



In this issue:

Income/Franchise: Illinois: Amended Rules on Combined Returns, Overpayments, and Nonresident Withholding Issued	1
Income/Franchise: Taxpayers Ask the US Supreme Court to Review Decisions Upholding State Law that Retroactively Rescinds Michigan’s MTC Membership.....	2
Income/Franchise: Montana: Amended Rules on Sourcing Non-TPP Sales and Water’s Edge Elections Issued	2
Income/Franchise: Texas Comptroller Explains Treatment of Vendor Funded Incentives for Franchise “Margin” Tax Purposes.....	3
Sales/Use/Indirect: State High Court Affirms that Distributor’s In-State Activities Subjected National and Drop-Shipped Sales to Washington B&O Tax	3
Multistate Tax Alerts	4

Income/Franchise:
Illinois: Amended Rules on Combined Returns, Overpayments, and Nonresident Withholding Issued

Amended 86 Ill. Adm. Code Secs. 100.5060, 100.5100, 100.5130, 100.5215, 100.7035, 100.8010, and 100.9400, Ill. Dept. of Rev. (eff. 11/2/16). The Illinois Department of Revenue (Department) has issued amended administrative rules that, among numerous other changes, provide guidance on the filing of unitary returns by certain taxpayers who otherwise are not permitted to join with other members of their unitary business group in the filing of a single combined return – including computation examples for 90 percent-or-more-owned partnerships. Additional revisions adopt regulations pursuant to Illinois Public Act 98-925, allowing a taxpayer to elect to apply overpayments of Illinois

income tax reported on any return or amended return against the taxpayer's Illinois income tax obligation for a subsequent taxable year; previously, such election could only be made on a timely-filed original return. Pursuant to Illinois Public Act 98-478, which generally repeals the authority of partnerships and S corporations to file Illinois composite returns, the amended rules also provide guidance for partnerships and S corporations on withholding Illinois income tax from all nonresident partners and shareholders, including computing the required withholding to allow credits earned by the partnerships or S corporations and passed through to the nonresident partners and shareholders to reduce the amount of required withholding.

URL: <ftp://www.ilga.gov/JCAR/AdminCode/086/086001000O50600R.html>

URL: <ftp://www.ilga.gov/JCAR/AdminCode/086/086001000P51000R.html>

URL: <ftp://www.ilga.gov/JCAR/AdminCode/086/086001000P51300R.html>

URL: <ftp://www.ilga.gov/JCAR/AdminCode/086/086001000Q52150R.html>

URL: <ftp://www.ilga.gov/JCAR/AdminCode/086/086001000S70350R.html>

URL: <ftp://www.ilga.gov/JCAR/AdminCode/086/086001000W80100R.html>

URL: <ftp://www.ilga.gov/JCAR/AdminCode/086/086001000BB94000R.html>

— Brian Walsh (Chicago)
Managing Director
Deloitte Tax LLP
briawalsh@deloitte.com

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

Income/Franchise:

Taxpayers Ask the US Supreme Court to Review Decisions Upholding State Law that Retroactively Rescinds Michigan's MTC Membership

On November 16, 2016, multiple taxpayers filed petitions with the US Supreme Court to review the Michigan Court of Appeals' holding that the enactment of Michigan Public Act 282 of 2014 (PA 282), which retroactively rescinds Michigan's membership in the Multistate Tax Compact (Compact) effective January 1, 2008, was consistent with both the Contract and the Due Process Clauses of the US Constitution. In doing so, some taxpayers query whether the Compact has the status of a contract that binds its signatory states, and whether a state law that imposes retroactive tax liability for a period of almost seven years "in a manner that upsets settled expectations and reasonable reliance interests" violates the Due Process Clause. Another filed petition asks the US Supreme Court whether a state, without violating the constitutional bar against the impairment of contracts, can retroactively withdraw from the Compact so as to divest taxpayers of benefits under that Compact for a period of 6½ years before that withdrawal; and whether consistent with Due Process, if a state can by statute change its tax laws retroactively for a period of more than six years, where the change was not promptly instituted and where the change was designed to increase state tax revenues by overriding a Michigan Supreme Court decision determining taxpayer obligations under prior law.

See previously issued Multistate Tax Alert for more details on the Michigan Court of Appeals' September 2015 ruling upholding the retroactive application of PA 282. Note that the Michigan Supreme Court denied a subsequent petition to review this case.

URL: <https://www2.deloitte.com/us/en/pages/tax/articles/multistate-tax-alert-michigan-court-upholds-law-retroactively-rescinding-michigan-mtc-membership.html?id=us:2em:3na:stm:awa:tax:120216>

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

Chuck Wright (Detroit)
Senior Manager
Deloitte Tax LLP
charleswright@deloitte.com

Income/Franchise:

Montana: Amended Rules on Sourcing Non-TPP Sales and Water's Edge Elections Issued

MAR Notice No. 42-2-960: ARM 42.23.108, 42.23.109, 42.23.112, 42.23.113, 42.23.116, 42.23.212, 42.23.303, 42.23.312, 42.23.313, 42.23.403, 42.23.421, 42.23.424, 42.23.601, 42.23.702, 42.23.802, 42.23.803, 42.23.804,

42.23.805, 42.26.101, 42.26.202, 42.26.301, 42.26.302, 42.26.311, 42.26.313, and 42.26.505 and the repeal of ARM 42.23.117, Mont. Dept. of Rev. (11/14/16). The Montana Department of Revenue (Department) has issued amended rules that, among numerous other changes, revise definitions of the terms “costs of performance” and “income producing activity” with the intent of providing additional guidance for corporate taxpayers that are reporting sales other than sales of tangible personal property in their sales apportionment factor, including such definitions as adopted by the Multistate Tax Commission. Other rule changes provide additional detail highlighting the Department’s “longstanding practice” concerning the disallowance of “retroactive” water’s-edge elections, as well as the procedures necessary for making a valid water’s-edge election in certain situations concerning the acquisition of a non-water’s-edge taxpayer by an entity not subject to tax in Montana, and the acquisition of a foreign entity by a Montana taxpayer that has not previously owned foreign entities.

[URL: http://revenue.mt.gov/Portals/9/rules/adoption_notices/42-2-960adp-arm.pdf](http://revenue.mt.gov/Portals/9/rules/adoption_notices/42-2-960adp-arm.pdf)

— Greg McClure (Denver)
Managing Director
Deloitte Tax LLP
gmclclure@deloitte.com

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

Income/Franchise: Texas Comptroller Explains Treatment of Vendor Funded Incentives for Franchise “Margin” Tax Purposes

Tax Policy News, Tex. Cmptlr. (11/16). The Texas Comptroller (Comptroller) explains that while Texas statutes and administrative rules do not specifically address the state franchise tax treatment of various vendor-provided allowances, credits and rebates to retailers via different programs and arrangements to support merchandise purchased for resale (i.e., vendor-funded incentives (VFIs)), the computation of cost of goods sold (COGS) under Texas Tax Code Sec. 171.1012 excludes from COGS selling costs and advertising costs. Accordingly, the Comptroller explains that it has determined that contra-expense accounts for VFIs related to certain advertising or selling activities are likewise excluded from the COGS calculation. However, volume and sales-based VFIs (if not reported as revenue) must be included in the COGS calculation as a contra-expense pursuant to a recent Comptroller letter ruling (201608950L), which lists the following such VFIs as examples:

[URL: https://www.comptroller.texas.gov/taxes/tax-policy-news/2016-november.php](https://www.comptroller.texas.gov/taxes/tax-policy-news/2016-november.php)

[URL: https://star.cpa.texas.gov/view/201608950L?hide_banner=true](https://star.cpa.texas.gov/view/201608950L?hide_banner=true)

- Coupon Program-Face Value;
- Depletion Allowance/Volume Incentives;
- Mark Down Funding;
- New Item Allowances;
- Sales Based Incentives; and
- Temporary Price Reductions.

Please contact us with any questions.

— Russell Brown (Dallas)
Partner
Deloitte Tax LLP
rubrown@deloitte.com

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

Sales/Use/Indirect: State High Court Affirms that Distributor’s In-State Activities Subjected National and Drop-Shipped Sales to Washington B&O Tax

Avnet Inc. v. State of Washington, Wash. (11/23/16). The Washington Supreme Court has affirmed a Washington Court of Appeals holding that an out-of-state distributor of electronic components, computer products and embedded technology was subject to state business and occupation (B&O) tax on two categories of sales of goods (i.e., “drop-

shipped sales” and “national sales”) delivered to Washington addresses from distribution centers located outside Washington – agreeing that B&O statutes and regulations subject both categories of these Washington-bound sales to the B&O tax consistently with the Commerce Clause. The Court found that the distributor’s in-state activities could not be “dissociated” from its drop-shipped and national sales under a former version of Wash. Admin. Code Sec. 458-20-193 (Rule 193). In prior versions of Rule 193, taxpayers that had significant in-state activity and conducted no other business in Washington other than the business of making sales had the burden of establishing that their in-state activities were not significantly associated in any way with their sales into Washington. That is, if certain sales could be dissociated from the taxpayer’s in-state activity, they could be excluded from B&O taxation. In this case, the Court explained that the distributor’s in-state office “with over 40 employees consisting of account managers, sales and marketing representatives, engineers, and technology consultants” was significantly associated with establishing and holding the market for its products in Washington.

URL: <https://www.courts.wa.gov/opinions/pdf/920800.pdf>

Under the facts, the “national sales” category involved transactions where the distributor’s customer placed an order from a location outside Washington via a sales office of the distributor located outside Washington, but directed the distributor to ship some or all of the products to one of the customer’s Washington facilities. The “drop-shipped sales” category also involved the distributor’s customer located outside Washington placing an order via a sales office of the distributor located outside Washington, but where the customer directed the distributor to ship products to a third party located in Washington (generally the customer’s own customer). Note that the Court did not address the Washington Department of Revenue’s recent removal of the dissociation concept from the current version of Rule 193.

— Andy Colson (Seattle)
Managing Director
Deloitte Tax LLP
acolson@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.

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.

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.