In this issue:

Amnesty:
Virginia: Amnesty Program Begins September 13, 2017 and Ends November 14, 2017 Providing for Potential 50% Interest Waiver and 100% Penalty Waiver and Includes Post-Amnesty Penalties

P.D. 17-156: Guidelines for the Virginia Tax Amnesty Program, Vir. Dept. of Tax. (9/5/17). Pursuant to legislation enacted earlier this year [H.B. 2246; see *State Tax Matters*, Issue 2017-9 for more details on this new law] and the signed state budget bill [H.B. 1500], the Virginia Department of Taxation (Department) has issued some additional guidance on its administration of the 2018 fiscal year tax amnesty program – announcing that the program will run for a 62-day period beginning on September 13, 2017, and ending on November 14, 2017. This program 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. At the conclusion of the amnesty period, "any remaining amnesty-qualified liabilities will be assessed an additional 20 percent penalty."
URL: https://www.tax.virginia.gov/laws-rules-decisions/rulings-tax-commissioner/17-156
URL: http://lis.virginia.gov/cgi-bin/legp604.exe?ses=171&typ=bil&val=hb2246
URL: http://newsletters.usdbriefs.com/2017/Tax/STM/170303_1.html
URL: https://budget.lis.virginia.gov/bill/2017/1/HB1500/Chapter/

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Income/Franchise:
Indiana Ruling Holds that Taxpayer Successfully Showed Nexus with Foreign Jurisdictions for Sales Factor "Throwback" Purposes

Memorandum of Decision No. 02-20160336R, Ind. Dept. of Rev. (8/30/17). The Indiana Department of Revenue (Department) recently ruled in favor of an out-of-state taxpayer regarding its sales factor computation for state adjusted gross income tax purposes, holding that it was entitled to a reduction because some of its sales in certain foreign jurisdictions should *not* have been sourced to Indiana under Indiana's "throwback" rule. More specifically, upon reviewing the taxpayer's submitted documentation, the Department held that the taxpayer successfully showed that its subsidiaries' activities in Germany, Canada, Great Britain, China, Indonesia, South Korea, Thailand, and Singapore exceeded the protections afforded under P.L.86-272, and that it thus would be subject to a net income tax in these countries. Accordingly, Indiana's throwback rule was deemed inapplicable to the income derived from the taxpayer's sales to these specific foreign jurisdictions during the tax year at issue. In doing so, the Department also explained that in addition to considering the presence of employees providing more than mere solicitation in these foreign jurisdictions, it was applying the "Finnigan" concept by considering royalty income received by the taxpayer's subsidiaries from the use of intellectual property in foreign jurisdictions for purposes of determining nexus with these countries for throwback rule purposes.
URL: http://www.in.gov/legislative/iac/20170830-IR-045170369NRA.xml.pdf

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Income/Franchise:
New York: ALJ Rules in Favor of Taxpayer; Receipts from Online Services Sourced Out-of-State

DTA No. 826545, N.Y. Dept. of Tax. & Fin. (8/24/17). On August 24, 2017, a New York State Administrative Law Judge (ALJ) ruled in favor a Colorado-based corporation conducting a web-based litigation support business (Taxpayer), finding that receipts from its activities (under prior law) were properly sourced outside of New York as receipts from the performance of services for purposes of calculating the receipts factor under the Article 9-A state business corporation franchise tax. The ALJ also determined that the receipts should be sourced outside of New York even if the state was correct in asserting that the receipts were properly classified as "other business receipts."
URL: https://www.dta.ny.gov/pdf/determinations/826545.det.pdf

For its tax years ending in 2009 and 2010, the Taxpayer generally charged its customers three types of fees: a site setup fee, a monthly user access fee (or base license fee) and a variable license fee. The New York State Department of Taxation and Finance (Department) asserted that revenues from the monthly user access fees and the variable license fees constituted "other business receipts," and were properly sourced to New York using a customer location approach.

The Taxpayer asserted that its receipts were properly classified as receipts from the performance of services and therefore sourced to the location where the services were performed (i.e., outside of New York). Alternatively, the Taxpayer argued that if it were determined that its receipts should be classified as "other business receipts," they still should be sourced to Colorado because the activities and work that generated the receipts were performed in Colorado. The Department argued that the Taxpayer's receipts were not receipts from the performance of services as no employees, agents, subcontractors or other persons on behalf of the Taxpayer were involved in the performance of the transactions generating the receipts. Alternatively, the Department maintained that the receipts were the result of the Taxpayer allowing access to and use of its software (i.e., licensing of intangibles) and therefore should be sourced based on customer location.

The ALJ agreed with the Taxpayer, ruling that the statutory provision addressing the sourcing of receipts derived from the performance of services, former N.Y. Tax Law § 210.3(a)(2)(B), was applicable because the statute does not require human involvement at the moment of sale in order for services to have been performed. Moreover, the ALJ rejected the Department's argument that the receipts in question were derived from the sale of intangibles, noting that a determination of a taxpayer's business activities must be made from the perspective of the taxpayer's clients. In this case, the ALJ determined that the Taxpayer's clients do not pay the Taxpayer merely to host their documents on the Taxpayer's servers or to access the Taxpayer's software. Rather, the clients pay the Taxpayer to use its system, which includes access to the Taxpayer's proprietary software and use of the Taxpayer's personnel, so that they can effectively and efficiently manage electronic discovery and other complex litigation matters. Importantly, the ALJ further determined that even if the receipts at issue were properly classified as "other business receipts," they should be sourced to the location of the activities that generated the fees (not sourced based on customer location), which in this case was Colorado.

Lastly, the ALJ noted that legislation enacted subsequent to the tax periods at issue changed the allocation of service receipts to a customer sourcing approach for Article 9-A state business corporation franchise tax purposes, applicable for tax years beginning on and after January 1, 2015. The ALJ noted that this change would have been unnecessary if the allocation of service receipts was interpreted as the Department asserted in this case.

Note that this case is consistent with two other recent New York ALJ cases holding that, before 2015, receipts from services delivered electronically are sourced the same as all other services – that is, to the location where the services were performed and not based on the location of the customer.

Note also that an ALJ determination is not precedent in the Division of Tax Appeals or any New York State judicial proceeding, and may be appealed.

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Income/Franchise:
New York State Department of Taxation and Finance Removes Draft Proposed Regulation Section 4-2.12 Regarding Receipts from Certain Services to Investment Companies

On August 31, 2017, the New York State Department of Taxation and Finance (Department) removed its Draft Proposed Regulation Section 4-2.12, regarding receipts from certain services to investment companies, from the draft proposed Subpart 4-2 Specific Apportionment Rules. In doing so, the Department stated that such receipts should be sourced using the rules for N.Y. Tax Law §§ 210-A(5)(b)(5), 210-A(5)(d) or 210-A(10), as applicable. The Department further stated that "it is deliberating the other sections this draft regulation as well as additional apportionment issues." The Department expects that a new revised draft of this apportionment regulation will be available in the future.
URL: https://www.tax.ny.gov/bus/ct/pending/Apportionment_draft_text_8-31-17.pdf

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Income/Franchise:
South Carolina Appellate Court Affirms that Satellite TV Provider Must Source Subscription Receipts Based on Market because “Signal Delivery” is Income-Producing Activity

Case No. 2015-001509, S.C. Ct. of App. (8/30/17). The South Carolina Court of Appeals (Court) has affirmed an administrative law court decision that a nationwide provider of direct broadcast satellite video services must source 100% of its subscription receipts from South Carolina customers to South Carolina for state corporate income tax purposes because the underlying primary “income producing activity” on such receipts is the delivery of the signal into homes and businesses and onto the television sets of its customers. In doing so, the Court explained that while other out-of-state activities proffered by the taxpayer and occurring prior to the delivery of signal are important for the taxpayer in that they can help lead to income, S.C. Code Ann. section 12-6-2295(A)(5) requires consideration of activities that actually produce income and thus these other activities are “too attenuated” to be considered “income-producing” for sourcing purposes.
URL: http://www.sccourts.org/opinions/HTMLFiles/COA/5513.pdf

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Income/Franchise:
Virginia Supreme Court Holds that Intercompany Royalty Payments Must be Taxed in Another State to Qualify for “Subject-to-Tax” Addback Exception

Case No. 160681, Va. (8/31/17). The Virginia Supreme Court (Court), in a 4-3 split decision, has upheld a limitation on the so-called “subject to tax” statutory exception to Virginia’s related-party intangible expense addback statute – regarding income that is subject to a tax based on or measured by net income or capital imposed by Virginia, another state, or a foreign government – concluding that only the portion of intercompany royalty payments at issue that was actually taxed by another state falls within this exception. The Court also ruled that an exception may exist to the extent the related party items were actually subject to tax in a combined reporting state, or were subject to tax as a result of an addback statute, and remanded the case back to the Virginia circuit court for a determination of what portion was subject to tax.
URL: http://www.courts.state.va.us/opinions/opnscvwp/1160681.pdf

It is interesting to note that legislation enacted as part of the 2014 and 2016 state budget bills, which was retroactive to 2004, was not invoked or relied upon by the Virginia Department of Taxation (Department) in this case. This legislation could seemingly impact the Department’s ongoing response to the Court’s holding regarding addback statutes and combined reporting states as it impacts the “subject to tax” safe harbor. It remains to be seen whether these noncodified provisions will be a factor in the Department’s ongoing approach to this issue. Note that it is believed that other cases regarding this issue are docketed for Virginia circuit court.

Please contact us with any questions; and stay tuned for a forthcoming Multistate Tax Alert with more details on this decision as well as some related taxpayer considerations.

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Indirect / Sales / Use:
New York Advisory Opinion Explains Taxation and Sourcing of Interactive Software with Customized "Skinning"

TSB-A-17(15)S, N.Y. Dept. of Tax. & Fin. (8/1/17). A recently issued state sales and use tax advisory opinion addresses whether New York State and local sales tax applies to certain charges to retailers located both in-state and out-of-state for:
URL: https://www.tax.ny.gov/pdf/advisory_opinions/sales/a17_15s.pdf

1. Interactive training software that is customized to each retailer and distributed electronically;
2. License fees related to the creation of videos that are embedded in the software;
3. Software and video license fees when they are charged in a lump sum; and
4. Monthly or annual subscription fees.

The opinion concludes that the taxpayer's sale of software, software and videos for one lump sum, and its subscription fees will be subject to New York State and local sales tax when they are used by the retailers' employees in New York State; however, they will *not* be subject to tax when sold for use by the retailers' employees outside New York State. Under the facts, the retailers use the taxpayer's "app" to access and download training software for use in training their own employees. The opinion explains that the taxpayer's charge for its training software constitutes receipts from the lease or license to use or consume taxable prewritten computer software, and that this charge for the taxpayer's software includes the charge for the prewritten software used for all retailers before it is "skinned" to a specific retailer plus the charges for skinning. In this respect, this charge for the custom modification is not separately stated from the charge for the prewritten software and thus the entire charge is subject to sales tax when used by the retailers' employees in New York State. Note that "skinning" in this context involves customizing the taxpayer's core code to reflect a retailer's logo, name or other individual attributes; the code is also modified to work with each retailer's operating system.

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Transfer:
New York: New Law Extends Certain Real Property Transfer Tax Rate Reductions to September 1, 2020

A.B. 7523, signed by gov. 9/1/17. New law extends the tax rate reductions under the New York State real estate transfer tax and the New York City real property transfer tax for certain conveyances of real property to existing real estate investment trusts (REITs) to September 1, 2020. Note that the standard New York State real estate transfer tax rate is 0.4%, while the standard New York City real property transfer tax rate is 2.625%, for transfers of non-residential property interests valued at more than $500,000 – for a total standard combined rate of 3.025%. However, for qualified transfers to REITs, the New York State real estate transfer tax rate is reduced to 0.2% of the value of the property interest conveyed; and the New York City real property transfer tax rate is reduced to half the applicable standard rate, or 1.3125%, for transfers of non-residential property interests valued at more than $500,000. Previously, these reduced tax rates for certain qualified transfers to REITs had been set to expire on September 1, 2017.
URL: http://nyassembly.gov/leg/?default_fld=&leg_video=&bn=A07523&term=2017&Summary=Y&Text=Y

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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 FTB proposes new withholding regulation for pass-through entities
On September 8, 2017, the California Franchise Tax Board is holding an Interested Parties Meeting to discuss recently issued proposed language for a new regulation – California Code of Regulations, title 18, Section 18662-7 – that, if adopted, would change the withholding requirements for domestic pass-through entities. Notable changes that would result from this proposed regulation include:

- Withholding on a pass-through entity owner's distributive share of California source income (instead of distributions paid);
- A withholding rate that varies depending on whether the pass-through entity owner is an individual, C corporation, S corporation, or other upper-tier pass-through entity (instead of the flat seven percent rate);
- A ten-day notification requirement for reporting withholding payments to owners; and
- Two new forms – Form 592-Q (filed when a withholding payment is made to the FTB on behalf of a nonresident owner), and Form 592-PTE (filed on an annual basis by a pass-through entity that is allocating withholding payments to its owners).

It should be noted that, as required under current law, upper-tier pass-through entities still must allocate withholding paid by a lower-tier pass-through entity to every owner of the upper-tier pass-through entity (including California residents) and cannot claim a refund of any excess withholding.

This Multistate Tax Alert summarizes proposed Regulation Section 18662-7 and provides some taxpayer considerations.
[Issued August 31, 2017]
URL: https://www2.deloitte.com/us/en/pages/tax/articles/california-ftb-proposes-new-withholding-regulation-for-pass-through-entities.html?id=us:2em:3na:stm:awa:tax:090817