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State Tax Matters
The power of knowing.
June 28, 2024

In this issue:

Income/Franchise:
Federal: US Supreme Court Affirms Ninth Circuit's Decision Upholding Constitutionality of Transition Tax

Docket No. 22-800, US (6/20/24). In a case brought forth by a couple challenging the one-time mandatory repatriation tax ("transition tax") provisions under Internal Revenue Code (IRC) section 965 by claiming it resulted in taxes paid on their 2017 federal income tax return as an unapportioned direct tax with retroactive application that violates the US Constitution's Apportionment Clause and Due Process Clause [see *State Tax Matters*, Issue 2023-27, for additional details about the couple's challenge], the US Supreme Court (Court) affirmed the Ninth Circuit's holding that the transition tax provisions included in Subpart F of the IRC – "which attributes the realized and undistributed income of an American-controlled foreign corporation to the entity's American shareholders, and then taxes the American shareholders on their portions of that income" – do *not* exceed Congress's constitutional authority. In doing so, the Court explained that Congress has "long taxed shareholders of an entity on the entity's undistributed income," and it did the same with the transition tax. The Court emphasized that its holding in this case is "narrow" and limited to:
URL: https://www.supremecourt.gov/search.aspx?filename=/docket/docketfiles/html/public/22-800.html
URL: https://dhub.deloitte.com/Newsletters/Tax/2023/STM/230707_2.html

1. Taxation of the shareholders of an entity,
2. On the undistributed income realized by the entity,
3. Which has been attributed to the shareholders, and
4. When the entity itself has not been taxed on that income.

In other words, according to the Court, "our holding applies when Congress treats the entity as a pass-through." Concurring and dissenting opinions follow. Please contact us with any questions.

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Income/Franchise:
Arkansas: New Law Provides Another Corporate Income Tax Rate Reduction by Lowering Top Rate to 4.3%

H.B. 1001, signed by gov. 6/19/24. Effective immediately and applicable for tax years beginning on or after January 1, 2024, recently signed legislation lowers the top state corporate income tax rate (*i.e.*, on net income exceeding $11,000) for both domestic and foreign corporations from 4.8% to 4.3% [see S.B. 8 (2023), and *State Tax Matters*, Issue 2023-38, for more details on state corporate income tax rate reductions enacted in 2023]. Please contact us with any questions.
URL: https://www.arkleg.state.ar.us/Bills/Detail?id=hb1001&ddBienniumSession=2023%2F2024S2&Search=
URL: https://www.arkleg.state.ar.us/Bills/Detail?id=SB8&chamber=Senate&ddBienniumSession=2023%2F2023S1
URL: https://dhub.deloitte.com/Newsletters/Tax/2023/STM/230922_1.html

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Income/Franchise:
Arkansas: Utilization of Credits Treated Similarly to NOLs on State Returns Filed After Federal Adjustments

Case No. 23-TAC-02064, Ark. Tax App. Comm. (5/23/24). The Arkansas Tax Appeals Commission (Commission) ruled in favor of an Arkansas consolidated corporate income taxpayer that submitted a revised state return for its 2015 tax year reflecting changes in its net operating loss (NOL) and credit utilization from an amended state return for its 2014 tax year that had been filed pursuant to federal tax adjustments made by the Internal Revenue Service on its 2014 federal return – where the taxpayer understood that while the statute of limitations was closed for the 2015 tax year, its submission of the 2015 return was for purposes of supporting and supplementing its filed amended Arkansas corporate income tax returns for tax years 2016 and 2017. Specifically at issue in the ruling was whether the taxpayer's Arkansas corporate income tax liability for the open 2016 and 2017 tax years is determined using the credit utilization as originally filed versus using the corrected credits utilization information "after taking into account the 2014 amendment and downstream effects." Noting that Arkansas administrative rules provide for calculation of an NOL deduction by accommodating corrected calculations from an otherwise closed year, the Commission held that "while there is no rule similarly on point, the same principles should apply to redetermining credit utilization in closed years for purposes of determining the correct amount of tax in the open year." In doing so, the Commission reasoned that while tax credits are not NOLs, "it is more consistent to treat year-to-year credits utilization adjustments as subject to redetermination, similar to net operating losses, than to treat them as set in stone." Please contact us with any questions.
URL: https://ig.arkansas.gov/tax-appeals-commission/ig-decisions-search/

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Income/Franchise:
Hawaii: New Law Updates State Conformity to Internal Revenue Code

H.B. 2484, signed by gov. 6/21/24. Effective immediately, new law updates statutory references to the Internal Revenue Code (IRC), providing that for taxable years beginning after December 31, 2023, references to the IRC in Hawaii income tax laws generally refer to the federal law in effect as amended as of December 31, 2023. Note that Hawaii continues to decouple from some specified IRC sections. Please contact us with any questions.
URL: https://www.capitol.hawaii.gov/session/measure_indiv.aspx?billtype=HB&billnumber=2484&year=2024

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Income/Franchise:
Hawaii: New Law Revises Some Pass-Through Entity-Level Tax Provisions Including Tax Rate

S.B. 2725, signed by gov. 6/19/24. Applicable for taxable years beginning after December 31, 2023, recently signed legislation revises various provisions under Hawaii law allowing qualifying pass-through entities to make an annual election to pay an entity-level state tax (PTET) [see S.B. 1437 (2023) and previously issued Multistate Tax Alert for more details on this PTET]. For instance, the legislation amends the PTET rate applied to the sum of all qualified member's distributive shares and guaranteed payments of Hawaii taxable income to be fixed at 9%, rather than imposed at the highest individual income tax rate under Haw. Rev. Stat. section 235-51. For pass-through entities electing to pay the PTET, the legislation also permits certain "qualified members" entitled to a tax credit to use the credit against the member's net income tax liability in subsequent years until exhausted. Moreover, the legislation adds a definition for "qualified member" as meaning a member of an electing pass-through entity that is an individual, trust, or estate, and simultaneously repeals the definitions for "direct member" and "indirect member." Under the new law, a "member" means:
URL: https://www.capitol.hawaii.gov/session/measure_indiv.aspx?billtype=SB&billnumber=2725&year=2024
URL: https://www.capitol.hawaii.gov/session/measure_indiv.aspx?billtype=SB&billnumber=1437&year=2023
URL: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-multistate-tax-alert-hawaii-enacts-pass-through-entity-tax-election.pdf

1. A shareholder of an S corporation;
2. A partner in a general partnership, a limited partnership, or a limited liability partnership; or
3. A member of a limited liability company that is treated as a partnership or S corporation for federal income tax purposes.

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Income/Franchise:
Kansas: New Law Lowers Tax Rates for Some Banks and Financial Institutions

S.B. 1, signed by gov. 6/20/24. Newly signed legislation contains several tax-related measures, including provisions that lower Kansas' privilege tax rates for financial institutions for tax years 2024 and thereafter by providing that the normal tax rate for banks is reduced from 2.25% to 1.94%, and the normal tax rate for trust companies and savings and loan associations is reduced from 2.25% to 1.93%. Under the new law, the applicable Kansas surtaxes on these financial institutions remain the same. The legislation also contains some individual income tax-related revisions, including tax rate changes. Please contact us with any questions.
URL: https://www.kslegislature.org/li_2024s/b2023_24/measures/sb1/

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Income/Franchise:
Michigan Appellate Court Reverses Lower Court to Hold that Insurance Affiliate Must File as Part of Combined Return

Case No. 364790, Mich. Ct. App. (6/20/24). In a case involving a unitary business group (UBG) comprised of an insurance company and its Michigan corporate income tax (CIT)-filing affiliates and treatment under the Michigan premium tax (imposed under Mich. Comp. Laws section 206.635), the "retaliatory tax" (imposed under Mich. Comp. Laws section 500.476a), and calculation of the Michigan automobile insurance placement facility credit (under Mich. Comp. Laws section 206.637(1)(c)), the Michigan Court of Appeals (Court) reversed a Michigan Tax Tribunal (Tribunal) ruling to hold summary judgment for the insurance company and its affiliates. Specifically, the Court held that because it was undisputed that the insurance company and its affiliates comprised a UBG under Michigan income tax code provisions, they must file a collective unitary Michigan CIT return rather than respective separate CIT returns, including for purposes of calculating the insurance company's underlying Michigan insurance taxes and credits at issue. In doing so, the Court explained that for purposes of defining a UBG and who must file a Michigan combined return, "the question is not whether the Legislature intended to include every subcategory of tax, but whether the Legislature intended to

exempt any particular subcategory," and that it "must apply a statute that clearly includes insurance companies within the UBG scheme without explicit exception or modification."
URL: https://www.courts.michigan.gov/49e08f/siteassets/case-documents/uploads/opinions/final/coa/20240620_C364790_32_364790.opn.pdf

In its earlier ruling, the Tribunal confirmed that the collective entities met the elements of a UBG but held that Michigan law requiring UBGs to file Michigan combined returns did *not* apply to the insurance taxes at issue and such taxes must *not* be calculated on a groupwide basis. In a footnote, the Court acknowledged that it was "not entirely unsympathetic" to various policy arguments and "important questions" regarding the inclusion of insurance companies in the UBG scheme raised by the Michigan Department of Treasury, but it concluded that such issues "need to be addressed by the Legislature and not this Court." Please contact us with any questions.

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Income/Franchise:
Minnesota: Multinational Company Must Use Alternative Apportionment to Account for Foreign Currency Hedging

Case No. 9485-R, Minn. Tax Ct. (6/24/24). In a case involving a multinational science and technology company that managed its foreign currency exchange exposure through an in-house program that buys and sells forward exchange contracts (FECs), the Minnesota Tax Court (Court) held that:
URL: https://mn.gov/tax-court-stat/published%20orders/2024/E.I.%20du%20Pont%20v.%20COR%2006-24-24.pdf

- Minnesota's standard statutory apportionment method for Minnesota corporate franchise tax purposes, as applied to the company, did not fairly reflect all of its taxable net income allocable to Minnesota for the tax years at issue; and
- The Minnesota Department of Revenue's alternative apportionment method, excluding FEC gross receipts from the calculation of the apportionment factor but including net income from FEC transactions, fairly reflected its net income in Minnesota for the tax years at issue.

In doing so, the Court explained while the FEC transactions at issue constitute an ordinary business activity for the company and are "an unquestionably prudent risk management practice," they only play a supportive risk

management function (*i.e.*, to mitigate cash flow volatility associated with foreign exchange rate fluctuation and to protect the value of the company's assets, operations, and cash flows) – which is "distinct from its other business practices." The Court reasoned that, under these facts, including FEC gross receipts in the company's Minnesota apportionment factor substantially distorted its income arising from taxable business activities in Minnesota, "as it quantitatively distorts total sales, net income, and, ultimately, the apportionment factor by nearly threefold." Please contact us with any questions.

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Income/Franchise:
Montana DOR Adopts Rule Changes Reflecting Elimination of Tax Haven Jurisdictions List

Amended ARM 42.26.311 and Repeal of ARM 42.26.306, Mont. Dept. of Rev. (6/21/24). The Montana Department of Revenue adopted rule changes reflecting state corporate income tax legislation enacted in 2023 [see S.B. 246 (2023) and *State Tax Matters*, Issue 2023-21, for more details on this legislation] which removed "tax haven" corporations from the water's-edge group of affiliated corporations effective for tax periods beginning after December 31, 2022. The rule changes reflect how C corporations in a unitary relationship with a taxpayer incorporated in a previously designated tax haven no longer need to have their income and apportionment factors included in the water's-edge combined filing group. Please contact us with any questions.
URL: https://rules.mt.gov/browse/collections/5e1173a6-33c7-4df8-b426-5e0077cfc430/policies/c149615c-ecf2-466f-aa54-e221db82cbac
URL:
http://laws.leg.mt.gov/legprd/LAW0203W$BSRV.ActionQuery?P_SESS=20231&P_BLTP_BILL_TYP_CD=SB&P_BILL_NO=246&P_BILL_DFT_NO=&P_CHPT_NO=&Z_ACTION=Find&P_ENTY_ID_SEQ2=&P_SBJT_SBJ_CD=&P_ENTY_ID_SEQ=
URL: https://dhub.deloitte.com/Newsletters/Tax/2023/STM/230526_2.html

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Income/Franchise:
Oregon: State High Court Affirms that Company's In-State Activities Exceed P.L. 86-272 Protections

Case No. S069820, Or. (6/20/24). In a case involving whether a manufacturer's in-state activities conducted via independent contractors were protected under P.L. 86-272 for Oregon corporate excise tax purposes, the Oregon Supreme Court (Court) affirmed [see *State Tax Matters*, Issue 2022-34, for more details on the Oregon Tax Court's 2022 ruling in this case] that the pursuit of "prebook orders" by its in-state representatives invoking incentive agreement contractual provisions used by the company to ensure that its wholesaler customers treated each of those orders favorably went beyond the scope of "solicitation of orders" under P.L. 86-272 and such in-state activities were *not de minimis* under *Wrigley*. The Court highlighted that, under the facts, when the company contractually required wholesalers to "accept and process" prebook orders, the wholesalers understood that they must comply with that obligation or else they would face substantial economic penalties and lose the right to continue selling the manufacturer's products. As a result, the Court reasoned that, under the facts, the manufacturer's in-state representatives were doing more than "enabling" wholesalers to sell the underlying products to retailers; rather, they were "requiring" wholesalers to sell those products and facilitating those subsequent sales, which exceeded the scope of permitted "solicitation of orders." Please contact us with any questions.
URL: https://cdm17027.contentdm.oclc.org/digital/collection/p17027coll3/id/11957/rec/1
URL: https://dhub.deloitte.com/Newsletters/Tax/2022/STM/220826_4.html

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Income/Franchise:
Rhode Island: New Bank Tax Law Permits Single Sales Factor Election, Includes Intercompany Expense Addback, and Requires Combined Reporting Information Report

H.B. 7927 / *S.B. 3152*, signed by gov. 6/24/24. Recently signed legislation provides that for tax years beginning on or after January 1, 2025, some banking institutions may elect a single sales factor apportionment methodology for calculating their net income under Rhode Island's bank excise tax. Once successfully made, the election generally remains in effect for all subsequent tax years, except that, after a minimum of five subsequent tax years "in the event of a material change of facts or law, a taxpayer may apply to the tax administrator to revoke the election." For tax years beginning on or after January 1, 2025, the legislation also imposes some intercompany expense "addback" adjustments for certain banking institutions electing single

sales factor apportionment and that would otherwise be included in a "unitary business" with non-banking corporations, subject to some listed exceptions such as to avoid unlawful "duplicate taxation" or if doing so would be "unreasonable."
URL: https://webserver.rilegislature.gov/BillText/BillText24/HouseText24/H7927A.pdf
URL: https://webserver.rilegislature.gov/BillText/BillText24/SenateText24/S3152A.pdf

The legislation further authorizes a combined reporting study, which generally requires each banking institution that is part of a "unitary business" to file an information report with its Rhode Island bank excise tax return for the taxable years beginning after December 31, 2023, but before January 1, 2026 "in a manner prescribed by the tax administrator" for the combined group containing the combined net income of the combined group. Failure to accurately do so potentially may result in added special penalties. According to the legislation, this new information report must provide:

1. The difference in tax owed as a result of filing a combined report compared to the tax owed under the current filing requirements;
2. The volume of sales in Rhode Island and worldwide; and
3. Taxable income in Rhode Island and worldwide.

Correspondingly, the Rhode Island tax administrator must submit its findings on or before March 15, 2027 to certain members of the Rhode Island Legislature "analyzing the policy and fiscal ramifications of changing the bank excise tax statute to a combined method of reporting." Please contact us with any questions.

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Income/Franchise:
South Carolina ALJ Says Bank's Various Income Streams Must be Sourced Based on Borrower Location and Gain from Stock Sale is Apportionable

Docket No. 20-ALJ-17-0168-CC, S.C. Admin. Law Ct. (6/25/24). In a case involving a bank that engaged in banking business in South Carolina, as well as other states, and was subject to South Carolina's bank tax, an administrative law judge with the South Carolina Administrative Law Court (Court) sided with the South Carolina Department of Revenue in concluding that applicable South Carolina sourcing law required the

taxpayer to source its loan interest, credit card interest and fees, and credit card interchange fees (merchant fees) to South Carolina based upon the location of the bank's South Carolina borrowers. Moreover, the Court concluded that the bank must include the gain on its sale of certain credit card company stock – which was considered held in direct connection to its banking business – in its calculation of apportionable income, and the stock constituted intangible personal property. The Court explained that the bank must include the income from mortgage loan interest and mortgage loan servicing fees from South Carolina borrowers in its gross receipts from within South Carolina under applicable state sourcing provisions, as it constituted income from intangibles rather than services. The Court also explained that income generated from the bank's sales of certain South Carolina mortgages at issue must be included in its gross receipts from within South Carolina, because the mortgages were tied to real estate in South Carolina. Please contact us with any questions.
URL: https://scalc.net/search.aspx

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Sales/Use/Indirect:
Arizona: New Law Postpones Date to Establish Certification Process for Third-Party Providers that Determine TPP Transaction Sourcing

H.B. 2909, signed by gov. 6/18/24. Recently signed legislation amends a bill enacted earlier this year [see H.B. 2382, signed by gov. 4/10/24, and *State Tax Matters*, Issue 2024-16, for more details on this earlier legislation] by delaying, until January 1, 2028, the requirement for the Arizona Department of Revenue to establish a certification process for third-party providers that offer certain Arizona transaction privilege tax (TPT) sourcing services to taxpayers for transactions involving tangible personal property. Previously, this certification process had to be created by January 1, 2026. Please contact us with any questions.
URL: https://apps.azleg.gov/BillStatus/BillOverview/81564
URL: https://apps.azleg.gov/BillStatus/BillOverview/80236
URL: https://dhub.deloitte.com/Newsletters/Tax/2024/STM/240419_5.html

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Sales/Use/Indirect:
Michigan Appellate Court Affirms that Use Tax is Due on In-State Company's Direct Mail Advertising

Case No. 365613, Mich. Ct. App. (6/20/24). The Michigan Court of Appeals (Court) affirmed that an in-state company that periodically conducted direct mail advertising campaigns for its business through an out-of-state contracted marketing firm owed Michigan use tax on mailed advertisements that were prepared and purchased out-of-state but then distributed in Michigan, because the facts showed that the level of control the company exercised over the advertisements in Michigan was sufficient enough to warrant the assessment. Rejecting the company's claim that it had relinquished control over the advertisements before they became tangible property and were disbursed in Michigan, the Court agreed with the lower court that the company retained some level of control over the advertisements in Michigan at all relevant phases of the production and distribution process, rendering its use of the advertisements a taxable use under Michigan law – and highlighted that "only some control need be exercised." Under the facts, the company was headquartered in Michigan and the relevant work of its employees (*e.g.*, reviewing and revising the advertisement proofs, and contributing to the data that went into deciding the customer mailing lists) was performed in Michigan. Please contact us with any questions.
URL: https://www.courts.michigan.gov/49e071/siteassets/case-documents/uploads/opinions/final/coa/20240620_c365613_35_365613.opn.pdf

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Sales/Use/Indirect:
South Carolina High Court Says Durable Medical Equipment Exemption is Unconstitutionally Discriminatory

Case No. 2023-000317, S.C. (6/26/24). In a case involving a South Carolina statutory sales tax exemption for the sale of durable medical equipment that is paid for directly by Medicaid or Medicare funds but only when the seller's principal place of business is located in South Carolina ("DME exemption"), the South Carolina Supreme Court (Court) held that the DME exemption unconstitutionally discriminates against interstate commerce in violation of the dormant Commerce Clause. Moreover, the Court held that because it was not shown that the South Carolina Legislature "would have passed the remainder of the DME exemption absent the unconstitutional language," the Court declined to "sever only the offending language" and instead declared the entire DME exemption "void going forward." In doing so, the Court acknowledged that its decision to invalidate the entire DME exemption "presents a close question, as it is based on a lack of evidence

regarding legislative intent rather than affirmative evidence to that effect," but noted that the South Carolina Legislature "may, if it elects, reenact the exemption, save the unconstitutional limitation on a seller's principal place of business." Please contact us with any questions.
URL: https://www.sccourts.org/opinions/HTMLFiles/SC/28211.pdf

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Property:
Oregon Tax Court Magistrate Rejects "Dark Store Theory" Valuation of Big-Box Retail Store

Case No. TC-MD 210115R, Or. Tax Ct. (6/21/24). In an unpublished order of the Magistrate Division of the Oregon Tax Court, the presiding magistrate held that the taxpayer failed to meet its burden of proof that the real market value of its subject property – an in-state big-box retail store – for the tax year at issue was lower than the value determined by the county board of property tax appeals. In doing so, the presiding magistrate rejected the taxpayer's valuation which assumed the property was occupied without a lease, "implying it is vacant and values the property as if it were to be demised," as such perspective "does not match the current owner-occupied economically stable condition of the property." The judge explained that, under the facts, both parties agreed that the subject property was in good condition, that the taxpayer had no intention of vacating the site, and that the property was in a "stabilized" condition. Please contact us with any questions.
URL:
https://cdm17027.contentdm.oclc.org/digital/search/collection/p17027coll3%21p17027coll5%21p17027coll6/searchterm/TC-MD%20210115R/field/all/mode/all/conn/all/order/date/ad/desc

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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 bill suspends net operating losses, limits certain tax credits, and clarifies apportionment
On June 13, 2024, the California legislature passed Senate Bill 167 (SB 167). If enacted, SB 167 provides for a three-year suspension of net operating losses (NOLs) under the California Personal Income Tax and Corporation Tax, a three-year cap on the use of business incentive tax credits to offset no more than $5 million of tax per year, and retroactive application of the Franchise Tax Board's Legal Ruling 2006-1 issued on April 28, 2006, with respect to the treatment of apportionment factors attributable to income exempt from California Corporation Tax Law.
URL: https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202320240SB167
URL: https://www.ftb.ca.gov/tax-pros/law/legal-rulings/2006-01.pdf

This Multistate Tax Alert summarizes some of the relevant provisions in SB 167.
[Issued June 24, 2024]
URL: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-multistate-tax-alert-california-bill-suspends-net-operating-losses-limits-certain-tax-credits.pdf