Notes on the Answers

1. The statutory interpretation question is whether a use tax applies to goods that are purchased with a plan to use them and then sell them. Generally, the answer to that question should be “yes”. The purchase for resale exception really ought to apply only to goods that are intended to be sold and only sold (not also used). Of course, if we accept the store’s position that the computers are just being tested rather than used, then the problem goes away. But a systematic plan for giving workers a fringe benefit is not easily dismissed as just a testing plan. If it really were just testing, we should expect that the price of the tested computers would go up rather than down.

From a policy perspective, the application of a use tax followed by a sales tax is a poor result. We currently do get that result when goods subject to a use tax are brought into a state and later sold. Only the weak enforcement of the use tax prevents the issue from being more significant. It can be significant for items that need to be registered with the state, such as autos and boats. The proper result from the point of tax policy would be to impose a use tax only on the value of the use, in this case the month of use by the employees. The 10% decline in value of the computers is a good proxy for the value of that use. Taxing that 10% would mean that the full value of the computers would get taxed.

The problem notes that some computers are found to be defective, and replacement parts are installed. It seems that these malfunctioning parts do not qualify for the “sale for resale” exception because that exception seems to require an actual sale, not just an intent to sell. I had not noticed this issue when I wrote the exam. I gave extra credit for the couple of students who noticed the issue.

2. Yes, the tax is internally consistent.

State D is taxing on a domiciliary basis, so the issue is someone different from the normal internal-consistency issues. A similar issue arises in the Hunt-Wesson case, where the rule denying an interest deduction was internally consistent.

The basic test is whether there would inevitably be double taxation if every state adopted the same rule. In our case, the answer is no. A bank can be domiciled only in one state, so the domiciliary tax is internally consistent. State D does tax registered branches of foreign banks, but it also exempts from its tax the foreign branches of foreign banks.

3. I cannot say for sure if the tax is fairly apportioned. This case is based in part on Lehman Brothers v. State Bank Commissioner, decided by the Delaware Supreme Court in November of 2007.
The taxpayer argued that the tax was not fairly apportioned, and lost. I would not be surprised if the taxpayer seeks *certiorari* in the U.S. Supreme Court.

As noted in the answer to question 2, above, the tax is internally consistent, which means it passes one of the main tests for fairly apportioned set forth in the *Container* case. Still, the risk of double taxation is high, since most states will tax banks, such as DCo, on an apportionment basis. And any state that does tax on an apportionment basis is likely to cause double taxation. I generally not in favor of an aggressive application of the so-called “externally consistent” test. But the facts here do provide a pretty good case for its application.

In the end, I think the issue is whether apportionment taxation should be given some priority over domiciliary taxation. I’m inclined to think it should, since apportionment is the more basic rule and the rule least likely to result in tax avoidance or double taxation.