MAY 2022

THE BR STATE + LOCAL TAX SPOTLIGHT

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Note from the Editors

By Eugene J. Gibilaro and Anna Uger

Welcome to the May 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:

- The New York State Department of Taxation and Finance's proposed revised regulations that update guidance on the state's Corporate Franchise Tax;
- The Connecticut General Assembly's decision to not move forward with a proposed amendment that would have added taxation to the state's False Claims Act; and
- A New York Administrative Law Judge's ruling in favor of an out-of-state broker-dealer in a case involving the sourcing of its receipt of certain fees.

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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KARA M. KRAMAN
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New York State Updates Draft Corporate Franchise Tax Regulations

By Kara M. Kraman

On April 29, 2022, the New York State Department of Taxation and Finance (the "Department") released what it refers to as a "final update" to its draft corporate franchise tax regulations relating to all topics except for apportionment, which it indicated will be forthcoming in summer 2022. The Department anticipates that it will commence the State Administrative Procedure Act process in fall 2022 to formally propose and adopt these draft regulations and asks that comments be provided by June 30, 2022. Once finalized, these regulations will provide welcome guidance on the corporate franchise tax reform law that went into effect over seven years ago on January 1, 2015.

The most potentially far-reaching of these revised draft regulations are the provisions—now addressing Public Law 86-272 ("P.L. 86-272") protection for activities conducted via the Internet. In general, P.L. 86-272 provides businesses with immunity from state income taxes when their activities in a state are limited to the solicitation of sales of tangible personal property. The updated draft regulations, which the Department notes are "largely modeled after the [Multistate Tax Commission] model statute," address whether certain business activities conducted over the Internet go beyond solicitation of sales of tangible personal property and are thus no longer protected from state income taxation by P.L. 86-272.

> **Once finalized, these regulations will provide welcome guidance on the corporate franchise tax reform law that went into effect over seven years ago on January 1, 2015.**

Under the updated draft regulations, while presenting "static text or images" will not remove P.L. 86-272 protection, activities such as replacing damaged products or giving technical advice on how to use products will be considered to go beyond mere solicitation and remove P.L. 86-272 protection. The draft regulation provides several examples illustrating which Internet activities do and do not qualify for P.L. 86-272 protection. Qualifying activities include providing a static list of frequently asked questions (FAQs) on a website, placing cookies on customers' computers as long as those cookies are only used for purposes entirely ancillary to soliciting sales (such as remembering items in a shopping cart), and maintaining a website that enables customers to purchase, select a delivery method, and pay for tangible personal property offered for sale.

Among the activities that would not qualify for P.L. 86-272 are offering an electronic chat service that advises customers on the use of purchased products; soliciting and receiving branded credit card applications; placing cookies on customers' computers that will be used for purposes that are ancillary to the solicitation of sales (such as to develop new products or identify new items to offer for sale); offering extended warranty plans for sale; allowing customers to apply for non-sales positions with the company through the website; providing upgrades and repairs remotely; and contracting with New York customers to stream videos and music.

Due to the extensive nature of Internet activities that can cause a business to lose P.L. 86-272 protection under the draft regulations, a business seeking to maintain its protected status may want to carefully tailor its website to curtail any potentially problematic activities if the regulations are adopted in their current form. However, at the current time, the Department's website reminds taxpayers that the draft regulations are not final and may not be relied upon. □

MITCHELL A. NEWMARK
PARTNER

Tax Justice Prevails as Connecticut Sinks FCA Expansion

By Mitchell A. Newmark

The Connecticut General Assembly was heading toward including taxation in the expansion of the state's False Claims Act, Conn. Gen. Stat. § 4-274, *et seq.* (the "FCA") via Senate Bill 426. Expansion of the FCA is laudable to combat fraud. Including taxation in the FCA would have been a huge policy mistake. If S.B. 426 had passed, companies and high-net-worth individuals would have fled Connecticut. S.B. 426 died in the General Assembly, hopefully not to be resurrected in its current form.

What happened? The existing FCA in Connecticut is narrow. It is limited to actions with respect to state-administered health and human services programs. S.B. 426 was drafted to simply remove the limiting language, *i.e.,* remove the references to "a state-administered health or human services program." Removing that limit would have made taxpayers vulnerable to claims under the FCA seeking treble damages plus the costs of investigation and prosecution, which can be brought by the Connecticut Attorney General or a person initiating the action.

We are pleased that tax justice prevailed and the proposed expansion of the FCA to include tax claims was shut down—for now.

Further, as Distinguished Professor Richard Pomp noted, in his individual capacity, in a letter to the General Assembly, there was a fundamental fairness flaw regarding limitations periods:

> By eliminating the existing tax bar, S.B. 426 would extend the False Claims Act's existing ten year statute of limitations to tax claims, which are now covered in general by a three year statute. The ten year statute means that years that are closed under the tax law would become fair game under the bill. [Letter from Richard D. Pomp, Alva P. Loiselle Professor of Law at the University of Connecticut Law School, to Connecticut Appropriations Committee (Apr. 21, 2022).]

The Connecticut AG, commented on S.B. 426 that:

> Currently, over 100 agencies, offices and quasi-public agencies spend tax dollars on behalf of the government of the State of Connecticut. Only nine of these agencies are covered under the current Connecticut False Claims Act, leaving billions of tax dollars vulnerable to fraud and abuse. [Judiciary Committee, Joint Favorable Report, S.B. 426.]

The AG's comment highlights another flaw in the bill. The Connecticut Department of Revenue Services ("the Department") is charged with policing tax obligations, is staffed with competent people to do so, and should be supported in its role. If the General Assembly believes that the Department needs to increase activity and, if increased funding of the Department is necessary, then the funds should be appropriated and directed to increase the number of audits conducted by hiring and training more auditors.

With the end of S.B. 426's attempt to remove the words "state-administered health or human services program", the attempt to make the terms of the FCA very broad also ended. The General Assembly had previously declined to limit the impact of S.B. 426 by ignoring the Amendment offered by Senator John Kissel which provided:

> (d) The provisions of this section shall not apply to claims, records or statements made or presented to establish, limit or reduce liability for the payment of taxes to the state or any other governmental authority.

We are pleased that tax justice prevailed and the proposed expansion of the FCA to include tax claims was shut down—for now. Please keep in touch and stay tuned as to whether the General Assembly takes another shot at expansion. For now, tax justice prevails! □

IRWIN M. SLOMKA
SENIOR COUNSEL

Judge Rules in Favor of Securities Broker-Dealer on Application of New York Broker-Dealer Sourcing

By Irwin M. Slomka

Although it has been more than 20 years since the enactment of customer-based sourcing for registered securities broker-dealers under the New York State corporate franchise tax, there have been few cases interpreting it. Therefore, a recently decided case involving the sourcing of an out-of-state broker-dealer's receipt of certain fees merits attention. *In re TD Ameritrade, Inc.* (N.Y. Div. of Tax App. DTA No. 829523, Apr. 28, 2022). In *TD Ameritrade,* an Administrative Law Judge held that no portion of those fees should be sourced to New York under the broker-dealer sourcing rules because the mailing addresses of the "customers" that paid the fees—two related national banks—were outside New York State.

Facts. TD Ameritrade is an online securities broker-dealer headquartered in Omaha, Nebraska, with significant operations in New Jersey and Texas. Individual and institutional investors maintain brokerage accounts with TD Ameritrade. As is typical, brokerage clients deposit funds into their brokerage accounts, and direct TD Ameritrade on how the funds should be invested and what securities trades to make.

Under Article 9-A, a registered securities or commodities broker-dealer sources in its receipts factor prescribed categories of receipts, including brokerage commissions, margin interest, and account maintenance fees, based generally on the mailing address of the "customer[s] responsible for paying" the receipts. Tax Law former § 210(3)(a)(9). At issue was the sourcing of fees denominated as "marketing fees" paid to TD Ameritrade by related banks having mailing addresses outside the State. The fee is in exchange for TD Ameritrade having directed billions of dollars of client deposits into a pooled omnibus account, and for performing certain recordkeeping services.

Dispute. In its Article 9-A returns for the years 2012 through 2014, TD Ameritrade included the marketing fees in the denominator of its receipts factor, but not in the numerator. On audit, the Department sourced the fees based on the same percentages that TD Ameritrade used to source its brokerage commissions—that is, based on the mailing addresses of its brokerage clients. The Department's position was that TD Ameritrade's brokerage clients, not the banks, were the "customer[s] responsible for paying" the marketing fees, arguing that the fees represented interest being paid by the brokerage clients.

Decision. The ALJ held in favor of TD Ameritrade, finding that the banks paid the fees in exchange for TD Ameritrade having deposited large amounts of funds with them and performing certain recordkeeping services. According to the ALJ, this made the banks the "customer[s] responsible for paying" those fees under the broker-dealer sourcing rules. The ALJ found no support in the record for treating the fees as interest that TD Ameritrade received from its brokerage clients. Since the mailing addresses of the banks were in New Jersey, the Department could not source the fees to the State. The ALJ also held in the alternative that if the banks were not the customers, then the broker-dealer sourcing rules were inapplicable, and the fees would then be sourced to where the services were performed by TD Ameritrade, which was in Nebraska and Texas, not New York.

The ALJ held in favor of TD Ameritrade, finding that the banks paid the fees in exchange for TD Ameritrade having deposited large amounts of funds with them and performing certain recordkeeping services.

Observations. Although subject to appeal, the ALJ's decision that the banks were TD Ameritrade's "customer[s] responsible for paying" the fees finds support from two factual determinations. First, that it was the banks that actually paid the fees to TD Ameritrade. Second, that TD Ameritrade's brokerage clients could not have themselves commanded the higher yield that was received from the banks, which the ALJ felt proved fatal to the Department's claim that the brokerage clients were the customers paying interest to TD Ameritrade. □

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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.

29th Annual Paul J. Hartman State & Local Tax Forum

- Craig B. Fields and Nicole L. Johnson will speak at Vanderbilt University Law School's 29th Annual Paul J. Hartman State and Local Tax Forum, being held October 19 through 21, 2022, at the Lowes Vanderbilt Hotel in Nashville, Tennessee. There will also be a virtual option available for all program sessions. Craig's session, "Leading Practices in Audits, Assessments, and Alternative Dispute Resolutions," will take place Wednesday, October 19. Nicole's session, "Allocable Income," will take place Thursday, October 20. To learn more, please click here. □

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

- Nicole L. Johnson will serve as a panelist at the Council on State Taxation's ("COST") 2022 Income Tax Conference & Spring Audit Virtual Sessions, which will be held May 23 through 25, 2022, as a live online event. Nicole's session, "Restructuring with Purpose: A Business Purpose Master Class," will take place on Monday, May 23, from 12:40 to 1:40 p.m. EDT, and will discuss how to establish a business purpose and, most importantly, how to appropriately document that purpose. 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 today, May 19, 2022, 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 To learn more, please click here. □

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