

# STATE+LOCAL TAX INSIGHTS

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## IN THIS ISSUE

**MOFO SALT 2018 YEAR IN REVIEW:  
CONTINUED SUCCESS IN A CHANGING  
STATE TAX WORLD**

Page 1

**UPCOMING SPEAKING ENGAGEMENTS**

Page 2

**NEW PARTNER PROMOTION**

Page 3

**SAVE THE DATE: MOFO EAST**

Page 4



## MOFO SALT 2018 YEAR IN REVIEW: CONTINUED SUCCESS IN A CHANGING STATE TAX WORLD

By [Craig B. Fields](#) and [Matthew F. Cammarata](#)

Following the enactment of the Federal Tax Cuts and Jobs Act in late 2017, many interesting state tax issues emerged concerning states' responses—or lack thereof—to federal tax reform. The past year also saw the U.S. Supreme Court decide a small case involving a company by the name of Wayfair, Inc. While the tax news cycle in 2018 may have been dominated by these emerging issues, states remained active over the past year on the enforcement front in both audits and litigation and we are happy to report that our clients secured many public and non-public victories.

In Colorado, the Supreme Court granted the Department of Revenue's request to appeal from a Court of Appeals decision in favor of Agilent Technologies, Inc. ("Agilent").<sup>1</sup> The Court of Appeals had held that the Department could not force Agilent to file a combined tax return with a subsidiary holding company

# Upcoming Speaking Engagements

## January 29 – 30, 2019

### Ohio Tax Conference Columbus, Ohio

- “State & Local Tax Basics: An Introduction to Multistate Taxation”  
Mitchell A. Newmark
- “Tax Challenges of the Mobile Workforce: Payroll, Withholding, State Tax Nexus and Pending Federal Legislation”  
Nicole L. Johnson
- “Nexus After *South Dakota v. Wayfair, Inc.*: Emerging Issues in State Tax Nexus – The Most Rapidly Changing Area of Taxation”  
Mitchell A. Newmark

## February 8, 2019

### The 2019 National Multistate Tax Symposium Orlando, Florida

- “Sales Factor Deep Dive – Defining Today’s ‘Market’”  
Craig B. Fields

## February 26, 2019

### Council on State Taxation, 2019 Sales Tax Conference & Audit Session Atlanta, Georgia

- “Penalties, Penalties, Penalties – Are There Ways to Mitigate Them?”  
Mitchell A. Newmark
- “Best Practices for Handling Sales Tax Exemptions and Direct Payment Permits”  
Nicole L. Johnson

## February 28, 2019

### Bar Association of San Francisco Tax Section Meeting San Francisco, California

- “State and Local Tax – 2018 Year in Review”  
William H. Gorrod

## March 20, 2019

### Tax Executives Institute – Philadelphia Chapter Malvern, Pennsylvania

Craig B. Fields, Hollis L. Hyans, Nicole L. Johnson, Mitchell A. Newmark, Rebecca M. Balinskas, William H. Gorrod and Philip S. Olsen

## May 15 – 16, 2019

### Georgetown University Law Center, 2019 Advanced State and Local Tax Institute Washington, D.C.

- “Alternative Apportionment”  
Craig B. Fields
- “State Tax Conformity with Federal Tax Reform: What Does the State Tax Landscape Look Like 18 Months after the TCJA?”  
Mitchell A. Newmark

## May 22, 2019

### Energy Tax Association: 28th Annual Meeting New York, New York

- “Significant Developments in State and Local Taxation”  
Craig B. Fields and Nicole L. Johnson

## June 20, 2019

### California Lawyers Association Webinar

- “California Sales and Use Tax Issues for Nonprofit Organizations”  
William H. Gorrod

that earned all of its income from foreign subsidiaries that operated solely outside of the United States and that had no property or payroll of its own.<sup>2</sup> Colorado law provides that corporations with 80% or more of their property and payroll located outside the United States cannot be

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included in a combined return and that corporations with more than 20% of their property and payroll located in the United States are required to be included in a combined report. Since Agilent’s subsidiary was a holding company with no property or payroll of its own, the Court of Appeals held that the subsidiary was properly excluded from Agilent’s combined return. This result was supported by the Department’s own regulation, which provided explicitly that a corporation with no property and payroll cannot, by definition, meet the statutory standard of having more than 20% of its property and payroll in the United States. The Court also held that the subsidiary



# Morrison & Foerster is pleased to announce that **NICOLE L. JOHNSON** has been elected a partner of the firm.

could not otherwise be combined under the Department’s authority to allocate income and deductions among related corporations to avoid abuse or under the economic substance doctrine.

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## As we have explained in a [previous issue](#)—words matter.

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Both the Department and Agilent have filed briefs with the Colorado Supreme Court and we are awaiting the scheduling of oral argument. We believe the Court of Appeals’ decision was correctly decided and look forward to appearing before the Colorado Supreme Court to argue that it should be affirmed. The case is important because it demonstrates that a state taxing authority should and will be bound by its own rules and regulations. As we have explained in a [previous issue](#)—words matter—and state taxing authorities should administer tax laws according to the words of statutes and regulations as written and not in furtherance of a desired result.

The case is also important because it demonstrates the advantage of presenting several different paths to obtain relief. Although the Court of Appeals accepted our principal argument that Agilent should not be combined with a subsidiary that had no property and payroll, we argued in the alternative that: (1) Colorado was bound to follow the federal income tax treatment of Agilent’s subsidiary, pursuant to which the subsidiary still failed to meet the statutory test as it had all of its property and payroll outside the United States as the result of its ownership of certain foreign entities that were disregarded for federal tax purposes; and (2) Agilent failed to meet three of the six statutory factors required for combination under Colorado law. Agilent therefore has several arguments on which to obtain relief.

In a published and precedential decision, the Tax Court of New Jersey held that ADP Vehicle Registration, Inc.

(“ADPVR”) maintained a regular place of business outside of New Jersey and was therefore entitled to apportion its income using the standard three-factor apportionment formula, resulting in approximately 2% of its income being attributed to New Jersey.<sup>3</sup> The Division of Taxation had asserted that 100% of ADPVR’s income should be allocated to New Jersey. New Jersey law during the years at issue permitted only corporations with a “regular place of business” outside of New Jersey to use the three-factor apportionment formula and imposed a mandatory 100% allocation factor on all corporations that did not maintain a regular place of business outside of the State. ADPVR was a holding company that held as its sole asset a unitary ownership interest in a partnership engaged in business throughout the United States. The partnership was headquartered in California at an office where over 60 employees reported to work every day to conduct the partnership’s business. As a result of the Tax Court’s finding that the partnership’s California headquarters constituted a “regular place of business” for ADPVR, the company was entitled to apportion its income to New Jersey using the three-factor apportionment formula.

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## Like the *Agilent* decision in Colorado, [ADPVR] demonstrates that states cannot interpret the tax law in a manner that ignores the plain language of their own rules and regulations.

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The decision is important for several reasons. First, like the *Agilent* decision in Colorado, it demonstrates that states cannot interpret the tax law in a manner that ignores the plain language of their own rules and regulations. New Jersey, for example, had issued a regulation that listed several factors to “assist in the determination” of what constitutes a regular place of business, but argued in this case that a business location must meet all of the factors in the regulation to qualify as a regular place of business. The

Court appropriately rejected this argument and accepted instead our argument that under the plain language of the regulation, the list of factors is not absolute.

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## The decision in [ADPVR] demonstrates the advantage of presenting several different paths to obtain relief.

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Second, the decision shows that taxpayers should not hesitate to fight assessments that are not supported by solid evidence. In this case, ADPVR presented evidence that amply documented the partnership's California operations. In the face of this evidence, the Court rejected the Division's attempts to impose a 100% allocation factor based on both immaterial facts and an incorrect reading of its own regulation.

Finally, like *Agilent*, the decision demonstrates the advantage of presenting several different paths to obtain relief. Although the Court found that ADPVR maintained a regular place of business out-of-state, we argued that even if the Court did not so find, the Division nonetheless had the obligation to fairly apportion the company's income under another statute providing for alternative apportionment. ADPVR therefore could have achieved the same successful result under this alternative argument.

In Pennsylvania, the Board of Finance and Revenue held that Archer Daniels Midland Company ("ADM") was entitled to include its gross receipts from hedging transactions in its sales factor denominator.<sup>4</sup> The Pennsylvania sales factor is broadly defined to include "all gross receipts of the taxpayer" with limited exceptions. The Board found that, in the absence of any statutory definition, the term "gross receipts" must include total

gross receipts without any deductions.<sup>5</sup> The Board's decision rejected the Department of Revenue's attempt to increase ADM's sales factor and further supports the recurring theme that words matter and a state taxing department should be bound by the plain language of the statute.

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## The Board's decision rejected the Department of Revenue's attempt to increase ADM's sales factor.

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In Virginia, the Supreme Court granted Kohl's Department Stores, Inc.'s petition for rehearing and held that the Department of Taxation's interpretation of the law is entitled to no weight if it is not set forth in a duly promulgated regulation.<sup>4</sup> The Court held that the subject-to-tax safe-harbor of the State's royalty addback statute applied only where the royalties are included in a post-apportioned tax base and actually taxed in another state. The Court also accepted our alternative arguments that the safe-harbor to the addback applies when the royalties are subject to tax in a combined filing in another state and when the royalties are added back to the payor's taxable income in another state.

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## The Virginia Supreme Court held that the Department of Taxation's interpretation of the law is entitled to no weight if it is not set forth in a duly promulgated regulation.

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In addition to these public record victories, we worked with our clients to achieve numerous nonpublic victories before state taxing authorities throughout the country in matters

# SAVE THE DATE

## Annual State + Local Tax East Coast Update

**Friday, May 10, 2019**

9:00 a.m. – 3:30 p.m.  
New York, New York

### Topics to be discussed include:

- New Jersey Combined Reporting Rules
- SALT Litigation and Other Developments Around the Country

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involving a diverse array of tax types. For example, one city located in a Western state entirely canceled a multimillion dollar assessment of utility taxes that had been proposed against our client.

In a Southern state, we successfully resolved a contentious property tax matter before litigation, securing valuable property tax exemptions for our client moving forward.

In a Southeastern state, a revenue department asserted that our client's federal consolidated group should be combined for state corporate income tax purposes. We successfully resolved that audit for our client, a Fortune 200 global retailer, for a small fraction of the amount assessed.

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## **A southwestern state . . . conceded 100% of a multimillion dollar assessment.**

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A Southwestern state that contended all our client's income, operations and sales should be attributed to that state for corporate income tax purposes conceded 100% of a multimillion dollar assessment.

In a Northeastern state, we resolved a refund dispute in the span of approximately two months, resulting in a complete concession by the state and a refund that exceeded \$1 million. In that same state, our representation of the majority shareholders of an S Corporation led to a

complete concession by the state taxing authority prior to trial, allowing our clients to utilize losses to offset income earned on a flow-through basis from the S Corporation.

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## **We resolved a refund dispute in the span of approximately two months, resulting in a complete concession by the state and a refund that exceeded \$1 million.**

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Whether it was in response to federal legislative or judicial developments, economic conditions or rapidly evolving technology, the state tax world has seen remarkable change over the past year. As we look ahead to 2019, we are excited to partner with our clients to develop creative and effective strategies to deal with new developments in the law and to continue to achieve victories in litigation and audits pending before courts, tribunals and state revenue authorities throughout the country.

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<sup>1</sup> *Dep't of Revenue v. Agilent Techs., Inc.*, No. 17SC840 (Colo. May 21, 2018).

<sup>2</sup> *Agilent Techs., Inc. v. Dep't of Revenue*, 2017 COA 137 (Colo. App. 2017).

<sup>3</sup> *ADP Vehicle Registration, Inc. v. Dir., Div. of Taxation*, No. 014946-2014 (N.J. Tax Ct. Dec. 11, 2018).

<sup>4</sup> *Archer Daniels Midland Co.*, BF&R Docket No. 1523133 (Pa. Bd. of Fin. & Revenue Jan. 18, 2018).

<sup>5</sup> *Id.*

<sup>6</sup> *Kohl's Dep't Stores, Inc. v. Va. Dep't of Taxation*, 295 Va. 177 (2018).

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This newsletter addresses recent state and local tax developments. Because of its generality, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. If you wish to change an address, add a subscriber, or comment on this newsletter, please write to Rebecca M. Balinskas at Morrison & Foerster LLP, 250 West 55<sup>th</sup> St., New York, New York 10019, or email her at rbalinskas@mofo.com, or write to Matthew F. Cammarata at Morrison & Foerster LLP, 250 West 55<sup>th</sup> St., New York, New York 10019, or email him at mcammarata@mofo.com.

# MORRISON FOERSTER

## STATE + LOCAL TAX

# WHAT SEPARATES US FROM THE REST?

**OUR EXPERIENCE.** We've been doing it longer, have more experience and published decisions, and have obtained a greater number of favorable settlements for our clients than the rest.

**OUR TRACK RECORD OF PROVEN SUCCESS.** We've successfully litigated matters in nearly every state, and have resolved the vast majority of matters without the necessity of trial.

**OUR NATIONAL PERSPECTIVE.** We approach state and local tax issues from a nationwide perspective, taking into account the similarities and differences of SALT systems throughout the United States.

**OUR DEPTH.** Our team is comprised of a unique blend of public and private backgrounds with experience spanning various industries. We're nationally recognized as a leading practice for tax law and tax controversy by *Chambers*, *Legal 500* and *Law360*. In fact, we've been referred to as "one of the best national firms in the area of state income taxation" by *Legal 500 US* and were rated Law Firm of the Year for Litigation – Tax by the 2016 "Best Law Firms" Edition of *U.S. News & World Report – Best Lawyers*.

For more information about Morrison & Foerster's State + Local Tax Group, visit [www.mofo.com/salt](http://www.mofo.com/salt) or contact Craig B. Fields at (212) 468-8193 or [cfields@mofo.com](mailto:cfields@mofo.com).