

5 KEY TAKEAWAYS

National State Tax Cases, Issues, and Policy Matters to Watch

Members of [Kilpatrick's](#) prominent State and Local Tax Team (SALT) [Sam Breslow](#), [David Hughes](#), and [Kylan Memminger](#) recently spoke at the Chicago Tax Club Winter Meeting about **"National State Tax Cases, Issues, and Policy Matters to Watch."**

Key takeaways from the presentation, include:

1

Pre-Wayfair Physical Nexus. Companies should be aware that states are generally becoming more aggressive in asserting nexus based on the in-state activities of remote retailers and marketplace facilitators in years prior to the *Wayfair v. South Dakota* decision. While economic activity can establish nexus in the post-Wayfair environment, physical presence through employees, inventory and offices can still create sales and use tax nexus. See, e.g., *Amazon Services LLC v. South Carolina Department of Revenue*, case number 2019-001706, Opinion No. 6047, South Carolina Court of Appeals, January 24, 2024; *Orthotic Shop Inc. and S&F Corporation v. Department of Revenue*, No. 39321-6-III (Wash. Ct. App. Jan. 23, 2024).

2

Ohio CAT Sourcing and the Ultimate Destination. In sourcing tangible personal property for purposes of the Commercial Activity Tax ("CAT") the place where the property is "ultimately received after all transportation has been completed" controls – this is where the purchaser is considered to receive the property. In several recent cases, the Department taxed goods shipped to a distributor in Ohio, despite the goods ultimately being delivered to a customer outside the state. On the very same day, the Ohio Board of Tax Appeals recently sided with the taxpayer in *VVF Intervest LLC v. Harris*, No. 2019-1233 (Ohio Bd. Tax App. 2023), but against the taxpayer in *Jones Apparel Group/Nine West Holdings v. McClain*, Nos. 2020-53, 2020-54 (Ohio Bd. Tax App. 2023). Why the difference in treatment? Records – whether the taxpayer can show that the goods were ultimately shipped outside of Ohio. As for timing, the seller does need to have contemporaneous knowledge of the ultimate destination at the time of shipment.

3

What is Tangible Personal Property? The District Court of the City of Denver recently held in *Netflix Inc. v. Dep't of Revenue of Colo.*, No. 2023CV30184, (Denver Dist. Ct. 2024) that Colorado sales tax does not apply to Netflix's streaming subscription services because the products are not "corporeal," under the state's statutory definition of tangible personal property. Looking to the definition of "tangible personal property" at the time the statute was adopted (way back in 1935), the focus is on whether the streaming service affects the senses and may be seen and handled. Under this definition, streaming services are not tangible personal property. This decision is counter to a recent Arizona Court of Appeals decision in *ADP, LLC v. Ariz. Dep't of Revenue*, 254 Ariz. 417, No. 1 CA-TX 21-0009 (Ariz. Ct. App. Jan. 31, 2023), where the court held that SaaS constitutes tangible personal property. What's the difference between the cases? The state's definition of tangible personal property is much broader in Arizona than Colorado.

4

California Permits Deductible Income in the Apportionment Factor. The California Office of Tax Appeals (OTA) effectively overruled a longstanding position of the California Franchise Tax Board (FTB) in deciding that taxpayers were permitted to include gross receipts from deductible income in the apportionment sales factor. Several recent OTA rulings are indicative of the OTA's willingness to broadly construe gross receipts attributable to business income when computing the sales factor. See, e.g., *In the Matter of the Appeal of Southern Minnesota Beet Sugar Cooperative and Subsidiary*, OTA Case No. 19034447, 2023-OTA-342P (OTA Mar. 17, 2023); *In the Matter of the Appeal of Microsoft Corporation and Subsidiaries*, OTA Case No. 21037336, 2024-OTA-130 (OTA July 27, 2023).

5

Transfer Pricing in South Carolina. States generally have three options to address what they consider to be improper profit shifting between or among related affiliates: 1) transfer pricing adjustments (similar to Internal Revenue Code Section 482 adjustments); 2) add back of intangible expenses; and 3) forced combination of unitary affiliates. South Carolina has chosen door #3...even though by statute, it is a separate return state. Nevertheless, relying on South Carolina Supreme Court precedent, the Department of Revenue has had some recent success in combining affiliated companies in order to reverse perceived profit shifting. The most recent example is the *AutoZone* case. Despite this DOR win, the tide might be turning due to new legislation that will make it harder for the Department to forcibly combine related entities. *CarMax Auto Superstores, Inc. v. S.C. Dep't of Revenue*, No. 21-ALJ-17-0182-CC (S.C. Admin. Law Ct. July 12, 2024).

For more information, please contact:

www.ktslaw.com

Sam Breslow, sbreslow@ktslaw.com
David Hughes, dhughes@ktslaw.com
Kylan Memminger, kmemmingner@ktslaw.com