

New Louisiana corporate income and franchise tax laws address budget issues

Overview

In March 2016, Governor John Bel Edwards signed into law a number of tax bills which include the following sweeping changes to Louisiana franchise and income tax law:

- Expanding state franchise tax imposition to certain limited liability companies (LLCs) and other entities treated as subchapter C corporations for federal income tax purposes
- Expanding state franchise tax imposition to corporations that own property in Louisiana indirectly through a partnership, joint venture, or any other business organization
- Creating a new holding company deduction from the state franchise tax base for a portion of a corporation's investments in and advances to its subsidiaries
- Limiting utilization of net operating losses (NOLs) to 72% of Louisiana net income for state corporation income tax purposes
- Requiring NOLs to be utilized on a last-in, first out (LIFO) basis from the most recent taxable loss year for state corporation income tax purposes
- Requiring an "addback" adjustment for related party interest expense, intangible expense, and management fees for state corporation income tax purposes
- Potentially establishing a flat 6.5% corporate income tax rate
- Restoring the state corporation income tax dividends received deduction for dividends from certain banking institutions

In addition to the above legislation that was signed into law the Louisiana House and Senate issued a joint resolution proposing to amend the Constitution of Louisiana to permit elimination of the federal income tax deduction for state corporation income tax purposes.

In this Tax Alert we summarize these law changes that have various enactment dates and effective dates as specified in the discussion that follows.

Expanding state franchise tax imposition

House Bill 19,¹ which was signed into law by Governor Edwards on March 10, 2016, expands the imposition of the state franchise tax by amending the definition of taxable "corporations" to include all entities taxed as subchapter C corporations for federal income tax purposes.² Previously, only corporations were subject to the state franchise tax.³ Additionally, the new law expands the imposition of the franchise tax to corporations that own property in the state, either directly or indirectly through other related business entities including partnerships, joint ventures, or any other business organizations, including corporate subsidiaries.⁴ This change legislatively overturns the holdings of the Court of Appeal of Louisiana, First Circuit in *Utelcom, Inc. v. Bridges*.⁵

House Bill 19 also provides that an LLC must be treated and taxed for state franchise tax purposes in the same manner that it is treated and taxed for federal income tax purposes.⁶

House Bill 19 also creates a new holding company deduction from the state franchise base for a portion of a corporation's investments in and advances to its subsidiaries.⁷ The deduction is limited to 80% or more owned subsidiaries that are subject to the Louisiana franchise tax.⁸ The deduction is determined by multiplying the

¹ Act No. 12, 2016 Extra Sess. (1st Extra. Sess.) HB 19 (March 10, 2016). A copy of HB 19 is available here.

² *Id.* at Sec. 2, adding new La. Rev. Stat. § 47:601.C.(1)(b).

³ La. Rev. Stat. § 47:601.C.

⁴ Act No. 12, 2016 Extra Sess. (1st Extra. Sess.) HB 19 (March 10, 2016) at Sec. 2, amending La. Rev. Stat. § 47:601.A.(3).

⁵ *Utelcom, Inc. v. Bridges*, 77 So. 3d 39, La. App.1 Cir. 2011 (9/12/2011), review denied, 83 So. 3d 1046 (3/2/2012).

⁶ Act No. 12, 2016 Extra Sess. (1st Extra. Sess.) HB 19 (March 10, 2016) at Sec. 1, amending La. Rev. Stat. § 12:1368 and at Sec. 2, adding new La. Rev. Stat. § 47:601.C.(1)(b).

⁷ *Id.* at Sec. 2, adding new La. Rev. Stat. § 47:602.G.

⁸ *Id.* adding new § 47:602.G.(2).

parent's investments in and advances to qualifying subsidiaries by the subsidiaries' respective state franchise tax apportionment factor.⁹

The new law also increases Louisiana's initial franchise tax from \$10 to \$110.¹⁰

House Bill 19 is effective for taxable periods beginning on or after January 1, 2017.¹¹ For calendar year taxpayers, this franchise tax period is reported on the 2016 Corporate Income and 2017 Franchise tax return.

Observation: Deductions similar to that created by House Bill 19 have previously been held to violate the federal Commerce Clause. See *Fulton Corp. v. Faulkner*.¹² In particular, limiting the deduction to only corporations subject to Louisiana franchise tax and further limiting the deduction by the subsidiary's state franchise tax apportionment factor would seem similar to provisions found by the U.S. Supreme Court in *Fulton* to facially discriminate against interstate commerce. In addition, imposition of the franchise tax based solely on activities conducted by corporate subsidiaries may raise questions regarding the limits of nexus under the Due Process Clause of the U.S. Constitution.

NOL limitations and modifications

House Bill 20,¹³ which was signed into law by Governor Edwards on March 9, 2016, limits NOL utilization to 72% of Louisiana net income for state corporation income tax purposes.¹⁴ The law as amended now allows a state corporation income tax deduction equal to 72% of NOL carryovers to such year, further limited to 72% of Louisiana net income in the carryover year.¹⁵ House Bill 20 is effective January 1, 2016.¹⁶

House Bill 116,¹⁷ which was signed into law by Governor Edwards on March 15, 2016, provides that the ordering of NOL utilization must be on the LIFO method, beginning with the most recent taxable loss year.¹⁸ House Bill 116 is effective January 1, 2017.¹⁹

Observation: Taxpayers with Louisiana net operating loss carryforwards from multiple years may need to reconsider their ability to utilize such carryovers during the statutory NOL carryover period which remains unchanged.

Related party interest, intangible expense and management fees "addback" modification

House Bill 55,²⁰ which was signed into law by Governor Edwards on March 10, 2016, requires that certain deductions arising from transactions between related parties be added back to taxable income for state corporation income tax purposes. Such deductions include interest expenses and costs, intangible expenses and costs, and management fees directly or indirectly paid or accrued to a related party.²¹ Exceptions to the addback include the following:

- An addback would not apply to the extent the related member was subject to tax on the corresponding item of income in Louisiana or any other state, or was subject to a tax by a foreign nation which has an enforceable income tax treaty with the United States;²²
- An addback would not apply if the corporation establishes that the related party transactions did not have as a principal purpose the avoidance of any Louisiana tax. If the related party transactions have a substantial business purpose and economic substance and contain terms and conditions comparable to a similar arm's-length transaction between unrelated parties, the transaction shall be presumed to not have as its principal purpose tax avoidance, subject to rebuttal by the Department of Revenue;²³ and

⁹ *Id.* adding new § 47:602.G.(3).

¹⁰ *Id.* at Sec. 2, amending La. Rev. Stat. § 47:611.A.

¹¹ *Id.* at Sec. 3.

¹² *Fulton Corp. v. Faulkner*, 516 U.S. 325, 116 S. Ct. 848 (02/21/1996).

¹³ Act No. 6, 2016 Extra Sess. (1st Extra. Sess.) HB 20 (March 9, 2016). A copy of HB 20 is available [here](#).

¹⁴ *Id.* at Sec. 1, amending La. Rev. Stat. § 47:287.86(A).

¹⁵ La. Rev. Stat. § 47:287.86(A), as amended.

¹⁶ *Id.* at Sec. 4.

¹⁷ Act No. 24, 2016 Extra Sess. (1st Extra. Sess.) HB 116 (Mar. 15, 2016). A copy of HB 116 is available [here](#).

¹⁸ *Id.* at Sec. 1, amending La. Rev. Stat. § 47:287.86(C)(2).

¹⁹ *Id.* at Sec. 2.

²⁰ Act No. 16, 2016 Extra Sess. (1st Extra. Sess.) HB 55 (Mar. 10, 2016). A copy of HB 55 is available [here](#).

²¹ *Id.* at Sec. 1, adding new La. Rev. Stat. § 47:287.82.

²² *Id.* adding new La. Rev. Stat. § 47:287.82.A.(1).

²³ *Id.* adding new La. Rev. Stat. § 47:287.82.A.(2).

- An addback would not apply to the portion of the related party transactions that the corporation establishes was paid, accrued, or incurred, directly or indirectly, by the related member during the same taxable year to a person that is not a related member.²⁴

House Bill 55 is effective for tax years beginning on or after January 1, 2016.²⁵

Proposed constitutional amendment to repeal the federal income tax deduction for state corporation income tax

House Bill 31²⁶ contains a joint resolution of the House and Senate for a proposal to amend the Constitution of Louisiana to which previously mandated federal income taxes paid should be allowed as a deduction for state income taxes purposes. Under the proposed amendment, the mandate would only apply when computing state *individual* income taxes.²⁷ As such, assuming passage of the amendment, legislation to repeal the federal income tax deduction currently allowed for state corporation income tax purposes would be constitutional. The deduction allowed to individual taxpayers would not be affected. The amendment to the state constitution must be ratified by a majority vote of the Louisiana voters at the statewide election²⁸ which is scheduled to be on November 8, 2016 election ballot.²⁹

House Bill 95,³⁰ which has yet to be signed into law by Governor Edwards as of this Tax Alert's release, includes the statutory amendments necessary to remove the state corporation income tax deduction for federal income taxes previously allowed corporations under the law.³¹ This new law would be effective for all tax years beginning on or after January 1, 2017³² contingent upon passage of the constitutional amendment proposed in House Bill 31.³³

Proposed changes to the state corporation income tax rate

House Bill 29,³⁴ which was signed into law by Governor Edwards on March 9, 2016, would eliminate the graduated state income tax rates currently in effect for corporations and establish a flat state corporation income tax rate of 6.5%.³⁵ House Bill 29 is effective for tax years beginning on or after January 1, 2017³⁶ contingent upon passage of the constitutional amendment provided in House Bill 31.³⁷

Restoration of 100% dividends received deduction from certain banking institutions

House Bill 7,³⁸ which was signed by Governor Edwards on March 4, 2016, permits 100% of amounts received as dividend income from certain banking corporations to be subtracted from a taxpayer's gross income in computing its state corporate income tax liability.³⁹ Currently, the law allows 72% of such dividends to be subtracted. House Bill 7 is effective March 3, 2016, and is applicable on any return filed for any taxable year beginning on or after January 1, 2015.⁴⁰

ASC 740 Treatment

Pursuant to ASC 740, "Income Taxes," companies are required to account for the effect of a change in income tax law in the period that includes the enactment date of that law change. Therefore, the enactment of the bills discussed above could have significant financial statement implications in the reporting period that includes the enactment date.

²⁴ *Id.* adding new La. Rev. Stat. § 47:287.82.A.(3).

²⁵ *Id.* at Sec. 2.

²⁶ HB 31, 2016 Extra Sess. (1st Extra. Sess.) (Mar. 8, 2016). A copy of HB 31 is available [here](#).

²⁷ *Id.* at Sec. 1.

²⁸ La. Const. art. XIII, § 1.(C)

²⁹ HB 31, 2016 Extra Sess. (1st Extra. Sess.) (March 8, 2016) at Sec. 3.

³⁰ HB 95, 2016 Extra Sess. (1st Extra. Sess.). A copy of the enrolled bill is available [here](#).

³¹ *Id.* at Secs. 1 and 2.

³² *Id.* at Sec. 3.

³³ *Id.* at Sec. 4.

³⁴ Act No. 8, 2016 Extra Sess. (1st Extra. Sess.) HB 29 (March 9, 2016). A copy of HB 29 is available [here](#).

³⁵ *Id.* at Sec. 1.

³⁶ *Id.* at Sec. 2.

³⁷ *Id.* at Sec. 3.

³⁸ Act No. 1, 2016 Extra Sess. (1st Extra. Sess.) HB 7 (March 4, 2016). A copy of HB 7 is available [here](#).

³⁹ *Id.* at Sec. 1.

⁴⁰ *Id.* at Secs. 2 and 4.

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