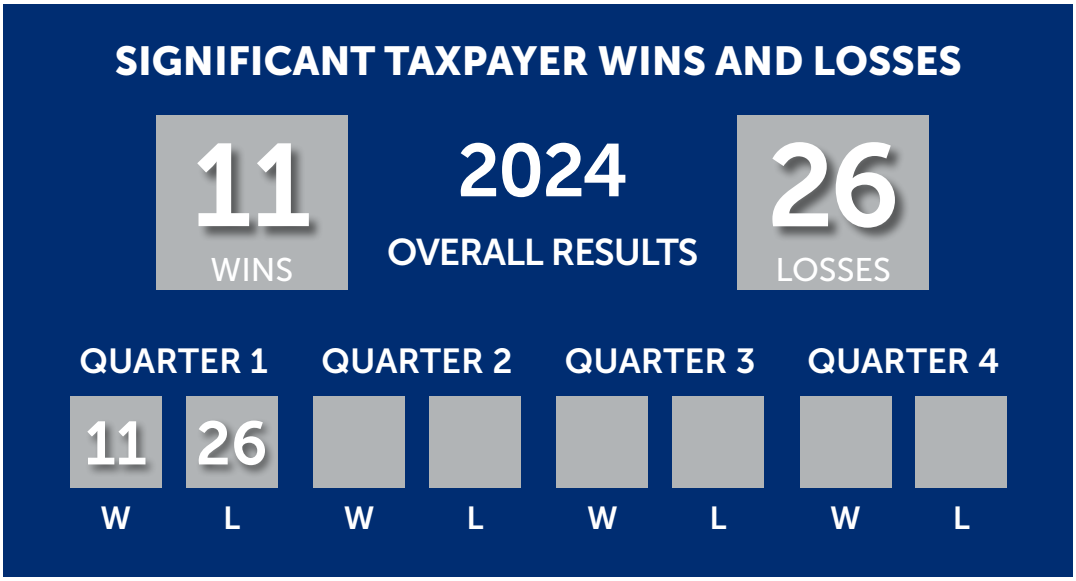
EVERSHEDS SUTHERLAND SALT SCOREBOARD Q1 2024

This is the first edition of the Eversheds Sutherland SALT Scoreboard for 2024. Since 2016, we have tallied the results of what we deem to be significant taxpayer wins and losses and analyzed those results. Our entire SALT team hopes that you have found the SALT Scoreboard's content useful. This edition includes discussions of bundled transactions and manufacturing benefits, as well as a spotlight on digital services taxation cases.

1st quarter 2024

In the first quarter of 2024, taxpayers prevailed in 29.7% (11 out of 37) of the significant cases.* Taxpayers won 42.9% (6 out of 14) of the significant corporate income and franchise tax cases and 20.0% (3 out of 15) of the significant sales and use tax cases.



*Some items may have been decided in a prior quarter but included in the quarter in which we summarized them.

Year-to-date

Taxpayers prevailed in **6** out of 14 significant corporate income and franchise tax cases across the country

Taxpayers prevailed in **3** out of 15 significant sales and use tax cases across the country

SIGNIFICANT MULTISTATE DEVELOPMENTS

Bundled Transactions

CASE: *Bekkerman v. California Department of Tax & Fee Administration*, 99 Cal.App.5th 1264 (Cal. Ct. App. 2024).

SUMMARY: A California Court of Appeal held that purchases of "discounted" cell phones bundled together with wireless services were subject to sales tax based on the cell phone's full price. Plaintiffs challenged Regulation 1585—which governs the tax treatment for bundled transactions—on the grounds that it (1) violated the Revenue and Taxation Code, and (2) was not adopted in compliance with the Administrative Procedures Act (APA) because the Department did not sufficiently consider economic impact on businesses. In response, the court held that the regulation was compliant with the Code because it bridged the statutory gap of how to measure which portion of the bundled transaction was attributable to tangible personal property. The court also analyzed the regulation's history, noting that the longstanding interpretation spoke to its consistency. Additionally, the court found the regulation met all APA requirements. Thus, the Court of Appeal blessed the application of Regulation 1585 to determine the tax on bundled transactions with discounted items. View more here.

Interest Expense Addback

CASE: *Huhtamaki Inc. v. Alabama Department of Revenue*, Dkt. No. BIT. 19-890-JP (Ala. Tax Tribunal Feb. 26, 2024).

SUMMARY: The Alabama Tax Tribunal held that a packaging manufacturer was not required to add back interest payments indirectly made to foreign affiliates through a U.S. parent company. The manufacturer made several interest payments to its U.S. parent company, which then transferred the payments to foreign affiliates in countries with an income tax treaty with the U.S. (making a portion of such interest income deductible in the foreign counties). The Department argued that the manufacturer failed to qualify for the subject-to-tax exception under the add-back statute. The Tribunal disagreed with the Department, and held that the subject-to-tax exception was not defeated based on the fact that foreign affiliates could deduct a portion of the interest payments. View more here.

Sales Tax Exemption

CASE: *American Aviation Supply, LLC v. Illinois Department of Revenue*, 2024 IL App (1st) 230072 (Ill. Ct. App. Feb. 29, 2024).

SUMMARY: The Illinois Appellate Court held that aviation fuel sold to airlines—and subsequently stored at O'Hare International Airport—is not exempt from the Retailer's Occupation Tax because the fuel was not consumed solely outside of the state. The taxpayer, an aviation fuel retailer, argued that its fuel was subject to an exemption for property temporarily stored in the state and subsequently used outside of the state. Only 2% of the fuel was consumed in Illinois, and the remaining 98% was used outside the state. Relying on the statute's plain language, the court disagreed with the taxpayer, holding that the entire use or consumption of the property at issue must be outside of Illinois. Because the taxpayer's fuel was loaded on planes in Illinois and partly consumed in the state, the court concluded that the fuel at issue did not qualify for the exemption. View more here.

Fuel Tax

CASE: *Buchanan Energy (N) LLC v. County of Cook*, 2024 IL App (1st) 220056 (Ill. Ct. App. Mar. 22, 2024).

SUMMARY: The Appellate Court of Illinois issued a split decision in a case involving local fuel taxes transferred by a fuel distributor to affiliated gas station operators in Cook County. Specifically, the fuel distributor failed to collect tax on fuel transferred to two types of affiliate stations: (1) stations owned by the distributor but operated by an affiliate ("Buck's"); and (2) stations owned and operated by another affiliate ("Buchanan South"). The Appellate Court of Illinois found that transfers to Buck's were not taxable because, as the taxpayer owned the station, there was no taxable transfer to a retail dealer. The court, however, reached the opposite conclusion with respect to sales to Buchanan South. The court held that because the taxpayer did not own the stations, the transaction constituted a taxable transfer to a retail dealer. View more here.

Spotlight on Digital Services Taxation

CASE: *DirecTV LLC v. City of Baton Rouge*, Docket No. L01329 (La. Bd. of Tax Appeals Mar. 14, 2024).

SUMMARY: The Louisiana Board of Tax Appeals granted summary judgment to a satellite television service provider, holding that its sales of video-on-demand and pay-per-view are not subject to sales tax. A group of local parishes assessed the taxpayer under the theory that video-on-demand and pay-per-view services were tangible personal property because the content was "perceptible to the senses" and temporarily stored on set-top boxes. The Board of Tax Appeals referenced the decision in *Normand v. Cox Communications Louisiana LLC* — holding that "to conclude that the mere status of being perceptible does not automatically render something taxable tangible personal property" because doing so would make the cable television service exemption "read virtually out of existence." View more here.

CASE: *Matter of Dynamic Logic, Inc. v. Tax Appeals Tribunal of the State of New York*, 224 A.D.3d 1184 (N.Y. App. Div. 2024).

SUMMARY: The New York Appellate Division, Third Department, held that a taxpayer provided taxable information services, rather than consulting service, for sales tax purposes. The services at issue included report creation, data and survey response analysis and interpretation, client campaign response comparison, and consulting and recommendations for advertising effectiveness, among others. The court held that the taxpayer's services did not fall within the sales tax exclusion—which applies to information services that are not or may not be substantially incorporated in reports furnished to other persons—because portions of the taxpayer's database generally appears on reports furnished to customers. Thus, the court held that the services provided were information services (not consulting services) because their primary function was the collection and analysis of information. View more here.

CASE: *City of Lancaster v. Netflix, Inc., et al.*, 99 Cal.App.5th 1093 (Cal. Ct. App. 2024).

SUMMARY: A California Court of Appeal held that localities do not have a private right of action to pursue franchise fees from non-franchise holder streaming video providers. The court found that California law only expressly authorizes a local government to bring an action concerning the underpayment or nonpayment of franchise fees against franchise holders. Additionally, the court held that the legislative intent did not indicate the creation of an implied right to bring a legal action against any company that does not hold a franchise. View more here.

Manufacturing

CASE: *In the Matter of the Petition of E. & J. Gallo Winery*, DTA Nos. 830277, 850146 (N.Y. Div. Tax App. Feb. 15, 2024).

SUMMARY: A New York state administrative law judge concluded that a winery qualified as a "qualified New York manufacturer" ("QNYM") even though it (1) did not have any employees at the winery, and (2) outsourced its land management operations to an independent land management contractor. The winery was thus entitled to a reduced corporate franchise tax rate. The Department argued that the winery was not entitled to the QNYM benefits on the basis that the taxpayer did not principally use the qualifying property for the production of goods by manufacturing, processing, assembling, refining, viticulture, and other commercial activities because the activities were performed by a third-party contractor and the grapes were in a dormancy period for a period of time. But the ALJ rejected the Department's argument, and found that (1) the third-party contractor's activities constituted use of the property and (2) the grapes being in a dormancy period was still a "crucial part of the annual growth cycle for grapes." View more here.

Use Tax

CASE: *Ellingson Drainage, Inc. v. South Dakota Department of Revenue*, 3 N.W.3d 417 (S.D. 2024).

SUMMARY: The South Dakota Supreme Court held that South Dakota's use tax, as applied to the taxpayer, did not violate the Commerce or the Due Process Clauses of the Fourteenth Amendment, despite some of the taxed equipment being used in South Dakota for only one day. In particular, the court held that the tax was fairly related to the benefits provided because the taxpayer enjoyed the same benefits as any other business present in the state and was free to use the equipment in state as often as it wanted. Moreover, the court found that the use tax statute was externally consistent and did not include a requirement that the equipment be "at rest" to be subject to the tax. Rather, the taxed activity was "simply an in-state use of equipment that was purchased outside the state without ever having paid sales taxes on the property." View more here.

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