

A Response to Cram’s *Ellingson’s* Defense: Credits Do Not Cure an Externally Inconsistent Tax

by Richard D. Pomp and Jeffrey A. Friedman



Richard D. Pomp



Jeffrey A. Friedman

Richard D. Pomp is the Alva P. Loiselle Professor of Law and the Board of Trustees Distinguished Professor at the University of Connecticut School of Law. Jeffrey A. Friedman is a partner at Eversheds Sutherland (US) LLP in Washington. Both are members of the *Tax Notes State* advisory board.

In this Thoughts in Brief, Pomp and Friedman comment on Richard Cram’s latest article regarding *Ellingson Drainage*, finding fault with Cram’s central premise on both legal and factual grounds.

The authors are counsel to Ellingson Drainage Inc. in its Supreme Court petition for certiorari in *Ellingson Drainage Inc. v. South Dakota Department of Revenue*, Dkt. No. 23-1202 (2024).

Copyright 2024 Richard D. Pomp and Jeffrey A. Friedman.
All rights reserved.

On September 16 Richard L. Cram, director of the Multistate Tax Commission’s National Nexus Program, published an article in *Tax Notes State* questioning the basis of Ellingson Drainage Inc.’s

petition for certiorari with the Supreme Court.¹ The petition asks the Court to overturn the Supreme Court of South Dakota’s decision upholding a use tax on the full fair market value of Ellingson’s property, whether used for a day or for the entire year.

The central premise of Cram’s argument is that no constitutional problem exists with the South Dakota tax because the state provides a credit for taxes paid to other states. Cram believes that the credit obviates the need for apportionment “by eliminating the risk of multiple taxation.”² His premise is both legally and factually incorrect.

Cram not only misdescribes the purpose of the external consistency test, but also misapplies it. He correctly notes that under *Jefferson Lines*,³ fair apportionment serves “to ensure that each State taxes only its fair share of an interstate transaction.”⁴ How can the state’s use tax, which disregards the days an asset is used in South Dakota, pass this test? Cram dodges this question by pivoting: “The fair apportionment prong concerns the risk of multiple taxation,”⁵ and thus the South Dakota credit saves the day. Throughout the remainder of his article, he circles back to South Dakota’s credit eliminating “the risk of multiple taxation.” A risk of multiple taxation, however, is not the test for external consistency.⁶

¹ Richard L. Cram, “Credits: Cure for Use Tax Apportionment,” *Tax Notes State*, Sept. 16, 2024, p. 767.

² *Id.* at 768.

³ *Oklahoma Tax Commission v. Jefferson Lines*, 514 U.S. 175 (1992).

⁴ Cram, *supra* note 1, at 770.

⁵ *Id.*

⁶ See *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 280 (1978) (refusing to invalidate Iowa’s single-sales-factor formula “based on speculative concerns with multiple taxation,” when 44 of the 45 other states used a different apportionment formula).

A credit generally satisfies the *internal* consistency test.⁷ However, as Ellingson explained in its petition, to be *externally* consistent, a state tax must “reasonably reflect[] the in-state component of the activity being taxed,”⁸ and it must not reach “beyond that portion of value that is fairly attributable to economic activity within the taxing State.”⁹ These mandates are not dependent on a risk of multiple taxation or the provision of a credit. A credit neither reflects the “in-state component of the activity being taxed,” nor attributes value to the “economic activity within the taxing jurisdiction.” What is being credited is activity in other states, not in the taxing state. In this case, no credit is available because no taxes were paid to other states. Simply put, a credit does not save an externally inconsistent tax.

Cram also confuses the imposition of a sales tax and a use tax by concluding that each can only take place in one state. That conclusion is wrong, logically and legally. In describing *Jefferson Lines*, he remarks, “The Court determined that there was no need to apportion the sales tax because of the fact that the sale was consummated in only one state.”¹⁰ Then Cram seeks to hopscotch that conclusion to a use tax by equating it with Ellingson’s use of its property purchased in Minnesota and used for one day in South Dakota: “Ellingson’s use of its construction equipment in South Dakota — *an activity that occurred entirely within the state.*”¹¹ This depiction misdescribes Ellingson’s use of the equipment, which occurred in multiple states, unlike a sales tax transaction.¹² In fact, the South Dakota statute at issue in *Ellingson* applied *only* to tangible personal property used in multiple states, that is, property “*not originally purchased for use in this state, but thereafter used, stored or consumed in this*

state.”¹³ That a taxable use may occur in multiple states is also confirmed by Massachusetts’s legislative adoption of apportionment for sales and use taxes,¹⁴ something that Cram’s contributor, Michael Fatale, general counsel at the Massachusetts Department of Revenue, must know.¹⁵

Finally, attempting to refute Ellingson’s reliance on property tax cases, which irrefutably require apportionment of property taxes when property is used in multiple states, Cram claims that ad valorem property taxes are “not analogous” to South Dakota’s use tax because they “serve different purposes” and are “assessed differently.”¹⁶ Neither the purpose nor the assessment of these taxes supports his position. Both are imposed on the use of tangible personal property in a state, and the purpose of a tax cannot obviate the need for fair apportionment.

The Supreme Court should accept Ellingson’s petition and hold that external consistency requires a tax that reasonably reflects the in-state activity to be taxed. A credit is not a universal cure for an external consistency violation. ■

⁷ Jerome R. Hellerstein and Walter Hellerstein, *State Taxation*, para. 4.16[1][b] (“The provision of a tax credit for taxes paid to other states on the same tax base will generally provide a complete defense to any allegation that a tax is internally inconsistent.”).

⁸ *Goldberg v. Sweet*, 488 U.S. 252, 262 (1989).

⁹ *Jefferson Lines*, 514 U.S. at 185.

¹⁰ Cram, *supra* note 1, at 771.

¹¹ Cram, *supra* note 1, at 772 (emphasis added); *see also id.* at 774 (“Its activity on which use tax was imposed — use of construction equipment in South Dakota to complete drain tile projects — occurred solely within that state.”).

¹² *See McLeod v. J.E. Diltworth Co.*, 322 U.S. 327, 330 (1944).

¹³ S.D. Codified Laws section 10-46-3 (emphasis added).

¹⁴ *See* Mass. Gen. Laws ch. 64H, section 1; *see also* Technical Information Release 22-8, “Decision of the Massachusetts Supreme Judicial Court in *Oracle USA Inc. v. Commissioner of Revenue*” (May 19, 2022).

¹⁵ *See* Mass. Gen. Laws ch. 64H, section 1 (allowing taxpayers to apportion sales and use taxes); *Oracle USA Inc. v. Commissioner of Revenue*, Dkt. No. SJC-13013 (2021) (finding that Massachusetts taxpayers have a statutory right to apportion sales tax on software purchased for use in multiple states).

¹⁶ Cram, *supra* note 1, at 768.