Georgia Department of Revenue/Tax Bar Liaison Committee Meeting
One-Day Georgia Tax Seminar
December 2, 2015

Georgia Tax Litigation Update

A. Sales Tax

1. Georgia Motor Trucking Ass'n v. Georgia Dep't of Revenue, Fulton Superior Court, Case No. 2015-CV-26570.

Issue: Whether proceeds from Local Sales and Use Taxes on motor fuel (allegedly authorized by HB 170) are subject to earmarking requirements in Ga. Const. Art. III, Sec. IX, Para. VI(b) and must be spent on road and bridge maintenance.

Facts: Plaintiffs, which include an association representing the trucking industry and three motor carriers with "extensive operations in the state of Georgia [and] each of which routinely purchase motor fuel and pay motor fuel taxes in Georgia," seek to certify a class action under O.C.G.A. § 9-11-23 for a class consisting of "Georgia domiciled motor carriers who purchase motor fuel in the state of Georgia." Plaintiffs contend that House Bill 170 created new "Local Motor Fuel Taxes" and that the proceeds from these taxes are not being spent on road and bridge maintenance in violation of Ga. Const. Art. III, Sec. IX, Para. VI(b).

The Complaint includes five counts for relief. In Counts I and II, Plaintiffs seek a writ of mandamus to compel the Commissioner "to use the revenues from the Local Fuel Taxes for roads and bridges as mandated by Ga. Const. Art. III, Sec. IX, Para. VI" and to "to preserve the status quo" by issuing a writ to order the Commissioner "to deposit all funds collected as a result of the Local Motor Fuel Taxes into an escrow or trust account pending final determination of the issues raised herein." In Count III, Plaintiffs request declaratory relief to declare HB 170 as unconstitutional in violation of Ga. Const. Art. III, Sec. IX, Para. VI. In Count IV, Plaintiffs request "interlocutory extraordinary relief to preserve the status quo" under O.C.G.A. §§ 9-4-3 and 48-8-124 and request that Defendants "deposit all funds collected as a result of the Local Motor Fuel Taxes into an escrow or trust account pending final determination of the issues raised herein." In Count V, Plaintiffs request that they be awarded reasonable attorneys' fees out of an escrow fund under the common fund doctrine.

The Department moved to dismiss the Complaint in its entirety on October 16, 2015. The Department contends that the suit should be dismissed because (1) mandamus is inappropriate and cannot issue in this case; (2) declaratory and interlocutory injunctive relief are barred by sovereign immunity; (3) no

justiciable controversy exists in this case; and (4) HB 170 is not unconstitutional because Local Sales and Use Taxes are not "motor fuel taxes received by the state" as stated in Ga. Const. Art. III, Sec. IX, Para. VI(b) and has never been so interpreted.

Status: Oral argument is scheduled for December 22, 2015 before Judge Robert McBurney.

2. **Inglett & Stubbs Int'l, Ltd. v. Riley, Fulton Superior Court, Case No. 2015-CV-257902.**

Issue: Whether a contractor's purchases of electrical equipment and supplies to be used at a construction project in a foreign country is considered a "sale for resale," and not subject to Georgia Sales and Use Tax.

Facts: Petitioner Inglett is a Georgia contractor with its principal place of business in Smyrna, Georgia where it maintains its warehouse facility for the storage of goods purchased for use in its contracts. Petitioner provides electrical construction and services in international locations, and the company purchases electrical equipment, supplies, and other items from third-party vendors for use in its contracts. During the tax periods at issue, some of those vendors were located in Georgia and some were not, but all of the items at issue were delivered to Inglett's facility in Smyrna, where they were stored by Inglett and sometimes re-palletized to maximize shipping efficiencies or to group materials for a particular task together. The items stored in Inglett's Georgia warehouse were subsequently shipped overseas for use in performing Inglett's contracts with the federal government to build electrical distribution facilities at Army bases in Afghanistan. Inglett's vendors collected Georgia tax from the company on the items delivered to its Smyrna facility, but Inglett subsequently filed for a refund from the Revenue Department for those amounts for a total of $1.9 million.

Following the Revenue Department's denial of its claims, Inglett petitioned the Tax Tribunal for a refund, and the parties filed cross motions for summary judgment. The Tribunal granted the Commissioner's Motion for Summary Judgment and denied Inglett's, holding that Inglett's purchases of tangible personal property for use by the company in constructing electrical facilities at military bases in Afghanistan were "at retail" and not "sales for resale" because Inglett itself was the consumer of those items, not the U.S. Army. The Tribunal, citing O.C.G.A. § 48-8-63 and J.W. Meadors & Co. v. State, 89 Ga. App. 583 (1954), found that contractors buying supplies to perform construction contracts are deemed to be the end user of the supplies and such sales constitute retail sales regardless if the performance of the contract is outside of Georgia. Inglett subsequently petitioned for judicial review.

Status: The Superior Court (Judge Kimberly M. Esmond Adams) affirmed the Tax Tribunal's decision by Order dated October 30, 2015. Inglett filed an application for discretionary appeal to the Court of Appeals which is now pending.

3. **Georgia Power Co. v. Riley, Fulton Superior Court, Case No. 2015-CV-256560.**

Issue: Whether purchases for Georgia Power's electrical transmission and distribution system outside of its generating plants are eligible for the manufacturing machinery exemption in O.C.G.A. § 48-8-3(34) and Revenue Regulation 560-12-2-.62.

Facts: Petitioner Georgia Power is a rate regulated, investor owned electric utility that generates electrical energy it sells to retail customers in the State of Georgia and to wholesale customers in the State of Georgia and elsewhere. The company also sells electrical energy that Georgia Power did not generate to retail customers in Georgia and to wholesale customers, and it currently serves approximately 2.4 million customers. Georgia Power owns, either solely or jointly, thirty-six electric generating facilities located throughout the State of Georgia. The company also has over 1,700 substations in the State of Georgia, and tens of thousands of miles of transmission and distribution lines. Georgia Power filed monthly sales and use tax returns with the Revenue Department during the years 2009 and 2010 with respect to purchases or uses by Georgia Power of, among other items, items of tangible personal property used or to be used in the construction, maintenance, and operation of Georgia Power's transmission and distribution system. Georgia Power's contention is that its transmission and distribution system is part of a single manufacturing "plant" that includes the company's generating facilities because voltage is changed in the transmission and distribution system.

On December 26, 2012, Georgia Power timely filed with the Revenue Department a claim for refund of sales and use taxes paid for the tax period January 1, 2009 through December 31, 2009 in the amount of $8,176,424. On February 20, 2013, Georgia Power timely filed with the Revenue Department a claim for refund of sales and use taxes paid for the tax period January 1, 2010 through December 31, 2010 in the amount of $10,269,678. Both claims included tax Georgia Power had paid on such items as transformers, capacitors, voltage regulators, relays, and myriad other items used by the company in its transmission and distribution system. Both claims eventually were denied by the Revenue Department. Georgia Power filed this refund action in the Georgia Tax Tribunal on July 26, 2013. The case was tried before Tribunal Judge Charles Beaudrot on November 4-6, 2014. On January 5, 2015, after extensive post-trial briefing by the parties, Judge Beaudrot rendered his decision, holding that Georgia Power was not entitled to the refunds claimed.

The Tribunal found that the refund claims were properly denied because the production of electrical energy begins and ends at the generating plant, and a utility's transmission and distribution system functions to safely, efficiently, and reliably deliver the electrical energy generated at a plant to end users. The Tribunal also found, based on the expert testimony, that what happens in a utility's transmission and distribution system does not result in electrical energy having a different form, utility, or character from when the energy started out at a generating plant, as the energy's fundamental nature is not changed in that system. The Tribunal also refused to accept Georgia Power's argument that it operates a single "manufacturing plant" that encompasses the entire State inclusive of its transmission and distribution system. The Tribunal concluded that this position would read the term "manufacturing plant" out of the exemption statutes, would ascribe to the term something other than its ordinary meaning, and would apply the statutes and regulation in a way that reaches an absurd result.

Status: Georgia Power filed its petition for judicial review in Fulton Superior Court on January 30, 2015. Judge Henry Newkirk summarily affirmed the Tax Tribunal's decision. Georgia Power did not file an application for discretionary appeal.

4. **Scholastic Book Clubs, Inc. v. Riley, Georgia Tax Tribunal, Case No. 1552367.**

Issue: Whether Petitioner's activities in the State via the use of school teachers and other activities constitute a taxable nexus for sales and use tax purposes.

Facts: Petitioner Scholastic Book Clubs is a producer of children's educational materials that are sold and distributed through elementary schools. Teachers distribute flyers and order forms to students in their classrooms and return the order forms back to Petitioner. The ordered books are then delivered to the teachers to be distributed to students. Teachers receive bonus points from Petitioner based on the amount of books and materials sold and can use these bonus points to purchase items for classroom and personal use. Several states have already addressed this issue, including Connecticut, Tennessee, Kansas, Arkansas and California.

The Department issued an Official Assessment against Petitioner on March 23, 2015 for a total of $1,890,474.10 in principal sales and use tax for the periods of June 2008 through May 2013. The Petitioner appealed the assessment on April 29, 2015 claiming that it is not a "retailer" or "dealer" required to collect and remit sales tax and that it does not have a constitutional nexus in Georgia.

Status: The case is now in the discovery period.

5. **Douglasville Hospitality, Inc. v. Riley, Georgia Tax Tribunal, Case No. 1526300.**

Issues: Whether the statute of limitations to assess and collect sales and use taxes apply to a successor that purchases a business owing sales and use taxes.

Facts: A Predecessor to Petitioner had operated a hotel located in Douglasville, Georgia. Between 2009 and 2011 Predecessor incurred sales and use tax liabilities. On April 1, 2011, Predecessor sold the hotel to Petitioner for $2,341,000. Predecessor filed its last or final sales and use tax return with the Department on September 9, 2011. On June 16, 2014, within three (3) years of the date that Predecessor filed its last or final sales and use tax return (Form ST-3), the Department issued an Official Assessment and Demand for Payment Letter to Petitioner under the provisions of O.C.G.A. § 48-8-46 for sales and use taxes, penalties, and interest owed by Petitioner as a successor.

The Department issued the assessment against Petitioner because Petitioner did not obtain a receipt or certificate showing that the taxes, interest, and penalties owed by Predecessor had been paid and were not due. Further, the Department had not issued a receipt or a certificate that indicated that the sales taxes owed by Predecessor and assessed against Petitioner had been paid or that sales and use taxes were not due. The outstanding sales taxes, penalties and interest currently owed to the Department total $96,737.11.

Petitioner claimed that the Department cannot collect the sales taxes, interest and penalties set forth in the State Tax Execution because the statutes of limitations to assess and collect the taxes had expired. The Tribunal, in a decision issued July 23, 2015, found that the Department was entitled to summary judgment because: (1) Petitioner is liable for the sales taxes, interest and penalties under the provisions of O.C.G.A. § 48-8-46 as a successor; (2) the Department timely assessed the sales taxes, interest and penalties against Petitioner; and (3) the Department timely recorded a state tax execution against Petitioner and thus had the legal right to collect the liabilities from Petitioner.

Status: Petitioner did not appeal the Tax Tribunal decision.

B. Income Tax

1. Gaddy v. Georgia Dep't of Revenue, Fulton Superior Court, Case No. 2014-CV-244538.

Issues: Whether Georgia's Qualified Education Tax Credit, Ga. L. 2008, p. 1108, as amended ("HB 1133"), violates the Georgia Constitution.

Facts: HB 1133 allows individuals and business entities to receive Georgia income tax credits for donations made to approved Student Scholarship Organizations ("SSOs"). O.C.G.A. § 48-7-29.16. The SSOs then give scholarships funded by these donations to "eligible students" to attend a "qualified school or program." O.C.G.A. § 20-2A-1. A "qualified school or program" includes any "nonpublic pre-kindergarten program, primary school, or secondary school" that is accredited, adheres "to the provisions of the federal Civil Rights Act of 1964," and "satisfies the requirements prescribed by law for private schools in this state." Id. § 20-2A-1(2).

HB 1133 created a new tax credit statute in the Georgia Revenue Code, O.C.G.A. § 48-7-29.16. This Code Section allows Georgia taxpayers to take a credit each year against their Georgia income tax liability for donations to SSOs of up to $1,000 per individual, and $2,500 if filing a joint return. Id. § 48-7-29.16(b). Corporations are allowed a credit of the actual amount donated to an SSO or 75% of the corporation's income tax liability, whichever is less. Id. § 48-7-29.16(c). Taxpayers may not claim a credit which exceeds a taxpayer's total income tax liability, but may carry-forward an unused credit for a period of five years. Id. § 48-7-29.16(e).

Like restrictions in Title 20, Code Section 48-7-29.16 also provides that a tax credit will not be permitted "if the taxpayer designates the taxpayer's qualified education expense for the direct benefit of any particular individual." Id. § 48-7-29.16(d). SSOs are also prohibited from "soliciting contributions [by] represent[ing], or direct[ing] a qualified private school to represent, that, in exchange for contributing to the [SSO], a taxpayer shall receive a scholarship for the direct benefit of any particular individual." Id. § 48-7-29.16(g)(2). If an SSO violates this provision, its "status as a [SSO] shall be revoked for any such organization." Id.

Plaintiffs filed the Complaint on April 3, 2014 and served the Department on April 8, 2014. The Complaint includes six counts. Count I alleges that HB 1133 violates Educational Assistance provisions in Ga. Const. Art. VIII, § VII, ¶ I(b) because SSOs are private entities instead of the public authorities designated to run educational assistance programs and contributions for educational assistance are only authorized to be tax deductible, and not taken as a tax credit. Count II alleges that HB 1133 violates the Gratuities Clause in Ga. Const. Art. III, § VI, ¶ VI(a) because HB 1133 allows tax revenue to be

directed at private school students without recompense. Count III alleges that HB 1133 violates Georgia's Establishment Clause in Ga. Const. Art. I, § II, ¶ VII because HB 1133 "tak[es] funds from the Georgia treasury to provide unconstitutional aid to sectarian schools and SSOs."

Count IV alleges that the Department have violated O.C.G.A. § 48-7-29.16 by permitting SSOs to represent "that in exchange for a contribution, a taxpayer will receive a scholarship for the direct benefit of any particular individual" and by failing to revoke the status of these SSOs. Count V requests a writ of mandamus to compel the Commissioner to enforce O.C.G.A. § 48-7-29.16 by revoking the status of SSOs that represent that they will award scholarships for specific individuals. Count VI seeks injunctive relief against the Department as a result of the constitutional and statutory violations outlined in Counts I through IV. Plaintiffs also seek declaratory relief in their Prayer for Relief.

The Department filed their Answer and moved to dismiss the Complaint in its entirety on May 8, 2014. Plaintiffs also moved for judgment on the pleadings on Counts I-III and VI. Department moved to stay discovery on July 9, 2014.

The Department contends that the Complaint should be dismissed because the Plaintiffs lack standing, there is no case or controversy, the action is barred by sovereign immunity, and HB 1133 is not unconstitutional. Because HB 1133 is a tax credit and no public funds are spent on private religious schools, HB 1133 does not violate the Gratuities, Establishment, or Educational Assistance Clauses of the Georgia Constitution. Plaintiffs have also not sufficiently alleged a violation O.C.G.A. § 48-7-29.16 nor is mandamus against the Commissioner appropriate for any such violation.

Status: The Motion to Dismiss and Motions for Judgment on the Pleadings are still pending and before the Court, Judge Kimberly M. Esmond Adams.

2. **Bourassa v. Georgia Dep't of Revenue, Georgia Tax Tribunal, Docket No. 1407354.**

Issue: Whether Petitioner met his burden of demonstrating that the taxes assessed against him were incorrect; whether the Department met its burden of proving that the making of a jeopardy assessment was reasonable under the circumstances; whether service of the jeopardy assessment upon Petitioner was proper.

Facts: Petitioner was arrested and subsequently pled guilty to violations of Georgia's controlled substances act. After Petitioner's arrest, agents seized assets, including bank accounts, certificates of deposit, and cash. Based on the information provided to the Department by the Cobb County District Attorney's office, the Department calculated that Petitioner sold

approximately $776,000 of alprazolam and marijuana during each taxable year 2007 and 2008. Because of Petitioner's criminal history and Petitioner's failure to file returns for those years, the Department issued a jeopardy assessment under O.C.G.A. § 48-2-51 and a garnishment action in order to secure the assets seized from Petitioner. The Department then applied the seized assets to Petitioner's total tax liability. Petitioner filed a Petition with the Tribunal on August 19, 2013, alleging that the jeopardy assessment was unreasonable and that Petitioner had not been provided adequate notice of the assessment.

The Petition includes three grounds for relief. Petitioner claims that the amount of the jeopardy assessments overstates Petitioner's income, and Petitioner was unable to earn income for a portion of taxable year 2008 because he was incarcerated for part of that year. Due to his incarceration, Petitioner further argues, the jeopardy assessment and garnishment action were inappropriate as he could not dissipate the funds or otherwise prevent the Department from satisfying the tax liability. Finally, Petitioner claims that he did not receive adequate notice of assessment pursuant to O.C.G.A. § 48-2-45 because the notice was sent to his power of attorney holder; Petitioner denies that his power of attorney holder was authorized to receive service of the assessment. Petitioner requests that the Tribunal reverse the jeopardy assessment.

The Department filed its answer to the Petition on December 16, 2013. The Department contends that Petitioner failed to meet his burden of demonstrating that the taxes, interest, and penalties assessed against him for taxable years 2007 and 2008 were incorrect. The Department also asserts that the jeopardy assessment was reasonable under the circumstances because Petitioner was the leader of a multi-state drug-ring, dealt in large amounts of cash, and used nominee structures, including fraudulent businesses, to conceal assets. Petitioner was a gang member and convicted of violating the Georgia Street Gang and Terrorism Prevention Act, and there was a substantial possibility that Petitioner could have moved his assets to other gang members or co-defendants. Finally, the Department maintains that service of the jeopardy assessment was proper because it was delivered to Petitioner's last known address, provided by Petitioner under oath during a guilty plea allocution, and served upon Petitioner's power of attorney holder.

Status: Hearing held on September 16-17, 2015. Proposed findings of fact and conclusions of law submitted on November 6, 2015. A decision by the Tax Tribunal is pending.

3. **Rosenberg v. Riley, Georgia Tax Tribunal, Case No. 1414626.**

Issue: Whether the Texas Franchise Tax should be considered a "tax on or measured by income" and allowed to be adjusted on a partner's return under O.C.G.A. § 48-7-27(d)(1).

Facts: The Petitioner was a resident of the State of Georgia during 2008 and filed a Georgia individual income tax return for that tax year. During 2008, Petitioner was the owner of membership interests in a series of pass-through entities with indirect ownership of interests in a company that operated in Texas. The Texas entity filed a Texas Franchise Tax return and paid Texas Franchise Taxes for 2008.

In an amended return dated September 12, 2012, Petitioner changed his Georgia taxable net income from $1,317,585 to $857,302 and claimed a total tax refund in the amount of $41,293, plus statutory interest, mainly from adjusting his pass through income for payment of the Texas Franchise Tax. In a letter dated September 12, 2013, the Department denied Petitioner's claim for refund, stating in part "[t]he Department does not consider the Texas Margin Tax to be a tax on or measured by income and, therefore, no adjustment can be made under O.C.G.A. § 48-7-27(d)(1)." The Petitioner appealed the denial of Petitioner's refund claim.

On cross-motions for summary judgment, the Tribunal granted Petitioner's motion and found that the Texas Franchise Tax can be adjusted because it is measured by gross income and operates similar to an income tax.

Status: After the Tribunal granted Petitioner's motion for summary judgement, the parties entered into a joint consent order to resolve the remaining issues in the case and agree to a formula to adjust Texas Franchise Taxes. No party filed an appeal to Superior Court.

4. **Staples/Quill Corporate Income Tax Litigation, Georgia Tax Tribunal, Case Nos. 1561322, 1561323, 1561324, 1561325, 1561326.**

Issue: Whether subsidiaries with no physical presence in Georgia can have taxable nexus through the contacts of an affiliate; whether an apportionment factor can be created for the out-of-state entity; whether transactions between affiliates are reasonable and at arms-length; whether the transfer-pricing study is reasonable.

Facts: Staples the Office Superstore, LP is a Massachusetts partnership that owns a 100% interest in Staples the Office Superstore, LLC. Staples the Office Superstore East, Inc. operates distribution centers and retail stores selling office supplies in various states, including Georgia. Staples Contract and Commercial, Inc. is engaged in the operation of a catalog business, selling

office supplies and equipment and a contract stationer business in various states, including Georgia. Staples East and Staples Contract and Commercial file corporate income returns in Georgia but Staples LLC and Staples LP do not. Staples LLC sells substantial product and merchandising services to Staples East and Staples Contract and Commercial allegedly based on a transfer pricing study. Allegedly, neither Staples LLC nor Staples LP operate or have any physical presence in Georgia.

Quill Corporation is a direct mail supplier of office supplies and equipment to small and medium-sized businesses. Quill Lincolnshire sells substantial product, merchandising, and administrative services to Quill Corporation allegedly based on a transfer pricing study. Quill Corporation files corporate income tax returns in Georgia, but Quill Lincolnshire does not. Allegedly, Quill Lincolnshire does not have any physical presence in Georgia.

The Department assessed Staples LLC, Staples East, Staples Contract and Commercial, Quill Corporation, and Quill Lincolnshire for principal tax in the amount of $5,574,761.00, $2,163,972.00, $2,707,711.00, $727,690.00 and $1,837,701.00, respectively. All five entities appealed their assessments.

Status: The case is currently in an extended remand period.

C. Property Tax

1. Southern LNG v. MacGinnitie, Fulton Superior Court, Case No. 2010-CV-190289.

Issue: Whether the superior court erred in granting the petition for mandamus Southern LNG ("Southern") filed against the Revenue Commissioner, which seeks to compel the Department of Revenue to treat Southern as a public utility.

Facts: Southern alleges that the Commissioner improperly has refused to treat Southern as a "public utility" required under Georgia's Revenue Code to return its property for ad valorem tax purposes to the Department of Revenue rather than Chatham County. Under Georgia's "centralized assessment" system, certain companies must return either all or some of their property to the State Revenue Commissioner. That category includes public utilities like Atlanta Gas Light and Southern Natural Gas, which operate pipeline systems in multiple counties for transporting and distributing gas to their customers, but excludes companies like Georgia Natural Gas, which markets its products to customers through pipelines operated by companies like Atlanta Gas. Southern – which does not own a distribution system for its natural gas products – nevertheless claims that it should be treated like Atlanta Gas and Southern Natural Gas rather than Georgia Natural Gas.

After the company was unsuccessful in convincing the Revenue Department, Southern sued the Commissioner in Fulton Superior Court (Judge Shawn LaGrua) for declaratory judgment and mandamus relief. The Superior Court first dismissed Southern's complaint based on sovereign immunity on February 18, 2011. The Supreme Court reversed that decision in part, finding that sovereign immunity does not bar mandamus relief. Southern LNG, Inc. v. MacGinnitie, 290 Ga. 204 (2011). On the first remand, the Superior Court granted summary judgment in favor of the Department and found that Southern's property tax appeals in Chatham County constituted an adequate legal remedy to mandamus. After another appeal by Southern, the Supreme Court remanded again for a finding that the Revenue Commissioner could be joined and bound by a ruling in Chatham County so as to constitute an adequate legal remedy to mandamus. Southern LNG, Inc. v. MacGinnitie, 294 Ga. 657 (2014). On the second remand, the Superior Court ruled on August 27, 2015 that the Chatham County proceedings did not constitute an adequate legal remedy to mandamus and found that Southern should be considered a public utility and be centrally assessed by the Department.

Status: The Department filed an appeal to the Supreme Court on September 15, 2015. As of this date, the case has not been docketed yet.

2. **BellSouth Telecommunications, LLC v. Riley, Georgia Tax Tribunal, Case No. 1426716.**

Issue: The issues in this case include BellSouth's correct unit value as of January 1, 2013, what constitutes a tax-exempt intangible for property tax purposes, and how such an intangible is properly valued and subtracted from a unit value.

Facts: For the 2013 tax year the Department determined that BellSouth Telecommunication's unit value was $13.8 billion. Revenue multiplied that unit value by an 18.8% allocation percentage and then deducted amounts for motor vehicles and working capital, resulting in a Georgia taxable fair market value of $2.5 billion. BellSouth returned a unit value of $13.354 billion, used roughly the same allocation percentage as the Revenue Department, and then deducted amounts for motor vehicles, working capital, software, "customer relationships," "trademark," and "technology."

After a number of discovery disputes, the Department filed a motion to compel discovery to obtain, among other things, the work papers that BellSouth's experts relied upon in their valuation report. The Tribunal granted the motion to compel regarding the work papers.

Status: The case is currently in the discovery period.