taxnotes state

Volume 102, Number 12 ■ December 20, 2021

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Reprinted from *Tax Notes State*, December 20, 2021, p. 1325

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In this installment of Audit & Beyond, the authors review some key state tax rulings of 2021 — including cases involving single-sales-factor apportionment, nexus, and filing fees.

Many state and local tax practitioners maintain an internal list of cases that have struck a chord with them or their clients. Sometimes that chord resonates favorably, while other chords make us shudder. We've decided to weigh in on some 2021 opinions that reached a high note and a few others that need tuning.

Leading with the high notes are *Vectren*[1] and another Michigan case, *Apex Laboratories International*.[2] Other cases reaching high notes include *U.S. Auto Parts Network*,[3] *B&H Foto*,[4] and *R.O.P. Aviation*.[5]

In *Vectren*, the Michigan Court of Appeals — on remand from the Michigan Supreme Court directing that it "address the plaintiff's arguments regarding the proper method for calculating the business tax due under the statutory formula" — reaffirmed its earlier ruling that including a gain from the sale of a business, while failing to represent the sales transaction in the sales factor, "runs afoul of the Due Process and Commerce Clauses . . . because it does not fairly determine the portion of income from the Sale that is reasonably attributed to in-state activities. Fairness, in part, requires that the choice of 'factors used in the apportionment formula must actually reflect a reasonable sense of how'" the business activity is generated (citation omitted).

In *Vectren*, application of the statutory single-sales formula without factor representation resulted in a tenfold increase in the sales factor from about 7 percent to 70 percent. While the court of appeals again ducked determining an

[1] *Vectren Infrastructure Services Corp. v. Department of Treasury*, No. 345462 (Mich. Ct. App. 2021). Two of the authors weighed in on an earlier Michigan Court of Appeals decision (331 Mich. App. 568 (2020)) that had concluded that use of Michigan's single-sales-factor apportionment formula was unreasonable and ran "afoul of the Due Process and Commerce Clauses," but did not address the proper method to be used to determine the business tax due. Joshua A. Labat, Zachry T. Gladney, and Clark R. Calhoun, "*Vectren*: The Most Cogent Alternative Apportionment Decision in Years," *Tax Notes State*, May 17, 2021, p. 709.

[2] *Apex Laboratories International Inc. v. Department of Treasury*, No. 19-000095-MT (Mich. Ct. Cl. 2021).

[3] *U.S. Auto Parts Network Inc. v. Commissioner of Revenue*, C339523 (Mass. App. Tax Bd. 2021).

[4] *People v. B&H Foto & Electronics Corp.*, Index No. 252106/2019 (N.Y. Sup. Ct. N.Y. County, 2021) (Decision & Order on Motion).

[5] *R.O.P. Aviation Inc. v. Director, Division of Taxation*, No. 001323-2018 (N.J. Tax Ct. 2021).

appropriate apportionment formula, remanding it to the trial court "if the parties are unable to agree upon one," we commend the appellate court for trying to lay the path toward a reasonable result. But it is incredibly unfortunate that this taxpayer (or any taxpayer) needs to go to that length (plus time and expense) to reach a reasonable result. Revenue departments should not ignore taxpayers' pleas for rationality and application of reasonable alternative apportionment methods.

Apex Laboratories International is a bit of a mixed bag of kudos and pans in which the taxpayer lost the battle but won the war. Here, a holding company formed by a private equity firm to hold the stock in a Canadian company was found to have nexus in Michigan, despite having no employees or offices anywhere, because of the actions taken in the state by the officers and directors of the private equity firm over the holding company. Holding companies have often posed tax challenges because they generally don't "do" anything (that is, an argument exists that they are not "doing business" anywhere). Imputing a separate entity's activities onto the holding company to determine that company's nexus is troubling and questionable.

On the kudos side, however, the Michigan Court of Claims concluded that none of the income from the holding company's sale of stock in the Canadian company was apportionable to the state because it made no Michigan sales, despite the fact that the "sale of stock was structured so as to avoid taxation that would otherwise apply in Canada" because the company was "subject to taxation in Canada." But it is questionable whether sales of business interests should be subject to the same apportionment regimes as income from ongoing businesses, as is looking to where a taxpayer made sales only in the current year in allocating income or loss from the sale of a business.

In *U.S. Auto Parts Network*, the Massachusetts Appellate Tax Board got it right when it granted summary judgment for the taxpayer and held that the taxpayer lacked nexus for periods before the June 21, 2018, U.S. Supreme Court decision in *Wayfair*. There, the board reviewed the Massachusetts Department of Revenue's since-repealed internet vendor rule,[6] which in addition to providing for cookie nexus provided that sales exceeding $500,000 resulting from 100 or more transactions triggered nexus. Cookies were defined as "text data files generally used by an Internet vendor to enhance its customer sales. Cookies are stored locally on computers and physical communications devices of the customers of an Internet vendor when such customers visit the vendor's website for the first time and act to identify the customer on each subsequent visit."[7]

Use of ephemeral physical presence standards obviated the utility of having an easily determined, objective standard. After *Wayfair*, resorting to nutty purported physical presence equivalents like cookie nexus should be relegated to the SALT trash heap. Further, the internet vendor rule was clearly an attempted end run around *Quill.* When states ignore Supreme Court precedent (be it *Quill*'s physical presence standard or any other subject), it sends the message that laws and decisions interpreting those laws can be flouted. Although we have not yet seen the Massachusetts Appellate Tax Board's findings of fact and report on the case, we suspect it was requested and could be issued shortly. The revenue commissioner may also file an appeal, but perhaps Massachusetts will do the right thing and let this issue fade into the sunset.

B&H Foto is a false claims case involving the relator's allegation that B&H Foto's Instant Savings program was the equivalent of manufacturer's coupons and should be included in the amount of receipts subject to sales tax. In dismissing the complaint, the court observed that the Instant Savings were offered by manufacturers to retailers and not customers, and it added that the retailers could pass the benefit on to customers. The Instant Savings amounts were therefore not the equivalent of manufacturer's coupons; as the court explained, "Advertising 'Instant Savings' is merely a marketing tactic to attract customers to a

[6] 830 Mass. Code Regs. 64H.1.7 (repealed as of Oct. 1, 2019).

[7] *Id.*

storewide sale, rather than evidence of a manufacturer's coupon." The court in *B&H Foto* also acknowledged that the mere recognition of a potential tax issue is not evidence of fraud; rather, it must be coupled with a statutory violation: "The absence of a statutory violation means that persistent fraud or illegality was not committed even if B&H believed it was acting unlawfully." As any SALT practitioner knows, tax law is often not black or white — but rather a muddy gray. This decision is one of many illustrating why vigilante tax "justice" is best left to tax departments.

One of our favorites is *R.O.P. Aviation*, which addresses whether a net operating loss carried forward from a closed year can be reduced in the application year. Revenue departments routinely opt not to audit taxpayers generating losses and instead will wait and consider challenging the amount of the NOLs available to offset income in a carryforward year. Given that carryforward periods can be as long as 20 years after the NOL derivation year, taxpayers' ability to address and successfully refute the adjustments may be severely compromised. Sometimes revenue departments will even use their discretionary adjustment authority by adjusting the income in the long-closed year.

In *R.O.P. Aviation*, the New Jersey Division of Taxation eliminated NOL carryforward amounts from closed years by asserting that intercompany leases were not at arm's-length rates. The New Jersey Tax Court bucked the trend of other states that allow adjustments in closed years to reduce NOL carryforward amounts, concluding that the adjustment was essentially the same as issuing an assessment for a closed year — and reasoning that the division could not do "indirectly what the statute does not permit directly." This is the right result. Revenue departments can audit any open year; their decisions to forgo audits because of resource issues should not become a taxpayer's problem.[8]

There are many cases that we could not dance to, but the U.S. Supreme Court's failure to grant certiorari in *New Hampshire v. Massachusetts*[9] was a disappointment, particularly since the issues of dueling taxability of employees by multiple states caused by the convenience of the employer rule will continue with a vengeance in 2022. Other troubling decisions include *Ferrellgas Partners*,[10] *Feltner*,[11] and *Wynne*.[12]

Ferrellgas Partners concerns New Jersey's imposition of a $150-per-partner filing fee (capped at $250,000 per partnership) for partnerships that derive income from the state. Ferrellgas Partners had 67,000 partners and owed $250,000 for complying with its informational reporting obligations to New Jersey, and it challenged the tax as a violation of the commerce clause. Charging a fee to comply with a state-mandated information reporting mandate (think: no good deed goes unpunished) is akin to imposing a fee for filing a tax return. It is also reprehensible and confiscatory when the actual cost of processing was estimated to be about $4 per return.[13] Further, the partner filing fee is unapportioned, and it is easy to see how interstate commerce can be adversely affected by those so-called fees (think: every state has such a fee or even a much higher fee). Ferrellgas has petitioned the Supreme Court for review.

The Court's denial of certiorari in *Feltner* was another disappointment. Here, the county confiscated land worth $144,500 for an unpaid tax debt of $65,189 and gifted the property to the county's land bank rather than having a public sale of the property, leaving the taxpayer without a mechanism to recover his surplus equity. This troubling result should never have

[8]One of the authors has long advocated for rejecting NOL adjustments from closed years. Paul H. Frankel and Amy F. Nogid, "Statutes of Limitation on Assessment Magically Disappear," *State Tax Notes*, July 7, 2014, p. 35.

[9]*New Hampshire v. Massachusetts*, Dkt. 22O154 (U.S. Sup. Ct. Motion for Leave to File a Bill of Complaint Denied June 28, 2021).

[10]*Ferrellgas Partners LP v. Director, Division of Taxation*, No. A-3904-18T-1 (N.J. App. Div. 2021).

[11]*Ohio ex rel. Feltner v. Cuyahoga County Board of Revision*, ___ U.S.___, 141 S. Ct. 1734 (2021).

[12]*Wynne v. Comptroller of Maryland*, No. 16-IN-OO-0216 (Md. Tax Ct. 2021).

[13]Ferrellgas estimated that the cost was about $4 per return ($19 million in salaries ÷ 4.7 million returns = $4 per return). Since Ferrellgas had 67,000 partners and paid $250,000, the cost to Ferrellgas was about $4 per *partner*. Even assuming that — as the Appellate Division suggests — costs other than salaries are involved, the profit New Jersey earned from the partner filing fee was huge.

occurred, and it is baffling why this was not found to violate the takings clause. This is not an isolated example of situations in which states obtain windfalls. A few other examples are failing to provide sales tax refunds for vendors who do not receive the sales tax payments from their customers and requiring holders to remit as unclaimed property amounts that the property owners themselves can no longer rightfully claim. Simply put, the government should treat those that support its existence with fairness. One is hard-pressed to find fairness in the Cuyahoga County Board of Revision's treatment of Elliot Feltner's property.

States often legislate in response to ongoing litigation or unfavorable decisions. However, when the legislation is made retroactive, or as purportedly clarifying prior law, due process concerns are rightfully triggered. In *Wynne*, the long-running saga continued. As readers may recall, in 2015 the U.S. Supreme Court held that Maryland's law was unconstitutional where it denied a credit for taxes paid to other states against the county portion of Maryland's personal income tax. As a result of legislation in 2014 and 2015, Maryland reduced the rate of refund interest to 3 percent from 13 percent for refunds resulting from *Wynne* credit claims.

Although the Maryland Tax Court previously found the lower tax rate to be unconstitutional,[14] the Maryland Court of Appeals reversed, finding that there was no dormant commerce clause issue with the rate reduction, and that the instant case resulted from a remand of that court to address additional issues — including whether the 14th Amendment's right to due process and the Fifth Amendment's protections against takings applied. The tax court held that these constitutional provisions were not violated because the right to the refund was viewed as occurring after the interest rate had been reduced (and the granting of interest is, according to the court, a matter of legislative grace, notwithstanding the fact that the state charges interest on its own assessments). However, the government's bait and switch after taking an unconstitutional position against taxpayers is at the very least unsettling. At most, to the extent refund claims were filed before the rate reduction was enacted, it is hard to fathom why the 14th and Fifth amendments are not implicated.

We expect 2022 to again offer SALT practitioners both high notes and other notes that make us shudder, but we are hopeful that more of us will be humming along rather than covering our ears. ■

[14] *Wynne v. Comptroller*, No. 16-IN-OO-216 (Md. Tax Ct. 2018).