JULY 2024

THE BR STATE + LOCAL TAX SPOTLIGHT

BLANKROME

CONTENTS

STATE + LOCAL TAX TEAM:

Craig B. Fields | craig.fields@blankrome.com
Nicole L. Johnson | nicole.johnson@blankrome.com
Mitchell A. Newmark | mitchell.newmark@blankrome.com
Irwin M. Slomka | irwin.slomka@blankrome.com
Eugene J. Gibilaro | eugene.gibilaro@blankrome.com
Kara M. Kraman | kara.kraman@blankrome.com
Joshua M. Sivin | joshua.sivin@blankrome.com
Philip M. Tatarowicz | phil.tatarowicz@blankrome.com
Melanie L. Lee | melanie.lee@blankrome.com

Note from the Editors

By Joshua M. Sivin, Melanie L. Lee, and Henry Q.P. Valentine

Welcome to the July 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 Mexico Again Loses Unity of Foreign Income
- To Be or Not To Be A Unitary Business
- South Carolina Supreme Court Declares Facially Discriminatory Sales Tax Exemption Invalid
- Potential State and Local Tax Implications of the U.S. Supreme Court's Decision in *Loper Bright Enterprises v. Raimondo*

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.

Co-Editors, *The BR State + Local Tax Spotlight*

JOSHUA M. SIVIN
Of Counsel
212.885.5025
joshua.sivin@blankrome.com

MELANIE L. LEE
Associate
212.885.5371
melanie.lee@blankrome.com

HENRY Q.P. VALENTINE
Summer Associate
212.885.5108
henry.spiro@blankrome.com

MITCHELL A. NEWMARK
PARTNER

New Mexico Again Loses Unity of Foreign Income

By Mitchell A. Newmark

The New Mexico Taxation & Revenue Department ("Department") wrongly ignored the statutory exclusion for foreign corporations incorporated in foreign countries that do not engage in a trade or business in the United States when it forced inclusion of such foreign subsidiaries in the New Mexico unitary filing group for Apache Corporation. In *Apache Corp. & Subsidiaries v. New Mexico Tax'n & Revenue Dep't*, Docket No. A-1-CA-39961 (NM Ct. of App. June 17, 2024), the New Mexico Court of Appeals analyzed the taxpayer's multiple challenges and even noted New Mexico's prior loss in *F.W. Woolworth Co. v. New Mexico Tax'n & Revenue Dep't,* 458 US 354 (1982), when it reversed the adverse ruling issued by the Administrative Hearing Officer ("AHO").

Apache Corporation ("Apache") engaged in petroleum and natural gas exploration and production, was headquartered in Texas, and conducted business via domestic and non-U.S. (*i.e.,* "foreign") subsidiaries. For 2015, Apache filed New Mexico unitary combined income tax returns that excluded the foreign subsidiaries. The Department included the foreign subsidiaries and assessed additional tax and interest, with penalties. Apache protested on constitutional grounds and later supplemented its protest to assert that the statutory definition of a unitary business excluded foreign corporations.

After a trial, the AHO ruled that the foreign subsidiaries were unitary and includible entities. Undeterred, Apache appealed.

On appeal, the New Mexico Court of Appeals explained that it must "look to the plain language of the statute…." So, recognizing its job, it observed that the statute required that an elective combined corporation income tax return "shall include the net income of all the unitary corporations." It further noted that "unitary corporation" is defined in statute Section 7-2A-2(Q) as:

two or more integrated corporations, *other than any foreign corporation incorporated in a foreign country and not engaged in trade or business in the United States during the taxable year,* that are owned in the amount of more than fifty percent and controlled by the same person and for which at least one of the following conditions exists:

(1) there is a unity of operations evidenced by central purchasing, advertising, accounting or other centralized services;

(2) there is a centralized management or executive force and centralized system of operation; or

(3) the operations of the corporations are dependent upon or contribute property or services to one another individually or as a group.

(Emphasis added.)

The Department argued, and the AHO had agreed, that if the foreign subsidiaries met the three unities test, inclusion in the combined return was appropriate. Apache highlighted that the statute contains a carve-out for a "foreign corporation incorporated in a foreign country and not engaged in trade or business in the United States during the taxable year[.]" The Department did not dispute that the subsidiaries at issue were incorporated in foreign countries and, though it initially disputed that the subsidiaries conducted no U.S. trade or business, on appeal the Department conceded that the subsidiaries did not engage in a trade or business in the United States in 2015. Apache argued that the subsidiaries met the terms of the carve-out and they should be excluded from the combined return.

The Court of Appeals noted that if the only test was the three unities test asserted by the Department and upheld by the AHO, then the statute's carve-out language would be superfluous. The Court of Appeals held: "We disagree with AHO's analysis because it negates the existence of the carve-out."

There are two important take-aways:

- **First, don't despair if you lose at the first appeal level—keep fighting because you can win!**
- **Second, the plain words of the statute must be considered: Words Matter!**

NICOLE L. JOHNSON
PARTNER

To Be or Not To Be A Unitary Business

By Nicole L. Johnson

Oftentimes companies are on the defense in establishing that they are not operating a unitary business to avoid excessive taxation by a State. Yet, there are occasions when companies take the offense—and are successful. In the recent decision in *Nationwide Agribusiness Insurance Company v. Dep't of Treasury*, No. 364790 (Mich. Ct. App. June 20, 2024), the company played offense better than Barry Sanders in the 1990s.

In *Nationwide,* the Company originally filed its Michigan insurance premiums tax returns on a separate return basis but subsequently filed amended returns on a combined basis. There was no form available to file on a combined basis, so the Company's only option was to create a combined reporting schedule. Although the Department of Treasury (the "Department") initially granted the refund requests, the Department reversed course and ordered the return of the refunds with interest (and assessed penalties!).

Michigan imposes numerous types of taxes on taxpayers—including the premiums tax. For those taxes, a "taxpayer" is defined as "a corporation, insurance company, financial institution, or unitary business group." Thus, the Company argued that it was a unitary business group and allowed to file as such.

The Michigan Court of Appeals correctly noted that whether a company is part of a unitary group "is not a matter of choice." Instead, it is a factual conclusion. In *Nationwide,* such factual conclusion was undisputed by the Department. However, the Department argued that unitary returns were not allowed because there was no explicit statutory authority for the filing of such returns under the premiums tax.

The Court quickly eschewed that argument based on the statutory definition of taxpayer. The Court went on to hold that when companies are a unitary business, the individual entities have "no meaningful existence." The individual entities that make up the unitary group cease to be separate taxpayers and only one taxpayer remains—the unitary business group.

Ultimately, the Company prevailed. The Court held that the Company was part of a unitary business group that was permitted to file the premiums tax on a combined basis. The takeaway? While many companies are focused on defending against audit adjustments, taking a proactive approach to your state tax filings can lead to definite benefits and more accurate filings.

> **Remember that just because the Department does not provide a form for a filing method does not mean that the preferred filing method does not exist.**

MELANIE L. LEE
ASSOCIATE

South Carolina Supreme Court Declares Facially Discriminatory Sales Tax Exemption Invalid

By Melanie L. Lee

It is well settled that states may not discriminate against interstate commerce in the name of intrastate economic development. Recently, in the consolidated cases *Orthofix, Inc. v. Dep't of Rev.*, App. No. 2023-000317 (S.C. June 26, 2024) and *KCI USA, Inc. v. Dep't of Rev.*, App. No. 2023-000318 (S.C. June 26, 2024), the South Carolina Supreme Court applied this principal to strike down a discriminatory sales tax exemption.

Facts: In 2007, South Carolina enacted a durable medical equipment ("DME") exemption (the "Exemption") whereby sales of DME paid for directly by Medicaid or Medicare funds are exempt from sales tax *only* when the seller's principal place of business is located in South Carolina. Businesses who sell otherwise eligible DME are not able to claim the exemption if their principal place of business is outside of the State.

Orthofix, Inc. ("Orthofix") and KCI USA, Inc. ("KCI"), two Delaware corporations selling DME with principal places of business outside of South Carolina, challenged the Exemption, arguing: (1) that it "facially discriminates against interstate commerce;" and (2) that the discriminatory "principal place of business in South Carolina" language should be severed from the Exemption. The circuit court agreed with Orthofix and KCI, finding the Exemption facially discriminatory, and severed the "principal place of business in South Carolina" language from the remainder of the Exemption.

Decision: In its decision, the South Carolina Supreme Court affirmed the circuit court's decision in part. Applying the dormant Commerce Clause, the Court found that a state law is "virtually *per se* invalid" and results in "improper economic protectionism if the law in question has either a discriminatory effect or a discriminatory purpose." The Department of Revenue ("DOR") offered no argument that the law did not have a discriminatory effect. However, the DOR argued that the law did not have a "discriminatory purpose" because the law is "merely intended to 'promote economic development' in South Carolina." The Court held that the DOR failed to put forth a "legitimate local purpose" that could not be served by non-discriminatory means.

Turning to the issue of severability, the Court first noted that its unconstitutional finding is limited to the part of the Exemption requiring the seller's principal place of business be in South Carolina. To test whether this unconstitutional language could be severed from the Exemption, the Court asked "whether the constitutional portion of the statute remains complete in itself, [capable of being executed,] wholly independent of that which is rejected, and is of such a character as that it may fairly be presumed that the Legislature would have passed it independent" of the unconstitutional portion.

Orthofix and KCI, the proponents of severability, could offer no evidence of legislative intent that the Exemption would have passed without the unconstitutional language. As a result, the Court determined it could not sever the language. Moreover, the Court noted as "telling" the absence of a "savings clause" in the Exemption, which typically evidences a legislature's intent that a law be "saved" should part of it be found to be unconstitutional.

> **Because the unconstitutional language could not be severed, the Court declared the entire Exemption invalid "going forward."**

However, the Court affirmed the circuit court's decision to order that Orthofix and KCI receive refunds of sales tax for the time periods at issue. Because it found the Exemption as a whole invalid, the Court "assum[ed]" going forward that all sellers of DME (including Orthofix and KCI) would be required to pay sales tax, absent the legislature enacting a new, modified DME exemption.

Four judges concurred with the majority, with one in a separate opinion explaining that severability was also not an option because if the Court "were to sever the unconstitutional language from the [Exemption], thereby expanding the scope of the [Exemption] to all sellers of DME, [the] Court would be making the decision to limit State revenue" prospectively in a way that would violate South Carolina's Constitution.

KARA M. KRAMAN
OF COUNSEL

Potential State and Local Tax Implications of the U.S. Supreme Court's Decision in *Loper Bright Enterprises v. Raimondo*

By Kara M. Kraman

On June 28, 2024, the U.S. Supreme Court issued its decision in *Loper Bright Enterprises et. al. v. Raimondo, Secretary of Commerce, et. al.*, No. 22-451 603 U.S. ___, (June 28, 2024), in which it held that in interpreting ambiguous statutes, courts are not required to defer to agency interpretations. The 6-2 majority opinion written by Justice Roberts overturned the Court's four-decade old decision in *Chevron U.S.A., Inc. v. NRDC* which required courts to defer to "permissible" agency interpretations of ambiguous statutes they administer as long as certain circumstances were met.

> **Although *Chevron* was not a tax case, the principle of deference to agency interpretation ("*Chevron* deference") was often invoked by courts deciding tax cases, almost universally to the taxpayer's detriment.**

Writing for the Court, Justice Roberts found that *Chevron* deference "cannot be squared with" the federal Administrative Procedure Act ("APA") which, among other things, "specifies that courts, not agencies, will decide *all* relevant questions of law arising on review of agency action." (Emphasis in original, quotations omitted.) The Court also noted that the deference to agency interpretation "was misguided because agencies have no special competence in resolving statutory ambiguities. Courts do."

State and Local Tax Implications

While the decision in *Loper Bright* held that *Chevron* deference was incompatible with the federal APA, which generally does not apply to the state and local taxing authorities that are involved in state and local tax controversies, the decision still has the potential to greatly impact state and local tax cases.

First, although state taxing authorities are not subject to the federal APA, many states have their own administrative procedure act that have provisions that are substantially similar to the provisions of the federal APA and therefore warrant a substantially similar interpretation.

Second, many state courts and administrative tribunals have cited to *Chevron* and applied *Chevron* style deference when deferring to a taxing authority's interpretation of a tax statute, including interpretations formally set forth in agency regulations. To the extent *Chevron* has been relied upon by courts when giving deference to administrative interpretations of tax statutes, this reliance is no longer appropriate. (It should be noted, however, that the Court in *Loper Bright* expressly stated that its decision does "not call into question prior cases that relied on the *Chevron* framework," so the Court's decision in *Loper Bright* does *not* provide a basis to challenge previous decisions.)

Third, while the Court's primary focus was on the conflict between the APA and the holding in *Chevron,* the Court also explained that it has always been the courts' job to interpret statutory provisions and that this is "no less true when the ambiguity is about the scope of an agency's own power—perhaps the occasion on which abdication in favor of the agency is *least* appropriate." (Emphasis in original.) This general principle, that a court's primary function is to interpret the law and that its function should not be usurped by an agency, is equally applicable at the state court level and can be used to help level the playing field between taxpayers and taxing authorities in controversies involving statutory interpretation.

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.

Introduction to Sales and Use Taxation

- Blank Rome of counsel Joshua M. Sivin will serve as a speaker for New York University School of Professional Studies' ("NYU SPS") Tax Conferences in July, being held July 15 through 26, 2024, in New York, New York. To learn more, please click here.

Advising Business Clients on Remote Sales Tax: Selling across State Lines—What Attorneys Should Know (2024 Edition)

- Blank Rome State + Local Tax partner Nicole L. Johnson and associate Melanie L. Lee will present "Advising Business Clients on Remote Sales Tax: Selling across State Lines—What Attorneys Should Know (2024 Edition)," a myLawCLE program being held Wednesday, July 24, 2024, from 11:00 a.m. to 1:10 p.m. EDT, as a live video broadcast. 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.

BLANKROME