EVERSHEDS SUTHERLAND

Bruins & Bison & Tigers, Oh My! A SALT Controversy and Litigation Update to Protect Your Company

TEI Nashville Tax Seminar Series

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Agenda

- Direct Taxes
  - Apportionment
  - Forced Combination
  - Transfer Pricing
  - NOLs
- Indirect Taxes (and other stuff)
  - Digital Ad Tax
  - Sales Tax
  - Gross Receipts Tax
  - Remote Work
  - ARPA

Polling Question

How do you feel about returning to the office?

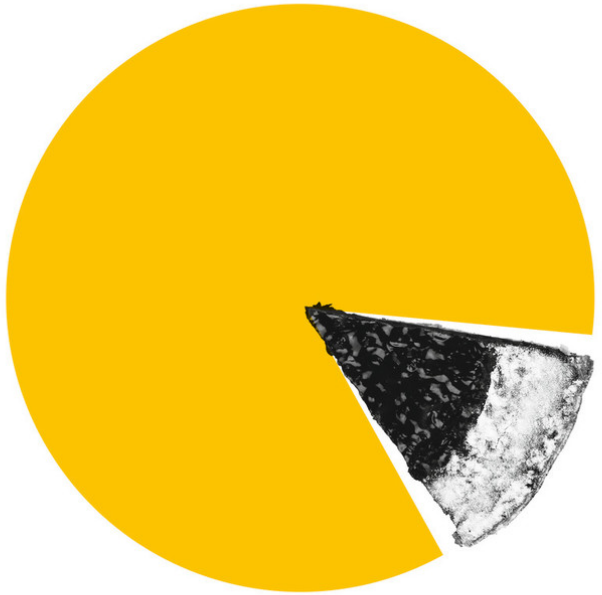
A. Very excited. I miss my co-workers.

B. Little worried.

C. Not that excited, I like working from home in my pajamas.

Direct Taxes

Apportionment



California – Single Sales Factor Apportionment

One Technologies, LLC v. Franchise Tax Board, No. 21STCV21844 (Cal. Super. Ct., filed June 11, 2021)

- Challenge to California Proposition 39, which requires most taxpayers to use single-sales factor apportionment and enacted market-based sourcing.
- Taxpayer argues the Proposition was invalid because it violated the California Constitution's requirement of single subject, object, or purpose.
- Suit seeks refund of franchise tax paid by taxpayers who used single sales factor apportionment as required by the Proposition.

Oregon – Commodity Hedging

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

- Issue: cross motions for summary judgment on whether the taxpayer had to include receipts from commodity hedging activities in its sales apportionment factor.
  - The Department argued that they should not be included because receipts from hedging arose from the assets that were not derived from Chevron's primary business activity.
- The Court denied both motions for summary judgment on whether the hedging receipts were derived from Chevron's primary business activity, because it is a fact-dependent analysis.

Pennsylvania – Market-Based Sourcing or COP

Synthes USA HQ Inc. v. Commonwealth of Pennsylvania, No. 108 F.R. 2016 (Pa. Commw. Ct. July 24, 2020)

- The Pennsylvania Legislature amended an apportionment statute to provide for market-based sourcing effective with the 2014 tax year
- This case reflects a Three Way Dispute: Department of Revenue versus Attorney General versus Synthes
  - Department of Revenue: Market-Based Sourcing
  - Pennsylvania Department of Revenue: Costs-of-Performance
  - Synthes: Market-Based Sourcing
- Commonwealth Court upheld the DOR's position that under the state's *prior* apportionment statute applying the former Costs-of-Performance statutory method to produce a Market-Based Sourcing result
- The case is on appeal to the Pennsylvania Supreme Court
  - The DOR and Synthes urge the Court to affirm and arguing that the AG is improperly seeking to overturn the refund award.
  - Synthes claims that even if the court found that the DOR's interpretation of the law was incorrect, historical application of the law compelled Synthes to receive the same treatment as other businesses (uniformity clause).

Polling Question

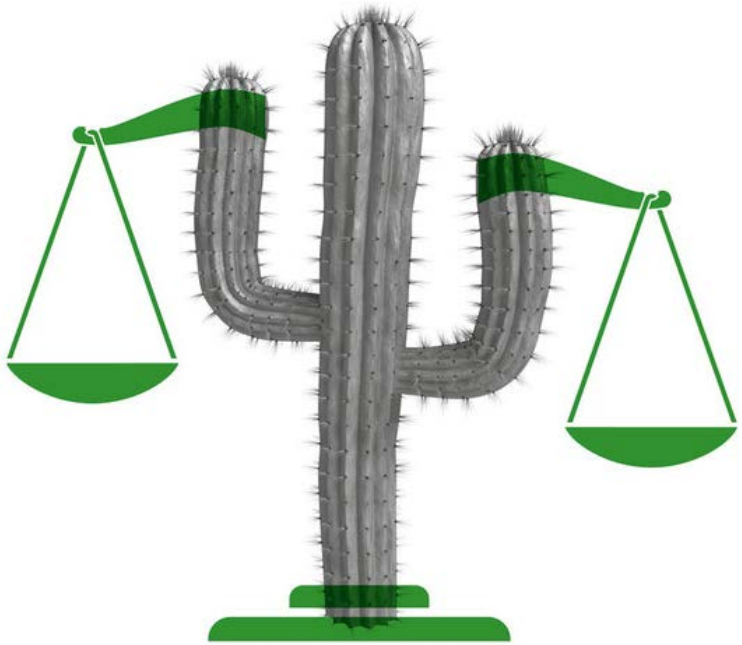
Do you think the Department of Revenue should be allowed to intervene in the *Synthes* case?

A. No, they have the attorney general representing them

B. Yes, the drama makes this case really interesting

C. No opinion

Texas – Cost of Performance Sourcing

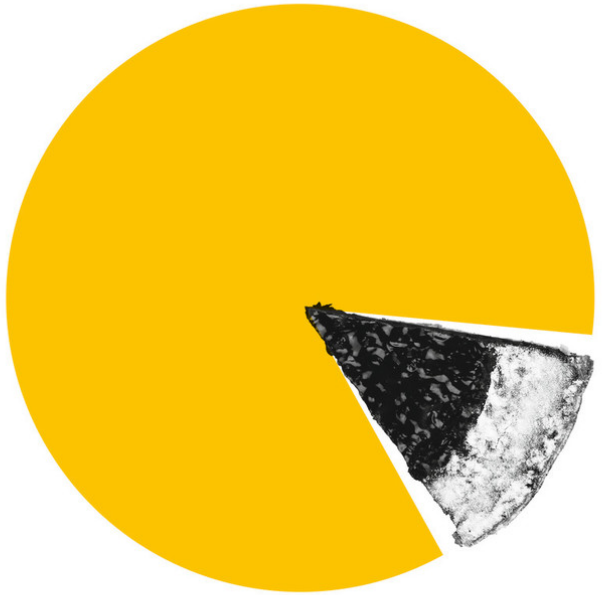


Hegar v. Sirius XM Radio, Inc., No. 03-18-00573-CV (Tex. App, 3rd Dist. 2020)

- The Appellate Court held that the receipts from subscription services should be apportioned to Texas based on the location of subscribers and not where the taxpayer performed its activities

  Supreme Court recently accepted petition for cert

Forced Combination



South Carolina - Forced Combination

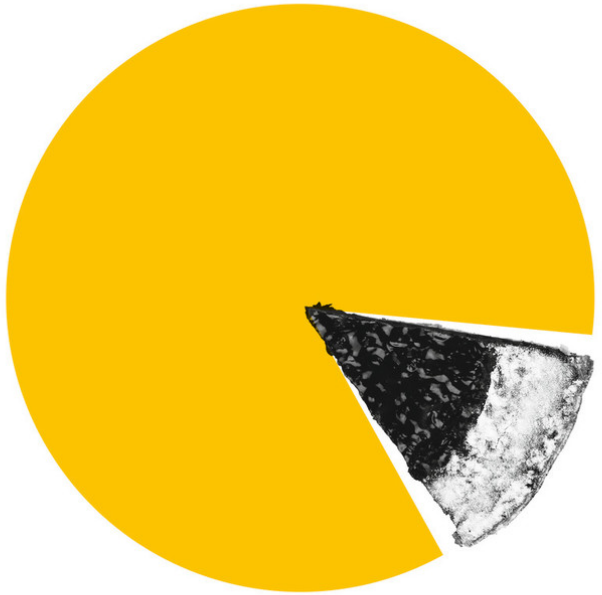
- Businesses are challenging South Carolina Department of Revenue's use of forced combination.
- At least three such cases are pending trial in South Carolina's Administrative Law Court: *AutoZone Investment Corp. v. Department of Revenue*; *Belk Inc. v. DOR*; and *Tractor Supply Co. v. DOR*.
- The Department is arguing that the statutory formula does not fairly reflect their business activity in the state and that unitary combination is a reasonable alternative apportionment method.
- The Department is relying on – *Media General Communications, Inc. v. Dep't of Revenue* to assert forced combination.
  - *Media General* held that the taxpayer was authorized to use a combined entity apportionment method because the standard apportionment formulas allowed result in a statutory distortion of Taxpayers' incomes.

Ohio – Look-through Sourcing

Defender Security Co. v. McClain, Slip Op. No. 2020-Ohio-4594 (Ohio Sept. 29, 2020)

- **Issue:** How should a taxpayer source income related to its sale of contracts to monitor home security systems to ADT?
  - ADT is not located in Ohio, but the taxpayer installs systems and sell contracts to ADT for Ohio customers
  - Ohio law apportions receipts from services and all other gross receipts not otherwise specifically addressed in the proportion to the purchaser's benefit in Ohio compared to everywhere
- **Holding:** Receipts are sitused to the location where ADT realizes the benefit derived from purchasing intangible contract rights from Defender Security Co. and not where their customers received the benefit of ADT's services
  - The payments for monitoring services were provided outside of Ohio

Transfer Pricing



State Transfer Pricing Developments

Recently, states have taken an evolved approach to transfer pricing challenges

- A committee of the MTC has developed a transfer-pricing program that would be available to the states - State Intercompany Transactions Advisory Service (SITAS). It is designed to:
  (1) Provide training for state staff to identify distorting intercompany transactions; and
  (2) Provide third-party support to combat transfer-pricing studies provided by taxpayers.
- Increasing scrutiny on transfer pricing studies and application of the arm's-length standard
- Increased focus on developing technical knowledge under 482
- Increasing reliance on contingency fee auditors
- States have began producing in-depth audit reports with respect to intercompany transactions and 482 analysis

State Transfer Pricing Developments

- States are turning to arm's-length principles (e.g., Georgia, Indiana, Rhode Island, North Carolina, South Carolina, Louisiana)
- On July 30, 2020, the North Carolina Department of Revenue announced a voluntary corporate transfer pricing resolution initiative
- Indiana has created a dedicated transfer pricing group within its audit division to handle the Advanced Pricing Agreement Program relating to transfer pricing issues

Polling Question

Which state tax publication do you most regularly read?

A. State Tax Notes

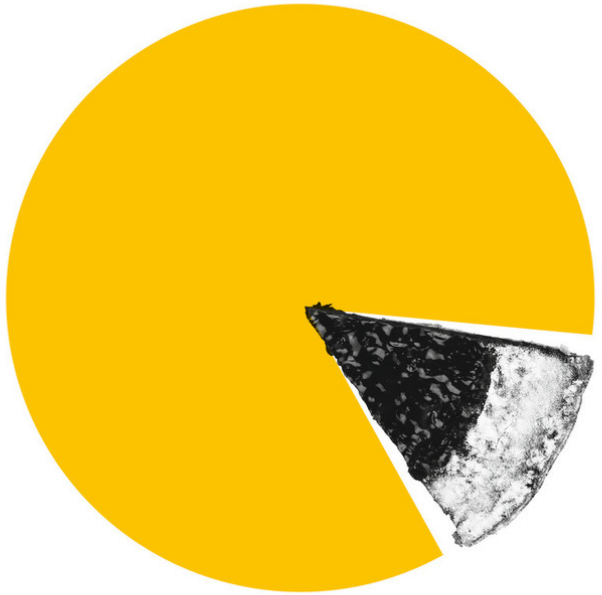
B. Law 360 State

C. Daily Tax Report State – (Bloomberg State)

D. Cheetah (CCH)

E. Checkpoint (RIA)

NOLs



New Jersey – Net Operating Losses

R.O.P. Aviation vs. Division of Taxation, Docket No. 001323-2018, New Jersey Tax Court (May 27, 2021)

- R.O.P. utilized NOLs from closed years to offset its 2014 income. The Division audited Company's 2012-2015 tax years.
- The Division made several adjustments to the Company's returns, including disallowing the use of the carried forward NOLs from 2007-2011.

New Jersey – Net Operating Losses (cont'd)

R.O.P. Aviation vs. Division of Taxation, Docket No. 001323-2018, New Jersey Tax Court (May 27, 2021)

- The court noted that New Jersey law prohibits an assessment of additional tax from being made more than four years from the date of the filing of a CBT return.
- The court found "that auditing a closed year and applying the revisions from that closed year in the open year of audit is doing indirectly what the statute does not permit directly: bypassing the four-year statute of limitations."
- The court also noted it was not bound by the IRS rules and treatment of this issue.

Indirect Taxes

(And Other Stuff)

Maryland's Digital Ad Tax – Kitchen Sink Litigation

- Litigation is pending in state and federal courts challenging Maryland's digital advertising gross revenues tax
- Jurisdictional and Procedural Issues
  - State case
  - Federal case
- Substantive Issues
  - Commerce Clause
  - Due Process
  - First Amendment
  - Supremacy Clause and ITFA
  - State constitutional challenges
- Next Steps

Polling Question

Who is your favorite WFH companion?

A. Dog

B. Cat

C. Kids

D. Spouse/S.O.

E. Other/prefer to be solo

Sales Tax on Software: The *Oracle* Case

- On May 21, 2021, the Massachusetts Supreme Judicial Court considered whether vendors could use the general abatement process to submit refund applications for the portion of sales tax attributable to out-of-state use of software in *Oracle USA, Inc. v. Comm'r of Revenue*.
  - The court held that the vendors had a statutory right to apportion the software transferred for use in more than one state.

- Apportionment (or Allocation) of Sales Price in Other States
  - Texas
  - New York State
  - Washington State and other "MPU" states

- Who's Next?

New York – Vendor Discounts

People of the State of New York vs. B&H Photo & Electronics Corp., Sup. Ct of NY (Sept. 21, 2021

- Action brought by Attorney General under New York's False Claims Act.
- Attorney General argued that B&H failed to pay sales tax on "Instant Savings" – amounts that manufacturers paid B&H to sell their goods.
  - Instant Savings were paid based on volume of goods sold but B&H was not contractually obligated to pass the discount on to customers.
  - Instant Savings typically paid as credit against future B&H purchases from manufacturers.
- Attorney General argued Instant Savings are akin to manufacturer coupons.
- Court held that because there is no privity of contract between manufacturer and customer, the savings program cannot be a manufacturer coupon.

Ohio CAT – Intercompany Transactions

Apple, Inc. v. Jeffrey A. McClain, Tax Commission of Ohio, Case No. 2021-1243, Ohio Board of Tax Appeals.

- Apple appealed an Ohio CAT assessment that was based on Ohio treating its app store sales as taxable intercompany transactions.
  - Apple noted that Ohio law offers a gross receipts exclusion for receipts in excess of an agent's "commission, fee or other remuneration."
- Apple argued that 70% of its receipts from sales of e-books and apps should be excluded in determining its CAT liability for the relevant period, highlighting contractual language that established the company as an agent of the developers and stated that Apple received a 30% commission on all prices paid by purchasers.

Remote Worker Litigation – NH v. MA … Moving On (*But More to Come*)

- New Hampshire filed a Motion for Leave to File Bill of Complaint in the United States Supreme Court on behalf of its residents, requesting that the Court find the Massachusetts' temporary emergency regulation is unconstitutional "extraterritorial assertion of taxing power."
  - Will a state impacted by another state's permanent or temporary convenience test also seek review by the Court?
  - Was the State of New Hampshire the right plaintiff?
  - New Jersey? Connecticut? Pennsylvania?
- Notable Pending Cases
  - *Morsy v. Dumans et al*., No. CV21-946057, Cuyahoga County Court of Common Pleas (filed April 8, 2021)>
  - *Boles, et al., v. City of St. Louis*, No. 2122-CC00713, St. Louis City. Cir. Ct. (filed April 13, 2021).
  - *Zelinsky v. New York State*, Tax Appeals Tribunal (filed July 2021).

Polling Question

Has your company adopted a teleworking policy?

A. Yes

B. No

C. In process

D. My cat's breath smells like cat food

ARPA Litigation – the Implications

- Over **twenty states** are challenging ARPA's "clawback provision" in **six different lawsuits** against the U.S. Treasury Department.
- The clawback provision states that a state or territory cannot use stimulus funds provided in the act "**to either directly or indirectly offset a reduction in the net tax revenue of such state or territory."**
- States and territories can't change laws or regulations, or reinterpret them, in such a way that would result in ARPA funds being used to cut taxes.
- Janet Yellen, the Treasury secretary, stated that:
  - ARPA does not prevent states from enacting a broad variety of tax cuts, provided that they are not offset by federal funds, and
  - States that offset cuts with federal funds only risk the amount of funds used in the offset.
- The complaints filed by the states explain that the U.S. Treasury's response "appears to confirm that the intent of the federal tax mandate…is to enforce a revenue-neutral tax policy across the board on every state in the country."
- On April 8, the U.S. Treasury clarified that the clawback provision does not stop states from making changes to conform with the Internal Revenue Code or other federal tax laws.

ARPA Litigation – Summary

State	Case Name	Win/Loss for the State	Summary
Kentucky and Tennessee	*Commonwealth of Kentucky et al. v. Janet Yellen et al. 9.24*	**Win**	The U.S. District Court for the Eastern District of Kentucky Central Division held that the states do have standing, and the ARPA tax cut provision is "unconstitutionally coercive."
Ohio	*Ohio v. Janet Yellen et al.*	**Win**	The United States Court of Appeals for the Sixth Circuit granted an expedited hearing, and held that the U.S. Treasury's brief is due by Sept. 28, an answer is due by Oct. 19, and an optional reply is due within seven days after the state's reply is filed.
Arizona	*Arizona v. Janet Yellen et al.*	**Loss**	The U.S. District Court for the District of Arizona found the state failed to show that it suffered a concrete injury sufficient for it to have standing in the court and dismissed the challenge to the provision.
Missouri	*Missouri v. Janet Yellen et al.*	**Loss**	The U.S. District Court for the Eastern District of Missouri, Eastern Division dismissed the action for lack of an Article III controversy.
West Virginia	*West Virginia et al. v. U.S. Department of the Treasury et al.*	**Loss**	The United States District Court for the Northern District of Alabama, Western Division held that while the states have standing and the claims are ripe, granting a preliminary injunction would do nothing to remedy the states' alleged harm.
Texas, Mississippi and Louisiana	*Texas et al. v. Janet Yellen, in her official capacity as Secretary of the Treasury et al.*	**Pending**	Texas, Louisiana and Mississippi asked the U.S. District Court Northern District of Texas, Amarillo Division to stop the U.S. Treasury Department from enforcing the clawback provision, arguing it unconstitutionally micromanages state tax policy decisions.

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