EVERSHEDS SUTHERLAND SALT SCOREBOARD Q2 2022

This is the second edition of the Eversheds Sutherland SALT Scoreboard for 2022. Since 2016, we have tallied the results of what we deem to be significant taxpayer wins and losses and analyzed those results. Our entire SALT team hopes that you have found the SALT Scoreboard's content useful. This edition includes a discussion of the legality of Seattle's payroll expense tax and a Massachusetts Supreme Judicial Court opinion on the taxation of capital gains, as well as a spotlight on a few notable New York cases.

2nd quarter 2022

In the second quarter of 2022, taxpayers prevailed in 32.5% (13 out of 40) of the significant cases.* Taxpayers won 44.4% (4 out of 9) of the significant corporate income tax cases and 21.4% (3 out of 14) of the significant sales and use tax cases.

SIGNIFICANT TAXPAYER WINS AND LOSSES

25 WINS | **2022** OVERALL RESULTS | **49** LOSSES

QUARTER 1		QUARTER 2		QUARTER 3		QUARTER 4	
12	22	13	27				
W	L	W	L	W	L	W	L

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

Year-to-date

Taxpayers prevailed in 8 out of 18 significant corporate income tax cases across the country

Taxpayers prevailed in 11 out of 35 significant sales and use tax cases across the country

SIGNIFICANT MULTISTATE DEVELOPMENTS

Payroll Expense Tax

CASE: *Greater Seattle Chamber of Commerce v. City of Seattle*, Case No. 82830-4-I (Wash. Ct. App. Jun. 21, 2022).

SUMMARY: The Washington Court of Appeals held that Seattle's newly adopted payroll expense tax is a constitutionally permissible tax on the privilege of doing business, rather than a prohibited tax on employees' right to work for wages. The tax is imposed on businesses that spend $7 million or more on payroll in the city. The Greater Seattle Chamber of Commerce challenged the validity of the tax in a declaratory judgment suit. The Chamber argued that the payroll expense tax was an unconstitutional tax on "the right to earn a living," rather than a permissible tax on the "privilege of doing business." The court held that the tax is a lawful exercise of the powers vested in the city by the state legislature and the state constitution. The court reasoned that engaging in business is a privilege on which the city may properly levy taxes, and the use of a business's payroll expense is an appropriate measure of that taxable incident. View more information.

Credits

CASE: *Comerica, Inc. v. Michigan Department of Treasury*, No. 161661 (Mich. 2022).

SUMMARY: The Supreme Court of Michigan held that tax credits assigned to a Michigan bank that merged into a Texas bank could lawfully be "passed" to the Texas bank. The Single Business Tax Act barred the Michigan bank from assigning the credits, but the court found no such assignment was attempted in this case. Instead, pursuant to the Banking Code, the Texas bank acquired the credits "by operation of law," and the tax did not explicitly or implicitly interfere with the Banking Code's operation. Because the "acquisition" was "automatic" under the Banking Code, the transfer was effected by operation of law. Thus, the court found that: (1) the Michigan bank's privileges were conferred on the Texas bank "by operation of" the Banking Code, not by assignment; (2) if the credits were privileges, no assignment was needed for them to pass to the Texas bank; and (3) because there was no assignment, the transaction did not violate the Act.

Video Service Provider Fee

CASE: *City of Lancaster v. Netflix et al.*, Case No. 21STCV01881 (Los Angeles Cnty. Super. Ct., Cal. Apr. 13, 2022).

SUMMARY: The Los Angeles County Superior Court held that streaming video service providers are not subject to local California video service provider fees. Consistent with its September 2021 decision, the court found that the Digital Infrastructure and Video Competition Act, which allows for a video service provider to be subject to a 5% fee on its gross income, did not apply to the streaming video service providers because: (1) neither company provides the type of video programming that traditional television does; and (2) the companies do not operate infrastructure in the public rights-of-way. The court further noted that the Act grants franchising authority to only the California Public Utilities Commission, and the city thus did not have the authority to compel the streaming video service providers to comply with the Act.

Intangible Income

CASE: *The 2009 Metropoulos Family Trust et al. v. Franchise Tax Board*, No. D078790 (Cal. Ct. App. May 27, 2022).

SUMMARY: The California Court of Appeal ruled that nonresident shareholders were subject to California tax on their pro rata shares of intangible income from an S corporation's sale of shares in a subsidiary. This sale of goodwill was sourced as business income apportioned at the S corporation level, not as intangible income to a nonresident under the personal income tax law. The court first held that the shareholders' intangible business income from the multistate unitary S corporation must be apportioned at the S corporation level. The gain realized by the S corporation passes to the shareholders in the same form as received by the S corporation (i.e., as apportionable business income). Second, the court held that the goodwill at issue acquired a business situs in California. The shareholders unsuccessfully asserted that the income should be treated as intangible income sourced to the nonresident shareholders' domiciles. But the court instead concluded that the goodwill acquired a business situs in California because the S corporation apportioned a percentage of its business income to California using UDITPA. Thus, the management and disposition of the intangible property was an integral part of the S corporation's regular trade or business operations. View more information.

Capital Gains

CASE: *VAS Holdings & Investments, LLC v. Commissioner of Revenue*, 186 N.E.3d 1240 (Mass. 2022).

SUMMARY: The Massachusetts Supreme Judicial Court ruled that the Massachusetts Department of Revenue lacked the statutory authority to tax an out-of-state S corporation's capital gains from the sale of its investment interest in an LLC that operated in Massachusetts. The court found that the Massachusetts statutes and regulations that authorized the imposition of the tax adhered to the unitary business principle. The court then determined that the corporation and the LLC lacked functional integration, centralization of management, and economies of scale, which are the "hallmarks" of a unitary business relationship. The court stressed that the corporation had "zero" involvement with the operations of the LLC, did not participate in its management or activities, and did not provide services or loan money to it. Further, while some shareholders of the corporation were members of the LLC's board, the board was neither functional nor active, and met only twice during the LLC's existence. Because the entities were not unitary and the corporation was domiciled in Florida, the court ruled that the Massachusetts corporate excise tax did not apply to the resulting income.

Spotlight on New York

CASE: *Matter of Genzyme Corp.*, No. 828091 (N.Y.S. Div. of Tax App. Apr. 7, 2022).

SUMMARY: The New York State Division of Tax Appeals determined that a corporation could not deduct royalty payments that it received from foreign affiliates when computing its entire net income for New York corporation franchise tax purposes. New York law allows royalty payments received from a related member to be entirely deducted from net income, so long as the entity making such payments is required to add them back to their New York corporate net income. The Administrative Law Judge explained that the taxpayer did not qualify for the royalty exclusion because its affiliates were not New York taxpayers, and therefore were not required to add back the royalty payments.

CASE: *Matter of TD Ameritrade, Inc.*, No. 829523 (N.Y.S. Div. of Tax App. Apr. 28, 2022).

SUMMARY: The New York Division of Tax Appeals determined that an online broker-dealer was required to source its marketing fee receipts to New Jersey based on the location of its bank customers, and not its brokerage customers. New York broker-dealer sourcing rules require that marketing fees are sourced to the address of the *customer* who is responsible for payment of the fee. The parties disputed the identity of the "customer responsible for paying." The Division of Taxation contented that the taxpayer's brokerage clients were the "customer[s]," whereas the taxpayer argued that its bank clients were the relevant customers. The Division of Tax Appeals agreed with the taxpayer, holding that the weight of the record clearly showed the banks were the "customer[s] responsible for paying" because they actually paid the fee (and not the brokerage clients). Therefore, none of the receipts could be sourced to New York.

CASE: *In the Matter of 201-C Town LLC v. City of Ithaca*, No. 532888 (N.Y. App. Div. Jun. 23, 2022).

SUMMARY: The New York Supreme Court, Appellate Division held that a local street permit fee was a valid fee, rather than an unauthorized tax. The petitioner owned real property in the city of Ithaca and planned to construct an apartment building on the land. Ithaca's Board of Public Works adopted a new fee schedule for street permits, requiring increased payments by permit holders such as the petitioner. The petitioner sought a declaration that the new street permit fee schedule was invalid as an unauthorized tax. The Appellate Division concluded that the fee schedule was a lawful exercise of the city's statutory authority to adopt local laws relating to the use of its roads, streets, and property, which included the power to charge a fee to cover the costs of that regulation. The Appellate Division found that the city had a rational basis for calculating the public costs arising from street and sidewalk closures and the new fee structure was based on a reasonable approximation of those costs.

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