



**In this issue:**

Income/Franchise: Massachusetts: Appeals Court Upholds Disallowance of Intercompany Debt on Cross-Border Hybrid Instrument Despite IRS Determination Allowing Partial Deduction..... 1

Income/Franchise: New York: Department Memo Summarizes Some Recently Enacted Article 9-A Corporation Tax Changes ..... 2

Income/Franchise: South Carolina: Draft Revenue Ruling Explains Use of NOLs Following a Change in Ownership ..... 3

Sales/Use/Indirect: Washington: New Rule Reflects Economic Nexus Standard for B&O Wholesaling Activities..... 3

Severance: Colorado: New Law Creates Reserve for Potential Oil and Gas Company Refunds..... 4

Multistate Tax Alerts ..... 4

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**Income/Franchise:**

**Massachusetts: Appeals Court Upholds Disallowance of Intercompany Debt on Cross-Border Hybrid Instrument Despite IRS Determination Allowing Partial Deduction**

*National Grid Holdings, Inc. v. Commissioner ("National Grid Holdings") and National Grid USA Services Company, Inc., v. Commissioner ("National Grid USA Services"),* Mass. App. Ct. (6/8/16). The Massachusetts Appeals Court recently upheld the decisions of the Appellate Tax Board (Board) in the companion cases of *National Grid Holdings* and *National Grid USA Services*. *National Grid Holdings* concerned deferred subscription arrangements (DSAs) between affiliated entities in the US and UK DSAs generally are a type of financing arrangement, often intended to be debt for US tax purposes and equity for UK tax purposes, which involve the sale and repurchase of an interest in a special purpose entity. The Massachusetts Department of Revenue argued that the DSAs were not *bona fide* indebtedness,

claiming that the repurchase provisions of the DSAs were not mandatory. The Board agreed, holding that the DSAs did not constitute true indebtedness as the notice of repurchasing stock provision was a right which only if exercised, triggered the taxpayer's obligation to repurchase stock. The Board further found that the fact that the advances were reflected as debt on the taxpayer's financial statements did not require that they be treated as debt in calculating the non-income measure of the state corporate excise tax, if the Board found that they were properly treated as equity for purposes of the income measure of the state corporate excise tax.

URL: <http://www.mass.gov/courts/docs/sjc/reporter-of-decisions/new-opinions/14p1662.pdf>

URL: <http://www.mass.gov/courts/docs/sjc/reporter-of-decisions/new-opinions/14p1861.pdf>

The IRS had previously audited the taxpayer for the same tax period and, as part of an audit closing agreement, had allowed a partial deduction of interest paid pursuant to the DSAs. The taxpayer argued that the IRS' determination should be binding for Massachusetts tax purposes. The Massachusetts Appeals Court upheld the Board's finding in *National Grid USA Services* that the IRS closing agreement did not constitute a binding determination of the interest deductions allowable for Massachusetts corporate excise tax purposes. The Massachusetts Appeals Court explained that the relevant Massachusetts statute defines net income as gross income less the deductions "allowable" under the Internal Revenue Code, but does not necessarily tie to the specific amount deducted for federal purposes. The Board found that the issue of whether an advance is debt or equity was subject to analysis under the existing Massachusetts and federal precedent, which had already been undertaken in *National Grid Holdings*.

Note that on April 4, 2016, the US Treasury and the IRS released Proposed Regulations under section 385 to address whether a purported debt instrument that is issued to a related party is treated as stock or debt, or as in part stock and in part debt, for federal income tax purposes.

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## Income/Franchise:

### New York: Department Memo Summarizes Some Recently Enacted Article 9-A Corporation Tax Changes

*TSB-M-16(3)C*, N.Y. Dept. of Tax. & Fin. (6/7/16). The New York State Department of Taxation & Finance has issued a memorandum summarizing certain Article 9-A corporation tax changes that were enacted as part of the 2016-2017 Budget Act, S6409C/A9009C (Budget Act) [see previously issued Multistate Tax Alert for more details on this Budget Act], including:

URL: [https://www.tax.ny.gov/pdf/memos/corporation/m16\\_3c.pdf](https://www.tax.ny.gov/pdf/memos/corporation/m16_3c.pdf)

URL: <http://www2.deloitte.com/us/en/pages/tax/articles/new-york-2016-2017-budget-act-amends-state-tax-law.html?id=us:2em:3na:stm:awa:tax:061716>

- Qualified financial instruments and other exempt income;
- Special additional mortgage recording tax credit; and
- Inclusion of certain leased real property assets impacting the subtraction modification available to certain thrifts and qualified community banks.

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## Income/Franchise: South Carolina: Draft Revenue Ruling Explains Use of NOLs Following a Change in Ownership

*Public Draft: Use of Net Operating Losses Following a Change in Ownership*, S.C. Dept. of Rev. (5/25/16). The South Carolina Department of Revenue (Department) has issued a thirteen-page draft revenue ruling that attempts to provide an overview of state net operating losses (NOLs), the application of Internal Revenue Code (IRC) Section 382 limitations on state NOL carryforwards, and the application of IRC Section 382 limitations and other NOL use limitations on South Carolina consolidated returns. The current draft includes a discussion of federal and state net unrealized built-in gains (NUBIGs) and net unrealized built-in losses (NUBILs), recognized built-in gains and losses (RBIGs and RBILs), application of the federal separate return limitation year (SRLY) rules, as well as a summary flowchart on built-in gains and losses. Comments on this public draft revenue ruling are due to the Department by June 28, 2016.

**URL:** [https://dor.sc.gov/resources-site/lawandpolicy/Advisory%20Opinions/PD-NOL\\_%20Section\\_382\\_limitations\\_RR.pdf](https://dor.sc.gov/resources-site/lawandpolicy/Advisory%20Opinions/PD-NOL_%20Section_382_limitations_RR.pdf)

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## Sales/Use/Indirect: Washington: New Rule Reflects Economic Nexus Standard for B&O Wholesaling Activities

*Amended Rule WAC 458-20-19401*, Wash. Dept. of Rev. (eff. 7/8/16). The Washington Department of Revenue has issued an amended administrative rule pursuant to legislation enacted in 2015 [*Engrossed Sub. S.B. 6138*; see previously issued Multistate Tax Alert for more details on this law change], which subjects state business and occupation (B&O) tax wholesaling activities to an economic nexus standard effective September 1, 2015. Prior to this law change, Washington's economic nexus standard had only applied to businesses with income from apportionable activities that were taxable under the catch-all "Service and Other Activities" and "Royalties" B&O tax classifications, among others. Now, wholesalers that lack physical nexus with Washington but that exceed delineated gross income/receipts thresholds, may be subject to B&O tax on their wholesale sales into Washington.

**URL:** <http://dor.wa.gov/Docs/Rules/draft/20-19401cr3pfrmdraftJune2016.pdf>

**URL:** <http://lawfilesexternal.wa.gov/biennium/2015-16/Pdf/Bills/Senate%20Passed%20Legislature/6138-S.PL.pdf>

**URL:** <http://www2.deloitte.com/us/en/pages/tax/articles/multistate-tax-alert-wa-amends-nexus-standards-rate-preference-me-exemption-and-penalties.html?id=us:2em:3na:stm:awa:tax:061716>

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## Severance:

### Colorado: New Law Creates Reserve for Potential Oil and Gas Company Refunds

*S.B. 218*, signed by gov. 6/10/16. Pursuant to a 2016 Colorado Supreme Court ruling that permitted state severance tax deductions for certain capital costs incurred by oil and gas companies, new law creates a substantial reserve from which resultant potential underlying severance tax refunds must be paid.

**URL:** [http://www.leg.state.co.us/clics/clics2016a/csl.nsf/fsbillcont/2BCD18229451509987257FAB0078B409?Open&file=218\\_enr.pdf](http://www.leg.state.co.us/clics/clics2016a/csl.nsf/fsbillcont/2BCD18229451509987257FAB0078B409?Open&file=218_enr.pdf)

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## Multistate Tax Alerts

What's new in the States? Our Multistate Tax Alerts highlight selected state tax developments relevant to taxpayers, tax professionals, and other interested persons. Read our more recent alerts below or visit the [archive](#) for ones you may have missed.

*No new alerts were issued this period. Be sure to refer to the archives to ensure that you are up to date on the most recent releases.*

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