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THE BR STATE + LOCAL TAX SPOTLIGHT

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Note from the Editors

By Joshua M. Sivin, Melanie L. Lee, and Lilian O. Umetiti

Welcome to the June 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:

- Missouri Court Rules Nonresidents Not Subject to Local Tax When Working Outside the Locality
- Arkansas Supreme Court Finds Online Travel Companies Not Liable for Hotel Taxes
- NYS Tax Appeals Tribunal Finds SaaS Fees Are Subject to Sales Tax

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.

Updates from previous editions. 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Office of Tax Appeals ("OTA") had designated its 2023 opinion in *Appeal of Microsoft Corporation and Subsidiaries* as non-precedential, and in the May 2024 edition of *The BR State + Local Tax Spotlight* that the Counsel On State Taxation had recommended to OTA that the OTA re-designate its opinion as precedential. As a further update, the Multistate Tax Commission has asked the OTA to continue to designate the decision as non-precedential. In addition, as part of California's budget for the upcoming fiscal year, California has adopted changes to its apportionment rules in response to *Appeal of Microsoft Corporation and Subsidiaries.*

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 decision in *Zilka v. Tax Review Board of Philadelphia.* We had previously updated in the May 2024 edition of *The BR State + Local Tax Spotlight* that the Appellant in that case (Diane Zilka) has petitioned the Supreme Court of the United States for a writ of certiorari. As a further update, in a June 10 order, the U.S. Supreme Court invited the solicitor general to file a brief in the case.

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CRAIG B. FIELDS
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Missouri Court Rules Nonresidents Not Subject to Local Tax When Working Outside the Locality

By Craig B. Fields

As a result of the COVID-19 pandemic, many states and localities tried to continue taxing nonresident employees who stopped working from their employer's location and began working from home in another jurisdiction. The Missouri Court of Appeals has ruled that St. Louis can subject nonresidents to its earnings tax only when the employees are actually providing their services within the City. *Boles v. City of St. Louis*, No. ED111495 (Mo Ct. App. May 28, 2024).

St. Louis imposes a 1% tax on compensation earned by non-resident individuals "for work done or services performed or rendered in the City." St. Louis City R.C. § 5.22.020.

Mark Boles and five other individuals are nonresidents of St. Louis who worked for City-based employers. At least some of each employee's work was performed remotely during 2020 and 2021. They either paid the earnings tax under pro-test or it was withheld from their paychecks. Each filed refund claims based on the number of days worked outside the City for each year.

St. Louis denied the refunds for remote work performed outside of the City, with the exception of remote work done while traveling for business purposes for their respective employers. The Court noted that the lower court had found that prior to 2020 the City did not distinguish between the purposes for the remote work and issued refunds to the employees for all remote work. The City modified the criteria for refunds in 2020 during the pandemic, issuing refunds only for business travel. (The lower court decision is discussed in the February 2023 issue of *Spotlight.*)

The Court focused on the language that the earnings tax applies only to work done or services performed or rendered "*in* the City." The Court found that the preposition "in" was used to indicate location. It then considered and rejected the City's position that the word "render" should be interpreted to mean "delivered" or "transmitted." Under the City's position, the Court would be required to read the statute as applying to "work done or services performed or [delivered] *into* the City" or "[delivered] *to* the City." The Court refused to replace the term "in" with the words "into" or "to."

The Court found additional support for its conclusion. First, the statute was enacted in 1959 and its language had never been amended. Remote work was not prevalent in the 1950s and 1960s due to the technology of the time. Accordingly, the statute would not have contemplated situations where a nonresident would be "transmitting" or "delivering" work into the City over the internet or any electronic means.

Second, the City conceded that the purpose of the statute was to enable it to provide various services. The Court noted that nonresidents only benefit from those services when they are physically working in the City. Finally, the Court's interpre-tation is consistent with the City's post-pandemic practice of excluding remote work when done for business travel.

Although the Court denied the employees' request for class action certification, the City has nonetheless agreed to a settlement whereby the City will pay refunds to all individu-als who worked remotely. Taxpayers who have not yet filed refund claims need to do so for the 2020 through 2022 years between July 1, 2024 through October 1, 2024.

> **There are currently numerous cases across the country challenging jurisdic-tions' ability to tax the compensation of nonresident employees when they are not working in the jurisdiction where their employer is located. It is hoped that those cases come to a similar conclusion.**

JOSHUA M. SIVIN
OF COUNSEL

Arkansas Supreme Court Finds Online Travel Companies Not Liable for Hotel Taxes

By Joshua M. Sivin

Reversing a decision from a circuit court, the Arkansas Supreme Court held last month that a group of online travel companies ("OTCs"), including Hotels.com, Expedia, and Orbitz, were not liable for state and local gross receipts and tourism taxes (together, the "hotel taxes"), penalties, and attorneys' fees and costs totaling over $45 million because the OTCs were not providing or furnishing accommodations to transient guests. The decision ended a nearly 15-year legal dispute between OTCs and government agencies in Arkansas. *Hotels.com LP v. Pine Bluff Adver. & Promotion Comm'n,* No. CV-23-416 (Ark. 2024).

Facts: Government agencies and the state of Arkansas brought a declaratory judgment action (which was granted class certification) against OTCs seeking more than 22 years' worth of unpaid hotel taxes. The hotel taxes applied to entities furnishing or providing accommodations to transient guests. The circuit court found that, under the plain language of the relevant statutes, the OTCs were "provider[s] of accommodations to [] transient guest[s]" and, thus, were entities subject to taxation under the hotel taxes.

The legislature made amendments in 2019 (after the years at issue in the case), which applied the hotel taxes to "accommodations intermediaries."

Decision: The Arkansas Supreme Court reversed the circuit court, finding that the OTCs were not taxable entities within the meaning of the hotel taxes. The Court found that there was ambiguity as to whether the OTCs were "any other provider of accommodations" and applied canons of statutory construction to determine the legislature's intent.

First, the Court found that the OTCs were not expressly listed as entities subject to the hotel taxes, and that the circuit court's conclusion that the phrase "any other provider of accommodations" encompassed OTCs was contrary to the doctrine of *ejusdem generis,* "which provides that when general words follow specific words in a statutory enunciation, the general words are construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words." The Court found that OTCs do not "own, operate, or manage lodging establishments" but rather are "accommodations intermediaries."

Further, the fact that the statutes were amended in 2019 to include "accommodations intermediaries" as taxable entities was compelling and supported the OTCs' construction. The Court found that the amendment to include intermediaries subject to tax demonstrated that the intermediaries were "newly subject to the taxes." If intermediaries were already subject to tax under the prior law, there would have been no need for the amendment, and legislative action is presumed to affect change: "the legislature will not be presumed to have done a vain and useless thing."

Finally, the Court's interpretation was consistent with the Department of Finance and Administration ("DF&A") understanding of the law before and after the 2019 amendments. The DF&A's 2019 legislative-impact statement observed that the amendments "'modif[y] existing law to include 'accommodations intermediary' as an entity furnishing, making available for, or otherwise arranging for the sale or use of a room[.]'"

Relying on the canons of statutory construction, the Court found that the legislative intent reflected that the OTCs were not subject to the hotel taxes prior to the 2019 amendments. "In this instance, the OTCs are online technology companies that facilitate reservations between travelers and lodging establishments that supply the rooms. This service does not fit within the plain language of 'renting, leasing, or otherwise furnishing' rooms."

Take Away: Where language in a statute is susceptible to more than one reasonable interpretation, it is ambiguous, and courts will look to the legislative intent to interpret the statute. Where, as in this case, amendments to a statute add a class of entities to be subject to tax under the new law, courts will likely determine that under the prior law, such entities were not subject to tax because legislatures are presumed to have knowledge of current law, and any amendments are meant to affect a change in law.

> **If the original statute applied to OTCs, there would have been no need for the 2019 amendment.**

EUGENE J. GIBILARO
PARTNER

NYS Tax Appeals Tribunal Finds SaaS Fees Are Subject to Sales Tax

By Eugene J. Gibilaro

The New York State Tax Appeals Tribunal recently upheld a sales tax assessment issued to a company that provided services to customers mostly through what the company described as a software-as-a-service ("SaaS") model. *In the Matter of the Petition of Beeline.com, Inc.*, DTA No. 829516 (May 2, 2024). The company, Beeline.com, Inc., charged vendor management service ("VMS") fees for a solution that included consulting services as well as a license to access the company's proprietary software technology. Significantly, in finding that the VMS fees were subject to sales tax, the Tribunal declined to apply the primary function or true object test to determine whether the company was selling nontaxable services or taxable prewritten computer software. Instead, the Tribunal concluded that when a single fee is charged for taxable tangible property and nontaxable services, the entire fee is subject to sales tax unless the taxable tangible property is merely ancillary or incidental to the sale of the nontaxable services.

> **This case is a reminder that, in mixed transactions involving sales of both taxable tangible property and nontaxable services, to the extent possible, the different items being sold should be broken out and separately stated on customer invoices.**

The Company provided services to large businesses assisting them with gathering, organizing, assembling, and managing their contingent labor force. The Company's chief operating officer testified that essentially what the company sold was a "matching" service to match customers that desired to purchase the services of temporary workers with the suppliers of temporary contingent labor. None of the consulting services that the Company provided were separately billed, there were no separate charges for any of the consulting services provided, and invoices sent to customers did not include a charge for a software license. The only charge was the single fee for the VMS bundled package of services.

After finding that the VMS software was taxable prewritten computer software, the Tribunal explained that the primary function or true object test is only used when considering integrated services that include both taxable services (*e.g.,* taxable information services) and nontaxable services. However, the test is not applicable "when considering the taxability of mixed bundles of tangible personal property and services in consideration of the fact that retail sales of tangible personal property are taxable unless specifically exempt, whereas services are taxable only if specifically enumerated in the Tax Law."

With respect to the taxability of a mixed bundle of tangible property and services, the Tribunal has instead considered whether the tangible property was "a significant part of the transaction, not merely a trivial element of a contract for services." The Tribunal concluded here that the VMS software "is the core element of [the Company's] business and is anything but incidental or ancillary to [the Company's] services." Finally, while the Company may have provided otherwise nontaxable services, the Company "failed to substantiate that claim by providing reasonable and separately stated charges for those services."

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.

Chambers USA 2024 Recognizes Blank Rome Attorneys and Practices

- Blank Rome LLP is pleased to announce that our practice groups and attorneys have again been ranked by Chambers USA, which recognized them as "leaders in their fields." To learn more, please click here.

COST 2024 Southwest/West Regional State Tax Seminar

- Blank Rome State + Local Tax partners Craig B. Fields and Mitchell A. Newmark will be speaking at a session titled "Discussion of State Tax Cases, Issues & Policy Matters to Watch" at the COST Southwest/West Regional State Tax Seminar on July 11th in Dallas, TX. Nicole L. Johnson and Eugene J. Gibilaro will also be speaking at a session titled "Alternative Apportionment: Issues and Considerations." To learn more, please click here.

The 31st Annual Paul J. Hartman State and Local Tax Forum

- Blank Rome State + Local Tax partner Nicole L. Johnson will be speaking at the 31st Annual Paul J. Hartman State and Local Tax Forum which will be held from October 28th through the 30th in Nashville, Tennessee. To learn more, please click here.

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