EVERSHEDS SUTHERLAND

SALT SCOREBOARD

Q1 2018

This is the ninth edition of the Eversheds Sutherland SALT Scoreboard, and the first of 2018. Each quarter, we tally the results of what we deem to be significant taxpayer wins and losses and analyze those results. This edition of the SALT Scoreboard includes insights regarding New Jersey's attempted taxation of foreign source income, Virginia's corporate income tax addbacks, and Detroit's sales factor numerator.

1st quarter 2018

Taxpayers did not fare well in the first quarter of 2018. Taxpayers prevailed in only 30.0% (15 out of 50) of the significant cases.* Taxpayers won 57.1% (4 out of 7) of the significant corporate income tax cases and 29.6% (8 out of 27) of the significant sales and use tax cases in the first quarter.

* Some items may have been decided in a prior quarter but included in the quarter in which we summarized them.

SIGNIFICANT TAXPAYER WINS AND LOSSES

15 WINS — **2018 OVERALL RESULTS** — **35** LOSSES

QUARTER 1		QUARTER 2		QUARTER 3		QUARTER 4	
15	35						
W	L	W	L	W	L	W	L

Corporate income tax vs. sales tax

Taxpayers prevailed in **4** out of 7 significant corporate income tax cases across the country

Taxpayers prevailed in **8** out of 27 significant sales and use tax cases across the country

SIGNIFICANT MULTISTATE DEVELOPMENTS

Apportionment

CASE: *Honigman Miller Schwartz & Cohn LLP v. City of Detroit*, No. 336175 (Mich. Ct. App. Jan. 18, 2018).

SUMMARY: The Michigan Court of Appeals held that sales of a Detroit attorney's services can be included in the sales factor numerator for Detroit income tax purposes only if the client received the services in Detroit. Gross revenue is included in the sales factor numerator only if derived from sales made, and services rendered, in the city. The court concluded that the relevant consideration in sourcing the sales at issue is where the service is delivered to the client, not where the attorney performs the service. Accordingly, the court held that only receipts from services provided to clients in the City of Detroit are considered "in-city" services includible in the sales factor numerator. View more information.

Addbacks

CASE: *Kohl's Dep't Stores, Inc. v. Virginia Dep't of Taxation*, Record No. 160681 (Va. Mar. 22, 2018).

SUMMARY: On rehearing, the Supreme Court of Virginia held that the Virginia addback statute's subject-to-tax exception applied only to the extent that royalties paid to a related member were actually taxed by another state, but that the exception does not require the related member to be the entity that actually pays the tax on the royalty income. Thus, the court permitted a partial exception for royalty income that was actually taxed as part of a combined return or added back to the taxpayer's income in another state. Because of the statute's ambiguity, the court looked to the legislative intent of the subject-to-tax exception and determined that extending the exception to royalty payments that were not taxed by another state would effectively negate the addback statute's intended operation and "resurrect the loophole" that the statute was designed to close.

Foreign Source Income

CASE: *RE: Infosys Ltd. of India, Inc. v. Dir., Div. of Taxation*, Dkt. No. 012060-2016 (N.J. Tax Ct. Mar. 19, 2018).

SUMMARY: On a motion to reconsider an earlier decision, the New Jersey Tax Court held that New Jersey could not require the

addback of a foreign corporation's foreign source income that was excluded from the federal tax base because of an international treaty. The statute at issue only permitted the addback of "specific exemptions or credits allowed in any law of the United States…" However, the court concluded that the addback did not apply to international treaties because they are governed by international law, not the "law of the United States." Also, neither the treaty protection nor the Internal Revenue Code limitations on foreign source income qualified as a "specific exemption or credit."

Interest

CASE: *Comp. of the Treas. v. Jason Pharm., Inc.*, No. 1952 (Md. Ct. Spec. App. Mar. 1, 2018).

SUMMARY: The Maryland Court of Special Appeals held that the Comptroller of the Treasury was not required to pay interest to a corporation on refunds of sales tax because the corporation's error in paying the tax was not "attributable to the State." Under Maryland law, interest is not owed by the state where the basis of the refund of tax paid is an error or mistake of the claimant not attributable to Maryland. After filing sales tax returns, a corporation determined that it qualified for a sales tax exemption. Because the corporation admitted that it had in effect originally misapplied the law through no fault of the state, the court found that the corporation was not entitled to collect interest on its sales tax refunds.

First Amendment

CASE: *Clear Channel Outdoor, Inc. v. Dep't of Fin. of Baltimore City*, Appeal No. 16-MI-BA-0571 (Md. Tax Ct. Feb. 27, 2018).

SUMMARY: The Maryland Tax Court held that Baltimore's excise tax on exhibiting outdoor advertising does not violate the First Amendment right to free speech. The Baltimore excise tax is imposed on the privilege of exhibiting outdoor advertising displays by a person who owns or controls a billboard, poster board or other sign and charges a fee for its use as an outdoor advertising display. The court held that the First Amendment's protections extend only to conduct that is inherently expressive. The display of a third party's messages on an outdoor advertising billboard in exchange for financial compensation lacks any expressive elements.

Transfer Pricing

CASE: *Hess Corp. v. Office of Tax & Revenue*, Case Nos. 2012-OTR-00027, 2011-OTR-00047, 2011-OTR-00049 (D.C. Office of Admin. Hearings Jan. 26, 2018).

SUMMARY: The District of Columbia Office of Administrative Hearings denied motions for summary judgment filed by multiple oil companies, finding that the companies had not shown the transfer pricing method developed by a third-party vendor of the DC Office of Tax Revenue to be unreasonable, arbitrary or capricious. The oil companies argued that the third-party vendor's transfer pricing analysis violated the transfer pricing principles established by I.R.C. § 482 because the analysis did not attempt to undertake any analysis of controlled transactions. However, the ALJ determined that it was a question of fact whether the controlled transactions could be separated and, as a result, the oil companies failed to carry their burden of establishing that there was no genuine issue of material fact. It was recently reported that the oil companies have reached a settlement in principle, but other companies may be continuing to litigate the issue.

Tax vs. Fee

CASE: *N. Cal. Water Ass'n. v. State Water Res. Control Bd.*, 230 Cal. Rptr. 3d 142 (Cal. Ct. App. 2018).

SUMMARY: The California Court of Appeal held that an annual fee imposed on water right permit and license holders was a fee and not an unlawful tax under California's Constitution. The court found that the State Water Resources Control Board produced sufficient evidence that the charges allocated to water right permit and license holders did not exceed the cost of the regulatory activities attributable to them. The fee was not a tax because the fee did not require the permit and license holders to pay for activities attributable to other right holders that were not subject to the fee.

CASE: *Norfolk S. Railway Co. v. City of Roanoke*, No. 7:16CV00176 (W.D. Va. Dec. 26, 2017).

SUMMARY: The US District Court for the Western District of Virginia held that a local storm water utility charge was not a tax for purposes of the Railroad Revitalization and Regulatory Reform Act of 1976. Rather, the court held that the charge was a regulatory fee because: (1) the charge was part of a comprehensive scheme for managing stormwater; (2) all of the revenue generated by the charge was used to fund stormwater-related facilities; and (3) the charge was structured more as a fee because it was not a blanket assessment on every property in the city and created "an incentive for owners of improved parcels to minimize the impervious surface area on their properties." Accordingly, the charge fell outside the purview of the 4-R Act's anti-discrimination tax clause.

Installation

CASE: *Home Depot U.S.A., Inc. v. South Carolina Dep't of Revenue*, Dkt. No. 15-ALJ-17-0253-CC (S.C. Admin. Law Ct. Mar. 12, 2018).

SUMMARY: The South Carolina Administrative Law Court upheld the South Carolina Department of Revenue's sales tax assessment on the sales of materials in a corporation's installation contracts with its customers. The corporation had remitted use tax on the cost of the materials used in its installation contracts, rather than remitting sales tax based on the retail price of the materials in the contracts. The court held that the corporation should have charged and collected sales tax on the retail price of the materials. The court reasoned that the corporation acted as a retailer and not a contractor when it initially purchased the materials at wholesale using a resale certificate. When the corporation resold the materials to customers at a retail sales price, the sales constituted the last transfer of the materials for consideration, on which sales tax should have been charged.

Solar Panels

CASE: *SolarCity Corp. v. Arizona Dep't of Revenue*, No. CV-17-0231-PR (Ariz. Mar. 16, 2018).

SUMMARY: The Arizona Supreme Court held that companies leasing solar panels are exempt from property taxes on the installed panels. Arizona imposes property tax on property owned or leased and used to operate "electric generation facilities." The Arizona Department of Revenue argued that the company's customers were operating "electric generation facilities" because excess generated energy was transmitted to the company's power grid and used by the company's other customers. The court held that even though the excess energy was not used by the solar panel lessees, the lessees themselves did not operate electric generation facilities.

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