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



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Note from the Editors

By Joshua M. Sivin and Melanie L. Lee

Welcome to the November 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:

- Use Tax Resale Exemption: Win at Missouri Supreme Court
- Michigan Tax Tribunal Holds That Parent Properly Excluded its Wholly Owned Subsidiary from its Unitary Business Group Return
- California Governor Signs a Handful of Tax-Related Bills into Law

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Use Tax Resale Exemption: Win at Missouri Supreme Court

By Mitchell A. Newmark

States often dig in on issues where they shouldn't, and we see that often in the sales and use tax context (as often as with other state taxes). The Missouri Director of Revenue incorrectly assessed use tax against a subsidiary ("Subsidiary") of Wal-Mart Stores, Inc. that purchased price scanners, credit card readers, computers and servers from third parties, installed or added software and hardware to the equipment as necessary, and re-sold the equipment to related entities. The related entities paid for the equipment plus a markup and delivery costs, used the equipment in connection with store operations, and paid use tax in their respective used jurisdictions.

Subsidiary refused to roll over and, after the Director lost at the Missouri Tax Commission, the Director appealed to the Supreme Court of Missouri.

Under the use tax law, a sale is "any transfer...of [] title or ownership...for a consideration paid..." Mo. Stat Sec 144.605(7). The use tax resale exemption applies to "processors, retailers, importers, manufacturers, wholesalers, or jobbers solely for resale in the regular course of business[.]" Mo. Stat Sec 144.615(6). Prior Missouri case law required only that the taxpayer show a subsequent transaction that satisfies the exemption statute and the sale statute. Further, another statute provided for use tax exemption when the property at issue was purchased for "the purpose of resale" if the "subsequent sale is...[s]ubject to a tax in this or any other state[.]" Mo. Stat Sec 144.018.1(1).

The Court held that Subsidiary met the statutory tests for exemption by resale. It also held that Subsidiary met the test for exemption as having been purchased for the purpose of resale and the subsequent purchase would be taxed in Missouri or another state.

The Director raised a new issue (regarding the treatment of an LLC for use tax purposes) in the Missouri Supreme Court—it had not raised that issue at the Missouri Tax Commission. The Court refused to address the newly raised issue.

It is important to remember that words matter. Subsidiary met the letter of the law. The Director should not have assessed use tax and should not have pursued the appeal. Justice prevails again!



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Michigan Tax Tribunal Holds That Parent Properly Excluded its Wholly Owned Subsidiary from its Unitary Business Group Return

By Irwin M. Slomka

Challenging a state corporate tax determination of a unitary business relationship between related corporations can be difficult. However, a recent decision of the Michigan Tax Tribunal shows that with good facts a business can rebut a unitary business finding and successfully avoid having to file on a unitary combined basis. *TTI, Inc. v. Michigan Dep't of Treasury, Mich. Tax Trib.*, No. 21-002481 (Oct. 17, 2023).

Facts: TTI, Inc. (“TTI”) is a Delaware corporation headquartered in Fort Worth, Texas that sells electronic components to original equipment manufacturers throughout the United States. In 2000, it acquired Mouser Electronics, Inc. (“Mouser”), a company that also sells electronic components, but instead to product developers and engineers through catalog and online sales, as its wholly owned subsidiary. After the acquisition, TTI and Mouser maintained separate headquarters, sales offices, warehouses and distribution facilities.

TTI included Mouser in its originally filed Michigan corporate income tax returns for the years 2013 through 2016 as part of its unitary business group. TTI later amended those returns—and amended its unitary returns filed in eleven other states—to exclude Mouser, resulting in refund claims. Following an audit, the Michigan Department of Treasury (“Department”) issued notices of Intent to Assess based on the Department’s view that Mouser was engaged in a unitary business with TTI. This litigation followed.

Dispute: TTI asserted that Mouser and TTI did not meet the definition of a “unitary business group” under Michigan law and, therefore, the two entities did not have to be combined. In relevant part,

a Michigan “unitary business group” exists where there are “business activities or operations” between or among substantially owned group members which either (i) results in a “flow of value” between or among those group members (“flow of value test”) or (ii) “are integrated with, are dependent upon, or contribute to each other.” (“contribution/dependency test”). MCL 206.611(6). The Department claimed that both tests were met.

Tribunal Decision: The Tax Tribunal concluded that TTI met its burden of proving that neither the flow of value test nor the contribution/dependency test was met.

1. **Flow of Value Test.** The Tribunal held that the flow of value test was not satisfied, finding an insignificant level of functional integration, centralized management and economies of scale. On the question of functional integration, the Department pointed to “significant intercompany sales” from TTI to Mouser of more than \$20 million annually. The Tribunal was of the view that this “paints a skewed picture” since such sales represented only 1 percent to 1.5 percent of TTI’s revenues. Similarly, Mouser’s sales to TTI represented only 1 percent of Mouser’s global sales. Therefore, intercompany sales were not significant. The Tribunal was also not persuaded by the Department’s inference that there was “cost savings” when one entity sold inventory to the other, noting that each acquired its inventory from third-party manufacturers and suppliers, which likely included a mark-up so that intercompany purchases reflected the same third-party markup resulting in no cost savings.

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The decision is somewhat less clear on the question of intercompany loans and receivables. While there were no direct loans between the two companies, there were unspecified intercompany receivables. However, in the absence of direct evidence of what the receivables pertained to or any discussion of the issue in the Department’s legal brief, the Tribunal concluded that the receivables reflected accounting entries for normal intercompany transactions, such as intercompany sales, and should not be considered separately from intercompany sales.

The Tribunal found no centralized management, noting that, while the two companies shared the same CEO/Chair and Secretary/Treasurer, overall each company’s operations and management were independent of the other. The Tribunal also concluded that the existence of a few shared employee benefits programs—for instance, a shared health insurance plan and 401(k) plan, and a single business insurance policy, the costs of which were borne respectively by each entity—did not rise to the level of a significant reduction in the costs of operations or administrative functions.

2. *Contribution/Dependency Relationship Test.* The Tribunal found that the three-part alternative “contribution/dependency relationship” test for a unitary business group also was not met. Looking at each of the three factors separately—“integration with,” “dependence upon” or “contribution to” each other—the Tribunal first found that the integration analysis for the “flow of value” test (discussed above) was no different than under the contribution test and supported TTI’s position. As for the dependence factor, the Tribunal concluded that while a wholly owned subsidiary is necessarily subordinate to its parent, that relationship alone cannot satisfy the dependence test as it would negate the criteria for determining a unitary business group in the first place. Finally, the Tribunal gave no weight to an internal company memo sent to TTI employees in 2000 discussing the acquisition of Mouser, which the Department contended was evidence of a unitary relationship, noting that the Department failed to adequately explain how the memo was relevant to the years in issue, more than a decade later.

While unitary business tax disputes are necessarily dependent on the particular facts, this Michigan decision demonstrates that the burden of proof is not insurmountable even where the law broadly defines a unitary business, and even in the face of millions of dollars of intercompany sales and some level of officer overlap.



KARA M. KRAMAN

OF COUNSEL

California Governor Signs a Handful of Tax-Related Bills into Law

By Kara M. Kraman

This fall, California Governor Gavin Newsom signed several tax-related bills into law on a diverse array of topics ranging from the use tax to the gun tax.

Use tax: On October 7, 2023, Governor Newsom signed a bill into law changing the threshold for a California business to register to pay use tax. Prior to enactment of the new law, a qualified purchaser that had more than \$100,000 in annual gross receipts was required to register with the California Department of Tax and Fee Administration (“CDTFA”) to pay use tax on purchases from out-of-state sellers. Under the new law, a qualified purchaser must make more than \$10,000 in purchases per year from an out-of-state seller on which use tax has not been paid and remitted by the remote seller in order to be required to register with CDTFA. The bill’s sponsor described the purpose of the bill as to update the “outdated and burdensome” old system which was in effect before the Supreme Court decision in *South Dakota v. Wayfair, Inc.* generally allowed states to collect use tax from out-of-state sellers. As California adopted a law post-*Wayfair* that requires out-of-state sellers that sell more than \$500,000 in property in California to register to collect and remit use tax, the legislature determined that the old use tax registration requirements should be updated and streamlined.

Gun tax: While the change to the use tax registration did not garner much attention from the press, one bill that did was one signed by Governor Newsom on September 26, 2023 that doubled the taxes on sales of guns and ammunition in California. While federal law already taxes gun and ammunition sales at either 10 or 11 percent depending on the type of gun, the new law

adds an additional 11 percent California tax on top of that, making California the only state to impose its own tax on guns and ammunition.

The Governor’s office described the legislation as a “first-in-the-nation effort to generate \$160 million annually on the sale of bullets to improve school safety and fund a gun violence intervention program.”

Settlement authority of the CDTFA: On October 8, 2023, Governor Newsom signed into law a bill that makes changes to certain tax administration provisions, including a provision giving the CDTFA sole authority to approve settlement agreements reducing a taxpayer’s liability for tax or penalties by up to \$11,500, with periodic adjustments to be made to that threshold for inflation. Prior to the enactment of the new law, settlements involving a reduction of tax or penalties of up to \$5,000 required joint approval from the executive director of CDTFA and the chief counsel’s office.

Extension of disaster relief deduction: On September 30, 2023, Governor Newsom signed a bill extending the State’s disaster relief loss deduction through December 31, 2028 for both individual and corporate taxpayers. The disaster relief loss deduction allows a taxpayer to declare a loss related to a California disaster declared by the President of the United States or the Governor of California. Prior to the enactment of the new law, the disaster relief loss deduction was scheduled to sunset on December 31, 2023.

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.

New York and Tri-State Taxation Conference

- ▶ Blank Rome State + Local Tax senior counsel [Irwin M. Slomka](#) and associate [Melanie L. Lee](#) will serve as speakers at the New York State Society of Certified Public Accountants' ("NYSSCPA") [New York and Tri-State Taxation Conference](#), being held Wednesday, November 29, 2023, in New York, New York. To learn more, please click [here](#).

State and Local Tax Issues for a Mobile Workforce

- ▶ Blank Rome State + Local Tax partner [Eugene J. Gibilaro](#) and of counsel [Joshua M. Sivin](#) will serve as speakers for the Federal Bar Association myLawCLE program "[State and Local Tax Issues for a Mobile Workforce](#)," being held Thursday, December 7, 2023, from 10:00 to 11:40 a.m. EST, as a live video-broadcast. To learn more, please click [here](#).

42nd Institute on State and Local Taxation

- ▶ Blank Rome State + Local Tax ("SALT") partners [Mitchell A. Newmark](#) and [Nicole L. Johnson](#) will serve as panel moderators at NYU School of Professional Studies' [42nd Institute on State and Local Taxation](#), being held December 11 and 12, 2023, in New York, New York. Blank Rome LLP is pleased to be a Platinum Sponsor of the program. 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.