Multistate Taxation

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Developments in Multistate Taxation

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United States Supreme Court

On December 2, 2013, the United States Supreme Court denied a petition for *writ of certiorari* filed by an online retailer seeking review of the New York Court of Appeals' determination that a New York statute that subjects online retailers without physical presence in the state to New York sales and compensating use taxes does not, on its face, violate the Due Process or Commerce Clauses of the United States Constitution.[1]

Arizona

The Arizona Court of Appeals held that gains recognized on the contribution of assets to a joint venture, proceeds from the sale of a business line and royalties received from patent rights constituted business income of a telecommunications corporation.[2] The court held that Arizona's statutory definition of business income contained both a transactional test and a functional test and that the state may tax corporate income as business income if the income satisfies either test. The court also stated that there was no liquidation exception to the statutory definition of business income.

The court held that the gain realized upon the contribution of a controls product line to a joint venture constituted business income under the functional test because the corporation's acquisition, control and use of the asset contributed materially to the corporation's production of business income and under the transactional test because the sale furthered the business objectives of the corporation and occurred in its regular course of buying and selling companies.

In addition, the court concluded that the sale of other product lines held by the corporation during the relevant tax years constituted business income under the functional test because the product lines produced business income while held by the corporation.

The court also stated that income realized by consolidated subsidiaries from the buying and selling of assets qualified as business income when those subsidiaries sold such assets as part of their operations, and holding and selling such assets was an integral part of the trade or business of the subsidiaries. Finally, the court concluded that a consolidated subsidiary's royalty income from patent rights qualified as business income when the purpose of acquiring and holding the patent rights was related to the trade or business operation of the subsidiary.

Michigan

The Michigan Court of Appeals held that the owner of multiple S corporations could not determine Michigan income tax liability by combining the property, payroll and sales for all of the S corporations to calculate a single apportionment percentage and then applying this apportionment percentage to each of the S corporations and that the Michigan Department of Treasury was correct in determining the owner's taxable income based on the business activities of each separate entity.[3] The court reasoned that the businesses were required to be unitary in order to apportion their income using a single apportionment percentage, that all business flowing through to a taxpayer was not necessarily regarded as a unitary business and that the owner had failed to establish that the S corporations comprised a unitary business.

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The Michigan Court of Appeals held that a corporation engaged in the business of selling engine parts and the installation of engine parts was performing a service with respect to the transactions that involved sales of engine parts plus the installation of those parts and that the Michigan Department of Treasury was correct in apportioning those sales to the state under the cost of performance rule.[4] The court looked to the incidental-to-service test to determine whether the transactions were principally a transfer of tangible personal property or a provision of a service. The court concluded that the engine parts in question were sold in furtherance of the corporation's services enterprise, not in furtherance of its retail enterprise and, therefore, that the transactions should have been sourced according to the cost of performance as a service, rather than having been sourced by destination as a sale of tangible personal property.

Virginia

The Virginia Tax Commissioner ruled that adjustments made to a corporation's net operating loss deduction carryforwards for tax years outside the limitations period for assessments were permissible because the adjustments corrected the amount of federal taxable income for tax years within the statute of limitations.[5] The Commissioner also ruled that interest expenses claimed by the corporation on intercompany loans to affiliated entities were permissible because the affiliated entities had economic substance, and the documentation regarding the loans demonstrated that the loans were made at arm's length. In addition, the Commissioner ruled that no portion of the corporation's payment to purchase merchandise from a subsidiary that designed and developed the merchandise and held the trademarks related to the merchandise constituted a royalty subject to Virginia's addback requirement. The Commissioner reasoned that the payment was not a royalty because the corporation did not make such payments based on a percentage of its profits and there was no specified sum per item sold that was designated as a royalty.

Endnotes

1 *Overstock.com v. New York State Dep't of Tax'n & Fin.,* 987 N.E.2d 621 (N.Y. 2013), *cert. denied,* No. 13-252 (U.S., Dec. 2, 2013).

2 *Harris Corp. v. Ariz. Dep't of Rev.,* No. 1 CA-TX 11-0006 (Ariz. Ct. App., Nov. 26, 2013).

3 *Winget,* No. 302190 (Mich. Ct. App., Dec. 5, 2013).

4 *Peaker Servs., Inc.,* No. 313983 (Mich. Ct. App., Nov. 26, 2013).

5 Rulings of the Tax Comm'r, No. 13-213 (Va. Dep't of Tax'n, Nov. 18, 2013).