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THE BR STATE + LOCAL TAX SPOTLIGHT

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CONTENTS

Note from the Editors

By Matthew F. Cammarata and Eugene J. Gibilaro

Welcome to the first edition of our new publication, *The BR State + Local Tax Spotlight.* We understand the unique demands of staying on top of important State + Local Tax developments, which happen frequently and across numerous jurisdictions. Staying updated on significant legislative developments and judicial decisions helps tax departments function more efficiently and improves strategy and planning. That is where *The BR State + Local Tax Spotlight* can help. In each edition, we will highlight for you important State + Local Tax developments that could impact your business. In this issue, we will be covering:

- Connecticut's recent legislation regarding the impact of telecommuting employees on nexus for the employer during the COVID-19 pandemic;
- A recent New Jersey appellate court decision finding a local payroll tax unconstitutional;
- An Idaho Supreme Court decision that addresses whether a passive holding company is unitary with the investment it holds; and
- A Wisconsin Court of Appeals decision in favor of the taxpayer that required the Department to follow its own published guidance, which the Department had tried to disavow before the court.

We invite you to share *The BR State + Local Tax Spotlight* with your colleagues and visit Blank Rome's State + Local Tax webpage for more information about our team. Click here to add State + Local Tax to your subscription preferences.

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NICOLE L. JOHNSON
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Connecticut Paves the COVID High Road

By Nicole L. Johnson

Recently, Connecticut enacted legislation providing that having an employee telecommuting from Connecticut will not create a taxable presence (*i.e.,* nexus) in the state for the employer. H.B. 6516, Gen. Assemb., Jan. Sess., 2021 (Conn. 2021). This is a much-needed boon for companies struggling with the unexpected tax consequences of the COVID-19 pandemic, including consequences as the result of employees working from home.

However, as with most things in life, the new law is not without its caveats. First, the Connecticut nexus prohibition only applies to 2020. Without additional legislation, employees telecommuting from Connecticut in 2021 will likely create a tax obligation in the state.

Second, the telecommuting employee must have worked remotely in Connecticut "solely due to COVID-19." *Id.* Although undefined by the law, the Department of Revenue Services ("Department") stated that determining when an employee is remotely working solely due to the pandemic is "largely dependent upon specific facts and circumstances." Conn. Dep't Revenue Servs., TSSB 2021-1, 1 (Mar. 26, 2021). The Department provided that telecommuting due to emergency orders, medical issues, or childcare needs all qualified as "due to COVID-19." *Id.* Interestingly, the Department did not state if those situations met the "solely due to COVID-19" as required by the new law. Nevertheless, employers should be cautious and maintain records regarding why an employee was telecommuting.

A few other states have issued similar guidance. For example, the Georgia Department of Revenue stated that it will not use an employee's relocation as the basis for establishing Georgia nexus or for exceeding the protections provided by P.L. 86-272. Ga. Dep't of Revenue Coronavirus Tax Relief FAQs (last visited Apr. 1, 2021). However, it warned that after the official work from home order ends, if the employee is still working from Georgia, the employer would have nexus in the state. *Id.*

Similarly, the Minnesota Department of Revenue affirmed that it will not seek to establish nexus for business income tax or sales and use tax solely because an employee is temporarily working from home due to the COVID-19 pandemic. Minn. Dep't of Revenue COVID-19 FAQs for Bus. (last visited Apr. 1, 2021). Like Connecticut, Minnesota limits the nexus reprieve to telecommuting solely due to the pandemic, but Minnesota does not define that limitation.

> **Connecticut is leaps and bounds above numerous other states that have not issued any guidance.**

While it is reassuring to have guidance from certain Departments of Revenue, Connecticut's legislation ensures that the stay of execution for nexus is more than a Department of Revenue's current position—it is law that is not subject to change based on an agency's policy decisions. Moreover, Connecticut is leaps and bounds above numerous other states that have not issued any guidance. *See e.g.,* Idaho State Tax. Comm'n Coronavirus and Idaho Taxes: Frequently Asked Questions and Answers (last visited Apr. 1, 2021), Mont. Dep't of Revenue COVID-19 Updates (last visited Apr. 1, 2021). Hopefully, more states will join Connecticut on the COVID high road in the coming months. □

MITCHELL A. NEWMARK
PARTNER

New Jersey Appellate Court Finds Payroll Tax Unconstitutional

By Mitchell A. Newmark

In a precedential decision, New Jersey's intermediate appellate court ruled that a Jersey City ordinance imposing a payroll tax was unconstitutional. *Mack-Cali Realty Corp. v. State,* No. A-3097-18, 2021 N.J. Super. LEXIS 21 (N.J. Super. Ct. App. Div. February 16, 2021). Jersey City, New Jersey, is home to many companies' back office operations in the New York metropolitan area. Therefore, we suspect that many companies will have this issue.

Facts: New Jersey has for many years had controversies regarding underfunding of schools in poorer districts. In 2018, a state statute was modified to allow Jersey City to enact a payroll tax, which had previously only been allowed for Newark, New Jersey, to assist with school funding. Jersey City's ordinance became effective on January 1, 2019.

Under the Jersey City ordinance, employers must pay a tax of one percent of "payroll." The term "payroll" is defined as "the total remuneration paid by employers to employees…for services…performed with the City of Jersey City; or…performed outside of the City of Jersey City but…supervised…in Jersey City." *Mack-Cali,* 2021 N.J. Super. LEXIS 21 at *14. A group of plaintiffs, which included real estate developers, urban renewal entities, business owners with operations in Jersey City, labor unions, and business trade associations, challenged the payroll tax, arguing among other things that the payroll tax is unconstitutional.

The Decision: The court held that the ordinance is internally inconsistent and violates the Due Process Clause and Commerce Clause of the U.S. Constitution. The court found that if New York City had a tax that is substantially similar to Jersey City's and a person worked in New York City and was supervised from Jersey City, the employee (and her services) would be taxed more than once—once by New York City by working in New York City and once by Jersey City by being supervised from Jersey City. Further, there was not a sufficient mechanism in the ordinance to ensure that the person would not be taxed twice.

The court held that the ordinance is internally inconsistent and violates the Due Process Clause and Commerce Clause of the U.S. Constitution.

While Newark's tax ordinance has the same constitutional flaw identified in Jersey City's tax, Newark's tax forms gloss over the question. A recent Newark payroll tax booklet states that "'Payroll' means an amount equal to the total remuneration paid by an employer to employees, which is subject to withholding by the employer for Federal income tax purposes for services, other than domestic services in a private residence. The Employer is responsible for the Payroll Tax." City of Newark, 2021 Payroll Tax Booklet (2021). □

HOLLY L. HYANS
PARTNER

Supreme Court Denies Review in Taxpayer Apportionment Win

By Holly L. Hyans

In a case involving whether a nondomiciliary state can apportion a gain earned by a passive holding company on the sale of an interest in a limited liability company ("LLC"), the Idaho Supreme Court found the gain was not apportionable, and the U.S. Supreme Court denied review. *Noell Indus. Inc. v. Idaho State Tax Comm'n,* 470 P. 3d 1176 (Idaho filed May 22, 2020), *cert. denied,* 209 L. Ed. 2d 130 (2021). This case is significant in that it adds clarity to the question—never addressed by the U.S. Supreme Court—of whether a passive holding company is unitary with the investment it holds. The careful analysis in Noell—examining the lack of operational connection between a passive holding company and an operating business, and the lack of any traditional indicia of a unitary relationship—should help support arguments by holding companies that gain on the sale of companies in which they had no active role should not be apportioned to nondomiciliary states.

This case is significant in that it adds clarity to the question—never addressed by the U.S. Supreme Court—of whether a passive holding company is unitary with the investment it holds.

Facts: Noell Industries Inc. ("Noell") was incorporated in Virginia in 1993 to develop and sell combat and tactical gear. Its assets were transferred in 2003 to Blackhawk Industries Products Group Unlimited LLC ("Blackhawk"), a Virginia LLC, in exchange for a 78.54% interest. Thereafter, Noell's activities were limited to owning the investment in Blackhawk and one other business. After 2003, Noell had no employees, shared no assets or expenses with Blackhawk, and provided no financing or services to Blackhawk.

Noell sold its remaining interest in Blackhawk in 2010, reporting and paying taxes on the gain to Virginia, its commercial domicile, and excluding the gain from its income apportionable to Idaho. The Idaho Tax Commission sustained an audit adjustment including the gain in apportionable income, but the district court struck the assessment and the Idaho Supreme Court agreed.

The Decision: The Idaho Supreme Court analyzed the relationship between Noell and Blackhawk under Idaho Code Section 63-3027(a)(1), which incorporates the UDITPA two-part test for business income, applying both the "transactional" test (examining whether the income arose from a transaction in the regular course of the taxpayer's trade or business) and the "functional" test (examining whether the income arose from property, the "acquisition, management, or disposition" of which constitutes "integral or necessary parts of the taxpayer's trade or business"). The court also applied the constitutional unitary business test, finding that the Idaho Tax Administrative Rules incorporated the unitary test as one method to determine whether income was apportionable business income.

The court found that neither the statutory nor constitutional test was met, since Noell did not regularly engage in buying or selling subsidiaries, and the interest in Blackhawk was a passive investment, and not a part of Noell's business operation. It determined that Noell was merely a parent holding company, and that the "high-level separation of the companies," and Noell's role as a shell holding company, demonstrated "substantial independence rather than the level [of] interdependence required to manifest unity." *Noell,* 470 P. 3d at 1187. □

CRAIG B. FIELDS
PARTNER

Court Requires Wisconsin Department of Revenue to Follow its Own Pronouncement

By Craig B. Fields

While state taxing agencies generally take the high road, it is important to remember that when they do not, the courts can require them to do so.

In *Wisconsin Department of Revenue v. Deere* and Company, No. 2020AP726, 2021 Wisc. App. LEXIS 74 (Wis. Ct. App. Feb. 25, 2021), the Wisconsin Court of Appeals held that Deere and Company ("Deere") was permitted a dividends-received deduction for distributions received from a Luxembourg limited partnership that was treated as a corporation for federal tax purposes. What makes this case particularly significant is that, in doing so, the court ruled that the Department of Revenue ("Department") was prohibited from arguing otherwise because such an argument was contrary to the Department's then-existing published guidance.

The court looked to a statute, which specifically prohibits the Department from taking a position that is contrary to any guidance that it has published, Wisconsin Statute Section 73.16(2)(a), and found that it applied here.

Facts: Deere and a wholly owned single member limited liability company ("Deere LLC") together owned 100% of a limited partnership that was organized under the laws of Luxembourg ("Deere Luxembourg"), but that checked the box to be classified as a corporation. Because Deere LLC was disregarded for federal income taxes, Deere was treated as the sole owner of Deere Luxembourg for tax purposes.

Both Deere and Deere LLC received cash distributions from Deere Luxembourg, which Deere included in its Wisconsin taxable income (including the distributions made to disregarded Deere LLC). Deere then deducted the distributions based on the state's dividends-received deduction.

The Department disallowed the deduction, asserting that it was only allowed for dividends received from a corporation with respect to its common stock and Deere Luxembourg, as a limited partnership, did not have common stock.

The Appeal: Deere challenged the Department's disallowance, making two separate arguments. First, Deere argued that the Wisconsin statutes treated Deere Luxembourg as a corporation—since the definition of "corporation" includes an entity that is not organized as a corporation but that is treated as a corporation under the Internal Revenue Code—and therefore the distributions from Deere Luxembourg were dividends from a corporation with respect to its common stock. Second, it argued that the Department could not argue against its published guidance, which provided that a limited liability company that is treated as a corporation under the Internal Revenue Code is treated as a corporation for Wisconsin tax purposes and that an interest in such a limited liability company is treated in the same manner as stock. Wisconsin Dep't of Revenue, Publication 119: Limited Liability Companies (LLCs) (2019).

While in the earlier administrative appeal, the Tax Appeals Commission agreed with Deere on both arguments, the court did not rule on the first one.[1]

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Instead, the court looked to a statute, which specifically prohibits the Department from taking a position that is contrary to any guidance that it has published, Wisconsin Statute Section 73.16(2)(a), and found that it applied here. That the guidance involved a limited liability company and not a limited partnership was not relevant. Indeed, the court found that the Department's position against Deere "cannot be reconciled with what the guidance stated about the tax treatment of LLCs that have elected corporate classification." *Wisconsin,* 2021 Wisc. App. LEXIS 74 at *14. Consequently, Deere was entitled to the dividends received deduction.

This decision is similar to *Department of Revenue v. Agilent Technologies, Inc.,* 441 P.3d 1012 (Colo. 2019), where the Colorado Supreme Court held that the Department of Revenue was bound by its own regulations and, consequently, could not force Agilent to file a combined return with one of its subsidiaries.[2] It is also consistent with the "square corners" doctrine, which the New Jersey courts have applied to preclude the assessment of tax where taxpayers made financial decisions relying on representations by state officials regarding how tax laws will be applied, only to have those officials change position later. *E.g., Milligan v. Director, Div. of Taxation,* 29 N.J. Tax 381 (N.J. Tax Ct. 2016).

While it is unfortunate that state taxing agencies do not always take the high road, it is good to remember that those transgressions can be successfully challenged in the courts. □

1. For a discussion of the Tax Appeals Commission's decision as well as other rulings regarding the check-the-box election, *see* Mitchell Newmark and Eugene Gibilaro, Respect My Election Tomorrow? States Should Follow Check-the-Box, State Tax Notes, 129 (2020).
2. Attorneys at Blank Rome represented Agilent in this matter.

What's Shaking: Blank Rome State + Local Tax Roundup

Blank Rome's nationally prominent State + Local Tax attorneys are thought leaders in the community and are frequent guest speakers at various local and national conferences throughout the year. Our State + Local Tax attorneys believe it is necessary to educate and inform their clients and contacts about topics that will impact their businesses. We invite you to attend, listen, and learn as our State + Local Tax attorneys interpret and discuss key legal issues companies are facing and how you can put together a plan of action to mitigate risk and advance your business in accordance with state and local tax laws.

University of Wisconsin at Milwaukee —2021 SALT Lecture Series

- Craig B. Fields will serve as a panelist at the University of Wisconsin at Milwaukee 2021 SALT Lecture Series, which will be held in Fall 2021 as a virtual conference. Craig will discuss significant nationwide developments in state and local taxation.

NYU State and Local Tax Study Group Virtual Events

- Holly L. Hyans and Nicole L. Johnson will serve as panelists at the NYU State and Local Tax Study Group, which will be held May 5 and June 9, 2021, as virtual events. Holly and Nicole will discuss current developments in state and local taxation.

Council on State Taxation ("COST") —2021 State Income Tax Webinar

- Nicole L. Johnson and Mitchell A. Newmark will serve as panelists at the COST 2021 State Income Tax Webinar, which will be held April 26–29, 2021. Blank Rome is pleased to be a sponsor of the program. Mitchell's session, "Qualifying to Do Business In A State—How Does That Impact an Entity's Tax Status?," will take place on Tuesday, April 27. Nicole will speak on the "Tax Planning for Rapidly Changing Supply Chains and Business Models" panel on Thursday, April 29. To learn more and to register, please visit the event webpage.

Tax Executives Institute ("TEI") —2021 71st Virtual Midyear Conference

- Craig B. Fields served as a panelist at the TEI 2021 71st Virtual Midyear Conference, which was held March 22–25, 2021, as an online event. Craig's session, "Handling State Tax Controversies to Win," addressed the pros and cons of litigation, and addressed how various approaches taken at the return preparation, audit, and appeals stage can decrease a company's exposure, and how to best position a company's state tax controversies to win. To learn more, please visit the event webpage.

Philadelphia Estate Planning Council ("PEPC") Roundtable

- Craig B. Fields and Nicole L. Johnson were the featured speakers at the PEPC Roundtable Program for PEPC members, "Expect the Unexpected: State Tax Concerns as a Result of COVID," which was held March 24, 2021, as an online webinar. Craig and Nicole provided insight into how individuals can successfully change their domicile and whether states will treat individuals as statutory residents due to their residing in a state other than their domiciliary state during the pandemic, as well as the attempts by some states to source earnings to their state based on an individual's pre-pandemic office location. To learn more, please visit the event webpage.

Council on State Taxation ("COST")—Super 8 East Midwestern Regional State Tax Webinar

- Craig B. Fields, Mitchell A. Newmark, and Eugene J. Gibilaro were featured speakers at the COST Super 8 East Midwestern Regional State Tax Webinar, "Transfer Pricing: Multistate Issues You Need to Know and Strategies to Defend Audits and Litigation," which was held March 10, 2021, as an online webinar. Craig, Mitchell, and Eugene provided insight into recent state transfer pricing developments, their experience with state transfer pricing audits, and practical advice for what taxpayers can do when defending transfer pricing audits and when to consider litigation. To learn more, please visit the event webpage.

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