State Tax Matters
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Income/Franchise:
Indiana: DOR Letter of Findings Holds Auditor Wrongfully Rejected Retailer's Transfer Pricing Study to Support Intercompany Charges

Letter of Findings No. 02-20150171, Indiana Dept. of Rev. (8/31/16). An Indiana Department of Revenue (Department) letter of findings recently held that an Indiana clothing retailer was *not* required to reapportion its gross operating margin between itself and its related purchasing entity to more fairly reflect its Indiana source income for state adjusted gross income tax purposes, because the underlying Department audit failed to provide sufficient grounds for rejecting the retailer's transfer pricing study under which the retailer had decreased its federal adjusted gross income – for Indiana apportionment purposes – by approximately $170 million. In doing so, the Department letter of findings acknowledges that the intercompany relationships between the retailer and its related purchasing entity raised a legitimate question as to whether or not the retailer's original reporting of its Indiana source income was unduly affected by the method by which it reported the income received from selling products to Indiana customers. However, the Department letter of findings explains that Indiana Tax Court case law from 2015 has found that application of the Department's discretionary authority to require an alternate, equitable apportionment of income under Indiana Code § 6-3-2-2(l), (m) is "ambiguous" and that such ambiguities are to be resolved against the Department. As such, the Department letter of findings agreed with the taxpayer in this case that the underlying audit

failed to address with sufficient specificity the perceived shortcomings in the transfer pricing study at issue. In addition, the letter of findings explains that the audit did not establish the "reasonableness" of its decision to reallocate the parties' "gross operating margin."
URL: http://www.in.gov/legislative/iac/20160831-IR-045160352NRA.xml.pdf

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Sales/Use/Indirect:
Michigan: Department of Treasury Discusses Taxation of Digital Products

Treasury Update, Mich. Dept. of Treasury (8/16). The Michigan Department of Treasury (Department) has issued guidance generally explaining that while Michigan law imposes state sales and use tax on the sale or use of certain prewritten computer software products, there is no specific tax imposition on the sale or use of other types of digital products (i.e., products that are accessed or obtained electronically). Consequently, the Department states that its current position is *not* to tax the sale of digital goods such as e-books, podcasts, electronic music, and telephone ringtones – "this is true whether the goods are downloaded, streamed, or accessed through a subscription service."
URL: http://www.michigan.gov/documents/treasury/Tax_Policy_Newsletter_-_August_2016_533394_7.pdf

In doing so, the Department lists some examples of taxable tangible personal property versus non-taxable digital goods:

- Recorded music produced and sold in the form of a vinyl LP, cassette tape, or compact disk is taxable tangible personal property. Recorded music that is sold in an "MP3" or other electronic format and is transferred electronically to the purchaser is considered a digital good and is *not* taxable in Michigan.
- A movie purchased in "DVD" form from a retailer is taxable tangible personal property. A movie that is "streamed" over the Internet by the retailer to the purchaser (i.e., the purchaser watches the movie as it is being "streamed") is a digital good and therefore is *not* taxable in Michigan.
- A book sold in hardcover or paperback form is taxable as a sale of tangible personal property. The sale of the same book in any of the various e-book formats is the sale of a digital good and is *not* taxable in Michigan.

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Multistate Tax Alerts

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California FTB Ruling: Application of "doing business" standard for throwback rule
The California Franchise Tax Board (FTB) recently released Chief Counsel Ruling 2016-03 (Ruling 2016-03) which provides guidance for multistate corporations with sales of both tangible personal property and sales of other than tangible personal property in determining whether they are taxable in another state for purposes of the throwback rule under the California corporate franchise tax and how California's "doing business" standard under California Revenue and Taxation Code (CRTC) section 23101(b)(2) applies in this context. The FTB concluded that:

1. The taxpayer must aggregate its sales of tangible personal property with the royalties that it received in determining whether it met California's "doing business" standard under CRTC section 23101(b)(2).

2. In determining whether the taxpayer is “taxable in another state” under CRTC section 25122, if the taxpayer meets the “doing business” standard under CRTC section 23101(b)(2) and its activities exceed the protections under P.L. 86-272, then the taxpayer would not throw back its sales of tangible personal property in those states to the California sales factor numerator.

This Multistate Tax Alert summarizes Chief Counsel Ruling 2016-03, and provides taxpayer considerations.
[Issued: September 1, 2016]
URL: http://www2.deloitte.com/us/en/pages/tax/articles/california-ftb-ruling-application-of-doing-business-standard-for-throwback-rule.html?id=us:2em:3na:stm:awa:tax:090916