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



CONTENTS

1. Note from the Editors
2. New Jersey Tax Court Awards Company a Refund Based on Its Use of Market-Based Sourcing for Years Prior to New Jersey's Adoption of the Same
3. New York City Announces Anticipated Deviations from Recently Promulgated New York State Corporate Tax Regulations
4. New Orleans Loses Bid to Tax Music Streaming Service
5. New York State Enacts Fiscal Year 2024–2025 Budget, New York City to Follow
6. What's Shaking: Blank Rome State + Local Tax Roundup

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Note from the Editors

By Joshua M. Sivin and Melanie L. Lee

Welcome to the May 2024 edition of *The BR State + Local Tax Spotlight*. We know the importance of remaining up-to-date on State + Local Tax developments, which appear often and across numerous jurisdictions. Staying informed on significant legislative developments and judicial decisions helps tax departments function more efficiently, along with improving strategy as well as planning. That is where *The BR State + Local Tax Spotlight* can help. In each edition, we will highlight important State + Local Tax developments that could impact your business. In this issue, we will be covering:

- New Jersey Tax Court Awards Company a Refund Based on Its Use of Market-Based Sourcing for Years Prior to New Jersey’s Adoption of the Same
- New York City Announces Anticipated Deviations from Recently Promulgated New York State Corporate Tax Regulations
- New Orleans Loses Bid to Tax Music Streaming Service
- New York State Enacts Fiscal Year 2024–2025 Budget, New York City to Follow

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.

Update(s) from previous editions. In the April 2024 edition of *The BR State + Local Tax Spotlight*, Nicole L. Johnson authored an article titled “Misapplication of *Complete Auto*” in which she discusses the South Dakota Supreme Court’s recent opinion in *Ellingson Drainage, Inc. v. South Dakota Department of Revenue*. The Appellant in that case (Ellingson Drainage, Inc.) has petitioned the Supreme Court of the United States for a writ of certiorari.

In the March 2024 edition of *The BR State + Local Tax Spotlight*, Irwin M. Slomka authored an article titled “Microsoft Prevails in California Dispute on Inclusion of Gross Foreign Dividends in Apportionment Formula.” We had previously updated in the April 2024 edition of *The BR State + Local Tax Spotlight* that the California Office of Tax Appeals (“OTA”) had designated its 2023 opinion in *Appeal of Microsoft Corporation and Subsidiaries* as non-precedential. As a further update, on May 1, 2024, the Counsel On State Taxation submitted a letter to the OTA recommending that the OTA 2023 *Microsoft* decision be designated precedential.

In the December 2023 edition of *The BR State + Local Tax Spotlight*, Eugene J. Gibilaro authored an article titled “State Tax v. Local Tax – Is There a Difference?” in which he discussed the Pennsylvania Supreme Court’s recent decision in *Zilka v. Tax Review Board of Philadelphia*. Since the publication of his article, the Appellant in that case (Diane Zilka) has petitioned the Supreme Court of the United States for a writ of certiorari. The Court has not yet granted or denied review.

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New Jersey Tax Court Awards Company a Refund Based on Its Use of Market-Based Sourcing for Years Prior to New Jersey's Adoption of the Same

By Kara M. Kraman

In an unpublished opinion, the New Jersey Tax Court held that a web-based business solutions company was entitled to use market-based sourcing to source its 2011 and 2012 receipts even though market-based sourcing was not officially adopted by New Jersey until 2019.

[*Solix, Inc. v. Dir., Div. of Taxation, 2024 N.J. Tax Unpub. LEXIS 6 \(Apr. 11, 2024\).*](#)

The Facts: Solix, Inc. (“Solix”), a web-based business solutions company headquartered in New Jersey, had approximately 900 employees, roughly 300 of whom were located in New Jersey. Solix’s primary business was acting as the third-party administrator for out-of-state governmental entities in operating and managing their governmental subsidy programs for the benefit of residents in and outside of New Jersey. As part of the services it provided, Solix created or customized proprietary software that was designed and developed by Solix’s information technology (“IT”) team in New Jersey. Solix also provided hands-on interactions with, and assistance to, non-New Jersey subsidy recipients, which were performed by its approximately 600 employees located in call centers outside of New Jersey.

Solix originally filed its 2011 and 2012 tax returns using the statutory cost-of-performance (“COP”) method of sourcing its receipts. However, it later amended its 2011 and 2012 returns to use a market-based method of sourcing, asserting refunds due. The Division of Taxation (“Division”) denied the refunds and determined that Solix should have used the 25-50-25 method of sourcing which was then applicable to certain service fees. Solix protested the Division’s refund denials administratively to the Division’s Conference and Appeals branch (“CAB”). CAB found that neither market-based sourcing nor the 25-50-25 method applied and determined that Solix should have instead used the COP method of sourcing its receipts.

The Decision: The Tax Court held that Solix properly sourced its receipts using market-based sourcing. The Court rejected the Division’s argument that the use of market-based sourcing was prohibited before its official enactment in 2019. The Court also noted that the Division’s internal disagreement with CAB about the appropriate method of sourcing (the Division did not pursue 25-50-25 sourcing at the Tax Court), together with its assertion for the first time that market-based sourcing is legally barred, “may suffice to overcome the initial presumption of the correctness of its final determination,” although the Court noted that it was still Solix’s burden to persuade the Court why its approach “is correct or more credibly appropriate.”

In this case, the Court found that Solix met its burden. The Court noted that while the applicable statute at the time provided for COP sourcing, the applicable regulation expressly permitted allocation “by some other reasonable method that should reflect the trade or business practice and economic realities underlying the generation of the compensation for services.” The Court determined that Solix’s receipts were not primarily attributable to the creation and use of its proprietary software created in New Jersey, but rather were primarily attributable to its hands-on interactions with non-New Jersey subsidy recipients, which were performed by Solix’s employees located outside of New Jersey.

As a result, the Court held that market-based sourcing better reflected the business practice and economic realities of Solix’s business.



IRWIN M. SLOMKA

SENIOR COUNSEL

New York City Announces Anticipated Deviations from Recently Promulgated New York State Corporate Tax Regulations

By Irwin M. Slomka

The New York City Department of Finance (“Department”) has recently announced on its [website](#) that its still-pending business corporation tax regulations under City corporate tax reform legislation enacted in 2015 are expected to contain several notable deviations from the New York State corporate tax reform regulations that were promulgated at the end of 2023. Although City regulations have not yet been released to the public, the Department states that its regulations will “substantially parallel” the comprehensive State regulations, which were the culmination of a nearly nine-year project. However, the Department has identified five major areas where it is likely to deviate from the State regulations:

1. *Application of unincorporated business tax (“UBT”) sourcing rules for corporate partners that receive a distributive share of partnership income.* The most controversial deviation from the State regulations would involve how the City taxes corporate partners that receive a distributive share of partnership income. The State’s regulations generally apply the “aggregate method” of taxation, which treats the corporate partner as having directly earned its distributive share of partnership receipts. For State corporate tax purposes, the corporate partner includes its distributive share of the partnership’s business receipts in its own apportionment factor and applies the corporate tax customer-based sourcing rules in computing its apportionment factor.

In its announcement, the Department states that it will not follow that regulation but instead will use New York City UBT sourcing—which does *not*

apply customer-based sourcing—to apportion the corporate partner’s distributive share of partnership income for City corporate tax purposes. Any non-partnership business income earned by the corporate partner would be separately apportioned using customer-based sourcing rules. It should be noted that the Department is already applying UBT sourcing to corporate partners on audit, notwithstanding the absence of a regulation, although the bifurcated apportionment method between partnership and non-partnership business income is a new development. Litigation has already commenced on this issue.

The Department states that the City law affords it great flexibility in determining how a corporate partner’s distributive share of partnership income is included in the partner’s income. It also points out that unlike the State, the City imposes an entity-level UBT on partnerships. The Department’s announcement does not explain, however, how the aggregate method—under which the corporate partner is treated as directly earning the partnership’s receipts—authorizes the application of UBT sourcing to the corporate partner’s share of those receipts.

2. *Authorize deviating from statutory apportionment methods based on individual facts and circumstances.* The Department is considering deviating from the State’s regulations regarding evidentiary standards, which provide, for example, that the party seeking to vary from the statutory

(continued on page 4)

apportionment formula or to overcome a presumption under an allocation method hierarchy must establish entitlement to such variance by “clear and convincing evidence.” Instead, the Department is considering a more general “individual facts and circumstances” standard, claiming that a “clear and convincing standard” is excessively burdensome on both the City and taxpayers.

3. *Allocation of income from passive investment customers using 8% fixed allocation where the location of investors is unknown.* The Department intends to follow the State’s regulations regarding the allocation of receipts from management, distribution and administration services provided to “passive investment customers” based on the location of the underlying investors in the non-corporate investment funds, similar to how such receipts are sourced when earned from mutual funds. It intends to deviate from the State’s regulation where the locations of those investors are unknown, under which those receipts are sourced based on where the contract with the service provider is “managed” by the passive investment customer. Instead, where investor locations are unknown, the City intends to use an 8% fixed allocation.

4. *Increase threshold for taxpayers to use billing address “safe harbor.”* The State’s regulations provide a customer billing address “safe harbor” for sourcing where the taxpayer has at least 250 business customers that purchase substantially similar products or services and no more than 5% of such receipts are from any particular customer. The Department intends to significantly limit the “safe harbor” by setting the threshold at 1,000 customers.

5. *Retain excess inclusion in income for holders of residual interests in real estate mortgage investment conduits (“REMICs”).* The Department intends to depart from the State’s regulation which excludes from entire net income (“ENI”) the amount of excess inclusion of a holder of a residual interest in a REMIC that is required to be reported under IRC § 860E, asserting that there is no statutory authority for its exclusion from ENI.

City officials now say that they expect to formally propose corporate tax reform regulations in early 2025.



MITCHELL A. NEWMARK

PARTNER

New Orleans Loses Bid to Tax Music Streaming Service

By Mitchell A. Newmark

The New Orleans Collector of Revenue (“Collector”) failed in its attempts to subject music streaming services to the City’s sales tax. In [Apple, Inc. v. Collector of Revenue of the City of New Orleans et. al.](#), Docket No. L01283 (May 2, 2024), the Louisiana Board of Tax Appeals, Local Tax Division, analyzed the Company’s summary judgment motion and noted (1) that the City did not file an opposition to the motion and (2) that the City would “not consent to the granting of the motion.” We often see collectors raise no specific objection to an assessment challenge, except proffering their “we say so” positions, essentially arguing that if a court will give you a win, so be it. That is not fairness in tax administration, and we hope the Louisiana Governor is listening.

The City issued assessments to the Company for the periods January 1, 2016 through October 31, 2018, asserting sales tax, interest, and penalties with respect to the Company’s music streaming subscriptions. The Company challenged, asserting the City’s assessments were an illegal, discriminatory tax under the Internet Tax Freedom Act (“ITFA”) codified in the notes to 47 U.S.C. § 151. The Board found three undisputed material facts: (1) the Company’s service uses the Internet to stream audio content, such as music, to devices connected to the Internet; (2) satellite radio service allows the streaming of audio content, such as music, using satellites to devices capable of receiving satellite signals; and (3) the audio content streamed using the Internet to the Company’s subscribers is similar to the audio content streamed by satellite radio providers using satellite signals.

The Board explained that the ITFA prohibits a state or political subdivision, such as New Orleans and Orleans Parish, from imposing discriminatory

taxes on electronic commerce. The ITFA defines the term “discriminatory tax” as a tax imposed on electronic commerce but not generally imposed by the taxing authority on transactions involving similar goods or services accomplished through other means. ITFA § 1105(2). The ITFA defines “electronic commerce” as a transaction conducted over the Internet. ITFA § 1105(3).

The Board found that it is undisputed that the Company’s streaming service is provided over the Internet. The Board further found that the City was pre-empted from subjecting satellite broadcast services to sales tax by the Federal Telecommunications Act (“FTA”) (reproduced at 47 U.S.C. § 152, note). FTA § 602(a). The Board reasoned that satellite music streaming services are not subject to the City’s sales tax and the City is attempting to subject to sales tax the same service by the Company because it is provided via the Internet. As such, the Board held that the City is attempting to impose a tax on an Internet service that it cannot impose on a similar satellite service, such an attempt is a discriminatory tax under the ITFA, and the sales tax on Internet music streaming is prohibited.

The takeaway is that often litigation proceeds, though the company is correct in its position, because a tax authority does not want to be seen as allowing the position or it does not like the outcome.

“We Say So” taxation has no place in the fair administration of tax.



MELANIE L. LEE

ASSOCIATE

New York State Enacts Fiscal Year 2024–2025 Budget, New York City to Follow

By Melanie L. Lee

On April 20, 2024, 19 days after the April 1 deadline, New York Governor Kathy Hochul signed into law several bills, including A8809 / [S8309](#) and A8806 / [S8306](#) (collectively, the “Budget”), which enact into law New York State’s \$237 billion budget for the fiscal years 2024–2025. Some of the more noteworthy, revenue-related provisions of the Budget are summarized below:

- *Extension of itemized deduction limitation.* Provides that individuals with adjusted gross income over \$10 million will continue to be subject to an itemized deduction limitation of 25% of any Federal charitable contribution for taxable years ending before 2030.
- *Clarification of the Metropolitan Commuter Transportation District (“MCTD”).* Clarifies that, effective January 1, 2024, the Metropolitan Commuter Transportation Mobility Tax applies to the net earnings from self-employment of individuals attributable to the MCTD, including the counties of Dutchess, Nassau, Orange, Putnam, Rockland, Suffolk and Westchester. The tax is imposed at a rate of .34% if such earnings attributable to the MCTD exceed \$50,000 for the tax year.
- *Commercial security tax credit.* Creates a security tax credit of \$4,000–\$6,000 for each eligible business retail location in the State. Eligibility is limited to employers of 50 or fewer on “qualified retail theft prevention measure expenses” including security officers, cameras and alarm systems.
- *Commercial property tax incentives.* Creates an affordable housing from commercial conversion incentive program. To be eligible, projects that convert non-residential buildings into eligible multiple dwellings must be commenced and completed by certain dates, and different projects may be classified within various tiers, with different incentives, depending on duration, location and other factors.
- *Tax rate reduction for certain combative sports.* Lowers the ticket tax from 8.5% to 3% (the same as for boxing and wrestling) for kick-boxing, single discipline martial arts and mixed martial arts matches or exhibitions, effective December 1, 2024.
- *Sales tax exemption extension.* Extends for one year the sales tax exemptions including for tangible personal property and services sold between financial institutions and their subsidiaries (relating to the Dodd-Frank Protection Act).
- *Amended tax return “loophole” closed.* Permits the tax department to take action on amended returns (*e.g.*, issuing a notice of deficiency) where the taxpayer has previously filed a petition with the Division of Tax Appeals for the tax year.

(continued on page 7)

Perhaps of more interest is what did not make it into the Budget—tax rate increases on the highest earners in the State making over \$5 million and over \$25 million, the requirement that vacation rental marketplace providers collect sales tax on vacation rentals that they facilitate, the repeal of the sales tax exemption for private aircraft and boats valued over \$230,000 and the State-level counterpart to the Federal Work Opportunity Tax Credit.

In 2023, Governor Hochul vowed not to increase income tax rates in the 2024–2025 budget, and after weeks of negotiations with the Senate and House, that promise seems to have been kept.

On April 24, 2024, New York City Mayor Eric Adams announced his \$111.6 billion executive budget (the “Proposal”) for the City for fiscal year 2025. Like the State Budget, the Proposal does not increase tax rates in the City. The Proposal does include climate budgeting (a process used to assess how the City’s investments impact the City’s ability to achieve climate goals), increased investments in the City’s CityFHEPS (rental assistance) program, forgiveness of \$2 billion in medical debt for qualified individuals and grants to Small Business Improvement Districts. In addition, the Proposal restores funding for additional New York Police Department recruiting but does not restore the \$24 million cut last fall from the City’s libraries. The City’s fiscal year 2025 budget is due June 30, 2024.

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.

State of the States

- ▶ Blank Rome State + Local Tax partners [Craig B. Fields](#), and [Nicole L. Johnson](#), will serve as speakers for an Energy Tax Association event being held Monday, May 20, 2024, in San Antonio, Texas. To learn more, please click [here](#).

Advanced State Taxation Related to Foreign Income

- ▶ Blank Rome State + Local Tax partner [Eugene J. Gibilaro](#) will serve as a panelist at the Council on State Taxation's ("COST") 2024 Intermediate/Advanced State Income Tax School, which will be held May 19 through 23, 2024, in Atlanta, Georgia. To learn more, please click [here](#).

Restrictions on a State's Ability to Tax

- ▶ Blank Rome State + Local Tax partner [Mitchell A. Newmark](#) will be speaking at the COST's SALT Basics School event on May 23rd in Atlanta, Georgia. To learn more, please click [here](#).

Tax Executives Institute ("TEI") 2024 Region 10 Conference

- ▶ Blank Rome State + Local Tax partners [Craig B. Fields](#), and [Nicole L. Johnson](#), will be speaking at the Tax Executives Institute's 2024 Region 10 Conference from May 22nd through May 24th in Dana Point, California. To learn more, please click [here](#).