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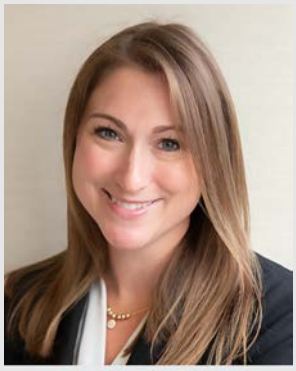

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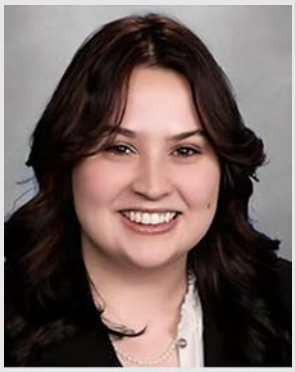

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In this installment of Pennsylvania's SALT Shaker, the authors explore some of this year's top state and local tax cases regarding issues like P.L. 86-272, nexus, sourcing and apportionment, and sales and use tax responsibilities.

As 2024 draws to a close, it is time to revisit some of the top state and local tax cases of the past year. Like every year, taxpayers and states continued to battle over various SALT issues, including P.L. 86-272, nexus, sourcing and apportionment, and sales and use tax responsibilities. This article explores how recent court decisions have affected these issues and more in some of the top SALT cases of 2024.

Continued Challenges to P.L. 86-272

In recent years, states have continued to challenge the protections of P.L. 86-272. Enacted in 1959, the federal law prohibits states from imposing income taxes on companies when their in-state activity is limited to the solicitation of sales of tangible personal property and orders are approved and shipped from outside the state. In 2024 the Minnesota Supreme Court was asked to determine whether the activities of the sales representatives of Uline Inc., a Wisconsin-based company, exceeded the protections of P.L. 86-272 and therefore subjected the company to Minnesota income and franchise tax.[1]

Uline's sales representatives created "Sales Notes" summarizing each customer interaction and providing relevant information about the customer, in addition to creating "Market News Notes," which contained a broader range of details about both Uline's competitors and customers.

The court sided with the Minnesota Department of Revenue and held that the creation of Market News Notes by sales representatives in Minnesota exceeded mere order solicitation, and the preparation of more than 1,600 Market News Notes by Uline's representatives was not a de minimis activity.

As we enter 2025, there are a number of P.L. 86-272 cases circulating in courts throughout the country that taxpayers and practitioners should continue to monitor, including a case challenging New York's adoption of guidance issued by the Multistate Tax Commission addressing the intersection of P.L. 86-272 and internet activities.

[1] *Uline Inc. v. Commissioner of Revenue*, 10 N.W.3d 170 (Minn. 2024).

Alternative Apportionment — Raised by Both Sides

In 2023 the South Carolina DOR began imposing forced combined reporting, through the use of alternative apportionment, which was met with significant challenges. In August 2023 the South Carolina Administrative Law Court (ALC) issued its first decision regarding this issue in *Tractor Supply*.[2]

Tractor Supply Co., a retailer, operates two subsidiaries, Michigan Tractor Supply Co. LLC and Texas Tractor Supply Co. LP. During an audit, the DOR contended that intercompany transactions were distorting the taxpayer's income and asserted the right to apply alternative apportionment. The department used combined reporting to recalculate the company's South Carolina tax liability and issued an assessment.

On appeal, the ALC ruled for the department, citing issues it found problematic. For example, Tractor Supply and Texas Tractor Supply entered into a procurement agreement under which services cost about $13 million but resulted in earnings between $300 million and $400 million. The court also raised concerns about the taxpayer's transfer pricing study and the 9.7 percent markup. The ALC reached a similar decision in July 2024 in *CarMax*,[3] again upholding the DOR's use of alternative apportionment. However, the South Carolina Legislature stepped in to address the issue prospectively. In March 2024 it enacted S. 298, which provides that the DOR may force corporate taxpayers to file a unitary combined return only if it finds that the taxpayer's intercompany transactions lacked economic substance or were not at fair market value. Further, it directs the ALC to decide whether adjustments other than requiring combined reporting are adequate to redetermine income attributable to a taxpayer's business activities in South Carolina.

The Oregon Tax Court decided another alternative apportionment case this year — but this time it was the taxpayer who sought to invoke alternative apportionment. In *Microsoft*, Microsoft argued that it was entitled to a refund of more than $11 million, based primarily on two main theories.[4] At issue was whether Microsoft's repatriated IRC section 965 income should be included in its sales factor. Oregon incorporated the federal rule to include repatriated IRC section 965 income in its tax base but modified it to exclude 80 percent of the repatriated income. Thus, Microsoft initially included in its base the 20 percent IRC section 965 income but did not include any portion of this income in its Oregon sales factor.

In seeking a refund, Microsoft first asserted that its repatriated IRC section 965 income was "sales" that should be "re-included" in its Oregon sales factor. Relying on *Oracle*,[5] Microsoft argued that the definition of sales generally excludes deemed dividends under subpart F because they "arise from the holding of intangible assets." However, an exception to the definition treats those amounts as sales if the controlled foreign corporation and the taxpayer were engaged in a single unitary business and the CFC's earnings and profits making up the subpart F amounts are from a single primary business activity shared by the CFC and the taxpayer. Because it was part of a water's-edge group and engaged in a single unitary business activity with its foreign subsidiaries, Microsoft argued that re-inclusion of its 20 percent repatriated IRC section 965 income to the sales factor was warranted.

Under its second theory, Microsoft argued that it was entitled to use alternative apportionment to receive factor representation and include in its Oregon sales factor denominator 100 percent of its IRC section 965 income.

In granting partial summary judgment, the Oregon Tax Court agreed with Microsoft's first argument and found that it was part of a water's-edge group and engaged in a single unitary business activity. However, re-inclusion of the 20 percent repatriated income to the sales factor resulted in a refund that was half the requested refund amount. The court denied any further

[2] *Tractor Supply Co. v. South Carolina Department of Revenue*, Dkt. No. 19-ALJ-17-0416-CC (S.C. Admin. Law Ct. Aug. 8, 2023).

[3] *CarMax Auto Superstores Inc. v. South Carolina Department of Revenue*, No. 21-ALJ-17-0182-CC (S.C. Admin. Law Ct. Aug. 15, 2024).

[4] *Microsoft Corp. v. Department of Revenue*, TC 5413 (Or. Tax Aug. 29, 2024).

[5] *Oracle Corp. v. Department of Revenue*, 24 OTR 359, 360 (Or. T.C. Oct. 6, 2021).

relief under Microsoft's factor representation theory, however, because Microsoft failed to make any specific argument related to the inaccuracy or unfairness of the reduced refund and failed to meet its burden of proof that it was entitled to factor relief beyond what the re-inclusion already provided.

Prospective Tax Relief Only

In 2014 Pennsylvania law allowed taxpayers to take a net loss carryover deduction of the greater of 25 percent of income or $4 million. As a result, taxpayers with Pennsylvania taxable income below the $4 million net loss cap were able to deduct their losses and reduce their taxable income to $0, while taxpayers with Pennsylvania taxable income greater than $4 million could not. In 2017 the Pennsylvania Supreme Court declared in *Nextel* that a dollar cap on net loss carryover deductions violated the state's uniformity clause.[6] Shortly after its *Nextel* decision, the court issued its decision in *General Motors*, holding that *Nextel* applied retroactively and that due process principles required recalculating GM's income tax without capping the net loss carryover deduction.[7]

In an abrupt change of heart, in November 2024 the Pennsylvania Supreme Court reversed its own decision in *General Motors*. The court held in *Alcatel-Lucent*[8] that its decision in *General Motors* was erroneous, and that *Nextel* should apply only prospectively. The court examined the three-part *Chevron*[9] test for retroactivity. The court reasoned that (1) *Nextel* was a novel holding, (2) retroactive application does not further application of the rule established in *Nextel*, and (3) the equities weigh in favor of prospective-only application. Regarding the third point, the court reasoned that "retroactive application of our decision in *Nextel* would require the Commonwealth to pay back millions of dollars in tax revenue that was collected and spent nearly a decade ago, in reliance on case law that this Court has since abandoned."

What Is the 'Income-Producing Activity'?

Earlier this year, the South Carolina ALC issued a decision holding Mastercard International Inc. liable for a $7.69 million tax judgment.[10] In *Mastercard*, the South Carolina DOR argued that Mastercard earns income by charging transaction processing fees and providing additional value-added services within its network. Therefore, the company's receipts should be sourced to South Carolina when a transaction is initiated there, the DOR said, claiming that is where the "income-producing activity" occurs. Conversely, Mastercard argued that the location of its income-producing activity is at its two data centers in Missouri or at any of the sites where its servers run its proprietary software and process the transactions.

While acknowledging that Mastercard processes transactions outside South Carolina, the ALC stated that those functions were secondary and instead sided with the department in finding that the South Carolina cardholders and merchants provide the market where the income-producing activities occur, and receipts should be sourced accordingly. Mastercard's case is under appeal and is another case practitioners should continue to monitor as we enter the new year.

Pre-*Wayfair* Nexus: Is the Statute Ambiguous or Not?

Although six years have passed since the U.S. Supreme Court's decision in *Wayfair*,[11] states are still grappling with pre-*Wayfair* nexus issues. First, in South Carolina, the DOR argued that Amazon Services LLC owed $12.5 million on third-party marketplace sales for the first quarter of 2016 — before the state amended its statutes to explicitly include marketplace language.[12] In January 2024 the South Carolina Court of

[6] *Nextel Communications v. Commonwealth*, 171 A.3d 682 (Pa. 2017).

[7] *General Motors Corp. v. Commonwealth*, 265 A.3d 353 (Pa. 2021).

[8] *Alcatel-Lucent USA Inc. v. Commonwealth*, No. 8 MAP 2023 (Pa. Nov. 20, 2024).

[9] *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971).

[10] *Mastercard International Inc. v. Department of Revenue*, No. 20-ALJ-17-0008-CC (S.C. Admin. Law Ct. June 3, 2024); *see also U.S. Bank N.A. v. Department of Revenue*, No. 20-ALJ-17-0168-CC (S.C. Admin. Law Ct. June 25, 2024).

[11] *South Dakota v. Wayfair Inc.*, 585 U.S. 162 (2018).

[12] *Amazon Services LLC v. South Carolina Department of Revenue*, No. 2024-000625 (S.C. Oct. 3, 2024).

Appeals upheld the ALC's ruling that found for the department.

In affirming the lower court's decision, the appeals court found that there was no ambiguity in the statute at the time. As such, Amazon Services had a duty to collect and remit sales tax for third-party sellers in 2016 because it was a business engaged in selling tangible personal property and had a physical presence in the state. The court of appeals also held that the imposition of sales tax on Amazon Services did not violate its constitutional due process or equal protection rights.

Meanwhile, in Wisconsin, the Dane County Circuit Court struck down the Wisconsin DOR's $8.5 million sales tax assessment against StubHub Inc.[13] In *StubHub*, the taxpayer argued that sales tax did not apply to its activities because the company itself did not sell the tickets. Rather, ticketholders used StubHub's platform to sell tickets, so StubHub's actual business activity was facilitation services, which were not subject to sales tax under Wisconsin law that existed at the time. While the DOR acknowledged that the ticketholders, and not StubHub, post the tickets for sale, it still argued that the company was a "person selling" taxable services under Wisconsin law and met the dictionary definition of seller for tax purposes. The circuit court rejected the department's arguments and held that the statutes were ambiguous and that ambiguity must be resolved in favor of the taxpayer and against the tax authority.

Amazon Services filed writ of certiorari with the South Carolina Supreme Court on April 17. On October 3 the court agreed to hear the case. Similarly, *StubHub* is on appeal to the Wisconsin Court of Appeals. Taxpayers and practitioners should continue to monitor developments in these cases in the coming year.

Use Tax — Certiorari Denied

On May 7 a Minnesota-based company, Ellingson Drainage Inc., appealed a South Dakota Supreme Court decision to the U.S. Supreme Court.[14] In *Ellingson Drainage*, the South Dakota Supreme Court agreed with the DOR and held that the department did not err in assessing unapportioned use tax on Ellingson's movable construction equipment. The South Dakota Supreme Court further explained that:

> having paid the use tax on its equipment that had otherwise not been subject to sales or use tax in another state, Ellingson was and is free to bring the equipment back to work on jobs in South Dakota where Ellingson will continue to enjoy the privilege of conducting its business without being subject to additional use tax.

In its petition for certiorari to the U.S. Supreme Court, the company argued that the DOR wrongfully ignored the length of time that the construction equipment was used in the state and should not have assessed use tax on the full FMV of the construction equipment, because the same equipment was also used in more than 20 states over the course of the audit period. The U.S. Supreme Court denied certiorari on October 7.

This year provided some interesting, and at times seemingly contradictory, decisions in various areas of SALT. While some cases have come to a final resolution, others should continue to be monitored in this constantly evolving area of law. We are looking forward to what 2025 has in store for SALT. ■

[13] *StubHub Inc. v. Department of Revenue*, No. 2024AP455 (Wis. Ct. App. Aug. 16, 2024).

[14] *Ellingson Drainage Inc. v. South Dakota Department of Revenue*, No. 30280 (S.D. Feb. 7, 2024).