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Income/Franchise:
California FTB Expands Treatment Set Forth in Previous Notice on Water's Edge Elections for Non-electing Unitary Foreign Affiliates

FTB Notice 2017-04, Cal. FTB (10/16/17). The California Franchise Tax Board (FTB) recently issued a notice (FTB Notice 2017-04) that extends the treatment set forth in FTB Notice 2016-02 [see previously issued Multistate Tax Alert for more details on this earlier notice] to include those unitary foreign affiliates that become California taxpayers in a taxable year beginning on or before December 31, 2017, solely due to the change in law under California Revenue and Taxation Code section 23101(b). FTB Notice 2016-02 generally addresses how California's economic nexus rules impact a California combined group's water's edge election when non-electing unitary foreign affiliates are involved. More specifically, FTB Notice 2016-02 provides guidance on how the FTB would treat an otherwise valid water's edge election when a non-electing unitary foreign affiliate of a water's edge combined group becomes a "taxpayer" because it is "doing business" in California solely as a result of applying the economic nexus standard under California Revenue and Taxation Code section 23101(b) – which became effective for taxable years beginning on or after January 1, 2011. FTB Notice 2016-02 had limited application only to unitary foreign affiliates that become taxpayers in California in a taxable year ending on or before December 31, 2016. FTB Notice 2017-04 "adheres to and incorporates by reference FTB Notice 2016-02 in all respects, except the specific date constraints listed as conditions for FTB Notice 2016-02 to apply."
URL: https://www.ftb.ca.gov/law/notices/2017/04.pdf
URL: https://www.ftb.ca.gov/law/notices/2016/2016-02.pdf
URL: https://www2.deloitte.com/us/en/pages/tax/articles/foreign-entitys-2015-taxable-year-california-waters-edge-election.html?id=us:2em:3na:stm:awa:tax:102017

See forthcoming Multistate Tax Alert for more details on this recently issued guidance, as well as related taxpayer considerations.

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Income/Franchise:
California FTB Addresses Conformity to Federal Information Filing Requirements Relating to Certain Foreign Financial Assets for Nonresident Aliens

Legal Ruling 2017-02, Cal. FTB (10/16/17). The California Franchise Tax Board (FTB) recently issued a legal ruling addressing whether California's conformity to federal information filing requirements relating to certain foreign financial assets imposed by Internal Revenue Code (IRC) section 6038D applies to nonresident aliens. Under three example scenarios, the FTB explains that California generally follows the federal law regarding application of the IRC section 6038D information filing requirements with income tax returns for nonresident aliens – with the FTB potentially imposing a minimum penalty of $10,000 for failing to provide a copy of the filed IRS Form 8938 with any

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corresponding California individual income tax return that is required to be filed, unless it can be shown that the failure was due to reasonable cause and not willful neglect.
URL: https://www.ftb.ca.gov/law/rulings/active/2017/02-1016.pdf

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Income/Franchise:
District of Columbia Office of Tax and Revenue Informally Comments on Market-Sourcing of Sales of Non-TPP

For tax years beginning after December 2014, D.C. Code Ann. sec. 47-1810.02(g)(3) provides that sales other than sales of tangible personal property are sourced to the District of Columbia (District) for business franchise tax apportionment purposes if the taxpayer's market for the sales is in the District. These sales factor sourcing provisions were enacted under legislation [The Fiscal Year 2015 Budget Support Act of 2014] that also mandated the District's Office of the Chief Financial Officer (CFO) to prescribe administrative regulations as necessary or appropriate to carry out the District's new market-based sourcing regime. To date, the District CFO has not officially released proposed or final administrative regulations on its market-based sourcing regime. However, a representative of the District's Office of Tax and Revenue (OTR) has informally indicated that market-based sourcing administrative rules are being contemplated and that, in the meantime, taxpayers may look to the Multistate Tax Commission's Model Apportionment Regulations for any additional guidance.

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Income/Franchise:
Massachusetts: Department of Revenue Issues Working Draft of Amendments to Regulation on Corporate Excise Tax Nexus

Working Draft 830 CMR 63.39.1 – Corporate Nexus, Mass. Dept. of Rev. (10/17/17). The Massachusetts Department of Revenue has issued a working draft of potential amendments to an administrative regulation that generally describes the circumstances under which certain business corporations will be subject to Massachusetts' corporate excise tax under M.G.L. c. 63 – including separate provisions for general business corporations, financial institutions, and insurance companies. Comments on this working draft are due by November 10.
URL: http://www.mass.gov/dor/businesses/help-and-resources/legal-library/regulations/63-00-taxation-of-corporations/working-draft-830-cmr-63-39-1.html

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Income/Franchise:
Montana DOR Issues Proposed Regulations Based on New Market-Sourcing, NOL, and Financial Institution Apportionment Provisions – also Reflect "Finnigan" Rule

Proposed Amended Mont. Admin. Rules 42.26.201, .202, .203 et al.; *Proposed Amended Mont. Admin. R. 42.23.802, 42.23.805*; *Proposed Amended Mont. Admin. Rules I through III*, Mont. Dept. of Rev. (10/13/17). The Montana Department of Revenue (Department) has issued proposed administrative rules reflecting recently enacted legislation [H.B. 511; see previously issued Multistate Tax Alert for more details on this new law] that revises Montana's adopted version of the Multistate Tax Compact, as recommended by the Multistate Tax Commission, including implementing market-based sourcing of certain sales of other than tangible personal property for state corporate income tax apportionment purposes (as well as for purposes of determining Montana source income for some pass-through businesses) – applicable to tax years beginning after December 31, 2017. Other proposed amendments attempt to "limit the risk of manipulation of the apportionment factors of a unitary combined group" by adopting the "Finnigan Rule" rather than the "Joyce Rule." The Department has also issued proposed rule amendments reflecting another recently enacted bill [H.B. 550; see *State Tax Matters*, Issue 2017-22 for more details on this new law] which, applicable to tax years beginning after December 31, 2017, revises net operating loss (NOL) provisions related to Montana's corporate income tax – permitting NOLs to be carried back three years and carried forward ten years. Lastly, the Department has issued proposed new administrative rules, which are modeled after regulations adopted by the Multistate Tax Commission, on how to more fairly apportion the receipts of financial institutions to states in which they do business for Montana corporate income tax purposes (by including specific types of receipts in the numerator of the receipts apportionment factor and explaining how such receipts are assigned to Montana).
URL: http://revenue.mt.gov/Portals/9/rules/proposalnotices_hearinginformation/42-2-985pro-arm.pdf
URL: http://revenue.mt.gov/Portals/9/rules/proposalnotices_hearinginformation/42-2-984pro-arm.pdf
URL: http://revenue.mt.gov/Portals/9/rules/proposalnotices_hearinginformation/42-2-986pro-arm.pdf
URL: http://leg.mt.gov/bills/2017/billpdf/HB0511.pdf
URL: https://www2.deloitte.com/us/en/pages/tax/articles/montana-adopts-market-based-sourcing-for-receipts-from-sales-of-non-tpp.html?id=us:2em:3na:stm:awa:tax:102017
URL: http://leg.mt.gov/bills/2017/billpdf/HB0550.pdf
URL: http://newsletters.usdbriefs.com/2017/Tax/STM/170602_2.html

The Department has scheduled a public hearing on these various proposals on November 2, 2017, and is asking that written comments be received no later than November 13, 2017. Please contact us with any questions.

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Income/Franchise: New Jersey Tax Court Upholds CBT Assessment Issued Against Out-of-State Corporate Limited Partner on Passthrough Income Received from Real Estate Partnerships

Docket Nos. 010921-2013, No. 010920-2013, and No. 010922-2013, N.J. Tax Ct. (10/4/17). A recently published New Jersey Tax Court (Court) decision upheld state corporation business tax (CBT) assessments issued against an out-of-state corporation (taxpayer) on its share of pass-through income received as a 99% limited partner from two foreign limited partnerships. The taxpayer had unsuccessfully argued that under *BIS LP, Inc. v. Director, Div. of Taxation*, it lacked CBT nexus with New Jersey as a holding company that merely received passive income from the two limited partnerships. The Court explained that, under the facts, the partnerships at issue were actively managed, operated, and controlled in all aspects by the same family of individuals that ultimately owned the taxpayer and the general partners, and who were all actively involved in their sole real estate business (*i.e.*, developing, building and selling homes) in New Jersey through the two limited partnerships. Accordingly, "in the absence of any evidence of absolute or finite lines between the corporate partners, their parent, and the partnerships' business operations," the Court explained that it could not conclude that the taxpayer was a mere passive investor or true limited partner with zero nexus to New Jersey. However, the Court did rule in favor of the taxpayer in vacating the imposed underpayment of tax penalties for 2005 and 2006, and cancelling the amnesty penalty for 2005 through 2007. Please contact us with any questions.
URL: https://www.judiciary.state.nj.us/attorneys/assets/opinions/tax/10921-13opn.pdf

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Income/Franchise: New York: Updated FAQs Discuss Inclusion of Alien Corporations in Combined Report and Article 9-A Taxation of Federal Treaty-Exempt Income

Corporate Tax Reform FAQs, N.Y. Dept. of Tax. & Fin. (updated 10/2/17). The New York Department of Taxation and Finance (Department) has issued updated frequently asked questions (FAQs) intended to further clarify corporate tax reform legislative amendments, many of which took effect for taxable years beginning on or after January 1, 2015.
URL: https://www.tax.ny.gov/bus/ct/corp_tax_reform_faqs.htm

- A new FAQ addresses when an alien (non-US) corporation that conducts a trade or business in New York is taxable under the Article 9-A state business corporation franchise tax and must be included on a combined report. The Department explains that if an alien corporation has income, gain, or loss that is effectively connected with its US trade or business for federal income tax purposes (ECI), the alien corporation must be included in a combined report with a taxpayer if it meets the combined reporting requirements under New York Tax Law section 210-C. Such a corporation will be included in a combined report regardless of whether or not it is itself a New York taxpayer. However, an alien corporation that has no ECI and is also not treated as a "domestic corporation" as defined in section 7701 of the Internal Revenue Code (IRC) is not includable in a New York combined report – such a corporation is not includable in a combined report even if it would otherwise be subject to tax under New York's nexus rules.
- A new FAQ addresses whether an alien corporation that has income all of which is exempt from federal taxable income under a US treaty obligation, but where the terms of the treaty permit state taxation of such income, is taxable under the Article 9-A state business corporation franchise tax. Responding affirmatively, the Department explains that an alien corporation not treated as a "domestic corporation" under IRC Sec. 7701 that has treaty-exempt income is taxable under the Article 9-A state business corporation franchise tax, if such income would be treated, in the absence of the exemption, as ECI and the corporation is subject to tax under New York's nexus rules as listed under New York Tax Law section 209. In such instances, the full amount of the alien corporation's treaty-exempt income must be added back to the corporation's entire net income for New York Article 9-A state business corporation franchise tax purposes.

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- A new FAQ clarifies that the term ECI includes both income and gain as well as loss. As such, if an alien corporation has ECI (including effectively connected losses), and is also subject to New York's nexus rules, it will be considered a taxpayer that is subject to the business corporation franchise tax. Additionally, even if the alien corporation does not conduct business in New York, it will still be subject to New York tax on its ECI if engaged in any of the activities listed in N.Y. Tax Law Sec. 209(1)(a). However, an alien corporation that meets New York's nexus standards but has no ECI and is not treated as a "domestic corporation" under IRC Sec. 7701, will not be subject to tax in New York.
- A new FAQ clarifies that a foreign corporation (*i.e.*, a non-New York corporation) that has $1 million or more in receipts, all of which are generated from activities related to the sale of tangible personal property and protected under Public Law 86-272, generally is not required to file a business corporation franchise tax return. The Department states that if such a corporation should choose to file a return, it should file a Form CT-3; check the box on line C of page 1 (this line states: "If you are disclaiming tax liability in New York State based on Public Law 86-272, mark an X in the box"); complete the entire return; and enter $0 on line 4 of Part 2 ("Tax due after credits"). The Department notes that a foreign corporation with $1 million or more in receipts from activities in New York is subject to tax and required to file an Article 9-A tax return if any of its receipts are derived from activities in the state other than those described in Public Law 86-272. Such taxable activities include, for example, the sale of digital products.

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Income/Franchise:
Pennsylvania Supreme Court Affirms that Fixed-Dollar Cap on NOL Carryover Deduction is Unconstitutional, But Finds that Percentage Cap is Valid

Case No. 6 EAP 2016, Pa (10/18/17). The Pennsylvania Supreme Court (Court) has partially affirmed the Commonwealth Court of Pennsylvania's 2015 decision, which held that the fixed-dollar statutory cap on Pennsylvania's net operating loss (NOL) carryover deduction, as applied to the taxpayer at issue for state corporate net income tax (CNIT) purposes, violates the Uniformity Clause of the Pennsylvania Constitution. However, the Court reversed the order of the Commonwealth Court of Pennsylvania that had directed the Pennsylvania Department of Revenue to issue a refund to the taxpayer. The Court prohibited the taxpayer from deducting its NOLs without regard to the cap in calculating its CNIT – holding that the fixed-dollar statutory cap on Pennsylvania's NOL carryover deduction was severable, and leaving intact the percentage cap of 12.5% of taxable income on Pennsylvania's NOL carryover deduction. In doing so, the Court reasoned that "each corporation will be entitled to avail itself of a net loss carryover deduction, as the legislature intended, but such deduction will be equally available to all corporations during that year, no matter what their taxable income" for the tax year at issue.
URL: http://www.pacourts.us/assets/opinions/Supreme/out/25654782.pdf#search=%226 EAP 2016 %27Supreme%2bCourt%27%22

See forthcoming Multistate Tax Alert for more details on this recently issued opinion, as well as related taxpayer considerations.

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Indirect/Sales/Use:
Maine Revenue Services Discusses New Economic Nexus Provisions, Along with Existing Affiliate and Click-Through Nexus Provisions

Instructional Bulletin No. 43, Me. Rev. Serv. (11/1/17). Maine Revenue Services has issued an updated sales and use tax bulletin reflecting recently enacted legislation [L.D. 1405 (S.P. 483); see *State Tax Matters*, Issue 2017-26 for more details on this new law] that generally requires the collection and remittance of Maine sales and use tax for out-of-state sellers of tangible personal property, other taxable products transferred electronically, or taxable services for delivery into Maine if:
URL: http://www.maine.gov/revenue/salesuse/IB43RegofSellers20171101.pdf
URL: http://www.mainelegislature.org/legis/bills/getPDF.asp?paper=SP0483&item=4&snum=128
URL: http://newsletters.usdbriefs.com/2017/Tax/STM/170630_8.html

- The person's gross revenue from delivery of tangible personal property, products transferred electronically or services that are taxable by Maine into Maine in the previous calendar year or current calendar year exceeds $100,000; or
- The person sold tangible personal property, products transferred electronically or services that are taxable by Maine for delivery into Maine in at least 200 separate transactions in the previous calendar year or the current calendar year.

Other items addressed in the bulletin explain Maine's remote seller affiliate and "click-through" nexus provisions, including their respective underlying rebuttable presumptions. Please contact us with any questions.

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Indirect/Sales/Use:
Mississippi: Comments on Proposed New Rule Requiring Out-of-State Sellers with Substantial Economic Presence to Collect Use Tax on In-State Sales are Due October 30

Proposed New Rule: Title 35, Part IV, Subpart 3, Chapter 9 [Proposed New Miss. Admin Rule 35.IV.03.09]: Out of State Sales into the State, Miss. Dept. of Rev. (1/12/17). The Mississippi Department of Revenue (Department) recently filed a "Concise Summary of Economic Impact Statement (10/10/17)" with the Mississippi Secretary of State concerning its proposed new rule, filed earlier this year in January, which states that certain out-of-state sellers with no physical presence in Mississippi must collect state use tax on their sales into Mississippi. More specifically, the proposal states that out-of-state sellers who lack a Mississippi physical presence but who are making retail sales of tangible personal property into Mississippi and have a "substantial economic presence" for sales and use tax purposes are required to register for a license with the Department to collect and remit tax as provided by Miss. Code Ann. Section 27-67-4(e). The proposed rule explains that "substantial economic presence" is created when sales into Mississippi exceed $250,000 per year based on the previous calendar year's sales. Additionally, nexus is deemed

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created under the proposal "when the consumer market is purposefully and systematically exploited by computer assisted shopping in addition to other customary means of media driven and catalogue distribution of solicitation made by out-of-state sellers."
URL: http://www.sos.ms.gov/ACProposed/00022459b.pdf
URL: http://www.sos.ms.gov/adminsearch/ACProposed/00022977a.pdf

According to the Department's recently filed statement on this proposal, "This new rule is intended to provide guidance to out of state sellers who have a substantial economic presence in the state and provides a list of activities considered to purposefully and systematically exploit the market," – and would become effective November 30, 2017. The Department additionally explains that this proposed new rule initially was filed on January 12, 2017, and a public hearing on the proposal was held on February 15, 2017. Written comments on this proposal are now due on October 30, 2017. Please contact us with any questions.

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Transfer:
New York City: State Appellate Court Affirms that Taxpayer is Subject to Tax in RPTT Matter

2017 NY Slip Op 07102, N.Y. App. Div. (10/10/17). The New York Supreme Court, Appellate Division (Court), has affirmed a 2016 New York City Tax Appeals Tribunal (Tribunal) ruling, which agreed with the administrative law judge's determination that a taxpayer was subject to New York City's real property transfer tax (RPTT) for the taxpayer's i) transfer of its 45% tenancy in common (TIC) interest to a limited liability company in return for a membership interest and ii) the subsequent sale of the membership interest. In doing so, the Court affirmed the Tribunal's conclusion that, upon application of both the end result and interdependence tests to the transactions in question, i) both tests were satisfied, ii) the step transaction doctrine should be applied, and iii) the transactions should be deemed a single taxable transaction. The Court also concluded that the taxpayer failed to demonstrate that the Tribunal's determination that the inapplicability of the "mere change in form of ownership" exemption to the contribution of the TIC interest to the limited liability company (when taking into account the entirety of the transactions that occurred on that single day) was neither rationally based nor supported by substantial evidence.
URL: http://www.nycourts.gov/reporter/3dseries/2017/2017_07102.htm

Note that the transfer of a controlling economic interest (*i.e.* 50% or more) in an entity with an interest in real property is generally subject to the RPTT. In this case, before the transactions in question took place, the taxpayer owned a 45% TIC interest in real property and another party (Y) owned the remaining 55% interest in such property. The parties then completed the following two transactions on the same day: First, the taxpayer and Y each contributed their TIC interests to a limited liability company (Owner LLC) in exchange for 45% and 55% membership interests in Owner LLC, respectively. Owner LLC also relieved the taxpayer (and not Y) of any liability under its $191 million mortgage on the property. The taxpayer and Y each asserted on their respective New York City RPTT returns that their transfers were exempt as a "mere change" of identity or form of ownership. Next, the taxpayer sold its 45% membership interest in Owner LLC to Y for consideration of approximately $25 million; the taxpayer claimed an exemption for this transaction (as a transfer of a non-controlling 45% economic interest in a limited liability company) on its New York City RPTT return and reported no tax due.

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

Ohio Supreme Court Holds that SERP is Exempt from Cleveland Taxation
On September 26, 2017, the Ohio Supreme Court held in *MacDonald v. Cleveland Income Tax Board Of Review* that amounts paid to a retired employee under a supplemental executive retirement plan ("SERP"), a nonqualified deferred compensation plan, were not subject to municipal income tax because such amounts qualified for the "pension" exemption under Cleveland Codified Ordinances § 191.0901(d).

This Multistate Tax Alert summarizes the factual background of the case, the Board of Tax Appeals' and the Ohio Supreme Court decisions, and provides taxpayer considerations.
[Issued October 12, 2017]
URL: https://www2.deloitte.com/us/en/pages/tax/articles/ohio-supreme-court-holds-that-serp-is-exempt-from-cleveland-taxation.html?id=us:2em:3na:stm:awa:tax:102017

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