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THE BR STATE + LOCAL TAX SPOTLIGHT

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CONTENTS

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Note from the Editors

By Eugene J. Gibilaro and Anna Uger

Welcome to the January 2022 edition of *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:

- A recent South Carolina administrative law court decision allowing a challenge to a refund claim denial even though a previous protest from an assessment was filed;
- A recent New Jersey tax court decision barring as untimely the state's bid to recover an erroneous income tax refund payment caused by the taxpayer's mistake; and
- A pair of recent New York administrative law judge decisions illustrating the importance of the "primary function" test for determining taxability under the New York State sales tax.

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.

Co-Editors, *The BR State + Local Tax Spotlight*

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Words Matter: South Carolina Refund Claim Is Timely, "Even Though" a Previous Protest Was Filed

By Mitchell A. Newmark

The South Carolina Administrative Law Court ("ALC") recently allowed a challenge to a refund claim denial to proceed, even though a protest had been filed from an assessment for the same set of years, which was paid and no contested case was filed. Order on Motions for Summary Judgment filed on January 10, 2022, and Order Denying Motion to Dismiss filed on December 31, 2021, *DIRECTV Group, Inc. v. S.C. Dep't of Revenue,* No. 21-ALJ-17-0378-CC (S.C. ALC).

The Facts: The Department of Revenue (the "Department") audited and assessed the years 2006 to 2011, the company protested, and the protest challenge was properly proceeding. Then, the Department audited the years 2012 to 2015, assessed the company, and the company timely protested and requested that it be held in abeyance while the 2006 to 2011 protest challenge proceeded. After the 2006 to 2011 protest challenge was resolved, the company asked the Department to issue a determination for 2012 to 2015. On July 6, 2018, the Department issued the determination (which was appealable by filing a contested case with the ALC within 30 days). The company paid the determination on July 31, 2018.

Don't be bullied by any tax agency reading its own statutes or rules in a way that goes against you and asserts that you lose because the tax agency says so.

On September 27, 2019, the company filed a claim for refund for 2012 to 2015. On November 22, 2019, the Department denied the refund claim on procedural grounds. The company timely protested the refund claim denial. On August 19, 2021, the Department issued a determination upholding the denial on procedural grounds. On September 16, 2021, the company filed a contested case with the ALC.

What's the beef? The Department's denial asserted that a company has a choice when presented with an assessment: 1) file a Department protest, or 2) pay the assessment and seek a refund. The Department asserted that the time to file a refund (within three years of return filing or two years of tax payment) is only applicable if no protest was filed. Here, the Department said that the company filed a protest and then asked that a determination be issued on the protest. As the requested determination was issued on July 6, 2018, according to the Department, a contested case must have been filed by August 6, 2018, and, inasmuch as a contested case was not filed by August 6, the company purportedly could not seek a refund.

The Decision: There are two levels of appeal: the Department level and, after the Department issues a determination, the ALC. The judge reviewed the refund statute (S.C. Code 12-60-470(A)), and summarized that a refund claim is considered timely if it is "filed within the period specified in Section 12-54-85 [the three-year/two-year rule] even though the time for filing a protest under Section 12-60-450 [90 days rule] has expired and no protest was filed." The ALJ ruled that the language "no protest filed" did not limit refund claims to only when no protest was filed. The "no protest filed" language modified the whole phrase—that is, even if no protest is filed. Therefore, the judge concluded that the Department was incorrectly reading the appeal procedure and, as long as no determination was appealed to the ALC following the determination issued on the assessment protest, the company could file a refund claim within two years from paying the amount on the determination that resulted from a protested assessment.

The Takeaway: Don't be bullied by any tax agency reading its own statutes or rules in a way that goes against you and asserts that you lose because the tax agency says so. Take a step back, read the language, and proceed. Words matter and neutral judges exist and will give you a fair shake. □

KARA M. KRAMAN
OF COUNSEL

State Barred by Statute of Limitations from Recovering an Erroneous Refund Payment

By Kara M. Kraman

The New Jersey Tax Court recently granted a pro se taxpayer's motion for summary judgment and ruled that the Division of Taxation was barred by the statute of limitations from recovering an erroneous income tax refund payment caused by the taxpayer's mistake. *Malhotra v. Dir., Div. of Tax'n,* 2021 N.J. Tax LEXIS 13 (Dec. 16, 2021).

Facts: The taxpayer, Punish Malhotra, was a New Jersey resident who worked in New York. Mr. Malhotra filed a New York State nonresident income tax return for 2013 reporting 100 percent of his income sourced to and taxable by New York State. Mr. Malhotra's Form W-2 showed that his employer only withheld income tax on behalf of New York and did not withhold any income tax on behalf of New Jersey. Mr. Malhotra and his spouse also filed a joint New Jersey resident income tax return with New Jersey reporting the amount of New York withholding shown on his W-2 as New Jersey withholding, and claiming a credit for his taxes paid to New York. As a result of the erroneous withholding reported on the New Jersey return and the credit claimed for New York tax paid, Mr. Malhotra reported an overpayment on his New Jersey return and requested and received a refund of income taxes paid.

The Division of Taxation later examined Mr. Malhotra's New Jersey return and corrected it to remove the amount reported as New Jersey withholding. More than three years after Mr. Malhotra received the refund of income taxes from the Division, the Division issued a NJ Gross Income Tax Adjustment underpayment billing notice ("billing notice") for the amount of the refund paid, plus penalty and interest. Cross-motions for summary judgment ensued.

The Decision: Under New Jersey law, "an assessment of a deficiency arising out of an erroneous refund may be made at any time within 3 years from the making of the refund, except that assessment may be made within 5 years from the making of the refund if it appears that any part of the refund was induced by fraud or misrepresentation of a material fact." N.J. Stat. § 54A:9-4.

The Division did not argue that Mr. Malhotra acted with fraudulent intent and did not challenge his assertion that his failure to pay the appropriate taxes was simply an innocent mistake. As a result, the court found that it did not need to reach the issue of intent.

Instead, the Division asserted that the term "misrepresentation" does not have an intent element, but only requires a false statement of a material fact, even an unintentional one. Accordingly, the Division asserted that Mr. Malhotra's mistaken claim of New Jersey withholding amounts constituted a misrepresentation of a material fact.

> **The court found that a common thread of [the] interpretations was that while a "misrepresentation" does not require the same level of intent as fraud, it cannot be done accidentally.**

In interpreting the phrase "misrepresentation of a material fact," the court looked to how that phrase had been interpreted by other courts in the context of contract law and insurance law, and to the Black's Law Dictionary definition. The court found that a common thread of those interpretations was that while a "misrepresentation" does not require the same level of intent as fraud, it cannot be done accidentally. The court further noted that if it found every mistake by a taxpayer amounts to a "misrepresentation," it would render the distinction between the five-year and three-year statute of limitations meaningless. As there was no dispute in this case that Mr. Malhotra's misstatement of New Jersey withholding amounts was anything other than an innocent mistake, the court held that the Division was barred by the statute of limitations from recovering its erroneous refund payment. □

IRWIN M. SLOMKA
SENIOR COUNSEL

Two New York Administrative Law Judges Reject Imposition of Sales Tax Where "Primary Function" is Not an Information Service

By Irwin M. Slomka

Two recent New York State decisions illustrate the importance of the "primary function" test for determining taxability under the New York State sales tax, in both cases involving the tax on information services. Applying that test, two separate Administrative Law Judges ("ALJ") held that New York State could not impose sales tax on, in one case, an online loan marketplace and, in another, on reports evaluating potential environmental risks to real property. *In re LendingTree, Inc.* (N.Y. Div. of Tax App. DTA No. 829714, Dec. 9, 2021); *In re Lender Consulting Servs., Inc.* (N.Y. Div. of Tax App. DTA No. 829198, Dec. 2, 2021).

Taxability of Online Loan Marketplace

In re LendingTree, Inc. involved an online loan marketplace that enabled prospective borrowers seeking mortgages and other loans to be connected with participating lenders seeking qualified borrowers. Through its online platform, LendingTree obtained loan request forms from borrowers, which it then verified and performed a limited credit score inquiry of the borrower. That information was transmitted to participating lenders. The lender could then communicate a conditional offer to the prospective borrower.

LendingTree charged lenders a "match fee" for matching a lender with a prospective borrower, as well as "closed loan fees" for loans that actually closed, although it did not charge "closed loan fees" for mortgages and home equity loans. Borrowers were not charged a fee. The Tax Department took the position that Lending Tree's online loan marketplace services were subject to New York sales tax as taxable information services.

The ALJ concluded, however, that the "primary function" of the service—its "true object"—was to facilitate the writing of loans by participating lenders, notwithstanding that information was being provided to match lenders. He found that the lending institution was not paying a fee for information, but rather a commission for the closed loan. Therefore, the ALJ held that LendingTree was not providing an information service, and therefore was not required to collect sales tax on its charges.

Taxability of Environmental Reports

In re Lender Consulting involved the taxability of reports provided to banks and other financial institutions making loans secured by commercial real property that needed to know of potential environmental impairments regarding the property. The environmental reports included a review of government environmental database records. Each level of environmental report included a government database search, with certain environmental reports having as attachments information reports that Lender Consulting purchased from others.

The Tax Department argued that the environmental reports constituted a taxable information service, contending that their primary function was the underlying information accompanying the environmental reports, and not the summary and opinion portion of the environmental reports.

The ALJ held that looking at the environmental reports in their entirety, their "primary function" was to provide financial institutions with an environmental professional's review and opinion regarding potential environmental risks, and not information. The ALJ held that Lender Consulting was not providing a taxable information service and cancelled the sales tax assessment.

> **Sellers should always evaluate whether the "primary function" of what is being sold is truly a taxable service.**

The Takeaway

While both *In re LendingTree* and *In re Lender Consulting* are subject to appeal, they are an important reminder that the furnishing of some information does not necessarily convert a nontaxable service into a taxable information service. Only where the "primary function" of what is being sold involves the furnishing of non-personal or non-individual information—for example, sales of pricing data or customer lists—should sales tax apply. While the controversial New York Court of Appeals decision in *Wegmans Food Markets, Inc. v. Tax Appeals Tribunal of the State,* 33 N.Y.3d 587 (2019), held that a sales tax "exclusion" should be interpreted against the taxpayer, the application of the "primary function" test does not involve questions of statutory interpretation, but rather an analysis of what is being provided. Sellers should always evaluate whether the "primary function" of what is being sold is truly a taxable service. So, too, should customers that are being charged sales tax on what may not be taxable in the first place. □

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

Blank Rome's nationally prominent State + Local Tax attorneys are thought leaders in the community as 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.

Mitchell A. Newmark's Panel Discussion Profiled by *Tax Notes*

- Mitchell A. Newmark's December 15 panel discussion at the New York University School of Professional Studies' Institute on State and Local Taxation was profiled by Tax Notes for a December 17, 2021, article on the unclear tax consequences of remote work continuing to be the new norm as the COVID-19 pandemic evolves. To learn more, please click here. □

COST 2021 SALT Basics School

- Mitchell A. Newmark will serve as a panelist at the Council on State Taxation's ("COST") 2021 SALT Basics School, which will be held the week of May 15, 2022. Mitchell's panel, "Restrictions on a State's Ability to Tax," will review the various restrictions on a state's ability to impose taxes such as constitutional restrictions, federal legislation, and judicial pronouncements. □

2022 National Multistate Tax Symposium

- Craig B. Fields will serve as a speaker at the 2022 National Multistate Tax Symposium, presented by Deloitte Tax LLP in collaboration with the Tax Section of the Florida Bar, being held February 9through 11, 2022, at Disney's Grand Floridian Resort & Spa in Lake Buena Vista, Florida. Craig's session, "State, Federal, and International Income Tax Convergence: Scanning the Sphere," will take place on Tuesday, February 1, from 1:45 to 2:45 p.m. and from 2:00 to 3:00 p.m. The session will explore how states continue to react to the global regulatory regime and new economy, often by broadening their corporate income tax bases and apportionment reach to encompass more forms of income and entities (foreign and domestic) through unitary combined reporting, intercompany expense disallowance, economic nexus standards, and erosion of P.L. 86-272 protections. To learn more, please click here. □

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