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

Income/Franchise:
Alabama: Proposed Amended Rule Reflects New Law that Includes Loans and Credit Card Receivables in Property Factor for Financial Institution Excise Tax Purposes

Proposed Amended Ala. Admin. Code r. 810-9-1-.05; *Proposed New Ala. Admin. Code r. 810-3-39-.03*, Ala. Dept. of Rev. (9/17). The Alabama Department of Revenue (Department) has issued proposed administrative rule amendments, including revisions that reflect recently enacted legislation [H.B. 263; see *State Tax Matters*, Issue 2017-17, for more details on this new law] mandating that loans and credit card receivables be included within a financial institution's property factor for Alabama financial institution excise tax (FIET) purposes, and sourced using the same methods as the Department uses to allocate and apportion a financial institution's interest receipts associated with such loans and credit card receivables – applicable to all tax years beginning on and after January 1, 2017. Another administrative rule proposal attempts to adopt a new rule on the election and mechanics of filing an Alabama consolidated corporate income tax return, including specifying that only corporations having substantial nexus with Alabama may be included as part of the Alabama affiliated group.
URL: https://revenue.alabama.gov/wp-content/uploads/2017/05/810-9-1-.05-2.pdf
URL: https://revenue.alabama.gov/wp-content/uploads/2017/05/810-3-39-.03.pdf
URL: http://alisondb.legislature.state.al.us/ALISON/SearchableInstruments/2017RS/PrintFiles/HB263-enr.pdf
URL: http://newsletters.usdbriefs.com/2017/Tax/STM/170428_2.html

A public hearing on these proposals will be held on October 10, 2017; please contact us with any related questions.

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Income/Franchise:
California FTB Chief Counsel Ruling Addresses Impact of Recorded Goodwill for Deemed Water's Edge Election "Business Assets Test"

Chief Counsel Ruling 2017-02, Cal. FTB (9/8/17). The California Franchise Tax Board (FTB) recently released a chief counsel ruling which held that goodwill recorded as a result of an acquiring company's acquisition of a target company should be included as a "business asset" of the target company for purposes of applying California's "deemed water's-edge election" business asset test under California Rev. & Tax. Code section 25113(c)(2). In doing so, the FTB explained that no exception to California statutes or regulations specifically excludes goodwill from the definition of "business assets" for purposes of calculating the business asset test. Accordingly, because the value of the target company's total business assets in this case, including the goodwill, was larger than that of the acquiring company when the new unitary affiliate group was established, the acquiring company was deemed to have made a water's-edge election.
URL: https://www.ftb.ca.gov/law/ccr/2017/02.pdf

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:
New Mexico Hearings Officer Holds in Taxpayer's Favor that Interest Income from Payment-in-Kind Notes is Nonbusiness Income Allocable Out-of-State

Decision No. 17-39, N.M. Tax. & Rev. Dept. (9/15/17). An administrative hearings officer (AHO) within the New Mexico Taxation and Revenue Department (Department) recently held in favor of the taxpayer that interest income it earned from certain payment-in-kind notes constituted nonbusiness income allocable to its out-of-state commercial domicile for New Mexico corporate income tax purposes under the transactional test, functional test, and dispositional test. Citing the holdings in *Allied Signal* and *Mead*, the AHO explained that an item of income is subject to apportionment either if:
URL: http://www.tax.newmexico.gov/uploads/files/17-39_Conagra%20Foods%20Food%20Ingredients%20Co_%20Inc.pdf

1. The taxpayer/payee and the income payor are engaged in a unitary business, or
2. The asset that generated the income was itself used as part of the taxpayer's unitary business operations in the taxing state.

Because the taxpayer and the buying parties in this case were *not* engaged in a unitary business, and the payment-in-kind notes at issue were *not* used as part of the taxpayer's unitary business operations in New Mexico, the AHO concluded that the underlying interest income at issue did not constitute apportionable business income under UDITPA.

Regarding the dispositional test specifically, the AHO explained that while the taxpayer initially received the payment-in-kind notes as part of a "sophisticated financing mechanism of the sale and disposition of its grain elevator business," of critical importance was the fact that the taxpayer fully apportioned the proceeds from the sale of the business line (including the full face value of the financing instrument payment-in-kind notes) as business income in New Mexico and paid the corresponding tax to New Mexico for that business income in the fiscal year of the sale. The AHO reasoned that after already apportioning and paying the appropriate New Mexico corporate income tax from its complete disposition of the line of business, no meaningful relationship remained between the payment-in-kind notes and the taxpayer's current lines of business, and that the taxpayer was not in the regular business of holding, trading, exchanging payment-in-kind notes or other sophisticated financial instruments – thus, such income constituted nonbusiness income. The Department had argued that such interest income constituted business income from the sale of a business line, as the underlying notes were issued pursuant to a business segment sale. Please contact us with any questions.

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Income/Franchise:
North Carolina Supreme Court Affirms that Taxpayer Cannot Claim Interest Deduction for "Market Discount Income" on Discounted US Bonds

Case Nos. 392A16 and 393PA16, N.C. (8/18/17). The North Carolina Supreme Court (Court) has affirmed that a taxpayer could *not* claim a deduction for "market discount income" – that is, income generated from the amount received from discounted US government bonds at maturity versus the amount initially paid for the discounted US government bonds – for North Carolina corporate income tax purposes because such income did *not* constitute deductible "interest" under state law. The taxpayer had unsuccessfully argued that such income should be deductible for North Carolina corporate income tax purposes as interest earned on US government obligations, because it is treated as such for federal income tax purposes. The Court agreed with the lower court in concluding that the undefined term "interest" as used in N.C.G.S. § 105-130.5(b)(1) is unambiguous and should be understood in accordance with its plain meaning as involving "periodic payments received by the holder of a bond," which was not the case here. The Court additionally noted that while market discount income is certainly treated as interest income for purposes of determining the taxpayer's federal taxable income, this fact does not necessarily mean that it should be treated as "interest" for all purposes under the North Carolina Revenue Act.
URL: https://appellate.nccourts.org/opinions/?c=1&pdf=35904

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Income/Franchise:
Wisconsin Governor Signs Budget Bill with Various Tax Law Changes – Including Updated State Conformity to IRC; Revised Sourcing and Apportionment Provisions; and NOL Limitations

A.B. 64 [2017 Wisconsin Act 59], signed by gov. 9/21/17. Recently enacted budget legislation contains various tax law-related changes, including:
URL: https://docs.legis.wisconsin.gov/2017/proposals/ab64

1. Generally updating references to the Internal Revenue Code as amended through December 31, 2016, with certain enumerated exceptions, for state corporate and individual income tax purposes;
2. Modifying sourcing rules for certain service revenue effective for tax years beginning after 2016 – such that gross receipts from service revenue are deemed in Wisconsin if the service relates to tangible personal property delivered directly or indirectly to customers in Wisconsin, or if the service is purchased by an individual who is physically present in Wisconsin at the time the service is received;
3. Generally limiting the number of years that taxpayers may retroactively re-compute their net operating losses to no more than four years following the unextended filing due date of the return for the taxable year in which the loss occurred; and
4. Modifying the apportionment of certain broadcasting revenue for tax years beginning after 2018, by requiring defined broadcasters to make two sourcing calculations.

This new law additionally:

1. Postpones the effective date of provisions allowing a retailer to claim state sales tax "bad debt" deductions or refunds in certain transactions involving affiliated lenders and private label credit cards to July 1, 2018 (previously, July 1, 2017);
2. Repeals the current grandfathered-in state sales tax on Internet access charges effective July 1, 2020;
3. Modifies Wisconsin's manufacturing and agriculture credit claimed by individuals; and iv) introduces a partially refundable research and development tax credit.

Stay tuned for a forthcoming Multistate Tax Alert for more details on this legislation.

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Indirect/Sales/Use: Illinois Appellate Court Holds that Internet Retailer Lacks Substantial Nexus and Thus Not Liable for Use Tax

Case No. 1-16-1601, Ill. App. Ct. (9/25/17). In a case originally brought forth under an Illinois False Claim Act action – alleging that on out-of-state Internet cosmetics retailer violated the Illinois Retailers' Occupation and the Use Tax Act by failing to collect and remit Illinois use tax on Internet and catalog sales to Illinois customers for the tax periods at issue – an Illinois Appellate Court (Court) recently affirmed the trial court's decision that the retailer did *not*:
URL: http://www.illinoiscourts.gov/R23_Orders/AppellateCourt/2017/1stDistrict/1161601_R23.pdf

1. Have a substantial nexus with Illinois pursuant to the Commerce Clause, and
2. Act with reckless disregard of its alleged obligation to collect and remit use taxes on its Internet and catalog sales.

In doing so, the Court agreed with the trial court that the Internet retailer lacked a physical presence in Illinois, and that a brick-and-mortar store operating in Illinois that licensed products from the same foreign licensor did *not* act as its agent or on the Internet retailer's behalf. The Court noted that, under the provided facts, the two entities maintained separate merchandise and employed separate marketing schemes – and actually competed with each other for business with the in-store employees:

1. Being discouraged from directing customers to the Internet retailer's website, and
2. Not accepting returns from the Internet retailer's online sales in the physical stores.

Please contact us with any questions.

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Indirect/Sales/Use:
Massachusetts Supreme Judicial Court Affirms that Wholesale Distributor Must Collect and Remit Tax on Goods Sold to Out-of-State Retailers in Drop Shipment Scenarios

Case No. SJC-12260, Mass. (7/31/17). The Massachusetts Supreme Judicial Court (Court) held that a wholesale distributor must collect and remit state sales and use tax on goods sold to certain out-of-state retailers under drop shipment arrangements where Massachusetts consumers order products from the retailers, which in turn, purchase the products from the wholesale distributor that then ultimately ships the products directly to the Massachusetts consumers on the retailers' behalf. The wholesale distributor had argued unsuccessfully that before state sales tax collection and remittance responsibilities could be imposed on it in these drop shipment transactions, Massachusetts must first establish that the respective retailers did not do business in Massachusetts under each transaction. Noting that the wholesale distributor in this case had obtained the relevant information as to whether or not the various retailers were registered as Massachusetts vendors, the Court held that Massachusetts' drop shipment rule placed the burden on the wholesale distributor to show whether the respective retailers were doing business in Massachusetts. The Court additionally rejected the wholesale distributor's constitutional arguments, explaining that because both in-state and out-of-state retailers were equally subject to tax collection and remittance responsibilities under Massachusetts' drop shipment rule, the statutory drop shipment rule does *not* violate the dormant commerce clause of the US Constitution. Please contact us with any related questions.
URL: https://www.lexisnexis.com/clients/macourts/

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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

Hurricane Irma Impact Upon Federal and Certain State Fleet/Fuel Taxes and Fuel Procurement
In response to fuel shortages caused by Hurricane Irma, the United States Environmental Protection Agency, the IRS and the State of Florida have issued fuel waivers related to the sale and use of dyed diesel fuel in highway vehicles. The waivers are intended to minimize disruption of diesel fuel supply in the provision of emergency response and disaster recovery services in areas affected by Hurricane Irma. Under qualifying circumstances, entities will temporarily avoid federal and state penalties associated with using dyed diesel fuel in on-road vehicles. Additionally, the IRS as well as various state agencies have issued temporary filing extensions for taxpayers affected by Hurricane Irma.

This Multistate Tax Alert summarizes the temporary federal and Florida fuel waivers as well as the filing extensions. [Issued September 22, 2017]
URL: https://www2.deloitte.com/us/en/pages/tax/articles/hurricane-irma-impact-upon-federal-and-certain-state-fleet-fuel-taxes-and-fuel-procurement.html?id=us:2em:3na:stm:awa:tax:092917