State Tax Matters
The power of knowing.
July 21, 2017

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Articles:
Potential State Tax Consequences of Federal Corporate Tax Reform

Most states generally begin the computation of state corporate taxable income with federal taxable income. Therefore, when there are changes to the federal income tax code, states are presented with the choice either to conform to or decouple from the federal changes. As many are aware, the most significant change to the federal income tax code since 1986 may be imminent, including several proposals for sweeping changes to the corporate income tax.

In this edition of Inside Deloitte, Valerie C. Dickerson, Scott Schiefelbein, and Kul Ahluwalia of Deloitte Tax LLP consider the potential state tax issues raised by key elements of the federal corporate income tax reform proposals of President Trump and House Republicans.
URL: https://www2.deloitte.com/us/en/pages/tax/articles/potential-state-tax-consequences-of-federal-corporate-tax-reform.html?id=us:2em:3na:stm:awa:tax:072117

Articles:
The District of Columbia Qualified High-Technology Company Program: Recent Developments

This edition of "Credits & Incentives Talk with Deloitte," a monthly column by Kevin Potter of Deloitte Tax LLP featured in the *Journal of Multistate Taxation and Incentives* (a Thomson Reuters publication), is co-authored with Scott Frishman and Jennifer Alban-Bond of Deloitte Tax LLP's multistate practice for the greater Washington D.C. area, and provides an overview of the District of Columbia tax credits and exemptions available to a Qualified High-Technology Company (QHTC).
URL: https://www2.deloitte.com/us/en/pages/tax/articles/the-dc-qualified-high-technology-company-program-recent-developments.html?id=us:2em:3na:stm:awa:tax:072117

Income/Franchise:
California FTB Chief Counsel Ruling Addresses How a Company Must Source "Non-marketing" Services under Market-Based Sourcing Rules

Chief Counsel Ruling 2017-01, Cal. FTB (4/7/17). The California Franchise Tax Board (FTB) recently released a chief counsel ruling which explains how the taxpayer must determine where the benefit of "non-marketing" services are received under California Code of Regulations (CCR) section 25136-2, and applies the rationale set forth under Chief Counsel Ruling 2015-03 where the FTB made a distinction between "marketing" and "non-marketing" services and applied a treatment to these service sales that was similar to the treatment provided under this regulation for "marketing" and "non-marketing" intangibles.
URL: https://www.ftb.ca.gov/law/ccr/2017/01.pdf

Under the provided facts, the taxpayer contracts directly with managed care organizations, health insurers, third-party administrators, employers, union sponsored benefit plans, worker's compensation plans, and government health programs to manage and administer certain health benefit services that such health plan providers are in turn contractually obligated to provide to their own clients and members. Analyzing the taxpayer's various provided services and surrounding circumstances, the FTB concluded the following:

1. Under California's market-based sourcing rules under Revenue and Taxation Code (RTC) section 25136 and CCR section 25136-2, sales from the taxpayer's services (which were "non-marketing" services) must be sourced to California to the extent that its direct customers (i.e. the health plan providers rather the taxpayer's customers' customers which were the health plan sponsors or their members) receive the benefit of the service in California;

2. The benefit of the service received by the taxpayer's direct customers is that of being relieved of the obligation to perform business functions that the taxpayer's direct customers would otherwise be required to perform themselves pursuant to their own underlying health plan agreements; and
3. For purposes of assigning sales under RTC section 25136 and CCR section 25136-2, the taxpayer must assign the sales of its services to California to the extent its direct customers received the benefit of the service in California, as determined under the cascading rules in CCR section 25136-2(c)(2). Notably, the FTB concluded that, under the cascading rules, to the extent that this information is unavailable or unclear in the underlying agreement or books and records, "the best reasonable approximation" of the location of where the benefits are received would be the location where the health plan customers would conduct the services provided by the taxpayer if they cancelled their contracts with the taxpayer.

Please contact us with any related questions, and stay tuned for a forthcoming Multistate Tax Alert with more details on this recent ruling.

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Income/Franchise:
Indiana Tax Court Rules in Taxpayer's Favor, Holding that Gain from Sale of Partnership Interest Constitutes Non-Business Income

No. 49T10-1307-TA-00065, Ind. Tax Ct. (7/11/17). An Indiana Tax Court held partially in favor of a taxpayer in the business of industrial, agricultural, and chemical manufacturing regarding its state adjusted gross income tax liability, holding that the taxpayer's gain from the sale of its interest in a pharmaceutical partnership constituted nonbusiness income, rather than apportionable business income, under both the transactional and functional tests. In doing so, with respect to the functional test, the Court explained that the facts showed that the taxpayer, a manufacturer, and the pharmaceutical entity at issue were *not* unitary and that except for some initial (*i.e.*, "start-up") flow of value between the two, the pharmaceutical entity had operated independently of the taxpayer and had paid the taxpayer arm's-length rates for all services it was provided. Additionally, the Court explained that the taxpayer exercised no more than the "occasional oversight" over the pharmaceutical entity than would be "typically afforded to an investor over his investment." Finally, the Court explained, there were no economies of scale amongst the two entities. The Court additionally ruled in favor of the taxpayer regarding certain intercompany loan transactions, holding that disallowance of the underlying interest expense deductions on audit was improper because they were made at arm's-length rates.
URL: http://www.in.gov/judiciary/opinions/pdf/071117mw.pdf

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Income/Franchise:
Michigan Department of Treasury Discusses Implications of Concluded Multistate Tax Compact Election Litigation

Notice to Taxpayers Regarding the Conclusion of Multistate Tax Compact Election Litigation, Mich. Dept. of Treas. (7/12/17). The Michigan Department of Treasury (Department) has issued a notice stating that because the US Supreme Court recently (i.e., on May 22, 2017 and June 19, 2017) denied review of petitions filed by multiple taxpayers that had challenged 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, "the legal issues regarding PA 282's retroactive repeal of the Compact are now fully resolved."
URL: http://www.michigan.gov/documents/treasury/Notice_Re_Compact_Litigation_578732_7.pdf

Accordingly, the Department explains that Michigan's Tax Compliance Bureau will now process all audits in which the use of the Compact's three-factor apportionment method is at issue that were held in abeyance pending the final outcome of the Compact litigation, and that this "may result in Intents to Assess or refund denials, as applicable, which reflect the use of the apportionment methodology required by statute…" The notice also states that impacted taxpayers that timely requested (and were acknowledged for) an informal conference which is in related abeyance will be contacted in writing by the Department to determine whether the matter is fully resolved. Lastly, regarding cases pending before the Michigan Tax Tribunal or the Michigan Court of Claims, whether in abeyance or on remand, the Department "intends to file motions for summary disposition with regard to the Compact election, unless the taxpayer stipulates to dismiss." Cases in which there are issues in dispute besides the Compact election will proceed towards resolution in the normal course of litigation; and taxpayers that wish to discuss the status of their case with the Department "are invited to have their legal counsel or representative contact the Assistant Attorney General representing the Department."

See previously issued Multistate Tax Alert for more details on the underlying denied review by the US Supreme Court, as well as related taxpayer considerations. Also, 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 also denied a subsequent petition to review this case.
URL: https://www2.deloitte.com/us/en/pages/tax/articles/us-supreme-court-denies-cert-in-taxpayer-challenges-to-mi-and-wa-retroactive-tax-law-amendments.html?id=us:2em:3na:stm:awa:tax:072117
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:072117

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Income/Franchise:
Texas Comptroller Discusses Policy Changes Regarding Temporary Credit for Business Loss Carryforwards

Letter No. 201706006L, Tex. Comptrlr. (6/30/17). The Texas Comptroller of Public Accounts (Comptroller) has released a letter discussing its two revised policies concerning the state franchise (margin) tax temporary credit for business loss carryforwards. Under its first described revised policy, the Comptroller states that once a taxable entity has preserved the temporary credit for business loss carryforwards and has taken this credit on a timely filed report, the taxable entity may claim this credit on any subsequent report, even if the subsequent report is not timely filed. Under the second described revised policy, the Comptroller explains that if a member entity leaves a combined group during the accounting period on which a report is based, the combined group may claim, subject to credit limitations, the departing member's entire amount of credit and the member's entire available credit carryover for that report year. For subsequent reports, the departed member's credit is no longer available to the combined group, and the combined group's credit carryover must be adjusted to remove the portion of carryover related to the departed member.
URL: https://star.cpa.texas.gov/view/201706006l

Please contact us with any questions, and stay tuned for a forthcoming Multistate Tax Alert with more details on these revised policies, including related taxpayer considerations.

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Indirect/Sales/Use:
Alabama DOR Withdraws Proposed Amended Rule that Would Have Taxed Certain Streaming Services and Digital Transmissions

Withdrawal of Proposed Amended Ala. Admin. Code Rule 810-6-5-.09 [Leasing and Rental of Tangible Personal Property], Ala. Dept. of Rev. (7/11/17). The Alabama Department of Revenue (Department) apparently has withdrawn a proposed amended administrative rule on the leasing and rental of tangible personal property that was filed in February 2017, and which originally was proposed to become effective for transactions occurring on or after July 1, 2017. Prior to this seeming withdrawal, the proposed amended rule had provided that certain streaming services and other digital transmissions would be subject to Alabama's rental tax as tangible personal property.
URL: http://www.alabamaadministrativecode.state.al.us/UpdatedMonthly/AAM-FEB-17/810-6-5-.09.pdf

Note that a similar rule proposal was filed by the Department in 2015, and had failed to reach final certification after many had claimed during the rule proposal phase that such taxation exceeded the Department's statutory authority. Comparable claims were made with respect to the 2017 version of this proposed amended rule as well.

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Indirect/Sales/Use:
Connecticut Department of Revenue Services Apparently Enforcing Economic Nexus Standard on Some Remote Sellers

The Connecticut Department of Revenue Services (Department) apparently has been stepping up its efforts to enforce collection and remittance of state sales taxes by some online and other out-of-state retailers, requesting by private letter that such remote sellers i) provide additional information detailing their sales made to in-state customers, or

else ii) voluntarily register for prospective sales tax collection and remittance. These requests appear to be consistent with policy stated in a Department release issued earlier this year [Media Release: Connecticut Pursues Sales Taxes Not Paid by On-Line Retailers; see *State Tax Matters*, Issue 2017-13 for more details on this release], which had explained that, "current state law requires out-of-state sellers of goods that have a substantial economic presence in the state to collect and remit sales tax." According to this earlier media release, Commissioner Kevin Sullivan had expressed, "We are going to close this tax loophole for big retailers doing big business in Connecticut and not competing fairly" – and that states must "assure the promise of the federal Commerce Clause that neither in-state nor out-of-state retailers will have an unfair advantage in the marketplace and in taxes paid to help maintain that marketplace."
URL: http://www.ct.gov/drs/cwp/view.asp?Q=591496&A=1436
URL: http://newsletters.usdbriefs.com/2017/Tax/STM/170331_7.html

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Indirect/Sales/Use: Georgia Department of Revenue Amends Administrative Rule on Manufacturing Exemption

Amended Rule 560-12-2-.62 Manufacturing Machinery and Equipment, Industrial Materials, and Packaging Supplies, Ga. Dept. of Rev. (7/5/17). The Georgia Department of Revenue has issued amendments to its administrative rule involving the state sales and use tax exemption on certain manufacturing machinery and equipment, industrial materials and packaging supplies – explaining that effective from July 1, 2017 until July 1, 2020, the exemption applies to:
URL: https://dor.georgia.gov/sites/dor.georgia.gov/files/related_files/document/LATP/Regulation/560-12-2-.62.pdf

> "maintenance and replacement parts for machinery or equipment, stationary or in transit, used to mix, agitate, and transport freshly mixed concrete in a plastic and unhardened state, including but not limited to mixers and components, engines and components, interior and exterior operational controls and components, hydraulics and components, all structural components, and all safety components."

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Indirect/Sales/Use: Idaho Supreme Court Holds that Retroactive Application of Exemption is Limited

Docket No. 44211 [2017 Opinion No. 88], Idaho (7/11/17). The Idaho Supreme Court has affirmed a district court's ruling that a state sales and use tax exemption for mandatory gratuities added to a customer's bill by the retailer that was enacted in 2011 and expressly stated to apply "retroactively to January 1, 2011," did *not* apply to the taxpayer's pre-2011 tax periods at issue because the 2011 legislation had changed the statute rather than merely clarified or reflected existing law. In doing so, the Court explained that the inclusion of a retroactive effective date in the 2011 legislation indicates that the state legislature had intended for the amendments to take effect from that date forward, and that statutory amendments generally "are not retroactive unless expressly so declared." Further, the Court explained that interpreting the 2011 legislative amendments to have effect to dates predating the retroactive January

1, 2011 effective date (*i.e.*, to the tax periods at issue) "would conflict with this Court's instruction to construe tax exemptions narrowly."
URL: https://isc.idaho.gov/opinions/44211.pdf

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Multistate Tax Alerts

Throughout the week, we highlight selected developments involving state tax legislative, judicial, and administrative matters. The alerts provide a brief summary of specific multistate developments relevant to taxpayers, tax professionals, and other interested persons. Read the recent alerts below or visit the archive.
Archive: http://www2.deloitte.com/us/en/pages/tax/articles/multistate-tax-alert-archive0.html?id=us:2em:3na:stm:awa:tax

California Supreme Court Upholds Levy of Documentary Transfer Tax on Transfer of Legal Entity Interest
On June 29, 2017, the California Supreme Court, in *926 North Ardmore Avenue, LLC, v. County of Los Angeles*, held that the Documentary Transfer Tax may be imposed under California Revenue and Taxation Code Section 11911 when a transfer of an interest in a legal entity results in a change in ownership of real property within the meaning of CRTC Section 64(c) or (d) so long as there is a written instrument reflecting a sale of the property (including the transfer of beneficial ownership of the property) for consideration.

This Multistate Tax Alert provides some background on the Documentary Transfer Tax, summarizes the California Supreme Court's decision in *Ardmore* and provides some taxpayer considerations.
[Issued July 14, 2017]
URL: https://www2.deloitte.com/us/en/pages/tax/articles/ca-supreme-court-documentary-transfer-tax-may-apply-to-transfers-of-legal-entity-interests.html?id=us:2em:3na:stm:awa:tax:072117