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

Administrative:
New Jersey Division of Taxation Releases Manual of Audit Procedures

New Jersey Manual of Audit Procedures (NJMAP), N.J. Div. of Tax. (3/7/17). The New Jersey Division of Taxation (Division) has released a "Manual of Audit Procedures," intended to provide a comprehensive overview of the procedures and guidelines available to it for completing all types of audits, as well as general guidance for both audit staff and taxpayers. Topics addressed include field audit preparation and procedures, sampling, work papers, nexus, and various subjects related to specific tax types (e.g., sales and use tax and corporation business tax). The Division explains that it will update this manual periodically to reflect foregoing changes, and that the tax rates in this first edition are based on laws in effect as of December 31, 2016.
URL: http://www.nj.gov/treasury/taxation/pdf/njmap.pdf

Please contact us with any related questions.

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Income/Franchise:
Federal Mobile Workforce State Income Tax Simplification Act is Introduced in US Senate

S. 540, introduced in US Senate on 3/7/17. Pending legislation has been introduced in the US Senate that, if enacted, would create a bright-line standardized 30-day threshold to determine nonresident state income tax liability with the intent of ensuring that:

- Employees clearly understand when they are liable for nonresident state income taxes, and
- Employers are able to accurately withhold these state individual income taxes.

The pending federal legislation generally attempts to simplify and standardize tax filing for employees and employers that conduct business in multiple states. More specifically, this pending federal legislation would limit state taxation of the wages or other remuneration of any employee who performs duties in more than one state to: i) the state of the employee's residence; and ii) the state(s) in which the employee is "present and performing employment duties for more than thirty days during the calendar year in which the wages or remuneration is earned." The bill generally applies these same standards to an employer's withholding and reporting requirements.

In general, under this pending federal legislation, an employer could rely on an employee's determination of the time he or she spends in each state during the year – unless the employer maintains a "time and attendance system" that records and tracks where employees perform their daily duties. In the latter case, this "time and attendance system" must be used to determine the number of days an employee works in each state.

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

S.B. 1290, signed by gov. 3/2/17. Effective ninety-one days after adjournment of the 2017 legislature and applicable for tax years beginning from and after December 31, 2016, new law generally conforms state corporate and personal income tax references to the federal Internal Revenue Code (IRC) as in effect on January 1, 2017, "including those

provisions that became effective during 2016 with the specific adoption of all federal retroactive effective dates," but excluding any change to the IRC enacted after January 1, 2017. For taxable years beginning from and after December 31, 2015 through December 31, 2016, the law generally conforms state corporate and personal income tax references to the federal IRC as in effect on January 1, 2016, including those provisions that became effective during 2015 with the specific adoption of all federal retroactive effective dates.
URL: https://apps.azleg.gov/BillStatus/GetDocumentPdf/450577

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Income/Franchise: Massachusetts DOR Announces Late-File Penalty Relief for Taxpayers Affected by Change in Federal Tax Return Due Dates

Technical Information Release, TIR 17-3: Late-File Penalty Relief for Corporate Taxpayers Affected by Change in Federal Tax Return Due Dates, Mass. Dept. of Rev. (3/2/17). The Massachusetts Department of Revenue (Department) has issued a technical information release that explains some relief being provided to taxpayers impacted by the variation between Massachusetts and federal due dates for C corporation income tax returns. The release announces that the Department generally anticipates waiving any late-file penalties imposed under G.L. c. 62C, § 33(a) in connection with a C corporation tax return that is filed after the applicable due date set forth in G.L. c. 62C, §§ 11 or 12, but on or before the due date for the corporation's federal income tax return. The Department also explains that the payment due with the return pursuant to G.L. c. 62C §§ 19 or 32(a), if any, remains due on the date prescribed by G.L. c. 62C, §§ 11 or 12.
URL: http://www.mass.gov/dor/businesses/help-and-resources/legal-library/tirs/tirs-by-years/2017-releases/tir-17-3.html

The release notes that while Massachusetts tax return filing due dates set forth in G.L. c. 62C, §§ 11 and 12 (in the case of corporations) and G.L. c. 62C, § 7 (in the case of partnerships) have not been amended to conform to the new federal due dates, "legislation that will conform these due dates is currently pending before the Massachusetts Legislature." Accordingly, this release announces relief intended to address some of the immediate consequences of the current non-conformity.

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Income/Franchise: New Jersey Tax Court Holds that Division Lacked Authority to Narrow the Scope of Favorable "Investment Company" Treatment under CBT

Case Docket No. 015083-2014, N.J. Tax Ct. (2/27/17). A recent New Jersey Tax Court (Court) ruling involving New Jersey's corporation business tax (CBT) and whether the taxpayer was entitled to investment company treatment pursuant to N.J.S.A. 54:10(a)-4(f) and -5(d) for tax years 2006 through 2009, held that the New Jersey Division of Taxation (Division) exceeded statutory authority when it amended an administrative regulation limiting which types of investments qualified a company for such favorable tax treatment. More specifically, the Court concluded that the Division's exclusion of "direct investment in non-publicly traded pass-through entity, if that entity would not satisfy the definition of investment company if it had been organized as a corporation," from its definition of qualified investment activities and assets, contravened the generally accepted meaning of "security" and the legislative intent behind N.J.S.A. 54:10A-4(f). In doing so, the Court explained that the Division cannot substitute its observations and opinion for legislative intent, and that "the decision to prohibit companies with direct investments in pass-through entities

from qualifying as investment companies is a policy decision to be decided exclusively by the legislature." Apparently, the amendments to N.J.A.C. 18:7-1.15(a) and (b) at issue were a response to a "proliferation in the use of flow through entities" and were intended to "limit tax planning through abusive reorganization making clear that such assets are outside the scope of qualifying assets of investment companies." 38 N.J.R. 1558 (a) (April 3, 2006).
URL: http://www.judiciary.state.nj.us/taxcourt/tax_published/15083-14opn.pdf

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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 Tangible Personal Property, Net Interest Income from Reverse Repurchase Agreements and Securities Borrowing Agreements, and Receipts from Railroad, Trucking and Omnibus Businesses

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, Draft Proposed Regulation Sec. 4-2.1 (Receipts from the Sale of Tangible Personal Property), Sec. 4-2.6 (Net Interest Income from Reverse Repurchase Agreements and Securities Borrowing Agreements), and Sec. 4-2.13 (Receipts from Railroad, Trucking and Omnibus Businesses) are reviewed.

Receipts from the Sale of Tangible Personal Property (TPP)

The sourcing of receipts from the sale of TPP is addressed in New York Tax Law Sec. 210-A.2. Specifically, the statute requires that receipts from the sale of TPP shipped to points within New York, or where the destination of the property is New York, are sourced to New York.

Under Draft Proposed Reg. Sec. 4-2.1, the Department provides additional guidance for taxpayers to source receipts from the sale of TPP to New York if:

- The property is shipped to a point in New York regardless of the type of carrier used, which party arranged for the shipment, or which party's vehicle was used to transport the property.
    - Note that if property is shipped outside of New York, the receipts are sourced to New York if the destination of the property is New York.
- Possession of property is transferred to a purchaser (or a purchaser's designee) at a point in New York, unless the presumption that property transferred in New York is destined for New York can be overcome with sufficient evidence to demonstrate that the destination is outside of New York.
- The possession of the property is transferred to a purchaser (or purchaser's designee) at a point outside of New York, but the destination of the property is a point in New York. The presumption that property transferred outside of New York is destined for a location outside of New York must be overcome with sufficient evidence to demonstrate that the destination is within New York.
- For purposes of overcoming presumptions of delivery destination, New York has identified examples of the types of evidence generally sufficient to demonstrate the destination of the property, such as bills of lading or shipping documents and purchase invoices that designate the destination location.

Net Interest Income from Reverse Repurchase Agreements and Securities Borrowing Agreements

New York Tax Law Sec. 210-A.5(a)(2)(E) addresses the sourcing of net interest income from reverse repurchase agreements and securities borrowing agreements. The Draft Proposed Regulations mirror the statute but also provide additional guidance on sourcing these receipts in the context of a combined report.

Under Draft Proposed Reg. Sec. 4-2.6(a), a taxpayer would source eight percent (8%) of its net interest income from reverse repurchase agreements and securities borrowing agreements to New York. Net interest income from reverse repurchase agreements and securities borrowing agreements generally is the amount of income from such agreements less the related interest expenses (described below), but may not be less than zero.

- For reverse repurchase agreements, the amount of interest expense to be deducted is "the interest expense associated with the value of the taxpayer's repurchase agreements where [the taxpayer] is the seller/borrower, provided the amount is limited to the value of the taxpayer's reverse repurchase agreements where it is the purchaser/lender." Draft Proposed Reg. Sec. 4-2.6(b)(1).
- For securities borrowing agreements, the amount of interest expense that can be deducted is "the interest expense associated with the value of the taxpayer's securities lending agreements where it is the securities lender, provided the amount is limited to the value of the taxpayer's security lending agreements where it is securities borrower." Draft Proposed Reg. 4-2.6(c)(1).
- In the event of a combined report, the net interest income for reverse repurchase agreements and securities borrowing agreements is determined in the same manner as described above and includes amounts for all members for the combined group. Draft Proposed Reg. 4-2.6(b)(2) & 4-2.6(c)(2).

Receipts from Railroad, Trucking, and Omnibus Businesses

New York Tax Law Sec. 210-A.6 addresses the sourcing of receipts from railroad and trucking businesses, based on the miles operated within New York during the period covered by the taxpayer's report. This is reflected in the Draft Proposed Regulations, which extend the general sourcing rule to omnibus businesses and also provide an exclusion for certain activities of omnibus businesses.

Draft Proposed Reg. Sec. 4-2.13 outlines when receipts from railroad,[1] trucking and omnibus businesses are included in the taxpayer's New York receipts. As with the statute noted above, receipts are sourced to New York by multiplying such receipts by a fraction whereby the numerator is the number of miles that such vehicles are operated in New York and the denominator is the total number of miles that such vehicles are operated. Notably, if an omnibus was used for the operation of a school bus, these miles are excluded from the fraction altogether.

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[1] Railroad businesses include surface railroads, whether or not operated by steam, subway railroad, elevated railroad, palace car, or sleeping car.

Income/Franchise:
New York Appellate Division Affirms that Income Earned from Credit Rating Business is Derived from Services and Sourced by Place-of-Performance

2017 NY Slip Op 01448, Supreme Court of New York, Appellate Division, First Department (2/23/17). The New York Appellate Division, First Department (Appellate Court), recently affirmed a New York City Tax Appeals Tribunal decision and rejected a taxpayer's claim that income earned from its credit rating business was "other business receipts," and should be sourced to where the receipts were earned (generally, audience location). The New York City Department of Finance (Department) had asserted and the New York City Tax Appeals Tribunal had agreed, that the income at issue was derived from the performance of services and therefore should be sourced to where the services were performed. The Appellate Court also ruled that by requiring the taxpayer to source its credit ratings receipts for New York City general corporation tax (GCT) purposes using this "place-of-performance" methodology, there was no breach of the taxpayer's First Amendment rights as the sourcing method was not based on the taxpayer's published content.
URL: http://www.nycourts.gov/reporter/3dseries/2017/2017_01448.htm

The Appellate Court noted that the terms used in the taxpayer's agreements with clients were indicative that a service was provided, namely the analytic review and issuance of a rating not contingent on public dissemination. The Appellate Court also noted that even where a rating was not issued, the taxpayer earned an annual surveillance fee for continued maintenance of the rating, where the client compensated the taxpayer based on the time, effort, and charges incurred.

While the Appellate Court agreed that the credit ratings at issue were a form of speech protected by the First Amendment, it ruled that the taxpayer's reliance on prior case law to demonstrate a violation of its First Amendment rights was unfounded. The Appellate Court explained that in the case the taxpayer referenced, the taxing body was applying different sourcing methods to the same type of revenue for different members of the press engaged in a substantially similar business. In contrast, the Appellate Court ruled that the Department in this case was not seeking to impose a different sourcing method inconsistent with other content publishers in the industry.

Note that as of January 1, 2015, only subchapter S corporations and qualified subchapter S subsidiaries under the Internal Revenue Code are subject to the GCT, and most other New York City corporate taxpayers are now subject to the Corporate Tax of 2015, under which the sourcing of receipts generally is market-based.

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Indirect/Sales/Use:
Trial Court Holds that South Dakota Cannot Impose Tax Collection Responsibilities on Remote Sellers that Lack an In-State Physical Presence

A South Dakota trial court recently granted summary judgment in favor of the taxpayers regarding legislation enacted in 2016 [*S.B. 106*, amending S.D. Codified Laws § 10-45 and 10-52; see previously issued Multistate Tax Alert for more details on this 2016 legislation and its stated intent to serve as a direct challenge to the current physical presence requirement of *Quill*], which requires the collection of South Dakota sales tax on sales into South Dakota if, in the previous or current calendar year, the seller's sales into South Dakota exceed $100,000 or the seller had 200 or more separate transactions into South Dakota. In doing so, the state trial court held that South Dakota is prohibited from imposing sales tax collection and remittance obligations on such sellers that lack an in-state physical presence pursuant to *Quill*.
URL: http://sdlegislature.gov/docs/legsession/2016/Bills/SB106ENR.pdf
URL: https://www2.deloitte.com/us/en/pages/tax/articles/multistate-tax-alert-south-dakota-enacts-sb-106-physical-presence-no-longer-required-for-sales-tax-collection.html?id=us:2em:3na:stm:awa:tax:031017

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Indirect/Sales/Use:
Wyoming: New Law Imposes Remote Seller Tax Collection Responsibilities Despite Lack of "Physical Presence"

H.B. 19, signed by gov. 3/1/17. Effective July 1, 2017, new law generally requires the collection of Wyoming sales tax for sellers of tangible personal property, admissions and taxable services on such sales into Wyoming if, in the previous or current calendar year, i) the seller's sales into Wyoming exceed $100,000, or ii) the seller had 200 or more separate transactions into Wyoming. Similar to legislation that was enacted in South Dakota in 2016 [see previously issued Multistate Tax Alert for more details on this previously enacted South Dakota legislation], this new Wyoming law authorizes the Wyoming Department of Revenue to bring action to obtain a declaratory judgment providing that such obligation for tax remission by an out-of-state seller lacking an in-state "physical presence" is valid under state and federal law – which would also operate as an injunction during the pendency of the action prohibiting the Department from enforcing this sales tax collection obligation on remote sellers that do not affirmatively consent or otherwise remit sales tax on a voluntary basis. The new law additionally provides that if a court has entered a judgment against a seller or otherwise lifted or dissolved the underlying injunction, the Department shall assess and apply this remote seller sales tax collection obligation "from the date the judgment is entered or the injunction is lifted with respect to that seller."
URL: http://legisweb.state.wy.us/2017/Enroll/HB0019.pdf
URL: https://www2.deloitte.com/us/en/pages/tax/articles/multistate-tax-alert-south-dakota-enacts-sb-106-physical-presence-no-longer-required-for-sales-tax-collection.html?id=us:2em:3na:stm:awa:tax:031017

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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 Issues Guidance on Application of *Swart* Decision
On January 12, 2017, the California Court of Appeal issued a published decision in *Swart Enterprises, Inc. v. Franchise Tax Board*, 7 Cal. App. 5th 497 (2017), holding that an out-of-state corporation was not "doing business" in California within the meaning of Cal. Rev. & Tax Code Section 23101 when the corporation's only connection to California was its passive ownership of a 0.2 percent membership interest in a California-based manager-managed limited liability company. On February 28, 2017, the California Franchise Tax Board (FTB) issued Notice 2017-01, which stated that the FTB will not appeal the *Swart* decision and provided guidance to taxpayers on the application of this decision to return filing obligations and/or claims for refund where the facts are the same as those present in the *Swart* case.
[Issued: March 6, 2017]
URL: https://www2.deloitte.com/us/en/pages/tax/articles/california-ftb-issues-guidance-on-application-of-swart-decision.html?id=us:2em:3na:stm:awa:tax:031017

Michigan Appellate Court Decision Narrowing Scope of Unitary Ownership Test Now Final
On January 24, 2017, the Michigan Supreme Court issued an Order refusing to hear the Michigan Department of Treasury's 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 MBT and Michigan 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.

On February 28, 2017, the Michigan Department of Treasury issued a "Notice to Taxpayers" stating that the Michigan Court of Appeal's decision in *Labelle Management* is now "binding precedent" and rescinding elements of administrative guidance which had previously stated that the requisite ownership/control existed between brother-sister affiliated companies. In this Notice, Treasury also states that the *Labelle Management* decision will be given "full retroactive effect and will apply it to all open years."

This Multistate Tax Alert briefly summarizes the Michigan Court of Appeal's decision in *LaBelle Management, Inc. v. Michigan Dep't of Treasury* and provides some taxpayer considerations. Particular attention should be given to ownership structures involving affiliated domestic C corporations, with a common foreign parent and no common US parent.
[Issued: March 1, 2017]
URL: https://www2.deloitte.com/us/en/pages/tax/articles/mbt-appellate-court-decision-narrowing-scope-of-unitary-ownership-test-now-final.html?id=us:2em:3na:stm:awa:tax:031017

Texas Appellate Court Disallows Certain Installation Labor Costs in Franchise Tax COGS Deduction
On February 24, 2017, the Court of Appeals, 3rd District of Texas, reversed an earlier decision by the 419th Travis County District Court, and held that Autohaus LP, LLP was not entitled to include certain costs associated with installing the automotive parts it sold for purposes of calculating the Texas franchise tax cost of goods sold (COGS) subtraction.

As of the release date of this Multistate Tax Alert, the taxpayer has not filed a motion for rehearing with the appellate court or a petition for review with the Texas Supreme Court. However, the period during which such filings may be made remains open.

This Multistate Tax Alert summarizes the Court of Appeal's decision and offers some taxpayer considerations.
[Issued: March 3, 2017]
URL: https://www2.deloitte.com/us/en/pages/tax/articles/tx-appellate-court-disallows-certain-installation-labor-costs-in-franchise-tax-cogs-deduction.html?id=us:2em:3na:stm:awa:tax:031017