Tax Tides: Navigating Recent SALT Developments

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In this installment of Pennsylvania's SALT Shaker, the authors review recent state and local tax developments and provide their insights on trending issues.

As the summer comes to an end, it is time to look back on some of the state and local tax developments that have occurred over the past eight months. Courts throughout the country have issued opinions on matters involving, among other topics, P.L. 86-272, sales and use tax exemptions, and class actions. This article discusses a few of these decisions and trending issues, including the good, the bad, and the surprising.

P.L. 86-272 Limitations

States have increased their challenges to the protections afforded by P.L. 86-272, and recent actions in Minnesota, Illinois, and Wisconsin highlight how states are attempting to limit the federal law. These rulings will influence how companies navigate state tax obligations.

On July 25, after years of debate in the lower courts, the Minnesota Supreme Court issued a ruling in favor of the Minnesota Department of Revenue, holding that Uline Inc.'s activities in the state exceeded mere solicitation and were not de minimis. In *Uline*, the court was asked to determine whether the activities of the Wisconsin-based company's sales representatives in Minnesota exceeded the protections of P.L. 86-272 and therefore subjected the company to Minnesota state income tax.[1]

During 2014 and 2015, Uline employed approximately 24 sales representatives whose sales territory included customers in Minnesota. Each sales representative was required to handle approximately 7,000 accounts in their territory, create "sales notes" for every customer visit, and meet a mandatory goal of preparing two "market news notes" per week. Sales notes recorded a summary of each customer's visit and helpful information related to the customer, while market news notes recorded a much broader range of information concerning both Uline's competitors and customers. The Minnesota DOR argued that these activities exceeded the protections of P.L. 86-272 and subjected Uline to the state's income tax.

[1] *Uline Inc. v. Commissioner*, No. A23-1561 (Minn. Aug. 7, 2024).

The court, in agreeing with the Minnesota DOR, found that the creation of market news notes by sales representatives in the state went beyond the solicitation of orders and was not de minimis. The court reasoned that if a few thousand dollars' worth of chewing gum was considered nontrivial in *Wrigley*,[2] then Uline's sales representatives' preparation of more than 1,600 market news notes during the tax years at issue must also be considered nontrivial. Therefore, the court concluded that the sales representatives' activities were not de minimis and exceeded the protections of P.L. 86-272 in Minnesota.

In a similar pending matter in Illinois, Pepperidge Farm Inc., a Connecticut corporation, filed a petition with the Illinois Independent Tax Tribunal seeking protection under P.L. 86-272 related to a $944,000 corporate income tax assessment.[3] In its petition, Pepperidge Farm argues that gross receipts from its New Jersey affiliate, Campbell Sales Co., should be excluded from the sales it apportions to Illinois, because its activities are protected by P.L. 86-272. Pepperidge Farm reasons that Campbell Sales Co. does not have an office in Illinois and its employees' activities in the state are limited to the solicitation of orders.

Pepperidge Farm further argues that while its employees "carry inventory samples, supplies and other equipment in Illinois, which they use in their solicitation activities," the employees do not resolve customer complaints; handle damaged products, repairs, or returns; or check the creditworthiness of any customers in the state. The Illinois DOR contends that the taxpayer's activities exceed the protections of P.L. 86-272 because they consist of more than mere solicitation and are not de minimis.

In Wisconsin, the DOR is challenging a decision by the Dane County Circuit Court, which held that the Wisconsin Tax Appeals Commission improperly granted summary judgment to the department and against the taxpayers. In *ASAP Cruises Inc.*,[4] the Florida-based taxpayer offers a software portal for travel agencies. ASAP Cruises Inc.'s co-owner submitted an affidavit explaining that its software should be considered tangible personal property and therefore be protected by P.L. 86-272. The department argued that software is not tangible personal property and is therefore not protected by P.L. 86-272. The circuit court held that the commission failed to properly consider the affidavit. The department appealed, and the case is awaiting decision by the Court of Appeals.

Pepperidge Farm and *ASAP Cruises* are cases to watch in the coming months. Meanwhile, *Uline* presents a roadmap of activities that the Minnesota Supreme Court views as exceeding the protections of P.L. 86-272. Taxpayers should be aware of states' increased scrutiny of P.L. 86-272 protection. Thus, companies engaged in selling tangible personal property should continue monitoring developments and maintaining clear guidance on what their sales force is permitted to do in states where P.L. 86-272 protection is claimed.

Sourcing Here, Sourcing There, Sourcing Everywhere

The proper sourcing of receipts is becoming an increasingly contentious issue between departments of revenue and taxpayers. In *Mastercard*, the South Carolina Administrative Law Court was asked to determine whether Mastercard International Inc.'s income-producing activity occurred in the state.[5] The South Carolina DOR determined that the Mastercard network was present in the state because of its contracts with South Carolina banks and advertisements in the state. Further, the department argued that Mastercard generated income in South Carolina because every time a card is used in the state a fee is generated.

Mastercard maintained that its income-producing activity is the fee it generates from contracting to perform services for issuer and

[2] *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214 (1992).

[3] *Pepperidge Farm Inc. v. Illinois Department of Revenue*, Case No. 24 TT 35 (Apr. 19, 2024).

[4] *ASAP Cruises Inc. v. Wisconsin Department of Revenue*, Appeal No. 19-I-258 (Wis. Ct. App. May 23, 2022).

[5] *Mastercard International Inc. v. South Carolina Department of Revenue*, Dkt. No. 20-ALJ-17-0008-CC (S.C. Admin. Law Ct. June 3, 2024).

acquirer banks, which it argued occurs in Missouri. The court agreed that the processing of the transactions occurs in Missouri but found that those functions are merely "secondary."

In agreeing with the DOR, the court held that Mastercard's income-producing activity is the charging of fees on the number and "gross dollar volume" of Mastercard transactions. Further, "cardholders, merchants, and their respective issuing and acquiring banks" can only complete these payment transactions by using Mastercard's payment system. To that extent, the court ruled that Mastercard must apportion its net income by sourcing the fees generated from transactions within the state to South Carolina. In reaching this finding, the court in part reasoned that South Carolina provides a market for Mastercard's business — an argument that is more in line with market-based sourcing than cost-of-performance sourcing. Practitioners should continue to monitor this case as it is appealed through the South Carolina courts.

Use Tax and the Constitution

Earlier this year, the South Dakota Supreme Court upheld the state DOR's assessment of an unapportioned use tax on Minnesota-based Ellingson Drainage Inc.'s moveable construction equipment.[6] Ellingson has filed a petition for certiorari with the U.S. Supreme Court. In its petition, Ellingson argues that the department wrongfully ignored the length of time that the construction equipment was used in the state (in some instances, just one day). Further, the company argues that the department should not have assessed use tax on the full fair market value of the construction equipment because the same equipment was also used in more than 20 states over the course of the audit period.

Additionally, Ellingson contends that the South Dakota court relied on a "false syllogism" by comparing the state's sales and use taxes. The court reasoned that use tax is a substitute for sales tax and because sales tax is not apportioned, use tax should not be apportioned either. Ellingson also challenges the South Dakota court's interpretation and application of the external consistency doctrine, arguing that the department's imposition of use tax on the entire FMV of the construction equipment fails to satisfy external consistency because the tax imposed is not reflective of Ellingson's economic activity in the state.

Practitioners should watch for the U.S. Supreme Court's decision on whether to grant certiorari in the coming months.

A Cautionary Exemption Tale

As many practitioners know, getting clients to maintain exemption certificates can be challenging. A recent case out of Mississippi highlights that even when a taxpayer believes it is complying with its obligations, its records can still be insufficient. In *Toolpushers*, the petitioner, a Wyoming corporation with a retail location in Mississippi, sold tangible personal property to purchasers in the oil and gas industry.[7] Toolpushers Supply Co. did not collect sales tax from purchasers that presented a valid retail sales tax permit, and it assumed the purchaser would resell the products. However, during an audit, the DOR determined that some of the purchasers consumed the products for their own use rather than reselling the products.

In its decision, the court found that Toolpushers relied almost exclusively on the purchaser's presentation of a retail sales tax permit and did not make a good-faith effort to determine whether the purchasers would consume the products themselves instead of reselling the products. The court held that Toolpushers was responsible for making a good-faith effort to determine whether the purchasers were retailers regularly selling or renting the products or if the purchasers would use the products themselves. This case represents a cautionary tale that practitioners — especially in Mississippi — should be reviewing with their clients.

[6] *Ellingson Drainage Inc. v. South Dakota Department of Revenue*, 3 N.W.3d 417 (S.D. 2024).

[7] *Toolpushers Supply Co. v. Mississippi Department of Revenue*, No. 2021-CT-01186-SCT (Miss. Feb. 22, 2024).

Sales Tax Class Actions — Good Policy?

Recently, there have been a number of class action lawsuits brought against retailers for the alleged improper collection of sales tax. Most of these cases seek relief under a state's consumer protection law. The plaintiffs generally claim that a retailer charged sales tax on an item that it should not have taxed, and that they are therefore entitled to relief above and beyond the tax itself.

Several cases in Pennsylvania that were removed to federal court were ultimately dismissed, in favor of the retailers. However, there are some that have remained in state court and were permitted to proceed. In one of these cases, the plaintiff filed a class action under the Unfair Trade Practices and Consumer Protection Law (UTPCPL) against several retailers for the alleged improper collection of sales tax on face masks.[8] The plaintiff alleged that the companies "engaged in unfair trade practices by charging sales tax for items they knew or should have known were nontaxable." The retailers filed preliminary objections, which were denied by the Pennsylvania Court of Common Pleas. The retailers then filed for an interlocutory appeal with the Pennsylvania Superior Court.

The superior court held that there was "no basis for concluding that activity merely related to trade or commerce was actionable under the UTPCPL" and that the collection of sales tax does not occur in the conduct of a trade or business within the meaning of the UTPCPL. In October 2023, the Pennsylvania Supreme Court granted allocatur. Similar cases are being held pending the outcome of *Garcia*.

Earlier this year, the commonwealth court dealt with an issue stemming from a similar underlying class action. In *Montgomery*, the plaintiff filed a proposed class action against Sheetz Inc. for collecting sales tax on two bottles of Perrier.[9] She argued that Perrier is water and should be exempt from tax. Further, she argued that carbonated water is only taxable as a "soft drink" if it is artificially flavored or carbonated, which she contended Perrier is not. Conversely, the DOR argued that the carbonation process Perrier goes through before it is bottled categorizes it as a taxable carbonated mineral water, because it is artificially carbonated. The commonwealth court ultimately sided with the department, holding that Perrier is considered a taxable "soft drink" for purposes of 72 Pa. Stat. section 7201(a) and is not exempt from tax.

In a class action brought in Washington, the claimant alleged that several grocery stores improperly collected sales tax on exempt juice beverage purchases.[10] The court of appeals held that the claimant should have filed suit against the state, not the grocery stores, and used the Washington tax refund procedures, not the state's Consumer Protection Act.

Another class action was recently filed in Florida against Uber Technologies Inc., claiming that Uber illegally collected sales tax on food delivery fees.[11] In each of these cases, the taxpayer did not keep the sales tax revenue. Instead, it was properly turned over to the state. In cases like *Montgomery*, the parties are arguing over taxability of a product for purposes of an underlying class action. Some states explicitly prohibit class actions related to sales tax collection. In states that do not, legislators should consider whether it is good tax policy to permit class actions related to the collection of sales tax, and courts should scrutinize whether the consumer protection laws were meant to encompass those actions.

As we enter the fall, practitioners and companies should continue to monitor these changes and the ever-evolving tide of SALT cases. ■

[8] *Garcia v. American Eagle Outfitters Inc.*, 293 A.3d 252 (Pa. Super. Ct. 2023), *reargd. denied* (May 22, 2023), *appeal granted*, No. 153 WAL 2023, 2023 WL 7143367 (Pa. Oct. 31, 2023).

[9] *Montgomery v. Commonwealth of Pennsylvania*, No. 336 FR 2020 (Pa. Commw. Ct. Apr. 23, 2024).

[10] *Caneer v. The Kroger Co.*, No. 85009-1-1 (Wash. Ct. App. July 8, 2024).

[11] *Stephanie Martin v. Uber Technologies Inc.*, Case No. 0:24-cv-61340 (Fla. Cir. Ct. July 25, 2024).