



In this issue:

Income/Franchise: Comments from Valerie Dickerson on State Tax Issues Related to Recently Finalized Treasury Regulations under IRC § 385.....	1
Income/Franchise: Taxpayer Asks US Supreme Court to Review Minnesota Supreme Court Case that Denied Use of MTC Three-Factor Apportionment	2
Income/Franchise: Louisiana: Proposed Regulations Reflect Market-Based Sourcing, Expanded Franchise Tax Imposition, and Intercompany “Addback” Provisions.....	3
Income/Franchise: New Jersey Tax Court Dismisses Summary Judgement in Fair Apportionment Case, But Finds Interest “Addback” Appropriate	3
Income/Franchise: New York Updates Draft Proposed Sourcing Regulations for Receipts from Other Services and Business Activities, and Digital Products	4
Sales/Use/Indirect: New Mexico: Royalties Constitute Taxable Gross Receipts, Including Trademark Fees as Bundled Components	5
Multistate Tax Alerts	5

Income/Franchise: Comments from Valerie Dickerson on State Tax Issues Related to Recently Finalized Treasury Regulations under IRC § 385

In a recent Tax Analysts “State Tax Today” article entitled “Final IRS Debt-Equity Reg Package Still Leaves State Questions,” Valerie Dickerson, managing partner of Deloitte Tax LLP’s Multistate Office of Washington National Tax, commented on some potential state tax issues associated with the new final and temporary IRC section 385 debt-

equity regulations. More specifically, regarding the modified consolidated group rule, which was issued in response to underlying comments received on its potential state tax implications during the proposal process, Valerie noted the following:

- “The final and temporary 385 regulations do not exempt intercompany debt between related parties filing separately for federal income tax purposes, nor do they exempt related parties that file in separate consolidated groups.”
- “Certain states require computation of a hypothetical separate federal taxable income as the starting point for computing state taxable income. There may be a population of states that seek to apply the documentation and prohibited leveraging rules to recast debt to equity for domestic-only debt at the state level.”

As such, companies should consult with their Deloitte tax advisors about the potential implications in specific state and/or local tax jurisdictions. See US Tax Alert, October 14, 2016 for more details on these section 385 regulations; also, stay tuned for a forthcoming Multistate Tax Alert that further discusses related taxpayer considerations from a state income tax perspective.

[URL: http://newsletters.usdbriefs.com/2016/Tax/TNV/161014_1suppB.pdf](http://newsletters.usdbriefs.com/2016/Tax/TNV/161014_1suppB.pdf)

— Valerie Dickerson (Washington, DC)
Managing Partner
Deloitte Tax LLP
vdickerson@deloitte.com

Dave Vistica (Washington, DC)
Managing Director
Deloitte Tax LLP
dvistica@deloitte.com

Alexis Morrison-Howe (Boston)
Senior Manager
Deloitte Tax LLP
alhowe@deloitte.com

Scott Schiefelbein (Portland)
Senior Manager
Deloitte Tax LLP
sschiefelbein@deloitte.com

Income/Franchise:

Taxpayer Asks US Supreme Court to Review Minnesota Supreme Court Case that Denied Use of MTC Three-Factor Apportionment

Kimberly-Clark Corporation & Subsidiaries v. Commissioner of Revenue, US (cert. petition filed 10/20/16). A taxpayer has asked the US Supreme Court to review a 2016 Minnesota Supreme Court decision, which had affirmed the denial of the corporate taxpayer’s election to use the equally weighted, three-factor formula prescribed in the Multistate Tax Compact (Compact). In 1983, Minnesota adopted the Compact which provided for the apportionment of income by an equally weighted, three-factor formula using sales, payroll, and property. In 1987, the Minnesota Legislature repealed only Articles III and IV of the Compact, which includes the provisions for apportionment. Subsequently, in 2013, the Legislature repealed the Compact in its entirety. The taxpayer in this case had contended that the adoption of the Compact in 1983 was a binding contractual agreement and could not be modified unless Minnesota fully withdrew from the Compact. However, following a similar line of reasoning as the Minnesota Tax Court, the Minnesota Supreme Court had upheld the Minnesota Tax Court’s conclusion that the taxpayer’s position was invalid based on the “unmistakability doctrine,” and a provision in the Minnesota Constitution which states that “[t]he power of taxation shall never be surrendered, suspended or contracted away.” In its petition to the US Supreme Court, the taxpayer is now asking whether, under the “unmistakability doctrine,” states are bound by contractual promises embodied in multistate compacts only if the contracting states make a separate and express “second promise” to abide by their initial contractual promise.

[URL: https://www.supremecourt.gov/search.aspx?filename=/docketfiles/16a254.htm](https://www.supremecourt.gov/search.aspx?filename=/docketfiles/16a254.htm)

Please contact us with any related questions.

— Ray Goertz (Minneapolis)
Managing Director
Deloitte Tax LLP
rgoertz@deloitte.com

Tom Cornett (Detroit)
Senior Manager
Deloitte Tax LLP
tcornett@deloitte.com

Income/Franchise:

Louisiana: Proposed Regulations Reflect Market-Based Sourcing, Expanded Franchise Tax Imposition, and Intercompany “Addback” Provisions

LAC 61:1.301, 302, and 311; LAC 61:1.1135; LAC 61:1.1115, La. Dept. of Rev. (10/20/16). The Louisiana Department of Revenue has issued proposed administrative rule amendments pursuant to recently enacted legislation [see previously issued Multistate Tax Alert for more details on this new law] that includes market-based sourcing for services and certain other revenues for Louisiana corporate income tax purposes. Additional proposed administrative rule amendments reflect other recently enacted legislation [see previously issued Multistate Tax Alert for more details on these other law changes] that expands imposition of Louisiana’s franchise tax, and requires an “addback” adjustment for certain related party interest expense, intangible expense, and management fees for Louisiana corporate income tax purposes. Note that the proposed regulation requiring an “addback” for certain related party expenses includes an exception for non-tax business purposes for conducting a transaction that must be supported by contemporaneous documentation; however, “mere statements or assertions that a transaction was intended to allow for better management or greater utilization of intangible assets, or similarly unsubstantiated claims are not sufficient to establish a principal non-tax business purpose.”

URL: <http://revenue.louisiana.gov/LawsPolicies/1610NO1070.pdf>

URL: <http://revenue.louisiana.gov/LawsPolicies/1610NO1068.pdf>

URL: <http://revenue.louisiana.gov/LawsPolicies/1610NO1069.pdf>

URL: <http://www2.deloitte.com/us/en/pages/tax/articles/louisiana-2nd-special-session-legislative-update.html?id=us:2em:3na:stm:awa:tax:102816>

URL: <http://www2.deloitte.com/us/en/pages/tax/articles/multistate-tax-alert-us-tax-new-louisiana-corporate-income-and-franchise-laws-address-budget-issues.html?id=us:2em:3na:stm:awa:tax:102816>

Taxpayers may wish to consider whether these draft proposed regulations could benefit from further clarification, keeping in mind that the deadline for submitting public comment on some of these proposals is November 10, 2016 (note, a few of these proposals list a November 29, 2016 deadline), and that a related public hearing on all the proposals will be held on November 30, 2016. Please contact us with any questions.

— Michael Matthys (Houston)
Manager
Deloitte Tax LLP
mmatthys@deloitte.com

Robert Topp (Houston)
Managing Director
Deloitte Tax LLP
rtopp@deloitte.com

Income/Franchise:

New Jersey Tax Court Dismisses Summary Judgement in Fair Apportionment Case, But Finds Interest “Addback” Appropriate

Canon Financial Services, Inc. v. Director, Division of Taxation, N.J. Tax Ct. (10/13/16). A recent New Jersey Tax Court (Court) unpublished ruling involving New Jersey’s corporation business tax rejects both the Division of Taxation’s (Division) and an in-state headquartered taxpayer’s summary judgment claims of appropriate apportionment in a case dealing with equipment financing – finding that neither party had presented a fair alternative apportionment formula under N.J.S.A. 54:10A-8 for the prior years at issue. That is, the Court rejected the application of both i) a 100% allocation factor, with credit for taxes paid to other jurisdictions, and ii) the standard three-factor apportionment formula, and remanded the case to the Division for further consideration of discretionary relief. Nonetheless, the “addback” of certain intercompany interest was deemed proper as there was no demonstration of an applicable exception.

URL: http://www.judiciary.state.nj.us/taxcourt/tax_unpublished/000404-2014.pdf

Please contact us with any related questions.

— Norm Lobins (Parsippany)
Managing Director
Deloitte Tax LLP
nlobins@deloitte.com

Mike Bryan (Philadelphia)
Managing Director
Deloitte Tax LLP
mibryan@deloitte.com

Income/Franchise:

New York Updates Draft Proposed Sourcing Regulations for Receipts from Other Services and Business Activities, and Digital Products

Draft Proposed New York State Business Corporation Franchise Tax Regulations, Section 4-2.3 (Receipts from the Sale of, License to Use, and Granting of Remote Access to Digital Products); Draft Proposed New York State Business Corporation Franchise Tax Regulations, Section 4-2.15 (Receipts from Other Services and Other Business Activities), N.Y. Dept. of Tax. & Fin. (10/19/16). The New York State Department of Taxation and Finance (Department) has released updated draft proposed regulations for New York State Business Corporation Franchise Tax Regulations Sections 4-2.3 and 4-2.15. These updated draft proposed regulations describe how to source the receipts under the hierarchies described in Tax Law sections 210-A(4) for digital products and 210-A(10) for other services and other business activities and include numerous examples. Note that these updated draft proposed rules replace the previously posted draft versions of the same rules (previously numbered as Section 4-4.9 for Receipts from Sales of Digital Products and as Section 4-4.6 for Receipts from Other Services and Other Business Activities). The draft proposed regulations are intended to clarify and interpret the general rules contained in section 210-A of the New York State Tax Law that are used to determine the business apportionment fraction, pursuant to the Department's broader effort "to amend the Article 9-A Business Corporation Franchise Tax Regulations to incorporate the changes made by the corporate tax reform legislation contained in the 2014-2015 and 2015-2016 enacted New York State Budgets."

URL: https://www.tax.ny.gov/bus/ct/pending/draft_Digital_Products_10-19-16.pdf

URL: https://www.tax.ny.gov/bus/ct/pending/draft_Services_and_Other_Business_Receipts_10-19-16.pdf

Regarding these updated draft proposed regulations, the Department stated that while most changes in the updated draft proposed rules were minor, notable changes to both Sections 4-2.3 (digital products) and 4-2.15 (other services/business activities) include:

- An inquiry safe harbor, which generally allows certain taxpayers (with more than 250 business customers purchasing substantially similar services/digital products that would be sourced similarly under the draft proposed Regulation Sections 4-2.3 or 4-2.15, as the case may be, with no more than 5% of such receipts coming from one customer) to determine the location where the benefit is received (or where a digital product is primarily used) without making reasonable inquiries from business customers, which is otherwise required as part of exercising due diligence; and
- Clarifications of the rules for intermediary transactions.

Updated draft proposed Regulations Sections 4-2.3 (digital products) also include a retail location exception for receipts from digital products and special rules for digital products delivered via physical means.

Taxpayers may wish to consider whether the draft proposed regulations and related examples could benefit from further clarification, keeping in mind that the deadline for submitting public comment on these proposals is January 19, 2017. Please contact us with any questions.

— Abe Teicher (New York)
Partner
Deloitte Tax LLP
ateicher@deloitte.com

Don Roveto (New York)
Partner
Deloitte Tax LLP
droveto@deloitte.com

Ken Jewell (Parsippany)
Managing Director
Deloitte Tax LLP
kjewell@deloitte.com

Dennis O'Toole (New York)
Managing Director
Deloitte Tax LLP
deotoole@deloitte.com

Mary Jo Brady (Jericho)
Senior Manager
Deloitte Tax LLP
mabrady@deloitte.com

Sales/Use/Indirect:

New Mexico: Royalties Constitute Taxable Gross Receipts, Including Trademark Fees as Bundled Components

Ruling No. 16-49, N.M. Admin. Hrgs. Office (10/17/16). In a ruling involving whether continuing royalty fees paid by franchisees to a restaurant franchisor constituted taxable "gross receipts" for the franchisor under New Mexico's gross receipts and compensating tax law, an administrative hearings officer held that the New Mexico Taxation and Revenue Department (Department) correctly determined that such amounts were taxable as receipts from granting the right to use a franchise employed in New Mexico, subject to gross receipts tax under NMSA 1978, Section 7-9-3.5(A)(1)(2007), and that the bundle of rights that is part of a franchise includes the grant of a trademark. The restaurant franchisor had unsuccessfully argued that the continuing royalty fees were consideration for its grant of a limited license to utilize its trademarks, claiming that such fees were therefore exempt from gross receipts tax under the definition of "property" as provided in NMSA 1978, Section 7-9-3(J)(2007). The administrative hearings officer reasoned that under NMSA 1978, Sec. 7-9-5 (2002), all of the restaurant franchisor's receipts in New Mexico are presumed subject to New Mexico's gross receipts tax and that under NMSA 1978, Sec. 7-9-3.5 (2007), the franchisor is obligated to pay gross receipts on the total amount of money or value of other consideration received from granting a right to use a franchise employed in New Mexico, including trademarks associated with the franchise. In doing so, the hearings officer explained that a franchise is to be treated as a compound or bundled form of property, which includes a license to use the franchisor's trademarks, and that the Department is *not* required to "unbundle" a franchise agreement for purposes of assessing New Mexico gross receipt taxes.

URL: http://realfile.tax.newmexico.gov/16-49_a_&_w_restaurants_inc.pdf

— Bryan Hoesly (Phoenix)
Senior Manager
Deloitte Tax LLP
bhoesly@deloitte.com

Stephanie Gilfeather (San Francisco)
Manager
Deloitte Tax LLP
sgilfeather@deloitte.com

Shona Ponda (New York)
Senior Manager
Deloitte Tax LLP
sponda@deloitte.com

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.

California FTB Amends Market Sourcing Regulation for Sales of Intangible Property and Marketable Securities

On September 15, 2016, the California Franchise Tax Board (FTB) filed with the California Secretary of State amendments to California Code of Regulations, Title 18, Section 25136-2 (Regulation 25136-2). The changes to Regulation 25136-2 provide guidance on the manner in which sales of intangible property and marketable securities should be assigned to California for purposes of the California sales factor. Specifically, Regulation 25136-2 provides:

- Definitions for marketable securities in general and for securities and commodities dealers,
- Assignment rules for marketable securities, and
- Assignment rules for interest, dividends, and goodwill.

The changes generally apply to taxable years beginning on or after January 1, 2015. This Multistate Tax Alert summarizes the changes to Regulation 25136-2, and provides taxpayer considerations.

[Issue Date: October 19, 2016]

URL: <http://www2.deloitte.com/us/en/pages/tax/articles/california-ftb-amends-market-sourcing-regulation-for-sales.html?id=us:2em:3na:stm:awa:tax:102816>

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as “Deloitte Global”) does not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2016 Deloitte Development LLC. All rights reserved.
36 USC 220506