State Tax Matters
The power of knowing.
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**In this issue:**

## Amnesty:
## Virginia: New Law Requires Implementation of Amnesty Program Providing for Potential 50% Interest Waiver and 100% Penalty Waiver; Additional Post-Amnesty Penalties May Apply

*H.B. 2246*, signed by gov. 2/20/17. Effective July 1, 2017, new law requires the Virginia Department of Taxation (Department) to administer a tax amnesty program at some point during its 2017-2018 fiscal year (i.e., at some point during July 1, 2017 through June 30, 2018) for at least 60 days, but no more than 75 days, which generally will be open to any taxpayer that is required but has failed to file a return or pay any tax administered by the Department. In exchange for participation and underlying payment, qualifying taxpayers potentially may receive a waiver of all civil or criminal penalties assessed or assessable and one-half of the interest assessed or assessable, resulting from nonpayment, underpayment, non-reporting, or underreporting of their tax liabilities. Outstanding assessments for which the date of assessment is less than 90 days prior to the first day of the amnesty program, or with respect to any liability arising from the failure to file a return for which the due date of the return is less than 90 days prior to the first day of the amnesty program, generally will be ineligible for amnesty under this program. Similarly, for state corporate and personal income tax purposes, this amnesty program generally will *not* apply to any tax liability that is attributable to taxable years beginning on and after January 1, 2016. The new law authorizes the Department to establish the precise dates of this amnesty program, as well as any necessary guidelines and procedural rules for participation and implementation.
**URL:** http://lis.virginia.gov/cgi-bin/legp604.exe?ses=171&typ=bil&val=hb2246

Additionally, the new law provides that any taxpayer eligible for this amnesty program that retains any outstanding balance after its close because of nonpayment, underpayment, non-reporting, or underreporting of any tax liability eligible for relief under this program, will be subject to a 20% penalty on such unpaid tax that is "in addition to all other penalties that may apply to the taxpayer." Also, any taxpayer that defaults upon any agreement to pay tax and interest arising out of a grant of amnesty under this program will be subject to reinstatement of the penalty and interest forgiven, as well as imposition of this additional 20% penalty.

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## Income/Franchise:
## MTC Formally Adopts Amendments to Model Regulations Reflecting Market-Based Sourcing

*Resolution Adopting Amendments to the Multistate Tax Commission's Model General Allocation and Apportionment Regulations*, Multistate Tax Comm. (approved on 2/24/17 via teleconference). Pursuant to the Multistate Tax Commission (MTC) Uniformity Committee's project for adoption of amendments to its Model General Allocation and Apportionment Regulation which began in 2014, the full MTC has now formally adopted the revisions to its model allocation and apportionment regulations under Multistate Tax Compact Article IV, Sections 1 and 17 (including implementation of Article IV, Section 17's market-based sourcing approach of receipts from the sale of services and intangibles), thereby also approving the most recent:
**URL:** http://www.mtc.gov/getattachment/Events-Training/2017/Special-Meeting/Resolution-of-the-Commission-Adpoting-Sec-1-and-17-Amendments-to-Regulations-2017.pdf.aspx

1. Clarifying amendments addressing the exclusion of dividends and interest from the receipts factor (as recommended by the Uniformity Committee), and
2. Inclusion of a voluntary mediation provision, which was originally proposed by the American Bar Association.

Other provisions in these adopted model regulations include definitions for “apportionable income” (previously “business income”) and “receipts” (previously “sales”), as well as reflect elimination of the requirement for equal weighting of the three-factor apportionment formula.

Note that at its December 2014 meeting, the MTC Uniformity Committee had voted to use the then recently-promulgated market-based sourcing regulations in Massachusetts as the working draft starting point for the MTC’s own model regulations to implement Article IV, Section 17’s market-based sourcing approach. The underlying “Section 17 work group” then spent over a year reviewing the Massachusetts market-based sourcing regulations and made numerous changes to the working draft. In addition, the MTC Uniformity Committee and Executive Committee made changes to the working draft during 2015 and 2016 before adopting a final version of the proposed amendments to the Section 17 regulations. On October 26, 2016, a “bylaw 7” survey of the states (*i.e.*, a survey in which member states are asked whether they would consider adoption of the proposal as a new addition or amendment to their tax statutes or regulations) was sent to the member states. The proposed amendments to the model allocation and apportionment regulations under Multistate Tax Compact Article IV, Sections 1 and 17 were then ultimately approved by the full MTC at its recent February 24, 2017 teleconference as the final step in this revision and adoption process.

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

*H.B. 1390*, signed by gov. 2/10/17. Applicable retroactively to tax years beginning on or after January 1, 2015, new law updates select corporate and personal income tax statutory references in Arkansas to federal income tax law as it existed on January 1, 2017 (previously, January 1, 2015) – including conformity to IRC Secs. 167 and 168(a)-(j) regarding depreciation; IRC Sec. 108 regarding discharge of indebtedness; IRC Sec. 163 regarding interest expense deductions; and IRC Sec. 851 et seq., relating to regulated investment companies (RICs), real estate investment trusts (REITs), real estate mortgage investment conduits (REMICs), and financial asset securitization investment trusts (FASITs). Effective for tax years beginning on or after January 1, 2015, the new law additionally updates other select corporate and personal income tax statutory references in Arkansas to federal income tax law as it existed on January 1, 2017, including conformity to:
**URL:** http://www.arkleg.state.ar.us/assembly/2017/2017R/Bills/HB1390.pdf

- IRC Sec. 267 regarding losses, expenses, and interest arising from transactions between related taxpayers (previously, a January 1, 2001 conformity date); and
- IRC Secs. 351, 354-358, 361, 362, 367, and 368 regarding corporate organization, reorganization, and recognition of gain (previously, a January 1, 2009 conformity date).

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## Income/Franchise:
## California FTB Discusses Treatment of Taxes Paid to Other States for Purposes of "Other State Tax Credit" and Allowable Deductions

*Legal Ruling 2017-01*, Cal. FTB (2/22/17). The California Franchise Tax Board (FTB) recently issued a legal ruling involving its treatment of taxes paid to another state for purposes of California's "other state tax credit" (OSTC) and allowable deductions, applicable for taxable years beginning on or after January 1, 2016. In doing so, the legal ruling explains that the determination of whether a payment of a tax to a sister-state qualifies for an OSTC or a deduction for California tax purposes turns on i) whether the tax is properly characterized as a tax on, or according to, or measured by income, and if it is ii) whether the tax is properly characterized as a net income tax. If the first prong is not met, the inquiry ends, and the taxpayer may claim a California deduction for the tax provided all other requirements are met, but may *not* claim the OSTC. However, if both the first and second prongs are met, then the next question is whether the tax is imposed by and paid to the other state such that the taxpayer may claim an OSTC. If the tax at issue is not a single, indivisible tax, but instead a multifaceted tax that consists of a combined set of separate and independent taxes, each tax must be analyzed independently under this same multi-pronged analysis.
**URL:** https://www.ftb.ca.gov/law/rulings/active/2017/01_0222.pdf

Note that the ruling references 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], and explains that when a tax operates as a tax imposed by and/or collected by a county, city, or other locality, the tax is not imposed by and paid to the other state, so the OSTC is not available for payment of the tax. In contrast, if the tax is imposed by a state statute and paid to the state, the tax is deemed a tax imposed by and paid to the state, even if the tax is labeled a county, city, or other locality tax.
**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:030317

Stay tuned for a forthcoming Multistate Tax Alert that further discusses this FTB legal ruling, as well as offers some taxpayer considerations.


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## Income/Franchise:
## Michigan Appellate Court Decision Narrowing Scope of Unitary Ownership Test is Now Final

On January 24, 2017, the Michigan Supreme Court declined to hear the Michigan Department of Treasury's (Department) appeal request of the Michigan Court of Appeal's published 2016 decision in *LaBelle Management, Inc. v. Michigan Dep't of Treasury*. As a result, the ownership test for purposes of determining if a unitary business group exists – for both the Michigan Business Tax (MBT) and Michigan Corporate Income Tax (CIT) – and specifically the interpretation of the term "indirectly," does *not* extend to "constructive" ownership situations, such as those that exist under IRC § 318 attribution rules.

See recently released Multistate Tax Alert that briefly summarizes the Michigan Court of Appeal's 2016 decision in this case and provides some taxpayer considerations, including commentary on the Department's related "Notice to Taxpayers" that was issued on February 28, 2017.

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## Income/Franchise:
## New Jersey Tax Court Holds that Lessor in Sale-Leaseback Transaction May Exclude Underlying Assets and Imputed Rent from CBT Apportionment Calculation

*Case Docket No. 011330-2015*, N.J. Tax Ct. (2/22/17). A recent New Jersey Tax Court (Court) ruling involving New Jersey's corporation business tax (CBT) granted the taxpayer's motion for partial summary judgment, holding that the taxpayer did *not* obtain a sufficient ownership interest in certain sale-leaseback assets (*i.e.*, buses sold by a government transit authority to the taxpayer so that the taxpayer could take the associated depreciation and amortization deductions, but then leased back to the government transit authority, which was generally responsible for all costs associated with operating, insuring, and maintaining the buses), and therefore, those assets could be excluded from the taxpayer's business allocation formula property factor for tax years 2002 through 2009. In light of this conclusion, the Court also held that imputed rental income from those assets could be excluded from the receipts (sales) factor of the taxpayer's CBT business allocation formula for the tax years at issue.
**URL:** http://www.judiciary.state.nj.us/taxcourt/tax_published/11330-15opn.pdf

Under the facts, the purpose of the sale-leaseback transaction was to transfer the federal tax benefits of owning the buses (*i.e.*, the depreciation and amortization deductions) to the taxpayer, while allowing the government transit authority to have operational control over the assets. Note that as a public entity, the government transit authority in this case had no use for the federal tax benefits associated with the assets because it did not pay federal income tax. The Court essentially reasoned that exclusion of such assets from the taxpayer's property factor was appropriate, because the overall facts showed that there was no intention of the taxpayer ever using the assets for its business operations – it merely engaged in the sale-leaseback of the buses to obtain the underlying federal tax deduction benefits.

Please contact us with any related questions.

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## Income/Franchise:
## Texas Appellate Court Disallows Installation Labor Costs in Costs of Goods Sold Deduction

On February 24, 2017, the Court of Appeals, 3rd District of Texas, reversed a previous decision by the 419th Travis County District Court, and held that a taxpayer was *not* entitled to include labor costs associated with installing the automotive parts consumed in the performance of auto repair services for purposes of calculating the Texas franchise tax cost of goods sold (COGS) subtraction.

Stay tuned for a forthcoming Multistate Tax Alert that summarizes the proceedings and arguments in this case, as well as offers some taxpayer considerations.

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## Indirect/Sales/Use:
## Pennsylvania DOR Provides Guidance on 2016 Legislation, Stating that All Support Services to Canned Software Sales are Taxable

*Letter Ruling No. SUT-17-001*, Penn. Dept. of Rev. (2/9/17). Pursuant to legislation enacted in 2016 [H.B. 1198 (Act 84)] that generally imposes state sales and use tax on electronically or digitally delivered, streamed or accessed video; photographs; books; any other otherwise taxable printed matter; applications (i.e., "apps"); games; music; any other audio, including satellite radio service; canned software; or any other otherwise taxable tangible personal property, the Pennsylvania Department of Revenue (Department) has issued a letter ruling discussing to what extent "support services to canned computer software" are subject to taxation. In doing so, the Department states that, under this new law, it considers *all* such support services to canned computer software as being subject to state sales and use tax when transferred in a sale at retail, or made use of after being obtained in a purchase at retail. More specifically, the Department explains that it considers any support involving the access to, use of, or alteration of the software itself as constituting a taxable component of the transaction – "stated differently, when a vendor who is providing support to software is afforded any access to the software itself, the vendor is rendering taxable support" – including electronic or remote access as well as direct physical access to the software. According to the letter ruling, this also includes any updates, upgrades, enhancements, patches, modules, and/or other modifications to canned software, whether provided and billed separately, or in conjunction with such support.
**URL:** http://www.revenue.pa.gov/GeneralTaxInformation/TaxLawPoliciesBulletinsNotices/Documents/Letter%20Rulings/SUT/sut-17-001.pdf
**URL:** http://www.legis.state.pa.us/cfdocs/billinfo/billinfo.cfm?syear=2015&sind=0&body=H&type=B&bn=1198

Examples of taxable support services to canned computer software listed in the ruling include the following:

- A vendor provides support via a remote desktop where it may access and alter the software directly;
- A vendor provides telephone support where it may troubleshoot/discuss the issue with the customer and subsequently provide a patch or module to fix the issue;
- A vendor distributes upgrades, patches, and/or modules to its customers;
- A customer sends a copy of the software program to a vendor which accesses, uses or alters and then returns the corrected version of the software;
- A vendor provides telephone support in the form of a call-in, help-desk providing direction as to the use, correction, or manipulation of the software; and
- A vendor provides training with respect to the use, correction, or manipulation of the software.

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## Indirect/Sales/Use:
## Virginia: New Law Requires Remote Sellers with In-State Inventory to Register and Collect Tax on Sales to In-State Customers

*H.B. 2058*, signed by gov. 2/20/17. Effective July 1, 2017, new law essentially provides that the storage of inventory within Virginia gives rise to nexus sufficient to require an out-of-state seller to register as a "dealer" for the collection of state sales and use tax on sales to customers within Virginia. More specifically, under this new law, a dealer is deemed to have sufficient activity within Virginia for state sales and use tax registration purposes if it owns tangible personal property that is "for sale located in this Commonwealth."
**URL:** http://lis.virginia.gov/cgi-bin/legp604.exe?171+ful+HB2058ER+pdf

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