

STATE AND LOCAL TAXES, LEX 7771*A.K.A. Multistate Taxation in the Digital Age*

Maximum Time: 3 hours

Maximum Points: 100

Tuesday, December 18, 2007, at 6:15-9:15 p.m., Room 1550

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 (McIntyre) and the name of the course (State & Local Taxes) 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 three (3) questions in Part I in your bluebook, noting the space limitations. Part II contains fifteen (15) multiple choice questions, and Part III contains fifteen (15) 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.

NOTE TO PROCTOR:

All copies of the Examination **MUST** be returned to you by the end of the examination period. The Appendix does not need to be returned. Please check carefully to be sure you can account for all exam 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. 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: 40)

General Instructions. Answer the following three 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. Sales Tax Issue

(Maximum points: 15)

(Maximum Length: 2 bluebook pages (28 lines), double spaced)

Dco operates a computer store and assembly operation located in State M, specializing in high-end computers typically used for playing computer games but also suitable for general purposes. It has 100 employees. Dco purchases computer parts, assembles the parts into operating computers, and sells the assembled computers at its store to retail customers. All of the parts are purchased from distributors and manufacturers located in State C.

Partly as a fringe benefit to its employees and partly as a method of quality control, Dco allows its employees to take home one new computer per month and use that computer for playing computer games. These "employee" computers are then returned to the store and, if they have shown no flaws, are sold to retail customers. In the rare cases in which the computers are found to be defective, the defective parts are replaced, and the refurbished computers are sold at retail. The computers used by the employees of Dco are identified to prospective customers as having been subject to a one-month burn-in procedure. The price is reduced by 10 percent. Dco collects the State M sales tax on the sales made to retail customers.

State M imposes a 6 percent sales tax on "sales at retail". Purchases for resale are exempt from the tax. That exemption is achieved by taxing only "sales at retail" and defining purchases for resale as not constituting a sale at retail. State M also imposes a 6 percent use tax on the use of tangible personal property within the State. It exempts the purchase of goods from the use tax if the goods are subject to the State M sales tax. With some limitation not relevant here, it also gives a credit against the use tax for sales taxes paid to other states. Exempts from the State M Sales and Use Tax Statute are set forth below.

State M Sales and Use Tax (Excerpts)

Sales Tax Imposed. Except as provided [elsewhere in the statute], there is levied upon and there shall be collected from all persons engaged in the business of making sales at retail, as defined below, an annual tax for the privilege of engaging in that business equal to 6% of the gross proceeds of the business.

Definitions. "Sale at retail" means a transaction by which the ownership of tangible personal property is transferred for consideration, if the transfer is made in the ordinary course of the transferor's business and is made to the transferee for consumption or use, or for any purpose other than for resale.

Use Tax Imposed. There is levied upon and there shall be collected from every person in this state a specific tax for the privilege of using, storing, or consuming tangible personal property in this state at a rate equal to 6% of the price of the property.

Exception to Use Tax. The use tax levied under this act does not apply to property sold in this state on which transaction a tax is paid under the general sales tax act if the tax was due and paid on the retail sale to a consumer.

Dco collects and pays over to State M a sales tax of 6 percent with respect to its sales to its retail customers in State M on the amounts actually charged to those customers. It does not collect or pay any use taxes to State M. Dco does not pay any sales or use tax in State C because State C does not apply its sales tax or use tax to exports.

On audit, the tax officials of State M assert that Dco should have collected a use tax on the computer parts purchased in State C with respect to the computers that were used for a month by its employees. These officials contend that the use tax should apply to those computers which were used for a month by the employees of Dco. Dco contends that no use tax is properly due.

Question 1. (15 points, 28 lines)

From a tax policy perspective, is it proper to impose a use tax on some or all of the purchase price of the computer parts used in the "employee" computers? Discuss.

B. Corporate Tax Issue

(Maximum points: 25)

(Maximum Length: 2 bluebook pages (28 lines), double spaced)

State D imposes its corporate income tax of 10 percent on all of the income of banks domiciled in that State unless the bank operates a branch or subsidiary located outside the State. If a domiciliary bank has a branch located outside the State and the bank demonstrates, by clear and convincing evidence, that it is taxable on the income of that branch in another State, then State D allows the domiciliary bank to deduct from its taxable income the income properly allocable to the foreign branch. If a bank domiciled outside of State D (“foreign bank”) has a branch in State D, then State D taxes only that portion of the income of the foreign bank properly allocable to the branch.

For the branch exception described above to apply, the taxpayer must demonstrate that its activities in another State constitute a branch for purposes of the Federal banking regulations. Under those regulations, the activities of a bank constitute a branch only if the bank has gotten advanced Federal approval for those activities to constitute a branch.

BCo is a bank domiciled in State D. Its income for the taxable year is \$40 million. It has extensive business activities in State N, where it claims to have earned most of its income. It has not obtained Federal approval, however, to treat its operations in State N as a branch. In addition, it has not paid any income tax to State N, although it has paid over \$1 million in transfer taxes to that State.

In preparing its tax return for State D, BCo attributed, in accordance with its books of account, 75 percent (\$30 million) of its income to State N. In computing its tax due to State D, it deducted that \$30 million from its total income of \$40 million, leaving only \$10 million taxable in State D. On audit, the tax officials of State D denied the deduction for the \$30 million and assessed a tax of \$4 million on the entire income of BCo. BCo challenges the denial of a deduction for the income it attributes to State N, claiming that State D’s taxing scheme violates the Dormant Commerce Clause.

Question 2. (10 points, 12 lines)

Is the State D tax internally consistent. Discuss.

Question 3. (15 points, 16 lines)

Is the State D tax fairly apportioned? Discuss, with references to relevant U.S. Supreme Court decisions.

II. Multiple Choice Questions (maximum points: 45)

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 Questions Omitted]

III. True/False Questions (maximum points: 15)

Mark your choice of alternative answers to each question by circling its identifying letter **on your copy of the exam**.

[T/F Questions Omitted]