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Administrative:
Idaho: New Law Provides for Independent Administrative Appeals Process

H.B. 24, signed by gov. 2/16/17. Effective immediately and applicable to protests received on and after July 1, 2017, new law clarifies that when a taxpayer requests a redetermination of an issued notice of deficiency (i.e., a protest), the redetermination must be performed by staff independent from the Idaho originating division's determination before the Idaho State Tax Commission (Commission). The new law also provides that the Commission's staff assigned to the administrative redetermination "may not engage in communications relating to the taxpayer's protest with employees of the originating division without first providing the taxpayer the opportunity to participate, except for questions that involve ministerial, administrative or procedural matters that do not address the substance of the issues or positions taken in the case." Additionally, the new law requires the Commission to promulgate administrative rules governing communications with the originating division to "ensure an independent review process."
URL: https://legislature.idaho.gov/wp-content/uploads/sessioninfo/2017/legislation/H0024.pdf

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Income/Franchise:
US Supreme Court Denies Review of Decision Affirming that Subsidiary Qualifying as "Financial Institution" Must Attribute its Securitized Student Loan Portfolio Entirely to Massachusetts for Property Factor Purposes

First Marblehead Corp. v. Comm'r of Revenue, US (cert. denied 2/21/16). The US Supreme Court has denied the taxpayer's request to review the Massachusetts Supreme Judicial Court's 2016 decision which affirmed – on remand from the US Supreme Court "for further consideration in light of" the US Supreme Court's 2015 decision in *Comptroller of the Treasury of Maryland v. Wynne* [see previously issued Multistate Tax Alert for more details on the *Wynne* case] – that a subsidiary qualifying as a "financial institution" subject to the state financial institution excise tax (FIET), rather than a "foreign corporation" that must be included on its parent company's combined Massachusetts corporate excise tax return, was required to determine the situs of its property factor using only its own activities and was *not* permitted to include the activities of third parties that performed activities on the subsidiary's behalf. As a result, the subsidiary was required to attribute its securitized student loan portfolio entirely to Massachusetts for purposes of computing its FIET property factor. In doing so, the Massachusetts Supreme Judicial Court held that the FIET taxation scheme, as applied to the subsidiary at issue, did *not* violate the internal consistency test discussed and affirmed in *Wynne*, and that the FIET taxation scheme as applied to the subsidiary satisfied the internal consistency test and therefore did not contravene the dormant Commerce Clause.
URL: https://www.supremecourt.gov/search.aspx?filename=/docketfiles/16-777.htm
URL: https://www2.deloitte.com/us/en/pages/tax/articles/multistate-tax-alert-supreme-court-rules-maryland-individual-income-tax-scheme-unconstitutional.html?id=us:2em:3na:stm:awa:tax:022417

In its filed petition for review, the taxpayer had asked the US Supreme Court whether:

1. An apportionment factor reflects a reasonable sense of how income is generated when it disregards the activities and entities that actually generate the income and instead arbitrarily assigns the income to the commercial domicile of an owner of the income-producing entities; and
2. The Massachusetts Supreme Judicial Court properly followed US Supreme Court precedent when it based its conclusion that an apportionment formula was internally consistent on an assumption that other states would apply an apportionment formula different from the formula in the statute it upheld.

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Income/Franchise:
Idaho: New Law Updates State Conformity to Internal Revenue Code

H.B. 26, signed by gov. 2/13/17. Effective immediately and applicable retroactively to tax years beginning on and after January 1, 2017, new law generally updates select corporate and personal income tax statutory references in Idaho to conform to federal Internal Revenue Code (IRC) provisions as in effect on January 1, 2017 (previously, January 1, 2016). Note that while Idaho conforms with the IRC section 179 expense provisions, Idaho does *not* conform to federal bonus depreciation.
URL: https://legislature.idaho.gov/wp-content/uploads/sessioninfo/2017/legislation/H0026.pdf

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Income/Franchise:
Massachusetts DOR Issues Technical Information Release on Corporation Excise Tax Treatment of Offshore Investment Companies

Technical Information Release, TIR 17-2: Massachusetts Corporation Excise Treatment of Offshore Investment Companies, Mass. Dept. of Rev. (2/16/17). The Massachusetts Department of Revenue (Department) has issued a technical information release that explains application of the Massachusetts corporation excise tax to offshore investment companies described in IRC Sec. 864(b)(2)(A)(ii) that conduct certain activities in Massachusetts – including “safe harbor” rules under which certain offshore investment companies will *not* be subject to the Massachusetts corporation excise tax. The new release also describes potential security corporation treatment for offshore investment companies that are subject to the corporation excise tax.
URL: http://www.mass.gov/dor/businesses/help-and-resources/legal-library/tirs/tirs-by-years/2017-releases/tir-17-2.html

The new release explains that if an offshore investment company conducts activities in Massachusetts, it may be considered to be doing business in Massachusetts and therefore subject to the Massachusetts corporation excise tax. Additionally, an offshore investment company that pursuant to IRC Sec. 864(b)(2)(A)(ii) is not engaged in the conduct of a US trade or business would not have effectively connected income (ECI) that would be subject to federal income tax. Therefore, if such an offshore investment company also had no non-ECI from US sources, it would have no federal gross income and thus would not be subject to the net income measure of the state corporation excise tax. However, the release explains that such an offshore investment company, if it is doing business in Massachusetts, would be subject to state tax on its net worth or tangible property or be subject to the minimum state excise tax.

Regarding listed “safe harbors” (i.e., activities that will not by themselves constitute doing business in Massachusetts for corporation excise purposes when conducted by an offshore investment company), the Department additionally explains that it has now determined that, given the character and extent of activities of offshore investment companies described in IRC Sec. 864(b)(2)(A)(ii), the holding of shareholders meetings or boards of directors meetings of such an offshore investment company in Massachusetts will not by itself result in the offshore investment company being treated as doing business for corporation excise tax purposes. This determination also extends to the holding of boards of directors meetings by non-US companies that serve as management companies for such offshore investment companies described in IRC Sec. 864(b)(2)(A)(ii), “provided such meetings are exclusively related to the management of such offshore investment companies.”

The release also explains that if an offshore investment company described in IRC Sec. 864(b)(2)(A)(ii) is doing business in Massachusetts and subject to the Massachusetts corporation excise tax, it may apply for “security corporation" classification if it is engaged exclusively in buying, selling, dealing in, or holding securities on its own behalf and not as a broker. A security corporation generally is subject to the higher of an excise on its gross income (based on federal gross income subject to certain modifications), or a minimum excise of $456. If such an offshore investment company, in addition to having no ECI (pursuant to I.R.C. § 864(b)(2)(A)(ii)), also has no US-source non-ECI, it would have no federal gross income. Thus, it would be subject only to the minimum excise imposed under G.L. c. 63, § 38B.

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Income/Franchise:
Montana: New Law Revises Partnership Return Due Dates to Conform with Federal Revisions

H.B. 42, signed by gov. 2/13/17. Effective immediately and applicable retroactively to tax years beginning after December 31, 2016, new law revises the due dates for filing Montana partnership information returns to accommodate the new federal due dates. Accordingly, under this new law, Montana partnership information returns are now generally due on or before the 15th day of the *third* month (previously, the *fourth* month) following the close of a partnership's annual accounting period.
URL: http://leg.mt.gov/bills/2017/sesslaws/ch0006.pdf

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Income/Franchise:
New York: Updated Draft Article 9-A Business Corporation Franchise Tax "Subject to Tax" Regulations Issued

Draft Amended New York State Business Corporation Franchise Tax Regulations Section 1-3.2(a)(4); Section 1-3.2(a)(6) and (7); Section 1-3.2(b)(4), N.Y. Dept. of Tax. & Fin. (2/10/17). The New York State Department of Taxation and Finance (Department) has released revised draft amendments to the New York State Business Corporation Franchise Tax Regulations concerning the activities that will subject a foreign corporation or members of a unitary group to Article 9-A taxation. The updated draft proposed regulations provide for an exception that corporate general partners are subject to tax under Article 9-A (i.e., when the underlying partnership is doing business, employing capital, owning or leasing property, maintaining an office, or deriving receipts from activity in New York State) if such partners are "already subject to tax under Article 9 or 33." Generally, these draft proposed regulations reflect that for tax years beginning on or after January 1, 2015, the activities that subject a foreign corporation or members of a unitary group to tax under Article 9-A have been expanded to include issuing credit cards in New York State and deriving receipts from activity in New York State when certain designated thresholds are met.
URL: https://www.tax.ny.gov/bus/ct/pending/nexus_draft_text_2-10-17.pdf

Note that these draft regulatory amendments have been posted for public comment *prior to* the State Administrative Procedure process to formally propose and adopt these regulations. Accordingly, these draft regulatory amendments "are not final and should not be relied upon." The Department is asking for public comments on these draft regulatory amendments to be provided by May 11, 2017.

The Department also generally notes that it ultimately intends to amend the Article 9-A Business Corporation Franchise Tax Regulations to incorporate the many changes made by the corporate tax reform legislation contained in the 2014-2015 and 2015-2016 enacted New York State Budgets.

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Income/Franchise:
A Closer Look at New York's Draft Proposed Regulations under Article 9-A Business Corporation Franchise Tax – Specific to Apportionment of Receipts from Loans and Net Income from Commodities

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. Below, the draft proposed regulations Sec. 4-2.5 (Receipts from Loans) and Sec. 4-2.7 (Net Income from Commodities) are reviewed.

Receipts from Loans

The sourcing of receipts from loans generally is addressed in New York Tax Law Sec. 210-A.5(a)(2)(A). Both the statute and Draft Proposed Regulation Sec. 4-2.5 provide separate rules for sourcing receipts from loans secured by real property and receipts from loans not secured by real property.

For the purpose completeness, before reviewing the regulations, it should be noted that the sourcing of net gains from the sale of loans is only addressed in the statute. In New York Tax Law Sec. 210-A.5(a)(2)(A)(v)(iii), net gains from the sale of loans secured by real property are sourced to New York by multiplying the gains by a fraction, whereby the numerator is comprised of gross proceeds from loans secured by real property in New York State and the denominator is comprised of gross proceeds from all loans secured by real property. In New York Tax Law Sec. 210-A.5(a)(2)(A)(v)(iv), net gains from the sale of loans not secured by real property are sourced to New York by multiplying the gains by a fraction, whereby the numerator is comprised of gross proceeds from loans not secured by real property in New York State and the denominator is comprised of gross proceeds from all loans secured by real property. For both types of loans, gross proceeds are "determined after the deduction of any cost incurred to acquire the loans but shall not be less than zero." New York Tax Law Sec. 210-A.5(a)(2)(A)(v)(iii) & (iv).

A loan generally is secured by real property if fifty percent or more of the value of the collateral used to secure the loan, when valued at fair market value (FMV) as of the time the loan was entered into, consists of real property. New York Tax Law Sec. 210-A.5(a)(2)(A)(v). Draft Proposed Regulation Sec. 4-2.5 would clarify the converse, that a loan is not secured by real property where real property constitutes less than fifty percent of the collateral used to secure the loan, when valued at FMV as of the time the loan is originated.

A taxpayer generally must source interest income from loans secured by real property to the location of the collateral being used to secure the loan. New York Tax Law Sec. 210-A.5(a)(2)(A)(i). Under Draft Proposed Regulation Sec. 4-2.5(a)(2), if the loan is secured by properties located in New York and another state, taxpayers would apportion interest income to New York by multiplying such interest income by a fraction where the numerator is the FMV of real property used to secure the loan in New York State and the denominator is the FMV of all real property used to secure the loan.

A taxpayer generally must source interest income from loans not secured by real property to the borrower's location as of the time the loan is originated. New York Tax Law Sec. 210-A.5(a)(2)(A)(ii). Draft Proposed Regulation Sec. 4-2.5(b)(3) would provide that:

- For individual borrowers, this location is based on the borrower's mailing address in the records of the lender.
- For borrowers that are business entities, this location is based on the borrower's commercial domicile.

All determinations that need to be made to properly classify a loan for sourcing purposes would be made at the time of origination and would be redetermined only at the time of refinancing. As such, when determining the type of loan (i.e. whether such loan is secured by real property or not secured by real property), the FMV of real property, or the location of borrower, taxpayers would look at the facts at the time the loan was originated and would re-evaluate those determinations only if the loan was refinanced. Draft Proposed Regulation Sec. 4-2.5(c).

Net Income from Commodities

New York Tax Law Sec. 210-A.2(a)(2)(I) addresses how to source net income from physical commodities. While the general sourcing rules provided in the statute and the draft proposed regulations are generally the same, the draft proposed regulations provide additional rules on how the rules would apply to combined groups.

Under Draft Proposed Regulation Sec. 4-2.7, the amount of net income included in New York receipts or everywhere receipts is determined separately for the sales of commodities actually delivered and sales of commodities where delivery does not occur. For both sales of commodities actually delivered and sales of commodities where delivery does not actually occur, net income is the amount of gross receipts or gains from the respective sales of commodities less the cost to acquire or produce them (and may not be less than zero).

- To determine the amount sourced to New York from sales of commodities actually delivered, the net income from such sales is multiplied by a fraction, "the numerator of which is the amount of gross receipts from sales of all commodities actually delivered to points within the state and the denominator of which is the amount of all gross receipts from sales of commodities actually delivered." Draft Prop. Reg. Sec. 4-2.7(a)(1).
- To determine the amount sourced to New York from sales of commodities where delivery does not actually occur, the net income from such sales is multiplied by a fraction, "the numerator of which is the amount of gains from sales of commodities where delivery does not actually occur to purchasers located in the state and the denominator of which is the amount of gains from all sales of commodities where delivery does not actually occur to all purchasers." Draft Prop. Reg. Sec. 4-2.7(a)(1).

Under Draft Proposed Regulation Sec. 4-2.7, for a combined group, as above, the amount of net income of the combined group from commodities sourced to New York is determined separately for sales of commodities actually delivered and sales of commodities where delivery does not actually occur using the formulas described above and taking into account the relevant amounts from all members of the combined group.

- Under Draft Proposed Regulation Sec. 4-2.7(c), the term "commodity" means the definition set forth in IRC Sec. 475(e)(2)(A),(B) and (C).

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Indirect/Sales/Use:
US Supreme Court Denies Review of Florida Supreme Court's Decision Involving Taxation of Internet Sales

American Business USA Corp. v. Florida Department of Revenue, US (cert. denied 2/21/17). The US Supreme Court has denied the taxpayer's request to review a 2016 Florida Supreme Court decision, which had i) upheld a Florida corporation's assessed Florida sales tax on its Internet sales of flowers, gifts, and other items of tangible personal property ordered by out-of-state customers for out-of-state delivery, and ii) quashed the Fourth District Court of Appeal's previous ruling that such tax imposition pursuant to a Florida statute concerning in-state florists had violated the dormant Commerce Clause of the US Constitution. In its filed petition for review, the taxpayer had asked the US Supreme Court whether a state can collect sales tax on out-of-state property ordered over the Internet for out-of-state delivery by relying on *Quill Corp. v. North Dakota*, 504 US 298 (1992) and the state's connection to the corporation that accepts the order and arranges the sale, or whether such tax violates both the Due Process and dormant Commerce Clauses of the US Constitution by imposing a sales tax on the out-of-state transfer of tangible personal property. Note that under the facts in this case, the taxpayer was headquartered, doing business and had a physical presence in Florida, and had charged/collected Florida sales tax from its customers on items delivered in Florida via in-state florists that grew and held such inventory in Florida. However, the taxpayer had *not* charged or collected Florida sales tax on items delivered outside Florida via out-of-state florists that grew and held such inventory outside of Florida.
URL: https://www.supremecourt.gov/search.aspx?filename=/docketfiles/16-567.htm

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Indirect/Sales/Use:
Georgia Tax Tribunal Holds that Out-of-State Book Club Company was a "Dealer" Required to Collect and Remit Tax on Sales to In-State Customers

Decision 2017-2 (Docket No. 1552367), Ga. Tax Trib. (2/14/17). The Georgia Tax Tribunal (Tribunal) recently held that an out-of-state company operating a mail-order "book club" qualified as a "dealer" under Georgia statutes, thus requiring it to register, collect and remit state use tax on its sales to Georgia customers. In doing so, the Tribunal reasoned that the out-of-state company "did more than merely function as a mail-order company" in that it i) utilized Georgia schools and teachers to facilitate book sales to school children in Georgia to establish and maintain its in-state market (i.e., it utilized and incentivized Georgia teachers for their participation in the book club and systematically solicited a consumer market in Georgia through its ongoing relationship with schoolteachers and parent educators); and ii) maintained interrelated and shared functions with two affiliates that both had an office, warehouse, and distribution center in Georgia and that were registered in Georgia to collect sales/use tax – with the three affiliates sharing similar names, an in-state market, mailing lists for in-state schools, logos and a website selling comparable books to Georgia schools. Referencing related case law from Alabama, Connecticut, and Tennessee, the Tribunal determined that the out-of-state company had Commerce Clause "substantial nexus" with Georgia through its reliance on Georgia schools, Georgia teachers, and Georgia parent educators to solicit and sustain its in-state consumer market. Under the facts, all of the out-of-state company's sales transactions in Georgia were dependent on and carried out by Georgia schoolteachers and parent educators who served the solicitation, administration, collection, distribution, and customer service functions of transacting the company's in-state book sales – these teachers and

educators, in turn, were rewarded with bonus points based upon sales volumes and referrals of other teachers. In this respect, the Tribunal explained, the Georgia teachers and parent educators served as the sole conduit through which the out-of-state company made its Georgia book sales.
URL:
http://gataxtribunal.georgia.gov/sites/gataxtribunal.georgia.gov/files/related_files/document/Scholastic%20Book%20Clubs%2C%20Inc.%20-%20Decision%202017%20-%202%20Ga.%20Tax%20Tribunal%2C%20February%2014%2C%202017.PDF

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