

New Mexico Tax Research Institute – 2018 Annual Conference

Developments in State Taxes: Case Review and Evolving Issues

Presenter

Helen Hecht, General Counsel, Multistate Tax Commission

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.

Recent MTC Developments

- Corporate Income Tax:
 - 2014 – Adoption of market-sourcing for receipts from sales of services and intangibles
 - 2017 – Adoption of market-sourcing regulations
 - 2018 – Proposed Sec. 18 rules for gross receipts from certain activities

Recent MTC Developments

- Sales & Use Taxes:
 - 2011 – Public hearing on use tax notice and information reporting model
 - 2011 – Decision to delay further work until after resolution of *DMA v. Brohl*
 - 2016 – After win in *DMA*, decision to revise model to include marketplaces and referrers
 - 2018 – Approval of revised model for public hearing (June 14)

Recent MTC Developments

- Pass-Throughs
 - MTC is working on model federal adjustments reporting statute incorporating changes in federal law governing the audit of large partnerships.
 - “Interested Parties” (COST, TEI, IPT, ABA, AICPA are also involved in this effort).

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.

Lesson

- Third-party participation in tax collection is not limited to sellers (or employers).
- Third-party tax collection obligations should lower overall tax collection burdens.

Sales and Use Taxes

- Merch. Warehouse Co. Inc. v. Dep't of Revenue; No. 49S10-17-12-TA-735; No. 49T10-1302-TA-09, (Indiana Sup. Ct.)
 - The exemption for electricity and property used in processing is not limited to the use by the taxpayer who ultimately produces the product.

Sales and Use Taxes

- 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)

Lesson

- What is not said in a tax exemption can be as important as what is said—especially if what is not said is a limitation that could have been said.

Corporate Income Tax

- In re General Electric, 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).

Lesson

- Resolving important issues through litigation rather than regulation is an inefficient, unfair, and time consuming process and does a disservice to taxpayers and the state.

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 Department 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).

Lesson

- From the beginning, cost-of-performance sourcing was viewed as ambiguous and that fact is becoming more and more obvious.

Corporate Income Taxes

- Transfer pricing (of particular significance to separate filing states):
 - *See's Candies Inc. v. Auditing Div. of the Utah State Tax Comm'n*, No. 140401556 (Utah 4th Judicial Dist. Ct. 2016)(pending Utah Sup. Ct.).
 - *Columbia Sportswear USA Corp. v. Indiana Dep't of Rev.*, No. 49T10-1104-TA-00032 (Ind. Tax Ct. 2015).
 - *Hess Corp., ExxonMobil Oil Corp., Eli Lilly and Co., AT&T Services Inc., Honeywell International Inc., and Shell Oil Co.* – reached settlement after court ruling declining to throw out the methodology used.

Lesson

- Transfer pricing and related issues are a fact of life for separate filing states and those states need to take a deliberate, rational approach to these unavoidable issues.
- See MTC's SITUS program – as well as other state efforts including Connecticut and Alabama.

Corporate Income Taxes

- Add-Back Cases:
 - Virginia Supreme Court: *Kohl's Department Stores Inc. v. Department of Taxation* (No. 160681 (Va. 2017))
 - Limitation of the requirement when payments are “subject” to tax means the payments must actually be taxable.
 - New Jersey Tax Court: *BMC Software Inc. v. Director, Division of Taxation* (No. 000403-2012 (N.J.T.C. 2017)).
 - Limitation of the 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.

Lesson

- Add-back statutes, once argued to be unconstitutional, can be implemented with reasonable limitations, provided that those limitations are explicit.

Corporate Income Tax

- Alternative Apportionment:
 - *Associated Bank NA v. Commissioner 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.

Lesson

- Alternative or equitable apportionment, as a remedial authority, has to be asserted by the state if it is to be maintained.

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.

Lesson

- The balance of federalism is fragile.

Other

- Federal Preemption:
 - *CSX Transportation, Inc. v. Alabama*, 11th Cir., D.C. Docket No. 2:08-cv-00655-AKK, Apr. 25, 2018.
 - Does the 4-R Act preempt sales tax imposed on fuel purchased by railroads.
 - *Renzenberger, Inc. v. N.M. Taxation & Rev. Dep't*, 409 P.3d 922, 2017 BL 260251
 - 49 U.S.C. § 14505 which prohibits certain state taxes on interstate transportation of persons and property does not apply to intrastate transportation of railroad employees.

Lesson

- Even in very limited areas, the ability of Congress to impose reasonable, workable statutory limitations on federal taxes is unproven.

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.
 - *Davis* involved primarily the Buck Act, but secondarily the principle of intergovernmental immunity.
 - The implications of intergovernmental immunity show up in things like the recent revisions of IRC Sec. 118 (which would now subject both federal and state contributions to capital to tax).
 - See also *United States v. New Mexico*

Lesson

- Just as discrimination has become the cornerstone of the commerce clause, it is probably also the cornerstone of state/federal intergovernmental immunity.

Other

- 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).

Lesson

- “The Constitution did not purport to exhaust imagination and resourcefulness in devising fruitful interstate relationships. It is not to be construed to limit the variety of arrangements which are possible through the voluntary and cooperative actions of individual States with a view to increasing harmony within the federalism created by the Constitution.”
 - *U.S. Steel v. Multistate Tax Comm’n*