



SEPTEMBER 2025

THE BR STATE + LOCAL TAX SPOTLIGHT **BLANKROME**



CONTENTS

1. Note from the Editors
2. Maryland Cannot Muzzle Taxpayers on Passthrough of Tax
3. North Carolina High Court Rules That Only State Courts May Determine That a Tax Statute is Unconstitutional
4. Ohio Supreme Court Gets to the Root of the Problem to Preserve Timber Farm's Tax Exemption
5. California Attorney General Clarifies OTA's Power to Disregard Conflicting Tax Regulations
6. What's Shaking: Blank Rome State + Local Tax Roundup

STATE + LOCAL TAX TEAM:

Craig B. Fields | craig.fields@blankrome.com
Eugene J. Gibilaro | eugene.gibilaro@blankrome.com
Nicole L. Johnson | nicole.johnson@blankrome.com
Mitchell A. Newmark | mitchell.newmark@blankrome.com
Irwin M. Slomka | irwin.slomka@blankrome.com

Joshua M. Sivin | joshua.sivin@blankrome.com
Philip M. Tatarowicz | phil.tatarowicz@blankrome.com
Melanie L. Lee | melanie.lee@blankrome.com
Stephanie N. Terinoni | stephanie.terinoni@blankrome.com

Note from the Editors

By Joshua M. Sivin and Melanie L. Lee

Welcome to the September 2025 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 developments and 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:

- Maryland Cannot Muzzle Taxpayers on Passthrough of Tax
- North Carolina High Court Rules That Only State Courts May Determine That a Tax Statute is Unconstitutional
- Ohio Supreme Court Gets to the Root of the Problem to Preserve Timber Farm's Tax Exemption
- California Attorney General Clarifies OTA's Power to Disregard Conflicting Tax Regulations

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

Maryland Cannot Muzzle Taxpayers on Passthrough of Tax

By Mitchell A. Newmark

Maryland must allow digital advertising taxpayers to separately state the amount of tax that is passed through to customers, so concludes a federal appeals court in a published opinion. *Chamber of Commerce of the U.S. et al. v. Lierman*, No. 24-1727 (U.S. Ct. App., 4th Cir. Aug. 15, 2025). The law is clear that if a government imposes a tax on a company that may be passed through to customers, the U.S. Constitution's First Amendment protects the company's right to explain the tax to its customers. Government is not permitted to hide the tax burdens that it imposes.

Maryland is the first U.S. state to impose a tax on revenues that companies produce by advertising on the internet. It applies to companies that generate at least \$100 million in global annual gross revenue and taxes the annual gross revenue. Further, via a clean-up bill, the statute imposing the tax provides: "A person who derives gross revenues from digital advertising services in the State may not directly pass on the cost of the tax imposed under this section to a customer who purchases the digital advertising services by means of a separate fee, surcharge, or line-item." Md. Code, Tax-Gen. § 7.5-102(c) (the "Passthrough Provision"). The Legislative history reveals that the purpose of the Passthrough Provision was to prevent companies that are subject to the tax from "simply pass[ing] the cost along to already struggling Maryland businesses, rather than absorb the cost of the tax."

Various companies and trade groups attacked the tax inasmuch as there is much in the tax that is subject to challenge. Several challenges were argued at the Maryland Tax Court during the week of July 28, 2025, including claims under the Internet Tax Freedom Act and, as of the date of this writing, decisions are still pending. However, the recent decision from the U.S. Court of Appeals is narrowly focused on the Passthrough Provision. The Chamber of Commerce plaintiffs asserted that the Passthrough Provision is a content-based restriction on political speech

that violates the First Amendment because it forbids them from explaining the tax to their customers and thus places political responsibility for price increases with Maryland and asserted, alternatively, that the provision unlawfully restricted commercial speech.

The Court observed that the Passthrough Provision prohibits passing through the tax by "separate" fees, surcharges, or line-items. The Court ruled that such prohibitions restrict the way that a price increase resulting from the tax can be communicated to customers. It reasoned that companies are permitted to pass the tax through to customers but are not permitted to tell the customers that there is a passthrough by separately stating a fee, surcharge, or line-item. Therefore, a company may only pass the tax through to customers in silence.

Maryland attempted to distinguish the Passthrough Provision as a prohibition from conduct—that the law prohibited the act of collecting the tax directly from customers and did not prohibit speech—to pass First Amendment muster. The Court was unmoved and reasoned that the incidence of the tax is on the company, not the customer, so a company is not passing through the incidence of the tax. A company is only stating the amount of increase in the invoice that the customer pays due to the tax, which is speech.

Maryland also tried to support the Passthrough Provision by asserting that it only prohibited commercial speech, which is subject to a lower threshold (intermediate scrutiny, that the law directly advances a substantial government interest and imposes a burden no more extensive than is necessary). The Court observed that an invoice calling attention to the Maryland tax was not inviting a commercial relationship. It was indeed akin to complaining about taxes, which the Court found "is among the oldest of American political traditions." Therefore, the Passthrough Provision should be subject to

(continued on page 3)

(continued from page 2)

Maryland Cannot Muzzle Taxpayers on Passthrough of Tax

a more difficult test (strict scrutiny, that the government demonstrate that the restriction furthers a compelling interest and is narrowly tailored to achieve the interest) in order to survive. The Court ruled that Maryland cannot survive either test because the obvious purpose of the Passthrough Provision is to make companies responsible for the tax while not permitting them to tell their customers the answer to the question: “Why have prices been raised?”

The Court held that Maryland’s clamp on a company’s ability to speak about the tax and the source of its burden on the customer fails the First Amendment of the U.S. Constitution on its face (that is, the challenge survives without waiting for an invoice itself to be generated and prohibited). The Court reversed the U.S. District Court’s decision and remanded the case for the District Court to construct a remedy. However, before ending its decision, it issued a parting shot at Maryland, stating that:

“The states are free to make controversial policy.... But with that freedom comes constraint. States may not forbid regulated parties to talk about their regulations unless they withstand First Amendment scrutiny. Maryland’s pass-through provision does not.”

The Takeaway: Government should freely admit the burdens it creates and cannot prevent taxpayers or purported taxpayers from complaining about taxes!



EUGENE J. GIBILARO

PARTNER

North Carolina High Court Rules That Only State Courts May Determine That a Tax Statute is Unconstitutional

By Eugene J. Gibilaro

On August 22, 2025, the North Carolina Supreme Court held that the North Carolina Office of Administrative Hearings (“OAH”), an administrative body within North Carolina’s executive branch, does not have the authority to decide that a tax statute is unconstitutional either on its face or on an as-applied basis. *North Carolina Dep’t of Revenue v. Phillip Morris USA, Inc.*, No. 242A23 (N.C. Aug. 22, 2025). The case makes clear to taxpayers wishing to challenge the constitutionality of a North Carolina statute, either facially or as-applied, that their exclusive remedy is challenging the statute in court.

It is also a reminder to taxpayers wishing to challenge the constitutionality of tax statutes in any state, that the first step in any such challenge is ensuring that their case is before an appeals body that has the authority to determine that the tax statute in question is unconstitutional.

The taxpayer here challenged a provision of the North Carolina franchise tax law that permitted a creditor corporation to deduct from its franchise tax base the debts owed to it by a related party debtor corporation so long as the debtor corporation also filed a North Carolina franchise tax return. N.C.G.S. § 105-122(b) (2013). The taxpayer argued on appeal at the OAH that the provision was unconstitutional as applied to the taxpayer because it amounted to prohibited economic protectionism whereby the benefit of the deduction was permitted based solely on whether the debtor corporation did business in North Carolina. The OAH agreed, holding that the provision violated the Commerce Clause of the U.S. Constitution as applied to the taxpayer. The Department of Revenue appealed, and the Special Superior Court Judge for Complex Business Cases

held that the OAH lacked subject matter jurisdiction over the taxpayer’s as-applied constitutional challenge to the franchise tax provision in question.

On appeal by the taxpayer, the North Carolina Supreme Court first held that a party can assert that a court lacks subject matter jurisdiction at any time in a case, even for the first time on appeal, and therefore, the fact that the Department did not raise the OAH’s lack of subject matter jurisdiction during the proceeding before the OAH did not preclude the Department from making the argument on appeal. The Court next explained that an administrative body, such as the OAH, “is a creature of the statute creating it” and “to be lawful, each agency action must ultimately be grounded in some piece of legislation.” Consequently, the Court was unpersuaded by the taxpayer’s argument that the OAH was authorized to decide as-applied constitutional challenges because it was not expressly barred from doing so by statute.

The Court instead reasoned that “if the legislature had wished to bestow the judicial power to decide as-applied constitutional challenges upon the OAH, it would have done so in clear-cut terms.” Finding (1) no such “clear-cut terms” in the applicable statutes; (2) that inferring the grant of authority to the OAH to decide as-applied constitutional challenges would raise “serious separation-of-powers issues;” and (3) that “a plausible interpretation of the statute would avoid the problem,” the Court adopted the “plausible interpretation” that the applicable statute did not grant the OAH the authority to decide as-applied constitutional challenges. The Court affirmed the lower court’s decision, remanding the case to the OAH and ordering that the OAH dismiss the taxpayer’s constitutional claims for lack of subject matter jurisdiction.



MELANIE L. LEE

ASSOCIATE

Ohio Supreme Court Gets to the Root of the Problem to Preserve Timber Farm's Tax Exemption

By Melanie L. Lee

The Ohio Supreme Court, reversing a decision of the Board of Tax Appeals, held that a timber farm's purchase of a Mercedes Benz vehicle qualified for a use tax exemption. [Claugus Family Farm L.P. v. Harris](#), Slip Op. No. 2025-Ohio-2807 (Ohio Aug. 13, 2025).

The Facts: Claugus Family Farm, L.P. ("CFF"), in business since 1902, operates an 1,100-acre timber farm in Ohio. In 2018, CFF purchased a Mercedes Benz Geländewagen and did not pay tax on the vehicle at the time of purchase, claiming the purchase of the vehicle was exempt from taxation because it would be used in timber farming. Ohio's Tax Commissioner disagreed with CFF's claimed exemption, finding that (1) CFF had not sold timber or reported any income since 2011, (2) CFF failed to provide any evidence that the vehicle "was used directly in farming activities," and (3) the primary use of the vehicle could not be determined because CFF did not quantify the vehicle's use in terms of a percentage.

The Law: Ohio offers a sales and use tax exemption for property purchased if "the purpose of the purchaser is to... use or consume the thing transferred primarily in producing tangible personal property for sale by farming, agriculture, horticulture or floriculture." R.C. 5739.02(B)(42)(n). To determine whether the exemption applies, a three-part test must be satisfied. First, the purchaser must be engaged in the business of farming. Second, the property purchased must be used in farming activities. And, third, the farming activities must account for the property's primary use.

The Decision: Both parties and the Court agreed that the aforementioned three-part test must be satisfied in order for the purchase of the vehicle to qualify for Ohio's

sales tax exemption. However, the Court found that both parties misapplied the three-part test by reading into the test requirements not found in the plain language of the applicable statute.

First, analyzing whether CFF is engaged in the business of farming, the Court found no requirement that CFF "show that it was actively engaged in the harvesting of its timber when it purchased the Mercedes to establish that it is engaged in the business of farming." Nor did the Court find a requirement that CFF generate a profit from its timber farm in order to be in the business. Instead, the Court looked to the testimony of CFF's managing general partner who established the decades of work it takes in order to establish a successful timber farm—which he defined as making as much money as possible while "the trees do the work." Though CFF was not "literally" cutting down timber for sale when it purchased the vehicle, CFF was engaged in long-term activities needed to create a successful timber farm, including removing invasive species from the forest and inspecting for damage caused by wind and lightning strikes. Thus, the Court concluded that these activities proved CFF engages in farming as a business.

Next, the Court turned to the second part of the test to determine whether the Mercedes was used by CFF in farming. Critically, the Court first pointed out to *both* parties that there is no requirement under the current law that the vehicle be used "directly" in farming. Though prior versions of R.C. 5739.02 contained a direct-use requirement, the legislature amended the law so that the term "directly" was nowhere to be found. As a result, the Court's view was that the amended law allows property to qualify for the exemption "even though it is used to perform an intermediate step in the process of producing

(continued on page 6)

(continued from page 5)

Ohio Supreme Court Gets to the Root of the Problem to Preserve Timber Farm's Tax Exemption

[timber]....” Finding that CFF used the Mercedes to carry people, chemicals, and equipment through the rugged terrain of the forest, the Court concluded that the vehicle was used in farming.

Finally, the Court addressed the third part of the test—whether the vehicle was used *primarily* in farming. Though the Commissioner argued that CFF needed to provide use or mileage logs to prove how the vehicle was used, the Court found no such requirement under the law. Refusing to “[insert] requirements that the legislature did not prescribe[,]” the Court looked to the only evidence before it which established the primary use of the vehicle. That evidence again was the testimony of CFF’s managing general partner, who testified that 95 percent of the vehicle’s use was farming activities. Relying on that testimony, the Court determined that the vehicle was used primarily in farming.

Finding that CFF satisfied the three-part test, the Court concluded that the Board of Tax Appeal’s decision to deny CFF’s exemption “was neither reasonable nor lawful.”

The Takeaway: In this case, the Court took the time to examine the plain language of the law that both parties seemed to neglect. However, taxpayers should not rely on the good graces of a court in order to establish their entitlement to an exemption.

Read the plain language of the statutory exemption as it was enacted during the years at issue and be wary not to read into it requirements that do not exist.

Even if a department of revenue or tax commissioner purports to impose a requirement to qualify for an exemption, if the requirement is not based in the law’s plain language, it may not have to be satisfied!



STEPHANIE N. TERINONI

ASSOCIATE

California Attorney General Clarifies OTA's Power to Disregard Conflicting Tax Regulations

By Stephanie N. Terinoni

In [Opinion No. 23-701](#), issued July 31, 2025, California's Attorney General settled a fundamental question about the reach of California's newest tax adjudicatory body: can the Office of Tax Appeals ("OTA") refuse to apply a regulation promulgated by another tax agency if the OTA concludes that the regulation conflicts with governing statutes? The Attorney General's answer is an unqualified *yes*—and, in doing so, the Opinion restores a long-standing administrative practice that had been in doubt since the 2017 reorganization of California's tax agencies.

A Short History of California's Tax Appeals System

For decades the elected State Board of Equalization ("Board") wore two very different hats: (1) administering certain business taxes and fees; and (2) adjudicating disputes arising under them. In 2017, concerns about that "operational culture" led the Legislature to transfer most of the Board's functions to two new entities. The California Department of Tax and Fee Administration ("CDTFA") assumed responsibility for administering sales, use, and other business taxes and fees, while the OTA—housed in the executive branch but structurally insulated from tax administrators—became an "independent and impartial appeals body." The OTA now decides protests of assessments issued by the CDTFA and the Franchise Tax Board ("FTB") (which administers the State's income and franchise taxes).

Although the Board had long entertained statutory challenges to tax regulations, the OTA—urged on by CDTFA and FTB—began declining to do so. The OTA even proposed a regulation that would have barred such challenges outright before withdrawing the proposal amid substantial public criticism. The OTA's director then requested an attorney general opinion.

The Opinion's Core Holding

California's Attorney General concluded that the OTA possesses the same adjudicatory authority the Board wielded: that is, when hearing a taxpayer's appeal, the OTA may examine whether application of a CDTFA or FTB regulation would "conflict with applicable statutes" and, if so, may resolve the case as though the regulation did not exist. The OTA must give the promulgating agency "appropriate deference," but it is not bound to enforce regulations that cannot be reconciled with the statute.

Importantly, the OTA's reach stops there. An OTA decision does not repeal or amend the regulation, remove it from the California Code of Regulations, or control its application outside the case at hand. The Opinion stresses that any broader question about the regulation's continued validity remains with the rulemaking agency, the Legislature, or the courts.

The Opinion relies principally on Government Code Section 15672, which makes the OTA the "successor" to the Board for all duties "necessary or appropriate to conduct appeals hearings." Because the Board had repeatedly entertained and sometimes sustained statutory attacks on both its own and FTB regulations, that power passed to the OTA unless the Legislature affirmatively withdrew it—and nothing in the 2017 reorganization statutes or subsequent amendments indicates such an intent.

The Opinion also cites Government Code Section 11342.2, the Administrative Procedure Act ("APA") provision declaring that a regulation "in conflict with" its enabling statute is not "valid or effective." In *Woods v. Superior Court* (28 Cal.3d 668, 671-672 (1981)) and numerous Board decisions, that language justified administrative refusal to apply an invalid rule. The OTA, the Attorney General reasoned, must perform the same analysis to "apply the appropriate law to the facts."

(continued on page 8)

(continued from page 7)

California Attorney General Clarifies OTA's Power to Disregard Conflicting Tax Regulations

APA Objections Rejected

Critics argued that an OTA ruling on a regulation's validity is a quasi-legislative act subject to the APA's notice-and-comment rulemaking requirements. The Opinion counters that the determination is quasi-adjudicative: the panel decides a discrete controversy between specific parties, using an adjudicative record, and issues a decision that is reviewable *de novo*. Because OTA opinions do not erase a regulation from the code or create rules of general application, the APA's rulemaking procedures are irrelevant.

Constitutional Concerns Addressed

The Opinion further rejects separation-of-powers challenges. Article III, Section 3.5 of the California Constitution forbids agencies from refusing to enforce a *statute* on constitutional grounds absent an appellate decision, but it is silent about regulations. Declining to apply a regulation because it conflicts with a statute therefore does not implicate the provision. Nor does the analysis usurp judicial authority—courts retain the last word and allowing administrative scrutiny actually conserves judicial resources by narrowing disputes.

Practical Implications

The Opinion realigns OTA practice with the policy objectives that drove the 2017 reform—an appeals forum that is “independent, objective, expert, and fair.”

Taxpayers may once again argue before the administrative tribunal that a regulation exceeds statutory authority, without the cost and delay of immediate resort to the courts. The CDTFA and FTB, in turn, must be prepared to defend their rules to the OTA.

In sum, the Opinion confirms that the OTA inherits the Board's long-standing authority to disregard tax regulations that clash with a statute. The Opinion restores an important taxpayer safeguard, clarifies the respective roles of California's tax agencies, and preserves a coherent separation between rulemaking and adjudication.

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.

National Association of State Bar Tax Sections Conference

- ▶ Blank Rome State + Local Tax partner [Eugene J. Gibilaro](#), will be speaking at the National Association of State Bar Tax Sections Conference in Seattle, Washington on September 25, 2025. His speech is titled "Backdoor Worldwide Combined Reporting / State Treatment of Foreign Income." To learn more, please click [here](#).

Paul J. Harman SALT Forum

- ▶ Blank Rome State + Local Tax partners [Craig B. Fields](#) and [Nicole L. Johnson](#) will be speaking at the Paul J. Hartman SALT Forum in Nashville, Tennessee on October 27, 2025. Their speeches are titled "Controversy Management in SALT: Tools, Tactics, and Trends" and "O Customer, Where Art Thou? Complications in Sourcing to the Customer," respectively. To learn more, please click [here](#).

Tax Executives Institute, Annual Meeting

- ▶ Blank Rome State + Local Tax partners [Mitchell A. Newmark](#) and [Eugene J. Gibilaro](#) will be speaking at the Tax Executives Institute Annual Meeting in San Francisco, California on October 27 and 28, 2025. Mitchell's speech is titled "SALT of the Earth – Grounding State and Local Tax Policy in Practice," and Eugene's speech is titled "Breakout Session: From Coast to Coast – The Top 10 SALT Developments Across the States." To learn more, please click [here](#).

NYU SALT Institute

- ▶ Blank Rome State + Local Tax partner [Craig B. Fields](#), will be speaking at the NYU SPS Institute on State and Local Taxation Conference in New York, New York on December 9, 2025. His speech is titled "The Intersection of Important International Issues." To learn more, please click [here](#).