Wayne State University
Law School

Winter Term, 1999

Prof. Michael J. McIntyre

STATE and LOCAL TAXATION

Maximum Time: 3 hours
Maximum Points: 100

Tuesday, May 4, 1999 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., 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 six (6) questions, some of which 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.) Some of the questions (subquestions) can be answered very briefly.

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. Nexus Issues

(Maximum points: 30)
(Maximum Length: 1½ bluebook page, double spaced)

Ling Industries, Ltd. (Ling) is a small corporation organized in Taiwan. It manufactures custom book cases and shelves, primarily for customers in the United States. It advertises occasionally in U.S. newspapers, including newspapers in Ohio. It also sends sales representatives to the United States. The sales representatives do not have the authority to conclude contracts. Potential customers must confirm by fax the terms of any sales agreement with the head office in Taiwan.

T is a salesman employed by Ling. He resides in Michigan, where he also has his office. Once a year, T runs an ad in various Ohio newspapers, announcing that he will be available for the coming week to Ohio residents, by appointment, to discuss his company's line of bookcases and shelves. He gives the phone and e-mail address of his Michigan office and invites Ohio residents to contact him there.

After lining up potential customers in Ohio, T goes to their homes in Ohio and measures their rooms for the custom bookcases. He explains that the bookcases will come as a kit, which the homeowner can install easily. The price for the bookcases is terrific — less than half of the price for competing products. After taking the measurements for a prospective customer, T sends a fax to the Taiwan office. A representative in that office determines the price for the work and sends the information directly to the prospective customer. If that individual decides to buy at that price, he or she gives a credit card number to the Taiwan office. The card is charged only when the kit has been shipped. The bookcase kit is sent directly to the customer through a common carrier.

Question 1. Answer each of the following subquestions.

(a) May Ohio impose its corporate income tax on Ling, assuming that Ling is engaged in business in Ohio under the Ohio corporate income tax statute? Explain what defenses, if any, Ling may have and whether those defenses can be raised successfully.

(b) Can Ohio constitutionally impose an obligation on Ling to collect its use tax on sales made to Ohio residents? Explain.

(c) Can Ohio constitutionally impose a sales tax on Ling's sale of bookcases and shelves to Ohio customers, assuming that *McLeod, Com'r of Revenue v. J.E. Dilworth Co*., Pomp & Oldman, p. 9-28, is still good law? Explain.

II. Sales Tax

(Maximum points: 10)
(Maximum Length: ½ bluebook page, double spaced)

Assume the facts set forth in question 1, above. Assume also that the Ohio sales and use tax applies to sales of tangible property in the state but does not apply to sales of services except in enumerated cases not here relevant.

Question 2. Can Ohio impose a sales or use tax on Ohio residents who make purchases from Ling under its statute?

III. Michigan Sales Tax

(Maximum points: 10)
(Maximum Length: 1 bluebook page, double spaced)

Question 3. Answer the following subquestions, making appropriate references to the Michigan General Sales Tax Act, Section 205.51 *et seq*.

(a) All states provide an exemption from the sales tax for purchases made for resale (the "sale for resale" exemption). How is this exemption achieved under the Michigan General Sales Tax Act?

(b) Many states impose sales tax on "shrink wrapped" software, such as Microsoft Word, that is sold through retail outlets, notwithstanding the fact that the software arguable does not constitutes tangible personal property. How does Michigan treat such sales? Are they exempt? If not, is "shrink wrapped" software classified as tangible personal property? Explain.

IV. Property Tax

(Maximum points: 10)
(Maximum Length: 1 bluebook page, double spaced)

On January 1, 1996, MCo purchased the XYZ office building, located in Southfield, Michigan. The purchase price was $18 million. In 1998, the building increased in value to $27 million. MCo rents out the building space to various tenants under long-term leases. The building currently is fully leased. MCo has received rental payments $3 million per year in 1996-1998. You may assume that the rule of thumb in the assessors office, when it is using the income method for valuing property, is to determine the value of rental property by multiplying the annual rental income by 10.

Question 4. Answer each of the following subquestions.

(a) What is the value of the XYZ office building for purposes of MCo's property tax assessment in 1996? What additional information, if any, do you need to answer the question? Discuss briefly?

(b) How is MCo's property tax determined for 1998, assuming that the applicable tax rate is 5 percent. That is, what number is the 5 percent multiplied by? What additional information, if any, do you need to answer the question?

V. Corporate Income Tax

(Maximum points: 20)
(Maximum Length: 1½ bluebook page, double spaced)

Consider the discussion in *Mobil Oil Corp. v. Com'r of Taxes of Vermont* (Pomp & Oldman, pp. 11-67, 71, 74-76) about whether the state of commercial domicile (New York) could tax all of the dividends received by Mobil from its subsidiaries. Suppose State A had a rule that allocates all dividend income to the payee's state of commercial domicile. ACo is domiciled in State A. It receives a dividend of $1 million from SCo, its wholly-owned subsidiary domiciled in State B. The dividend constitutes "operational income" within the meaning of *Allied Signal, Inc. v. Director, Division of Taxation (New Jersey)? See* Pomp & Oldman, pp. 11-146, 154 ("What is required [for income from a capital transaction to be part of the unitary business] instead is that the capital transaction serve an operational rather than an investment function.")

Question 5. Does ACo have grounds for challenging on constitutional grounds the State A rule described above? Discuss. Your answer should discuss the provision(s) of the Constitution the rule might offend and should discuss and evaluate ACo's best constitutional argument(s) to overturn the rule.

VI. Corporate Tax Avoidance

(Maximum points: 20)
(Maximum Length: 1½ bluebook page, double spaced)

The facts of *Geoffrey, Inc. v. South Carolina Tax Com'n*, Pomp & Oldman, p. 11-162, illustrate a common tax planning technique frequently used by corporations to minimize state taxes. The basic technique is for XCo, a company engaged in business in State A, to transfer intangible property, such as a patent or a trademark, to a related holding company, HCo, that is located in a tax-haven jurisdiction, such as State D. XCo then pays a deductible royalty to HCo. If the plan works, XCo's income is reduced by the amount of the deductible royalty, and HCo is not taxable in State A or State D.

South Carolina successfully prevented that technique from working in the Geoffrey case by treating the out-of-state holding company that owned the "Geoffrey the Giraffe" trademark as engaging in business in South Carolina through its act of leasing the trademark to the Toys " " Us stores operating in South Carolina. That approach raises some interesting constitutional issues that the U.S. Supreme Court has so far been unwilling to address.

Question 6. Answer each of the following subquestions.

(a) An alternative method that a state might employ to prevent the type of tax avoidance discussed above is to require members of a group of related corporations to file a combined report. Most states that use a combined report do not require the corporate group to include related foreign corporations (corporations organized in a foreign country, such as France or the Cayman Islands) in the combined report. Will the failure to include such companies in the combined report create a major loophole, with companies simply locating the holding company in a foreign tax haven country, such as the Cayman Islands, rather than in domestic tax haven jurisdictions, such as Delaware? If you think there will be a major loophole, discuss possible responses by the states. If you think there will not be a major loophole, explain why. (Hint: Remember to take account of possible Federal taxes.)

(b) Denying a company a deduction for payments made to a related company can cause double taxation if the related company is also taxable in that state. How can a state provide for relief for such double taxation without running afoul of the nondiscrimination prong of *Complete Auto*? Explain.

*** End of Exam ***