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THE BR STATE + LOCAL TAX SPOTLIGHT

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STATE + LOCAL TAX TEAM:

Craig B. Fields | craig.fields@blankrome.com
Nicole L. Johnson | nicole.johnson@blankrome.com
Mitchell A. Newmark | mitchell.newmark@blankrome.com
Irwin M. Slomka | irwin.slomka@blankrome.com
Eugene J. Gibilaro | eugene.gibilaro@blankrome.com
Kara M. Kraman | kara.kraman@blankrome.com
Philip M. Tatarowicz | phil.tatarowicz@blankrome.com
Madison A. Ball | madison.ball@blankrome.com
Peter H. Hull | peter.hull@blankrome.com
Anna Uger | anna.uger@blankrome.com

Note from the Editors

By Eugene J. Gibilaro and Anna Uger

Welcome to the June 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 Texas Supreme Court decision to strike down a locality's licensing fee that was calculated as a percentage of the licensee's revenue;
- A Kansas Supreme Court decision that a former Pizza Hut franchisee rightfully filed a nonresident return in the state after meeting his evidentiary burden of establishing that he had changed his domicile to Florida; and
- A Massachusetts Supreme Judicial Court decision that the Department of Revenue had no statutory authority to tax the gain recognized by a nondomiciliary S Corporation from its sale of a 50 percent interest in an LLC.

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

EUGENE J. GIBILARO
Of Counsel
212.885.5118
eugene.gibilaro@blankrome.com

ANNA UGER
Associate
212.885.5473
anna.uger@blankrome.com

EUGENE J. GIBILARO
OF COUNSEL

A Fee or a Tax? Beware of Localities Going Too Far

By Eugene J. Gibilaro

On May 20, 2022, the Texas Supreme Court held that a locality lacked authority under Texas law to impose a licensing fee on a construction trash-hauling company that was calculated as a percentage of the company's revenue. *Builder Recovery Servs., LLC v. The Town of Westlake, Texas,* No. 21-0173 (Tex. May 20, 2022). The Court rejected the locality's argument that its authority under Texas law to regulate "solid waste collection, handling, transportation, storage, processing, and disposal" necessarily permitted the imposition of a percentage of revenue fee, instead finding that the fee "resembles—at least in its mode of calculation—a traditional business tax" and "[f]rom the perspective of the fee-payer, … an unconstitutional occupation tax." *Id.* at 8-9. This case is a reminder that the authority of localities to impose taxes or fees is usually strictly limited by state law and companies being audited or assessed by localities should always consider whether the locality's tax or fee scheme complies with state law.

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Facts: The Town of Westlake's local ordinance required construction trash haulers like the company to obtain a license to operate in the Town. Licensees were required, among other things, to identify their vehicles and containers, maintain their vehicles and containers in good repair, maintain insurance and other paperwork, and submit certain reports to the town. Licensees were also required to pay a monthly license fee equal to 15 percent of their revenue generated in the Town.

The company brought a lawsuit in district court challenging the legality of the license fee. The Town informed the district court that the ordinance had been amended after the company brought its lawsuit decreasing the amount of the license fee from 15 percent to three percent of revenue. The district court issued a declaratory judgment that the 15 percent license fee was invalid and unlawful and awarded the company attorney's fees. The court of appeals held that the company's challenge was moot because the Town had replaced the 15 percent fee with the three percent fee. The appeal to the Texas Supreme Court ensued.

The Decision: The Texas Supreme Court first held that the company's lawsuit was not mooted by the amendment to the ordinance because the company's claim was that a percentage of revenue fee is unlawful regardless of the percentage. The Court found that a lawful fee "would have to be tethered to the Town's costs of administering the regulation" of construction trash haulers, but the percentage of revenue fee "is tethered only to the market price of trash-hauling services, not to the Town's cost of regulating." *Id.* at 9. The Court concluded that it was "unlikely" that the Legislature's grant to the Town of "the generic authority to regulate trash hauling" includes an implied grant of power to impose a percentage of revenue fee. *Id.* at 11. Finally, the Court remanded the case to the court of appeals for consideration of whether the unlawful percentage of revenue fee was severable from the rest of the ordinance or whether the Town's entire regulatory scheme must be struck down. □

NICOLE L. JOHNSON
PARTNER

Where's Home for the Franchise King?

By Nicole L. Johnson

Determining the location of a person's domicile is a fact-intensive inquiry—with potentially large tax consequences. For example, take the recent Kansas Supreme Court decision in *Bicknell v. Kansas Department of Revenue,* No. 120,935 (Kan. May 20, 2022). In that case, Mr. Bicknell asserted that he was a Florida resident for 2005 and 2006, but the Kansas Department of Revenue (the "Department") alleged that he never abandoned his Kansas domicile. On the line was an assessment of over $42 million, including interest and penalties.

Mr. Bicknell owned more than 800 Pizza Hut franchises—the largest Pizza Hut franchisee in the world at the time. For most of his life, Mr. Bicknell was a resident of Kansas and purchased a home in Florida in the early 1990s. In 2003, Mr. Bicknell decided to retire and move to Florida for a variety of personal reasons. His wife, however, chose to remain a resident of Kansas. In 2006, Mr. Bicknell sold his business for a substantial gain and filed a nonresident return in Kansas, which did not reflect the gain as taxable in the State.

After an audit, the Department issued an assessment asserting that Mr. Bicknell should have filed as a resident in Kansas for 2005 and 2006 and included the gain in taxable income. Kansas law "requires the concurrence of two factors to establish a change of domicile: (1) physical presence in a location; and (2) an intent to remain in that location, either permanently or indefinitely." *Id.* at 40. The court examined the evidence established during the eight-day hearing, which included the number of days spent in Kansas, the State that provided Mr. Bicknell with a driver's license, where he was registered to vote, and where he owned real property.

While the court agreed with the Department that the burden was on Mr. Bicknell to establish that he changed his domicile, the court found that Mr. Bicknell met that burden. The court held that there was substantial evidence in the record to support a finding that Mr. Bicknell moved from Kansas to Florida and intended to do so on a permanent basis.

The court's opinion sends a very clear message—the tax effect does not determine a taxpayer's domicile—no matter how large. Instead, it is the facts that matter.

The court's opinion sends a very clear message—the tax effect does not determine a taxpayer's domicile—no matter how large. Instead, it is the facts that matter. With many taxpayers seeking to move to lower tax jurisdictions, the key to success is following through with the move and not just on paper. Taxpayers need to change their driver's license, update their voter registration, move their belongings, and track the number of days spent in each location, among other things. With proper documentation, even the trickiest domicile case can be won. □

CRAIG B. FIELDS
PARTNER

Massachusetts High Court Rules, Although Constitutional, State Has No Statutory Authority to Tax Gain

By Craig B. Fields

Although the parties only argued the constitutionality of taxing the gain recognized by a nondomiciliary S Corporation from its sale of a 50 percent interest in a limited liability company ("LLC"), the Massachusetts Supreme Judicial Court ("SJC") ruled that while such taxation is constitutional, it is not permitted under the Massachusetts statutes. *VAS Holdings & Investments LLC v. Comm'r of Revenue,* No. SJC-13139, 186 N.E.3d 1240 (Mass. May 16, 2022). This case is an important reminder that taxpayers should raise all issues, both constitutional and statutory, when appealing tax assessments. Had the SJC not raised the statutory argument on its own, the assessment would have been upheld by the SJC as being constitutional.

Facts: As the result of capital contributions and mergers, a nondomiciliary S Corporation, VAS Holdings & Investments LLC ("VASHI"), owned a 50 percent interest in an LLC classified as a partnership for tax purposes. The LLC was almost exclusively based in Massachusetts. VASHI itself had no connection to Massachusetts.

> **This case is an important reminder that taxpayers should raise all issues, both constitutional and statutory, when appealing tax assessments.**

VASHI sold its interest in the LLC and recognized a large gain. While VASHI and its shareholders had paid tax to Massachusetts on their distributive shares of the LLC's income, VASHI asserted that its gain was not taxable because it was not engaged in a unitary business with the LLC.

Although the Department of Revenue (the "Department") agreed that VASHI and the LLC were not engaged in a unitary business, the Department asserted that it could constitutionally tax the gain due to the protections, opportunities, and benefits that Massachusetts provided to the LLC. Moreover, the Department computed the tax by apportioning the gain to Massachusetts using the apportionment formula of the LLC.

The Decision: The SJC first held that the unitary business principle is not the only way income can be constitutionally subject to taxation. Unlike most decisions where a court will only address constitutionality *after* it determines that the assessment is proper under the statute, here the SJC first analyzed the constitutional issue. It went through a lengthy analysis to hold the assessment constitutional since the gain was being apportioned using the LLC's, and not VASHI's, apportionment formula. The SJC found support for its conclusion based on *International Harvester Co. v. Wisconsin Department of Taxation,* 322 U.S. 435 (1944) and *Wisconsin v. J.C. Penney Co.,* 311 U.S. 435 (1940), where the U.S. Supreme Court found constitutional Wisconsin's privilege tax which required a nondomiciliary corporation doing business in Wisconsin to deduct a tax from dividends it paid to its investors, regardless of whether they were domiciled in Wisconsin.

The SJC then held that the Department had no statutory support for taxing the gain. Although raised neither before the Appellate Tax Board nor before the SJC, after oral argument the SJC asked for post-argument briefing on whether the imposition of tax was authorized by statute. After reviewing the statutes, the SJC concluded that the Massachusetts statutes predicated taxation based on the existence of a unitary business or transactions serving an operational function and, therefore, did not permit taxation of the gain. In contrast, the Ohio, New York City, and former New York State tax laws, which use the approach that the Department tried to adopt here, predicated taxation based on the apportionment percentage of the investee rather than the investor. □

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