# Multistate Taxation

*By Phil Tatarowicz and Bee-Seon Keum*

## Developments in Multistate Taxation

On January 23, 2012, the U.S. Supreme Court denied a petition for certiorari in *General Motors Corp. v. Michigan Department of Treasury*. In *General Motors*, an automobile manufacturer requested a refund of use tax paid on the interim business use of vehicles held for resale after the Michigan Supreme Court found that the vehicles were exempt from use tax under the resale exemption. While the refund request was pending, the legislature amended the use tax statute to make the temporary business use of inventory taxable on a retroactive basis for any open tax year. The Michigan Court of Appeals denied the refund request, holding that the period of retroactivity did not violate the manufacturer's constitutional rights. The Michigan Supreme Court denied review.[1]

The Court also denied certiorari in *Combs v. Texas Entertainment Association, Inc.*, in which operators of adult entertainment businesses requested the Court to decide whether a Texas fee on businesses that offer live nude entertainment in combination with alcohol consumption on the premises is a content-based tax that can be upheld as a regulation of secondary effects. The Texas Supreme Court held that the fee did not violate the right to free speech under the First Amendment.[2]



## New Jersey

The Tax Court held that the amount charged by an electric public utility for the distribution of electricity through the local distribution infrastructure to its consumer was subject to sales tax as receipts from "the transportation or transmission of natural gas or electricity by means of mains, wires, lines or pipes, to users or customers," a taxable "utility service" within the meaning of the statute.[3] In addition, all of the charges the legislature and Board of Public

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Utilities authorized electric public utilities to charge customers to recover expenses associated with electricity generation, demand management, customer services, energy-related social programs and other costs were properly included in the receipts from the utility services for the purpose of calculating sales tax. Such charges were included in receipts subject to sales tax because each made up a part of the total consideration paid for the provision of electricity distribution services to the taxpayers.

## New York

The Tax Appeals Tribunal ruled that equipment financing agreements between a manufacturer and governmental entities constituted business capital rather than investment capital and, therefore, required the manufacturer to report its income from the agreements as business income.[4] The manufacturer entered into various leases and installment sale arrangements with numerous government entities, providing them with equipment and receiving payments plus interest income over a period of time. The statute defines "investment capital" as "investment in stocks, bonds and *other securities* … " (emphasis added).[5] The Tribunal rejected the manufacturer's assertion that the income from the leases/sales constituted "other securities," reasoning that the financing agreements were not securities under the New York securities law.

## Pennsylvania

On January 27, 2012, the Pennsylvania Department of Revenue announced that it will offer a one-time extension on nexus compliance deadlines for remote sellers.[6] The announcement provides that the Department will extend until September 1, 2012, the deadline for remote sellers with physical presence in the state to become licensed and begin collecting sales tax. The Department issued a bulletin on December 1, 2011, which provided that vendors must collect sales taxes if they make sales through in-state affiliates making a commission or if they have a distribution or fulfillment center in the state.[7]

## Oregon

A telephone company was required to include receipts from interstate and international calls in the numerator of its Oregon sales factor for corporate income tax purposes. The company maintained equipment in Oregon and New Jersey to process calls and paid access charges to local exchange carriers (LECs) in Oregon to perform local call services in Oregon for the company. Under the statute, gross receipts are in Oregon if a greater proportion of the income-producing activity is performed in Oregon than in any other state, based on costs of performance. "Costs of performance" is defined as "direct costs," interpreted by the Department of Revenue as "costs that only incurred because the revenue producing transaction or activity in question occurred." The Tax Court concluded that the company's only direct costs were access charges and not all costs incurred to engage in the general business activity with respect to the interstate and international services as the company alleged. Furthermore, the LECs that collected access charges were performing local services *to* the company and not *on behalf of* the company. Therefore, the access charges were a direct cost of the company's income-producing activity in Oregon. Consequently, the receipts from interstate and international calls were includable in the numerator of the sales factor in Oregon.[8]

The Tax Court held that gains from the sales of stock of two subsidiaries were business income and, therefore, includable in the sales factor denominator for corporate income tax purposes. The taxpayer's primary business consisted of the sale of software, installation of software, software support and training for computer software. The taxpayer sold its stock in (a) a Japanese subsidiary that sold software to the Japanese market through various licenses with the taxpayer and (b) a U.S. subsidiary that was in the business of developing and licensing software that provided interactive network communications with consumer appliances. The statute provided that "sales" included gains from the sale of intangible assets not derived from the taxpayer's primary business activity, but included in the taxpayer's business income. The Department unsuccessfully argued that the sale of stock in the Japanese subsidiary should be excluded from the sales factor because the sale was not derived from transactions and activity in the regular course of the taxpayer's trade or business. However, the Tax Court rejected the taxpayer's argument that the sale of stock in the U.S. subsidiary should not be included in business income, finding that the subsidiary was unitary with the taxpayer under the functional test, and therefore, that the income from the sale of the U.S. subsidiary stock was business income.[9]

## Tennessee

The Court of Appeals held that an out-of-state book distributor had sufficient presence in Tennessee to be subject to the sales tax. The distributor had no real property, personal property or employees located in Tennessee, but made significant sales in Tennessee. The distributor conducted its business by mailing catalogs to teachers who distributed the catalogs to students, collected the students' orders and payments and returned them to the distributor. The distributor delivered the ordered products by common carrier. The court rejected the distributor's constitutional arguments on the basis that the distributor had used the Tennessee schools and teachers to create a "de facto marketing and distribution mechanism," regardless of whether or not the teachers were agents of the distributor. Therefore, the court concluded that the distributor's activities were sufficient to satisfy the substantial nexus requirement and *Quill*'s physical presence standard.[10]

### Endnotes

1 *GMC v. Dep't of Treasury,* Mich. Ct. App., 290 Mich. App. 355, 803 NW2d 698 (2010). *Appeal denied,* Mich. SCt, 489 Mich. 991, 800 NW2d 85 (2011). *Cert. denied,* SCt, Dkt. No. 11-532, 2012 U.S. LEXIS 1004 (Jan. 23, 2012).

2 *Combs v. Tex. Entertainment Ass'n,* Tex. App., 287 S.W.3d 852 (2009). *Rev'd and rem'd,* Tex. SCt, 347 S.W.3d 277 (2011). *Cert. denied,* SCt, Dkt. No. 11-655, 2012 U.S. LEXIS 1015 (Jan. 23, 2012).

3 *Atlantic City Showboat, Inc. v. Director, Div. of Taxation,* NJ Tax Ct., Dkt. No. 000036-2007, 2012 N.J. Tax LEXIS 1 (Jan. 24, 2012).

4 *Xerox Corporation,* NY Div. Tax App., Tax App. Trib., DTA No. 822620, [NY] St. Tax Rep. (CCH) ¶407-458 (Jan. 12, 2012). *Rev'g,* NY Div. Tax App., ALJ Unit, DTA No. 822620, [NY] St. Tax Rep. (CCH) ¶507-008 (Oct. 7, 2010).

5 N.Y. Tax Law § 208(5).

6 *News for Immediate Release* (Pa. Dep't of Revenue, Jan. 27, 2012).

7 *Sales and Use Tax Bulletin*, No. 2011-01 (Pa. Dep't of Revenue, Dec. 1, 2011).

8 *AT&T Corp. & Includible Subsidiaries v. Dep't of Revenue*, Ore. Tax Ct., Dkt. No. TC 4814, [Ore.] St. Tax Rep. (CCH) ¶401-011 (Jan. 12, 2012).

9 *Oracle Corp. v. Dep't of Revenue*, Ore. Tax Ct., Dkt. No. TC-MD 070762C, [Ore.] St. Tax Rep. (CCH) ¶401-012 (Jan. 19, 2012).

10 *Scholastic Book Clubs, Inc. v. Farr*, Tenn. Ct. App., Dkt. No. M2011-01443-COA-R3-CV, [Tenn.] St. Tax Rep. (CCH) ¶401-455 (Jan. 27, 2012).