Deloitte.

State Tax Matters
The power of knowing.
August 23, 2024

In this issue:

Income/Franchise:
Arkansas Tax Appeals Commission Confirms Single Sales Factor Applies to Special Industry Taxpayer

Docket No. 23-TAC-03206, Ark. Tax App. Comm. (7/10/24). In a ruling involving a construction company taxed as an S corporation, the Arkansas Tax Appeals Commission (Commission) held that the company must file its Arkansas pass-through entity tax return for the 2022 tax year by apportioning its income using Arkansas's standard statutory single sales factor apportionment formula, rather than Arkansas's previous three-factor apportionment formula which was imposed by the Arkansas Department of Finance and Administration (Department) pursuant to an administrative rule for taxpayers in the construction industry (*i.e.*, "Rule 1.26-51-718(d)"). In doing so, the Commission referenced state legislation enacted in 2019 [see S.B. 576 (2019) / Act 822 of 2019 for details on this legislation] that implemented single sales factor apportionment in place of the three-factor formula for tax years beginning on or after January 1, 2021 – noting that because the Department has not updated its administrative rules to reflect these statutory law changes, it must address "what rules remain good law and what rules have been superseded by statute." According to the Commission, "the better reading of Rule 1.26-51-718(d) after the enactment of Act 822 of 2019 is that the rule calls for certain construction industry-specific approaches to applying the single sales factor apportionment provided by current law, rather than reading it as preempting in advance an apportionment formula policy choice made by the General Assembly twenty years after the regulation was adopted." Please contact us with any questions.
URL: https://ig.arkansas.gov/tax-appeals-commission/ig-decisions-search/
URL: https://www.arkleg.state.ar.us/Bills/Detail?ddBienniumSession=2019%2F2019R&measureno=sb576

— Scott Bedunah (Dallas)
Partner
Deloitte Tax LLP
scbedunah@deloitte.com

Joe Garrett (Birmingham)
Managing Director
Deloitte Tax LLP
jogarrett@deloitte.com

Income/Franchise:
California: Taxpayer Associations Challenge Validity of Newly Enacted Apportionment Legislation

Case No. 24CV016118, Cal. Super. Ct., Sacramento County (complaint filed 8/14/24); Case No. 24CECG03564, Cal. Super. Ct., Fresno County (complaint filed 8/15/24). In separate complaints, two taxpayer associations have challenged the validity of recently enacted California legislation that adds Cal. Rev. & Tax Code section 25128.9 and essentially provides for retroactive application of the California 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 [see S.B. 167, signed by. gov. 6/27/24, and previously issued Multistate Tax Alert (July 1, 2024), for more details on this legislation]. One filed complaint seeks a declaratory ruling to prevent California from applying Cal. Rev. & Tax Code section 25128.9 either in its entirety

due to alleged violation of the US Constitution or, in the alternative, retroactively due to alleged violations of the US and California Constitutions. The other filed complaint alleges that while the recently enacted legislation purports to be a "clarification" of the Uniform Division of Income for Tax Purposes Act (UDITPA), it is actually "a significant change in California's income tax apportionment laws which have been in place for more than 57 years since UDITPA was enacted in 1966." Accordingly, the complaint argues that because the legislation is not a "clarification," it must be characterized as a retroactive statutory change, modifying laws enacted in 1966 – which is an "unprecedented and unreasonable period of retroactivity" that allegedly violates California taxpayers' due process rights under the US Constitution. Please contact us with any questions.
URL: https://leginfo.legislature.ca.gov/faces/billHistoryClient.xhtml?bill_id=202320240SB167
URL: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-multistate-tax-alert-california-enacts-senate-bills-167-and-175-on-nols-and-credits.pdf

— Valerie Dickerson (Washington, DC)
Partner
Deloitte Tax LLP
vdickerson@deloitte.com

Jairaj Guleria (San Francisco)
Partner
Deloitte Tax LLP
jguleria@deloitte.com

Ben Elliot (Sacramento)
Principal
Deloitte Tax LLP
belliott@deloitte.com

Kathy Freeman (Sacramento)
Managing Director
Deloitte Tax LLP
katfreeman@deloitte.com

David Han (Los Angeles)
Senior Manager
Deloitte Tax LLP
davihan@deloitte.com

Income/Franchise:
New York ALJ Denies Nonresident's Refund Request for Remote Work Performed During COVID-19 Pandemic Office Closure

Determination DTA No. 830731, N.Y. Div. of Tax App., ALJ Div. (8/8/24). In a case involving a nonresident claiming a refund of New York State individual income taxes paid on income he earned while working remotely in Pennsylvania for 196 days for a New York employer during calendar year 2020 after his New York City office closed due to the COVID-19 pandemic, an administrative law judge (ALJ) with the New York State Division of Tax Appeals denied the refund claim, holding that the taxpayer failed to meet his burden that he worked out-of-state due to his employer's necessity rather than for his own convenience. Noting that "the COVID-19 pandemic created extraordinary circumstances in 2020" and the "crisis certainly merited the closure of his employer's New York office," the ALJ referenced earlier "convenience of the employer" rulings and reasoned that the facts here nevertheless showed the employees' ability to work remotely from Pennsylvania was "permitted, but not obligatory." That is, according to the ALJ, the nonresident in this case was "in a situation

where he did not have to work remotely, but also could not work at the New York office," but nothing in the facts indicated that he specifically needed to carry out his employment duties at his Pennsylvania home as opposed to any other location. As such, the ALJ concluded that the nonresident did *not* work remotely from Pennsylvania out of his employer's necessity. Under the facts, the nonresident's employer had maintained an office for him in New York prior to the pandemic office closure, and the nonresident worked in New York for a total of 66 days in calendar year 2020 prior to this office closure. Please contact us with any questions.
URL: https://www.dta.ny.gov/pdf/determinations/830731.det.pdf

— Jack Trachtenberg (New York)
Principal
Deloitte Tax LLP
jtrachtenberg@deloitte.com

Don Roveto (New York)
Partner
Deloitte Tax LLP
droveto@deloitte.com

Mary Jo Brady (Jericho)
Senior Manager
Deloitte Tax LLP
mabrady@deloitte.com

Josh Ridiker (New York)
Senior Manager
Deloitte Tax LLP
jridiker@deloitte.com

Income/Franchise:
South Carolina ALJ Says Combined Reporting Corrects Distortion Resulting from Intercompany Transactions and East-West Structure

Case No. 21-ALJ-17-0182-CC, S.C. Admin. Law Ct. (8/15/24). In a case involving a national retailer and its various affiliates (including customer financing, trademark/tradename, back-office management, marketing, and real estate holding affiliates) whose overall organization included an "east-west structure" where the "East" taxpayer in this case challenged a South Carolina Department of Revenue (Department) audit assessment for fiscal years 2016 through 2018, the chief administrative law judge with the South Carolina Administrative Law Court (Court) continued to side with the Department in an amended order [see *State Tax Matters*, Issue 2024-29, for details on the original order] – concluding that separate reporting, along with South Carolina standard allocation and apportionment, failed to capture or correct resulting distortion from the taxpayer's use of "intercompany transfer pricing and a partnership with an east-west structure" and that combined unitary reporting ("CUR") constituted a reasonable and equitable alternative method to correct the distortion and result in a fair representation of the taxpayer's in-state business activity. In doing so, the judge continued to note that the taxpayer's intercompany transfer pricing and partnership with an east-west structure significantly distorted its in-state business activity and artificially lowered its tax burden in South Carolina "without reasonable and reliable justification," and that, pursuant to state caselaw, CUR was an authorized alternative apportionment method. Accordingly, the judge upheld the Department's application of the alternative apportionment method and ordered the "East" taxpayer to use combined unitary reporting on its South Carolina corporate income tax returns for fiscal years 2016 through 2018.
URL: https://www.scalc.net/search.aspx
URL: https://dhub.deloitte.com/Newsletters/Tax/2024/STM/240719_6.html

Responding to one of the arguments made by the taxpayer against mandated combined reporting and requesting intercompany adjustments under "482-princples" be made instead, the judge noted that "although addressing intercompany issues with Section 482 powers may have allowed separate reporting to remain intact, as this case clearly demonstrates, utilizing Section 482 power is a complicated and fraught venture that takes enormous time and resources to ostensibly arrive at the same result as CUR achieves in this case: a fair representation of the taxable business activity in this state for a single taxpayer." Please contact us with any questions.

— Art Tilley (Charlotte)
Managing Director
Deloitte Tax LLP
atilley@deloitte.com

Joe Garrett (Birmingham)
Managing Director
Deloitte Tax LLP
jogarrett@deloitte.com

Meredith Morgan (Charlotte)
Senior Manager
Deloitte Tax LLP
mmorgan@deloitte.com

Income/Franchise:
South Carolina ALJ Says Bank's Various Income Streams Must be Sourced Based on Borrower Location and Gain from Stock Sale is Not Apportionable

Docket No. 20-ALJ-17-0168-CC, S.C. Admin. Law Ct. (8/19/24). 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) continued to side with the South Carolina Department of Revenue in an amended order [see *State Tax Matters*, Issue 2024-26, for details on the original order] – 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. 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.
URL: https://scalc.net/search.aspx
URL: https://dhub.deloitte.com/Newsletters/Tax/2024/STM/240628_12.html

Amending its original opinion in this case, the Court also held that a preponderance of the evidence indicated that the bank's possession of certain credit card company stock was a "unique circumstance caused by the affairs of its parent company and for the benefit of its parent." In this respect, the Court concluded that the

credit card company stock was *not* connected to the bank's trade or business and thus its gain on the sale of the stock was *not* apportionable income. Please contact us with any questions.

— Art Tilley (Charlotte)
Managing Director
Deloitte Tax LLP
atilley@deloitte.com

Meredith Morgan (Charlotte)
Senior Manager
Deloitte Tax LLP
mmorgan@deloitte.com

Joe Garrett (Birmingham)
Managing Director
Deloitte Tax LLP
jogarrett@deloitte.com

Sales/Use/Indirect:
Tennessee Ruling Explains New Sourcing Provisions as Applied to In-State Repair Services on Equipment Shipped Out-of-State

Letter Ruling No. 24-05, Tenn. Dept. of Rev. (6/4/24). In a letter ruling involving application of Tennessee sales and use tax to repair services performed in Tennessee on equipment that was then shipped to customers out-of-state, the Tennessee Department of Revenue held that while such repair services generally are taxable under Tennessee law, pursuant to a law change from 2023 [see H.B. 323 (2023), and previously issued Multistate Tax Alert for details on Tennessee sales and use tax law changes relating to sourcing sales], beginning July 1, 2024, if the service is performed in Tennessee and the serviced property or software is then shipped or delivered by the seller to the purchaser outside Tennessee, "the sale is no longer sourced to Tennessee and reported as an exempt interstate sale." Specifically, the ruling explains that beginning July 1, 2024, the repair of tangible personal property, for sales tax purposes, is not sourced to Tennessee when the sale is made from a place of business within the physical limits of Tennessee, and where the serviced tangible personal property is delivered by the seller to the purchaser or the purchaser's designee outside the physical limits of Tennessee or to a carrier for delivery to a place outside the physical limits of Tennessee. Please contact us with any questions.
URL: https://www.tn.gov/content/dam/tn/revenue/documents/rulings/sales/24-05.pdf
URL: https://wapp.capitol.tn.gov/apps/BillInfo/Default.aspx?BillNumber=HB0323&GA=113
URL: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-multistate-tax-alert-tennessee-enacts-changes-to-sales-and-use-tax-laws.pdf

— Doug Nagode (Atlanta)
Managing Director
Deloitte Tax LLP
dnagode@deloitte.com

Joe Garrett (Birmingham)
Managing Director
Deloitte Tax LLP
jogarrett@deloitte.com

Liudmila Wilhelm (Atlanta)
Senior Manager
Deloitte Tax LLP
lwilhelm@deloitte.com

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

No new alerts were issued this period. Be sure to refer to the archives to ensure that you are up to date on the most recent releases.