JANUARY 2024

THE BR STATE + LOCAL TAX SPOTLIGHT

BLANKROME

CONTENTS

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
Joshua A. Sivin | joshua.sivin@blankrome.com
Philip M. Tatarowicz | phil.tatarowicz@blankrome.com
Melanie L. Lee | melanie.lee@blankrome.com

Note from the Editors

By Joshua M. Sivin and Melanie L. Lee

Welcome to the January 2024 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:

- Sales Tax & Bad Debts: Win at Indiana Tax Court Follows Federal
- New York State Tax Appeals Tribunal Denies Resident Credit for Tax Paid to Connecticut on Carried Interest
- New York Appellate Court Rules in Favor of S Corporation Shareholder Entitlement to New York QEZE Tax Credits

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*

JOSHUA M. SIVIN
Of Counsel
212.885.5025
joshua.sivin@blankrome.com

MELANIE L. LEE
Associate
212.885.5371
melanie.lee@blankrome.com

MITCHELL A. NEWMARK
PARTNER

Sales Tax & Bad Debts: Win at Indiana Tax Court Follows Federal

By Mitchell A. Newmark

Financed transactions can result in states asserting "heads I win, tails you lose" by taking the tax at the time of sale but not accepting pain when the installment sale is busted. When a sale of tangible personal prop-erty occurs, sales tax is typically due at the time of the sale on the entire purchase price. If the purchase is financed with installment payments, it is possible that the purchase price will not be recovered if the debt turns uncollectible.

A travesty of justice, aside from the advanced collection timing, is when sales tax is remitted on the full purchase price, but the full amount of the purchase price is not received. The Indiana Tax Court correctly ruled for the taxpayer's refund in such a scenario. *Indiana Finance Financial Corp. v. Indiana Department of State Revenue* Case No. 20T-TA-00017, (Ind. Tax Ct. January 4, 2024).

Facts: Automobile dealership Oak Motors, Inc. ("Oak") executed installment sale agreements with auto-buying customers and, as required by Indiana law, paid Indiana sales tax on the full amount of the sales price. Oak sold the installment agreements to related party Indiana Finance Financial Corp. ("Financial") without recourse for approximately 70 percent of the amount financed (that is, Financial purchased the agreements at approx-imately 30 percent discount). For federal and Indiana income tax purposes, Financial treated the installment sales under the federal market discount rules for gain/loss (Internal Revenue Code ("IRC") Section 1276) by increasing basis in the agreements by the market dis-count included in its gross income and decreasing basis by each installment payment made.

When customers defaulted, Financial repossessed the autos and sold them at auction or to Oak. For fair market value of post-repossession proceeds, Financial used the auction proceeds (for sales at auction) or a respected vehicle pricing guide (for sales to Oak), plus third-party receipts related to insurance and warranty claims.

On its federal and Indiana income tax returns to address the uncollectible receivable, Financial treated the value of repossessed vehicles using the same market discount rules and claimed bad debt deductions under IRC 166. It filed sales tax refund claims deducting the Indiana sales tax on the bad-debt-related value that had been included in amounts that Oak had previously paid to Indiana on the full purchase prices.

The Department denied Financial's sales tax refunds to the extent the market discount rules applied to the value of the repossessed vehicles. The Department asserted that Financial was required to reduce its unpaid installment agreement balances by 100 percent of the values of the repossessed vehicles—that Financial should not follow the federal market discount rules for the bad debt deduction. The Department recalculated Financial's adjusted basis by reducing unpaid balances by the full value of the repossessed property (not reduc-ing unpaid balances by the amount that was not market discount income).

(continued on page 3)

Decision: Indiana requires that the full amount of sales tax on installment sales is due at the time of the sale. Ind. Code 6-2.5-6-7. Indiana allows a sales tax deduction to the extent of amounts "which were written off as an uncollectible debt for federal tax purposes under Section 166 of the Internal Revenue Code…." Ind. Code 6-2.5-6-9(a). IRC Section 166 refers to the federal basis rules. Indiana case law requires that the mathematics of IRC Section 166 be followed and that use of the market discount rules to calculate the Indiana bad debt deductions for sales tax purposes prevents writing off more than was actually paid for the uncollectible receivables. *Indiana DOR v. 1 Stop Auto Sales, Inc.,* 810 N.E.2d 686, 686-88 (Ind. 2004); *SAC Finance, Inc. v. Indiana DOR,* 24 N.E.3d 541, 547 (Ind. Tax Ct. 2014), *review denied.*

The Tax Court analyzed the above-mentioned case law. It declined the Department's request to revisit the Tax Court's prior decision in *SAC Finance* (it had been decided by the same judge that was ruling on Financing's refund claim). The Tax Court reasoned that Indiana law requires that the Indiana sales tax deduction computation follow the federal bad debt deduction under IRC Section 166. The Tax Court held that Financial was entitled to its claimed refund based on its bad debt deduction that followed the calculation under IRC Section 166 by excluding only the portion of the repossessed autos that was not market discount income.

> **Words matter. Justice prevailed!**

KARA M. KRAMAN
OF COUNSEL

New York State Tax Appeals Tribunal Denies Resident Credit for Tax Paid to Connecticut on Carried Interest

By Kara M. Kraman

The New York State Tax Appeals Tribunal ("Tribunal") held that a New York resident was not entitled to a resident tax credit for tax she paid to Connecticut on her carried interest. *Matter of Greenberg,* DTA No. 829737 (N.Y.S. Tax App. Trib., Nov. 22, 2023).

Facts: Taxpayer was domiciled in New York State and City and filed a New York State resident income tax return for 2014. Taxpayer was a partner in Hildene Holding Company, LLC ("Hildene"), a holding company that had an interest in two hedge funds. The taxpayer received a K-1 from Hildene reporting ordinary income and carried interest, consisting of interest income, dividends, and capital gain received by Hildene from its investments in the funds.

The taxpayer filed a Connecticut nonresident income tax return reporting and paying tax on the ordinary income and carried interest sourced to Connecticut under Connecticut law. For New York income tax purposes, the taxpayer claimed a resident tax credit for the tax she paid to Connecticut on both the ordinary income and the carried interest. The New York Division of Taxation ("Division") agreed that the taxpayer was entitled to a resident tax credit for the ordinary income but denied her the resident tax credit for the carried interest income. The Administrative Law Judge ("ALJ") upheld the denial of the resident tax credit with respect to the carried interest income.

Decision: The Tribunal affirmed the determination of the ALJ. The Tribunal found that amounts distributed to the taxpayer as carried interest retained their character as income from intangible personal property pursuant to the well established rule that partnership income retains its character when passed through to partners. The Tribunal noted that a resident tax credit is only allowed for income tax imposed by another state where the income in question is subject to tax in both states *and* is "derived from" the other state. Under New York Tax Law, intangible personal property constitutes income derived from New York sources for nonresidents only to the extent that such income is from property employed in a business, trade, profession, or occupation carried on in New York. Citing to the Division's regulation, the Tribunal found that the resident tax credit is generally only allowable to the extent similar income to a non-resident is found to be derived from New York sources and would be subject to tax in New York. The Tribunal noted that in this case, New York would not tax this type of income if received by a nonresident because it would not be determined to have a New York source.

Ultimately, the Tribunal found that the taxpayer failed to show that the intangible assets of the Hildene funds that generated the carried interest income were employed in the conduct of Hildene's business at all. In fact, the Tribunal noted that the taxpayer had failed to even argue that the intangible assets were employed in a business. Accordingly, the Tribunal determined taxpayer did not meet its burden to establish entitlement to the resident credit.

> **While the taxpayer did not prevail in this case, the question remains as to whether a similarly situated taxpayer could prevail if it could affirmatively establish that the intangible assets generating the carried interest income were employed in a business in another state.**

IRWIN M. SLOMKA
SENIOR COUNSEL

New York Appellate Court Rules in Favor of S Corporation Shareholder Entitlement to New York QEZE Tax Credits

By Irwin M. Slomka

In a pair of decisions, a New York State appellate court has annulled decisions of the New York State Tax Appeals Tribunal that reduced certain tax credits available to the individual shareholders of their S corporation. *Matter of Herman Schreiber et. al. v. N.Y.S. Tax Appeals Trib., et. al.,* Case No. 535976 (3d Dep't 2023); *Matter of Sam Goldstein et. al. v. N.Y.S. Tax Appeals Trib., et. al.,* Case No. 535980 (3d Dep't 2023).

Facts: Messrs. Schreiber and Goldstein ("Shareholders") each own 50 percent, directly and through trusts, of the stock of B&H Foto & Electronic Corporation ("B&H"), a Manhattan-based S corporation retailer that principally sells electronics and photography equipment including through a significant amount of mail order and online orders shipped outside New York State. B&H is certified as a New York "qualified empire zone enterprise" ("QEZE"), entitling shareholders to claim the credits on their New York State income tax returns.

Shareholders filed New York State resident income tax returns reporting their respective shares of income from B&H, as well as their share of any QEZE tax credits. In part, the shareholder's QEZE credit is based on the ratio of the shareholder's share of S corporation income allocated within the State to the shareholder's New York adjusted gross income.

As New York State residents, Shareholders calculated their QEZE credits based on all of B&H's taxable income, including income from sales shipped outside the State. Following an audit, the Division of Taxation ("Division") reduced the credit by multiplying it by B&H's business allocation percentage ("BAP") of approximately 18 percent. The Tax Appeals Tribunal, relying on a court decision authorizing application of an S corporation's BAP, upheld the Division's use of B&H's BAP to reduce the Shareholders' QEZE credits. This judicial appeal by the taxpayers followed.

Decision: The Appellate Division held that the Tax Appeals Tribunal erred in concluding that the S corporation's BAP must be applied to the Shareholders' QEZE credits in all cases. The court found that use of B&H's BAP resulted in a drastic reduction of Shareholders' QEZE credit which would lead to an irrational result in the case. The court considered it significant that the tax law limits the QEZE credit to the "shareholder's *income* from the S corporation allocated within the state," rather than to "*sales* with a destination point within New York State." This suggests that the court found that the Shareholders, as New York State residents, reported all of their income from B&H to New York. This obviated the need to limit their QEZE credits based on B&H's BAP and demonstrated unambiguous entitlement to the full credit. The court found that restricting the QEZE credit was contrary to the statutory purpose of the QEZE economic development program.

> **The court annulled the Tribunal decision, authorizing a full QEZE credit and refund to the Shareholders.**

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.

Blank Rome Represents RadioShack Bankruptcy Trustee in Favorable Settlement

- Blank Rome State + Local Tax partner Mitchell A. Newmark represented the Bankruptcy Trustee for RadioShack and a subsidiary in connection with two cases before the New Jersey Tax Court spanning 10 years. To learn more, please click here.

The 2024 National Multistate Tax Symposium

- Blank Rome State + Local Tax partner Craig B. Fields will serve as a speaker for the 2024 National Multistate Tax Symposium in a session titled "Alternative Apportionment and Forced Combination—Dishing on the Latest," being held February 9, 2024, in Orlando, Florida.

BLANKROME