



APRIL 2022

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



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Note from the Editors

By Eugene J. Gibilaro and Anna Uger

Welcome to the April 2022 edition of *The BR State + Local Tax Spotlight*. We understand the unique demands of staying on top of important State + Local Tax developments, which happen frequently and across numerous jurisdictions. Staying updated on significant legislative developments and judicial decisions helps tax departments function more efficiently and improves strategy and planning. That is where *The BR State + Local Tax Spotlight* can help. In each edition, we will highlight for you important State + Local Tax developments that could impact your business. In this issue, we will be covering:

- An Oklahoma Supreme Court decision holding that the limitations period for a company's refund claim began running from its extended return deadline;
- A Texas Supreme Court decision holding that, for purposes of sales factor sourcing, a company's services are performed where its personnel or equipment is physically located; and
- A California intermediate appellate court decision ordering that \$1.7 million in late filing and payment penalties be waived as the company relied upon an employee's misrepresentations that tax returns were filed and payment was remitted to the City of San Francisco.

We invite you to share *The BR State + Local Tax Spotlight* with your colleagues and visit Blank Rome's State + Local Tax [webpage](#) for more information about our [team](#). Click [here](#) to add State + Local Tax to your subscription preferences.

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PARTNER

Court Holds Actual Extended Filing Date is Key in Determining Timeliness of Refund Claim

By Craig B. Fields

The Oklahoma Supreme Court held that a corporation’s refund claim was timely because it was filed within three years from the filing of its original return on extension. In doing so, the Court rejected the Oklahoma Tax Commission’s (“Tax Commission”) assertion that the claim had to be filed within three years of the return’s due date without extension. *In re Raytheon Co. & Subsidiaries v. Okla. Tax Comm’n*, 2022 OK 32, 2022 WL 1011840 (mandate issued Apr. 5, 2022).

Facts. Raytheon Company and Subsidiaries’ (“Raytheon”) original tax return for 2012 was due on March 15, 2013. Raytheon obtained an extension and timely filed the return on September 27, 2013. Subsequently, it determined that it had incorrectly included sales of Arizona property in the numerator of its Oklahoma sales factor.

On September 27, 2016, exactly three years from the date that it filed its original return on extension, it filed an amended return which corrected its sales factor and claimed a refund. While the Tax Commission did not dispute the calculation of the tax on the amended return, the Tax Commission nonetheless denied the refund on the basis that it was not filed within three years from the original due date of the return, without extension.

Ruling. The Oklahoma Supreme Court held that the statute—Section 2373—was ambiguous and that it therefore had to engage in statutory construction. The relevant portion of that statute provides: “the amount of the refund shall not exceed the portion of the tax paid during the three (3) years immediately preceding the

filing of the claim....” After reviewing the legislative history of the statute, other sections of the Oklahoma Code, the Internal Revenue Code, and the Tax Commission’s own regulations, the Court concluded that Raytheon’s taxes were paid when it actually filed its 2012 return and, therefore, its refund claim was timely. The Court believed that its holding best harmonized the various statutes and carried out the legislative objectives.

Two justices wrote concurring opinions. The first believed that the mistakenly paid taxes should be returned under a different statute which provides that the Tax Commission shall return to the owner moneys that remain after the liquidation of the taxpayer’s tax liability. “[T]he State’s integrity should require that money paid in error to it, money in which it had no authority over, must be returned.” The second justice believed that since the

statute at issue was not an exemption or a credit provision that it should be interpreted in favor of the taxpayer.

It appears that all of the justices were frustrated with the Tax Commission’s attempt to use procedural grounds to keep monies to

which it was not entitled. Indeed, the majority opinion noted that the Tax Commission “had no jurisdiction over the Arizona income and could not have attempted to assess liability for that income in the event Raytheon’s return was filed without the error.”

This case is an important reminder that when state departments of revenue try to take the low road, the courts can and often will assist taxpayers so that justice can prevail. □

This case is an important reminder that when state departments of revenue try to take the low road, the courts can and often will assist taxpayers so that justice can prevail.



NICOLE L. JOHNSON

PARTNER

A Common-Sense Approach to Sales Factor Sourcing

By Nicole L. Johnson

For years, departments of revenue have interpreted their states' sourcing statutes to use a market-state approach. Those attempts have ranged from reasonable interpretations to outlandish ones. Recently, the Texas Supreme Court beat back such an attempt by the Comptroller in *Sirius XM Radio, Inc. v. Hegar*, No. 20-0462, 2022 WL 879704 (Tex. Mar. 25, 2022).

Facts. At issue in the case was the sourcing of service receipts from Sirius' satellite radio. For apportionment purposes, Texas sources service receipts based on where the service was "performed." *Id.* at 2. In *Sirius*, the Comptroller argued that the receipts should be sourced to location of the "receipt-producing, end-product act," which was the location of the customer. *Id.* at 5.

While the trend among the states is to source receipts to the location of a company's market, this case serves as an important reminder that such sourcing can only be done by legislation—not simply by departmental interpretation.

Conversely, Sirius argued that the statutory language looked to where the personnel or equipment performing the service was located. *Id.*

Ruling. Despite the Comptroller's convoluted arguments, the Court held that "[t]he focus should be on the statutory words themselves." *Id.*, at 5. Accordingly, the Court looked to the meaning of the term "performed." Based on prior caselaw, the Court stated a service is performed where the "act [is] done." *Id.* at 4.

Significantly, the Court stated that had the Legislature intended to apply a market-state approach, it would have been easy for them to do so—by sourcing service receipts to "the place of receipt or the location of the customer." *Id.* at 4. However, the Legislature opted not to use such language for the sourcing of service receipts, though it did for other categories of receipts.

Based on the plain language of the sourcing statute, the Court determined that services are performed "where the taxpayer's personnel or equipment is physically doing useful work for the customer." *Id.* at 5.

The Texas Supreme Court's common-sense approach was so compelling that the Pennsylvania Senior

Deputy Attorney General Sean Kirkpatrick advised the Pennsylvania Supreme Court of the *Sirius* decision. Mr. Kirkpatrick stated that the *Sirius* decision is contrary to the Pennsylvania Department of Revenue's position in *Synthes USA HQ, Inc. v. Commonwealth*, No. 11 MAP 2021. In the *Synthes* case, the

Department of Revenue argued that the location of the "income-producing activity" is the location where the benefit is received (*i.e.*, market-based sourcing). The Pennsylvania Supreme Court has not issued its decision in that case yet.

While the trend is to source receipts to the location of a company's market, this case serves as an important reminder that such sourcing can only be done by legislation—not simply by departmental interpretation. □



EUGENE J. GIBILARO

OF COUNSEL

California Appellate Court Orders Penalty Waiver

By Eugene J. Gibilaro

On March 30, 2022, a California intermediate appellate court held that a penalty waiver of approximately \$1.7 million was required for the taxpayers, owners and operators of San Francisco boutique hotels, inasmuch as the taxpayers established that they “exercised ‘ordinary business care and prudence in the payment of their tax obligations.’” *Gajanan, Inc. v. City of San Francisco*, No. A160539, at 8 (Cal. Ct. App. Mar. 30, 2022). In reaching its conclusion, the court rejected San Francisco’s argument that “as a matter of law, reliance on an employee cannot constitute ordinary care ... no matter how careful plaintiffs were in hiring and supervising the employee.” *Id.* at 2. This case is a reminder that when states or localities impose waivable penalties as if they are strict liability, taxpayers should consider whether there are arguments justifying a waiver and, if so, they should not be afraid to press those arguments in court.

Facts. The hotel owners contracted with a hotel management company to manage and staff six hotels. The hotel management company had been managing hotels for a long time and had a good reputation. The hotel management company hired an employee in the position of controller (“the employee”) after confirming that the employee had the requisite experience and credentials and having the employee interviewed and vetted by experienced professionals. The employee’s duties for the hotels included filing returns and paying the San Francisco transient occupancy tax, the tourism improvement district fee, and the Moscone expansion district fee. The hotels collected these taxes from their customers and deposited them into an account accessible to the employee.

The employee failed to file the required returns and pay the taxes for three quarters before being terminated by the hotel management company after it was discovered that the employee had made an unauthorized transfer

out of the account of one of the hotels. The new controller hired by the hotel management company then discovered that the employee had altered journal entries and balance statements to make it look like the taxes were being paid. When the taxpayers learned of what had transpired, returns were filed for the back periods and all taxes due for those periods were paid. The city imposed late filing and late payment penalties, which the taxpayers paid before seeking a refund in court.

Ruling. The Court ruled that penalties should be waived inasmuch as the taxpayers produced evidence that demonstrated that they had exercised ordinary care in connection with the filing and paying of the taxes in

This case is a reminder that when states or localities impose waivable penalties as if they are strict liability, taxpayers should consider whether there are arguments justifying a waiver and, if so, they should not be afraid to press those arguments in court.

question. Relevant to the court’s determination was the following: (a) the hotels hired a qualified company to manage the hotels, as is common in the industry; (b) the hotel management company hired a qualified individual who was responsible for paying the taxes; and (c) the employee did not pay the taxes but made it appear to the taxpayers as though the taxes had been paid by lying to them, providing them with false financial statements, and offering plausible explanations for the non-filing notices that the taxpayers received from the city. Under these circumstances, the Court reasoned, the relevant penalty waiver provision at issue required San Francisco to refund the penalty amounts paid by the taxpayers. □



State + Local Tax Summit

Thursday, May 26, 2022

Registration: 8:30 a.m.–9:00 a.m. ET • Program: 9:00 a.m.–2:30 p.m. ET

Location: Blank Rome LLP

1271 Avenue of the Americas • New York, NY 10020

[REGISTER HERE →](#)

Please join us for our annual State + Local Tax Summit.

The Summit will include discussion of the state and local issues affecting your company, including:

- An overview of the top judicial and legislative updates across the country;
- An update on P.L. 86-272 protections; and
- What you need to know for a work from home policy perspective.

Breakfast and lunch will be served.

New York CPE and CLE certification will be requested. There is no fee to attend.

Please contact **Nicole Johnson** at **212.885.5286** or
nicole.johnson@blankrome.com for more information about this event.

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.

Council on State Taxation's 2022 Advanced State Income Tax School

- ▶ [Eugene J. Gibilaro](#) will serve as a panelist at the Council on State Taxation's ("COST") 2022 Advanced State Income Tax School, which will be held the week of May 15, 2022. Eugene's panel, "Advanced State Taxation Related to Foreign Income," will take place on Tuesday, May 17, from 11:00 a.m. to 12:00 p.m. EDT, and will explore state adjustments with a focus on adjustments related to foreign operations and transactions. To learn more, please click [here](#). □

Council on State Taxation's 2022 SALT Basics School

- ▶ [Mitchell A. Newmark](#) will serve as a panelist at the COST 2022 SALT Basics School, which will be held the week of May 15, 2022. Mitchell's panel, "Restrictions on a State's Ability to Tax," is scheduled for Tuesday, May 17, and will review the various restrictions on a state's ability to impose taxes such as constitutional restrictions, federal legislation, and judicial pronouncements. To learn more, please click [here](#). □

Lawline CLE

- ▶ [Craig B. Fields](#) and [Nicole L. Johnson](#) will serve as faculty for the Lawline CLE program, "State of the States: State & Local Tax Developments," taking place on Thursday, May 12, 2022, at 12:00 p.m. EDT, as a live webcast. Craig and Nicole will discuss the recent judicial developments in state and local taxation and provide a summary of the courts' decisions and the ramifications for taxpayers. The tax areas covered will include corporate income tax and sales & use tax. Topics include identifying recent tax developments that may impact clients; ramifications of each decision; and potential issues and opportunities that have arisen as a result of the decisions. To learn more, please click [here](#). □

Federal Bar Association and myLawCLE

- ▶ [Nicole L. Johnson](#) will serve as a speaker for the Federal Bar Association myLawCLE program "Mobile and Telecommuting Workforce: State Tax and Compliance Challenges," being held Tuesday, May 3, 2022, from 1:00 to 3:10 p.m. EDT, as an online webinar (also available as an on-demand video). The webinar will examine the myriad of state tax rules and obligations that can be triggered when employees work in states different than the location of their employer, including state income and sales tax nexus thresholds; employment tax withholding obligations; and state-specific rules such as the Convenience of the Employer rule. The webinar will also review non-tax employment obligations, including workers compensation, wage and hour requirements, onboarding remote employees, policies and procedures, protecting the business, and family leave policies and when those are triggered by mobile and telecommuting employees. To learn more, please click [here](#). □

Council on State Taxation's 2022 Income Tax Conference & Spring Audit Session

- ▶ [Craig B. Fields](#) and [Nicole L. Johnson](#) will serve as speakers at the COST 2022 Income Tax Conference & Spring Audit Session, which will be held April 25 through 28, 2022, in Denver, Colorado. Blank Rome LLP is pleased to be a sponsor of the program. Nicole's panel, "Restructuring with Purpose: A Business Purpose Master Class," will take place on Tuesday, April 26, from 1:45 to 2:45 p.m. MDT, and will discuss how to establish a business purpose and, most importantly, how to appropriately document that purpose. Craig's panel, "Ethical & Professional Challenges Facing Attorneys and Other State Tax Professionals," will take place on Wednesday, April 27, from 7:30 to 8:30 a.m. MDT, and will explore key tenets of ethical rules for attorneys and accountants working in the state tax arena, using vignettes and electronic audience polling. To learn more, please click [here](#). □