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## Income/Franchise:
## California FTB Discusses Possible Amendments to Rule on Sales Factor "Market-Based" Sourcing of Non-TPP Sales

*Discussion Paper*, Cal. FTB (1/4/17). On January 20, 2017, the California Franchise Tax Board (FTB) will hold an Interested Parties Meeting (IPM) to solicit public input regarding possible additional amendments to California Code of Regulations, title 18, section 25136-2, which governs market-based sourcing for receipts derived from sales of other than tangible personal property. This regulation was previously amended in September 2016 to include rules for the sourcing of receipts from marketable securities, interest, dividends, and goodwill [see previously issued Multistate Tax Alert for more details on these 2016 changes]; although the draft amendments originally included examples

illustrating how receipts from asset management services should be assigned to California, the examples were excluded from the final version adopted in September 2016.
**URL:** https://www.ftb.ca.gov/law/regs/25136-2/01202017-Discussion-Paper.pdf
**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:011317

The FTB has now issued a discussion paper on the issues that will be discussed at this next IPM. Notably, the FTB brought back the asset management examples and is considering amendments to clarify the definitions of "reasonable approximation" and "benefit of the service" with a focus on industries with government contracts, research and development contracts, and sales of intangible property. Other potential amendments cover freight forwarders, dividends, interest, and marketing intangibles, as well as various clean-up items that need to be made to the September 2016 version of the regulation.

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## Income/Franchise:
## Florida: Amended Rules Reflect Various 2016 Tax Legislative Enactments

*Amended Rules 12C-1.013, 12C-1.0222, and 12C-1.034*, Fla. Dept. of Rev. (eff. 1/10/17). Recently amended administrative rules reflect legislation enacted in 2016 that updated Florida's federal tax conformity date to the Internal Revenue Code as in effect on January 1, 2016, decoupled from federal bonus depreciation for property placed in service after December 31, 2014 and before January 1, 2021, and changed the due dates for corporate income tax returns, partnership information returns and estimated payments [see previously issued Multistate Tax Alert for more details on these 2016 legislative changes].
**URL:** https://www.flrules.org/Gateway/View_notice.asp?id=18421481
**URL:** https://www.flrules.org/Gateway/View_notice.asp?id=18421578
**URL:** https://www.flrules.org/Gateway/View_notice.asp?id=18421675
**URL:** http://www2.deloitte.com/us/en/pages/tax/articles/florida-legislative-update.html?id=us:2em:3na:stm:awa:tax:011317

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## Income/Franchise:
## A Closer Look at New York's Draft Proposed Regulations under Article 9-A Business Corporation Franchise Tax

*Draft Proposed New York Business Corporation Franchise Tax Regulations, Subparts 4-1, 4-2 and 4-3*, N.Y. Dept. of Tax. & Fin. (9/30/16). On September 30, 2016, the New York Department of Taxation and Finance (Department) released a draft document repealing New York Business Corporation Franchise Tax Regulations Subparts 4-1, 4-2, 4-3, 4-4, 4-5, 4-7, 4-8, 4-9 and 4-10, and proposing draft regulations for New York Business Corporation Franchise Tax Regulations Subparts 4-1, 4-2 and 4-3. These draft proposed regulations are intended to clarify and interpret the general rules contained in section 210-A of the New York 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." Below, the proposed rules for apportioning receipts from qualified financial instruments, marked to market net gains, and receipts, net gains and other income from other financial instruments are reviewed.
**URL:** https://www.tax.ny.gov/bus/ct/pending/draft_apportionment_regs_9-30-16.pdf

### Draft proposed regulation for Subparts 4-2.4: Receipts from Qualified Financial Instruments

Draft Proposed Reg. Sec. 4-2.4 outlines when receipts, net income, and net gains from qualified financial instruments (QFIs) are included in the taxpayer's New York receipts. A QFI generally is any financial instrument that is marked to market under Internal Revenue Code (IRC) Secs. 1256 or 475, and is described in one of the clauses of N.Y. Tax Law Sec. 210-A.5(a)(2), which is comprised of: loans; federal, state, and municipal debt; asset backed securities and other agency debt; corporate bonds; stock; partnership interests; other financial instruments; and physical commodities. Generally, if one of any type of these financial instruments is marked to market, all of that type will be deemed QFIs in the taxable year. Although their sourcing is determined in the same statutory clause (N.Y. Tax Law Sec. 210-A.5(a)(2)(G)), under the draft proposed regulations, QFI status would be determined separately for stocks and partnership interests. Similarly, under the draft proposed regulations, other financial instruments sourced under N.Y. Tax Law Sec. 210-A.5(a)(2)(H) generally would be evaluated separately by type of instrument in determining whether such instruments are QFIs.

QFIs do not include loans secured by real property; loans not secured by real property if the only loans the taxpayer has marked to market are loans secured by real property; stock that is investment capital; stock that generates other exempt income that is not market to market with respect to that other exempt income; and, under the draft proposed regulations, partnership interests that fail to meet the IRC Sec. 475(c) definition of security. With regard to a combined group, the QFI determination generally is made as if all corporations included in the combined group are a single corporation.

Taxpayers generally will source their receipts to New York under the market-sourcing rules outlined in N.Y. Tax Law Sec. 210-A.5(a)(2) unless they elect to follow the fixed percentage method of sourcing. If a taxpayer elects the fixed percentage method, then all income, gain or loss, including marked to market net gains, from QFIs constitutes business income, gain or loss. Under the fixed percentage method, 8% of all net income (not less than zero) from QFIs is considered New York source and is included in the numerator of the apportionment fraction. This election must be made "annually on an original, timely filed report, determined with regard to extensions for time for filing." The election cannot be revoked and is binding for the taxable year in which it is made. Under the draft proposed regulations, a combined group electing the fixed percentage method for sourcing must do so through its designated agent.

### Draft proposed regulation for Subparts 4-2.8: Marked to Market Net Gains

Draft Proposed Reg. Sec. 4-2.8 outlines the treatment of marked to market net gains. As noted above in reference to QFIs, if a taxpayer has made the fixed percentage method election, 8% of marked to market gains will be included in the taxpayer's New York receipts. Draft Proposed Reg. Sec. 4-2.8 applies to marked to market net gains for QFIs of a taxpayer that has not made the fixed percentage method election, and all financial instruments that are not QFIs (whether or not the taxpayer has made the QFI election). These marked to market receipts are sourced as follows under the proposal:

1. Marked to market net gains from stocks and partnership interests are excluded from both New York and everywhere receipts, unless otherwise required by the Commissioner in N.Y. Tax Law Sec. 210-A.5(a)(2)(G).
2. Marked to market net gains from each type of financial instrument included in New York receipts is determined by applying a fraction to the marked to market net gains from each type of financial instrument, the numerator of which is net gains from actual sales of that type of financial instrument included in New York receipts under the applicable clause of N.Y. Tax Law Sec. 210-A.5(a)(2), and the denominator of which is net gains from actual sales included in everywhere receipts for that type of financial instrument under the applicable clause of N.Y. Tax Law Sec. 210-A.5(a)(2).
3. If the taxpayer has no actual sales for a type of financial instrument that is marked to market or if the taxpayer has an overall net loss from the actual sale of that type of financial instrument, the amount of marked to market net gains (not less than zero) from that type of financial instrument included in New York receipts is determined by multiplying the marked to market net gains (but not less than zero) from that type of financial instrument by a fraction, the numerator of which is the sum of the amount of receipts included New York receipts under 210-A.5(a)(2)(A) – (I) and (J)(ii), and the denominator of which is everywhere receipts for these same categories.

**Draft proposed regulation for Subparts 4-2.9: Receipts, Net Gains and Other Income from Other Financial Instruments**

Draft Proposed Reg. Section 4-2.9(a) provides that "receipts, net gains (not less than zero), and other income (not less than zero) from other financial instruments includes receipts, net gains, and other income from financial instruments not described in N.Y. Tax Law Section 210-A.5(a)(2)(A) – (G), (I) and (J) and applicable regulations."

Draft Proposed Reg. Section 4-2.9(b) sets ground rules for determining whether the payor or purchaser with regard to the other financial instrument is located in New York. A government entity, as payor or purchaser, is located in New York if its main office is in New York; an individual, as payor or purchaser, is located in New York if its billing address is in New York; and a business entity, as payor or purchaser, is located in New York if its commercial domicile is in New York.

Draft Proposed Reg. Section 4-2.9(c) states that interest income from other financial instruments includes interest income derived from (1) deposit accounts, (2) money market mutual funds, (3) debt issued by a country, or political subdivision thereof, other than the US, and (4) funds deposited with the Federal Reserve (other than interest from federal funds sourced under New York Tax Law Section 210-A.5(a)(2)(F)). A taxpayer would include such interest income in its receipts factor if the payor is located in New York, and 100 percent of the interest income would be included in its everywhere receipts.

Draft Proposed Reg. Section 4-2.9(c) provides the following example: Taxpayer B receives $1,500 of income from Money Market Fund M. The commercial domicile of Money Market Fund M is State X. No interest income is included in New York receipts because the commercial domicile of Money Market Fund M is in State X. All $1,500 of income is included in everywhere receipts.

Under N.Y. Tax Law Section 210-A.5(a)(2)(H)(ii), net gains (not less than zero) from sales of other financial instruments and other income (not less than zero) from other financial instruments where the purchaser or payor is located in New York are sourced to New York, provided that, if the purchaser or payor is a registered securities broker or dealer or the transaction is made through a licensed exchange, then 8% of the net gains (not less than zero) or other income (not less than zero) is included in the numerator of the apportionment fraction. Under Draft Proposed Reg. Section 4-2.9(d)(1), for purposes of computing net gains (not less than zero) from other financial instruments, the gains from the sales of a particular type of other financial instrument would be reduced by the losses from that same type of financial instrument. Similarly, a taxpayer would compute its other income (not less than zero) from other financial instruments by each instrument type.

For taxpayers filing a combined report, Draft Proposed Reg. Section 4-2.9(d)(2) provides that "the gains from the sales of a particular type of other financial instrument for all members of the combined group is reduced by the losses from sales of that same type of other financial instrument for all members of the combined group." Similarly, other income (not less than zero) from other financial instruments would be computed for each type of instrument for all members of the combined reporting group.

Please contact us with any questions.

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## Income/Franchise:
## Tennessee DOR Explains How Telecoms Should Source Receipts from Non-TPP

*FAQs: Franchise and Excise Tax*, Tenn. Dept. of Rev. (1/5/17). The Tennessee Department of Revenue (Department) has issued an explanation on how certain taxpayers in the telecommunications industry should source their receipts from "other-than-tangible-property sales" to Tennessee for state franchise and excise tax purposes. More specifically, the Department explains that for tax years beginning July 1, 2016, taxpayers that:
**URL:** https://revenue.support.tn.gov/hc/en-us/articles/115000215543-For-purposes-of-the-franchise-and-excise-tax-how-should-taxpayers-in-the-telecom-industry-source-their-receipts-from-other-than-tangible-personal-property-sales-

- Primarily sell telecommunications, mobile telecommunications, internet access, video programming, or direct-to-home satellite television programming services, and
- Are members of an affiliated group of taxpayers that has incurred more than $150 million in aggregate qualified expenditures or has made sales in excess of $15 million that are subject to Tennessee sales and use tax,

should source their receipts from other-than-tangible-property sales to Tennessee by averaging the amounts calculated from two sourcing methods: i) cost of performance based on the earnings producing activity, and ii) market-based sourcing. According to the Department, such taxpayers should report their calculated Tennessee and everywhere receipts for both tangible and other-than-tangible sales on "Schedule N-Apportionment," as well as maintain detailed records to support their calculations.

Note that legislation enacted in 2015 [*H.B. 644*; see previously issued Multistate Tax Alert for more details on this 2015 law] included the adoption of market-based sourcing for sales other than the sale of tangible personal property for state franchise and excise tax purposes for certain taxpayers.
**URL:** http://www.capitol.tn.gov/Bills/109/Bill/HB0644.pdf
**URL:** http://www2.deloitte.com/us/en/pages/tax/articles/multistate-tax-alert-tennessee-enacts-broad-changes-to-state-tax-code.html?id=us:2em:3na:stm:awa:tax:011317

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## Income / Franchise:
## Texas: Appellate Court Issues Updated Opinion On Movie Theater Company's Right to Deduct Certain COGS

A Texas Court of Appeals (Court) recently withdrew its earlier 2015 opinion and judgment in a case involving whether the taxpayer was entitled to include certain facility-related exhibition costs as direct costs of producing its product (i.e., film exhibition) for purposes of calculating the Texas franchise tax cost of goods sold (COGS) subtraction [see previously issued Multistate Tax Alert for more details on this earlier 2015 opinion], and instead has substituted a new opinion for the case. Although the new opinion continues to find in favor of the taxpayer, the Court has now limited the basis of its finding to the narrower definition of tangible personal property found under Texas Tax Code § 171.1012(a)(3)(A)(ii).
**URL:** https://www2.deloitte.com/us/en/pages/tax/articles/multistate-tax-alert-texas-court-holds-movie-auditorium-costs-included-in-cogs-subtraction.html?id=us:2em:3na:stm:awa:tax:011317

Stay tuned for a forthcoming Multistate Tax Alert that will summarize the case history and the Court's grounds for its new opinion, as well as offer some taxpayer considerations.


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## Credits / Incentives:
## Massachusetts Life Sciences Center Announces Opening of Life Sciences Tax Incentive Program

*Press Release: Massachusetts Life Sciences Center Announces Opening of Life Sciences Tax Incentive Program*, Mass. Life Sciences Ctr. (1/5/17). The Massachusetts Life Sciences Center (MLSC) – a quasi-public state agency tasked with implementing the Massachusetts Life Sciences Act, a $1 billion initiative that was signed into law in June 2008 – recently announced that applications are now being accepted for a new round of the MLSC's tax incentive program. This program offers tax incentives, some of which are refundable credits, to encourage the growth of qualifying companies engaged in life sciences research and development (R&D), commercialization and manufacturing in Massachusetts. The MLSC states that it is actively encouraging applications from companies located outside of Greater Boston, including participation by "first-time applicants, minority and women-run businesses, and companies engaged in manufacturing." The MLSC further explains that this tax incentive program addresses the significant capital associated with the life sciences R&D cycle and the high costs of translating research into commercially viable products, noting that there are ten different incentives available through the program. To qualify, companies must receive certification from the MLSC and demonstrate both the scientific and economic merit of their expansion plans. The primary goal of the program is to incentivize life sciences companies of all sizes to create new long-term jobs in Massachusetts. A successful applicant will need to commit to the creation of, at minimum, ten incremental jobs in Massachusetts during 2017, and further commit to the retention of such jobs for the ensuing four years.
**URL:** http://www.masslifesciences.com/wp-content/uploads/Tax-Incentive-Program-Launch-Release-Final-1.5.17.pdf

All applications are due by February 16, 2017. Please contact us with any questions.


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## Multistate Tax Alerts

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*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.*