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State Tax Matters
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In this issue:

Income/Franchise:
Alabama: "Subject to Tax" Exception to Intercompany Intangible Expense Addback Statute Deemed to Apply

Docket Nos. BIT. 19-890-JP and BIT. 19-1091-JP, Ala. Tax Trib. (2/26/24). In a case involving a multinational manufacturing company filing Alabama separate company business income tax returns for the tax periods at issue, the Alabama Tax Tribunal (Tribunal) held that certain interest and royalty payments the taxpayer made to its parent company, which were then paid to foreign affiliates, were not subject to Alabama's intercompany intangible expense "addback" statute because the facts showed the payments were indirectly "attributed to" those foreign jurisdictions under state law and thus fell under the "subject-to-tax" statutory exception. Under the facts at hand, the Tribunal concluded that the intercompany intangible expenses at issue were shown to be subject to tax by foreign nations that have income tax treaties with the United States. The Tribunal additionally commented that just because some of the foreign affiliates were allowed to deduct a portion of these intercompany payments in calculating their jurisdictions' taxable net income did not defeat the taxpayer's entitlement to Alabama's subject-to-tax exception. Please contact us with any questions.
URL: https://www.taxtribunal.alabama.gov/wp-content/uploads/2024/02/OPO-19-890-19-1091.pdf

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Income/Franchise:
Missouri DOR Proposes Various Rule Updates Involving Net Operating Loss Computation

Proposed Amended 12 CSR 10-2.165: Net Operating Losses on Corporate Income Tax Returns, Mo. Dept. of Rev. (3/1/24). The Missouri Department of Revenue proposed various revisions to its administrative rule on computing net operating losses (NOLs) to, among other changes, update it to "better take into account changes in the law since the most recent amendment to this rule," as well as accommodate some subsequent NOL-related decisions from the Missouri Administrative Hearing Commission. The proposed updates clarify that nothing in the rule shall be interpreted as incorporating a federal agency's rule or guideline. The proposal also provides that, with some exceptions, to the extent an NOL is carried backward for more than two years or carried forward for more than twenty years on the federal income tax return, that amount of the NOL generally must be added to federal taxable income in arriving at Missouri taxable income. Moreover, "any amount of NOL taken against federal taxable income but disallowed for Missouri income tax purposes under section 143.121.2(4), RSMo, may be carried forward and taken against any income on the Missouri corporate income tax return" for a period of not more than twenty years following the year of initial loss.
URL: https://www.sos.mo.gov/CMSImages/AdRules/moreg/2024/v49n5March1/v49n5.pdf

Another proposed edit adds, "If a corporate member of an affiliated group incurs an NOL arising from a loss year for which such member files a separate Missouri return or no Missouri return, then that NOL cannot be carried to a consolidated Missouri income tax return for a different tax year (the carryover tax year), except insofar as that particular NOL is carried forward or backward and actually deducted on the affiliated group's consolidated federal income tax return for that carryover tax year, as reflected in the affiliated group's federal taxable income for that carryover tax year." Another addition explains that "in the situation of a corporate merger where the taxpayer whose loss year gave rise to the NOL did not survive the merger, the net operating loss addition modification must still be computed by reference to the addition and subtraction modifications for the loss year of the corporation that did not survive the merger." Comments on these proposed changes must be received within 30 days after their March 1 publication in the Missouri Register. Please contact us with any questions.

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Income/Franchise:
New Hampshire: Proposed Rule Updates Apportionment Factor Computation for Financial Institutions

Initial Proposal to Readopt with amendment Rev 304.10, N.H. Dept. of Rev. Admin. (1/19/24). The New Hampshire Department of Revenue Administration released initial proposed text revising its rule on computing special industry apportionment of financial institutions to reflect the market-based sourcing apportionment methodology adopted by 2019 state legislation. The proposal provides that the numerator of the receipts factor shall include receipts from merchant discount if the "transaction or the billing address of the credit cardholder" rather than "commercial domicile of the merchant" is in New Hampshire. Written comments on the proposal are due by March 15, 2024, and a related public hearing is scheduled for March 8, 2024. Please contact us with any questions.
URL: https://www.revenue.nh.gov/laws/documents/rev202-and-various-ip-text.pdf

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Income/Franchise:
New York ALJ Says Company is an In-State Manufacturer Despite Engaging Subcontractor for Production

Determination DTA No. 830227, N.Y. Div. of Tax App., ALJ Div. (2/15/24). In a case involving a multinational beverage manufacturing and distribution company, an administrative law judge (ALJ) with the New York State Division of Tax Appeals held that the company met the requirements of a "qualified New York manufacturer" ("QNYM") under Tax Law § 210 (1) (a) (vi) for the periods January 1, 2016 through December 31, 2019 through an in-state vineyard it acquired in 2016, and therefore it was eligible to utilize a reduced Article 9-A New York business corporation franchise tax rate for the underlying tax periods. In doing so, the ALJ reasoned that despite not having company employees physically working at its in-state vineyard and instead engaging a land management contractor to work onsite production, the company nevertheless "used" such property principally in the production of goods via qualified activities under state law. According to the ALJ, regardless of who is subcontracted to perform day-to-day labor at the New York vineyard, the company employed its grapevines for a purpose, and put the grapevines into service and thus qualified as a QNYM pursuant to state law under the facts for the tax years at issue. For tax year 2016, the ALJ also held that although the company purchased the vineyard in mid-December of 2016, because the company owned the vineyard at the close of 2016 and used the vineyard in the production of goods by viticulture in 2016, it constituted a QNYM in 2016 and was eligible to utilize a reduced Article 9-A New York business corporation franchise tax rate. Please contact us with any questions.

URL: https://www.dta.ny.gov/pdf/determinations/830227.det.pdf

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Income/Franchise:
Texas: Labor Costs for Repairing Customer-Owned Parts are Not Includable within Cost of Goods Sold

Hearing No. 116,007, Tex. Comptroller of Public Accounts (1/24/24). In a ruling involving a taxpayer providing aircraft instruments along with accessory services and support, the Texas Comptroller of Public Accounts (Comptroller) held the taxpayer's labor costs for repairing defective parts sent by customers for *essential* repairs were *not* includable within cost of goods sold (COGS) for Texas franchise tax purposes. Absent an exception, a taxable entity is only eligible to include within Texas COGS costs related to goods the entity *owns* under state law (see Tex. Tax Code § 171.1012(i)). As explained by the Comptroller, the taxpayer here performed repairs on:
URL: https://star.comptroller.texas.gov/view/202401016H?q1=116,007

1. Already-completed aircraft parts, and
2. Customer-owned aircraft parts; further, the taxpayer did not in any way modify, make, or complete distinguishable parts as a result of the repairs.

As such, the labor repair costs were determined to not be a cost to produce the parts ultimately sold by the taxpayer. Please contact us with any questions.

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Income/Franchise:
Wisconsin Tax Commission Says Individual Has Nexus from Out-of-State SMLLC's Software Licensing

Case Nos. 21-W-080 and 21-W-081, Wis. Tax App. Comm. (7/28/23). In a ruling involving a nonresident individual with sole ownership in an out-of-state single-member limited liability company (SMLLC) that developed educational software and sold licenses to use the software to Wisconsin third-party customers without selling underlying copyright rights in the software, the Wisconsin Tax Appeals Commission (Commission) concluded that such licensing of computer software subjected the individual to Wisconsin income tax, and the SMLLC to pass-through withholding, on the income generated by such licensing transactions. Specifically, the Commission reasoned that the sale of licenses for the use of computer software constituted the sale of intangible personal property under state law, and the underlying gross receipts from sales of the rights to copy, install, and use computer software under copyright license agreements were "gross receipts from the use of computer software" as that language is used in applicable Wisconsin statutes. As such, the Commission held that the sale of licenses for the use of computer software constituted "business transacted in Wisconsin," subjecting the nonresident individual to Wisconsin income tax and the SMLLC to underlying pass-through withholding tax. The Commission also concluded that P.L. 86-272 was not applicable to the facts because:
URL: https://taxappeals.wi.gov/Documents/Decisions/2022-2023/KUTA%20SOFTWARE,%20MICHAEL%20KUTA,%2021-W-080,%2021-W-081,%2021-I-082.pdf

1. Sales of licenses for the use of computer software are not sales of tangible personal property, and
2. Sales of licenses to use computer software were not the only activities of the SMLLC's business given that in-state customers received associated software support.

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Gross Receipts:
Washington DOR Explains B&O and Sales Taxation of Digital Entertainment Subscriptions

Publication – Tax Topics: Digital entertainment, Wash. Dept. of Rev. (12/12/23). The Washington Department of Revenue (Department) issued a publication explaining the Washington sales/use and business and occupation (B&O) tax consequences of certain transactions involving digital entertainment – specifically that Washington retail sales tax applies to digital entertainment subscription fees and that digital entertainment providers must collect and submit Washington retail sales tax, and pay B&O tax under the retailing classification, if they have a physical presence in Washington and have subscribers located in Washington. Regarding digital entertainment subscriptions, the Department clarifies that such subscriptions allow a user to download digital products such as movie streaming, videos, television programming, music, e-books, mobile apps, and games, and that it does not matter if the user pays for permanent or limited (*e.g.*, 24-hour period) use rights. Please contact us with any questions.
URL: https://dor.wa.gov/forms-publications/publications-subject/tax-topics/digital-entertainment

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Gross Receipts:
Washington DOR Explains B&O and Sales Tax Situsing of Periodic Lease Payments on Certain Aircraft

Publication – Tax Topics: Non-transportation aircraft – Sourcing periodic lease payments, Wash. Dept. of Rev. (12/11/23). The Washington Department of Revenue (Department) issued a publication explaining the Washington sales/use and business and occupation (B&O) tax sourcing of periodic lease payments on certain "non-transportation aircraft" (*i.e.*, aircraft *not* operated by air carriers authorized and certified by the United States Department of Transportation or another federal or foreign authority to engage in the transport of persons or property in interstate or foreign commerce). Providing some accompanying examples to illustrate, the Department states that sellers (lessors) must source periodic lease payments of a non-transportation aircraft to the "primary property location" for Washington retailing B&O tax and retail sales tax purposes, which is the location where the aircraft is primarily based or hangared and ready for use. Moreover, the Department explains that intermittent non-transportation aircraft use during a lease period does not change the primary property location during the lease payment period – noting that such intermittent use is typically flight time and other time spent temporarily away from the primary property location. Please contact us with any questions.
URL: https://dor.wa.gov/forms-publications/publications-subject/tax-topics/non-transportation-aircraft-sourcing-periodic-lease-payments

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Sales/Use/Indirect:
California Appellate Court Reverses Lower Court's Invalidation of Regulation on Bundled Sales of Cell Phones

Case No. C093763, Cal. Ct. App. (2/27/24). Reversing the trial court's 2020 decision to the extent it had invalidated an administrative regulation ("Regulation 1585") involving the discounted price of a wireless telecommunications device (*i.e.*, a cell phone) that a carrier-retailer charges in a sale bundled with wireless cellular service as applied to bundled cell phone sales in which the carriers pay no commissions to the retailers [see Case No. 34-2015-80002242-CU-WM-GDS, Cal. Super. Ct., Sacramento County (10/27/20) for details on this 2020 decision], a California Court of Appeal (Court) concluded that:
URL: https://www.courts.ca.gov/opinions/documents/C093763.PDF

1. The California Department of Tax and Fee Administration (CDTFA) may allocate a portion of the contract price in such a bundled transaction to the cell phone, and
2. Regulation 1585 was adopted in compliance with the California Administrative Procedure Act.

In doing so, the Court noted that the parties in this case did not dispute that only the payment for the cell phone is taxable, but they disagreed on how to measure the payment – thus, it is "an accounting problem of segregation" rather than "a legal problem of taxability." In this respect, the Court reasoned that Regulation 1585 "fills the gap, effectively attributing the portion of the contract price that is equivalent to the unbundled sales price to the cell phone, and the rest to the wireless services" where only the portion of the contract price allocated to the cell phone is subject to California sales tax. Accordingly, on remand, the Court directs the trial court to "enter an order denying the petition for writ of prohibition." This generally reinstates the CDTFA's position that wireless customers must pay sales tax based on the "unbundled sales price" of the cell phone. Please contact us with any questions.

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Sales/Use/Indirect:
California Appellate Court Affirms that Streaming Companies Don't Owe Local Franchise Fees

Case No. B321481, Cal. Ct. App. (2/22/24). In a lawsuit filed by a California city against various streaming entertainment companies claiming that they owed local video service provider fees imposed under California's Digital Infrastructure and Video Competition Act (Act), a California Court of Appeal (Court) affirmed that California localities do *not* have a right of action under the Act to bring the lawsuit against them. In doing so, the Court explained that although the Act expressly authorizes a local government to sue a franchise holder concerning unpaid or underpaid franchise fees, the Act does *not* authorize a local government to seek franchise fees from nonfranchise holders. The holding in this case is in line with similar court decisions in other states and jurisdictions. Note that this case involves franchise fees and not "City Utility Users Taxes" based upon Pub. Util. Code, § 799 et seq. Please contact us with any questions.
URL: https://www.courts.ca.gov/opinions/documents/B321481.PDF

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Sales/Use/Indirect:
Illinois DOR Adopts Rule Addressing Bad Debt Deductions on Installment Contracts for Cash Basis Retailers

Amended 86 Ill. Adm. Code 130.1960, Ill. Dept. of Rev. (eff. 2/8/24). Pursuant to state caselaw from 2021 that permitted bad debt refund claims for a cash basis taxpayer making installment sales [see *State Tax Matters*, Issue 2021-46, for additional details on this case], the Illinois Department of Revenue adopted amendments to an Illinois retailers' occupation tax rule to clarify that a cash basis retailer that cannot claim a bad debt deduction on its federal income tax return is entitled to claim a refund for Illinois sales tax paid by the retailer on that portion of an installment contract found to be worthless or uncollectable. The revisions update guidance on calculating bad debt, include examples, as well as provide additional direction regarding procedural requirements and recordkeeping. Please contact us with any questions.
URL: https://www.ilsos.gov/departments/index/register/volume48/register_volume48_8.pdf
URL: https://dhub.deloitte.com/Newsletters/Tax/2021/STM/211119_4.html

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Sales/Use/Indirect:
Minnesota DOR Explains Imposition of Retail Delivery Fee on Some Deliveries to In-State Customers

Retail Delivery Fee, Minn. Dept. of Rev. (2/21/24). The Minnesota Department of Revenue (Department) reminds taxpayers that starting July 1, 2024, there will be a "retail delivery fee" of 50 cents that applies to certain transactions involving retail delivery in Minnesota pursuant to legislation enacted in 2023 [see H.F. 2887 (2023), and previously issued Multistate Tax Alert for more details on this new fee]. According to the Department, this fee generally applies to each transaction where charges for tangible personal property subject to sales tax (including clothing) equal or exceed $100, with some exceptions. The Department also explains that the retail delivery fee:
URL: https://www.revenue.state.mn.us/retail-delivery-fee
URL: https://www.revisor.mn.gov/bills/bill.php?f=HF2887&b=house&y=2023&ssn=0
URL: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-multistate-tax-alert-minnesota-enacts-retail-delivery-fee-and-other-sales-and-use-tax-law-changes.pdf

- Is not subject to sales tax if separately stated on the receipt or invoice;
- Applies once per transaction, regardless of the number of shipments made;

- Is shown as a separate line item on the receipt as "Road Improvement and Food Delivery Fee;" and
- Follows Minnesota sourcing rules for application.

Regarding exclusions, the Department provides that a taxpayer is *not* liable for Minnesota's retail delivery fee if it is one of the following:

- A retailer, who for the previous calendar year, had Minnesota retail sales that totaled less than $1,000,000; or
- A marketplace provider facilitating a sale for a retailer, who during the previous calendar year, made Minnesota retail sales through the marketplace that totaled less than $100,000.

When calculating the retail sale threshold for these retailer exclusions, the Department instructs to include all taxable and nontaxable retail sales, but do not include sales where the purchaser is buying for resale. 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: https://www2.deloitte.com/us/en/pages/tax/articles/multistate-tax-alert-archive.html?id=us:2em:3na:stm:awa:tax

California court denies FTB's motion to modify judgment declaring P.L. 86-272 guidance invalid
On February 13, 2024, the San Francisco Superior Court issued an order denying the California Franchise Tax Board's ("FTB's") motion to vacate and modify the court's judgment entered in December of 2023 ("Motion to Vacate and Modify Judgment"), in *Am. Catalog Mailers Ass'n v. Franchise Tax Bd.*, which concluded that the FTB's Technical Advice Memorandum 2022-01 ("TAM 2022-01") and Publication 1050 were void because they constituted regulations that were required to be adopted, but were not adopted, in compliance with the California Administrative Procedure Act ("APA"). On the same date, the court also issued a separate Order,

concluding that the taxpayer was the prevailing party in this case under the applicable California provisions, thereby awarding the taxpayer attorney's fees in the amount of $332,891.50.

This Multistate Tax Alert summarizes the court's February 2024 order denying the FTB's Motion to Vacate and Modify Judgment.
[Issued February 26, 2024]
URL: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-multistate-tax-alert-california-court-denies-ftbs-motion-to-modify-judgment-declaring-pl-86-272-guidance-invalid.pdf