Department of Administrative and Financial Services

Summary of two recent decisions of the Maine Law Court regarding state tax matters

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- **Taxable "sale price" under the Maine Sales and Use Tax Law: *Apple Inc. v. State Tax Assessor*, 2021 ME 8 (Feb. 18, 2021)**
- **Under the Maine Sales and Use Tax Law, the taxable "sale price" is "the total amount of a retail sale valued in money, whether received in money or otherwise." 36 M.R.S.A. § 1752(14)**
- **The Law Court has broadly interpreted the statutory definition of sale price to include all payments that a retailer receives for the sale of tangible personal property, whether the payments come from the purchaser or from a third party. See *Flippo v. L.L. Bean, Inc.*, 2006 ME 62, ¶¶ 10-17, 898 A.2d 942; *Flik Int'l Corp. v. State Tax Assessor*, 2002 ME 176, ¶¶ 19-21, 812 A.2d 974.**

Summary of two recent decisions of the Maine Law Court regarding state tax matters

Apple Inc. v. State Tax Assessor, 2021 ME 8

- **In *Apple Inc. v. State Tax Assessor*, 2021 ME 8, the Law Court held that the taxable sale price of iPhones that Apple Inc. ("Apple") sold to its customers included payments that Apple received from three wireless telecommunications carriers that reimbursed Apple for selling the iPhones at reduced prices.**
- **Between 2010 and 2013, Apple had contracts with three wireless telecommunications carriers: AT&T, Verizon, and Sprint.**

Summary of two recent decisions of the Maine Law Court regarding state tax matters

Apple Inc. v. State Tax Assessor, 2021 ME

- **Pursuant to those contracts, Apple sold iPhones to its customers at a reduced price ($199, for example, instead of the full retail price of $649 for one particular model iPhone) when the customers also purchased a long-term wireless service contract from the carrier.**
- **For each such iPhone that Apple sold at a reduced price, the carrier (*e.g.*, Verizon) was contractually required to and did promptly reimburse Apple for the $450 subsidy ($649 minus $199) that Apple had extended to its customer on its iPhone sale.**
- **Apple thus received a total of $649 on its sale of that iPhone ($199 plus $450), but collected and remitted sales tax on a sale price of $199 on these sales.**

Summary of two recent decisions of the Maine Law Court regarding state tax matters

Apple Inc. v. State Tax Assessor, 2021 ME

- **If a customer did not purchase a long-term wireless service contract from the carrier, then Apple did not reduce the price of the iPhone to the customer.**
- **Apple charged its customer the full retail price of $649 and received a total of $649 on its sale of that same model iPhone.**
- **Apple collected and remitted sales tax on a sale price of $649 on these sales.**
- **In both scenarios, Apple sold the same product and received the same amount of money on its sale ($649) – the only difference between the two transactions was the number of payments to Apple and their source.**

Summary of two recent decisions of the Maine Law Court regarding state tax matters

Apple Inc. v. State Tax Assessor, 2021 ME 8

- **After an audit, the Assessor determined that Maine sales tax was due on a sale price that included not only the reduced amount that the customer paid Apple ($199), but also the subsidy reimbursement that the carrier paid Apple ($450).**
- **The Assessor issued an assessment of Maine sales and use tax and interest against Apple in the total amount of $539,238.**
- **Apple appealed the Assessor's decision on reconsideration upholding the assessment to the Board of Tax Appeals ("Board").**
- **The Board upheld the assessment, and Apple appealed the Board's decision to the Superior Court, where the case was transferred to the Business and Consumer Docket.**

Summary of two recent decisions of the Maine Law Court regarding state tax matters

Apple Inc. v. State Tax Assessor, 2021 ME 8

- **The trial court ruled in Apple's favor.**
- **The trial court concluded that the subsidy reimbursements that Apple received from carriers were not part of the taxable sale price of the iPhones that Apple had sold, but instead reflected compensation to Apple for securing long-term wireless service contracts for the carriers.**
- **The Assessor appealed the trial court's decision to the Law Court.**

Summary of two recent decisions of the Maine Law Court regarding state tax matters

Law Court decision in *Apple*

- **The Law Court ruled in the Assessor's favor.**
- **The Law Court held that the payments that Apple received from the carriers were part of the sale price of iPhones that Apple sold to its customers because Apple expected at the time of sale that it would be reimbursed by the carriers for the price discounts that Apple granted to customers who entered into wireless service contracts with the carriers.**

Alternative apportionment under the Maine Corporate Income Tax Law: *State Tax Assessor v. Kraft Foods Group, Inc.*, 2020 ME 81 (June 4, 2020)

- **Under the Maine Corporate Income Tax Law, if the regular apportionment provisions of 36 M.R.S.A. § 5211 "do not fairly represent the extent of the taxpayer's business activity in this State," the taxpayer may petition for, or the Assessor may require, "in respect to all or any part of the taxpayer's business activity, if reasonable" the "employment of any other method to effectuate an equitable apportionment of the taxpayer's income." 36 M.R.S.A. § 5211(17).**
- **This provision is sometimes referred to the "alternative apportionment" provision**

Summary of two recent decisions of the Maine Law Court regarding state tax matters

State Tax Assessor v. Kraft Foods Group, Inc., 2020 ME 81

- **During the years at issue, Kraft Foods Inc. and its affiliates ("Kraft") comprised a unitary business that operated in part in Maine.**
- **Kraft manufactured and sold many food and beverage products, including Nabisco crackers and cookies, Kraft cheeses, and DiGiorno frozen pizzas.**
- **Kraft also owned and managed valuable trademarks, patents, and other intellectual property ("IP") related to its food and beverage products.**

Summary of two recent decisions of the Maine Law Court regarding state tax matters

State Tax Assessor v. Kraft Foods Group, Inc., 2020 ME 81

- **In 2010, Kraft sold to Nestle USA, Inc. ("Nestle"), and its affiliates most of the assets from its frozen pizza business, including trademarks, patents, and other IP owned by Kraft Foods Global Brands, Inc., the Kraft affiliate that managed all the Kraft IP ("KFGB"), and by Kraft Pizza Company ("KPC").**
- **The sale to Nestle resulted in roughly $3.3 billion in federal taxable income to Kraft.**
- **Most of that income derived from Kraft's sale of its IP.**
- **That income was recognized by three different Kraft entities: KPC (roughly $2 billion), KFGB (roughly $1.3 billion), and Kraft Foods Global, Inc. ("KFG") ($340,000).**

State Tax Assessor v. Kraft Foods Group, Inc., 2020 ME 81

- **When Kraft filed its 2010 Maine income tax return, it excluded from the income that was subject to Maine tax all of the $3.3 billion in income that it had recognized from the Nestle sale.**
- **Kraft subtracted roughly $3 billion of it pursuant to 36 M.R.S.A. § 5200-A(2)(F) on the theory that the income was not taxable by Maine under the Constitution.**

Summary of two recent decisions of the Maine Law Court regarding state tax matters

State Tax Assessor v. Kraft Foods Group, Inc., 2020 ME 81

- **This case involved two adjustments that the Assessor made to Kraft's 2010 Maine corporate income tax return – resulting in two assessments.**
- **In the first assessment, the Assessor disallowed the $3 billion subtraction modification and assessed $1,832,717 in tax, statutory interest, and a 25% substantial understatement penalty.**
- **In the second assessment, the Assessor disallowed a $306,729,484 "capital loss carryforward" that Kraft had claimed on its 2010 Maine return (which had the effect of excluding from Maine income tax the remainder of the $3.3 billion in income from the Nestle sale) and issued a supplemental assessment for $192,448 in tax, statutory interest, and a 25% substantial understatement penalty.**

State Tax Assessor v. Kraft Foods Group, Inc., 2020 ME 81

- **Kraft appealed the Assessor's decision on reconsideration upholding the first assessment to the Board of Tax Appeals.**
- **Kraft argued that (1) the $3 billion in income was not taxable by Maine because KPC was not part of its unitary business; (2) if the $3 billion in income was taxable by Maine, then Kraft was entitled to an alternative apportionment under 36 M.R.S.A. § 5211(17) where the $3 billion in income from the Nestle sale would be apportioned pursuant to a sales factor that was much smaller than Kraft's regular sales factor; and (3) the substantial understatement penalty should be abated because there was "substantial authority" for Kraft's filing position, *see* 36 M.R.S.A. § 187-B(4-A).**
- **The Board accepted Kraft's arguments on alternative apportionment and penalty abatement.**
- **The Assessor appealed the Board's decision regarding the first assessment to the Superior Court.**

State Tax Assessor v. Kraft Foods Group, Inc., 2020 ME 81

- **Thereafter, Kraft appealed the Assessor's decision on reconsideration upholding the second assessment directly to the Superior Court.**
- **Kraft argued that the second assessment was not timely under 36 M.R.S.A. § 141(2)(A).**
- **Section 141(2)(A) provides that an assessment may be made within 6 years from the date a return was filed "if the tax liability shown on the return, after adjustments necessary to correct any mathematical errors apparent on the face of the return, is less than 1/2 of the tax liability" determined by the Assessor.**
- **In determining whether the 50% threshold is satisfied, the Assessor "may not consider any portion of the understated tax liability for which the taxpayer has substantial authority supporting its position."**

Summary of two recent decisions of the Maine Law Court regarding state tax matters

State Tax Assessor v. Kraft Foods Group, Inc., 2020 ME 81

- **The two Superior Court appeals were transferred to the Business and Consumer Docket and consolidated.**
- **Kraft conceded that KPC was part of its unitary business and that the $3 billion in income from the Nestle sale was taxable by Maine, but pressed its claims for alternative apportionment under 36 M.R.S.A. § 5211(17) and penalty abatement.**
- **The trial court rejected Kraft's alternative apportionment claim, upheld about 1/3 of the substantial understatement penalty from the first assessment, but abated the rest of that penalty based on its conclusion that Kraft had substantial authority, in part, for its filing position.**
- **The trial court held that the second assessment was timely under section 141(2)(A).**

Summary of two recent decisions of the Maine Law Court regarding state tax matters

State Tax Assessor v. Kraft Foods Group, Inc., 2020 ME 81

- **Kraft appealed the trial court's decision regarding the first and second assessments to the Law Court; and the Assessor cross-appealed to the Law Court from the trial court's decision to abate 2/3 of the penalty from the first assessment.**
- **The Law Court upheld both assessments in full**
- **With respect to the first assessment, the Court rejected Kraft's argument that it was entitled to alternative apportionment, concluding that Kraft had not proven that the regular sales factor in 36 M.R.S.A. § 5211 did not fairly represent the extent of Kraft's business activity in Maine.**
- **The Law Court also upheld the substantial understatement penalty in full, ruling that Kraft had not proven that it had substantial authority for its 2010 filing position.**
- **As to the second assessment, the Law Court rejected Kraft's argument that the assessment was time-barred by section 141(2)(A).**