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Income/Franchise:
MTC to Move Forward in Drafting a Model Uniform Statute and Regulation for Reporting Federal Partnership Audit Adjustments

On August 1, 2017, the Uniformity Committee of the Multistate Tax Commission (MTC) agreed that its partnership work group should move forward with drafting a proposed model statute and regulation that would address how states may respond to changes in the federal partnership audit and adjustment process, and which possibly may be based upon a draft proposal that was submitted for its consideration by representatives of several interested parties – including the Council On State Taxation, Tax Executives Institute, Inc., Institute for Professionals in Taxation, American Bar Association, and American Institute of CPAs. This submitted draft proposal suggests amending the MTC's "Model Uniform Statute for Reporting Federal Tax Adjustments with Accompanying Model Regulation" that was adopted in 2003, by also incorporating changes that address the underlying new partnership audit and adjustment issues.
URL: http://www.mtc.gov/getattachment/Uniformity/Project-Teams/Partnership-Informational-Project/Model-Uniform-Statute-and-Regulation-for-Reporting-Adjustments-to-FTI-and-Federal-Partnership-Audits-6-28-17-draft_submitted-on-07-05-17.pdf.aspx

Note that the federal Bipartisan Budget Act of 2015 (Pub. L. No. 117-74) provides for a new centralized audit regime to be applied to all entities taxed as partnerships with a default rule stipulating that federal audits, adjustments, assessments, and collections occur at the entity level, generally effective for audits of returns filed for tax years beginning on or after January 1, 2018.

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Income/Franchise:
California: FTB Continues to Move Forward with Draft Amendments to Market-Based Sourcing Regulation

Tax News, Cal. FTB (8/17). The California Franchise Tax Board (FTB) reports that the most discussed issues from its second "Interested Parties Meeting" (IPM) on proposed amendments to California's market-based sourcing regulation (California Regulation Section 25136-2) held on June 16, 2017 [see previously issued Multistate Tax Alert for more details on this meeting] were:
URL:
https://www.ftb.ca.gov/Professionals/Taxnews/Editions/2017/August.shtml?WT.mc_id=News_Content_Tax_News_Current_August
URL: https://www2.deloitte.com/us/en/pages/tax/articles/california-ftb-to-hold-second-interested-parties-meeting-on-amendments-to-market-based-sourcing-regulation.html?id=us:2em:3na:stm:awa:tax:080417

- Assignment of service fees from government and long-term contracts, and
- Assignment of asset management fees.

Other issues discussed at this second IPM include, but are not limited to:

- Changing the term "other countries" to one with more clarity,
- Assignment of services rendered by a subcontractor,
- Assignment of services in connection with freight forwarding, and
- Various clean-up issues.

The FTB notes that the deadline for further comments to be taken into consideration before the next round of proposed draft language is August 15, 2017, and that the next IPM for discussing proposed amendments to California Regulation Section 25136-2 "will take place in September or October 2017." The FTB additionally notes that FTB staff

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are "currently updating the 50 state analysis on assignment of sales of services and sales of intangible property," as well as preparing a "50 state analysis to evaluate assignment of asset management fees." For more information or questions please reach out to any of the following individuals listed below.

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Income/Franchise:
California Court of Appeal Discusses Whether Capital Gains from Sale of Stock Constitutes Apportionable Business Income

No. C081522, Cal. Ct. App. (7/27/17). A California Court of Appeal (Court) partially affirmed a trial court's decision in a case involving whether capital gains from a taxpayer's sale of stock in another entity constituted apportionable business income for purpose of the California franchise tax, holding that such determination under the functional test must be made by examining the entire relationship between the taxpayer (a financial technology processor for banks) and the other entity (an information technology services provider) rather than only the taxpayer's acquisition of such stock in isolation. However, the Court disagreed with the trial court's determination that it did not need to apply the functional test at specific moments in time, remanding the case back to the trial court and noting that the trial court "will likely conclude" the such stock was still integral to the taxpayer's business at the time it was sold.
URL: http://www.courts.ca.gov/opinions/nonpub/C081522.PDF

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Income/Franchise:
Indiana Rulings Hold that Service Revenue from Online Courses Must be Sourced Based on Student Location

Letters of Findings 02-20150399, 02-20150400, 02-20150401, Ind. Dept. of Rev. (7/26/17). In recent letter rulings involving the sourcing of certain online course service revenue received by three related for-profit higher education institutions providing career-oriented educational services for purposes of computing their sales factors under the state adjusted gross income tax, the Indiana Department of Revenue (Department) held that such receipts were *not* derived from their underlying out-of-state activities in course development and production but rather that such revenue resulted from the taxpayers' "ability to deliver and render their services to the students residing in Indiana by means of online courses and the Indiana students who pay for the services performed in Indiana." The taxpayers unsuccessfully argued that Indiana's "cost of performance" rules mandate that they source all such online revenue to their out-of-state corporate headquarters or online center in Illinois because the majority of their related costs were incurred at these out-of-state locations. However, the Department reasoned that the underlying course development and production, standing alone, did not have value unless the taxpayers took steps to ensure that the Indiana students attended the online courses and received the educational services for which they paid. Accordingly, the Department concluded that the service revenue from online courses at issue was attributable to Indiana and taxable in Indiana because the income producing activity was performed in Indiana – and the taxpayers failed to show otherwise.
URL: http://www.in.gov/legislative/iac/20170726-IR-045170321NRA.xml.pdf

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Income/Franchise:
Oregon: New Law Excludes Certain Receipts from Sales Factor Computation

H.B. 2273, signed by gov. 8/2/17. Effective on the 91st day after the date on which the 2017 session of the 79th Legislative Assembly adjourns sine die, and applicable to tax years beginning on or after January 1, 2018, new law provides that for purposes of calculating the sales factor for state corporate income tax purposes, the term "sales" not only refers to non-allocated amounts under Or. Rev. Stat. Secs. 314.615 through 314.645, but must also constitute gross receipts received from transactions and activity occurring in the regular course of the taxpayer's trade or business. To this end, under this new law, the term "sales" for sales factor computation purposes specifically excludes:
URL: https://olis.leg.state.or.us/liz/2017R1/Measures/Overview/HB2273

- Receipts from hedging transactions and from the maturity, redemption, sale, exchange, loan or other disposition of cash or securities;
- Property or money received or acquired by an agent, intermediary, fiduciary or other person acting in a similar capacity on behalf of another in excess of the recipient's commission, fee or other remuneration;
- Amounts received from others and held in trust by the taxpayer; and
- Any other exceptions designated by rule by the Oregon Department of Revenue.

Note that other legislation recently enacted in Oregon [S.B. 28; see previously issued Multistate Tax Alert for more details on this legislation] replaces the state's current cost-of-performance apportionment methodology for sales of items other than tangible personal property with market-based sourcing.
URL: https://olis.leg.state.or.us/liz/2017R1/Downloads/MeasureDocument/SB28/Enrolled

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URL: https://www2.deloitte.com/us/en/pages/tax/articles/oregon-governor-signs-market-sourcing-legislation.html?id=us:2em:3na:stm:awa:tax:080417

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Income/Franchise: Texas Comptroller Discusses Policy Changes Regarding Receipts Factor Treatment of Net Losses from Sale of Investments and Capital Assets

Letter No. 201707002L, Tex. Comptrlr. (7/7/17). The Texas Comptroller of Public Accounts (Comptroller) has released a letter discussing its revised policy regarding the treatment of net losses from the sale of investments and capital assets in calculating "gross receipts" for apportionment purposes under the state franchise (margin) tax. In doing so, the Comptroller references the Texas Supreme Court's 2016 decision [see previously issued Multistate Tax Alert for more details on this ruling], which held that state law does not require taxpayers to include a net loss from the sale of investments and capital assets in its apportionment factor denominator for Texas franchise tax purposes – explaining that it will also apply this decision to the calculation of Texas receipts as there must be "symmetry between Texas receipts and gross receipts everywhere." Accordingly, under its revised policy, the Comptroller explains that net loss from the sale of all investments and capital assets is *not* included in a taxpayer's gross receipts everywhere and a net loss from the sale of all Texas investments and Texas capital assets is *not* included in a taxpayer's Texas receipts for apportionment purposes.
URL: https://star.cpa.texas.gov/view/201707002l
URL: http://www2.deloitte.com/us/en/pages/tax/articles/texas-supreme-court-decision-in-hallmark-marketing.html?id=us:2em:3na:stm:awa:tax:080417

To calculate gross receipts everywhere, the letter states that all gains and losses from all sales of investments and capital assets within the accounting period are added together to determine the net gain or net loss; if the combination results in a net loss, the entity's underlying gross receipts everywhere are zero, and if the combination results in a net gain, the net gain is the entity's underlying gross receipts everywhere. If the entity has Texas and out-of-state sales of investments and capital assets, a separate calculation must be made to determine Texas receipts by adding together Texas gains and losses. If the combination of Texas gains and losses results in a net loss, the entity's underlying Texas receipts are zero; if the combination of Texas gains and losses results in a net gain, the Texas net gain is reported as Texas receipts. "For a combined group, all gains and losses from the sale of investments and capital assets for all members of the combined group are added together to determine the net gain or net loss." The letter includes some sample calculations to help illustrate the Comptroller's updated policy. Please contact us with any questions.

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Income/Franchise: Virginia Department of Taxation Discusses Impact of Changes to Federal Corporate Income Tax Extended Due Date

Tax Bulletin No. 17-9, Vir. Dept. of Tax. (7/28/17). The Virginia Department of Taxation (Department) discusses how certain corporations now have a seven-month filing extension for Virginia income tax purposes due to recent federal legislation (*i.e.*, H.R. 3236 – the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015) and administrative action by the Internal Revenue Service wherein such corporations have an additional filing

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extension for federal income tax purposes, effective for returns filed for taxable years beginning after December 31, 2015. More specifically, the Department explains that beginning with Virginia's taxable year 2016 corporate income tax returns, Virginia will grant up to a seven-month filing extension to C corporations as Virginia Code § 58.1-453(A) grants corporations an extension of time to file their returns to the later of:
URL: https://www.tax.virginia.gov/laws-rules-decisions/tax-bulletins/17-9

- Six months after the due date for filing the original Virginia corporate income tax return, or
- 30 days after the due date for filing the federal corporate income tax return on extension.

The Department notes that prior to taxable year 2016, Virginia generally granted a six-month filing extension for state corporate income tax returns; accordingly, the Virginia extended due date generally had fallen on the fifteenth day of the tenth month after year-end (*i.e.*, October 15 for calendar year filers). Effective for state corporate income tax returns filed with respect to taxable year 2016 and each taxable year thereafter, Virginia now will grant a seven-month filing extension to all C corporations; accordingly, because of the recent federal changes and the Department's authority to grant an extension pursuant to Va. Code § 58.1-105(A), the Virginia extended due date for C corporations generally now will fall on the fifteenth day of the eleventh month after year-end (*i.e.*, November 15 for calendar year filers).

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Indirect/Sales/Use:
Massachusetts DOR Proposes New Regulation Attempting to Adopt "Bright Line" Nexus for Some Remote Sellers

Proposed New Regulation 830 CMR 64H.1.7, Mass. Dept. of Rev. (7/28/17). The Massachusetts Department of Revenue (Department) has proposed a new administrative regulation that would adopt "bright line" economic nexus for some remote sellers, "taking into consideration the relevant provisions of the US constitution and federal law." The proposed regulation addresses circumstances under which an Internet vendor with a principal place of business located outside Massachusetts would be required to register, collect and remit Massachusetts sales or use tax pursuant to Mass. Gen. Laws chapters 64H and 64I, and includes definitions for various relevant terms such as Internet vendors, online marketplace facilitators, and cookies. More specifically, the proposed new rule would implement a bright line economic nexus rule for out-of-state Internet vendors as follows:
URL: http://www.mass.gov/dor/businesses/help-and-resources/legal-library/regulations/64h-00-sales-and-use-tax/proposed-830-cmr-64h-1-7.html

- For the period beginning October 1, 2017 through December 31, 2017, if during the preceding twelve months, October 1, 2016 to September 30, 2017, it had in excess of $500,000 in Massachusetts sales from transactions completed over the Internet and made sales resulting in a delivery into Massachusetts in 100 or more transactions; and
- For each calendar year beginning with 2018, if during the preceding calendar year it had in excess of $500,000 in Massachusetts sales from transactions completed over the Internet and made sales resulting in a delivery into Massachusetts in 100 or more transactions.

The proposed new rule also states that "unlike the mail order vendor at issue in *Quill*," Internet vendors with a large volume of in-state sales "invariably have one or more of the following contacts with the state that function to facilitate or enhance the vendor's in-state sales and constitute the requisite in-state physical presence":

- Property interests in and/or the use of in-state software (e.g., "apps") and ancillary data (e.g., "cookies") which are distributed to or stored on the computers or other physical communications devices of a vendor's in-state customers, and may enable the vendor's use of such physical devices;

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- Contracts and/or other relationships with content distribution networks resulting in the use of in-state servers and/or the receipt of other related in-state services; and/or
- Contracts and/or other relationships with online marketplace facilitators and/or delivery companies resulting in in-state services, including, but not limited to, payment processing and order fulfillment, order management, return processing or otherwise assisting with returns and exchanges, the preparation of sales reports or other analytics and consumer access to customer service.

Additionally, the proposed rule provides that such types of contacts "will generally establish state sales or use tax jurisdiction in the case of a non-Internet vendor when the US constitutional requirements are met." As an example, the proposed rule states that a non-Internet vendor may be subject to state sales or use tax jurisdiction based upon the in-state ownership or use of computer software or hardware, or the receipt of in-state services provided by a marketplace facilitator or delivery company.

Note that this administrative rule proposal follows the Department's previous issuance and subsequent revocation of a directive [Directive No. 17-1, see *State Tax Matters*, Issue 2017-14, for more details on Directive No. 17-1; and Directive No. 17-2 [Revocation of DD 17-1 In Anticipation of a Proposed Regulation], see *State Tax Matters*, Issue 2017-27, for more details on Directive No. 17-2], which had been scheduled to take effect on July 1, 2017, and similarly had attempted to adopt a bright line economic nexus rule for some remote sellers. Note also that on June 28, 2017, in a case filed by trade groups representing Internet and catalog vendors challenging the validity of Directive 17-1, a Massachusetts superior court held that Directive 17-1 was invalid and unenforceable because it was adopted in violation of the Administrative Procedure Act, Mass. Gen. Laws chap. 30A, §§ 1-25.
URL: http://www.mass.gov/dor/businesses/help-and-resources/legal-library/directives/directives-by-years/2017-directives/dd-17-1.html
URL: http://newsletters.usdbriefs.com/2017/Tax/STM/170407_7.html
URL: http://www.mass.gov/dor/businesses/help-and-resources/legal-library/directives/directives-by-years/2017-directives/dd-17-2.html
URL: http://newsletters.usdbriefs.com/2017/Tax/STM/170707_9.html

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Indirect/Sales/Use:
New York: Advisory Explains that Cloud Collaboration Service Constitutes Taxable Prewritten Software Product

TSB-A-17(9)S, N.Y. Dept. of Tax. & Fin. (7/6/17). A recent sales/use tax advisory opinion explains that a taxpayer's described "cloud collaboration service" product is subject to New York state and local sales taxes because it constitutes prewritten software. In doing so, the opinion explains that the essence of the taxpayer's product is software, as the product facilitates the operation of a customer's telecommunications system by allowing the customer to remotely access the software. This software then "instructs" the customer's own equipment to perform various functions, such as instructing the customer's switching apparatus on how to route a telephone call or to direct a call to voice mail if the user does not answer. As such, the taxpayer's receipts from the product constitute receipts from the sale of prewritten computer software because its customers have the right to use, control, and direct the use of, its software to facilitate the operation of the customers' telecommunication systems. Under the facts, a customer contracts with the taxpayer to modify the taxpayer's software to allow it to interact with the customer's telecommunication system and to instruct the customer's telecommunication equipment to perform various functions. By contracting with the taxpayer to purchase a license to use the product, the customer essentially is directing the use of the taxpayer's

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software to interact with its telecommunications system. In this respect, the advisory opinion explains that the customer obtains constructive possession of the taxpayer's software. The opinion states that the taxpayer must collect the associated tax based on the portion of the receipts attributable to its customers' telecommunications systems located in New York.
URL: https://www.tax.ny.gov/pdf/advisory_opinions/sales/a17_9s.pdf

The opinion also notes that the taxpayer's start-up charges are separate from the charges for the license to use its software and that because such charges are for modifying the taxpayer's software to enable it to interact with and direct the customer's telecommunication system, they constitute nontaxable receipts from custom software so long as the charges for the customization are reasonable and separately stated on the invoice or billing statement provided to the customers.

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Indirect/Sales/Use:
Washington DOR Discusses New Law that Expands B&O Tax Economic Nexus Provisions

Tax Topic: New Nexus Standard for Retailing B&O Tax, Wash. Dept. of Rev. (7/31/17). The Washington Department of Revenue (Department) has issued guidance pursuant to recently enacted legislation [H.B. 2163; see previously issued *State Tax Matters*, Issue 2017-27, for more details on this legislation] that extends "economic nexus" for state business and occupation (B&O) taxes to persons engaged in retail sales so long as the retailer has more than $267,000 in receipts from Washington, or at least 25% of the retailer's total property, payroll or total receipts are in Washington during the current or immediately preceding calendar year. The guidance states that the test for determining whether an out-of-state business is subject to Washington's B&O tax changed on July 1, 2017, wherein a business engaged in a retailing activity now has nexus with Washington either by having a physical presence in Washington or by exceeding any of these bright line thresholds. The guidance additionally explains that in determining whether the business has exceeded the $267,000 receipts threshold, retailing income is included along with income taxable under the wholesaling, service and other activities, or royalties B&O tax classifications. Regarding timeframe for determining nexus, the guidance clarifies that the nexus thresholds are measured by a business's receipts in the current year or the prior year: "In other words, if a business has exceeded one or more of the economic nexus thresholds in either the prior calendar year or the current calendar year, the business has nexus for B&O tax purposes in the current year and must register in Washington." The guidance provides some examples to help illustrate this new law's application, including how to determine taxability in 2017, and well as in 2018 and beyond.
URL: http://dor.wa.gov/Content/GetAFormOrPublication/PublicationBySubject/TaxTopics/NexusRetailingBO.aspx
URL: http://lawfilesext.leg.wa.gov/biennium/2017-18/Pdf/Bills/House%20Passed%20Legislature/2163.PL.pdf#page=1
URL: http://newsletters.usdbriefs.com/2017/Tax/STM/170707_12.html

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Indirect/Sales/Use:
Washington DOR Proposes Amended B&O Tax Rule on Financial Institution Apportionment to Conform with MTC Changes

Proposed Amended WAC 458-20-19404, Wash. Dept. of Rev. (7/14/17). The Washington Department of Revenue (Department) has issued a proposed amended administrative rule addressing how financial institutions must apportion gross income for state business and occupation (B&O) tax purposes when they engage in business both within and outside of Washington. These proposed amendments are issued pursuant to state law authorizing the Department to adopt financial institution apportionment rules that are consistent with the model adopted by the Multistate Tax Commission (MTC). Accordingly, the Department is proposing to amend this administrative rule on a permanent basis [Note: see *State Tax Matters*, Issue 2017-18, for details on similar emergency amendments made earlier this year] to remain consistent with the MTC's change in its model method of apportionment for financial institutions, which became effective for tax years starting on or after January 1, 2016.
URL: http://dor.wa.gov/Docs/Rules/draft/20-19404cr2frmdraft2ndJuly2017.pdf
URL: http://newsletters.usdbriefs.com/2017/Tax/STM/170505_9.html

Written comments on this proposal must be submitted by September 13, 2017, which is also the date of the related hearing. The Department currently lists the date of "Intended Adoption" as September 20, 2017. Please contact us with any questions.

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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

North Carolina Tax Legislation Enacted
On June 21, 2017, North Carolina Governor Roy Cooper signed House Bill 59 (H.B. 59). H.B. 59 as enacted impacts state income, franchise, sales and use, and excise taxes. In addition, on June 28, 2017, the North Carolina General Assembly overrode Governor Cooper's veto of Senate Bill 257 (S.B. 257) – thereby enacting S.B. 257 into law – which includes further modifications to North Carolina tax law.

This Multistate Tax Alert highlights some of the more notable North Carolina tax law changes (which have various effective dates as specified within) that were contained in these two bills, including:

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- Corporate Income and Franchise Tax:
  - Updates the North Carolina income tax code to conform to the Internal Revenue Code as of January 1, 2017;
  - Provides guidance on the Railroad Intermodal Facility Credit;
  - Decreases the corporate income tax rate from 3 percent to 2.5 percent effective for tax years beginning on or after January 1, 2019; and
  - Amends the franchise tax to include a flat minimum tax of $200 for the first $1 million of an S corporation's tax base.
- Sales and Use Tax:
  - Enacts significant sales and use tax exemptions for certain sales of equipment, repeals the 1 percent "mill machinery" privilege tax, and makes sales of mill machinery, mill machinery parts and accessories exempt from sales tax, effective July 1, 2018; and
  - Adds a sales tax exemption for certain fulfillment facilities and a sales tax refund for transformative projects, effective July 1, 2017.

[Issued July 28, 2017]
URL: https://www2.deloitte.com/us/en/pages/tax/articles/north-carolina-tax-legislation-enacted.html?id=us:2em:3na:stm:awa:tax:080417

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