



This Week in State Tax (TWIST)

December 16, 2024



Minnesota: Tax Court Holds Pharmacy Services Sourced to Gopher State

The Minnesota Tax Court recently addressed whether a taxpayer’s income from the provision of pharmacy benefits management services were sourced to Minnesota (i.e., the location of the Plan members). The case focused on contracts between two members of a combined group—an insurance provider (HIC) that offers medical and drug insurance products to plan members, and a pharmacy benefits manager (HPS) that provides various services related to HIC’s plan members. Among the services provided by HPS were maintaining the formulary (i.e., covered drugs), recruiting and maintaining a network of pharmacies, and claims adjudication. Minnesota law attributes receipts from the performance of services to “the state where the services are received.” If the location of where services are received is not readily determinable, Minnesota applies a cascading set of sourcing rules that looks to the ordering location or billing address of the customer.

The taxpayer first argued that the plain language of the sourcing rule required a determination of where the taxpayer’s “direct customer” received the services, not where the customer’s customer received the services. Further, in the taxpayer’s view, reading the sourcing statute, as a whole, the third and fourth rules (i.e., the location of the ordering office or billing office), foreclose the possibility of sourcing by looking to where the customer’s customer (i.e., Plan member) received the services. The Commissioner of Revenue argued that the services of HPS were received by the subscribers to the various plans offered by HIC. The tax court disagreed with the taxpayer, holding that under the cascading rule, the plain language of the statute requires a determination of where the services are received, and a taxpayer may only apply the cascading rules if the location of receipt is not readily determinable. The court further held that nothing in the services sourcing rule limited the sourcing determination to the “direct recipient” or “direct customer” of the taxpayer. There is nothing in the statute that specified any required relationship between the taxpayer and the recipient of the services. Further, the definitions of received do not specify who needs, orders, or is offered the service in any particular context.

The taxpayer also pointed to a Minnesota Supreme Court decision in *Lutheran Brotherhood Research Corp.*, in which the court rejected a look-through approach for sourcing services provided by a mutual fund service provider to a family of funds. However, the court noted that *Lutheran Brotherhood* decision did not establish an absolute rule that receipts from services should be sourced to the taxpayer’s “direct customers.” Rather the sourcing determination was a “plain language” determination based on the factual record.

Based on the facts presented in this matter, the court held the taxpayer failed to support its claims that any portion of the receipts at issue should be sourced to a location outside of Minnesota where HIC, as the insurance

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provider, received the taxpayer's services. In the court's view, the facts presented by the taxpayer pertained entirely to how HPS performed its responsibilities to HIC and how a provider fee was paid. As it was previously stipulated that all disputed fees should be sourced together, the facts offered by the taxpayer did not provide sufficient evidence to dispute the Commissioner's determination that the receipts should be sourced to Minnesota. Contact [Matthew Saunders](#) for questions about [Humana MarketPoint, Inc. v. Commissioner of Revenue](#).

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