June 14, 2024

349 East Tax Alert

$1 Million Missed Opportunity

In a decision published today, a West Virginia taxpayer received appellate-level confirmation that it missed an opportunity to save nearly $1 million.[1] The taxpayer (and its affiliates) owned and maintained wireless telecommunications equipment. The taxpayer also owned retail stores selling mobile phones, tablets, accessories, and subscriptions to Sprint's national wireless telecommunications network.

The taxpayer purchased thirty West Virginia retail outlets from another vendor. However, some customers of the purchased company needed an upgraded iPhone to access Sprint's wireless network. To retain these customers, the taxpayer provided new phones free-of-charge. The taxpayer paid West Virginia use taxes on those phones. Several years later, the taxpayer claimed a refund of those use taxes, asserting that it actually "sold" the telephones as part of its sale of Sprint subscriptions.

The court rejected the taxpayer's claim, observing that the taxpayer "cites to no evidence that it attempted at any point to apportion or allocate any of the amounts (or 'value in money') it received from the customer-recipients of the Free Mobile Phones (as part of the subscription price paid or otherwise) to attempt to collect sales and use tax from its customers on the 'consideration' paid as part of the 'resale' of the Free Mobile Phones." (Footnote omitted; the taxpayer also asserted another basis for refund which, too, was rejected.)

If the taxpayer charged (or allocated) a non-deminimis amount for the phones, it would have collected sales taxes from its customers on that much smaller amount – and saved itself nearly $1 million in use taxes plus lawyers' fees plus the value of its employees' time spent litigating this.

Unfortunately, use tax errors involving items provided free-of-charge are not unusual. In 2018, the Arkansas Supreme Court held a restaurant chain liable for use tax on the retail value of meals it provided for free to its employees. In a not-to-be-forgotten quote, the court stated as follows "[the taxpayer] argues that application of section (D)(2) would lead to absurd results as it could decide to charge its managers .01 cents and then only remit tax on that amount. It contends the State of Arkansas would subsequently receive much less taxes than it would if it applied its wholesale value argument. This is true."

Observation: Despite the Arkansas Supreme Court's statement about the validity of a hypothetical .01 cents charge, taxpayers are well-advised to charge a more defensible amount for items that they are selling.

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[1] *Shenandoah Personal Communications, LLC, v. Irby, State Tax Comm. Of West Virginia,* (No. 23-ICA-235 6/12/24)