SALT Update

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Agenda

- INCOME TAX ISSUES
  - P.L. 86-272
  - Alternative Apportionment
  - Sourcing
  - Economic Substance/Sham Transaction
  - Unitary Group Inclusion
- SALES & USE TAX ISSUES
  - Software
  - True Object Test
- PROPERTY TAX ISSUES
- OTHER TAX ISSUES
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- SCOTUS

INCOME TAX ISSUES:
Public Law 86-272

Public Law 86-272

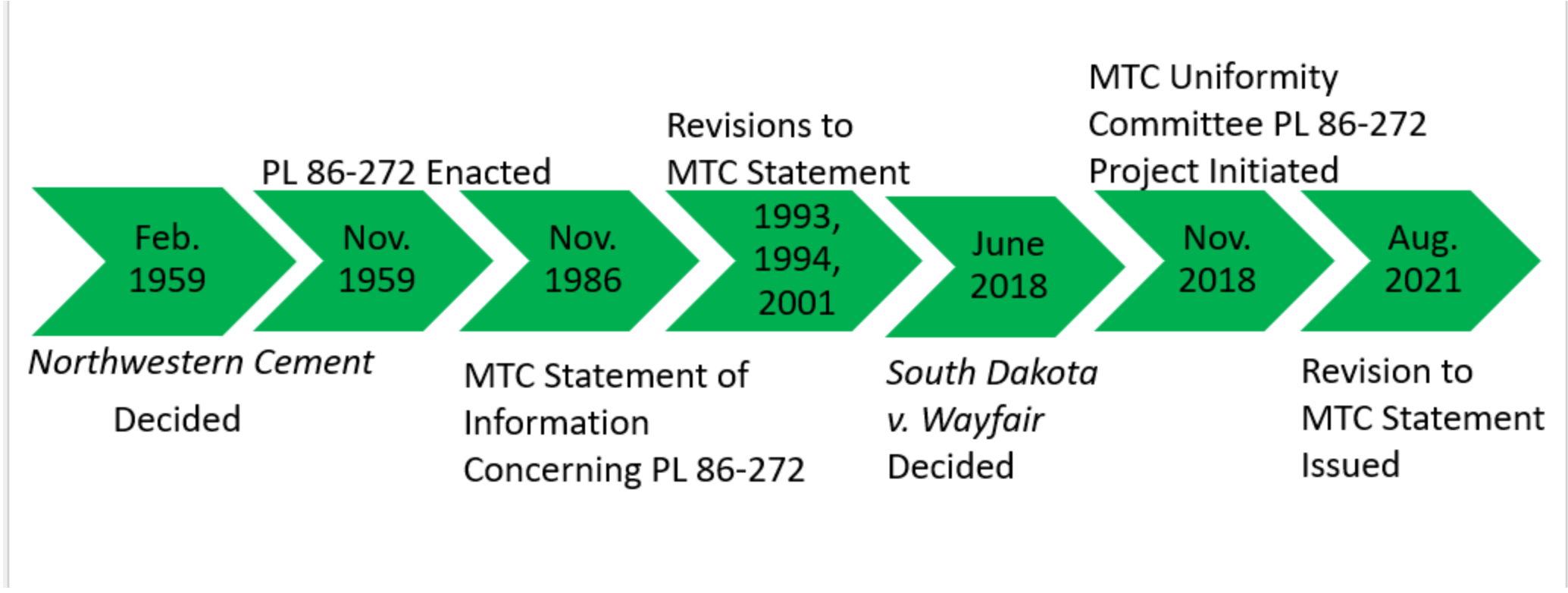
MINIMUM STANDARDS. No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

- (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
- (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

Public Law 86-272

- Applies only to net income taxes
- The only protected “business activity” in the state is the solicitation of orders for sales of tangible personal property
- The orders solicited in the state must be
  - sent outside the state for approval
  - filled by shipment from delivery outside the state
- Limited to "mere solicitation" and activities “ancillary” to solicitation
- De minimis activities - *Wisconsin Dept. Of Revenue v. William Wrigley, Jr. Co., 505 U.S. 214 (1992)*

Brief Background



MTC Adopts New “Guidance”

According to the MTC Guidance, the following activities are not protected:

1. Providing post-sales assistance through an electronic chat/email that customers accessed through company’s website;
2. Soliciting or receiving online credit card applications;
3. Inviting and/or accepting applications for employment through web-based platform;
4. Placing internet ‘cookies’ on computers of customers that are designed to gather market or product research;
5. Transmitting code or electronic instructions via the internet to fix or upgrade products;
6. Offering or selling extended warranty services over the internet;
7. Contracting with a marketplace facilitator to house products or inventory or to fulfill orders; and
8. Contracting with in-state customers to stream videos and music to electronic devices.

California—*American Catalog Mailers Ass'n v. FTB*

FACTS:

- California first state to adopt MTC's revised statement, publishing Technical Advice Memorandum ("TAM") 2022-01 in Feb. 2022.
- American Catalog Mailers Association ("ACMA") filed complaint arguing guidelines in TAM and FTB Publication constituted "underground regulations" and violated California Administrative Procedure Act.

HOLDING:

- San Francisco Superior Court of California, issued ruling for ACMA and found both TAM and FTB Publication were invalid on procedural grounds.
- Since this decision, other states attempted to learn from CA's mistake and pass their own P.L. 86-272 guidance.

New York —*American Catalog Mailers Ass'n v. Dep't Tax. & Fin.*

FACTS:

- In 2023, NY drafted corporate income tax regulations adopting MTC's revised statement.
- Aril 2024, ACMA filed suit against NY Dep't of Tax. and Fin. challenging regulations, arguing:
  - Regulations violated Supremacy Clause of U.S. Constitution.
  - Retroactive application of regulations violated 14th Amendment Due Process

HOLDING:

- April 2025, Albany Co. Supreme Court held regulations do not violate Supremacy Clause.
  - P.L. 86-272 does not prohibit states "from identifying and regulating which internet activities are construed to constitute more than solicitation of orders."
- Court agreed with ACMA that retroactive application of regulations violated 14th Amendment Due Process Clause, because (1) no public purpose; (2) excessive; and (3) did not provide ACMA with any opportunity to alter their behavior to adapt to new regulation

New Jersey —*American Catalog Mailers Ass'n*

- September 2023, NJ Division of Taxation issued TB-108 and informally announced it would follow MTC's revised P.L. 86-272 guidance.
- June 2025, NJ became second state to formally adopt MTC's revised guidance and establish guidelines for when certain internet activities exceed P.L. 86-272 protections.
- September 2025, ACMA filed a complaint against NJ Division of Taxation, challenging constitutionality of N.J. Admin. Code § 18:7-1.9A.

Massachusetts—*American Catalog Mailers Ass'n*

- March 2025, MA Dep't of Revenue became next state to propose regulation addressing tax implications of internet activities under P.L. 86-272.
- Proposed rule would adopt portions of MTC's revised guidance.
- ACMA submitted comments opposing proposed regulation, noting that DOR "is usurping a role explicitly reserved by the U.S. Constitution for Congress: namely, regulating interest commerce."

Massachusetts —*American Catalog Mailers Ass'n*

- October 2025, DOR adopted revised regulation.
- Revised regulation provides examples of in-state business activities that would not be entirely ancillary to solicitation of orders of TPP and, therefore, not protected under P.L. 86-272.
- Specifically, placement of Internet cookies onto computers of in-state customers that gather customer search information used to adjust production and inventory amounts, develop new products or identify new items to offer for sale would not be protected.

Minnesota — *Uline v. Commissioner* (2024)

FACTS:

- S-Corporation headquartered in Wisconsin.
- Sold industrial and packaging products.
- Shipped from out of state via common carrier.
- No offices or other facilities in MN.
- Only employees in state were sales tax representatives.
- Commissioner argued that several activities in MN exceeded P.L. 86-272 protections.

Minnesota — *Uline v. Commissioner* (2024)

- Tax Court held the following activities did not exceed P.L. 86-272:
  - 1) Attending job fairs without conducting interviews or hiring in state → not doing business in state.
  - 2) Work from home by an owner not engaged in solicitation activities → not "frequent or regular."
  - 3) Accepting product returns 10 times in 2-year period → not solicitation, but de minimis.
  - 4) Passing along customer complaints and defective products → ancillary to solicitation.
- Tax Court held the following activity exceeded P.L. 86-272:
  - Preparing market news notes, which documented information related to competitors
- Upheld by Minnesota Supreme Court.

Wisconsin —*ASAP Cruises* (2025)

- FL corporation sells travel services through independent travel consultants to individuals and businesses. ASAP pays consultants a commission based on sales volume.
- ASAP argued:
  - P.L. 86-272 sets “lower limit” on taxation and applies to sales of services.
  - ASAP sold SaaS, which is tangible personal property
- WI Tax Appeals Commission (WTAC):
  - ASAP sells services and is not protected by PL 86-272; granted WI MSJ.
- Dane County Circuit Court:
  - WTAC erred in rejecting affidavit of co-owner and VP of ASAP and improperly granted state’s MSJ. Remanded case back to WTAC.
- WI Court of Appeals:
  - Reversed circuit court and concluded that even if affidavit were considered, ASAP’s activities still exceed P.L. 86-272 protection.

Federal Change?

SEC. 70302. SOLICITATION OF ORDERS DEFINED.

Section 101(d) of Public Law 86—272 (73 Stat. 555) is amended—

(1) in paragraph (1) by striking "and" at the end,

(2) in paragraph (2) by striking the period at the end and inserting "; and", and

(3) by adding at the end the following:

"(3) the term 'solicitation of orders' means any business activity that facilitates the solicitation of orders even if that activity may also serve some independently valuable business function apart from solicitation.".

INCOME TAX ISSUES:
Alternative Apportionment

UDITPA § 18: Alternative Apportionment

18(a): If the **allocation** and apportionment provisions of this Article do not **fairly represent the extent of the taxpayer's business activity** in this State, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(1) separate accounting;

(2) the exclusion of any one or more of the factors;

(3) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this State; or

(4) the employment of **any other method** to effectuate an equitable allocation and apportionment of the taxpayer's income.

Alternative Apportionment Considerations

- What is “fair apportionment” under *Complete Auto Transit*?
- Does UDITPA Sec. 18 (Minn. Stat. 290.20) apply
  - What are the alternative apportionment methods?
  - Who has the burden of proof?
    - Existing factor does not fairly represent
    - Alternative factor will fairly represent
  - When and how is the alternative method applied for or asserted?
    - In advance of filing? Amended return?

Minnesota — *E.I. DuPont*

FACTS:

- E.I. DuPont manufactures and sells products worldwide. To manage foreign currency exchange exposure, DuPont bought and sold forward exchange contracts (FECs).
- MN's statutory apportionment method: DuPont included gross receipts from FECs in denominator of its apportionment formula (approximately $65 billion in 2013/2014 and $50 billion in 2015).
- Department used alternative apportionment authority and assessed tax on basis that only net income from FECs should be included in the denominator (approximately $60 million in 2013, $650 million in 2014, and $408 million in 2015).
- DOR argued statutory apportionment method did not fairly reflect DuPont's net income in the state.

Minnesota — *E.I. DuPont* Cont.

HOLDING (MN Tax Court):

- FEC transactions earned in ordinary course of business and were integral to its main business activities but were qualitatively different from DuPont's other business transactions because they were a risk management tool supporting the company's business and did not serve any independent profit-oriented purpose.
- Including gross receipts from FECs quantitatively distorted total sales, net income, and apportionment factor by nearly threefold. Gross receipts from FECs made up more than 70% of DuPont's everywhere sales (sales factor denominator).
- Commissioner met his burden that using net proceeds from FECs fairly reflected DuPont's taxable net income in MN.
- E.I. DuPont appealed to MN Supreme Court on basis receipts were earned in normal course of business (stipulated fact)

Minnesota — *E.I. DuPont* Cont.

HOLDING (MN Supreme Court):

- August 2025, MN Supreme Court affirmed state court's decision, upholding $9 million assessment.
- MN DOR lawfully excluded receipts from currency hedging transactions in its apportionment formula.
- Commissioner met its burden of proof required to use alternative apportionment.
- FEC transactions were "qualitatively different" from other business income.

Virginia — *Department of Taxation v. FJ Management Inc.*

FACTS:

- FJ Management ("FJM"), corporation with principal place of business in UT and qualified to do business in VA.
- FJM operated approximately 220 interstate travel centers in US and Canada.
- FJM's subsidiaries operated oil refineries in UT and CA and oil pipelines in TX.
- In 2008, due to bankruptcy, FJM sold travel centers to 3rd-party in exchange for cash and minority ownership interest in purchaser.
- Per agreement, refineries supplied travel centers fuel for next 20 years
- In 2013-15 Amended Returns, FJM reported distributions from its minority partnership interest as allocable non-unitary business income and excluded partnership's receipts, property, and payroll.

Virginia — *Department of Taxation v. FJ Management Inc.*

HOLDINGS:

- May 2025, VA Supreme Court declined to hear VA Dep't of Taxation's appeal of VA Court of Appeals decision.
- Appeals court affirmed that FJM did not have unitary relationship with partnership that it had a minority interest in.
- Result: appeals court rejected Department's use of the blended apportionment formula to tax FJM's income derived from its connection with the partnership as unconstitutional.

Florida — *JetBlue Airways Corp. v. Dep't of Revenue* (9/1/25)

FACTS:

- Airline's taxable income is calculated by dividing the number of miles it carries passengers within the "Florida box" (a statutorily defined geographical area) by the miles it carries passengers everywhere.

- JetBlue contended that the "Florida box" included international waters and portions of other states where Florida has no authority to tax, in violation of the Commerce Clause.

Florida – *JetBlue Airways Corp. v. Dep't of Revenue* (Sep. 2025)

HOLDING:

- Florida's income tax applied to 7% of JetBlue's income is fair by any reasonable, economic measure
- No internal consistency violation because the statute defines state territory based on specific geographic features within Florida.

South Carolina — *Tractor Supply* (Jan. 2024)

- Retailer with two subsidiaries had intercompany transactions (one purchased inventory and sold it to the other at cost plus 9.7% markup).
- Tractor Supply filed as a single entity for 2014-16 under separate-filing regime.
- SC issued assessment imposing forced combined reporting by using alternative apportionment, arguing that taxpayer's income was being distorted by intercompany transactions.
- ALJ Decision (motion for reconsideration denied):
  - Recognized DOR expert did not conduct a transfer pricing study or determine appropriate transfer price.
  - Held intercompany transactions were not arm's length.
  - Held "combined unitary reporting would achieve something very close to implementing a reasonable transfer price."
- On appeal before South Carolina Court of Appeals.

Meanwhile in South Carolina…

- Mar. 2024 — SC legislature enacted law that DOR can only require a company to file a combined return if it determines that company's intercompany transactions lack economic substance or are not at fair market value. Written notice required. Joint agreement with taxpayer of what the alternative filing method should be.
- Jun. 2024 — *AutoZone Investment Corp.* and *Dollar Tree Stores* appeals challenged SC's decision to require combined unitary reporting as an alternative apportionment method settled.
- Aug. 2024 — ALJ issued final order in *CarMax*, upholding DOR's requirement that CarMax use combined unitary reporting as an alternative apportionment method.
  - CarMax appealed; currently pending before SC Court of Appeals
  - DOR arguing that: "combined unitary reporting is an accepted and judicially approved alternative apportionment method, particularly when the taxpayer operates within a unitary business group."

INCOME TAX ISSUES:
Sourcing

Sourcing Overview

Sourcing Services

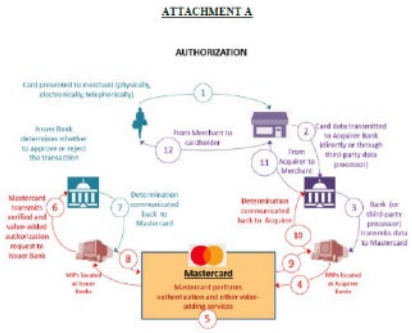
- Cost of Performance
- Market-Based (*e.g.*, SC, FL, PA)
- Look-Through Sourcing

Florida — *OptumRx Inc. v. Dep't of Revenue*

FACTS:

- OptumRx, CA corporation domiciled in MN, worked with health plans offering Rx drug plans to their plan members.
- Health plans outsourced management and operation of drug plans to OptumRx.
- OptumRx was audited for tax years 2016—2018. Assessed additional corporate income tax and accrued interest of $12,265,275.
- Filed an administrative appeal with DOR.
  - OptumRx argued FL improperly sourced its PBM services.
  - Cost-of-performance sourcing rule requires services to be sourced outside state.
  - DOR did not properly include its pharmaceutical manufacturer rebate income in its sales factor.
- DOR affirmed; OptumRx filed an appeal in circuit court.

South Carolina — *Mastercard* (Jun. 2024)



FACTS:

- Mastercard operates a payment systems network.
- Mastercard argued:
  - Its customers were banks.
  - Its income-producing activity is the delivery of transactional messages to banks that process transactions on behalf of issuer and acquirer banks.
  - Messages to the processor banks were all delivered outside SC.
  - Mastercard's activities all took place in MO at its data centers and at other locations around the country where it has servers running its software. NOT in SC.

HOLDING (ALJ):

- Mastercard's income-producing activity was a result of charging fees based on the number and gross dollar volume of transactions using the company's branded cards
- Mastercard processed $83.2 billion relating to transactions in SC.
- Mastercard promotes its cards and services to cardholders and merchants in SC.

Mastercard Appealed (Nov. 2024)

Washington — *SYNNEX Corp.*

- Synnex distributes and makes wholesale sales of IT products throughout U.S. through drop shipments.
- Drop shipments (WAC 458-20-193) involve two separate sales, which involves the reseller:
  - Selling TPP to its customer;
  - Purchasing that TPP from a wholesaler and instructing that wholesaler to deliver TPP directly to reseller's customer.
- DOR determined that under Rule 193, customer's location is the "place of receipt in a drop shipment transaction" and, therefore, Synnex owed an additional $6.1 million in B&O tax for Audit Period.
- Synnex challenged Rule 193 as exceeding DOR's statutory authority, claiming that "purchaser" is the wholesaler, not the retail customer. If the wholesale purchaser never receives product in WA, the sales should be sourced to the out-of-state location of wholesale purchaser under RCW 82.32.730(1)(c).
- DOR argued the purchaser is defined under the statute as including the customer who actually receives the goods in WA, because that customer takes physical possession of the product.
- Court of Appeals held DOR's rule should be upheld because "an agency charged with the administration and enforcement of a statute may interpret ambiguities within the statutory language through the rule making process."

Washington — *Bett Patterson & Mines, PS*

- Law firm apportioned its insurance defense receipts to insurance companies' billing addresses, arguing that the insurance companies' legal departments received the benefit of the litigation at the headquarter location.
- Court of Appeals rejected taxpayer's method:
  - "[T]he benefit of the taxpayer's insurance litigation services was received at the location where the litigation occurred."
  - "[T]he helpful or useful effect of the legal services is realized in the jurisdiction where the attorneys obtain results for their clients."
- Takeaway: Taxpayers must analyze discrete business activity separately for B&O tax purposes.
  - Litigation: Apportioned to the jurisdiction where the related court sits.
  - Consulting: May be apportioned to where the customer receives and uses the service.
- Note: Cannot merely claim apportionment is "extremely time consuming and resource intensive."

California — Regulations Adoption

- Cal. Code of Regulations, title 18, section 25136-2: CA Franchise Tax Board (FTB) adopted final regulations concerning market-based sourcing rules for sales of services and intangible personal property.
- Amendments were first approved in 2016, and subsequently revised in Sep. 2024 and May 2025. The amendments are applicable to taxable years on or after January 1, 2026
- Key amendments:
  - Requires use of taxpayer's reasonable approximation method unless FTB shows by preponderance of the evidence that method is not reasonable
  - Creates presumption for location of the receipt of the benefit of the service based on whether service relates to (1) real property; (2) tangible personal property; (3) intangible property; (4) individuals physically present in the state
  - Permits the use of taxpayer's contacts or books and records to overcome presumption of location of receipts
  - Applying the look through approach to source asset management fees to the location of the investor's domicile

California — Regulations Adoption

- Key amendments:
  - For sales of corporate stock or a passthrough entity interests and receipts derived from dividends or goodwill, if more than 50% of the corporate or passthrough entity assets being sold consists of intangible personal property, then receipts are in California based on the underlying entity's sales factor
  - If more than 50% of the assets are real or tangible personal property, receipts are assigned to California based on the average of in-state property and payroll factors
  - For large volume professional services, defined as providing services to more than 250 customers in any single professional service, receipts are assigned based on the customer's billing address. But if more than 5% of the receipts are derived from a single customer, the default rule to assign receipts is inapplicable

INCOME TAX ISSUES: Economic Substance/Sham Transactions

Illinois — *PepsiCo Inc.* (March 2025)

- PepsiCo manufactures, markets, and sells snacks, food, and beverages in approximately 200 countries. Frito Lay ("FLNA") operates PepsiCo's domestic snack business,
- As part of 2010 restructuring, PepsiCo reorganized international operations of FLNA and its subsidiaries. Claimed goals of the reorg were to:
  - Centralize foreign branch operations;
  - Establish a platform for future operations;
  - Isolate PepsiCo from branch business risk; and
  - Align foreign expatriates on U.S. payroll into a single entity.
- PGM LLC was created in 2010 as SMLLC of FLNA — all U.S. paid expatriates were assigned as employees of PGM, resulting in compensation being treated as foreign payroll.
- Under Illinois' 80/20 law, unitary business group can exclude members "whose business activity outside of U.S. is 80% or more of any such member's total business activity."
- PGM restructuring resulted in exclusion of FLNA's domestic income of $2.4 billion from PepsiCo's unitary group.

Illinois — *PepsiCo Inc.* (Mar. 2025)

- Illinois DOR determined FLNA's income was incorrectly excluded under the 80/20 law because:
  - PGM has no economic substance and should be disregarded; and
  - PGM should not be considered the expatriates' employer in light of economic realities.
- Tax Tribunal agreed with DOR on both issues:
  - PGM is nothing but a "shell corporation" with no economic substance that was only created to lower PepsiCo's tax liability.
    - PGM had no assets, no capitalization, no management or supervisory employees, no offices, and no business operations.
    - Internal PepsiCo documents focused on the tax savings and sometimes failed to acknowledge PGM's existence.
  - PGM is a shell company that never exerted any control over the expatriates — PGM "exists only on paper in order for PepsiCo to avoid certain states' income taxes."

Wisconsin — Skechers USA (Jun 2.025)

- Skechers formed a subsidiary (SKII) and contributed 100 percent of the domestic IP and employees to SKII and then licensed the IP back from SKII, paying royalties and interest. Skechers claimed deductions for royalty payments made to the subsidiary.
- WIDOR disallowed the deductions, asserting the transactions were a sham.
- Wisconsin Tax Appeals Commission held Skechers' licensing transaction with subsidiary lacked economic substance and did not have a valid business purpose:
  - Only purpose was tax avoidance; an
  - No evidence presented of change to business practices, profitability, or intellectual property .
- Dane County Circuit Court affirmed.

Skechers USA — (June 2025) Wisconsin

- On appeal to Wisc. Ct. App., Skechers argued that SKII was not required to have a business purpose upon formation because it later became independently viable and grew to have economic substance (*e.g.*, has employees, office spaces, contracts with third parties, etc.).
- Wisconsin Court of Appeals Upheld Assessment
  - Skechers' entity viability and economic activity standard was not supported by law.
  - Held commission's decision is "amply supported by the record, which shows that Skechers' creation of SKII was prompted by a recommendation from its outside auditor as part of a larger strategy to minimize Skechers' state tax liabilities."

SALES TAX ISSUES:
Software & Internet

South Carolina — *Amazon Servs., LLC v. Dep't of Revenue*

FACTS:

- During 2024, SC Appeals Court held that Amazon owed taxes on third-party sales for three months of 2016 — pre-*Wayfair* and before the state passed a law explicitly imposing tax obligations on online marketplaces
- Case on appeal to South Carolina Supreme Court; oral arguments heard during May 2025
- The Justices asked questions on two main issues:
  - Was the 2019 marketplace facilitator law enacted to clarify ambiguity in the 2011 sales tax law?
  - Did the 2011 law lack clarity on what it means to be "in the business of selling"?

Wisconsin — *StubHub* (pending)

- In 2019, Wisconsin enacted marketplace provisions.
- Issue: Was StubHub required to collect sales tax before 2019?
- StubHub argued it was not a “seller” because it did not transfer property or services.
- WTAC Held:
  - StubHub is a “seller” providing service of selling taxable admissions at retail.
  - StubHub’s role “is not entirely passive” because it:
    - Adds fees on each transaction;
    - Directs agents who physically mail tickets to buyers;
    - Operates proprietary software that issues codes for electronic tickets sold.
  - Rejected DOR’s request for penalties, which was premised on tax guidance applicable to “ticket brokers.”
- Wisconsin Circuit Court reversed! (StubHub won!) Wisconsin’s tax statutes did not unambiguously apply to StubHub.
- Pending before Wisconsin Court of Appeals (awaiting opinion)

Georgia — *Uber* (May 2025)

- Georgia DOR assessed Uber $22 million in sales tax for 2012-15 under theory that Uber is a taxicab "headquarters operator" under Georgia's taxicab regulation and was required to collect and remit sales tax because it was selling transportation (taxable in Georgia).
- Uber argued:
  - It is not a taxicab operator;
  - It is a marketplace and should not be required to collect sales tax pre-Wayfair; and
  - The tax is discriminatory under the ITFA.
- Georgia Tax Tribunal, Superior Court, and Court of Appeals each agreed with the DOR.
- Uber requested review by Georgia Supreme Court (Jul. 2025).

Washington — Expanded Sales Tax Base

- IT training services, technical support, and other similar services.
- Data Processing.
- Custom website development services.
- Custom software and customization of prewritten computer software.
- Temporary staffing services (only definition that is a sale at retail sale if sold to an affiliate).

- Investigation, security services, security monitoring services, and armored car services.
- Advertising services, including all digital and nondigital services related to the creation, preparation, production, or dissemination of advertisements.
- Live presentations including, …, lectures, seminars, workshops, or courses.

Washington — Largest Tax Increase in History

- B&O tax rate increases and new surcharges. ESHB 2081.
  - Watch out for the Advanced Computing Surcharge a.k.a. the Workforce Education Investment Surcharge
- Sales tax expansion. ESSB 5814.
- Elimination of certain tax preferences. SB 5794.
- New taxes on EV credits and luxury items. HB 2077; ESSB 5801. Watch out flying the private jet to Washington!
- New B&O tax classification for payment card processing. HB 2020.

Maryland — *Chamber of Commerce et al v. Lierman*

FACTS:

- Took effect on January 1, 2022
- Applies to any entity with at least $100 million in global ad tax revenue and $1 million in annual gross revenues from digital advertising services in MD.
- The Chamber of Commerce, NetChoice, and the Computer & Communications Industry Association filed suit.

HOLDING:

- In August 2025, U.S. Court of Appeals for the Fourth Circuit found that the pass-through restriction in Maryland's digital ad tax provision violates the First Amendment free speech rights of affected companies in an attempt to shield Maryland lawmakers from "criticism and political accountability."
- "The pass-through prevents companies from describing the tax in the one setting where the consumer is guaranteed to look: the invoice."
- Notably, this decision does not eliminate MD's digital ad tax

SALES & USE TAX
True Object Test

Rhode Island — Decl. Order 2025-01 (1/29/2025)

FACTS:

- Customers mail in saliva specimens to Taxpayer's laboratory for DNA analysis.
- Taxpayer produces individualized genealogy and health history reports, which customers access via the Taxpayer's website.

RI Division of Taxation's Ruling:

- Taxpayer sells access to software that allows customers to access ancestral and health history reports online.
- Taxpayer could not share the ancestral and health history information with its clients if the product were not computer software.
- The key feature of the product is Taxpayer's web-site that allows Taxpayer's clients to view data and reports.

Colorado — *Netflix Inc. v. DOR*

- **Issue**: What is TPP?
- In 2021, CO DOR adopted a rule imposing sales tax on all sales of TPP regardless of delivery method, which includes streamed media. The rule was later codified in 2021 Digital Goods Law. Note: CO imposes sales tax on TPP, which includes "corporeal personal property."
- Netflix began remitting sales tax under the rule, but also sought a tax refund, arguing that TPP includes only physical objects that can be seen and touched.
- DOR denied refund request, and Netflix appealed to district court, arguing that TPP includes items that are perceptible to the senses and have a "physical presence capable of transfer."
- July 2025, Colorado Court of Appeals determined that Netflix streaming subscriptions qualify as taxable TPP because they are corporeal property, and subject to sales tax.

New York — *Matter of FacilitySource LLC* and *Matter of FacilitySource Northeast Services LLC*

FACTS:

- Subscription Fees included prewritten software bundled with nontaxable services.
- Companies argued facility management services were not subject to sales tax because primarily function was integrated facilities management.

HOLDING:

- NY Tax Tribunal held that the bundled transaction included integral prewritten software, which made the entire subscription fee taxable; and
- While Tribunal had applied the primary function test to bundled sales of taxable and nontaxable services, the primary function test was inapplicable to bundles that included TPP and nontaxable services.

Sales & Use Tax Exemptions

Arizona — *9W Halo OPCO*

- AZ Court of Appeals held that taxpayer's laundry business did not qualify as a processing operation for a use tax exemption related to its machinery and equipment.
  - Taxpayer provided federally regulated industrial laundry services to healthcare clients, sanitizing over 600,000 pounds of textiles weekly.
  - Sanitizing process involved sorting, prewashing, four wash cycles using certified chemicals to remove microbes and spores, specialized drying methods, inspection, and folding.
- Question: Whether taxpayer's business met definition of a processing operation to qualify for the use tax exemption on M&E used directly in processing.
- AZ DOR relied on dictionary definitions accepted in prior precedents which referred to processing as subjecting material to manufacturing or preparation for market.

California — *Medtronic USA, Inc. v. CDTFA*

- **Issue**: Are manufactured insertable monitors implanted into patients "medicines"?
  - Medtronic argued devices exempt because devices were "medicines."
  - Distinguished splints, bandages, compresses, externally used on the body to their device permanently implanted within.
- CA exemptions strictly construed: accepted only when clearly mandated, and rejected in any doubtful case.
- "Medtronic is in the unenviable position of having a product whose function touches several of the concerns of the [medicine exemptions]. Unfortunately, those touches are too tenuous to establish the firm basis needed for an exemption."

Indirect Tax Grab Bag!

Arizona — *Dove Mountain Hotelco*

- AZ Supreme Court held The Ritz-Carlton Dove Mountain Hotel and Spa subject to TPT on its proceeds from the Marriott Rewards Program that compensated it for “free stays” by program members.
- Compensation Received from Hotel Rewards Program for Complimentary Stays is subject to TPT.
- Marriott, as most hotels, has a loyalty marketing program that Dove Mountain, a Marriott branded hotel, participated in.
- Marriott rewards program was administered by Marriott Rewards, LLC. When a guest would use points for a complimentary stay at Dove Mountain, Marriot Rewards would compensate Dove Mountain.
- Issue: whether that compensation was subject to TPT under the hotel classification.
- AZ Supreme Court held that compensation for the complimentary stays was taxable.

Hawai‘i — *Hawaiian Airlines, Inc.*

- **Issue**: Hawaiian Airlines indemnified Boeing for any taxes Boeing might incur for maintenance supply parts it sold to Hawaiian.
  - Boeing did not remit GET on its sale of maintenance parts to Hawaiian.
- HI DOR audited Boeing and disagreed with Hawaiian and Boeing’s analysis re exemption.
- Hawaiian paid its portion of the GET, sued for refund.
- Tax Court and Intermediate Court of Appeals (ICA): Held no actual dispute at the time the subject payment under protest was made. *Grace* II
- HI Supreme Court: NOPA constituted formal administrative decision. Distinguished *Grace* I & II:
  - There, payment under protest was made after the Department only gave notice it would be conducting an audit; “no demand” and “no determination of tax liability.”
  - Here, audit complete, NOPA contained “demand,” and a “determination of tax liability.”

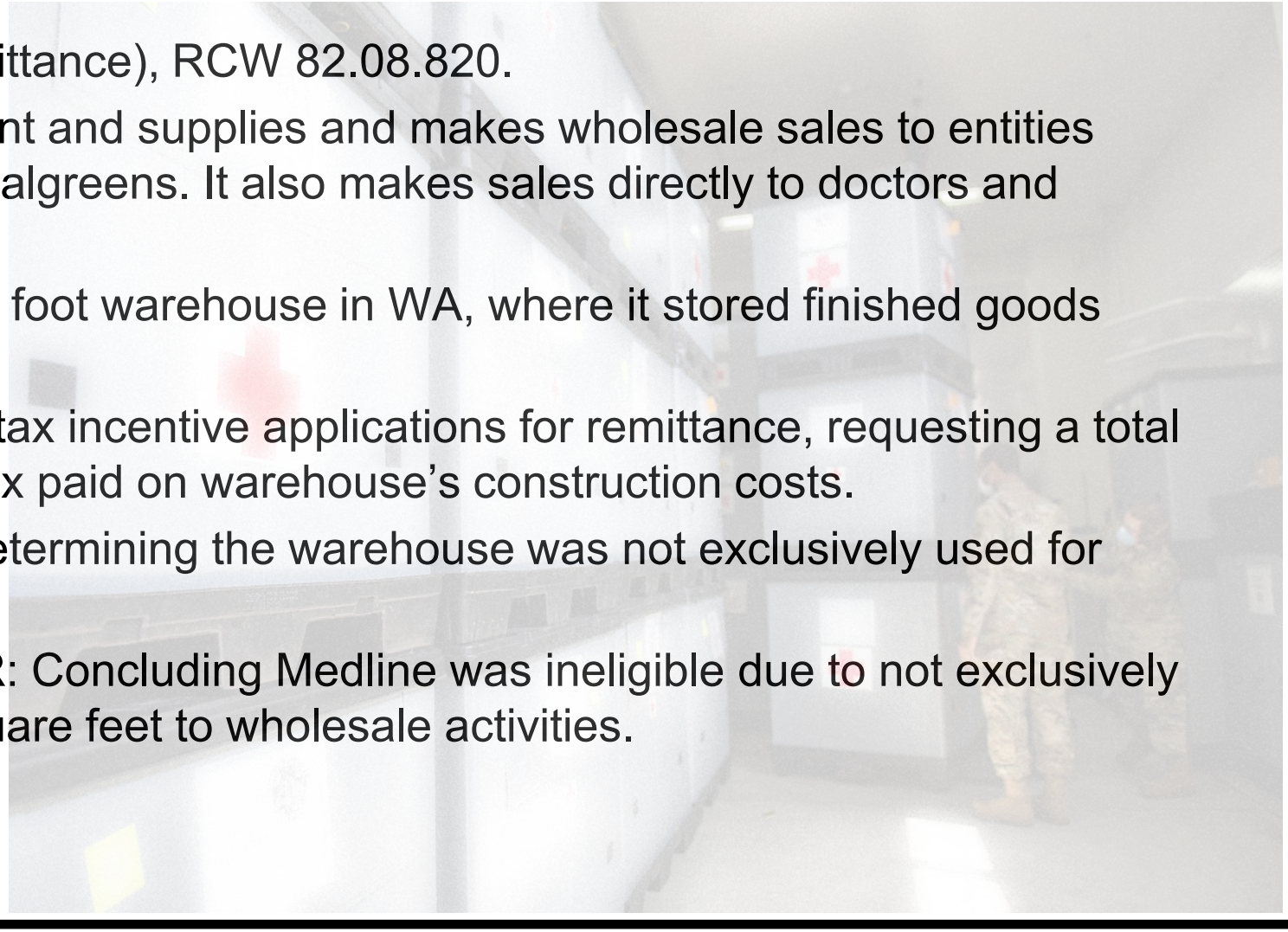
Hawai‘i — *Booking.com B.V.*

- **Issue**: Does GET discriminate by violating ITFA or Commerce and Supremacy clauses of the U.S. Constitution?
  - Booking.com, HQ’d in Amsterdam, argued imposition of tax on its electronic commerce is discriminatory because it subjects online merchants to taxation not imposed on brick-and-mortar merchants.
  - DOTax motion to dismiss, circuit court lacked subject matter jurisdiction.
  - ICA affirmed Circuit Court’s lack of jurisdiction.

Washington — *Antio, LLC v. DOR*

- **Issue**: Investment Income
- Since 1990, nearly all taxpayers not explicitly excluded (banking, lending, or security businesses) relied on B&O tax deduction to deduct “amounts derived from investments.”
- Consistent with DOR’s website—be careful with interim guidance!—which long confirmed that "most mutual funds, private investment funds, family trusts, and other collective investment vehicles…are allowed the B&O tax deduction for amounts derived from investments.“
- WA Supreme Court upheld this narrow interpretation of the investment income deduction, requiring taxpayers to ensure any amount of "investment" income is an "incidental investment of surplus funds" to qualify for deduction.
- Decision created significant ambiguity and uncertainty for investment funds and investors.
- Legislature passed clarifying language in ESHB 2081.

Washington — *Medline Industries*



- **Issue**: sales tax incentive (remittance), RCW 82.08.820.
- Medline sells medical equipment and supplies and makes wholesale sales to entities such as Costco, Target, and Walgreens. It also makes sales directly to doctors and hospitals.
- Medline built a 702,093 square foot warehouse in WA, where it stored finished goods intended for sale.
- Medline submitted warehouse tax incentive applications for remittance, requesting a total of about $2.4 million in sales tax paid on warehouse's construction costs.
- DOR denied the application, determining the warehouse was not exclusively used for wholesale sales.
- Court of Appeals affirmed DOR: Concluding Medline was ineligible due to not exclusively dedicating at least 200,000 square feet to wholesale activities.

Washington — *First Data Merchant Services*

- **Issue**: What is "gross income of the business"?
- First Data is a leading global payment processing company.
- Question presented is two-fold:
  - (1) Can a company accrue as income money it indisputably will never receive or control?
  - (2) Can amounts a company does not accrue for services that a company does not provide (or contract for others to provide), be consideration to that company?
- Div. III oral argument was on 10/15, so stay tuned!
- **Takeaway**: We must do a better job as practitioners explaining GAAP, the ASC, and what it means to have accrued revenue.

Washington BTA

- ***Limelight Networks, Inc.***
  - **Issue**: Whether content delivery network (CDN) services were subject to retail sales tax and retailing B&O tax as "digital automated services."
  - RCW 82.04.192(3)(a) "Digital automated service," except as provided in (b) of this subsection (3), means any service transferred electronically that uses one or more software applications.
  - Note: “(b) of this subsection (3)” provides exclusions: “ ‘Digital automated service’ does not include[.]”

- ***Tacos Guaymas v. Dep’t of Revenue***
  - Issue: Whether (and to what extent) DOR can estimate.
  - Estimated underreported sales excise taxes and penalties totaling over $6.2 million.
  - While taxpayer failed to preserve suitable records, DOR’s revised estimates of underreported tax were unreasonable and excessive.

SALES & USE TAX
Class Actions

Pennsylvania — *Garcia v. American Eagle*

- **Facts**:
  - Garcia filed a class action under Pennsylvania's Unfair Trade Practices and Consumer Protection Law ("UTPCPL") after purchasing cloth face masks from various retailers.
  - Complaint alleged that the retailers "engaged in unfair trade practices by charging sales tax for items they knew or should have known were nontaxable."
  - Retailers filed preliminary objections, alleging that Garcia's complaint was legally insufficient and failed to state a claim because the improper collection of sales tax is not actionable under the UTPCPL.
- **Held**:
  - Retailers didn't violate a state consumer protection law when they collected sales tax on cloth face masks during COVID-19
  - Garcia can't sue under the UTPCPL because a merchant's collection of sales tax doesn't occur "in the conduct of any trade or commerce" as contemplated by the law. The collection is done at the behest of the government.

Florida — *Rogolino v. Walmart*

- **Facts**:
  - Plaintiff filed class action against Walmart for unlawfully charging Florida customers sales tax on delivery fees
  - Argued that collecting tax on delivery fees is illegal if the purchaser has the option to pick up the item at the merchant's location instead of taking delivery.
- **Held**:
  - Case should proceed to arbitration because shoppers agreed to arbitration when they accepted the terms of use of the retailer's website

Illinois — *People ex rel. Lindblom v. Best Buy*

- **Facts**:
  - Plaintiff asserted that Best Buy knowingly failed to collect and remit sales tax on appliances purchased with installation services (instead paid use tax on the cost of the goods if appliances were sold with installation services).
  - DOR had issued a compliance alert in June 2015 explaining that retailers are not acting as construction contractors when they installed TPP.
  - Trial Court dismissed the False Claims Act Suit and granted MSJ to Best Buy
- **Held**:
  - Best Buy was obligated to pay sales tax on the transactions at issue.
  - Plaintiff had not established that Best Buy knowingly avoided its tax obligations before the DOR June 2015 compliance alert, but that Best Buy's actions after the compliance alert raise a genuine issue of material fact for trial.
  - Reversed the trial court and remanded.

SCOTUS

Wisconsin — *Catholic Charities Inc. et al.*

FACTS:

- Catholic Charities argued that it qualifies for an unemployment tax exemption
  - It serves people who are disabled, low-income or elderly
  - Motivated by religious beliefs
  - The state shouldn't be making determinations about what work qualifies as religious
- Wisconsin argued that Catholic Charities were not operated for primarily religious purposes and were not a religious organization
  - The state argued that religion played no role in the decision.

HOLDING:

- The US Supreme Court ruled that Wisconsin discriminated against a group of catholic charities when it denied them an unemployment exemption
- The Justices held that denying the exemption violates the First Amendment because the state did not treat Catholic Charities with "religious neutrality"
- Wisconsin granted exemptions to other religious entities that provided charitable services similar to Catholic Charities, however, these services were provided directly by the church, rather than a separate church-controlled nonprofit like Catholic Charities

PUNG v. ISABELLA COUNTY

FACTS:

- Michigan law provides for a property tax exemption from the local school district tax if the owner occupies the property as his/her principal residence
- Timothy Pung filed an affidavit claiming the exemption in 1994
- Pung died in 2004 and the exemption was still active at his time of death
- Pung is survived by heirs who continued to live in the residence
- However, the heirs never filed a new affidavit claiming the exemption after Pung's death. The assessor revoked the property's exemption in 2012 which led to an unpaid tax bill of $2,241.93
- The property was sold at public auction for $76,008
- Fair market value for the property was $194,400

PUNG v. ISABELLA COUNTY

- The U.S. Supreme Court granted certiorari on October 3, 2025

ISSUES:

- (1)Whether taking and selling a home to satisfy a debt to the government, and keeping the surplus value as a windfall, violates the takings clause of the Fifth Amendment when the compensation is based on the artificially depressed auction sale price rather than the property's fair market value; and
- (2) whether the forfeiture of real property worth far more than needed to satisfy a tax debt but sold for a fraction of its real value constitutes an excessive fine under the Eighth Amendment, particularly when the debt was never actually owed

Thank you

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