanded the definition of a "vendor" liable for sales and use tax to include an "accommodations intermediary" that facilitates the sale of an accommodation for a fee
  - The court agreed that the statute was ambiguous as to whether Travelocity was liable for sales and use tax and that ambiguity must be interpreted in the taxpayer's favor
- Based on legislative history the court reasoned that a subsequent addition of "accommodations intermediary" to the statute was an indication that prior to the amendment a company such as Travelocity was not included in the statutory definition of a vendor liable for the tax

South Carolina – what about pre-*Wayfair* sales?

Amazon Services LLC v. S.C. Dep't of Revenue, No. 17-ALJ-17-0238-CC (S.C. Admin. Law Ct. Sept. 10, 2019)

- The South Carolina Administrative Law Court concluded that Amazon was required to collect and remit sales and use tax on third-party seller sales made on the Amazon marketplace
- The ALC held that Amazon retained extensive control over every aspect of the transactions, including being the only contact for the purchaser, and prohibiting the third-party merchants from accepting payments for the products
- South Carolina enacted a marketplace collection law in April 2019
- Amazon appealed to the South Carolina Court of Appeals
  - Appeal, Answer, and Reply Briefs filed, but assignment of case and other deadlines have been delayed due to Covid-19

Uniformity litigation

Delaware

In re Delaware Public Schools Litigation, 239 A.3d 451 (Del. Ch. Ct. 2020)

- Delaware counties used assessment methodologies that violated Delaware's "true value" statute as well as the "uniformity clause" of the state's constitution
- The counties assessed all property based on valuations from the 1970s and 1980s
- The uniformity clause was violated because properties appreciated at different rates
- Sales ratio studies confirmed that properties were assessed at different percentages of fair market value

Delaware

Verisign, Inc. v. Dir. Of Revenue, No. N19C-08-093 (Del Super. Ct. 2020)

- The DOR improperly limited the amount of separate company NOL the taxpayer could claim on its Delaware income tax return to the amount of its federal consolidated NOL deduction
- The DOR's limitation on NOLs violated the state constitution's uniformity clause
- The court found that the DOR's policy was consistent with Delaware's income tax statute and that the policy did not discriminate against interstate commerce
- However, it ruled that the DOR's policy violated the state constitution's uniformity clause by creating two classes of taxpayers and by treating taxpayers that file a federal consolidated return differently than those that do not

Georgia

Rice v. Fulton County, No. A20A1898. (Ga. Ct. App. Dec. 15, 2020)

- The Georgia Court of Appeals Dec. 15 reversed the trial court's dismissal of a class action lawsuit from Fulton County homeowners for failure to state a claim
- The complaint alleged that the Board engaged in “sales chasing” by selectively targeting recently sold properties for reappraisal at the increased sales price while leaving the assessed values of similarly situated unsold properties unchanged
  - Taxpayers alleged that the sales chasing behavior violated the state constitution’s uniformity clause, the Equal Protection Clause of the fourteenth amendment and the state’s equalization statute

New Jersey

Plaza Twenty Three Station v. Township of Pequannock, 31 N.J.Tax 420 (2020)

- The Tax Court ruled that the valuation of a commercial property in 2018 and 2019 was improperly based solely on a 2017 sale of the property
- This caused the assessments to be unconstitutional spot assessments
- Therefore the property valuations were reduced to the assessed value prior to the 2017 sale
  - The Uniformity Clause of the state constitution requires that all real property assessed and taxed locally or by the State for allotment and payment to taxing districts shall be assessed according to the same standard of value.
  - Discrimination under the Equal Protection clause occurs when a property is intentionally assessed at a higher percentage of true value than similarly-situated properties, and this 'in fact bears unequally on persons or property of the same class'

Virginia

International Paper Co. v. County of Isle of Wight, 847 S.E.2d 507 (Va. 2020)

- A machinery and tool (M&T) property tax relief program payments were integrated into the taxation process and had the same effect as partial tax exemption
- The tax relief formula treated taxpayers differently based upon whether the county had lawfully owed that taxpayer a refund on taxes overpaid in prior years
- This created a sub-class of taxpayers because refund and relief payment were negatively correlated, and only taxpayers who had received a refund were required to pay the tax assessment increase
- Therefore net tax rates paid by taxpayers, given the payments made to some taxpayers by the tax relief program, were not uniform

More noteworthy cases

California voter initiative litigation

- A recent wave of local tax initiatives passed by simple majority vote in cities and counties across California has resulted in either court validation actions or challenges under the state constitution
  - Article XIII C, Section 2(d) of the California Constitution provides that "[n]o local government may impose, extend, or increase any special tax unless and until that tax is submitted to the electorate and approved by a two-thirds vote"
- Thus far, trial courts have split as to whether this provision applies to voter-initiated local taxes, and one appellate court already has concluded it does not
- Many of these cases are now on appeal

California – administrative procedure

LA Live Props. LLC v. Cty. of L.A., No. B298278 (Cal. Ct. App. Feb. 26, 2021)

- A county's failure to comply with statutory notice requirements did not render an assessment a "legal nullity" that would excuse the taxpayer from the requirement to exhaust administrative remedies
- For escape assessments, taxpayers are required to file an administrative request for reassessment and refund before filing a refund action in court unless the assessment is a "nullity as a matter of law"
  - The court concluded that the assessment may be treated as a nullity only when the real property at issue was not tax exempt, nonexistent, or outside the county's jurisdiction—circumstances that did not exist in the taxpayer's case

New Jersey – partnership filing fees

Ferrellgas Partners, LP v Dir. Div. of Tax'n, No. A-3904-18T1, (N.J. Super. Ct. App. Div. 2021)

- Taxpayer, a publicly traded limited partnership, took the position that the state's partnership filing fee (PFF) was a tax, not a uniform regulatory fee, and that it violated the Dormant Commerce Clause of the U.S. Constitution
- The court held that the facially-neutral PFF did not violate the dormant Commerce Clause solely because it is a flat amount and imposed on a payor involved in interstate commerce
- Taxpayer failed to prove discrimination against, excessive burden on interstate commerce, or that the PFF wasn't fairly related to the division's processing and review of partnership and partner returns

New Jersey – special legislation

Mack-Cali Realty Corp et al. v. State of New Jersey et al., case no. HUD-L-004903-18, Superior Ct. of New Jersey, Hudson County – case dismissed March 15, 2019

- Adoption of Jersey City's payroll tax was challenged by a group of businesses as being "special legislation" barred by the state's constitution, arguing that the tax targets out-of-towners who work in the city
- Superior Court Judge dismissed the case, ruling that the payroll tax ordinance is not special legislation prohibited under the state and federal constitution
- New Jersey AB 4163, enacted in mid-2018, allows municipalities with population > 200,000 to establish an employer payroll tax of up to 1%
  - Jersey City approved the ordinance in late 2018
  - Newark also imposes the tax
- Per the judge's ruling: "there is no other similarly situated city being excluded because there is no other city that meets the population requirement"

New York – property valuation during COVID-19

Matter of Crystal Run Galleria LLC v. Town of Wallkill, No. EF004035-2020 (Sup. Ct. Jan. 20, 2021),

- Taxpayer, a mall owner, was not entitled to a modification of the mall's valuation which was fixed by a 2017 consent order
- The taxpayer alleged that failure to take COVID-19 into account for the 2020 tax year violated the state constitution's prohibition on property tax assessments that exceed full market value
- The court held that by signing the consent order and judgment, the taxpayer waived any claims regarding a constitutional defect in the settlement
- Further, the court held that the COVID-19 pandemic did not affect the value of the property for the purposes of the FY 2020 assessment
  - The pandemic did not alter the property as of its March 1, 2020 assessment date and its *financial* impact was "wholly irrelevant" to determining the assessed value

New York – untimely filing

In the Matter of the Petition of Shahid Mahmood, Dkt. No. 828168
(N.Y. Tax Appeals Tribunal Apr. 15, 2021)

- Dismissing a taxpayer's exception to an order of an ALJ on the grounds that the exception was not timely filed
  - The taxpayer asserted that the filing delay was due to circumstances relating to the COVID-19 pandemic
  - Although the taxpayer had good cause to request an extension, the extension was not requested within the 30-day time period provided by statute
- The Appeals Tribunal takes the position that it lacks the authority to waive statutory deadlines
  - Contrast with guidance from the N.Y.C. Tax Appeals Tribunal

Ohio – municipal tax

Athens v. McClain, 2020 WL 6494232 (Ohio 2020)

- Two coalitions of Ohio municipal corporations brought a suit against the state tax commissioner on the right of the state to restrict the municipalities' income tax systems
  - 2014 legislation sought to streamline the municipal income tax system and centralize the collection and administration of the "net profit tax"
  - Municipalities argued the legislation violated the home rule powers granted to them by the state constitution
- Court found that the state constitution provided the General Assembly with powers to curb the municipalities' power to tax
- However, the statute directing the State Treasurer to retain one-half percent of municipal net profit taxes for collection and administration services, as part of centralized administration, rather crediting amount to fund that distributed funds to municipalities, exceeded General Assembly's general power to legislate
  - Municipalities exercising home-rule authority were not persons "subject to" the state's regulation, therefore municipal revenues could not be subject to state tax

Vermont – excessive fines

Vt. Nat'l Tel. Co. v. Dep't of Taxes, 2020 Vt. 83, (Vt. 2020)

- Taxpayer argued that a 23 percent penalty was an excessive fine under the Eighth Amendment
- Court held that because the Commission was authorized to impose up to a 25 percent penalty, there was a strong presumption that the taxpayer's penalty was not excessive
- The court held that although the taxpayer may not have willfully or intentionally underpaid, by relying on the advice of its accountants and not seeking a formal ruling, it "assumed the risk" of receiving a penalty

Polling Question

What type of Zoomer are you?

A. The one without video

B. The one in PJs

C. The one walking the dog

D. The one who forgets to mute

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