EVERSHEDS SUTHERLAND

SALT SCOREBOARD

Q4 2017

This is the fourth quarter and year-end wrap-up of the 2017 Eversheds Sutherland SALT Scoreboard. 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 our year-end observations for 2017, a discussion of the Pennsylvania Supreme Court's decision in *Nextel*, and a spotlight on apportionment cases. For 2018, we will reset our tallies and track the latest developments as they are issued in the new year.

4th quarter 2017

Taxpayers fared better in the fourth quarter than the prior three and prevailed in 42.9% (21 out of 49) of the significant cases.* Taxpayers won seven significant corporate income tax cases and six significant sales and use tax cases in the fourth quarter. These results elevated the 2017 overall taxpayer winning percentage to 41.0% (98 out of 239), with taxpayers prevailing in 48.5% (32 out of 66) of the significant corporate income tax cases and 36.2% (34 out of 94) of the significant sales and use tax cases.

* 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

98 WINS

2017 FINAL RESULTS

141 LOSSES

QUARTER 1		QUARTER 2		QUARTER 3		QUARTER 4	
26	37	22	33	29	43	21	28
W	L	W	L	W	L	W	L

Corporate income tax vs. sales tax

Taxpayers prevailed in **32** out of 66 significant corporate income tax cases across the country

Taxpayers prevailed in **34** out of 94 significant sales and use tax cases across the country

SIGNIFICANT MULTISTATE DEVELOPMENTS

Net Operating Losses

CASE: *Nextel Commc'ns of the Mid-Atlantic, Inc. v. Pennsylvania Dep't of Revenue*, 171 A.3d 682 (Pa. 2017).

SUMMARY: The Pennsylvania Supreme Court held that the flat $3 million cap on net operating loss (NOL) carryforwards violated the state's Uniformity Clause. The flat-dollar cap caused taxpayers to be treated differently depending on whether they had taxable income of greater than $3 million. Only taxpayers with $3 million or less in taxable income could use NOLs to reduce their taxable income to zero and pay no tax. The court struck down the flat-dollar cap on NOL carryforwards, but retained the cap based on a percentage of a taxpayer's taxable income. View more information.

EVERSHEDS SUTHERLAND OBSERVATION: This decision will impact taxpayers with income under the flat-dollar cap, many of which may now be subject to assessment. For example, consider a taxpayer that filed its 2016 return reporting $5 million in taxable income and applying $5 million of NOLs to reduce its taxable income to zero, thus paying no tax. Under this decision, that taxpayer would be limited to an NOL deduction of 30% of taxable income, or $1.5 million, leaving the taxpayer with taxable income of $3.5 million and a tax liability of approximately $350,000.

Combined Reporting

CASE: *Agilent Techs., Inc. v. Dep't of Revenue of Colorado*, No. 16CA0849 (Colo. App. Nov. 2, 2017).

SUMMARY: The Colorado Court of Appeals held that a corporate parent doing business in Colorado was not required to include its subsidiary holding company that had no property or payroll in Colorado or elsewhere in its Colorado unitary combined corporate income tax report. The holding company was not an "includable" corporation under Colorado's combined reporting regime because it did not have more than 20% of its property and payroll assigned to locations in the US. *See also Oracle Corp. v. Dep't of Revenue of Colorado*, No. 16CA1316 (Colo. App. Nov. 30, 2017). View more information.

Fractionally Owned Aircraft

CASE: *Jetsuite Inc. v. Los Angeles*, 224 Cal.Rptr.3d 145 (Cal. Ct. App. 2017).

SUMMARY: The California Court of Appeal held that the entire value of an air taxi company's jets were subject to the County of Los Angeles 1% personal property tax, despite the fact that the jets spent 40% of their time outside of California. The brief touchdowns of the jets in out-of-state airports were insufficient for other states to acquire situs over the jets such that California could no longer tax the full value of the aircraft. View more information.

Step Transaction Doctrine

CASE: *GKK 2 Herald LLC v. City of New York Tax Appeals Trib.*, 154 A.D.3d 213 (N.Y. App. Div. 2017).

SUMMARY: The New York State Supreme Court, Appellate Division, held that certain real estate transactions were subject to the New York City Real Property Transfer Tax under the step transaction doctrine. The taxpayer, along with a third party, contributed 45% and 55% tenant-in-common interests in real estate to a newly formed LLC in exchange for membership interests. Later that day, the taxpayer sold its 45% LLC membership interest. The court held that this was a taxable transfer of the 45% tenant-in-common interest in exchange for cash and debt relief, rather than an exempt change of form in ownership, followed by the exempt transfer of a non-controlling interest in an entity that owns real property. View more information.

Insurance

CASE: *Aetna, Inc. v. New York City Tax Appeals Trib.*, 154 A.D.3d 542 (N.Y. App. Div. 2017).

SUMMARY: The New York State Supreme Court, Appellate Division, affirmed the Tax Appeals Tribunal's decision that a taxpayer's subsidiary health maintenance organizations (HMOs) were subject to the New York City General Corporation Tax (GCT). The Tribunal had reasoned that the GCT exemption for companies doing an insurance business in New York did not apply. The HMOs were regulated almost entirely under New York's Public Health Law, not the Insurance Law, and therefore were not doing an insurance business in the state. View more information.

Spotlight on Apportionment Cases

SIGNIFICANT DEVELOPMENTS

CASE: *Univ. of Phoenix, Inc. v. Indiana Dep't of Revenue*, 64N.E.3d 1271 (Ind. Tax Ct. 2017).

SUMMARY: The Indiana Tax Court concluded that an online university's receipts must be sourced using Indiana's statutory methodology, which requires sourcing based on income-producing activities and costs of performance, rather than market-based sourcing. The court explained that under Indiana's costs of performance regime, receipts are sourced "based on the seller's acts," and "not from the view of the buyer or consumer." The court also explained that "income producing activities are not limited to what [customers] directly pay for, as the Department urges, but encompass acts a seller directly engaged in with the purpose to generate revenue." The court rejected the Department's argument that the university was required to determine its income-producing activities and costs of performance using a transactional approach, and concluded that the university's operational approach was acceptable. Ultimately, the court found that the university had income-producing activities both inside and outside of Indiana, and that a greater proportion of its costs of performance was incurred outside of Indiana. Therefore, the receipts at issue could not be sourced to Indiana.

CASE: *Michigan Host, Inc. v. Comptroller of the Treasury*, No. 12-IN-OO-1187 (Md. Tax Ct. Feb 1, 2017).

SUMMARY: The Maryland Tax Court affirmed the Comptroller's use of alternative apportionment to assess an out-of-state taxpayer. Under Maryland's three-factor formula, the taxpayer's apportionment factor would have been zero. However, using its authority to apply an alternative apportionment formula, the Comptroller assessed the taxpayer for interest income it received from its Maryland-based parent company. The court held that the assessment was justified because the taxpayer: (1) earned intangible income from the activities of its parent; and (2) had no operational existence as a separate entity independent from its parent. Similar to its recent rulings involving in-state operating companies and affiliated out-of-state holding companies, the court upheld the Comptroller's alternative apportionment formula, which used the parent's apportionment factors to compute the taxpayer's Maryland taxable income. View more information.

CASE: *Corp. Exec. Bd. v. Virginia Dep't of Taxation*, No. CL16-1525 (Va. Cir. Ct. Sept. 1, 2017).

SUMMARY: The Virginia Circuit Court rejected a taxpayer's request for alternative apportionment and held that the use of the state's costs of performance method to source the taxpayer's sales of executive education services delivered via the internet was not unconstitutional or inequitable. The taxpayer argued that the costs of performance method did not accurately reflect its business activity in the state and sought to source its sales based on the addresses of the subscribers. However, the court concluded that deviation from Virginia's statutory apportionment formula was unnecessary because Virginia's apportionment rules look to the state where the income-producing activity occurs (not the state where the taxpayer's customers benefited), and all activities related to the maintenance, development and improvement of the taxpayer's product occurred in Virginia.

CASE: *In re Catalyst Repository Sys.*, DTA No. 826545 (N.Y.S. Div. of Tax App. Aug. 24, 2017).

SUMMARY: A New York State Division of Tax Appeals Administrative Law Judge (ALJ) held that the taxpayer's remotely accessed litigation support services must be sourced using New York's "location of performance" sourcing method. The taxpayer's clients used the service to search, analyze, and review their own data. The ALJ rejected the Department's argument that to be considered receipts from services under New York Law, the services must be performed by humans. Classifying the taxpayer's charges as service receipts, the ALJ permitted the taxpayer to source its receipts to its Colorado location, which houses its systems and technical staff.

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