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Exam No.

593-039 State & Local Taxation
Fall Semester 2004

UNM School of Law
Final Examination
Three Credits

Professor Desiderio & Eads
Wednesday, December 8, 2004
9:00 a.m. – noon (3 hours)

Examination Format

1. **Laptop** computer users: Start the Securexam program entering your examination number, course name, professor's name, & date of examination. Click "proceed" to enter the program. Type START in the next window that is displayed but do NOT press the enter key until the proctor says to begin the exam.

2. **Bluebooks** for writing: write on every-other line and only on the front page of each sheet. On the front of bluebook record the class name, professor's name, & date of exam. Make sure to number each bluebook in order.

Go to the exam check-in table at the conclusion of the exam & fill out an examination receipt.

593-039 STATE & LOCAL TAXATION
Semester 1, 2004-2005

UNM SCHOOL OF LAW
FINAL EXAMINATION
THREE CREDITS

PROFESSOR Robert J. Desiderio
PROFESSOR James Eads
Wednesday, December 8, 2004
9:00 am to 12:00 Noon

INSTRUCTIONS

1. This examination includes two questions. You must answer both. Each question will be given equal weight. Each question should be allocated equal time.

2. You may have with you in the examination your casebook, any materials Jim and I have distributed, and any notes and outlines you have prepared or actively helped in their preparation. You may not have with you any other books, materials, or information.

3. You have three hours in which to complete the examination.

GOOD LUCK!

QUESTION 1.

Clinton Moving & Storage Company ("CMS"), is engaged in the business of moving household goods on an interstate basis. It's corporate headquarters is located in Little Rock, Arkansas with an operating office located in Chappaquah, New York. It began operations in 2000 and has had little success, due in large part to the inattention of senior management, who are also engaged in other enterprises. In 2001 the company had only one transaction. That transaction consisted of moving the household goods of a customer from New Mexico to Arkansas. The contract was entered into in Cimarron, NM and the goods were transported from Cimarron to Little Rock using the state and interstate highway system that passes through New Mexico, Texas and Oklahoma, and comes to rest in Arkansas.

New Mexico imposes a state gross receipts tax on transportation services. Texas imposes a state transportation use tax on moving services based on the percentage of the services that are performed in Texas. Although Oklahoma once taxed the transportation of people, it does not tax the movement of goods. Arkansas does not

tax services, it does impose a franchise tax on corporations headquartered in Arkansas. The Arkansas tax is based in part on gross receipts.

The contract for movement of the goods was signed in New Mexico, but payment did not occur until the delivery in Arkansas. Because CMS paid no taxes anywhere for 2001, CMS was contacted by tax auditors from New Mexico, Texas and Arkansas in 2004 who sought and obtained CMS' records for 2001. After reviewing those records, New Mexico, Texas and Arkansas, issued tax assessments. New Mexico assessed its gross receipts tax on the entire amount CMS received for the move. Texas has assessed its transportation use tax on a portion of CMS' receipts based on the number of miles traveled in Texas compared to the total miles traveled during the move. Arkansas has assessed its corporate franchise tax based on the entire amount of receipts received by CMS.

Please prepare a memorandum analyzing CMS's tax liabilities to New Mexico, Texas and Arkansas. Although your analysis should not be limited to *Central Greyhound Lines, Inc. v. Mealey and Oklahoma Tax Comm'n v. Jefferson Lines, Inc.,* those cases must be the primary basis for you analysis.

QUESTION 2.

Alpha Air Lines, Inc. ("Alpha") is a Delaware corporation with its principal place of business and commercial domicile in Cheyenne, Wyoming, a state without a corporate income tax. It is one of the world's largest airlines, providing air transportation of persons and property for hire in 31 states and in many foreign countries. Alpha's revenues from its air transportation services are derived largely from (1) ticket sales for scheduled passenger service; (2) charges for nonscheduled passenger service (e.g., transporting military personnel); (3) charges for transportation of freight; and (4) charges for other miscellaneous services related to air transportation. Alpha regularly and consistently reports any income (or loss) associated with such revenues as apportionable business income (or loss) in every state in which it does business.

Priceline.com, Inc. ("Priceline") is a Delaware corporation with its principal place of business and commercial domicile in Stamford, Connecticut. Created in 1997 and commencing operations in 1998, Priceline pioneered a new type of e-commerce known as a "demand collection system." Using a simple consumer proposition – "name your price," Priceline collects consumer demand in the form of individual customer offers guaranteed by a credit card, for a particular product or service at a price set by the customer. With respect to air transportation, for example, Priceline's web site permits customers to purchase airline tickets by (1) specifying (a) the origin and destination of the trip, (b) the dates on which they wish to depart, and (c) the price they are willing to pay, and (2) guaranteeing the offer with a credit card. When Priceline receives an offer, it determines whether the offer can be fulfilled under the available fares, rules, and inventory that have been provided by

participating airlines. If Priceline is able to obtain an airline ticket within the parameters specified by the customer, the customer's credit card is charged, and the ticket is delivered to the customer.

For Priceline to implement its business plan, it needed access to deeply-discounted, unpublished fares that airlines, hotels, car rental agencies, etc. would be willing to make available to Priceline. It was by no means clear, however, at least when Priceline was little more than an novel marketing idea, that providing such access would be in the interest of established travel service providers like Alpha, because Priceline's business model threatened to undermine their own established pricing and marketing structures. Consequently, to induce these travel service providers to make such access available, Priceline needed to offer something in return. What it offered, at least in Alpha's case, was a warrant (or option) to buy Priceline's stock.

Under a series of agreements concluded by Priceline and Alpha in 1998, Alpha agreed to provide Priceline with access to unpublished fares (the "Participation Agreement"), and Priceline agreed to provide Alpha with options to buy Priceline stock (the "Warrant Agreement"). When Priceline sold Alpha tickets pursuant to the Participation Agreement, Priceline remitted to Alpha the amount specified in the unpublished fare schedule. Alpha treated all revenue from such sales as apportionable business income in all the states in which it did business. The business income that Alpha has received through the Participation Agreement has never been very significant, amounting to less than 2% of revenues.

Under the Warrant Agreement, Alpha received options to acquire roughly 13% of Priceline's common stock for a little more than $1 per share at the time the stock was worth approximately $4 per share. Shortly after Alpha's right to exercise its options to acquire the Priceline stock matured, Alpha purchased roughly 13% of the Priceline's stock pursuant to the options. Based on advice from Goldman Sachs, its financial advisor, Alpha disposed of a substantial portion of its Priceline stock during fiscal year 2002, when Priceline stock's price ranged from $60 to $71 per share, and it realized a gain of some $778 million.

Most of the states in which Alpha does business, all of which you should assume have adopted the Uniform Division of Income for Tax Purposes Act, have taken the position that the $778 million is business income apportionable in part to those states. Alpha has resisted this claim, contending that the income is not business income and, even if it is, the income is not constitutionally apportionable. It has treated all of the income as allocable to its commercial domicile, Wyoming. Write a memorandum analyzing the issues raised.

END OF EXAMINATION

HAPPY HOLIDAYS!