

Multistate Taxation in the Digital Age

Maximum Time: 3 hours

Maximum Points: 100

Tuesday, April 29, 2003, at 9:30 a.m. to 12:30 p.m.

Instructions

1. Write your **Exam Number**, the name of your instructor (McIntyre), and the name of this course (Multistate Taxation) 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 (and an appendix). Answer the three (3) questions in Part I in your bluebook, noting the space limitations. Part II contains ten (10) 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. Accompanying the exam is an Appendix, which you may retain.
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. 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. 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: 50)

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: 25)

(Maximum Length: 4 bluebook pages, double spaced)

In the case of *barnes&noble.com* (2002), the Board of Equalization (BOE) of the State of California held that an on-line book seller (B&N On-Line) was required to collect the California use tax on sales to California customers (see Appendix to this Exam) for tax year 1999. The taxpayer's nexus with California was through its relationship with Barnes & Nobel Booksellers, Inc. (B&N), a major bookseller with many stores located throughout the United States, including California. B&N On-Line made its sales of books, videos, music and computer software over the Internet, and these items of tangible personal property were delivered to its customers by common carrier or the U.S. mail. In holding that B&N On-Line had nexus with California and was required to withhold the California use tax under the California statute, the BOE gave great emphasis to the fact that B&N distributed discount coupons at its stores in California on behalf of B&N On-Line.

On February 5, 2003, the California Board of Equalization granted B&N On-Line a rehearing. The issue in the rehearing will be whether B&N On-Line ceased to have nexus in California for the last quarter of 1999 because B&N ceased distributing coupons for B&N On-Line at the end of the third quarter of 1999. The taxpayer is not challenging the decision of the BOE that it is liable to collect the use tax (or to pay the tax itself if it fails to withhold) for the period during which B&N was distributing the coupons. In California, the sales tax is due on a quarterly basis.

Question 1.

What argument(s) can the California tax authorities make that B&N On-Line has Commerce Clause and Due Process nexus for the quarter after B&N ceased to distribute coupons on its behalf? Discuss, with reference to any relevant U.S. Supreme Court cases. Do NOT discuss issues arising under the California statute. You should assume that the BOE is prepared to conclude that the requirements of the California statute have been met.

Question 2.

Assume that B&N On-Line is selling into Michigan and the B&N's actions in Michigan on behalf of B&N On-Line are similar to its actions in California. Assume also that H.B. 4571, relating to affiliate nexus (see Appendix to this Exam), has been adopted by the Michigan legislature and signed into law. Would B&N On-Line be required to collect the Michigan use tax on its sales to Michigan customers under the statute? Discuss. Indicate the (probable) facts that the tax department should try to develop and present to make its case under the statute.

B. Corporate Tax

(Maximum points: 25)

(Maximum Length: 3 bluebook pages, double spaced)

Off-Beat Sports, Inc. (Off-Beat) is a Delaware corporation that hosts various live sports events, such as strong-man boxing, women's mud wrestling, and big-foot car hauling contests. The events are staged in New York City and are shown on cable television throughout the country. Off-Beat earns gross income of \$100,000 from sales of tickets to its events and \$900,000 in licensing fees from cable television stations. The licensing fees are based on a reputable survey by an independent company of the ratings of the shows put on by Off-Beat. Off-Beat pays income taxes to New York and no other state. For simplicity, assume that Off-Beat has no deductible expenses.

Off-Beat advertises its programs on national television and in newspapers all over the country, including newspapers that are headquartered in State B and cater to the State B audience. It also runs promotions on the cable television stations located in State B. It receives a 50 percent discount on these promotional ads because they also benefit the cable station companies.

State B has attempted to impose its corporate income tax on an apportioned share of Off-Beat's taxable income. It uses a two-factor apportionment formula, property and receipts (sales); the two factors are equally weighted. For purposes of the apportionment formula, Off-Beat has no property located within State B. It has in-state receipts of \$100,000 for purposes of the receipts factor. That amount is the sum of the payments received by Off-Beat from cable TV operators located in State B. The corporate tax rate in State B is 10 percent.

Off-Beat claims that it is not taxable in State B because it does not have nexus with the state under the U.S. Constitution and because State B is barred from imposing the tax under P.L. 86-272.

Question 3.

- a. How much of Off-Beat's pre-apportionment income is apportioned to State B under the two-factor apportionment formula adopted by that state, assuming that the corporate tax is valid. Show your calculations.
- b. Is Off-Beat exempt from the State B corporate income tax under P.L. 86-272? Explain.
- c. Does Off-Beat have a physical presence in State B? Discuss.
- d. Does Off-Beat have Due Process nexus with State B? Explain, with reference to relevant Supreme Court cases.
- e. Does Off-Beat have Commerce Clause nexus with State B? Explain.

II. Multiple Choice Questions (maximum points: 30)

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 Omitted]

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