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In this article, Semes discusses recent cases *DuPont* and *U.S. Bank* and what these decisions portend for the future of state and local tax litigation.

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June 30 marked the end of the 2023/2024 fiscal year for almost every state. Tax court decisions from Minnesota (*DuPont*¹) and South Carolina (*U.S. Bank*²), and a Maryland hearing in the last week of June, suggest that apportionment and digital advertising taxes (DATs) will be hotly litigated in the new fiscal year and beyond. These cases and this hearing also raise issues and questions that remain unanswered.

Beginning with *Quill* (1992) and *Geoffrey* (1993), and until *Wayfair* (2018), nexus dominated the state and local tax litigation landscape for over two decades. While significant nexus issues circled in a holding pattern around *Geoffrey* and *Wayfair*, apportionment issues came to the

forefront. Serving as the petri dish for many SALT issues, California led the way with *Microsoft*³ and *General Mills*,⁴ which addressed the issue of whether high-volume hedging receipts were to be included in the sales factor at net or gross. Beginning several months before *Wayfair*, courts east of California — in Indiana,⁵ Pennsylvania,⁶ South Carolina,⁷ Texas,⁸ and Virginia⁹ — issued conflicting decisions (although interpreting identical or, in the case of South Carolina, substantially similar statutes) on how to source receipts from the sales of services or intangibles.

The Minnesota (*DuPont*¹⁰) and South Carolina (*U.S. Bank*¹¹) decisions continue the apportionment controversy trend. The June 27 Maryland hearing addressed what has become — and will likely continue to be — one of the most hotly contested state tax issues. This article analyzes these cases and the issues they raise.

DuPont — Minnesota — June 24, 2024

The facts in *DuPont* are strikingly similar to those of the California *Microsoft* and *General Mills* cases in that all three taxpayers sought to include the “gross” value of receipts from certain types of

³ *Microsoft Corp. v. California Franchise Tax Board*, 139 P.3d 1169 (Cal. 2006).

⁴ *General Mills v. California*, 146 Cal. Rptr. 3d 475 (Cal. Ct. App. 2012).

⁵ *The University of Phoenix Inc. v. Indiana Department of State Revenue*, 88 N.E.3d 805 (Ind. T.C. 2017).

⁶ *Synthes USA HQ Inc. v. Commonwealth*, 289 A.3d 846 (Pa. 2023).

⁷ *Dish DBS Corp. v. South Carolina Department of Revenue*, 2016-001642; 2018-UP-404 (S.C. Ct. App. 2018).

⁸ *Sirius XM Radio Inc. v. Comptroller of Public Accounts*, 643 S.W.3d 402 (Tex. 2022).

⁹ *The Corporate Executive Board Co. v. Virginia Department of Taxation*, 822 S.E.2d 918 (Va. 2019).

¹⁰ *DuPont*, Dkt. No. 9485-R.

¹¹ *U.S. Bank*, Dkt. No. 20-ALJ-17-0168-CC.

¹ *E.I. duPont de Nemours and Co. v. Commissioner of Revenue*, Dkt. No. 9485-R (Minn. T.C. 2024).

² *U.S. Bank National Association v. South Carolina Department of Revenue*, Dkt. No. 20-ALJ-17-0168-CC (S.C. Admin. Law Ct. 2024).

hedging or financial activities, and the state in each case argued that (a) doing so did not fairly reflect the taxpayer's business activities in the state, and (b) including the "net" value of those receipts fairly reflected the taxpayer's business activities in the state. More specifically, *General Mills* involved commodity futures hedges, *Microsoft* involved short-term treasury investments, and *DuPont* involved foreign exchange contracts (FECs).

The similarity of the facts and issues caused Minnesota Tax Court Judge Wendy Tien to do a deep dive into the California analysis. After doing so, and similar to the Franchise Tax Board in *Microsoft* and *General Mills*, Judge Tien held that:

- although the plain language of the statute (which requires sales to be included "at gross" in the taxpayer's sales factor) is a high burden to overcome, the commissioner put on expert testimony that overcame this burden and proved that the FEC activity was qualitatively different from its regular business activities, and that including the FEC receipts "at gross" would cause quantitative distortion of DuPont's business activity in the state; and
- the commissioner proved by clear and cogent evidence that its alternative apportionment method — including the FEC receipts "at net" — fairly reflected DuPont's business activities in the state.

The factual and legal similarity of these cases does not mean that they should be tossed aside for the simple proposition that high-volume hedging activities may distort a taxpayer's sales factor. Instead, these cases should cause one to ask some of the questions that appear at the end of this article.

U.S. Bank — South Carolina — June 25, 2024

Because our economy has shifted away from the manufacturing of tangible goods to the provision of services, the sourcing of receipts from the sale of services — or, speaking more broadly, receipts from sales of "other than tangible personal property" (TPP) — has been and continues to be a source of controversy. South Carolina Administrative Law Judge Milton Kimpson was asked to determine how U.S. Bank's receipts from mortgage loan interest, mortgage

loan servicing fees, credit card interest, and credit card exchange fees were to be sourced.¹² To answer these questions, Kimpson first had to find that the sourcing rules for the bank tax at issue were similar to those for the income tax. Having answered that question in the affirmative, Kimpson needed to determine whether the receipts at issue were from the sale of services or from the sale of intangible property. After evaluating the expert testimony provided by both the South Carolina Department of Revenue and the taxpayer, Kimpson concluded that U.S. Bank's receipts from all the activities in question were receipts from intangibles.

Kimpson found that because the DOR's "method of sourcing income from intangibles to the state of the borrower are longstanding administrative practices, such method is entitled to deference from this Court." Assuming U.S. Bank were to appeal, query how the recent U.S. Supreme Court decision in *Loper Bright*¹³ may influence whether an appellate court would agree with deferring to the DOR's long-standing practice. At footnote 24, Kimpson further held that the location of U.S. Bank's customer was an appropriate proxy for where the income-producing activity occurred. It is curious that he relied on the recent (and questionable) Pennsylvania Supreme Court decision in *Synthes*,¹⁴ which is also directly contrary to the Indiana, Texas, and Virginia decisions noted above.

Regarding U.S. Bank's gain on its sale of stock, which represented a 5.1 percent interest in class B shares, Kimpson found that U.S. Bank "failed to show that its Visa stock was not connected to its business." Putting the burden of proof to the side, it is curious that the opinion contains no discussion of the unitary business principle and the constitutional standards.

Finally, Kimpson found that U.S. Bank did not base its positions regarding several of the items in question on "substantial authority" or "reasonable basis"; he therefore upheld the

¹² *U.S. Bank*, Dkt. No. 20-ALJ-17-0168-CC (also at issue was whether U.S. Bank's sale of Visa stock was to be included in its apportionable base).

¹³ *Loper Bright Enterprises v. Raimondo*, No. 22-451 (S. Ct. 2024).

¹⁴ *Synthes*, 289 A.3d 846.

imposition of “substantial underpayment penalties on [those] streams of income.” Nonetheless, and noting that U.S. Bank had failed to provide evidence to support its position but providing no other explanation, Kimpson relieved U.S. Bank of the penalties associated with the tax on the gain on the sale of Visa stock.

Maryland Hearing — June 27, 2024

Also, in the last week of the fiscal year, the Maryland Tax Court (Chief Judge Anthony Wisniewski presiding) heard arguments in ongoing challenges to Maryland’s DAT. Much has been written about these challenges, which are playing out in both federal and state courts. In California, S.B. 1327 proposes a tax on digital advertising similar to Maryland’s. Although the California proposal is titled “The Data Extraction Mitigation Fee Law,” that law imposes a “tax equal to 7.25 percent of gross receipts derived from data extraction transactions in this state,” and Sen. Steve Glazer (D) himself has stated that the “mitigation fee is the same as our sales and use tax of 7.25 percent.”¹⁵

The senator’s comment is telling when one considers that at the June 27 hearing, Chief Judge Wisniewski probed both the comptroller and the taxpayer’s counsel on how a gross receipts tax (like the DAT) is similar to a sales tax and asked the parties for supplemental briefing on the issue. More specifically, the chief judge asked the parties to submit post-trial briefs explaining whether the DAT sufficiently resembles a sales tax to apply the “true object” test to it and, if so, how that affects the Internet Tax Freedom Act similarity analysis. The chief judge also asked the parties to address in their post-trial briefs whether nontaxable, nondigital advertising services are, in fact, subsumed into taxable digital advertising services and, if so, how their being bundled (that is, not separately stated) affects the ITFA analysis. These questions demonstrate that the various types of state taxes (income, property, sales and use, gross receipts) combined with a rapid proliferation of digital goods muddies the analysis of SALT issues.

These Cases and Hearing Foreshadow A Portion of the SALT Controversy Future

The first thing to notice is a question that was not asked of the tax courts in the apportionment and sourcing cases. *DuPont* did address the commissioner’s alternative apportionment argument, but the taxpayer did not proffer that the single sales factor (SSF) as applied to its facts may not fairly reflect its business activities in the state. In the first year at issue — 2013 — Minnesota gave 2 percent weight to each of the property and payroll factors, and 96 percent to the sales factor.¹⁶ This weighting reflected the trend across the country of moving toward an SSF and away from an equally weighted property, payroll, and sales formula. This trend toward SSF raises a host of issues, including whether ignoring the production side of generating income (property and payroll) properly reflects a particular taxpayer’s business activities in the state; what sort of evidence (remember, the commissioner in *DuPont* proved by clear and convincing evidence that it was fair to reflect the FEC receipts at net and not gross) a party might present to overcome the presumption of the SSF being valid; and how relevant, if at all, the weighting of the apportionment factor imposed by other states in which the taxpayer operates is, and — the flip side of the coin — how relevant is the manner in which the taxpayer reports in other states (see, for example, *Corporate Executive Board*¹⁷). The answers to these questions could turn the tide on future apportionment controversy.

In *DuPont*, the parties did not dispute that the income from the FECs was part of DuPont’s unitary business. However, if DuPont had chosen to outsource its foreign currency hedging function to an unrelated party, which we’ll call FC Services, would FC Services have sufficient nexus with Minnesota to be subject to tax? If so, should FC Services source 100 percent of its receipts from its sales to DuPont to Delaware (where DuPont is headquartered and, presumably, where the invoice would be sent), or should Minnesota “look through” and apportion based on DuPont’s Minnesota apportionment factor? And if that were

¹⁵ Sen. Glazer, “Senator Glazer’s Floor Remarks on Bill to Revive Journalism” (July 3, 2024).

¹⁶ Minn. Stat. section 290.191 (2023).

¹⁷ *Corporate Executive Board*, 822 S.E.2d at 929.

the case, how would FC Services obtain that information from DuPont? Would DuPont be required to provide that information to FC Services? And, coming full circle, does FC Services' Minnesota apportionment factor need to include a property and payroll factor to fairly reflect its Minnesota business activities?

These cases also demonstrate the importance of expert testimony. In both cases, (a) the taxpayer and government put on experts to support their respective positions, and (b) the triers of fact relied heavily on that testimony in reaching their decisions.

U.S. Bank also illustrates the importance of precisely defining the item being sold. Is what's being sold a service, an intangible, TPP, or something else? Further, does a sales tax statute that, for instance, defines software as a service (SaaS) as TPP for sales tax purposes mean that SaaS is sourced for income tax as TPP? And taking that analysis a step further, should a taxpayer that creates SaaS qualify as a manufacturer and, if so, for what other types of taxes?

The events transpiring in Maryland and California (and other states) signal that we are not likely to see a final resolution to the DAT saga in Maryland for several years. And who knows how many more years of litigation will ensue if another state decides to go down the trail Maryland has begun to blaze, which causes one to wonder whether a state would be prudent to adopt a DAT (regardless of what it is called) whose viability is far from certain for so many reasons (for example, because of the ITFA, First Amendment, commerce clause, foreign commerce clause, and due process clause). Finally, the chief judge's questions suggest additional layers of complexity in resolving these issues.

In conclusion, we SALT nerds are not likely to run out of things to talk about for quite a while. That said, I will continue to take my wife's advice and not discuss these types of issues when socializing with muggles (those wonderful people who rightfully neither care nor want to know about what we do). Nonetheless, I believe that apportionment, sourcing, and DATs will dominate our conversations for the foreseeable future. ■

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