

STATE and LOCAL TAXES

Maximum Time: 3 hours

Maximum Points: 100

Wednesday, May 8, 2002, at 9:30 a.m.

Instructions

1. Write your **Exam Number**, the name of your instructor (McIntyre), and the name of this course (State & Local Taxes) on the cover of your Bluebook. Please do this now. If you are typing your exam, you must put your Exam Number on the top right of every page and the name of the instructor and the name of the course on the first page.
2. Thank you for putting your **EXAM NUMBER** on the cover of your bluebook. (If you have not done so, please stop reading and do so now.) Please do **NOT** put your own name (or other personal information — e.g., LL.M. student, graduating senior) on your bluebook.
3. This is an **open book** examination. You are expected to have with you a copy of the Pomp & Oldman Casebook and the other handouts from the course. You are permitted to have any books, notes or other materials you have used during the course. You may use a pocket calculator.
4. This examination has three parts. Answer the two (2) questions in Part I in your bluebook, noting the space limitations. Part II contains twelve (12) multiple choice questions, and Part III contains ten (10) True/False questions. Answer both of those parts on your copy of the exam by circling the appropriate choices.
5. In writing in your bluebook, do not use the back side of the pages and please double space (that is, write on every other line). If you are typing, please leave big margins and double space.
6. **Note To Proctor:** *All copies of the Examination MUST be returned to you by the end of the examination period. Please check carefully to be sure you can account for all copies. Persons allowed to leave the examination room for any reason must leave their copy of the examination with you to hold until they return.*

Assumptions Applicable to this Examination

Unless a question specifies otherwise, make the assumptions set forth below in answering the questions on this examination:

1. Any State mentioned is one of the states of the United States.
2. States mentioned have in force a corporate income tax and a retail sales tax.
3. The corporate income tax follows UDITPA. In particular, the State uses the three-factor apportionment formula and makes the usual UDITPA distinction between business and nonbusiness income.
4. A state has **not** adopted a combined reporting rule.
5. Any Indian Tribe mentioned is recognized by the Federal government as an Indian Tribe and its Reservation is recognized as a reservation for purposes of Federal Indian law.

I. Essay Questions (maximum points: 42)

General Instructions. Answer the following two questions in your bluebook. Write in ink and do not write in the margins. The space limitations for questions in each part are stated below. Please be concise. Number your answers clearly!

Note to typists: 1 line of a bluebook is equivalent to 1 line of a typed page (8½" x 11") with 1½ inch margins (pica) or 2 inch margins (elite). This notice is typed with a pica font and has 1½ inch margins.

A. E-Commerce Issue (Maximum points: 22)

(Maximum Length: 3 bluebook pages, double spaced)

Borders Online (Online) makes online retail sales of tangible personal property, including books about cats, via the Internet. The goods that Online sells to California purchasers are delivered from outside California. Online is a wholly-owned subsidiary of Borders, a national bookstore chain. Online's Web site states that goods purchased from Online can be returned to any Borders store in the State for a cash refund. Borders has over 100 stores in California, and it receives a small number of returns from Online, representing less than one percent of its gross sales. Online does not have any place of business in California and does not own any property in California. None of its employees work in California. Any merchandise purchased from Online that is returned to a Borders store in California is not sent back to Online but remains with the store and is added to the store's inventory. Borders takes the position that it accepts the Online returns as a service to its own customers. In a few cases, Borders has accepted returns from Barnes & Noble, one of its major competitors, as a service to its own customers. Borders does not advertise its willingness to accept returns from Barnes & Noble or other book sellers.

California law imposes a use tax on California residents who purchase goods from remote vendors for use in California. In addition, it imposes a use tax collection obligation on every retailer engaged in business in California. If the retailer fails to collect the use tax, it becomes liable to pay the tax itself. "Engaged in business" is defined to mean "any retailer having any representative, agent, salesperson, canvasser, independent contractor, or solicitor operating in California under the authority of the retailer or its subsidiary for the purpose of

selling, delivering, or taking orders.”

California has asserted that Online has an obligation under the above statute to collect the use tax due on sales to California customers. It has asserted a tax deficiency against Online for its failure to collect the use tax over the past three years.

Question 1.

Does Online have to collect the California use tax on sales made to California customers? Discuss its collection obligation under State law and any defenses it may have under the Commerce Clause and/or Due Process Clause of the U.S. Constitution.

B. Tax Policy

(Maximum points: 20)

(Maximum Length: 2 bluebook pages, double spaced)

The governor of State J has come to you for advice. She has been told by her corporate tax staff that many corporations are avoiding taxes in the State by setting up a holding company in State D and stripping profits from State J by paying royalties, interest, and rental payments to that holding company. The governor wants to propose legislation to stop these abuses. She is unclear, however, as to the level of political support she will be able to muster in the State Legislature. As a result, she wants you to give her three proposals for dealing with this problem, beginning with the broadest and most aggressive and ending the narrowest and least aggressive.

Question 2.

Prepare a brief memo for the governor, setting forth three options for dealing with the holding company problem. Start with the most aggressive option and end with the least aggressive option. In setting forth each option, explain how it will deal with the holding company problem and note any weaknesses in the option.

II. Multiple Choice Questions (maximum points: 48)

Mark your choice of alternative answers to each question by circling its identifying letter **on your copy of the exam**. *Do Not circle more than one alternative answer* per question. Your score will be based on the number of correct answers. No points are deducted for incorrect answers. In answering each question, make the assumptions stated on page two (2) of this examination unless a contrary assumption is stated in the question.

If you believe that unstated facts are crucial to your answer, or if you believe that a question is ambiguous, go ahead and answer the question as best you can. Then circle the number of the question on the question sheet and, on the space provided on the last page of this exam, identify the unstated facts or the ambiguities and explain their relevance to the question. If your grounds for challenging a question are well-founded and if you have properly shown the relevance of an alleged omission of fact or ambiguity to the answer, you will receive full credit for your answer. There are no intentional ambiguities or omissions of necessary facts.

*Warning: If you decide to explain your answer, you do so at your own risk. You will receive **no credit** for circling what I have judged to be the correct answer to a question if you have challenged that question and your grounds for doing so are unfounded or incorrectly stated.*

[Multiple choice and True False Not Released.]