Recent and Significant Court Cases

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U.S. Supreme Court Decisions

U.S. Supreme Court — Scrutinizing Due Process

N. Carolina Dep't of Rev. v. The Kimberley Rice Kaestner 1992 Family Trust, No. 18-457 (U.S. June 21, 2019)

- The Supreme Court of North Carolina held that the Department unconstitutionally taxed the income of The Kimberley Rice Kaestner 1992 Family Trust (the Trust), an irrevocable *inter vivos* out-of-state trust, based solely on the North Carolina residence of the beneficiaries.
- Trust did not have sufficient minimum contacts with the state to satisfy the Due Process Clauses of the federal and state constitutions.
- U.S. Supreme Court affirmed . . . narrowly: "The presence of in-state beneficiaries alone does not empower a State to tax trust income that has not been distributed to the beneficiaries *where the beneficiaries have no right to demand that income and are uncertain to receive it*." (emphasis added).

U.S. Supreme Court — Sovereign Immunity

***Franchise Tax Bd. of California v. Hyatt*, 587 U.S. ___ (2019)**

- Hyatt sued FTB in state court of Nevada for torts allegedly committed during tax audit.
- Round 1 in U.S. Supreme Court: Affirmed NV Supreme Court: Full Faith and Credit Clause didn't prohibit Nevada from applying its own immunity law.
- Remand to N.V. Supreme Court: No cap on FTB tort liability (unlike Nevada state agencies).
- Round 2 on U.S. Supreme Court: NV required to apply same cap on tort liability…but no decision re: whether to overturn *Nevada v. Hall*, which permitted suits against states in court of another state.
- Round 3 in U.S. Supreme Court: *Nevada v. Hall* overturned.

U.S. Supreme Court — Judicial Deference

Kisor v. Wilkie, No. 18-15, 588 U.S. ____ (Jun. 26, 2019)

- Challenge to *Auer*, which says that deference must be given to an agency's reasonable reading of its own genuinely ambiguous regulations.
- Issue: Whether VA could define the meaning of "relevant" in its regulation, putting the onus on the veteran to demonstrate it was not a valid interpretation.
- Held: *Auer* deference upheld (although case remanded for review in light of the limitations set forth for the *Auer* deference).

Gundy v. United States, No. 17-6086 (U.S. Jun. 20, 2019)

- Sex Offender Registration and Notification Act (SORNA), intended to combat sex crimes and crimes against children, requires a broad range of sex offenders to register and imposes criminal penalties.
- Specified that Attorney General "shall have the authority" to "specify the applicability" of SORNA's registration requirements to pre-Act offenders and "to prescribe rules for [their] registration."
- Issue: Whether SORNA was an unconstitutional delegation of legislative authority.
- Held: the court affirmed Congress's authority, but the opinions indicate that the extent of Congress's power to vest authority in administrative agencies may be on unstable footing…and state regulatory programs may have to pick up the slack.

Income Taxes

Kentucky — Nexus Combination / Consolidation

***World Acceptance Corp. v. Commonwealth*, No. 2015-CA-001852-MR, (Ky. Ct. App. Jan. 4, 2019) (unpublished)**

- The Kentucky Court of Appeals ruled that a parent company could not file a consolidated return with its subsidiary.
- Under Kentucky law, an "affiliated group" of "includible corporations" must file a consolidated corporate tax return.
- Although the parent did not satisfy the statutory definition of an "includible corporation," it argued that an alternative definition applied.
- The appellate court disagreed and held that the parent company could not file a consolidated return with its subsidiary because it fell within the exception for an 'includible corporation' and no other qualification applied.

South Carolina — Allocation & Apportionment

Dish DBS Corp. v. S.C. Dep't. of Rev., No. 2016-001642 (S.C. Ct. App. Oct. 31, 2018)

- In an unpublished opinion, the South Carolina Court of Appeals held that the taxpayer failed to prove the Department's income tax assessment was erroneous and upheld the administrative court's decision.
- The Court concluded that:
  - South Carolina is not a pro rata cost of performance state. The exclusion of the phrase "based on costs of performance" (found in UDITPA) "indicated the legislature's intent that the apportionment of receipts attributable to South Carolina not be based on costs of performance.
  - South Carolina is not a market share state. Instead, South Carolina provides a "flexible standard based upon the income producing activities for a given industry."
  - Taxpayer's income-producing activities were the "delivery of its satellite signal to its subscribers, and the activities were best represented by its South Carolina subscription receipts."

Tennessee — Allocation & Apportionment

Comcast Holdings Corp. v. Tenn. Dep't of Revenue, No. M2017-02250-COA-R3CV (Tenn. Ct. App. Apr. 25, 2019)

- The Tennessee Court of Appeals held that the DOR's cost-of-performance rules permit taxpayers to identify different categories of earnings-producing activity and then analyze each separately.
- The Court, however, disagreed with the taxpayer's categories of earnings-producing activities.
  - Court also "refrain[ed] from suggesting an ideal list of categories."
- Therefore, the Court held that the taxpayer did not meet its burden of proof to overturn the Department's assessment.

Virginia — Alternative Method of Apportionment

Corp. Exec. Bd. Co. v. Virginia Dep't of Taxation, 297 Va. 57 (2019)

- The Virginia Supreme Court concluded that costs of performance methodology as applied to an in-state service provider did not violate the Due Process or Commerce Clauses of the US Constitution, and the service provider was not entitled to relief under state regulation.
- Under the statutory apportionment formula, nearly 100% of the service provider's receipts were sourced to Virginia although 95% of its sales occurred outside the state. In addition, since a number of other states employed a market-sourcing formula for sourcing services, the provider paid state on more than 120% of its income.
- In denying relief, the court explained that duplicative taxation, by itself, does not violate the Constitution.
- Additionally, the Court noted that since the provider's products were developed in Virginia and resided on in-state servers, the state's apportionment did not "reach beyond that portion of value that is fairly attributable to economic activity within the taxing state."
- Relief under the state's regulation was denied because the provider could not establish that inequity was attributable to Virginia as opposed to changes adopted more recently by other states.

New Jersey — IP Holding Company Nexus

Crown Packaging Technology, Inc. v. Dir., Div. of Taxation, No. 003249-2012 (N.J. Tax Ct. Feb. 26, 2019)

- The New Jersey Tax Court denied a holding company's motion for partial summary judgment seeking a determination that the taxpayer lacked nexus with New Jersey.
  - The taxpayer's only connection to the state was the receipt of royalties from an affiliate doing business in New Jersey.
- The court acknowledged that the taxpayer's facts appeared to be distinguishable from the facts in *Lanco, Inc. v. Dir., Div. of Taxation*, 188 N.J. 380 (N.J. 2006), but the facts regarding the taxpayer's in-state activities were not sufficiently developed and discovery was still incomplete.
  - *Lanco* held that an out-of-state company lacking a physical presence in New Jersey was deemed to be doing business in the state by receiving state-sourced royalty income.

New Jersey — State and Local Tax Addback

Daimler Investments US Corp. v. Dir., Div. of Taxation, No. 008165-2016 (N.J. Tax Ct. Jan. 31, 2019)

- The New Jersey Tax Court agreed with the taxpayer's argument that intercompany payments made under a tax-sharing agreement from the taxpayer's financing arm to affiliates do not constitute a tax and need not be added back into the financing arm's New Jersey taxable income.
  - The court disagreed with the Division's position that the payments were indirect tax payments. Rather, the payments are an accounting mechanism to calculate, estimate and reconcile the parent's payment of the taxpayer's tax obligations on its apportioned income in combined reporting states.
- However, the court concluded that the taxpayer must add back the pro rata share of its tax liability paid by the parent in combined reporting jurisdictions.

Tennessee — Right to Apportion

***PopularCategories.com, Inc. v. Gerregano*, No. M2017-01382-COA-R3-CV (Tenn. Ct. App. Dec. 20, 2018)**

- The Tennessee Court of Appeals held a company doing business in Tennessee that is incorporated in Florida had the right to apportion its net worth and net earnings for purposes of the franchise and excise taxes.
- The court disagreed with the Department of Revenue's argument that the taxpayer was not entitled to apportion its net worth and net earnings because it did not do business outside of the state.
- The court determined that the taxpayer's incorporation in Florida was doing business with the state such that it must apportion for Tennessee's taxes.

New York City — Non-Unitary Partner's Interest Subject to Tax

***In the Matter of Goldman Sachs Petershill Fund Offshore Holdings Corp.*, TAT(H)16-9(GC) (N.Y.C. Tax Trib. Dec. 6, 2018)**

- The New York City Tax Appeals Tribunal ruled that an investment management company with no activities in the city owes general corporation tax (GCT) on capital gain from the sale of a minority interest in a LLC.
  - The taxpayer owned an 88.91% interest in a limited partnership that conducted no business activities in the City.
  - The limited partnership, in turn, owned 9.99% of an interest in a LLC that had business activity in the city.
- The Tribunal found that "[a] jurisdiction's ability to tax turns on whether nexus exists between that jurisdiction and the taxpayer's business being sold." Other factors – such as whether there was a unitary business between the owner entity and the sold business – did not need to be considered; nexus is sufficient.

Mississippi — Statute of Limitations Upheld

Kansler v. Mississippi Dep't of Revenue, 263 So. 3d 641 (Miss. 2018), *reh'g denied* (Feb. 28, 2019)

- The Mississippi Supreme Court upheld the state's three-year statute of limitations period for filing amended Mississippi income tax returns.
- The statute prevented the taxpayer from filing an amended return to claim a credit for income taxes paid to another state.
- Applying the *Pike* balancing test, the court found that the statute of limitations was not facially discriminatory and that the taxpayer did not show that the burden on interstate commerce was clearly excessive in relation to the state's interest.

Utah — Restraining the Tax Commission's Discretion

Utah State Tax Comm'n v. See's Candies, Inc., 2018 UT 57, 435 P.3d 147

- See's Candies deducted IP royalty payments made to an insurance company also owned by Berkshire Hathaway.
- The Utah Supreme Court affirmed the lower court's decision finding that the Tax Commission abused its discretion by denying the entire intercompany royalty expenses when the Tax Commission failed to consider federal IRC § 482 guidance and failed to look at the taxpayer's transfer-pricing study.
  - The court agreed with the taxpayer's argument that the Utah statute, section 59-7-113, granting the Tax Commission discretionary authority, is ambiguous.
  - The court found that due to the striking similarities between section 59-7-113 and IRC § 482, it is appropriate to look at federal IRC § 482 guidance to resolve such ambiguity.

California — Nexus Through LLC Ownership

Bunzl Distribution USA, Inc. v. Franchise Tax Bd., 27 Cal. App. 5th 986 (Ct. App. 2018), *modified* (Oct. 24, 2018), *reh'g denied* (Oct. 29, 2018), *review denied* (Dec. 19, 2018)

- The California Court of Appeal held that a corporation must include income from its nonresident LLC subsidiaries when determining its California income tax liability.
    - Payment of the state tax and fee on a disregarded entity does not allow a corporation to exclude the disregarded entity's income when calculating its state income tax liability under UDITPA.
- The court rejected the taxpayer's argument that the LLCs should be treated as separate, stand-alone entities because the nonresident corporate owners had declined to consent to California tax jurisdiction, and the LLCs had paid the taxes and fees imposed on the disregarded entities.
- The court distinguished the case from *Swart*, where an out-of-state corporation's only connection to the state was its passive ownership of a 0.2% interest in a California LLC.
    - The court found that the taxpayer had substantial nexus with the state because the company and its two wholly-owned corporate subsidiaries are 100% owners of LLCs "that conduct significant business in California."

California — Broad "Doing Business" Rejected

In the Matter of the Appeal of Satview Broadband, Ltd., No. 18010756 (Cal. Office of Tax App. Sept. 25, 2018)

- The Office of Tax Appeals (OTA) rejected the Franchise Tax Board's (FTB) narrow interpretation and application of *Swart Enterprises, Inc. v. Franchise Tax Board*, 7 Cal.App.5th 497 (Cal. Ct. App. 2017) involving California's "doing business" standard.
  - In *Swart,* the California Court of Appeal held that a taxpayer passively holding a 0.2% interest in a California-based LLC was not "doing business" in California.
- The OTA held that merely owning a 25% passive, non-managing interest in a LLC was not "doing business" in California.

Louisiana — Credit for Texas Franchise Tax Paid by Pass-Through Entities

Smith v. Robinson, Dkt. No. 2018-CA-0728 (La. Dec. 5, 2018)

- The Louisiana Supreme Court ruled that residents who owned an S-corporation and LLC were entitled to a credit against their Louisiana income tax liability for Texas franchise tax paid by the pass-through entities.
- The court held that Louisiana's limit on the credit for taxes paid to other states to those states with a reciprocal credit discriminated against interstate commerce.

Oregon — Look-Through Approach Rejected

***Cook v. Dep't of Revenue*, No. TC 5298 (Or. Tax Ct. Aug. 17, 2018)**

- The Oregon Tax Court held that income from pass-through entities is apportioned at the entity level, not at the shareholder level.
- The court rejected the Department of Revenue's argument that the distributive share of income or loss from each pass-through entity, in which the taxpayer was an owner, should be aggregated, even those not doing business in Oregon.

New Jersey — Royalty Addback

Lorillard Tobacco Co. v. Dir., Div. of Taxation, No. 008305-2007 (N.J. Tax Ct. Feb. 27, 2019)

- The New Jersey Tax Court found a taxpayer could deduct the full amount of royalty payments paid to its intangible holding company subsidiary where the subsidiary filed Corporation Business Tax (CBT) returns and paid tax on the royalty payments, even if the subsidiary's New Jersey allocation factor was lower than the taxpayer's factor.
- The court invalidated the application of the Schedule G-2 exception that limited the royalty addback exception depending on the different allocation factors of the royalty payor and payee.

Oregon — Exceeding P.L. 86-272

Santa Fe Natural Tobacco Co. v. Dep't of Revenue, No. TC-MD 170251G (Or. Tax Ct. Feb. 26, 2019)

- The Oregon Tax Court held that an out-of-state cigarette manufacturer's in-state activities violated P.L. 86-272, resulting in the manufacturer being subject to Oregon's corporation excise tax.
- The manufacturer sold cigarettes to Oregon wholesalers, which then sold them to in-state retailers.
- The court held that the manufacturer's program where it paid wholesalers to accept returns of non-saleable cigarettes from retailers for replacement or refund exceeded the protections provided by P.L. 86-272.

Sales & Use Taxes

Michigan — Use Tax Due on Cellphones Given to Customers

***Emery Elecs., Inc. v. Dep't of Treasury*, No. 342250 (Mich. Ct. App. Feb. 12, 2019)**

- The Michigan Court of Appeals upheld the imposition of use tax on phones that were given away for no charge by a company in conjunction with its sales of mobile phone service contracts.
  - The company sold service contracts for a single mobile phone service provider and also purchased phones from the provider.
- The company argued that its purchase price for the phones was zero, asserting that it had been reimbursed by the provider for the cost of phones.
- The court determined that the company was not reimbursed by the provider, but instead was paid a commission by the provider for the sale of service contracts.

Texas — Hotel Consumables Not Purchased for Resale

Alamo Nat'l Bldg. Mgmt., LP v. Hegar, No. 13-17-00040-CV (Tex. App. Jan. 24, 2019)

- The Texas Court of Appeals held that a hotel owner was not entitled to a resale exemption for the hotel consumables it offered to its guests during their stay.
  - Alamo purchased items such as soap, lotion, cups and coffee, among other things, using a resale certificate.
  - The items were not separately invoiced to customers and the hotel's website indicated that the items were "free" and included in the hotel rate.
  - Guests paid a single rental price and were not informed they were paying for the consumables even though Alamo asserted that 35% of the room rental price was for these consumables.
- Court found that the trial court had sufficient grounds to conclude that Alamo did not purchase the items for resale and upheld the assessment.

South Carolina — Damage Waivers are Taxable

Rent-A-Center East, Inc., v. Dep't of Revenue, No. 2016-001210 (S.C. Ct. App. Jan. 16, 2019)

- The South Carolina Court of Appeals upheld the imposition of sales tax on sales of optional "waivers," which were sold to renters and relieved them from liability of damaged or stolen rental property.
  - The taxpayers operated retail stores in South Carolina from which customers could rent-to-own durable consumer products.
  - In conjunction with the rentals, taxpayers could purchase waivers that released the customer of its liability if the property was damaged, lost, or stolen.
- The Court found that the waivers were part of a bundle subject to sales tax under the "true object" test because the waivers were "merely incidental" and "inextricably linked" to the sales of the taxable rentals.

Louisiana — Online Marketplace Required to Collect

Normand v. Wal-Mart.com USA LLC, No. 18-CA-211 (La. Ct. App. Dec. 27, 2018)

- The Louisiana Fifth Circuit Court of Appeal held that Walmart.com is a "dealer" required to collect and remit sales tax on sales made through its online marketplace, including sales by third-party retailers.
- The court agreed with the lower court's finding that the "legislature's choice of the term 'dealer' and its definition clearly encompasses a wider group of people than 'seller.'"
- Louisiana Supreme Court has granted writ.

Indiana — Business Purpose for Out-of-State Sales

Richardson's RV, Inc. v. Ind. Dep't of State Revenue, 112 N.E.3d 192 (Ind. 2018)

- The Indiana Supreme Court held that an RV dealership was liable for uncollected sales tax on RV sales even though it delivered the RVs to buyers at out-of-state locations.
  - The RV dealership is based in Indiana, which is approximately eight miles from the Michigan border.
  - When the RV dealership made sales to Michigan customers, it would drive the RVs to Michigan where customers would sign confirmations of delivery and receive the keys to their new RVs.
- The court found that the RV dealership delivered the RVs in Michigan solely to avoid paying Indiana sales tax with no other independent, non-tax-related business purpose.

Ohio — Promotional Items as Sale-for-Resale

Cincinnati Reds, L.L.C. v. Testa, 2018-Ohio-4669, 155 Ohio St. 3d 512, 122 N.E.3d 1178 (2018)

- The Ohio Supreme Court found that the Cincinnati Reds do not owe use tax on purchases of bobbleheads and other promotional items that incentivize fans to attend games because consideration for these objects is factored into ticket prices.
    - These purchases qualify for the sale-for-resale exemption.
- The court was persuaded by the taxpayer's argument that the promotional items were used to boost attendance for games not expected to sell out.
    - The taxpayer charged the same ticket price, regardless of whether a promotional item will be given away.

New York — Gift Cards

In the Matter of Apple Inc., No. 827287 (N.Y. Div. Tax App. Nov. 1, 2018)

- The New York Division of Tax Appeals held that the free gift cards customers received with qualifying purchases did not reduce the sales price of the underlying property subject to sales tax.
  - Apple Inc. ran a promotional program on qualifying purchases of computers and tablets whereby customers received free gift cards to be used in its applications store.
  - Due to Apple's payment system constraints, Apple was required to charge customers for the full value of the gift card and reduced the sales price of the tangible personal property by the same amount.
- The Division reasoned that because customers were required to make qualifying purchases of computers and tablets to receive the free gift card, there was no sale of the gift card.

Pennsylvania — IP Royalties Not Taxable

Downs Racing, LP v. Commonwealth, 196 A.3d 603 (Pa. 2018)

- The Pennsylvania Supreme Court held that royalty fees for certain intellectual property were not subject to Pennsylvania sales tax.
  - The royalties were payments between third parties for IP used in the operation of gaming machines.
- The court found the IP was not subject to sales tax because it did not constitute, nor ancillary to, tangible personal property.
  - The Commonwealth argued that the IP was taxable canned software.

Alabama — All Software Taxable

Russell Cty. Cmty. Hosp., LLC v. State Dep't of Revenue, No. 1180204 (Ala. May 17, 2019)

- Alabama Supreme Court ruled that all software, including custom software, is tangible personal property subject to sales tax.
- Prior case law and the DOR's regulation seemed to acknowledge that customized software was not taxable.
- One concurring opinion urged legislature to "clarify how a transaction involving software and services is to be documented and invoiced."
- Dissenting opinion noted that the majority had ignored the Department's regulation, which provides that "custom software programming" is not subject to sales tax.

General & Miscellaneous

Arizona — Car Rental Agency Surcharge is Constitutional

Saban Rent-a-Car LLC v. Ariz. Dep't of Revenue, 434 P.3d 1168 (Ariz. 2019)

- Maricopa County imposes a surcharge on car rental agencies to fund a stadium and other sports and tourism-related ventures.
- The Arizona Supreme Court held that the surcharge did not violate the dormant Commerce Clause or the anti-diversion provision of the Arizona Constitution.
- Commerce Clause: The court found no discriminatory intent against out-of-staters despite them paying most of the surcharges.
- Anti-Diversion Provision: The provision limits tax revenues related to the use or operation of vehicles on roads to only highway and street purposes. But the court held that the provision does not apply to the surcharge on car rental agencies.

New Jersey — Assessment Issued to Wrong Corporation and Address

***Merrill Lynch Credit Corporation v. Division of Taxation*, Dkt. No. 004230-2017 (N.J. Tax Ct. Sept. 28, 2018) (unpublished).**

- The New Jersey Tax Court rejected a taxpayer's due process claim, finding that the Division of Taxation properly issued the notice of assessment.
- The Division issued the assessment in the name of the predecessor, rather than successor corporation and addressed it to the wrong ZIP code.
- The court rejected these arguments because:
  - (1) The taxpayer's office executed prior statute waivers in the name of the predecessor corporation; and
  - (2) The assessment was delivered to the proper address where agents of the taxpayer accepted and signed the mail return receipt card.

Louisiana — Refund from Department's Mistake of Law

***Bannister Properties, Inc. v. Louisiana*, Dkt. No. 2018-0030 (La. Ct. App. Nov. 2, 2018)**

- The Louisiana Court of Appeal held that a taxpayer was not entitled to a franchise tax refund, despite the overpayments having resulted from the Department's mistake of law.
- The Department could not issue a refund when the tax was paid as a result of a "mistake of law arising from the misinterpretation by the secretary" of the state's laws or the promulgated rules and regulations.
    - Rather, the taxpayer could only recover franchise tax paid under a mistaken interpretation of law by the Department by: (1) paying the tax under protest (and filing a petition to recover the payment under protest; or (2) seeking recovery from the Louisiana Legislature under the claim against the state procedure.

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