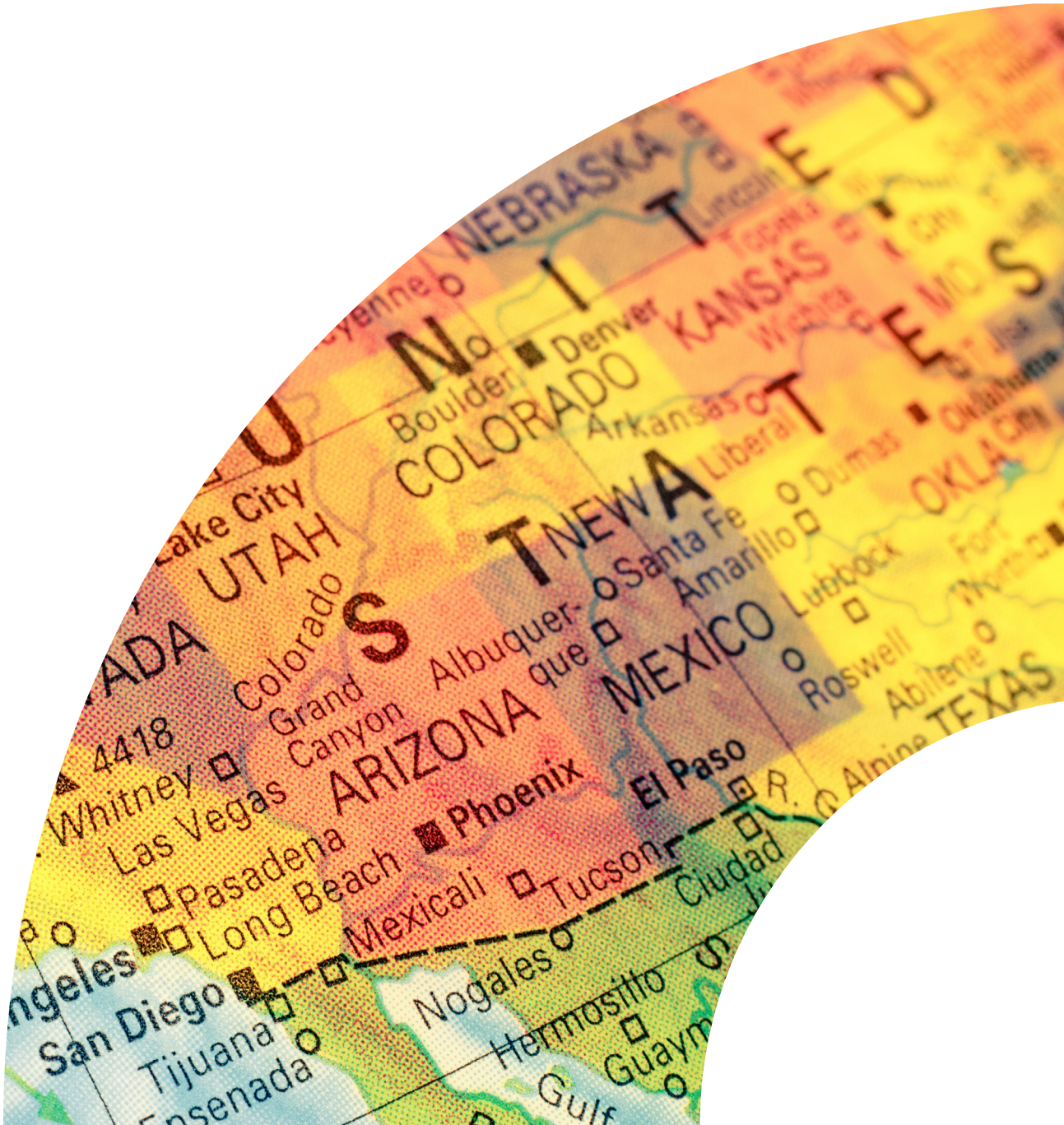
Grant Thornton

Top 10 SALT Stories of 2022



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In our end-of-year summary of the top state and local tax (SALT) stories released in December 2021, we raised the hope that everything would get back to normal from the perspective of recovering from the pandemic. At the same time, we thought it was "patently clear that as of this writing the pandemic still casts a long shadow over everything, including SALT." In many respects, 2022 was a year in which getting back to normal, or at least to a new normal, basically happened. Seeing our colleagues in SALT and beyond became commonplace again. We were grateful to be able to attend live conferences with stages and microphones, in conjunction with happy hours and plenty of networking. Seeing and interacting with people for the first time in three years (outside of a video context) following a shared, traumatic experience, was in a word, awesome.

While getting back to a new normal in many respects became a goal and then a reality this year, resulting in the pandemic casting a smaller shadow than in 2021, the pandemic has changed behavior that is dramatically affecting SALT outcomes for businesses, individuals, and state and local governments in an endless number of ways. For example, the pandemic required many businesses to shift to remote and hybrid work arrangements in which their employees visit the office far less frequently.

For many businesses, this change has resulted in reconfiguring their physical footprint, with implications affecting where they are subject to SALT, and how much corporate income tax liability they ultimately owe across multiple jurisdictions. For many employees that obtained the flexibility to work from anywhere, they have reconsidered where to live. To the extent they acted on that newfound flexibility and moved to a different state or locality, that decision affected their personal income tax profiles.

For municipalities seeing less in-person activity because of the growth in remote and hybrid work, the shift is problematic from a budgetary perspective, as less sales taxes are collected from commuters who would normally be having lunch or coffee at a location close to the office. And in the longer term, commercial real estate vacancy rates may not fall back to historic norms, which eventually could lead to lower real property assessed values and consequent lower property tax collections.

With this backdrop in mind, we cannot forget that those interested in SALT are still dealing with uncertainty wrought by historic and current factors unrelated to the pandemic. Think sweeping federal income tax laws, numerous state-specific tax reform initiatives, ambiguously drafted SALT statutes, regulations that often go well beyond the intent of the statutes, a lack of uniformity throughout the country, and case law from both federal and state courts that try to make sense of the matters in front of them, but often provide surprising results. These factors are influencing many of the SALT developments that continue to dominate this field's diverse discourse.

In our continuing effort to track what's important in the SALT world, our Grant Thornton SALT team in the Washington National Tax Office considered what happened this year, and then ranked the 10 most important SALT stories of 2021 in order of perceived importance. For the second year in a row, the development of pass-through entity tax regimes led the list, though many other late-breaking developments have potentially considerable effect. To prove the point, in the past month alone, courts have ruled on matters affecting the constitutionality of the Maryland digital advertising tax, the sales factor sourcing method applicable to the Texas and Florida corporate-level taxes, and state reactions to the federal American Rescue Plan Act's "tax mandate" provision. Based on what we have recently seen, the accelerating pace of SALT developments occurring in a very dynamic fiscal environment may well be a feature of the "new normal," challenging businesses, individuals, and governmental units alike to stay informed and responsive.

1. Adoption of state PTE taxes continues

The adoption by states of pass-through entity (PTE) tax regimes as a work around to the federal $10,000 SALT deduction limitation adopted under the Tax Cuts and Jobs Act (TCJA) has continued to take hold, with a clear majority of states now offering this option to PTEs and their owners.[1] In 2018, states first began enacting elective PTE tax regimes to work around the SALT deduction cap, with Connecticut being the only state to adopt a mandatory PTE tax. Under these regimes, the PTE is permitted to deduct state and local income taxes paid at the entity level for federal income tax purposes, followed by a deduction for the PTE tax on the distributive share of the PTE owners' income. Depending on the structure of the PTE tax, the owner generally claims a corresponding tax credit against their personal tax liability or an exclusion on the portion of the owner's pass-through income subject to the entity tax.

Seven states had enacted PTE taxes by November 2020,[2] when the Internal Revenue Service first confirmed that state PTE tax regimes would be respected for federal purposes, therefore providing an acceptable framework for partnerships and S corporations to deduct the tax at the entity level.[3] In response, 15 states moved rapidly to adopt their own elective state PTE regimes in 2021.[4] The trend did not let up in 2022, with eight additional jurisdictions acting to adopt PTE taxes to date, bringing the total number to 30.[5] Notably, New York City became the first locality to enact a PTE tax in an effort to benefit resident PTE owners subject to the city's personal income tax.[6] Originally intended to be available beginning with the 2023 tax year, subsequent corrective legislation makes the New York City PTE election available beginning with the 2022 tax year after the New York State PTE tax election deadline for 2022 was extended to Sept. 15, 2022.[7] Virginia's adoption of an elective PTE tax regime was distinctive in its creation of a PTE tax regime with retroactive effect to tax years beginning on or after Jan. 1, 2021.[8]

[1] P.L. 115-97 (2017). The TCJA capped the individual SALT deduction at $10,000 for individuals and most married couples for the 2018-2025 tax years. IRC § 164(b)(6)(B).
[2] Connecticut, Louisiana, Maryland, New Jersey, Oklahoma, Rhode Island, and Wisconsin enacted PTE-level taxes through 2020.
[3] The IRS confirmed that PTE businesses may claim an entity-level deduction for state and local income tax paid under state laws that shift the burden from individual owners to the business entity. Notice 2020-75, Forthcoming Regulations Regarding the Deductibility of Payments by Partnerships and S Corporations for Certain State and Local Income Taxes, Internal Revenue Service, Nov. 9, 2020.
[4] Alabama, Arizona, Arkansas, California, Colorado, Georgia, Idaho, Illinois, Massachusetts, Michigan, Minnesota, New York, North Carolina, Oregon, and South Carolina enacted PTE taxes during 2021.
[5] Kansas, Missouri, Mississippi, New Mexico, Ohio, Utah, Virginia, and New York City joined the list of jurisdictions to enact PTE taxes in 2022.
[6] N.Y. Ch. 59 (A.B. 9009/S.B. 9009), Part MM, Subpart B, Laws 2022, § 1, adding N.Y. TAX LAW ART. 24-B, §§ 867-873. For further discussion, see GT SALT Alert: "New York enacts city-level pass-through entity tax."
[7] N.Y. Ch. 555 (A.10506/S.9454), Laws 2022, § 14, amending Ch. 59, Part MM, Subpart B, § 12. For further discussion, see GT SALT Alert: "New tax provisions enacted for New York City."
[8] Va. Ch. 690 (S.B. 692/H.B. 1121), Laws 2022, adding Va. Code Ann. § 58.1-390.3. For further discussion, see GT SALT Alert: "Virginia elects elective pass-through entity tax."

While the states continued to adopt PTE tax regimes at a speedy pace during 2022, the lack of uniformity in these efforts has continued to present complexity for multistate PTEs deciding whether to elect into such regimes. For example, state rules vary with respect to the timing of the election, with some states allowing entities to make the election on an originally filed or extended tax return, while others require an earlier election to be made. Making the election on a return generally filed months after the end of a tax year has raised questions for PTEs with respect to whether they have made a valid election for the applicable tax year to support claiming the federal deduction for state PTE taxes paid in that year. In response to such concerns, states, including Colorado and Virginia, created special election mechanisms allowing taxpayers to file a PTE election in 2022 and make optional corresponding estimated payments to ensure that the federal deduction may be claimed in the same tax year.

Certain states enacted important corrective legislation in 2022 to address significant and often unintended technical shortcomings in their PTE tax regimes that became apparent during what for most was the first year of implementation in the 2021 tax year. For example, California amended its PTE tax law by expanding the definition of eligible electing PTEs to include owners that are themselves PTEs, and amending the state's credit ordering rules to address the application of the PTE tax credit relative to other credits including the other state tax credit.[9] As part of its 2022 budget legislation, New York state updated its PTE tax law by creating a new category of electing S corporations with resident shareholders in order to include all items of income in the tax base as opposed to only income derived from New York sources.[10] With perhaps the most ambitious PTE tax legislation to date, Colorado amended its PTE tax law to allow for retroactive elections going back to the 2018 tax year, raising important logistical and practical issues that is likely to involve a labor-intensive compliance process in order for PTEs to take advantage of these elections.[11]

One of the most important questions that has arisen with respect to the application of the election by multistate PTEs is whether states will provide a credit to resident PTE owners against their personal income tax liability for PTE taxes paid to other states. There remains a significant lack of uniformity in this area due to the novelty of the PTE tax regimes and because a minority of states still lack their own PTE tax with a similar credit mechanism. Recognizing this issue, several states made legislative or administrative updates to their resident credit provisions in 2022 to specify that a resident credit will be permitted for entity-level taxes paid to other states, including the District of Columbia (which does not have its own PTE), Kansas and Virginia. California also made an important technical correction to its resident credit provision, enabling PTE owners to count their PTE tax credit amount as part of their California tax liability for purposes of the resident credit calculation.[12] While states like Illinois, New Jersey and New York only respect PTE tax systems in other states that are "substantially similar" to theirs for purposes of the allowing the resident credit, they maintain an updated, and typically broad list of such states.

While state PTE taxes continue to be a popular revenue-neutral workaround to the federal SALT deduction limitation, the differing nature of each state PTE tax regime requires a thorough analysis. Leaders of PTEs are faced with making elections that will impact the tax liability of their owners, some of which may benefit more than others due to factors such as their resident state and their ownership interest in the PTE. With the continued adoption of state PTE taxes in 2022, it remains important to monitor state administrative guidance that continues to be released, given that the state taxing authorities are often left to implement specific rules for each PTE tax. Finally, there remains the possibility that Congress may change or increase the SALT deduction limitation, although this prospect looks less likely at least during the next two years of divided control between the U.S. Senate and House.

[9] Cal. Ch. 3 (S.B. 113), Laws 2022. For further discussion of this corrective legislation, see GT SALT Alert: "California amends elective pass-through entity tax."
[10] N.Y. Ch. 59 (A.B. 9009/S.B. 8009), Laws 2022. For further discussion of this budget legislation, see GT SALT Alert: "New York enacts city-level pass-through entity tax."
[11] Colo. S.B. 22-124, Laws 2022. For further discussion of this legislation, see GT SALT Alert: "Colorado amends pass-through entity tax."
[12] Cal. Ch. 705 (S.B. 851), Laws 2022, § 1, amending CAL. REV. & TAX CODE § 17052.10(e)(1). For further discussion, see GT SALT Alert: "California amends PTE owner resident credit legislation."

2. Maryland digital advertising tax invalidated by state trial court

In February 2022, Maryland became the first state to enact a tax on gross proceeds derived from digital advertising services in the state.[13] Enacted by the state legislature following an override of a veto by the Maryland governor, the tax is imposed on entities with global gross revenues of at least $1 billion.[14] Entities having annual gross revenues derived from digital advertising services in Maryland of at least $1 million in a calendar year are required to file a tax return.[15] The tax rate ranges from 2.5% to 10% based on the amount of the entity's annual global gross revenue.[16] While the tax was enacted with the intent of targeting large technology companies, the tax likely impacts other non-technology companies deriving digital advertising revenue from the state.

The short history of Maryland's digital advertising services tax is a controversial one. Although the initial legislation intended for the tax to be effective beginning with the 2021 tax year, subsequent emergency legislation delayed the effective date of the tax to the 2022 tax year due to various difficulties in implementing the tax.[17] The delayed effective date resulted from concurrent lawsuits filed in both state and federal court alleging a violation of electronic commerce under the Internet Tax Freedom Act (ITFA), the Commerce Clause and Due Process Clause of the U.S. Constitution, and the First Amendment to the U.S. Constitution.[18] In response to widespread criticism of the tax, the corrective legislation also amended Maryland law to specify that "digital advertising services" does not include advertising services or digital interfaces owned or operated on behalf of a broadcast or news media entity. Additionally, the subsequent legislation prohibits digital advertisers from passing on the cost of the tax to customers purchasing digital advertising services via a separate fee, surcharge or line-item.

In the federal lawsuit, four business groups sought a declaration and injunction from a Maryland federal district court against enforcement of the tax. In March 2022, the federal court dismissed much of the lawsuit, ruling that the federal Tax Injunction Act (TIA) bars a challenge to the tax itself because Maryland state courts provide a speedy remedy to challenge the tax. However, the federal court ruled that the plaintiffs could challenge the pass-through provision of the tax, the remaining issue being whether the provision violates companies' free speech rights under the First Amendment as opposed to merely regulating their conduct.

In the state lawsuit, Comcast and Verizon filed a complaint in a state trial court, seeking a declaration that the tax is illegal under the ITFA, also alleging Commerce Clause, due process and First Amendment violations. After the litigation cleared various procedural hurdles, the state trial court struck down the tax in a bench ruling in October at the conclusion of oral arguments from both parties in support of their summary judgment motions. The court subsequently issued a brief order declaring that the tax: (i) discriminates against companies providing digital advertising services in violation of the ITFA; (ii) targets out-of-state companies and interstate commerce by using worldwide gross revenues to calculate the tax, in violation of the Commerce Clause; and (iii) singles out certain companies for selective taxation in a way that is not content-neutral, in violation of the First Amendment.[19]

[13] Md. Ch. 37 (H.B. 732), Laws 2021; vetoed by Maryland Gov. Larry Hogan, May 7, 2020; final vote to override veto of both bills, Feb. 12, 2021. For further discussion of the Maryland digital advertising tax, see GT SALT Alert: "Maryland enacts digital ad gross revenues tax
[14] MD. CODE ANN., TAX-GEN. § 7.5-303.
[15] MD. CODE ANN., TAX-GEN. §§ 7.5-201(a); 7.5-301(a).
[16] MD. CODE ANN., TAX-GEN. § 7.5-103.
[17] Md. S.B. 787, Laws 2021.

[18] U.S. Chamber of Commerce et al. v. Franchot, U.S. District Court for the District of Maryland, Northern Division, No. 1:21-cv-00410, filed Feb. 18, 2021; Comcast of California/Maryland/Pennsylvania/Virginia/West Virginia LLC et al. v. Maryland Comptroller of the Treasury, Circuit Court for Anne Arundel County, Md., No. C-02-CV-21-000509, filed April 15, 2021. For further discussion of the federal and state litigation, see GT SALT Alert: "Maryland court invalidates state's Digital Advertising Services Tax."
[19] Comcast of California/Maryland/Pennsylvania/Virginia/West Virginia LLC et al. v. Maryland Comptroller of the Treasury, Circuit Court for Anne Arundel County, Md., No. C-02-CV-21-000509, order issued Oct. 20, 2022.

With the state court ruling, the future of Maryland's digital advertising tax remains more uncertain than ever. Maryland appealed the state court's ruling invalidating the tax and continues to defend the tax in federal court despite objections to the tax from the outgoing Maryland governor and comptroller. In the meantime, following a hearing, the federal court issued an order dismissing the case on the grounds that the pass-through provision issue had become moot in light of the state court's decision to invalidate the tax.[20] It should be noted that since the case was dismissed without prejudice, the federal court litigation could be revived in the event the state court's decision is overturned on appeal.

From a compliance perspective, companies subject to the tax are faced with the decision of whether to continue making estimated payments in view of the currently conflicting court decisions at the state and federal levels. Other states that have considered similar digital advertising taxes are unlikely to continue with such proposals until there is further clarity from the courts regarding whether Maryland's tax withstands constitutional and legal scrutiny. Maryland's experience to date in defending this tax illustrates the difficulties of attempting to tax the digital economy to seek additional revenue sources from businesses that may otherwise have no other connection with the state.

[20] U.S. Chamber of Commerce et al. v. Franchot et al., U.S. District Court for the District of Maryland, No. 21-cv-00410, order issued Dec. 2, 2022.

3. Continued corporate and personal income tax rate reductions

Most states found themselves in an unusually strong fiscal position in 2022 as tax collections significantly exceeded projections.[21] States had anticipated a steep decline in sales tax revenue due to the closure of brick-and-mortar retailers and restaurants due to the pandemic, but sales tax revenue ultimately was more resilient than anticipated as a result of strong online sales. States used some of the unexpected budget surpluses to bolster rainy day funds and provide tax refunds. Also, states received substantial federal funding under the American Rescue Plan Act (ARPA)[22] to combat the adverse economic effects of the COVID-19 pandemic. State revenue growth is expected to continue for the next several months, albeit at a reduced rate.[23] However, the Federal Reserve Bank's persistent increases in interest rates to combat inflation and the possibility of an economic recession in the next year may substantially imperil future growth. Two major states already are predicting an end to their budget surpluses. California is projected to have a budget deficit beginning with the 2023-24 fiscal year based on lower revenue estimates.[24] Similarly, New York has announced reductions in its tax receipts forecast that could result in budget deficits beginning with the 2024 fiscal year.[25]

Given the states' relatively strong fiscal condition in 2022, many states were able to reduce corporate income tax and/or individual income tax rates. One of the biggest corporate income tax reductions was enacted by Pennsylvania.[26] For tax years beginning in 2023, the corporate income tax rate is reduced from 9.99% to 8.99%. For tax years beginning after 2023, the tax rate is scheduled to be reduced by 0.5% per year until it reaches 4.99% for tax years beginning on or after Jan. 1, 2031.

Some states enacted income tax rate reductions that are contingent on the state meeting specified revenue goals. Iowa enacted legislation in March 2022 to reduce individual income tax rates beginning with the 2023 tax year and to phase to a flat tax rate.[27] Also, the legislation provided for a contingent reduction in corporate income tax rates beginning with the 2023 tax year if certain fiscal state revenue targets are met.[28] The Iowa Department of Revenue announced in September 2022 that the tax receipts exceeded the statutory thresholds and the corporate income rates will be reduced beginning with the 2023 tax year.[29] Also, Kentucky enacted legislation providing that if certain budget conditions are met, the personal income tax rate will be reduced from 5% to 4.5%.[30] The Kentucky Department of Revenue has announced that this rate reduction will apply to the 2023 tax year.[31]

[21] Erica MacKellar and Andrea Jimenez, *State Fiscal Conditions are Strong, but Uncertainty Looms*, National Conference of State Legislatures, Sept. 19, 2022.
[22] P.L. 117-2 (2021).
[23] Erica MacKellar and Andrea Jimenez, *State Fiscal Conditions are Strong, but Uncertainty Looms*, National Conference of State Legislatures, Sept. 19, 2022.
[24] *California's Fiscal Outlook*, Legislative Analyst's Office, The California Legislature's Nonpartisan Fiscal and Policy Advisor, Nov. 16, 2022.
[25] Press Release, *Governor Hochul Announces Update to State Budget Financial Plan Reflecting Changes to the National Economic Outlook*, Office of New York Governor, Aug. 1, 2022.
[26] Pa. Act 53 (H.B. 1342), Laws 2022, amending 72 PA. STAT. § 7402(b). For further information, see GT SALT Alert: "Pennsylvania reduces corporate income tax rate."
[27] Iowa H.F. 2317, Laws 2022. Prior to this legislation, Iowa imposes a graduated individual tax with nine brackets and a top marginal tax rate of 8.53%. After 2022, the top marginal rates and number of brackets will be reduced as follows: for the 2023 tax year, 6.00% and four brackets; for the 2024 tax year, 5.70% and three backets; for the 2025 tax year, 4.82% and two brackets; and for tax years after 2025, a flat rate of 3.90%. For further discussion of this legislation, see GT SALT Alert: "Iowa reduces corporate, individual income tax rates."
[28] Id. Under existing law, Iowa's corporate income tax for the 2022 tax year is imposed at the following graduated tax rates: 5.5% on the first $100,000 of Iowa taxable income; 9.0% on Iowa taxable income between $100,001 and $250,000; and 9.8% on Iowa taxable income over $250,000. If certain fiscal conditions are met, the rate eventually will change to a 5.5% flat tax.
[29] Order 2022-03, Iowa Department of Revenue, Sept. 27, 2022. For tax years beginning on or after Jan. 1, 2023, the corporate income tax rates for income between $100,000 and $250,000, and income greater than $250,000 are reduced to 8.4%.
[30] Act 212 (H.B. 8), Laws 2022, amending KY. REV. STAT. ANN. § 141.020(2)(a). For further discussion of this legislation, see GT SALT Alert: "Kentucky bill reduces personal income tax rate."
[31] DOR Announces Updates to Individual Income Tax for 2023 Tax Year, Kentucky Department of Revenue, Sept. 21, 2022.

At least three states enacted legislation to lower corporate income tax rates in 2021 and enacted legislation in 2022 to further reduce rates. Specifically, Arkansas enacted legislation in December 2021 to reduce the top corporate income tax rate from 5.9% to 5.7% for tax years beginning after 2022, with further contingent reductions to 5.5% and 5.3% in the 2024 and 2025 tax years, respectively.[32] In August 2022, Arkansas accelerated this rate reduction by lowering the rate to 5.3% for tax years beginning after 2022.[33] Nebraska similarly enacted legislation in 2022 to increase its previously enacted corporate income tax rate reductions.[34] New Hampshire also enacted Business Profits Tax (BPT) rate reductions in 2021 and 2022.[35]

Idaho enacted two separate laws in 2022 to reduce corporate income tax rates. In February 2022, Idaho enacted legislation retroactively in effect Jan. 1, 2022, to reduce the corporate income tax rate from 6.5% to 6%.[36] In September 2022, Idaho enacted legislation further reducing the corporate income tax rate to 5.8% for tax years beginning after 2022.[37] Utah also enacted corporate tax rate reductions in 2022.[38]

Finally, voters approved ballot measures at the Nov. 8, 2022, general election addressing income tax rate changes. In Colorado, voters approved a proposition that reduces the state corporate and individual income tax rate from 4.55% to 4.4% for tax years beginning on or after Jan. 1, 2022.[39] Massachusetts voters followed the recent of trend of imposing an additional income tax on high-income individuals by approving a constitutional amendment to impose an additional 4% tax on income over $1 million.[40] This income level will be adjusted annually for inflation, and the tax applies to tax years beginning on or after Jan. 1, 2023.

[32] Ark. Act 1 (H.B. 1001) and Act 2 (S.B. 1), Laws 2021, Second Extra. Session.
[33] Ark. Act 2 (S.B. 1), Laws 2022.
[34] Nebraska's reduced corporate income tax rates apply to taxable income over $100,000. Under legislation enacted in 2021, for taxable years beginning in 2022, the rate was reduced from 7.81% to 7.50%. For taxable years beginning on or after Jan. 1, 2023, the rate was further reduced to 7.25%. Neb. L.B. 432, Laws 2021. Under legislation enacted in 2022, the tax rate is further reduced as follows: for taxable years beginning in 2024, the rate is 6.50%; for tax years beginning in 2025, the rate is 6.24%; for tax years beginning in 2026, the rate is 6.00%; for taxable years beginning on or after Jan. 1, 2027, the rate is 5.84%. The rate on the first $100,000 remains at 5.58%. Neb. L.B. 873, Laws 2022, amending NEB. REV. STAT. § 77-2734.02.
[35] In 2021, New Hampshire enacted legislation reducing the BPT rate from 7.7% to 7.6% for tax years ending on or after Dec. 31, 2022. N.H. Ch. 91 (H.B. 2), Laws 2021, amending N.H. REV. STAT. ANN. § 77-A:2. In 2022, New Hampshire enacted legislation further reducing the BPT rate from 7.6% to 7.5% for tax years ending on or after Dec. 31, 2023. N.H. Ch. 189 (H.B. 1221), Laws 2022, adding N.H. REV. STAT. ANN. § 77-A:2.III.
[36] Idaho Ch. 1 (H.B. 436), Laws 2022, amending IDAHO CODE § 63-3025(1).
[37] Idaho Ch. 1 (H.B. 1 a), Extra. Session, amending IDAHO CODE § 63-3025(1).
[38] For tax years beginning on or after Jan. 1, 2022, the Utah corporate income tax rate is reduced from 4.95% to 4.85%. Utah S.B. 59, Laws 2022, amending UTAH CODE ANN. §§ 59-7-104; 59-7-201.
[39] Prop. 121, Colorado Secretary of State, 2022 General Election, Unofficial Results (updated Nov. 11, 2022). For further discussion of the various ballot measures considered by voters at the Nov. 2022 general election,see GT SALT Alert: "Voters decide various tax legislation in ballots."
[40] *Massachusetts Election Results*, THE NEW YORK TIMES (unofficial results) (updated Nov. 11, 2022). This adds a new paragraph to MASS. CONST. art. IV.

4. ARPA tax mandate litigation

In an effort to address the economic effects of the COVID-19 pandemic, ARPA was enacted in March 2021 and provided substantial funds for distribution to state and local governments. Under ARPA, states are required to use the funds for either a wide variety of pandemic-related purposes, or to make necessary investments in water, sewer or broadband infrastructure.[41] Specifically, states are prohibited from using the funds to offset a reduction in state net tax revenue resulting from a change in law, regulation or administrative interpretation during a "covered period" that reduces any tax (commonly known as the offset provision), or from depositing the funds into a pension fund.[42]

In response to numerous requests by states for information on the scope of this provision, the U.S. Treasury Department adopted an interim rule to provide further guidance to states regarding when the ARPA tax mandate would be triggered.[43] In January 2022, the Treasury Department issued a final rule in substantially the same form as the interim rule, which became effective on April 1, 2022.[44] The final rule generally provides that states are considered to impermissibly use ARPA funds to offset a reduction in net tax revenue where they fail to offset the reduction through means unrelated to ARPA funds.[45]

Approximately 20 states have filed six lawsuits challenging the ARPA offset provision. States typically argue that the offset provision violates the U.S. Constitution's Spending Clause.[46] These cases are at various stages in the federal court system, with four decisions on ARPA challenges decided by federal appellate courts in 2022.

Appellate courts in two circuits considered whether states have standing to challenge the ARPA restrictions. In May 2022, the U.S. Court of Appeals for the Ninth Circuit ruled that Arizona had standing to challenge the offset provision.[47] Arizona argued that the provision is unconstitutionally ambiguous and unduly coercive. On July 14, 2022, the U.S. Court of Appeals for the Eighth Circuit reached the opposite conclusion and held that Missouri lacked standing to challenge the ARPA offset provision.[48] The court explained in the Missouri case that the state did not face any "actual or imminent" injury in challenging the provision that prohibits states from using ARPA funds to offset net tax revenue reductions. Rather, the court determined that Missouri alleged merely hypothetical harms that would result from the offset provision based on its consideration of tax reduction polices. These decisions create a split among the circuits of the federal appellate court on the issue of whether states have standing to challenge the ARPA offset provision. In October 2022, Missouri filed a request for the U.S. Supreme Court to consider its case.[49]

On Nov. 18, 2022, the U.S. Court of Appeals for the Sixth Circuit released two decisions concerning whether state ARPA challenges are justiciable claims that may be considered by courts. In response to the ARPA challenges raised by Kentucky and Tennessee, the court reached different conclusions for each state.[50] The court explained that both states initially had standing to bring their ARPA challenges because the offset provision "at least arguably proscribed the post-acceptance enactment of any revenue-reducing tax cut."[51] However, the court noted that the Treasury Department's implementing regulation provides certain safe harbors permitting states to cut taxes. Neither Kentucky nor Tennessee offered additional evidence of a concrete plan to violate Treasury's regulation.

[41] Social Security Act, Title VI, 42 U.S.C. § 802(c)(1). The "covered period" began on March 3, 2021, and ends on the last day of the fiscal year in which the funds are used or returned to the federal government. As the funds obtained from ARPA must be spent by Dec. 31, 2024, the ending date of the covered period could extend for several years. The states are required to comply with certification and reporting requirements to receive the funds, and the federal government has the right to recoup the funds if the states do not comply with the ARPA restrictions.
[42] Social Security Act, Title VI, 42 U.S.C. § 802(c)(2).
[43] 31 C.F.R. Part 35, RIN 1505-AC77, *Coronavirus State and Local Fiscal Recovery Funds*. 2018 through 2020 for up to five years. IRC § 172.
[44] 31 C.F.R. § 35.1 et seq.
[45] The final rule confirms that a reduction in net tax revenue could result from any "covered change," including a change in law, regulation, or administrative interpretation that reduces any tax. However, the final rule clarifies that a covered change does not include changes that the state cannot control, or income tax changes simply conforming to changes in federal law. 31 C.F.R. § 35.3.
[46] The Spending Clause provides that "Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States . . .." U.S. CONST. art. I, § 8, cl. 1.
[47] *Arizona v. Yellen*, 34 F.4th 841 (9th Cir. 2022). The district court previously had dismissed the case for lack of subject matter jurisdiction. The appellate court remanded the case to the district court to consider the merits of Arizona's Spending Clause and Tenth Amendment claims.
[48] *Missouri v. Yellen*, 39 F.4th 1063 (8th Cir. 2022). For further discussion of this case, see GT SALT Alert: "Missouri barred from challenging ARPA offset restriction."
[49] *Missouri v. Yellen*, petition for cert. filed (U.S. Oct. 14, 2022) (No. 22-352).
[50] *Kentucky v. Yellen*, U.S. Court of Appeals for the Sixth Circuit, No. 21-6108, Nov. 18, 2022.
[51] Id.

Because Kentucky did not present evidence for any other theory of injury, the appellate court reversed the district court's conclusion that Kentucky's claim was justiciable and vacated the court's injunction to the extent it bars enforcement of the offset restriction against Kentucky. In contrast, the appellate court held that Tennessee had a justiciable challenge that the regulation and the underlying offset restriction burden the state with compliance costs. The appellate court affirmed the district court's injunction on the basis that the offset provision is impermissibly vague under the Spending Clause.

In *Ohio v. Yellen*, the U.S. Court of Appeals for the Sixth Circuit reversed the district court's determination that Ohio's ARPA challenge is justiciable and vacated the permanent injunction.[52] The district court previously permanently enjoined enforcement of the offset restriction because its terms were "unconstitutionally ambiguous" under the Spending Clause.[53] Following the district court's decision, the Treasury Department promulgated its ARPA regulation that disavowed Ohio's interpretation of the offset provision and explained that it would not enforce the offset provision as if it barred all tax cuts. The appellate court determined that the regulation's disavowal of Ohio's broad view of the offset provision mooted the case. However, the court noted that its decision does not prevent Ohio from raising other challenges of ARPA's funding conditions.

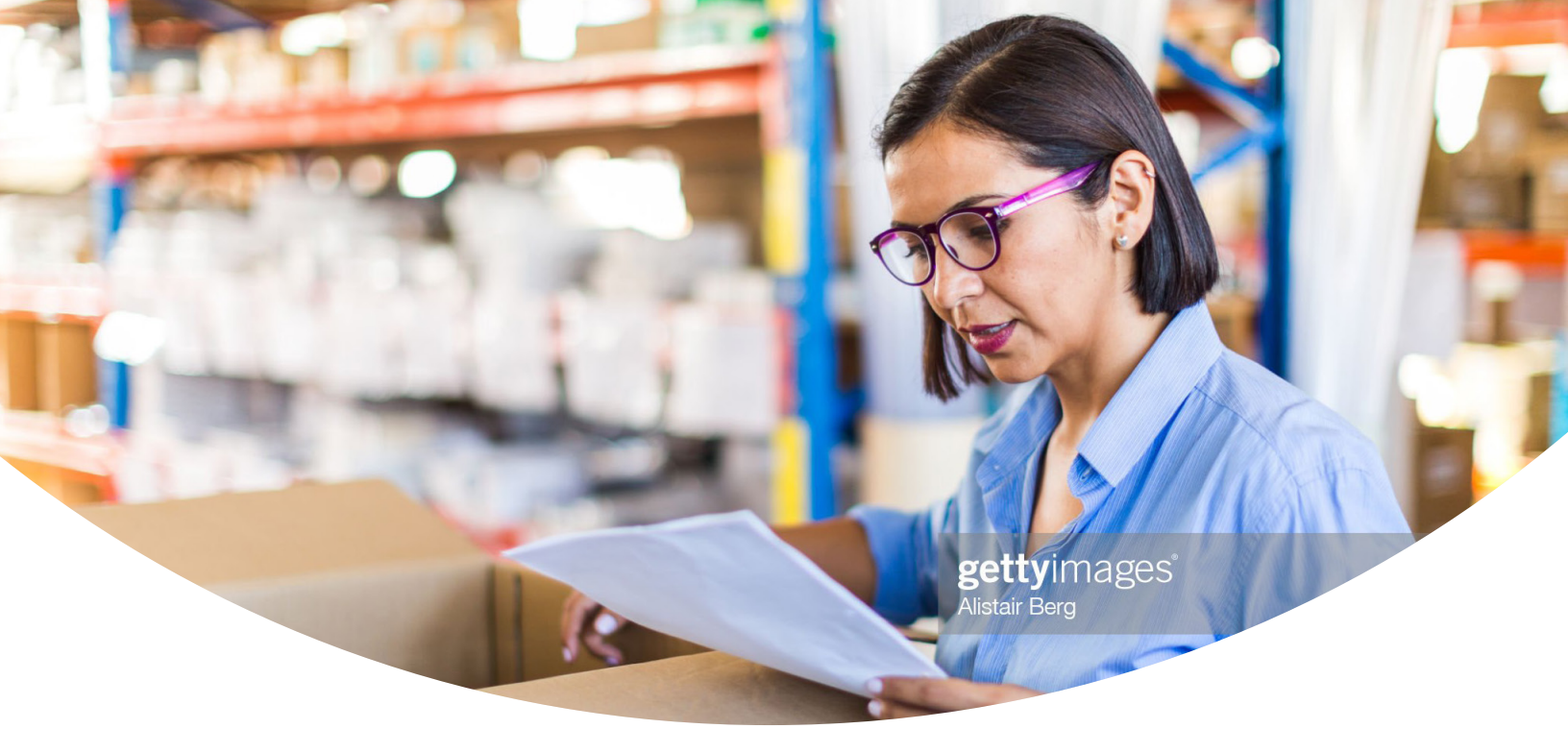
States had mixed success during 2022 on their ARPA litigation before various circuits of the federal appellate court, and such litigation shows no sign of stopping soon. There is a possibility that the U.S. Supreme Court will ultimately consider the ARPA standing issue in response to the conflicting results among different circuits of the federal appellate court. Based on the recent decisions by the Sixth Circuit, the Treasury Department's ARPA regulations may affect whether states have justiciable claims.

[52] *Ohio v. Yellen*, U.S. Court of Appeals for the Sixth Circuit, No. 21-3787, Nov. 18, 2022.
[53] 547 F. Supp. 3d 713 (S.D. Ohio 2021).

5. Sales tax inventory nexus litigation

In recent years, several states have asserted inventory nexus for remote sellers participating in the Fulfillment by Amazon (FBA) program prior to the *South Dakota v. Wayfair* decision in 2018 and the subsequent enactment of marketplace facilitator laws. Under the FBA program, as a means to facilitate transport of a remote seller's inventory to the ultimate customer, the inventory may be temporarily relocated to an intermediate state without the seller's knowledge. Relocating the inventory can give retailers physical presence in a state where they may not be registered to collect sales tax. As a result, states including California, Pennsylvania and Washington have begun asserting nexus and sales tax collection and remittance obligations based on such tangential physical presence.

California has aggressively pursued unpaid sales taxes from remote sellers participating in the FBA program by assessing FBA sellers for periods before the enactment of the state's marketplace facilitator law in 2019. The Pennsylvania Department of Revenue (Pennsylvania DOR) has taken a slightly more measured approach by mailing notices and registration demand letters to FBA sellers identified as having sales tax collection and remittance obligations owing to the storage of inventory in the state. The registration demand letters suggested that failure to participate in the Pennsylvania DOR's voluntary compliance program may result in additional enforcement actions.



In response to these state actions, the Online Merchants Guild, a trade association for independent online retailers, filed a lawsuit on behalf of the FBA sellers in a California federal court challenging California's authority to issue sales tax assessments against FBA sellers. Likewise, the Guild filed a lawsuit in Pennsylvania federal court challenging the Commonwealth's registration demands and seeking declaratory and injunctive relief. However, both federal cases were dismissed on jurisdictional grounds: the California federal district court ruled that the lawsuit was barred by the TIA because a speedy remedy was available in state court,[54] while the Pennsylvania federal district court dismissed the case on comity grounds, reasoning that the lawsuit was better suited for state court.[55]

The Guild continues to face procedural obstacles with the California litigation in federal court, with the Ninth Circuit U.S. Court of Appeals most recently affirming the district court's decision to dismiss the case under the TIA.[56] However, the Guild has fared better in Pennsylvania after re-filing its lawsuit against the Pennsylvania DOR in state court. In September 2022, the Pennsylvania Commonwealth Court ruled that the Pennsylvania DOR failed to establish that FBA sellers had sufficient minimum contacts with the state under the Due Process Clause of the U.S. Constitution to mandate the collection and remittance of sales tax.[57]

With this decision, the Pennsylvania court became the first to rule against a state based on the merits of an inventory nexus case. The court's decision may influence ongoing inventory nexus cases in other states including California, where it remains to be seen whether the Guild will bring its lawsuit in state court. Depending on how the courts interpret the presence of inventory as a means to assert sales tax nexus, a split across the jurisdictions may develop in the coming months, making it more likely that the U.S. Supreme Court would have the opportunity to evaluate whether to weigh in on the conflict.

[54] *Online Merchants Guild v. Maduros*, U.S. District Court for the Eastern District of California, No. 2:20-cv-01952, Oct. 13, 2021. For further information, see GT SALT Alert: "Federal court dismisses California sales tax suit."
[55] *Online Merchants Guild v. Hassell*, U.S. District Court for the Middle District of Pennsylvania, No. 1:21-cv-00369, May 28, 2021.
[56] *Online Merchants Guild v. Maduros*, U.S. Court of Appeals for the Ninth Circuit, No. 21-16911, Nov. 9, 2022.
[57] *Online Merchants Guild v. Hassell, Pennsylvania Commonwealth Court*, No. 179 M.D. 2021, Sept. 9, 2022. For further discussion of this decision, see GT SALT Alert: "Pennsylvania denies nexus based on inventory."

6. State reaction to MTC's revised statement on Public Law 86-272

In August 2021, the Multistate Tax Commission (MTC) adopted revised guidance interpreting longstanding federal protections against state income tax to reflect the modern economy and internet business activities.[58] Specifically, the MTC approved an updated statement on Public Law 86-272 (P.L. 86-272), the 1959 federal law that limits the state taxation of income from sales of tangible personal property if the taxpayer's only business activities in the state are the solicitation of orders that are approved and shipped from outside the state.[59]

The revised statement includes a new subsection to determine what constitutes protected or unprotected activities under federal law, specifically addressing activities conducted using the internet. In general, when a business interacts with a customer via the business's website or app, it is engaged in "business activity" within the customer's state that exceeds P.L. 86-272 protection. Alternatively, if the website merely presents static text or photos, there is no engagement or facilitation within the customer's state. The statement provides a listing of 11 different activities conducted by internet businesses and explains whether they are protected or unprotected for P.L. 86-272 purposes. States are not bound by the MTC's revised statement and are responsible for individually adopting its principles.

During 2022, California and New York became the first states to react to the MTC's revised statement. On Feb. 14, 2022, the California Franchise Tax Board (FTB) released administrative guidance, Technical Advice Memorandum (TAM) 2022-01, to explain its positions on the application of P.L. 86-272 protection in the modern economy for companies with internet transactions.[60] The FTB's TAM does not explicitly adopt or reference the MTC's revised statement, but the TAM generally is consistent with the positions set forth in the statement, by addressing the same 11 internet activities that are outlined in the MTC's statement and reaching the same conclusions. The application of the guidance is unclear because the TAM does not contain any effective date or limiting principle concerning how it may be applied by the FTB in auditing prior years. In May 2022, the FTB expanded its prior guidance on P.L. 86-272, FTB Publication 1050, to include activities conducted via the internet that is consistent with the TAM.[61] In August 2022, the American Catalog Mailers Association (ACMA) filed litigation in California superior court that challenges TAM 2022-01 and FTB Publication 1050.[62]

[58] *Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272*, Multistate Tax Commission, revised Aug. 4, 2021.
[59] Pub. L. No. 86-272, 15 U.S.C. §§ 381-384.
[60] *Technical Advice Memorandum (TAM) 2022-01*, California Franchise Tax Board, Feb. 14, 2022. For further information, see GT SALT Alert: "California guidance covers P.L. 86-272 protection."
[61] FTB Publication 1050, Application and Interpretation of Public Law 86-272, California Franchise Tax Board, revised May 2022.
[62] *American Catalog Mailers Association v. Franchise Tax Board*, California Superior Court, San Francisco County, No. CGC-22-601363, filed Aug. 19, 2022. The complaint requests judicial declarations that: (i) the guidance is invalid because it directly contradicts P.L. 86-272 when applied to remote sellers with no property or payroll in the state; (ii) the guidance is invalid as improper underground regulations, adopted without following the Administrative Procedure Act; and (iii) the retroactive application of the guidance prior to its publication violates Due Process. On Nov. 17, 2022, the superior court declined the FTB's request to dismiss the action.

In April 2022, the New York Department of Taxation and Finance posted a revised draft regulation adding "[n]ew provisions, largely modeled after the MTC model statute" that "address PL 86-272 and activities conducted via the internet."[63] The New York draft regulation includes the 11 examples provided in the MTC's statement and like California, reaches the same conclusions regarding whether each transaction is protected by P.L. 86-272. While the New York draft regulation generally is consistent with the MTC's statement, the draft regulation adds language that conceivably could be used to further reduce the P.L. 86-272 protection for internet sellers beyond the intent of the MTC's statement.[64] The language, which is part of a broader regulatory effort addressing the tax reform provisions adopted by New York for tax years beginning on or after Jan. 1, 2015, has not been finalized to date. Similar to the guidance issued by California, the draft regulations do not provide an effective date and could apply retroactively.

Other than California and New York, no other states have issued formal guidance concerning the application of P.L. 86-272 to internet transactions. However, New Jersey reportedly is planning to issue regulations on this topic. The Oregon Department of Revenue intended to promulgate regulations to address P.L. 86-272 protection as it applies to internet transactions, but it issued a letter to the state's rules committee explaining that it "has decided to put the matter on hold at this time."[65] The adoption of the MTC's revised statement by other states remains uncertain. The MTC's statement has generated controversy and some people question its interpretation of a federal law that could subject businesses to income tax filing obligations by engaging in certain internet activities in a state even though they have no physical presence there. Taxpayers and other states will be closely following the California litigation to see if the state's guidance on the application of P.L. 86-272 to internet transactions that is consistent with the MTC's revised statement is upheld by courts.

[63] N.Y. COMP. CODES R. & REGS. tit. 20, § 1-2.10 (draft). For further discussion of the New York draft regulations, see GT SALT Alert: "New York finalizing corporate business tax reform."
[64] N.Y. COMP. CODES R. & REGS. tit. 20, § 1-2.10(f) (draft). The draft regulation provides that "[s]olicitation activities [that are protected] do not include those activities that the corporation would have reason to engage in apart from the solicitation of orders but chooses to allocate to its New York State sales force, or to engage in via the Internet, including interacting with customers or potential customers through the corporation's website or computer application."
[65] *Letter to Rules Advisory Committee Members, P.L. 86-272*, Oregon Department of Revenue, Sept. 20, 2022.

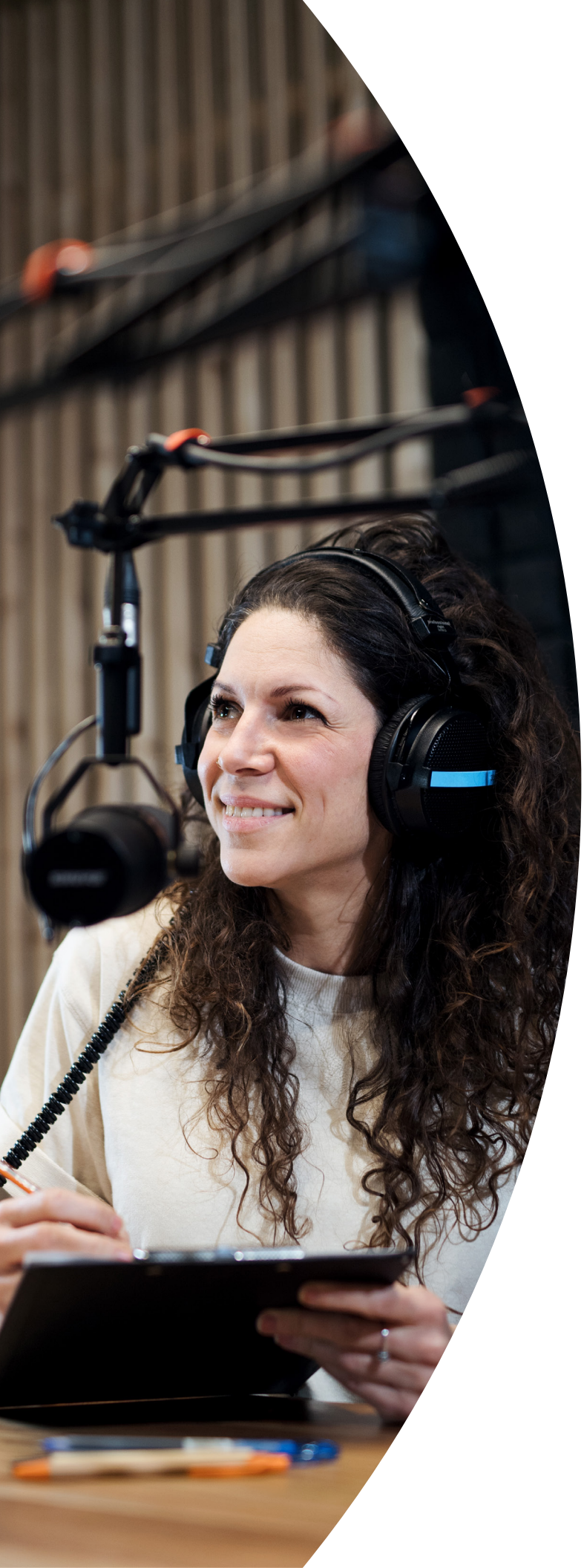
7. Market-based sourcing developments

Apportionment and the sourcing of sales from items other than tangible personal property have been perennially important SALT topics. There have been numerous apportionment sourcing developments during the past 15 years as many states changed from a cost-of-performance method focused on the location of activities performed by the service provider, to a market-based sourcing method in which the sale is sourced via a representation of the marketplace. Continuing this trend, there were significant market-based sourcing developments in 2022 involving a mix of litigation, legislation and administrative guidance.

Perhaps the most significant apportionment development in 2022 was the well-publicized Texas Supreme Court decision in *Sirius XM Radio v. Hegar*.[66] This case concerned the proper sourcing of subscription receipts by a satellite radio producer and distributor that incurred most of its production costs outside Texas. The state historically has sourced service receipts by applying an origin-based methodology using cost of performance. In 2020, the Texas Court of Appeals agreed with the Texas Comptroller of Public Accounts that a service is performed in Texas if there is a "receipt-producing, end-product act" in the state.[67] This market-based approach sourced service receipts to Texas if the subscriber's radio was in the state. In reversing the Court of Appeals, the Texas Supreme Court held that the receipts should be sourced to the state where the radio programming is produced. The court remanded the case to the Texas Court of Appeals to determine the fair value of the taxpayer's receipts that were performed in the state. On remand, the Texas Court of Appeals affirmed the trial court's conclusion that the taxpayer properly used of cost-of-performance data to source the fair value of its service revenue in Texas.[68] The case, which continues to call into question how to source service receipts for purposes of the state's franchise tax, could be appealed by the comptroller. At the same time, the comptroller's approach with respect to amending its longstanding regulations on the subject of sourcing service receipts,[69] as well as revisiting previously released letter rulings in light of *Sirius* and regulatory revisions, continues to be closely watched.

In Florida, a circuit court ruled in *Target Enterprise, Inc. v. Department of Revenue* that a taxpayer's use of the cost-of-performance method to source service revenue for purposes of the Florida corporation income tax was correct.[70] The taxpayer earned revenue from a retail operating services agreement with its corporate parent, and sourced its service revenue from that agreement outside Florida based on the fact that the vast majority of its payroll costs were incurred outside the state. The Florida Department of Revenue (Florida DOR) audited the taxpayer and assessed based on the position that the taxpayer did not sufficiently support its cost-of-performance sourcing position, ultimately imposing an alternative apportionment method based on the percentage of retail square footage of the corporate parent's stores in Florida. The circuit court sided with the taxpayer on the cost-of-performance method that it used, and its documentation of this method. Further, the court rejected the Florida DOR's alternative apportionment method, in part because the formula relied upon the corporate parent's business activity, rather than the corporation's activity itself. The case, which does not explicitly address the ability to use market-based sourcing in determining the location of a taxpayer's income producing activity, may be appealed by the Florida DOR.

[66] *Sirius XM Radio, Inc. v. Hegar*, 643 S.W.3d 402 (Tex. 2022). For further discussion of the Texas Supreme Court's opinion, see GT SALT Alert: "Texas court interprets service sourcing rules" and Saylor Sims, Debasish Chakrabarti, Robert Gershon & Richard Jackson, Texas Supreme Court Addresses Sourcing of Electronically Delivered Services, TAX NOTES STATE, July 4, 2022.
[67] 604 S.W.3d 125 (Tex. App. 2020). For a detailed discussion of the Texas Court of Appeals' decision, see GT SALT Alert: "Texas OKs in-state radio subscription sourcing."
[68] *Hegar v. Sirius XM Radio, Inc.*, Texas Court of Appeals, Third District, Austin, No. 03-18-00573-CV, Nov. 10, 2022. For further discussion of this decision, see GT SALT Alert: GT SALT Alert: "Texas allows cost-of-performance data for sourcing service receipts."
[69] TEX. ADMIN. CODE § 3.591(e)(26).
[70] Circuit Court of the 2nd Judicial Circuit, Leon County, Fla., No. 2021-CA-002158, Nov. 28. 2022.



States also enacted important legislation in 2022 concerning market-based sourcing. In July 2022, Pennsylvania enacted legislation that applies market-based sourcing to receipts from sales of intangible property and certain financial transactions.[71] Prior to the enactment of this legislation, Pennsylvania law required that receipts from sales of intangible property be sourced primarily using a cost-of-performance method. Effective for tax years beginning after Dec. 31, 2022, the law adopts a market-based sourcing approach, bringing the sourcing rules in line with the current method used for sales of services.[72] Also, Idaho retroactively adopted market-based sourcing for tax years beginning on or after Jan. 1, 2022.[73]

There were some notable administrative developments concerning market-based sourcing in 2022. The California FTB issued a Legal Ruling to address the application of the state's market-based sourcing rules set forth in California law and regulations to certain services provided to business entity customers.[74] The FTB had previously issued two Chief Counsel Rulings (CCRs) addressing where a business entity customer receives the "benefit of the service" under certain taxpayer-specific fact patterns.[75] The new ruling marked a shift in the FTB's historical administrative guidance by revoking prior CCRs and providing three scenarios to address the relevant considerations when assigning receipts from the sale of services to business entities for sales factor numerator purposes. The Legal Ruling provides a "look through" approach by sourcing receipts based on the impact to the ultimate consumer. Finally, West Virginia amended its corporate income tax regulations to reflect the 2021 legislation that adopted a single sales factor apportionment formula and market-based sourcing for tax years beginning on or after Jan. 1, 2022.[76]

[71] Pa. Act 53 (H.B. 1342), Laws 2022, amending 72 PA. STAT. § 7401(3)2.(a)(17). For further discussion of Pennsylvania market-based sourcing for intangible receipts, see GT SALT Alert: "Pennsylvania reduces corporate income tax rate."
[72] Id.
[73] Idaho Ch. 52 (H.B. 563), Laws 2022, amending IDAHO CODE § 63-3027.
[74] Legal Ruling 2022-01, *Numerator Assignment of Gross Receipts from Sales of Services to Business Entities*, California Franchise Tax Board, March 25, 2022. For further information, see GT SALT Alert: "California receipts sourcing ruling voids prior CCRs."
[75] Chief Counsel Ruling 2017-01, California Franchise Tax Board, April 7, 2017; Chief Counsel Ruling 2015-03, California Franchise Tax Board, Dec. 31, 2015.
[76] W. VA. CODE ST. R. §§ 110-24-1–110-24-27.

8. Gain sourcing litigation

Several significant cases in California, Massachusetts, and New York addressed the sourcing of gains from sales by out-of-state entities. In *Metropoulos Trust*, the California Court of Appeal held that a nonresident shareholder's California source income from an S corporation's sale of intangible property, specifically goodwill, was partially from California sources and not sourced entirely to the shareholders' states of domicile[77] The court concluded that the nonresident S corporation shareholders were taxable on their pro rata share of the gain, because it was business income partially sourced to California under the state's Uniform Division of Income for Tax Purposes Act (UDITPA) statutes. After deciding the issue of sourcing under California's UDITPA provisions, the court noted that, even if the statute addressing a nonresident's income from intangible property had applied, the same result would occur because the goodwill had partially acquired a business situs in California through the S corporation's activities. This decision highlights concerns faced by owners of a PTE enterprise when substantial gains from the sale of a lower-tier PTE conducting a multistate business are triggered.

In *VAS Holdings & Investments LLC v. Commissioner of Revenue*, the Massachusetts Supreme Judicial Court held that the state did not have statutory authority to tax an out-of-state S corporation on the capital gain it received from selling its 50% membership interest in an in-state limited liability company (LLC).[78] The court determined that taxation of the gain was permissible under both the Commerce Clause and Due Process Clause of the U.S. Constitution because the S corporation received financial benefits from the LLC whose growth was tied to the protections, opportunities and benefits provided by Massachusetts. The parties agreed there was no unitary relationship between the entities, but the court decided to consider whether the state had statutory authority to impose tax on the gain. The court concluded that the state only provides statutory authority to tax the gain if there is a unitary relationship between the entities. Because the entities were not unitary, there was no statutory authority to tax the gain. In response to the decision, the Massachusetts Department of Revenue has issued guidance regarding the somewhat limited set of circumstances in which the state believes that the *VAS Holdings* decision applies on a prospective and/or retroactive basis.[79]

The New York Supreme Court Appellate Division affirmed a decision of the New York City Tax Appeals Tribunal that the capital gain arising from a Delaware corporation's sale of its minority interest in an LLC conducting business in the city was subject to the city's General Corporation Tax even though the Delaware corporation itself had no other presence in the city.[80] The nexus between the city and the corporation was the LLC's activities in the city, which generated the corporation's investment income.

The taxation of gain received by out-of-state entities becomes complex because of the interplay between nexus and constitutional issues. The Massachusetts and New York decisions concern the "investee nexus" approach that is used by some states to tax gain. Massachusetts does not currently provide authority for imposing tax on based on the "investee nexus" approach. However, New York follows the "investee nexus" approach and allows imposition of tax on an out-of-state entity that has no ownership interest in a PTE entity based in New York City. Taxpayers should be aware that other jurisdictions may attempt to impose tax on gain in "investee nexus" situations in which no unitary relationship exists between the entities.

[77] *The 2009 Metropoulos Family Trust v. California Franchise Tax Bd.*, 79 Cal. App. 5th 245 (2022). For further discussion of this case, see GT SALT Alert: "California sources part of nonresident sale gain to state."
[78] *VAS Holdings & Investments LLC v. Commissioner of Revenue*, 186 N.E.3d 1240 (Mass. 2022). For further information on this case, see GT SALT Alert: "Massachusetts rules gain from LLC sale non-taxable."
[79] Technical Information Release 22-14, VAS Holdings & Investments LLC v. Commissioner of Revenue: Apportionment of Gain from the Sale of a Pass-through Entity (PTE) Interest Based Entirely Upon the Attributes of the PTE, Massachusetts Department of Revenue, Nov. 30, 2022.
[80] *Goldman Sachs Petershill Fund Offshore Holdings (Delaware) Corp. v. New York City Tax Appeals Tribunal*, New York Supreme Court, Appellate Division, First Department, No. 2021-02517, April 12, 2022.

9. The *MoneyGram* case

Although the U.S. Supreme Court has not taken up a state tax case since the landmark *South Dakota v. Wayfair* ruling in 2018, the court is currently considering its first unclaimed property case in over 30 years. Commonly known as the *MoneyGram* case, the consolidated cases involve a long-standing dispute between Delaware and 30 other states over which state is entitled to escheat approximately $300 million in uncashed checks issued by MoneyGram Payment systems.[81] The outcome of the litigation is likely to have an important bearing on which states may claim uncashed checks under existing state escheatment rules.

For years, MoneyGram escheated funds received for uncashed checks to Delaware under common law rules established by the court in 1965, in *Texas v. New Jersey*.[82] In that case, the court established that if the last known address of the owner of the property is unknown, unclaimed property is reported to the holder's state of incorporation. MoneyGram and many large corporations are incorporated in Delaware, which relies heavily on unclaimed property as part of its general fund revenue. Delaware argues that the MoneyGram checks are third-party bank checks and thus should be governed by the common law rules. In contrast, the challenging states argue that the checks are money orders or "similar written instruments," therefore coming under the jurisdiction of a 48-year-old federal law known as the Disposition of Abandoned Money Orders and Traveler's Checks Act of 1974.[83] If the law applies to the MoneyGram checks, they escheat to the state where the purchase occurred.

The case itself has an interesting procedural history, given the fact that the court in 2017 appointed a special master, a judge sitting on the Second Circuit U.S. Court of Appeals, to hear oral arguments from the parties and provide recommendations to the court on how it should rule. In 2021, the special master issued a report agreeing with the challenging states, determining that the abandoned checks fell within the scope of the federal law, meaning they should revert to the state where purchased. The court agreed to hear oral arguments in the case after Delaware submitted exceptions to the special master's report and requested that the court reject his recommendations.

During oral arguments held on Oct. 3, the first day of the court's term, the justices appeared concerned with the use of strict definitions under the federal law in determining whether the checks may be characterized as "money orders" or "similar written instruments," as the states argue, or whether they are considered third-party bank checks, as Delaware is urging them to do. The outcome of case will depend in large part on whether the court considers the substance over the form of the underlying financial instruments in deciding whether the federal law applies.

In an interesting turn of events, the special master in late October issued an order partially reversing his opinion on whether the federal unclaimed property governs all checks in the case. In the order, the judge concluded that he could no longer stand by his earlier recommendations to the court after hearing the oral arguments before the court and reviewing the record. Instead, he found that only some of the checks, known as "agent checks," are governed by the law and escheat to the state where purchased. In the judge's view, the other checks, or "teller's checks," fall under the jurisdiction of the common law and would therefore escheat to Delaware. To be sure, the special master's change in opinion is a surprising development at this stage of the litigation. Most recently, both Delaware and the challenging states submitted comments regarding the special master's revised recommendation.

Regardless of the procedural quirks involved, the outcome of the *MoneyGram* case will no doubt carry important implications regarding the scope of the federal unclaimed property law at issue and may also help to define key financial terms that often find themselves at the center of unclaimed property disputes. The ultimate classification of such property is arguably most important to Delaware given the adverse revenue implications to the state if the court renders a decision in the coming months in favor of the challenging states.

[81] *Delaware v. Pennsylvania et al.* and *Arkansas et al. v. Delaware*, U.S. Supreme Court, Nos. 22O145 & 22O146, docketed May 31, 2016 & June 13, 2016..
[82] 379 U.S. 674 (1965).
[83] 12 U.S.C. § 2501-03.

10. Rollout of the Colorado retail delivery fee

In 2021, Colorado became the first state to enact legislation imposing a state-level retail delivery fee on certain motor vehicle deliveries to a Colorado location with at least one item of tangible personal property (TPP) subject to state sales tax.[84] While the fee did not become effective until July 1, 2022, the Colorado Department of Revenue (Colorado DOR) issued guidance on the implementation of the fee only shortly before the effective date, giving retailers and marketplace facilitators little time to comply with the new requirements.[85] The compliance difficulties associated with the collection of this novel, complex fee have caused confusion for both in-state and remote sellers in determining the extent to which they are required to collect the fee and how to do so.

Currently imposed at a rate of $0.27 per sale, the retail delivery fee is imposed on the purchaser but must be collected and remitted by the retailer or marketplace facilitator that collects the sales tax on the underlying TPP sold or delivered, including delivery by a third party. The fee does not apply if all items of TPP included in a sale are exempt from sales tax or if the underlying sale of property is made on a wholesale basis.[86] The total fee must be separately stated on the invoice as a unified line-item item designated as "retail delivery fees."[87] The fee results in additional compliance burdens for retailers, as the fee is reported and paid on a new return separate from the retailer's sales tax return but is due at the same filing frequency as the sales tax returns. Further, a retailer that has an existing sales tax account and is required to charge the fee will need to register for a retail delivery fee account.

Tasked with providing guidance governing the fee's implementation, the Colorado DOR issued two rounds of draft regulations outlining the administration and enforcement of the fee, with the most recent draft regulations being issued in September 2022.[88] At a public hearing held in November, several retailers voiced concerns with the implementation of the fee under the Colorado DOR's proposed rules. Businesses asked for further clarification on when the fee should be applied in the case of third-party shipping companies. Others noted challenges with collecting the fee in cases where customers lease or hire trucks to accept delivery of goods. The concerns raised by the retailers illustrate the complexity associated with the fee as the Colorado DOR has yet to finalize the draft rules implementing the fee.

[84] Colo. S.B. 21-260, Laws 2021, adding COLO. REV. STAT. § 43-4-218.
[85] Retail Delivery Fee, Colorado Department of Revenue, June 2022. For further discussion of the Colorado retail delivery fee, see GT SALT Alert: "Colorado's retail delivery fee effective July 1."
[86] COLO. REV. STAT. §§ 43-4-218(3)(c); 39-26-102(19), (20).
[87] COLO. REV. STAT. § 43-4-218(6)(b).
[88] COLO. CODE REGS. § 43-4-218, issued Sept. 23, 2022 (draft regulation).

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Contacts

Jamie C. Yesnowitz
Washington, DC
T +1 202 521 1504
E jamie.yesnowitz@us.gt.com

Chuck Jones
Chicago
T +1 312 602 8517
E chuck.jones@us.gt.com

Patrick Skeehan
Philadelphia
T +1 215 814 1743
E patrick.skeehan@us.gt.com

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