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SALT SCOREBOARD Q4 2016

This is the fourth quarter and year-end wrap-up of the 2016 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 2016, insights regarding the Ohio Supreme Court's decision in *Crutchfield Corp. v. Testa*, and a spotlight on New Jersey. We are closing the book on 2016 and are gearing up for a fresh start in 2017. We have reset our tallies and are tracking the results as they are issued in the new year.

FOURTH QUARTER 2016

Overall, the fourth quarter of 2016 was tough for taxpayers, as states and localities prevailed in 38 out of 62 significant cases.[1] 16 corporate income tax cases and 25 sales and use tax cases made our cut of significant cases.

1 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

96 WINS

2016 FINAL RESULTS

127 LOSSES

QUARTER 1		QUARTER 2		QUARTER 3		QUARTER 4	
24	24	21	39	27	26	24	38
W	L	W	L	W	L	W	L

YEAR IN REVIEW

It has been quite a year on the state and local tax front. By our count, there were 223 significant state and local tax cases this year. Taxpayers prevailed in 26 out of 57 significant corporate income tax cases and 40 out of 98 significant sales and use tax cases. Taxpayers were particularly successful in Louisiana in 2016, where they prevailed in 10 significant state and local tax cases, including a number of victories at the Louisiana Circuit Courts of Appeal. On the other end of the spectrum, taxpayers were less successful in states like Massachusetts, Michigan and Washington.

SIGNIFICANT Q4 MULTISTATE DEVELOPMENTS

Nexus

CASE: *Crutchfield Corp. v. Testa*, No. 2015-0386, Slip Op. 2016-Ohio-7760 (Ohio Nov. 17, 2016).

SUMMARY: The Ohio Supreme Court held that physical presence nexus does not apply to the Ohio commercial activity tax, and that the commercial activity tax's $500,000 gross receipts threshold was permissible under the Commerce Clause.

SUTHERLAND OBSERVATION: *Crutchfield* illustrates that the physical presence test for substantial nexus articulated in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), has limited application to taxes other than sales tax. Moreover, several states have adopted "anti-*Quill*" legislation or regulations based on the belief that *Quill* should be overturned. Because several states have adopted similar economic standards, *Crutchfield* may have far-reaching consequences.

Unitary Business

CASE: *ComCon Prod. Serv. I, Inc. v. Fran. Tax Bd.*, No. B259619 (Cal. Ct. App. Dec. 14, 2016).

SUMMARY: The California Court of Appeal upheld Comcast's $2.8 million franchise tax refund. The court determined that: (1) Comcast and its subsidiary, QVC, were not unitary, such that QVC was properly excluded from Comcast's combined group; and (2) a termination fee Comcast received from a failed merger constitutes apportionable business income. View more information.

Apportionment

CASE: *Rent-A-Center West Inc. v. S.C. Dep't of Revenue*, 792 S.E.2d 260 (S.C. Ct. App. 2016).

SUMMARY: The South Carolina Court of Appeals determined that the Department of Revenue, which argued that the taxpayer's receipts factor denominator should exclude its nationwide retail sales revenue, failed to satisfy its burden of showing that the statutory apportionment formula did not fairly represent the taxpayer's business activities in South Carolina. View more information.

SUTHERLAND OBSERVATION: The apportionment analysis and result in this case flows from *CarMax Auto Superstores West Coast, Inc. v. South Carolina Department of Revenue*, 411 S.C. 79 (2014). Here, the court determined that the Department of Revenue again failed to carry its burden of showing that the statutory formula did not fairly represent the taxpayer's business activity in the state.

Apportionment

CASE: *In re Gerson Lehrman Group, Inc.*, TAT(H)08-79(GC), TAT(H)12-38(GC) (N.Y.C. Tax Appeals Tribunal, Admin. Law Judge Div. Oct. 4, 2016).

SUMMARY: An Administrative Law Judge of the New York City Tax Appeals Tribunal determined that a taxpayer's receipts for consulting services must be allocated based on where the services were rendered, not where the solicitation and payment for the services occurred. View more information.

False Claims Act

CASE: *People ex rel. Beeler, Schad & Diamond, P.C. v. Relax the Back Corp.*, No. 03 L 11525 (Ill. App. Ct. Oct. 17, 2016).

SUMMARY: The Appellate Court of Illinois held that a defendant out-of-state retailer was not liable under the state's False Claims Act because it conducted a good faith inquiry into its use tax collection obligations for both its Internet and catalog sales. View more information.

Drop Shipments

CASE: *Avnet, Inc. v. Wash. Dep't of Revenue*, 384 P.3d 571 (Wash. 2016) (en banc).

SUMMARY: The Washington Supreme Court held that drop shipments and sales from out-of-state are subject to the Washington business and occupation tax even when an in-state office was not involved in placing or completing the sales. Although the taxpayer's Washington office was not involved with the sales, the taxpayer's activities satisfied the substantial nexus prong of the dormant Commerce Clause because its Washington employees provided the corporate office with intelligence regarding Washington markets, met with the taxpayer's sales teams and suppliers to strategize on how to create a greater demand for the products and services, and worked with customers to improve products and design new prototypes. View more information.

SIGNIFICANT DEVELOPMENTS

CASE: *Canon Fin. Serv., Inc. v. Dir., Div. of Tax.*, Dkt. No. 000404-2014 (N.J. Tax Ct. Oct. 13, 2016).

SUMMARY: The New Jersey Tax Court held that apportioning all of a company's income to New Jersey for corporate business tax purposes, even with the allowance of a credit for taxes paid to separate-return states, failed to fairly reflect the company's business activities in New Jersey. The court also held that the company was not entitled to use a three-factor formula because it did not have a regular place of business outside of New Jersey. View more information.

CASE: *Bank of Am. Consumer Card Holdings v. N.J. Div. of Tax.*, 29 N.J. Tax 427 (2016).

SUMMARY: The New Jersey Tax Court determined that credit card issuers must source to New Jersey all of their interest and interchange fee receipts, and half of their credit card service fees, from New Jersey accountholders. The Tax Court also found that the Division of Taxation could not apply the throw-out rule to any of the taxpayers' receipts because the Division failed to identify any state that would not have jurisdiction to tax the taxpayers' sales if New Jersey's economic nexus standard applied. View more information.

CASE: *Flagstar Bank, FSB v. Dir., Div. of Tax.*, 29 N.J. Tax 130 (2016).

SUMMARY: The New Jersey Tax Court held that the Division of Taxation could not throw out receipts from the taxpayer's denominator because the taxpayer had nexus with other states under New Jersey's nexus standards, but required that the taxpayer include in its receipts factor numerator interest income, origination fee income and gross proceeds of sales attributed to loans to New Jersey borrowers; however, the taxpayer must exclude loan service fee income and income on sales of loan servicing rights. View more information.

CASE: *HD Supply Waterworks Group, Inc. v. Dir., Div. of Tax.*, Nos. 003035-2015, 003488-2015, 003492-2015 (N.J. Tax Ct. Jan. 5, 2017).

SUMMARY: In a 2017 SALT Scoreboard "sneak peek" of what lies ahead, the New Jersey Tax Court quashed the Division of Taxation's deposition notices for the CEO/President of the taxpayer, finding that the Division was not entitled to conduct an "apex deposition" based on the CEO's lack of direct knowledge of the facts and the availability of other witnesses. However, the Tax Court did allow the Division to issue 15 interrogatories to the taxpayer, which "may" be directed toward the CEO/President.

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