Federation of Tax Administrators

Tax Litigation Update

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Gillette Company, et. al. v. California Franchise Tax Board, No. S206587 (Cal. 2015).

- On December 31, 2015, the CA Supreme Court (Court) unanimously reversed the CA Court of Appeal's decision from 2012 and denied the taxpayers' election to change their corporation franchise tax apportionment formula to apply provisions of the Multistate Tax Compact ("Compact").
  - The taxpayers had sought to use the equally weighted, three-factor apportionment formula (property, payroll, sales) available under the Compact Election in lieu of the three-factor formula with double-weighted sales provided in California Revenue & Taxation Code.

- The Court held that the Compact was not a binding reciprocal agreement among the member states; thus, the CA legislature may eliminate the Compact's election provision. The Court applied a four-factor test derived from Northeast Bancorp v. Board of Governors, FRS, 472 U.S. 159 (1985).

- The California Supreme Court's decision is not yet final.
  - A petition for a writ of certiorari was filed with the U.S. Supreme Court on May 27, 2016.
  - The named taxpayer is now *The Procter & Gamble Manufacturing Company, et. al*.

Kimberly-Clark Corp. & Subsidiaries v. Comm'r of Revenue (Minn. Tax Court Docket No. 8670-R, June 19 2015).

- The Minnesota Tax Court assumed "(without deciding) that the Compact was a contract among Minnesota and the other States that adopted it and that the Compact created binding obligations." However, no Compact provision "constitutes a clear and unmistakable promise to refrain from using the State's sovereign power to alter the apportionment election provided by Articles III and IV. Thus, the Tax Court held that the Minnesota Legislature's 1987 repeal of Articles III and IV of the Multistate Tax Compact (Compact) was valid and did not substantially impair a binding contractual obligation.
- MN Supreme Court decision pending.

Crutchfield v. Testa, Ohio Board of Tax Appeals, Nos. 2012-926, 2012-3068, 2013-2021

- Current case pending in the Ohio Supreme Court
- Taxpayer is headquartered in Virginia. It sells products to customers around the country, including to customers in Ohio. Taxpayer asserted that it has no physical presence of any kind in Ohio – it had no Ohio property, no activities in Ohio. It did not target Ohio in its marketing campaigns.
- Board of Tax Appeals: No jurisdiction to address Constitutional challenges and rejected taxpayer's statutory argument that it was not "doing business in the state" because taxpayer had over $500,000 in sales to Ohio customers
- Internet Nexus Theory: Commissioner argued that interstate online sales created the equivalent of physical presence in the state. The consumer interacts with the computer on a local level (not interstate) similar to a door to door salesperson. The Commissioner also argued internet retailers have an in-state presence through digital assets (cookies, etc.) that are downloaded to consumer's computers.
- Other challenges to bright line nexus statute
  - NewEgg, Inc. v. Testa, Ohio Board of Tax Appeals, No. 2012-234
  - Mason Cos., Inc. v. Testa, Ohio Board of Tax Appeals, No. 2015-0794

In re Estate of Hambleton, 335 P.3d 398 (2014)

- Background — In 2013, the Washington Legislature retroactively broadened the interpretation of a “taxable transfer” under the state’s Estate and Transfer Tax Act to include some tax qualified terminable interest property (QTIP) assets when a spouse died, which were not previously included. The amendment was a response to a taxpayer-favorable decision in 2012 in *In re Estate of Bracken*. Taxpayers challenging the constitutionality of the 2013 amendment involved estates that had filed estate tax returns for the 2006 and 2007 tax years while the *Bracken* litigation was ongoing.

- Washington Supreme Court’s determination:
  - The amendment’s economic purpose to prevent an unanticipated significant fiscal shortfall was a legitimate legislative purpose.
  - The eight year period of retroactivity was rationally related to the period for which the fiscal shortfall was concerned. Further, to not apply the amendment retroactively would have been “arbitrary” given that certain estates would have paid tax while others had not.

Harley-Davidson v. Franchise Tax Board, 237 Cal. App. 4th 193 (Cal. Ct. App. May 28, 2015).

- The California Court of Appeal concluding that the trial court erred in sustaining the FTB's demurrer to the taxpayer's U.S. Commerce Clause challenge of California Revenue and Taxation Code section ("section") 25101.15.
  - Section 25101.15 allows intrastate businesses to choose annually whether to compute their tax using the combined reporting method or the separate accounting method
  - Interstate unitary businesses are required to compute tax using only the combined reporting method.
- In holding for the taxpayer, the Court of Appeal ruled that:
  - "The statutory scheme facially discriminates on the basis of an interstate element in violation of the commerce clause[,]"
  - Reversed the trial court's decision, and
  - Remanded the case to the trial court with instructions that it determine "whether the taxation scheme . . . 'advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.'"
- Review denied by: *Harley-Davidson, Inc. v. Franchise Tax Bd., 2015 Cal. LEXIS 6266 (Cal. Sept. 16, 2015).*

AT&T Corp. v. Miss. Dep't of Revenue, 04-CV-001393-CH1 (Miss. Ch. Mar. 20, 2015).

- Miss. Code Ann. 27-7-15(4)(i) allows an exclusion from a taxpayer's gross income for intercompany dividends received from domestic affiliates doing business and filing income tax returns in Mississippi.
- The Mississippi Chancery Court held that the dividend exclusion statute violates the U.S. Constitution's Commerce Clause, ruling that such an exclusion discriminates against interstate commerce because it "clearly favors domestic corporations over foreign competitors and discourages corporations from choosing to locate their operations outside Mississippi."
- Having found the dividend exclusion statute to be unconstitutional, the court found that the only appropriate remedy that would place the taxpayer in the same position as all other taxpayers who had enjoyed the tax benefits would be to "strike the offensive limitations and grant those applicable tax benefits to [the taxpayer] for the tax years at issue."
- The Mississippi Department of Revenue has appealed the Chancery Court's decision to the Mississippi Supreme Court under docket no. 2015-CA-00600.

Lorillard Licensing Co. LLC v. Div. of Taxation, 2015 N.J. Tax LEXIS 19 (Dec. 4, 2015).

- At issue before the Tax Court of New Jersey in *Lorillard* was the appropriate application of the state's throw-out rule.
- The Appellate Court affirmed the decision of the lower court saying the that after successfully asserting in a prior decision that a trademark holding company is subject to tax under the Corporation Business Tax ("CBT")in New Jersey, by application of an economic nexus standard, the State cannot assert a contrary standard for purposes of the state's throw-out rule.
- "Where a taxpayer has 'the requisite constitutional contacts with a State' to authorize taxation under the United States Constitution, receipts from that State cannot be removed from the denominator of the receipts fraction under the Throw-Out Rule", citing the lower court decision.
- Application of the Throw-Out Rule is limited "to receipts that are not taxed by another state because the taxpayer does not have the requisite constitutional contacts with the state."

Vodafone Ams. Holdings, Inc. v. Roberts, 2016 Tenn. LEXIS 182, (Tenn. 2016).

- Taxpayer originally filed returns using a “Primary Place of Use” (“PPU”) method for sourcing its telecom receipts. Taxpayer subsequently concluded that the correct method for sourcing its telecom receipts was Cost of Performance (“COP”) and filed refund claims based on COP calculations.
- The Tennessee Tax Commissioner invoked his authority to impose on the taxpayer a variance rejecting taxpayer’s statutory claim to a COP sourcing method in favor of PPU, which required Vodafone to include the sales receipts from Tennessee billing addresses in the numerator of the receipts factor of the apportionment formula. The Commissioner claimed that COP was too complicated and open to potential taxpayer bias. Taxpayer argued that the regulation giving the Commissioner the authority to impose a variance should not apply because its business does not represent an "unusual fact situation“.
- On March 23, 2016, the Tennessee Supreme Court affirmed the lower court decision “[f]inding no abuse of the Commissioner's discretion [to impose the variance].” The court also agreed that the standard statutory tax apportionment formula did not "fairly represent the extent of [Taxpayer’s] business activity in this state."

Agilent Tech., Inc. v. Dep't of Revenue, Docket No. 2014-CV-393 (Colo. Dist. Ct. Jan. 20, 2016).

- The Taxpayer is the parent of a combined group which is subject to the Colorado corporate income tax. The Taxpayer sought to exclude, under Colorado's "80/20" rule, a subsidiary domestic holding company from its Colorado combined return whose sole interests were in foreign entities that are disregarded for federal income tax purposes. The Colorado Department of Revenue argued that it is not bound by the federal "check-the-box" designations.
- On Jan. 20, 2016, a Colorado District Court found that the Colorado statutory reference to the definition of "corporation" for federal income tax purposes ***does not require Colorado to follow an entity's classification under the federal check-the-box rules*** and therefore the activities of the foreign disregarded entities were not taken into account for purposes of the "80/20" calculation. The Court found that the domestic holding company was nevertheless excluded from the combined group, citing Colo. Code Regs. § 39-22-303.12(c), which states that corporations without property and payroll cannot are not includable C Corporations for purposes of the Colorado combined report.
- At this time, it is unclear whether the Colorado Department of Revenue will appeal the Colorado district court's decision.

State of Washington, Dep't of Revenue v. Avnet, Inc., (Washington Supreme Court No. 92080)

- The taxpayer is a multistate wholesaler of electronic components. It has facilities and employees within the State of Washington.
- Taxpayer pays Washington B&O tax on inbound sales that are generated as a result of its activities within the State of Washington. Taxpayer does not pay the tax on inbound sales or drop-shipments into Washington if those sales were generated as a result of its activities outside of the State of Washington.
- Taxpayer relies on *Norton Co. v. Dep't of Revenue,* 340 U.S. 534 (1951), in support of its contention that the Commerce Clause requires that its sales in interstate commerce be "dissociated" from its local sales for purposes of state taxation.
- *Norton* has never been explicitly overruled by the US Supreme Court.
- The MTC has filed an amicus brief arguing that the former *Norton* majority "dissociation" rule was replaced by the *Norton* dissent view of "dissociation" as given ultimate expression in *Tyler Pipe.*
- Taxpayer also asserts "dissociation" was required under former Rule 193.

First Marblehead Corporation v. Massachusetts Commissioner of Revenue (MA Supreme Judicial Court of Appeals No. 11609, on remand from US. Supreme Court to reconsider in light of Comptroller of the Treasury v. Wynne, 576 U.S. 2015 _____).

- Gate Holdings is a wholly-owned subsidiary of Taxpayer. Its commercial domicile is in Massachusetts. The MA courts treated Taxpayer and its subsidiaries as financial institutions.
- Subsidiary facilitates and coordinates the issuance and securitization of student loans.
- Subsidiary is “essentially a holding company” with no employees, payroll, tangible assets, or office space anywhere.
- The issue is where should Subsidiary’s property be sourced for purposes of apportionment under the MA financial institutions excise.
- The MA Supreme Judicial Court initially held that the Commissioner’s rule presumptively sourcing the property to the commercial domicile if the taxpayer has no principal place of business elsewhere does not violate the dormant Commerce Clause and that the taxpayer cannot source the property to a state where the loan servicers, wholly unrelated to Subsidiary or Taxpayer, are located.
- US Supreme Court vacated the judgment and remanded in light of *Wynne* to reconsider the internal consistency test.
- Commission has filed an amicus brief asserting that the MA rule, properly understood, cannot result in double taxation.

Additional Issues

Dormant Commerce / Equal Protection

- *Wal-Mart Puerto Rico, Inc. v. Zaragoza-Gomez, 2016 U.S. Dist. LEXIS 42224 (D. P.R. Mar. 28, 2016).*
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New Jersey Corporate Business Tax Basis Cases

- *Toyota Motor Credit Corporation v. Director, Division of Taxation, 28 N.J. Tax 96 (N.J. Tax Ct. Aug. 1, 2014).*
- *Ford Motor Credit Company v. Director Division of Taxation, 2014 N.J. Tax Unpub. LEXIS 43 (N.J. Tax Ct. Aug. 5, 2014).*
- *MCI Communication Services, Inc. v. Director, Divisions of Taxation, 2015 N.J. Tax Unpub. LEXIS 58 (N.J. Tax Ct. Jul. 20, 2015).*

Additional Issues

PA NOL Cap unconstitutional

- *Nextel Communications of the Mid-Atlantic, Inc. v. Commonwealth of Pennsylvania, 129 A.3d 1 (Pa. Commw. Ct. 2015*).

Re-characterization of International Debt

- *National Grid Holdings, Inc. v. Comm'r of Revenue, No. ATB 2014-357, Mass. App. Tax Bd., (2014).*
- *National Grid USA Service Co. v. Comm'r of Revenue, No. ATB 2014-630, Mass. App. Tax Bd. (2014).*

Business Purpose / Economic Substance

- *Gore Enter. Holdings, Inc. v. Comptroller of the Treasury of Maryland, 87 A.3d 1263 (Md. 2014).*
- *Staples, Inc. v. Comptroller of the Treasury of Maryland, 2015 Md. Tax LEXIS 6 (Md. Tax Ct. Mary 28, 2015).*

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