Multitate Taxation

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Developments in Multistate Taxation

Illinois

The Illinois Department of Revenue ("Department") issued a general information letter explaining that an out-of-state call center that contracts services to retailers in Illinois may be subject to income tax. The call center coordinated contracted labor on an as-needed basis for its customers, some of which were located in Illinois. The Department stated that the applicable regulation allowed tax immunity for the use of independent contractors only for "limited activities" and contracting sales of services in Illinois on a regular basis may subject the call center to Illinois income taxation.[1]

Indiana

The Indiana Department of Revenue ("Department") ruled that an out-of-state limited liability company (LLC) whose related corporation, a retail merchant that sold Sci-Fi games to distributors and retailers, did not have nexus with Indiana for purposes of the adjusted gross income tax (AGIT). The games that the retail merchant sold were available for purchase in Indiana at a convention during the years in issue. Additionally, the retail merchant sent most of its employees to a retailer summit hosted in Indiana for several days. The LLC did not come into Indiana for the retail summits, nor did the LLC have a presence at the convention. The Department accepted the LLC's position that its activities in Indiana did not go beyond "mere solicitation" and were therefore protected by P.L. 86-272.[2] Although the Department rejected the LLC's position that the retail merchant was also protected by P.L. 86-272, it observed that the Department had not assessed the retail merchant for the AGIT. Finally, the Department abated negligence penalties because the LLC was incorrectly assessed on the AGIT.[3]

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Iowa

An administrative law judge (ALJ) upheld a corporate income tax assessment on two out-of-state trademark companies wholly owned by a large company (the "parent company") engaged in the marketing and production of alcoholic beverages, including Jack Daniel's and Southern Comfort whiskeys. In producing Jack Daniel's whiskey, the parent company purchased the "distillate" from its subsidiary (the "distillery") that was wholly owned by one of the trademark companies, distilled it for several more years, bottled the final whiskey product and sold it in Iowa through the Iowa Alcoholic Beverages Division ("ABD"). The distillery paid royalties to its parent trademark company based on the net sales of the Jack Daniel's distillate. The parent company paid the other trademark company royalties based on net sales of Southern Comfort.

The ALJ concluded that the trademark companies were not materially different from the trademark company in *KFC Corp. v. Iowa Dep't of Revenue*, in which the Supreme Court of Iowa held that Iowa could constitutionally impose tax on an out-of-state corporation on revenue arising from the use of its trademarks by third-party franchisees in Iowa.[4] The ALJ stated that, like the corporation in *KFC*, the trademark companies were based out of state, created to protect intellectual property and earned income from the use of their intangibles within Iowa. Therefore, the ALJ held that the trademark companies could be subject to tax without violating the U.S. Constitution or Iowa law. The ALJ also upheld the Department of Revenue's penalty assessments for late filing and underpayment.[5]

New Jersey

Out-of-State Software Developer–Corporate Business Tax

The New Jersey Superior Court, Appellate Division, held that an out-of-state software developing company had nexus with New Jersey and was therefore subject to the Corporation Business Tax (CBT), because the company allowed one of its employees to telecommute full-time from her New Jersey residence. The employee in question developed and wrote software code, which became a part of a web-based product that the company sold, from a laptop computer in New Jersey. The court observed that an employee's creation of a computer code in New Jersey for her software developer employer was no different from a foreign manufacturer employing someone to fabricate parts in New Jersey for a product that will be assembled elsewhere. Rejecting the company's Constitutional arguments, the court held that the company was subject to the CBT not simply because the employee lived in New Jersey, but because the employee's full-time work in New Jersey created a sufficient minimum connection with New Jersey to subject the company to tax. The court also noted that the company benefited from all of the protections that New Jersey law afforded to its employee.[6]

Intercompany Transfer Pricing and APAs

The New Jersey Division of Taxation ("Division") issued guidance on the use of intercompany transfer pricing and advance pricing agreements (APAs) in the context of intercompany transactions.[7] The guidance explains that, pursuant to N.J.S.A. 54:10A-10 and N.J.A.C. 18:7-5.10, the Director of the Division of Taxation (the "Director") has the authority to examine intercompany transactions and adjust the entire net income of taxpayers in order to make a "fair and reasonable" determination of the amount of tax due and that Code Sec. 482 standards will be used. The Director will accept an APA with the IRS and third-party pricing studies used as a basis for the APA and will make no adjustments to Line 28 of Schedule A if the taxpayer can demonstrate that it has met the standards of Code Sec. 482. However, the Director has the authority to examine APAs and challenge their underlying assumptions and interpretations if the "true earnings" of the taxpayer from business carried on in New Jersey are not reflected by the terms of the APA. The guidance replaces a previously issued guidance (TAM 2011-17).[8] The Division expressed its intent to codify the contents of the guidance in a regulation.

New York

The New York Department of Revenue ("Department") ruled that an out-of-state company that performed payment processing services and the merchants that received payment from customers through the company's services were not subject to sales and use tax. The company's services allowed businesses and consumers to purchase goods and services online or over the telephone from merchants and pay for the goods and services at a local retail store using cash. The Department concluded that: (1) the company's services were not subject to sales and use tax because they were not enumerated as a taxable service; (2) the merchants using the company's services to receive payments from customers were not "vendors" required to collect sales and use tax; and (3) the merchants' use of the company's services to receive payments did not constitute "doing business" for purposes of the Article 9-A Corporation Franchise Tax.[9]

North Carolina

The North Carolina Court of Appeals held that an office equipment leasing company that purchased and used parts, supplies and materials to fulfill its optional maintenance agreements was entitled to a use tax credit against sales taxes erroneously collected and paid on the optional maintenance agreements. The North Carolina Department of Revenue ("Department") refused to credit the company because there was allegedly no proof that the company had refunded to its customers the sales tax that was erroneously collected. The court held that the Department must credit the company based on the general provision in the North Carolina statutes that required a credit for excess taxes paid. The court ruled that a more specific provision, which prohibited a refund on taxes erroneously collected on "exempt or nontaxable sales," did not govern because it only applies to "exempt or nontaxable sales" and the Department concluded that the optional maintenance agreements were subject to use taxes and not sales taxes.[10]

Texas

The Texas Supreme Court dismissed, for lack of jurisdiction, an original proceeding brought by a group of corporations claiming that the Texas franchise tax was unconstitutional. The corporations did not pay their taxes under protest or first request a refund from the Comptroller before bringing their suit as required by the statute. Furthermore, the corporations did not bring their suit in the district court as required by the statute on the basis that the Supreme Court had exclusive and original jurisdiction over a challenge to the constitutionality of the franchise tax. In rejecting the corporation's suit for lack of jurisdiction, the Supreme Court explained that (1) the statute did not create a right to sue independently of the statutory requirements and (2) allowing the corporations to bring suit without first lodging their complaints by protest or refund claim would deprive the Comptroller of the notice of the assertion of illegality.[11]

Endnotes

1 General Info. Letter, Ill. Dep't of Rev. IT 12-0001-GIL (Jan. 12, 2012).

2 Interstate Income Tax Law of 1959 (P.L. 86-272), commonly known as "P.L. 86-272."

3 Ind. Dep't of Rev. Letter of Finding No. 02-20110251 (Feb. 29, 2012).

4 *KFC Corporation v. Ia. Dep't of Rev.,* Ia. SCt, 792 NW2d 308, [Ia.] St. Tax Rep. (CCH) ¶201-296 (2010).

5 *Matter of Jack Daniel's Prop., Inc. & Southern Comfort Prop., Inc.,* Iowa Dep't of Inspections & App., Nos. 09DORFC002 and 09DORFC004 (July 28, 2011) (released Mar. 2012).

6 *Telebright Corp. Inc. v. Director, Division of Taxation,* N.J. Super. Ct. App. Div., No. A-5096-09T2 (Mar. 2, 2012).

7 N.J. Div. of Tax'n, TAM-2012-1 (Feb. 16, 2012).

8 In TAM 2011-17, the Division provided that it has the right in particular instances to use other criteria besides an APA to determine a fair and reasonable tax because the New Jersey regulation goes beyond the scope of Code Sec. 482.

9 N.Y.S. Dep't of Tax. & Fin. Advisory Opinion (Feb. 9, 2012).

10 *Technocom Bus. Systems, Inc. v. N.C. Dep't of Revenue,* N.C. Ct. App., No. COA11-655 (Feb. 21, 2012).

11 *In re Nestle USA, Inc., Switchplace, LLC, & NSBMA, LP, Realtors,* Tex. SCt, No. 11-0855 (Jan. 12, 2012).