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THE BR STATE + LOCAL TAX SPOTLIGHT

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Note from the Editor

By Eugene J. Gibilaro

Welcome to the December 2022 edition of *The BR State + Local Tax Spotlight.* We recognize the importance of remaining informed on State + Local Tax developments, which appear often and across numerous jurisdictions. Staying up-to-date on significant legislative developments and judicial decisions helps tax departments function more efficiently, along with improving strategy and planning. That is where *The BR State + Local Tax Spotlight* can help. In each edition, we will highlight important State + Local Tax developments that could impact your business. In this issue, we will be covering:

- Massachusetts Commissioner of Revenue Issues Guidance Seeking to Limit Taxpayer Win in Apportionment Case
- Ohio Supreme Court Rules that the State is Not Entitled to Tax NASCAR's Broadcast and License Fees
- Whose Income Producing Activity Is It Anyway?

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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Massachusetts Commissioner of Revenue Issues Guidance Seeking to Limit Taxpayer Win in Apportionment Case

By Eugene J. Gibilaro

In the wake of the taxpayer win at the Supreme Judicial Court of Massachusetts in *VAS Holdings & Investments LLC v. Commissioner of Revenue,* 489 Mass. 669 (2022) (*"VAS"*), the Commissioner of Revenue has issued guidance in the form of a Technical Information Release ("TIR") purporting to offer the Commissioner's interpretation of the decision and seeking to limit the application of *VAS* to other taxpayers' cases. Massachusetts Commissioner of Revenue, TIR 22-14 (Nov. 30, 2022). While the TIR is useful in understanding the Commissioner's position, ultimately it is the *VAS* decision itself, and not the Commissioner's interpretation of the decision, that will control in future cases. Taxpayers should be prepared to push back against the Commissioner's attempts to limit the impact of the *VAS* decision.

In *VAS,* the Supreme Judicial Court of Massachusetts held that Massachusetts law adheres to the unitary business principle in determining apportionability of income and the Commissioner's attempt to apportion and tax gain recognized by a non-domiciliary S corporation from the sale of its interest in a pass-through entity operating in Massachusetts, based on the apportionment factors of the pass-through entity, and with which the S corporation was not engaged in a unitary business, violated Massachusetts law. *VAS,* 489 Mass. at 686.

The TIR explains that the Commissioner will continue to take the position that gain from the sale of an interest in a pass-through entity operating in Massachusetts is taxable by Massachusetts when the gain is recognized by a nonresident individual "actively engaged in the in-state business of the [pass-through entity], in either the year of the sale or in a prior year." *VAS* did not specifically address this issue inasmuch as the taxpayer in *VAS* was an entity and not an individual. The Commissioner's view is that the gain recognized in this factual scenario is authorized by a state statutory provision permitting the taxation of "gross income derived from or effectively connected with [a] trade or business, including any employment, carried on in the commonwealth." M.G.L. c. 62, § 5A(a). Whether the statutory provision referenced by the Commissioner actually authorizes taxation of a nonresident individual's gain from the sale of an intangible interest in an entity operating in Massachusetts remains ripe for challenge.

Moreover, the TIR states that the Commissioner will not apply *VAS* to gains from sales of pass-through entities when such sales are treated as asset sales under the Internal Revenue Code (for example, a deemed asset sale pursuant to I.R.C. §338(h)(10)). *VAS* was not limited only to sales of interests in pass-through entities that are treated as sales of interests in pass-through entities for federal income tax purposes and whether the Commissioner is correct to make this distinction also remains ripe for challenge.

> **Taxpayers should be prepared to push back against the Commissioner's attempts to limit the impact of the VAS decision.**

Finally, the TIR explains that a claim for abatement based on *VAS* must be made within the statutory limitations period for the Massachusetts tax return with respect to which the abatement is claimed. A non-domiciliary corporate taxpayer or a nonresident individual taxpayer "must clearly demonstrate that it apportioned the gain from the sale of the [pass-through entity] interest based entirely on the [pass-through entity's] apportionment attributes" and that "it was proper to apportion the gain from the sale of the [pass-through entity] interest without including in whole or part the apportionment attributes of any other entity." Abatements will not be granted to non-domiciliary corporate taxpayers "where taxable gain is properly includible in the unitary business income of the taxpayer" and will not be granted to nonresident individuals "actively engaged in the in-state business of the [pass-through] entity, either in the year of the sale or in a prior year." □

IRWIN M. SLOMKA
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Ohio Supreme Court Rules that Ohio is Not Entitled to Tax NASCAR's Broadcast Fees and License Fees

By Irwin M. Slomka

Ohio's ability to tax receipts under the Ohio commercial activity tax ("CAT") in the case of nationwide contracts that license the right to use intellectual property has now been significantly limited. The Ohio Supreme Court has held that the Department of Taxation ("Department") may not source NASCAR's broadcast and licensing revenues under the CAT using estimates based on Ohio television viewership or Ohio's percentage of the U.S. population. *NASCAR Holdings, Inc. v. McClain,* Slip Opinion No 2022-Ohio-4131 (Ohio Supreme Ct., Nov. 22, 2022). In ruling for NASCAR, the Court concluded that under the specific language of the CAT sourcing statute, NASCAR's revenues from its licensing of intellectual property could not be "sitused" to Ohio.

The Facts: NASCAR Holdings, Inc. ("NASCAR") sanctions auto races throughout the United States and abroad. It is headquartered in Daytona Beach, Florida, and during the tax years 2005 through 2010 held only seven racing events in Ohio. NASCAR maintained no permanent offices, owned no tangible property, and employed no permanent workers in the state. As a result, NASCAR never registered for the CAT and the Department commenced a CAT audit of NASCAR's revenue streams.

> **The decision shows that courts often prefer to decide cases based on the actual statutory language, and only reach constitutional arguments where necessary.**

NASCAR earned broadcast revenues by selling to FOX Broadcasting the right to broadcast races in the United States and in certain foreign countries in exchange for a fixed fee. It also earned media revenue by licensing the right to use its brand in marketing efforts and to operate its website worldwide, also for a fixed fee. In addition, NASCAR licensed its trademark and trade name anywhere in the United States and Canada, in exchange for licensing fees that were based on a percentage of net sales of licensed products anywhere.

The Department sourced NASCAR's broadcast and media revenues to Ohio using Nielsen Ratings, and sourced its license fees using U.S. Census data. NASCAR claimed that these revenues should be sourced to Florida, its commercial domicile.

The Board of Tax Appeals upheld the Department's use of ratings and Census data, on the grounds that the underlying contracts conferred "the right to use the intellectual property" in Ohio. NASCAR appealed to the Ohio Supreme Court.

The Ohio CAT applies to gross receipts "sitused" to the state. For receipts from intellectual property, there are two alternative sourcing rules: (1) receipts from the right to use intellectual property are "sitused" to Ohio "to the extent the receipts *are based on the amount of use of the property* in [Ohio];" or (2) if the receipts are not based on the amount of use of the property, but instead on the "right to use the property," they are "sitused" to Ohio only "to the extent the receipts are *based on the right to use the property* in [Ohio]." R.C. § 5751.033(F). This distinction was critical to the Court's reversal in favor of NASCAR.

The Decision: Although NASCAR raised both a statutory and a dormant Commerce Clause challenge, the Court first addressed the statutory argument and never reached the constitutional challenge. It agreed with NASCAR that the contractual right for FOX to use broadcast rights in a territory that includes Ohio did not mean the revenues were "based on the right to use" the intellectual property in Ohio. Since NASCAR received a fixed fee whether or not any part of its intellectual property was used by FOX in Ohio, no part of the fee could be sitused to Ohio under alternative (2) above. The same result was reached for NASCAR's fixed media revenues.

As for NASCAR's licensing fees, which were not fixed, the Court noted that the Department had also erroneously sourced the fees based on Census data because of the licensee's "right to use" NASCAR's marks, the same statutory situsing alternative as for the other revenue streams. The Court rejected the partial dissent's conclusion that the first situsing rule was actually triggered, pointing out that this was not the position relied on by the Department in its assessment.

The decision shows that courts often prefer to decide cases based on the actual statutory language, and only reach constitutional arguments where necessary. According to the Court, if the Department believes the statutory language fails to reflect market state principles underlying the CAT, it "is free to take up that matter with the legislature." □

NICOLE L. JOHNSON
PARTNER

Whose Income Producing Activity Is It Anyway?

By Nicole L. Johnson

Both states and taxpayers have struggled with how to correctly source service receipts for apportionment purposes. The myriad of state sourcing provisions certainly do not add any clarity to the issue. Muddying the waters even further are those states that source services to the location of the income-producing activity based on costs of performance—yet the Departments of Revenue interpret those provisions to mean market-based sourcing.

A slew of recent cases, including *Hegar v. Sirius XM Radio, Inc.,* No. 03-18-573-cv, (Tex. App. Nov. 10, 2022), have added some much-needed clarity to the issue. Included in the list of recent cases is the Florida Circuit Court decision in *Target Enterprise, Inc. v. Fla. Dep't of Revenue, Fla. Cir. Ct.,* No. 2021-CA-002158, (Nov. 28, 2022).

The Facts: The *Target Enterprise* case involved a subsidiary of Target Corporation. The subsidiary, Target Enterprise, Inc. ("TEI"), provided various services to Target and to third parties. TEI's employees who performed those services were primarily located at TEI's headquarters, in Minnesota.

For Florida corporate income tax purposes, TEI sourced its service receipts to the location of its employees. The Florida Department of Revenue (the "Department") audited TEI and contended that TEI's services should be sourced based on a percentage of Target Corporation's retail square footage in Florida over Target Corporation's total retail square footage in the United States. Notable, the Department's method did not relate to any activity of TEI. The Department's administrative rule sourced services to the location of the income-producing activity, which is determined based on the location of the costs to perform those services.

The Decision: The court in *Target Enterprise* held that this sourcing rule involves a two-step process. First, determine the taxpayer's income producing activity. Second, balance the costs incurred to perform those services. In this case, the court held that "there can be no question that TEI's 'income producing activity' was performing the services…[and those] services were performed by employees of TEI."

Significantly, the court held that for services—as was at issue—the income-producing activity was the performance of that service, not some other incidental activity. This is an important victory for taxpayers that are battling Departments of Revenue that insist that the income-producing activity is something other than the performance of the service itself—for example, where the payment is made for the service or where the order for the service is placed.

> **Muddying the waters even further are those states that source services to the location of the income-producing activity based on costs of performance—yet the Departments of Revenue interpret those provisions to mean market-based sourcing.**

In addition, the court held that the best evidence of TEI's costs to perform the service was the payroll apportionment workpapers, which were provided to the Department during the audit. Thus, TEI had sufficiently substantiated its sourcing and the Department was without authority to adjust such sourcing.

In light of this recent taxpayer victory, companies should continue to evaluate where their receipts are sourced for those states that still source to the location of the income producing activity. □

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.

The 2023 National Multistate Tax Symposium

- Blank Rome State + Local Tax partner Craig B. Fields will serve as a speaker at the 2023 National Multistate Tax Symposium, presented by Deloitte Tax LLP in collaboration with the Tax Section of the Florida Bar, being held February 8through 10, 2023, in Lake Buena Vista, Florida. Craig's session, "Multistate Income/Franchise Tax Hot Topics: P.L. 86-272 and Related-Party Transactions," will take place on Friday, February 10. To learn more, please click here. □

Telecommuting Tax Traps

- Blank Rome State + Local Tax partners Nicole L. Johnson and Craig B. Fields will present the Lorman live webinar "Telecommuting Tax Traps" on Thursday, March 2, 2023. In this webinar, Nicole and Craig will discuss the tax traps faced by businesses with an increasingly mobile workforce. □

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