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THE BR STATE + LOCAL TAX SPOTLIGHT

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Note from the Editors

By Eugene J. Gibilaro and Joshua M. Sivin

Welcome to the June 2023 edition of *The BR State + Local Tax Spotlight.* We know the importance of remaining up-to-date on State + Local Tax developments, which appear often and across numerous jurisdictions. Staying informed on significant legislative developments and judicial decisions helps tax departments function more efficiently, along with improving strategy as well as 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:

- Locality Cannot Pay Contingent Fee to Attorney to Litigate for Increased Property Value
- When Tax Collection Is an Unconstitutional Taking
- North Carolina Cellphone Company Required to Collect Sales Tax on Sale of Right to Purchase Pre-Paid Cell Service
- The Conundrum of Sourcing Income for Nonresidents

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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Locality Cannot Pay Contingent Fee to Attorney to Litigate for Increased Property Value

By Craig B. Fields

The Texas Supreme Court held that, while permitted in certain limited circumstances, a school district cannot pay a contingent fee to an attorney to litigate its challenge to increase the appraised value of property. *Pecos Cnty Appraisal Dist and Kinder Morgan Prod. Co. v. Iraan-Sheffield Indep. Sch. Dist*., No. 22-0313 (May 19, 2023).

The Facts: A school district in Pecos County, Texas, retained an attorney to pursue claims regarding whether the Pecos County Appraisal District had undervalued Kinder Morgan's mineral interests in the school district. The school district agreed to pay the attorney 20 percent of any additional amounts received.

Kinder Morgan filed a motion alleging that the attorney lacked the authority to represent the school district because the school district had no power to hire an attorney on a contingent fee basis for the appraisal litigation.

The Decision: While noting Kinder Morgan's reference to the lawyer as a "tax ferret" (a fury mammal that was a beloved pet of Queen Elizabeth I) and the attorney's reference to the company as a "tax cheat" and "the progeny of Enron," the Court analyzed the statute relied upon by the school district to support its contingent fee, Tex. Tax Code Section 6.30(c). That statute provides that a governing body may pay an attorney a contingent fee "to enforce the collection of delinquent taxes."

The Court found the statute inapplicable for several reasons. First, there were no "delinquent taxes" as the school district was asserting that the appraisal for the property should be higher and there had been no such finding: "But the taxes at issue in this litigation have yet to be assessed or imposed. They cannot possibly be 'delinquent.'" Moreover, there could be no "collection" of the taxes at issue because those taxes had not been assessed. Similarly, there could be no "enforcement" of a payment obligation that had not yet arisen.

> **While finding that the school district could not pay the attorney a contingent fee, the Court did not dismiss the school district's case seeking to increase the appraised value. Instead, it remanded the case to allow the school district to either modify its agreement with the attorney or retain other counsel on terms that are lawful.**

Clearly, the use of contingent fee auditors and/or attorneys should be limited only to collection activities. When an amount of taxes has become due and payable and there is no question that it is properly due, it is not improper for a jurisdiction to retain someone to assist in the collection of such amounts and to pay a contingent fee for those services. It is never proper, however, for an auditor, appraiser or attorney representing a jurisdiction to be paid a contingent fee to audit, appraise property, or litigate for the jurisdiction in a case involving the amount due. As the Court noted, "[t]he law has long acknowledged that contingent-fee arrangements creating a personal profit motive to maximize taxation may be 'unfair and unjust to the public.'"

EUGENE J. GIBILARO
PARTNER

When Tax Collection Is an Unconstitutional Taking

By Eugene J. Gibilaro

When has a tax collection procedure gone so far as to violate the Takings Clause of the U.S. Constitution? On May 25, 2023, the U.S. Supreme Court issued its decision in *Tyler v. Hennepin* County, 598 U.S. ____ (2023), holding that it constituted an unconstitutional taking when a Minnesota County sold a taxpayer's home valued at $40,000 to satisfy her $15,000 property tax debt and kept the remaining $25,000 rather than returning it to her. On June 5, 2023, the U.S. Supreme Court issued an order vacating and remanding two cases to the Nebraska Supreme Court with facts similar to *Tyler* for further consideration in light of the *Tyler* decision.

> **It is encouraging to see the U.S. Supreme Court moving quickly to ensure that state courts throughout the country apply the constitutional protections for taxpayers articulated in Tyler.**

The *Tyler* Decision: In *Tyler*, the lower court held that the Minnesota County pocketing the excess $25,000 did not constitute an unconstitutional taking because Minnesota law did not recognize a property interest in surplus proceeds from a tax foreclosure sale conducted after adequate notice to the taxpayer owner. The U.S. Supreme Court did not dispute that the County had the power to force a sale of the taxpayer's home to recover unpaid property taxes. However, the County could not "use the toehold of the tax debt to confiscate more property than was due" and, by doing so, the County had "effected a 'classic taking in which the government directly appropriates private property for its own use.'" In support of its conclusion, the U.S. Supreme Court found that the principle that a government cannot take more from a taxpayer than they owe traces its origins at least as far back as the Magna Carta in 1215. Moreover, the Court observed that Minnesota's rule was a minority rule and currently 36 states and the federal government require that excess value be returned to the taxpayer. The Court concluded that "[t]he taxpayer must render unto Caesar what is Caesar's, but no more."

The Nebraska Cases: Like Minnesota, Nebraska employed a minority rule that excess value was not required to be returned to the taxpayer. In *Fair v. Continental Resources*, No. S 21-074 (Neb. Mar. 18, 2022), the taxpayer owed $5,268 in property taxes, interest, and fees and, in order to collect the amount due, the County effected a transfer of the title to his home to a third party. The home had an assessed value of $59,759, but no excess value from the title transfer was returned to the taxpayer. In *Nieveen v. Tax* 106, No. S-21-364 (Neb May 13, 2022), the taxpayer owed approximately $3,797 in delinquent property taxes and the home to which the County transferred title to a third party had an assessed value of $61,900. As in *Continental Resources*, none of the excess value from the title transfer was returned to the taxpayer. Like the lower courts in *Tyler*, the Nebraska Supreme Court found that the failure to return excess value to the taxpayers did not violate the Takings Clause because, according to the Nebraska Supreme Court, the taxpayers had no property interest in the suruplus equity value of their homes. These decisions appear incomptabile with *Tyler* and, given its order to vacate and remand the cases, it seems that the U.S. Supreme Court agrees. Stay tuned for further developments in these cases.

JOSHUA M. SIVIN
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North Carolina Cellphone Company Required to Collect Sales Tax on Sale of Right to Purchase Pre-Paid Cell Service

By Joshua M. Sivin

The North Carolina General Court of Justice, Superior Court Division determined that Wireless Center of NC, Inc. ("Wireless Center") was required to remit and collect sales tax on products known as Real Time Replenishments ("RTRs"). *North Carolina Dep't of Rev. v. Wireless Ctr. of NC Inc.*, Case No. 22 CVS 7036 (Gen. Ct. of Justice, Sup. Ct. Div., June 2, 2023).

The Facts: Wireless Center sells phone equipment, products, and services as an independent contractor with Boost Mobile ("Boost"). Among the products sold by Wireless Center are RTRs. Purchasing RTRs does not automatically activate a customer's cellular service; rather, RTRs add value to a customer's Boost account which may be used to activate or extend one of Boost's prepaid plans or to purchase other products and services. Wireless Center did not collect sales tax on the sale of RTRs during the audit period.

> **The Decision: Wireless Center argued that because RTRs may be used to purchase an array of goods and services from Boost, they are gift cards and should be taxed at the point of use rather than at the point of sale.**

Under the relevant statute, sales of prepaid wireless calling service ("PWCS") are subject to sales tax. PWCS is defined as "a right that . . . [a]uthorizes the purchase" of wireless service. The Court found that by purchasing an RTR in any amount, "a customer has paid in advance for *the right to later purchase* wireless service in that predetermined amount. Whether a customer proceeds to purchase wireless service is immaterial because *the right to purchase* was already acquired." (Emphasis in original.) The court found that the "right to purchase" was acquired when the customer bought the RTR.

The Court further determined that the fact that Boost revised its business model during the audit period to allegedly collect tax upon the use rather than the sale of RTRs (the period following the change in business model is referred to as "Period II") did not remove RTRs from the definition of PWCS and the North Carolina Office of Administrative Hearings finding that RTRs were not PWCS during Period II was erroneous.

As for Wireless Center's argument that tax liability was satisfied during Period II, the Court found that in the absence of records establishing such satisfaction, Wireless Center was unable to overcome the presumption that the tax assessment was correct.

NICOLE L. JOHNSON
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The Conundrum of Sourcing Income for Nonresidents

By Nicole L. Johnson

The general rule of thumb for nonresidents has long been that nonresidents can only be taxed by a state on income earned in that state (i.e., source income). Seems simple enough, right?

> **As every state tax professional knows, nothing is ever simple when it comes to taxes.**

Notably, states—and localities—have separate determinations as to when income is earned in their jurisdiction.

The recent pandemic highlighted many of the issues for determining when income is earned in a state as employees were working away from the office. For example, the oft-challenged pandemic legislation in Ohio that allowed localities to treat work performed outside that locality as if that work was performed in that locality. *See*, Ohio H.B 197; *see also Morsy v. Dumas,* Case No. CV 21 946057 (Oh. Ct. Comm. Pleas, Sept. 26, 2022); *Shaad v. Adler*, Case No. 2022-0316 (Oh. Sup. Ct. Decision pending).

Courts in Missouri also recently grappled with this issue of determining where services were rendered by nonresidents for purposes of the St. Louis Earned Income Tax. *Boles v. City of St. Louis*, Cause No. 2122-CC00713 (Mo. Cir. Ct., Jan. 19, 2023). And those examples don't even begin to cover the myriad of sourcing issues created by states that have the Convenience of the Employer rule (e.g., New York, Pennsylvania, and others). Thus, the recent decision in *Baty v. Alabama Department of Revenue* was refreshing in its simplicity. Docket No. 22-298-LP (Ala. Tax Trib., May 19, 2023).

In Baty, the taxpayer was a Florida resident who worked for an Alabama company. The taxpayer alleged that because he worked from home in Florida for a portion of each day that his income was not Alabama-sourced. The Alabama Tax Tribunal held that the taxpayer performed services in Alabama and, therefore, is subject to tax on his Alabama-sourced income. However, Alabama law is clear: Income is sourced to the state if the work is physically performed in the state (with limited exceptions). Ala. Admin. Code r. 810-3-14-.05. Thus, the employee would only be subject to Alabama taxes on the portion of his wages related to work physically performed in Alabama.

Given the difficulties in determining where work is performed or rendered, states that have a more bright-line standard of sourcing income to the location where the work was physically performed eliminate much of the confusion and difficulties that surround vague or ill-defined statutes. A little bit of clarity goes a long way.

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.

This Tonic Will Solve Your Problems in M&As and Exemptions

- Blank Rome State + Local Tax partner Mitchell A. Newmark will serve as a speaker at the Institute for Professionals in Taxation's ("IPT") 2023 Annual Conference, being held June 25 through 28, 2023, in Grapevine, Texas. To learn more, please click here.

Blank Rome Attorneys and Practices Highly Ranked in The Legal 500 United States 2023

- Blank Rome LLP is pleased to announce that our practice groups and attorneys have been highly ranked and recommended in The Legal 500 United States 2023. Researchers at The Legal 500 conduct annual, in-depth market research and gather information from individual law firms as well as feedback from peers and clients to form an objective analysis and prepare comprehensive rankings and editorial of the U.S. legal market. To learn more, please click here.

The 30th Annual Paul J. Hartman State and Local Tax Forum

- Blank Rome State + Local Tax partner Nicole L. Johnson will be speaking at the 30th Annual Paul J. Hartman State and Local Tax Forum which will be held from October 23rd through the 25th in Nashville, Tennessee. Nicole will be a panelist for a session titled "Local Taxes- Current Issues and Litigation/Post-Wayfair, Gross Receipts." To learn more, please click here.

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