

JUDICIAL DEVELOPMENTS IN THE
INCOME AND SALES TAX WORLD:
THE YEAR IN REVIEW

**2017 Federation of Tax Administrators
Annual Meeting**

Seattle, Washington

6/12/17

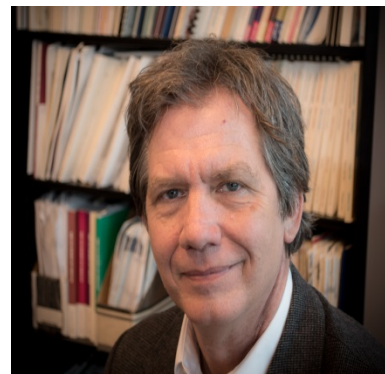
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(the opinions expressed are personal to the presenters)

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U.S. Supreme Court Developments



Notable for Cases that Didn't Reach the Court or Certiorari Denied:

Retroactivity:

DOT Foods v. Washington

IBM v. Michigan

Quill:

DMA v. Brohl: Court declines to hear appeal of case upholding Colorado use tax reporting regime

Disassociation: (no petition for certiorari filed)

WA Dep't of Revenue v. Avnet (12/16)

State May Tax Outward Bound Sales (the Florida Florist case):

Florida Department of Revenue v. American Business USA Corp.

Wynne v. Comptroller:

Are there other shoes to drop?

In 2015, the USSCT held that Maryland was required to give its residents a credit for income taxes paid in other states, since Maryland taxed 100% of a resident's income, so that interstate taxpayers would not bear a higher tax burden than intra-state taxpayers—using the “internal consistency” test.

Matkovich v. CSX (WV S. Ct. No. 15-0935, 11/16)(petition for certiorari pending): West Virginia Sup. Ct. holds state must give a compensating tax credit for local-level sales taxes imposed in other states under *Wynne*, even though W.Va. doesn't allow its cities or counties to impose sales taxes.

Many states impose some limitations on residents' credit for other states' (and foreign country) taxes;

Must states credit taxes paid at the LLC level in other states?

Nexus, Nexus, Nexus

- *Crutchfield v. OH Dep't of Taxation* (11/16): Ohio Supreme Court upholds “economic nexus” standard for Ohio Commercial Activities Tax against out of state retailers. Parties settled rather than pursue USSCT appeal.

Cf., FTB NOTICE 2016-02: Fall-out from Adoption of Economic Nexus Test: can taxpayers elect water’s edge reporting when unitary foreign entities are left off the original election? <https://www.ftb.ca.gov/law/notices/2016/2016-02.pdf>.
- *Swart Enterprises, Inc. v. FTB* (Ca. District Court 1/17): out of state minority partners (0.2%) of LLC operating in California not subject to \$800 minimum franchise tax imposition. FTB announces it will not appeal decision.
- *Irwin Naturals v. WA Dept. of Revenue*, WA App. Ct. No. 73966-2-1 (7/16): rejects notion of “disassociation” for B&O taxes imposed on vendor with in-state wholesaling and out-of-state retail sales via internet.
- *Capital One Auto Finance v. OR Dep't of Revenue* (12/16): Taxpayer argued that Oregon’s “doing business” standard for excise tax required a physical presence in state. The tax court disagreed. Economic nexus is the appropriate standard.

Economic Nexus for IHC Income in Colorado

- ***Target Brands, Inc. v. Colorado Dept. of Rev.***, 2015CV33831, District Court, City and County of Denver, Colorado (1/27/2017)
- Target Brands, Inc. (TBI) was subject to income tax nexus under the “economic presence” concept because it licensed trademarks for use in state in 22 Target stores;
- TBI was also “doing business” in Colorado as a statutory matter by licensing trademarks;
- District court held that state failed to demonstrate that alternative apportionment formula (market-based single sales factor instead of three-factor formula) was justified, reducing tax imposition by 66%.
- Cross appeals are expected.

Corrigan v. Testa, Slip Op. No. 2016-Ohio-2805.

Ohio S. Ct. rules state lacks due process nexus to impose personal income tax on owner of LLC who sold his 79% ownership interest in toilet manufacturing company headquartered in Ohio, invalidating Ohio statute requiring more-than-20% owners to pay capital gains tax on dispositions.

Compare: *Ryan Legg Irrev. Trust v. Testa* (12/23/16): Ohio resident founder/50% co-owner of Ohio S corp. trucking-logistics business transferred shares to nonresident Delaware irrev. trust (co-owner and family were beneficiaries), then trust sold shares to other co-owner; Ohio assessed tax on \$18 million gain; Ohio Supreme Court upheld tax against due process challenge: resident grantor/founder/co-owner's extensive contacts with Ohio were attributed to nonresident trust.

Sales and Use Tax Nexus

American Catalog Mailers Association and NetChoice v. Gerlach, 6th Circuit S.D. (4/29/16): one of many pending cases setting up a challenge to *Quill v. North Dakota's* physical presence rule for sales and use tax impositions.

Direct Marketing Association v. Brohl, 814 F.3d 1129 (10th Cir. 2016)(parties settled after cert. den.)

Scholastic Book Clubs, Inc. v. State of Alabama, Dkt. No. 14-374, AL Tax Tribunal (3/25/16)(even unpaid representatives of taxpayer can create nexus)

Alternative Apportionment

(not to be confused with Alternative Facts):

- ***Associated Bank, N.A. v. Minnesota CIR***, Tax Court No. 8851-R (4/1817) (Income from loans held by LLC not subject to apportionment under financial institutions apportionment statute applicable to corporate LLC owner.)
- ***Comcast v. OR Dep't of Revenue***, Tax Ct. (10/16)(taxpayer properly classified as a broadcaster and subject to market-based apportionment on all of its receipts, including internet sales.)
<http://law.justia.com/cases/oregon/tax-court-regular-division/2016/tc-5265.html>.
- ***Rent-A-Center West v. SC Dep't of Revenue***, Ct of App. (10/16)(Department failed to show that mixing royalty receipts and retail sales receipts skewed taxpayer's receipts factor)
- ***Canon Financial Services, Inc. v. NJ Dep't of Taxation*** (10/16)(Taxpayer entitled to multi-state apportionment but tax agency justified denial of three-factor formula)
<http://law.justia.com/cases/new-jersey/tax-court/2016/000404-20.html>.
- ***Genetech, Inc. v. MA Dep't of Revenue Supreme Judicial Ct*** (1/17)(Slicing genes is “manufacturing” activity; application of single sales factor apportionment does not deprive taxpayer of due process)
<http://law.justia.com/cases/massachusetts/supreme-court/2017/sjc-12083.html>.

Economic Substance, Transfer Pricing and State Reallocation Statutes

Utah Tax Commission v. See's Candies, Inc., Utah S. Ct. No. 20160910-SC (pending). Question presented: is the state bound by IRC Sec. 482 transfer pricing regulations when applying similar state statute to deny deduction for intangible property expenses paid to related party?



Transfer Pricing and Economic Substance, Cont.

- *Agilent Technologies v. Colorado DOR*, Colo. Ct. App. No. 2016CA849 (pending). Taxpayer argues it properly excluded a domestic subsidiary from its water's edge return where the subsidiary lacked domestic property, payroll and sales and thus qualified as a foreign operating company. The district court agreed. The Department claims it has statutory authority to reallocate the income of the FOC to the operating company and that the FOC lacks economic substance.
- *District of Columbia Office of Tax & Revenue v. ExxonMobil Oil Corporation et.al.*, Court of Appeals Dkt. June 30, 2016. In *Microsoft v. District of Columbia* (2012), the ALJ determined that the District's application of its re-allocation authority to impose tax based on "comparative industry profits" was arbitrary and capricious. The district did not appeal; the ALJ later agreed offensive collateral estoppel applied to prevent re-litigation of the methodology. The court of appeals held that collateral estoppel did not apply.