

New Mexico Tax Research Institute – 2018 Annual Conference

# Developments in State Taxes: Case Review and Evolving Issues

# Presenters

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The views expressed in this presentation are those of the presenter and are not necessarily the views of the Multistate Tax Commission or its members.

# Nexus

## ■ *South Dakota v Wayfair*

U.S. Sup. Ct. Dkt. No. 17-494

- Whether Quill's physical presence rule should be overturned.
- 60 amicus briefs – on the petition and the merits
- FantasySCOTUS predicts a 5-4 split to affirm
- Decision expected last week of the Court's term (June 25)

# Nexus

- ***Swart Enterprises, Inc. v. Franchise Tax Board***  
**CA Appellate Court 5th District Dkt. No. F070923, 1/12/17**
  - Mere ownership of a .2% interest in a California LLC was not “doing business” in the state for purposes of the Franchise Tax’s minimum tax.
  - Swart had no physical presence in California. It invested in Cypress LLC. Swart was not involved in the operations of the LLC and had no right or authority to act for it. The FTB argued the LLC interest constituted “doing business” in the state.

# Nexus

- ***Capital One Auto Fin., Inc. v. Dep't of Revenue***  
22 OTR 326, 2016 BL 429657 (T.C. 2016)
  - Oregon Tax Court concluded that two bank subsidiaries of Capital One Financial Corp. had substantial nexus with Oregon due to their extensive economic activities even though neither entity had property or payroll in the state.
  - The Tax Court rejected argument that the banks must have physical presence to be subject to the tax.

# Nexus

- ***Target Brands, Inc. v. Dep't of Revenue***  
District Court City and County of Denver Colorado. No. 2015CVV33831, 1/27/17
  - Colorado District Court held an out-of-state holding company that licensed the use of its intellectual property to an affiliate on a nationwide basis was “doing business” in Colorado for state corporate income tax purposes—applying economic presence.

# Sales and Use Taxes

- ***Amazon Services LLC v. South Carolina***  
S.C. Administrative Law Court, (No. 17-ALJ-17-0238-CC)(not yet argued)
  - Section 12-36-70(1)(a) defines a “retailer” and a “seller” as every person selling tangible personal property whether owned by the person or others.
  - South Carolina is arguing that Amazon should be charging and collecting tax on all its third-party seller transactions.

# Sales and Use Taxes

- ***Merch. Warehouse Co. Inc. v. Dep't of Revenue***  
87 N.E.3d 12, 2017 BL 445043 (Ind. 2017)
  - The exemption for electricity and property used in processing is not limited to the use by the taxpayer who ultimately produces the product.
  - See also *Sherwin-Williams Co. v. Iowa Dept. of Revenue*, 789 N.W.2d 417 (Iowa 2010). Where the question was—does a paint mixing machine qualify as exempt manufacturing equipment. (Yes)
  - And *King Drugs, Inc. v. Commonwealth, Revenue Cabinet*, 250 S.W.3d 643, 646, 2008 BL 88727, 3 (Ky. 2008). Where the question was how broadly to interpret an exemption for sales of “devices”. (Broadly)



# Corporate Income Tax

## Foreign Dividends:

### ■ *In re General Electric*

#### New Mexico Decision and Order No. 18-12

- Foreign dividends and Subpart F income included in the base income of a taxpayer electing to file on a consolidated basis (as with corporations filing on a combined basis).
- Case considered “close” because the department had not issued specific guidance.
- In light of the repatriation requirement under TCJA – this is a timely decision – especially since the state has also not addressed what happens if this income were *not* included (and whether related deductions would therefore apply).

# Corporate Income Tax

## NOLs:

- **State Department of Revenue v. Coca Cola Refreshment, U.S.A. Inc.**  
**Alabama Appellate Court, Dkt. 2160412, September 8, 2017**
  - Alabama Appellate Court allowed the use of net operating losses incurred in separate return years to offset the income of the consolidated group. In affirming the decision, the Court agreed with the Administration Law Judge's reading of the limitation that losses prior to the affiliate becoming a "member" of the group did not limit separate return years.

# Corporate Income Taxes

## Cost-of-Performance Sales Sourcing:

- ***Comcast Holdings Corp. v. Roberts***  
No. 12-1749-1, slip op. at 3-6 (Tenn. Ch. Sept. 7, 2017)
  - District court ruled that cost-of-performance method excluded indirect costs so that cable television service receipts should be sourced to location of customer.
- ***University of Phoenix Inc. v. Indiana Dep't of State Revenue***  
88 N.E.3d 805, 806 (Ind. T.C. 2017)
  - Tax court ruled that cost study showing indirect costs contributed to service should be followed (so that the educational services were not sourced to location of remote students).

# Corporate Income Taxes

## Transfer Pricing:

- ***See's Candies Inc. v. Utah State Tax Comm'n*** No. 140401556 (Utah 4th Judicial Dist. Ct.2016) (pending Utah Sup. Ct.)
  - Whether Utah's separate statutory authority, adopted in the 1930's and modelled on IRC Sec. 482, can be used to related party deductions (arising after a tax-free transfer of intangible property), or whether Utah is bound to use IRS regulations even though when the IRS applies these regulations it does so after recognizing the gain on the transfer of the intangible property under Sec. 367(d).

# Corporate Income Taxes

## Add-Back Cases:

- ***Kohl's Department Stores Inc. v. Dep't of Taxation***  
294 Va. 57, 803 S.E.2d 336 (2017)
  - Limitation of the add-back requirement when payments are "subject" to tax means the payments must actually be taxable in the other state (post-apportionment).
- ***BMC Software Inc. v. Director, Div. of Taxation***  
No. 000403-2012 (N.J.T.C. 2017)
  - Limitation of the add-back requirement where it would be "unreasonable" applies where payments were made to affiliate under a software licensing agreement and were substantively equal to transactions with unrelated parties.

# Corporate Income Tax

## Alternative Apportionment:

- ***Associated Bank NA v. Comm'r of Revenue***  
Minn. Sup. Ct., Dkt. No. A17-0923
  - A bank dropped its loan portfolio into wholly owned LLCs because, under state statutes, rules for sourcing of receipts from financial transactions apply to “corporations.”
  - State is seeking to use its alternative apportionment authority to have the receipts sourced as they would have been in the hands of the parent.

# Constitutional and Other

## Sovereign Immunity:

- ***California Franchise Tax Board v. Hyatt***  
U.S. Sup. Ct. Dkt. No. 17-1299 (petition pending)
  - Does state sovereign immunity permit state revenue agencies and officials be sued in the courts of a sister state?
- ***Crutchfield Corp. v. Harding***  
Vir. Cir. Ct. Albemarle Cnty. No. CL17001145-00
  - Virginia enacted an ALEC model law giving that state adjudicatory jurisdiction over suits against other states asserting nexus to impose sales tax collection duties.

# Constitutional and Other

## Anti-Commandeering:

- ***Murphy v. National Collegiate Athletic Association***  
No. 16-476. Argued December 4, 2017—Decided May 14, 2018
  - Federal statutory provision in the Professional and Amateur Sports Protection Act (PASPA) that prohibited state authorization of sports gambling schemes violates the anti-commandeering rule.
  - The anti-authorization provision does not constitute a valid preemption provision. The Constitution confers upon Congress the power to regulate individuals, not States.
  - The ruling was 7-2 on the anti-commandeering issue and 6-3 on whether the remainder of the statute could be severed (answer, no).



# Constitutional and Other

## Federal Preemption:

- ***CSX Transportation, Inc. v. Alabama***  
11th Cir., D.C. Docket No. 2:08-cv-00655-AKK, Apr. 25, 2018
  - The 4-R Act's "catch all" preemption against "another" state tax that discriminates against railroads preempts sales tax imposed on fuel purchased by railroads since water carriers pay no tax on fuel used in interstate shipping.
  - But the 11th Cir. ruled that imposing the sales tax on railroads and the fuel tax on truckers did *not* discriminate because, in part, the railroads could have paid the (sometimes) lower fuel tax.

# Constitutional and Other

## Intergovernmental Immunity:

- ***Dawson v. Steager, Comm'r of Rev.***  
U.S. Sup. Ct., Dkt. No. No. 17-419
  - Asks the court to apply *Davis v. Mich. Dep't of the Treas.* to the W.V. tax exemption provided for state law enforcement but not federal law enforcement agents.
  - *Davis* involved primarily the Buck Act, but secondarily the principle of intergovernmental immunity.
  - The U.S. Solicitor General has asked the Court to take the case.

# And Finally

## Compact Litigation:

- The last of the state supreme courts to rule on the issue (Oregon – *Health Net Inc. v. Oregon Dep't of Revenue*) has ruled in the state's favor.
- As a result, the states may amend the compact apportionment formula (which is enacted into statute in every member state).

# Questions?

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