

STATE and LOCAL TAXATION

Maximum Time: 3 hours

Maximum Points: 100

Wednesday, May 8, 1996 at 1:30 p.m.

Instructions

1. Write your **Exam Number**, the name of your instructor (McIntyre), and the name of this course (State & Local Tax) 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., LLM 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*, Bulletin 95-1 issued by the Multistate Tax Commission and related materials, the property tax materials prepared by Prof. Shoettle, 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. A copy of the *Standard Pressed Steel* case is attached.
4. This examination has four (4) questions and a one-point extra credit question. Questions III and IV each have subquestions. Write neatly in your bluebook, observing the space limits. A substantial and proportionate penalty will be imposed for exceeding the space limits. (In practice, no penalty will be imposed if your answer exceeds the limit by no more than two lines.)
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:** Students may keep their copy of the Examination.

Questions

General Instructions. Answer the 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.

I. Corporate Income Tax

(Maximum points: 20)

(Maximum Length: 1 bluebook page, double spaced)

State Q imposes a corporate income tax at a rate of 5 percent on all corporations engaged in a unitary business in the state. For corporate groups filing a combined report, the corporate tax statute provides that the amount of tax due is *the greater of*:

(1) 5 percent of the unitary business income attributable to the state on a combined report, determined by applying a three factor formula (sales, payroll, property) to the pre-apportionment income of the unitary business, as shown on the combined report; and

(2) 5 percent of the income of each member of the corporate group engaged in business in the state, determined under the separate accounting method.

Question 1. Does the tax described above violate the Commerce Clause of the U.S. Constitution, as interpreted by the U.S. Supreme Court? Explain.

II. Sales Tax

(Maximum points: 20)

(Maximum Length: 1½ bluebook pages, double spaced)

Assume that the U.S. Supreme Court has granted certiorari in *Orvis Co. v. Tax Appeals Tribunal*, 86 N.Y. 2d 165, 1995 N.Y. Lexis 1140 (1995), p.867 of the Pomp & Oldman casebook. You are

clerking for one of the Justices hearing oral argument in that case. Your Justice is hostile to the State's position and asks you to prepare for her a list of questions to ask at oral argument that will put the State on the defensive.

Question 2. What are the four most devastating, penetrating, insightful questions your Justice should ask the attorney general representing the state at the oral argument. Indicate the order in which the questions are to be asked. If you think it is not obvious, you may explain why you are asking a particular question, or why you are asking your questions in a particular order.

Note: Do not ask anything about the use by Orvis of depositions rather than live testimony and do not ask anything about the procedural posture of the case.

III. Property Tax

(Maximum points: 20)

(Maximum Length: 1½ bluebook pages, double spaced)

State M has a property tax. The property tax act (PTA) provides in relevant part as follows:

PTA, Sec. 4.

(1) A homestead is exempt from the tax levied by a local school district for school operating purposes, up to an assessed value of \$40,000, if the property owner claims an exemption as provided in this section.

(2) An owner of property may claim an exemption under this section by filing an affidavit on or before May 1 with the local tax collecting unit in which the property is located. The affidavit shall state that the property is owned and occupied as a homestead by the owner of the property on the date that the affidavit is signed. The affidavit shall be on a form prescribed by the Department of Treasury.

(3) A husband and wife who are required to file or who do file a joint State M income tax return are entitled to not more than 1 homestead exemption.

(4) Upon receipt of an affidavit filed under subsection (2), the assessor shall exempt the property from the collection of the tax levied by a local school district for school operating purposes with respect to property tax on the first \$40,000 of assessed value.

(5) For purposes of the PTA, a "homestead" is the principal residence of an individual who is resident in the State of M for the year in which the homestead exemption is claimed.

Question 3a. (10 points) What argument(s) can be made that the statute described above violates the federal Constitution? What Clause? Explain.

Question 3b. (10 points) What changes might State M make in the statute to avoid constitutional challenge and still preserve the basic purpose of the homestead exemption? Explain.

IV. Nexus Issues (Partial Take-Home)

(Maximum points: 40)

(Maximum Length: 4 bluebook pages, double spaced)

The Multistate Tax Commission (MTC) has been concerned about the income taxation and use tax collection responsibilities of an out-of-state direct marketing computer company that solicits orders through advertising in computer magazines. These orders are shipped from out-of-state to the buyers. The company has no property or employees in the customer's state. The company's one year warranty provides for repair services in the customer's state. The warranty is included with the purchase of the computer. The terms of the warranty provide that if the customer requires repairs, he or she must contact the company. The company then arranges for the repair of the computer by a local repairperson, located in the customer's state. This repairperson is paid directly by the company for the cost of the repairs. The company deals with a number of such repairpersons, who are independent of the company and not controlled by it in any manner. These repairpersons perform work for the general public and for other out-of-state sellers as well as for the company.

The MTC has issued Bulletin 95-1, distributed in class, which sets forth its view that the use of repairpersons under the facts described above would cause the direct marketing computer company to be subject to income taxation in the state of sale. The MTC position has been criticized by various taxpayer groups. A major critic of Bulletin 95-1 is the Committee on State Taxation (COST). COST is a nonprofit trade association based in Washington, D.C. It was formed in 1969 as an advisory committee to the national Council of State Chambers of Commerce, and today it has a membership of more than 430 major multistate corporations engaged in interstate and international business. COST has offered the following analysis of Bulletin 95-1:

The MTC's characterization of certain activities as "squarely" establishing "constitutional [Commerce Clause] nexus" is simply unsupported. The legal reasoning for the positions asserted is not supported by the cases cited, nor has the MTC's new nexus theory been addressed or approved by the U.S. Supreme Court.

* * *

In its Commerce Clause substantial nexus analysis, the bulletin states that the Supreme Court has "uniformly held that the in-state presence of a representative of an out-of-state seller who conducts regular or systematic activities in furtherance of the seller's business, such as solicitation of sales or *provision of services*, creates nexus." [Emphasis added.] Furthermore, "[t]he characterization of the relationship between the out-of-state

seller and its in-state representative conducting business on the out-of-state seller's behalf does not affect the nexus determination." In both instances, the bulletin cites the pre-*Quill* Supreme Court decisions in *Scripto Inc. v. Carson*, *Tyler Pipe Industries Inc. v. Washington Department of Revenue*, and *Standard Pressed Steel v. Department of Revenue* as support. There are three problems with the bulletin's strict Commerce Clause nexus analysis, however:

(1) The cases cited stand for due process nexus principles, not Commerce Clause principles, and thus cannot serve as binding precedent.

(2) The cases do not stand for the propositions for which they are cited (even if a due process decision could also support a Commerce Clause argument, these cases do not stand for the positions for which they were ostensibly cited). Put another way, the bulletin relies on pre-*Quill* cases and language attributable to due process analysis and concerns (and cited in this regard by *Quill* itself) to support a specific finding of Commerce Clause "substantial nexus."

(3) The bulletin's reference to "provision of services" is misleading, because none of the cases deal with provision of services (as opposed to solicitation of sales) except *Standard Pressed Steel*. In that case, the taxpayer paid its employee located within the state to perform a variety of employment-related functions and services — a circumstance we agree creates nexus.

Note: *Standard Pressed Steel*, referred to by the MTC and by COST, is attached.

Question 4a (25 points). Evaluate COST's comments on Bulletin 95-1. Do you think that the attempt of COST to distinguish the pre-*Quill* cases is persuasive? Explain.

Question 4b (15 points). General Motors (GM) sells automobiles that it manufactures in Michigan to distributors located in Utah. The distributors make sales of the GM automobiles to local customers. GM provides a five-year warranty to Utah customers purchasing a GM automobile from the distributors. Under GM's sales agreement with the Utah distributors, the distributors are obligated to provide the warranty services to qualified buyers and are paid for doing so by GM. [Note: As a service to customers, the distributors occasionally will replace stale gum that they find in the ashtrays of automobiles brought in for warranty work, but the replacement gum is bought in the marketplace and is not charged to GM.]

GM occasionally sends representatives to Utah to inspect the repair facilities of its distributors. GM also conducts a national advertising campaign that includes TV, radio, magazine, and newspaper ads directed at Utah residents.

Under the logic of Bulletin 95-1, is GM subject either to income tax or to use tax in Utah? Explain. Assume that GM has no presence in Utah aside from the contacts mentioned above.

V. Extra Credit
(maximum points: 1)

The name of the chewing gum case hinted at in the "Note" in question 4b is _____ . Note: No extra credit and perhaps some lost points if you discussed the bogus chewing gum "issue" in question 4b.

*** End of Exam ***