

# Multistate Taxation

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*By Philip M. Tatarowicz and Ted W. Friedman*

## Developments in Multistate Taxation

### Illinois

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The Illinois Supreme Court held that a life insurance company was subject to a double interest penalty for additional income taxes that were assessed following federal adjustments made after an amnesty period had ended.<sup>1</sup> The court found that the reference to payment of “all taxes due” in the amnesty provision meant “taxes that were properly reportable at the time the initial tax return was required to be filed, rather than taxes known to be due during the amnesty period.” Therefore, the court held that because the company “failed to pay those taxes during the amnesty period, it became liable for the 200% interest” penalty imposed by the Illinois Department of Revenue. The court also held that the imposition of the 200-percent interest penalty did not violate the company’s substantive due process rights.

### Indiana

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The Indiana Tax Court held that the income a corporation received as a partner of a general partnership doing business in Indiana was income derived from sources within Indiana.<sup>2</sup> The corporation argued that, under Indiana law, receipts in the form of “dividends from investments” are attributable to Indiana only if a taxpayer’s commercial domicile is in Indiana. The court determined that the “critical question” was whether the income the corporation received as a partner had the character of operational income or investment income because, if it was operational income, it was not income in the form of “dividends from investments.” The court held that “the mere fact that” the corporation was a partner in a general partnership gave its income from the partnership the character of operational income and, therefore, it constituted income derived from sources

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within Indiana and was taxable. The court also found that the corporation's "lack of control" by reason of its minority interest was insufficient to show that it did not participate in the management of the partnership and, thus, that it was a mere passible investor similar to a limited partner.

## Michigan

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On July 3, 2013, the Michigan Supreme Court granted a corporation's application for leave to appeal the Michigan Court of Appeals decision in *IBM Corp. v. Department of Treasury*.<sup>3</sup> In *IBM Corp.*, the Michigan Court of Appeals "reluctantly" found that there was no way to harmonize a Michigan statute that allowed a taxpayer to elect to apportion its income according to the three-factor formula in the Multistate Tax Compact ("Compact") and the Michigan Business Tax Act, which mandates the use of a single-factor apportionment formula. The court held that the Business Tax Act repealed by implication the election provision found in the Compact and that the taxpayer was required to compute its tax liability pursuant to the Business Tax Act. *IBM Corp.* is an unpublished opinion and, pursuant to Michigan's appellate rules, is not precedentially binding under the rules of *stare decisis*.

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Declining to follow *IBM Corp.*, the Michigan Court of Claims found that the Compact is a binding compact that cannot be repealed by a conflicting statute and held that a corporation may elect to apportion its income tax according to the Compact.<sup>4</sup> The court also found that the Michigan modified gross receipts tax is not an "income tax" under the Compact and, therefore, cannot be apportioned according to the Compact. Both parties have appealed the decision to the Court of Appeals.

## Mississippi

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The Supreme Court of Mississippi held that the Mississippi Department of Revenue's use of an alternative apportionment method for a corporation was not a promulgation of a rule in violation of the Mississippi Administrative Procedures Act and that the Department did not abuse its discretion in imposing penalties against the corporation.<sup>5</sup> The corporation timely filed its income tax returns for the years at issue, used the standard apportionment method for service companies and, as a result, determined that it had no income subject to tax in Mississippi. The Department

concluded, however, that the corporation should have used an alternative apportionment method and issued assessments against the corporation, including interest and penalties. The court reasoned that Mississippi law permits the Department to require alternative apportionment when the standard allocation of income does not fairly represent a taxpayer's activity in the state and found that the Department's use of alternative apportionment was justifiable because the corporation's allocation of zero income, despite having employees in the state and receiving substantial income for services provided to customers in the state, did not fairly represent its Mississippi activities.

Regarding penalties, the court determined that the trial court was correct in ruling that it could reverse the Department's decision to impose penalties only if the corporation proved that such an imposition was unsupported by substantial evidence presented to the Department, was arbitrary and capricious, was beyond the power of the Department, or was in violation of the corporation's statutory or constitutional rights—which the trial court found that the corporation had failed to do. In addition, the court held that the trial court applied the proper standard of review and determined that the purpose of a Mississippi statute providing for a *de novo* review was limited to examining whether the Department's decision was supported by substantial evidence, was not arbitrary and capricious, was within the Department's power to make, and did not violate the taxpayer's statutory or constitutional rights.

## New Jersey

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New Jersey recently issued a technical bulletin addressing the sales and use tax implications of cloud computing.<sup>6</sup> The bulletin provides that the sale of Software as a Service ("SaaS") is a sale of a service and not a sale of tangible personal property ("TPP"). Therefore, most charges for SaaS are not subject to sales tax. However, charges for SaaS where the software is accessed and used as a tool for providing information to customers by an information service provider are sales of information services that are subject to sales tax. Similarly, the bulletin provides that the sale of Platform as a Service ("PaaS") is a sale of a service and not a sale of TPP. Because use of a software application or platform is not listed as a taxable service, where use of the software is the true object of the sale, PaaS is not subject to sales tax, so long as the use and access to PaaS does not include the transfer of tangible personal property. Further, the

bulletin provides that the sale of Infrastructure as a Service ("IaaS") is also a sale of a service and not a sale of TPP. Unlike other cloud computing services, IaaS providers may provide separately stated charges for the use or rental of hardware related to the service. As there is no exchange of title or possession, such charges are not treated as rentals. "Although these charges may be separately stated, they are merely add-ons to the customer's IaaS arrangement and are therefore, part of the sales price that make[s] up the underlying receipt for the service." Where the use of the software and supported network is the true object of the sale, IaaS is not subject to sales tax.

## ENDNOTES

- <sup>1</sup> *Metro. Life Ins. Co. v. Hamer*, No. 114234 (Ill. June 20, 2013).
- <sup>2</sup> *Vodafone Americas Inc. v. Indiana Dep't of Rev.*, No. 47T10-1002-TA-7 (Ind. Tax Ct. June 18, 2013).
- <sup>3</sup> *IBM Corp. v. Dep't of Treasury*, No. 306618 (Mich. Ct. App. Nov. 20, 2012), leave to appeal granted, No. 146440 (Mich. July 3, 2013).
- <sup>4</sup> *Anheuser-Busch, Inc. v. Dep't of Treasury*, No. 11-85-MT (Mich. Ct. Cl. June 6, 2013), appeal docketed, No. 316743 (Mich. Ct. App. June 13, 2013), appeal docketed, No. 316977 (Mich. Ct. App. June 27, 2013).
- <sup>5</sup> *Equifax, Inc. v. Dep't of Rev.*, No. 2010-CT-01857-SCT (Miss. June 20, 2013).
- <sup>6</sup> Technical Bulletin, No. TB-92 (N.J. Div. of Tax'n July 3, 2013).



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