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Key developments

**Connecticut budget bill contains significant corporate income tax changes**

On 30 June 2015, Connecticut Governor Dannel Malloy signed the FY 2016–17 budget bills PA 15-244 and SB 1502 (collectively, the Act), which contain significant corporate income tax changes.

Effective for income years beginning on or after 1 January 2016, Connecticut adopts mandatory unitary combined reporting. The combined group’s net income, additional tax base and apportionment factors are determined on a water’s edge basis (but also includes as part of the water’s edge group any affiliated corporations that are incorporated in a tax haven) although a worldwide or affiliate group election is available. Insurance companies remain exempt from the corporate income tax. While unlikely, it is unclear whether the state could require inclusion in the group as a non-taxable member. Financial services companies are subject to combined reporting and can be included in a combined return with non-financial service company members.

The combined group income is the aggregate net income or loss of every taxable member and non-taxable member of the combined group derived from a unitary business. The Act specifies how the combined group should calculate its net income (e.g., establishes provisions for intercompany deductions, eliminations, inclusions and exclusions) and apportion it to Connecticut. The Act also provides rules for use of net operating losses (NOLs) and tax credits incurred by a taxable member both for those earned prior to enactment of unitary combined reporting and after. Generally, the Act provides that an NOL or tax credit of a taxable member earned in a taxable year beginning on or after 1 January 2016 can be shared with other entities that were members of the combined group in the year in which the loss or credit occurred. On the other hand, NOLs or tax credits of a member earned in a taxable year beginning prior to 1 January 2016 can be shared with other entities that were members of the combined group in the year in which the loss or credit occurred. On the other hand, NOLs or tax credits of a member earned in a taxable year beginning prior to 1 January 2016 when it was filing on a separate company basis can only be used by that member to offset its share of taxable income assigned to it under mandatory combined reporting. An important exception, however, is provided that permits the sharing of pre-2016 NOLs or tax credits of a member with other entities that were members of the same elective pre-2016 combined reporting group of such taxable member.

The Act also includes financial statement relief for members of a unitary group that are publicly traded companies. Relief applies if the adoption of mandatory combined reporting results in an aggregate increase to the members’ net deferred tax liability, an aggregate decrease to the members’ net deferred tax asset or an aggregate change from a net deferred tax asset to a net deferred tax liability (determined according to Generally Accepted Accounting Principles).

Lastly, the Act maintains the current law as it relates to the calculation of the additional tax on capital.

In addition to the combined reporting provisions, the Act:

- Limits the deduction for NOLs to 50% of Connecticut taxable income, effective for income years beginning on or after 1 January 2015 (note: an alternative limit is available for corporations that are part of a combined group with over $6 billion in unused NOLs from tax years prior to 2013).
- Reduces to 50.01% (from 70.00%) the amount of credits that may be used against total liability under the Corporate Income Tax, effective for income years beginning on and after 1 January 2015.
- Imposes a 50.01% limit on the amount of hospital tax liability that hospitals may reduce by using tax credits, effective for each calendar quarter commencing on or after 1 July 2015.
- Extends for two years (through 2017) the 20% corporate surcharge (surcharge). For the income tax year commencing on or after 1 January 2018, the surcharge is reduced to 10% and will be fully phased out for subsequent years.

**Ernst & Young LLP’s insights**

Connecticut corporate taxpayers should begin to consider the implications of mandatory combined reporting as soon as possible, as this change is applicable to tax years beginning on or after 1 January 2016. Further complicating the analysis of which members should be included in the combined report will be dependent upon a listing of tax haven countries the determination of which has been delegated to the Connecticut Department of Revenue Services but may not be available or released until as late as 30 September 2016. Of special note to taxpayers that currently elect to file a unitary tax return is that the three-factor, double-weighted sales factor apportionment formula that is applied to the entire unitary group will not apply under the new rules. Instead, each member of the combined group will calculate its own apportionment based on the formula applicable to that member.
Louisiana law changes significantly affect corporate tax filers

On 19 June 2015, Governor Jindal signed income tax bills that will increase the tax burden of businesses and individuals in Louisiana by limiting the use of NOLs, credits, deductions and rebates to offset taxable income. These changes apply to originally filed returns that claim the exclusion, deduction, or credit filed on or after 1 July 2015, regardless of the tax year to which the return relates.

HB 624 reduces the amount of the Louisiana NOLs a taxpayer may deduct from 100% to 72%. For corporations with losses in current year income, the Louisiana Department of Revenue (LDR) is currently suggesting that this reduction will be interpreted to mean that they will be required to limit the utilization of the Louisiana NOL to not more than 72% of the carryover, creating at best a minimum tax on 28% of the taxpayer’s current year, post-apportioned Louisiana income. As of 30 June 2015, the LDR has not yet published official guidance, and there has been ongoing debate regarding the proper reading of the new legislation. Another bill, HB 218, extends the carryforward period for Louisiana NOLs from 15 to 20 years but eliminates the three-year carryback.

HB 624, in part, also makes the following notable changes:

- Reduces Louisiana’s dividend received deduction from the amount of dividend income claimed on the federal income tax return to 72% of the dividend income. This applies to all dividends, including deemed dividends, as well as dividends from affiliates.

- Reduces the percentage depletion deduction for oil and gas wells from 22.0% to 15.8% of the gross income from the property during the tax year, excluding 72% of rents and royalties. The bill further reduces the deduction from an amount not to exceed 50% of net income to an amount not to exceed 36% of net income.

- Reduces the subtraction modification of Louisiana income tax refunds from 100% of the refund to 72% of the amount of the refund.

- Reduce the amount of the Section 280C deduction from the total of disallowed expenses to 72% of disallowed expenses.

Provisions of HB 635 make significant changes to the following Louisiana tax rebate programs: enterprise zones, Louisiana Mega Project Energy Assistance Rebate, Quality Jobs, Competitive Projects Payroll Incentive Program and Corporate Headquarters Relocation Program.

HB 805 makes changes to the Inventory Tax Credit (ITC) and the research and development (R&D) tax credit. For taxpayers whose tax liability for ad valorem taxes paid is $10,000 or more, the ITC is changed from a refundable credit to one in which 75% of the excess credit amounts exceeding taxpayer liability is refundable and 25% of the excess credit amounts can be carried forward against future years’ income or franchise tax liability for five years. The R&D credit is now a non-refundable credit with a five-year carryforward.

HB 629 reduces or caps the amount that can be claimed under various tax credit programs, including Premiums Insurance Tax Credit (reduced), Digital and Interactive Media Credit (reduced), Motion Picture Tax Credit (capped), Angel Investor Tax Credit (reduced and capped), J obs Credit (reduced), Louisiana Basic Skills Training Tax Credit (reduced), Modernization Tax Credit (reduced and capped), Qualified New Recycling Manufacturing Equipment and Service Contracts Credit (reduced and capped), Corporate Tax Credit (reduced) and Credit for “Green Job Industries” (reduced), among others.

HB 402 grants individual taxpayers a credit for taxes paid to other states only if the other state provides a similar credit for Louisiana income taxes paid on income derived from property located in, or from services rendered in, or from business transacted in, Louisiana. Additionally, the credit is limited to the tax that would have been paid had the other jurisdiction's laws been the same as Louisiana's.

Ernst & Young LLP’s insights

If a 2014 extended return or a prior year originally filed return was filed by 30 June 2015, the law allows taxpayers to amend that return after 1 July 2015 to avoid the retroactive effects of the legislation, provided that any of the items adjusted by the legislation were properly claimed on the original return. Additionally, if a 2014 return is filed after 1 July 2015 and a valid filing extension has been allowed prior to 1 July 2015, then any portion of an exclusion or deduction disallowed by the following legislation shall be allowed as an exclusion, deduction or credit in the amount of one-third of the disallowed portion of the exclusion, deduction or credit on the taxpayer’s return for each of the taxable years beginning during calendar years 2017, 2018 and 2019.

Many of the new provisions are effective from 1 July 2015 through 30 June 2018. Thus, on 1 July 2018, the provisions are repealed, reverting to the laws in place pre-1 July 2015.
New York law amends 2014 corporate tax reform, conforms New York City’s corporate tax code to state law

On 13 April 2015, Governor Cuomo signed the New York FY 2015-16 budget bill (A. 3009-B/S. 2009-B) (the 2015 NYS Tax Bill), which includes provisions amending New York State’s (NYS) corporate tax reform legislation enacted in 2014 (2014 NYS Reform Bill). The governor also signed S. 4610-A/ A. 6721-A, which includes provisions conforming New York City’s (NYC) corporate tax laws, in substantial part, to the 2014 NYS tax reform as amended by the 2015 NYS Tax Bill (NYC Conformity Bill). These changes generally apply retroactive to 1 January 2015.

The 2015 NYS Tax Bill makes significant changes to three important definitional terms included in the 2014 NYS Reform Bill: (1) investment capital (narrows the definition), (2) investment income (eliminates the requirement to reduce investment income by hedging losses and caps investment income to not more than 8% of entire net income for all taxpayers) and (3) qualified financial instrument (QFI) (broadens its applicability).

In addition, the bills include the following technical corrections and substantive changes:

- Amend the 40% safe harbor election for interest attribution provisions
- Amend pre- and post-reform NOLs
- Add a definition of “loan secured by real property”
- Eliminate the “location of the treasury function of the business entity” from the hierarchy used to determine a corporation’s commercial domicile in apportioning certain types of receipts from financial instruments
- Include a new receipts factor sourcing provision for marked-to-market net gains
- Amend the financial services investment tax credit and have it sunset for property placed in service on or after 1 October 2015
- Eliminate R&D property as property allowing a taxpayer to be considered a qualified New York manufacturer
- Provide a reduction in New York gross receipts for the fixed dollar minimum tax
- Provide special apportionment rules for receipts from the operation of vessels and qualified air freight forwarders

The NYC Conformity Bill enacts a new subchapter to codify corporate tax reform for New York City’s separate general corporation tax. Despite general conformity to the New York state provisions, the NYC General Corporation Tax and its Banking Corporation Tax are not repealed. Furthermore, no changes were made to the NYC tax law as it applies to S corporations and, thus, the NYC corporate and banking corporation tax laws continue to apply to federal Subchapter S taxpayers just as if they were organized as C corporations for federal income tax purposes. Moreover, partnerships and limited liability companies treated as partnerships continue to be subject to the NYC Unincorporated Business Tax – no changes were made to that tax in the new laws.

The NYC corporate tax provisions that align directly with state law include:

- Mandatory combined reporting
- Substantial modifications to the definitions and treatment of investment income and investment capital
- Creation of a new category of non–taxable income titled “other exempt income”
- The 40% safe harbor revocable election for interest expenses attributed to investment income and other exempt income
- Customer sourcing provisions for receipts sourced to NYC and an 8% election for receipts from QFIs
- Computation of pre- and post-reform NOLs
- Elimination of the current subsidiary capital regime
- Increased fixed dollar minimum tax amounts

While a majority of the NYC tax reform provisions contain conforming language to the 2014 NYS Reform Bill, there are several significant deviations from state law. Specifically, NYC:

- Does not adopt the new economic nexus provisions
- Adopts a higher business income tax rate for financial corporations than for other corporations
- Includes an election to keep certain apportionment factor weighting after 2017
- Increases the maximum capital-based tax
- Provides a rate reduction for qualified NYC manufacturing corporations but not the 0% rate available for qualified manufacturers under the NYS tax reform provisions
Tennessee expands nexus provisions, adopts triple-weighted sales factor and market-based sourcing

On 20 May 2015, Governor Bill Haslam signed legislation (HB 644 and SB 603) implementing his FY 2015–16 tax-related budget proposal known as the Revenue Modernization Act (the Act). The Act adopts economic and factor presence nexus standards, implements a triple-weighted sales factor and adopts market-based apportionment sourcing for sales of non-tangible personal property.

Effective for all tax years beginning on or after 1 July 2016, the Act replaces the franchise and excise taxes’ current double-weighted sales factor methodology with a triple-weighted sales factor for all tax years beginning on or after 1 July 2016. Under the new law, net earnings and net worth are apportioned by multiplying the earnings by a fraction, the numerator of which is the property factor plus payroll factor plus three times the receipts factor and the denominator is five. Note that current apportionment methodologies for specialized industries (e.g., financial institutions, common carriers, pipelines) remain in place and are not affected by this change.

Effective for all tax years beginning on or after 1 July 2016, the Act replaces the excise and franchise taxes’ current cost of performance method for sourcing sales of sales other than sales of tangible personal property (e.g., non-TPP including services) with a market-based sourcing approach. Under this approach, receipts from non-TPP are in Tennessee if the taxpayer’s market for the sale is in the state. For sales of services, the taxpayer’s market for a sale is in Tennessee if and to the extent the service is delivered to a location in the state. The taxpayer’s market for a sale of intangible property is in Tennessee to the extent intangible property that is sold, rented, leased or licensed is used in the state (other conditions apply). If the state of assignment cannot be determined, the state of assignment is to be reasonably approximated. If the state of assignment cannot be determined or reasonably approximated, those receipts must be excluded entirely from the determination of the sales factor.
The Excise Tax provisions add an election for large taxpayers having sales for resale of tangible personal property to Tennessee-based “distributors” that meet both of the following requirements: (1) a Tennessee numerator in excess of $1 billion and (2) its Tennessee receipts factor exceeds 10%. Taxpayers meeting these two thresholds are allowed to elect to exclude such sales from their receipts numerator, and instead pay a graduated “gross receipts” tax on those excluded receipts (ranging from 0.500% down to 0.125%).

Other tax law provisions (1) change the ability to take the Excise Tax deductions for intangible expenses paid to affiliates and the methodology for same, and (2) clarify the sourcing of sales of securities by dealers pursuant to Internal Revenue Code (IRC) Section 475 for franchise and excise tax apportionment purposes. Both of these changes are effective for tax years beginning on or after 1 July 2016.

**Ernst & Young LLP's insights**

While Tennessee joins a growing number of states establishing bright-line nexus standards by statute, enforcement by the state may face a unique obstacle in the form of clear Tennessee judicial precedent that a physical presence is required before franchise or excise tax liabilities can be asserted. In 1999, the Tennessee Court of Appeals held in *J.C. Penney National Bank* that a physical presence was required in order for there to be substantial nexus for franchise and excise tax purposes. Thus, it remains to be seen how these provisions will be applied in light of that decision, and whether the Tennessee Department of Revenue (the Department) will perhaps initiate litigation with the goal of having *J.C. Penney National Bank* overruled.

The move toward a market-based sourcing approach for sourcing sales of services and non-tangible personal property pivots Tennessee’s sourcing position 180 degrees from its historic costs of performance (COP) method. It also differs in part from the approaches adopted in other states. In the past, market sourcing for sales of non-tangible personal property had only been permitted through the issuance of a variance by the Department. In these instances, out-of-state based sellers of services were compelled to use market sourcing instead of the historic COP approach to source receipts to Tennessee.²

**Other noteworthy developments**

**Legislative**

Arizona: Legislation (SB 1188) enacted 9 April 2015 updates the state’s date of conformity to the IRC to 1 January 2015. This includes “those provisions that became effective during 2014 with the specific adoption of all federal retroactive effective dates, but excluding any change to the IRC enacted after 1 January 2015.”

Florida: HB 7009, enacted on 15 May 2015, updates the state’s IRC conformity date to the IRC as amended and in effect as of 1 January 2015.

Hawaii: On 20 May 2015, legislation (SB 1133) was enacted to update the state’s conformity to the IRC to 31 December 2014, applicable starting in 2015.

Indiana: Effective for taxable years beginning on and after 1 January 2016, provisions of SB 441 repeal the state’s throwback rule and treat gross receipts from the sale of computer software as sales of tangible personal property for apportionment purposes. SB 441 also redefines “business income” to mean all income that is apportionable to Indiana under the U.S. Constitution. (Prior to 2016, business income is defined as all income arising from transactions and activity in the regular course of the taxpayer’s trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer’s regular trade or business operation).

In addition, changes to the state’s related party add-back provisions: (1) clarify “interest” subject to add-back by changing “directly related intangible interest” to “directly related interest”; (2) modify some of the add-back exceptions by providing that Indiana tax avoidance was not the principal purpose of the transaction, instead of a principal purpose as provided under law in effect prior to 2016; and (3) add a new exception under which add-back is not required if the recipient receives an item of income that corresponds to the directly related interest expenses and the recipient (a) is subject to the financial institutions tax (FIT), (b) files a FIT return, and (c) apportions the items of income that correspond to the intangible expenses and the directly related interest expenses in accordance with Ind. Code Article 6-5.5.
Lastly, SB 441 eliminates various income deductions, exemptions and credits for purposes of determining Indiana Adjusted Gross Income. SB 441 was enacted on 6 May 2015.

Provisions of HB 1472, enacted on 6 May 2015, update the state's date of conformity to the IRC as amended and are in effect on 1 January 2015 (formerly 1 January 2013).

HB 1001, enacted 7 May 2015, establishes a tax amnesty program that will run 15 September 2015 through 16 November 2015. Amnesty applies to taxpayers that have an unpaid tax liability for a listed tax that was due and payable for a taxable year ending before 1 January 2013. Amnesty applies to approximately 40 different taxes and fees, including corporate income, sales, withholding and financial institution taxes. Taxpayers participating in the amnesty program will have abated any interest, penalties, collection fees or costs otherwise due.

Iowa: Retroactively effective to 1 January 2015, SF 479 establishes special apportionment provisions that require broadcasters to apportion income from broadcasting to Iowa. Where income is derived by a broadcaster from broadcasting, the part attributable to a business in Iowa is in the proportion that the gross receipts from broadcasting derived from customers whose commercial domicile is in Iowa bear to the total gross receipts from broadcasting. If the income is derived by a broadcaster from national or local political advertising that is directed exclusively at one or more markets in Iowa, all gross receipts from such advertising are attributable to business within Iowa. SF 479 was enacted on 1 May 2015.

Kansas: HB 2109 establishes a tax amnesty program that will run 1 September 2015 through 15 October 2015. Amnesty applies to unpaid taxes due and owing for tax periods ending on or before 31 December 2013. Taxes subject to amnesty include income tax and state and local sales and use tax, among others. For taxpayers that comply with the terms of the amnesty program, the Department of Revenue will waive all penalties and interest. HB 2109 was enacted on 16 June 2015.

Maryland: Legislation (SB 763) enacted 14 April 2015 establishes a tax amnesty program that will run 1 September 2015 through 30 October 2015. Amnesty applies to taxpayers that on or before 31 December 2014 failed to file a return required or pay tax due for the corporate income tax, sales and use tax, withholding tax or individual income tax. The Department of Revenue will waive all civil penalties and one-half of otherwise applicable interest for all taxpayers that participate in, and comply with the terms of, the amnesty program. Amnesty does not apply to any taxpayer that was granted amnesty under a Maryland tax amnesty program held between calendar years 1999 and 2014 or taxpayers eligible for the 2004 intangible company settlement for periods before tax year 2003.

A new law (HB 72), enacted in response to the appeal to the US Supreme Court of the Comptroller of the Treasury of Maryland v. Wynne (Wynne) decision, expands the scope of Maryland's resident tax credit for income taxes paid to other states by allowing them to claim a credit against Maryland county income tax owed. Further, the Comptroller of the Treasury said that it will process refunds as soon as possible, in the order in which they were received. HB 72 became law on 29 May 2015 without the governor's signature.

Missouri: A new law (HB 384) establishes a tax amnesty program that will run 1 September 2015 through 30 November 2015. Amnesty applies to tax liabilities due, or due but unpaid, on or before 31 December 2014. Taxes covered by the amnesty program include the corporate franchise tax, sales and use tax, income tax and other taxes administered by the Department of Revenue. Eligible taxpayers complying with the terms of the amnesty program, including an agreement to comply with state tax laws for the next eight years, will have penalties and interest waived. HB 384 was enacted on 27 April 2015.

SB 19, enacted 6 May 2015, clarifies that the optional single sales factor method is available for sales other than the sale of tangible personal property. SB 19 also establishes market-based sourcing rules for sales of other than tangible personal property for multi-state corporate taxpayers electing this optional method. These rules provide generally that a sale is sourced to Missouri if the taxpayer's market for such sales is in the state. For sales of real property, the rules provide that sales are sourced to Missouri to the extent the property is located in the state. Sales of services are sourced to Missouri
to the extent the ultimate beneficiary of the service rendered by the taxpayer is located in the state. Lastly, SB 19 clarifies the specific rules regarding the sourcing of receipts from the rental, lease, license and sale of intangible property. These changes are effective 28 August 2015.

New Mexico: HB 2, enacted 15 June 2015, establishes an elective single sales factor apportionment formula for taxpayers whose principal business activity in New Mexico is a headquarters operation. Once the election is made, it is binding for at least three consecutive tax years (including a total of at least 36 months), and will remain in place until the taxpayer provides written notification to the Department of Taxation and Revenue that it is terminating the use of the election. The election applies to separate returns as well as those filing a consolidated or combined return.

In addition, sales of tangible personal property are sourced to New Mexico and included in the sales factor if the property is shipped from an office, store, warehouse, factory or other place of storage in the state to which it did not have nexus sufficient to impose a state income tax and the headquarters operation did not make an election to use the more heavily weighted sales factor apportionment formula (throwback). Thus, if the taxpayer does not elect the special apportionment factor, the taxpayer is subject to throwback.

Lastly, the bill clarifies that the phased-in single sales factor election for manufacturers (which was enacted in 2013) applies to a taxpayer whose principal business activity in New Mexico is manufacturing. These changes apply to taxable years beginning on and after 1 January 2015.

North Dakota: For tax years starting after 31 December 2015, SB 2292 phases in a single sales factor election and modifies certain provisions of the Multistate Tax Compact (the Compact) within the North Dakota Century Code. Currently, North Dakota uses an evenly weighted, three-factor apportionment provision. For tax years 2016 and 2017, the sales factor will be double-weighted; for tax year 2018, it will be weighted six times (75%); and for tax year 2019, the single sales factor will be fully effective. The election is binding for five consecutive tax years. Provisions of SB 2292 also amend the Compact by removing the Compact apportionment election provision from Article III, the apportionment formula in Article IV and the arbitration provisions of Article IX. SB 2292 was enacted on 20 April 2015.

Provisions of SB 2349, enacted on 23 April 2015, reduce North Dakota’s corporate income tax rates. Effective for taxable years beginning after 31 December 2014, the corporate tax rate is reduced as follows: (1) from 1.48% to 1.41% for the first $25,000 of taxable income, (2) from 3.73% to 3.55% on all taxable income exceeding $25,000 and not exceeding $50,000, and (3) from 4.53% to 4.31% on all taxable income exceeding $50,000.

Oklahoma: HB 2236 establishes a voluntary disclosure initiative that will run 14 September 2015 through 13 November 2015. The Tax Commission will waive penalties, interest, and other collection fees and costs that would be due and release any liens imposed for taxpayers participating in the amnesty initiative. Amnesty applies to various taxes that were due and payable for any tax period(s) ending before 1 January 2015, including income tax, withholding tax and bank in lieu tax. HB 2236 was enacted on 20 May 2015.

Oregon: Legislation (SB 63), enacted 16 June 2015, updates the state’s IRC conformity date to 31 December 2014. This change applies to transactions or activities occurring on or after 1 January 2015.

Puerto Rico: Act 72-2015, signed into law on 29 May 2015, amends Puerto Rico’s income tax provisions. Key changes include the following:

- Modify the formula for calculating the alternative minimum tax (AMT) and amend the AMT rate
- Limit the amount of income against which companies may apply their NOLs and limit NOL usage to 80% of a shareholder’s or partner’s distributive share in the aggregate net income of the corporation of individuals, partnerships and special partnerships
- Add a disallowance for any deduction for expenses incurred or paid for services rendered by a nonresident person if the taxpayer has not paid the applicable sales and use tax or value added tax (VAT)
- Limit the amount of income against the deduction and carryforward of capital losses that may be offset
- Extend the tax credit moratorium for the use of credits granted or purchased, and the issuance of tax credits, to tax years commencing before 1 January 2018

These changes are generally effective beginning in 2015.
Rhode Island: Effective for tax years beginning on and after 1 January 2016, Article 11 of HB 5900 reduces the corporate minimum tax to $450 (from $500). HB 5900 was enacted on 30 June 2015.

South Carolina: Legislation (S 526), enacted 8 June 2015, establishes a tax amnesty program, the date of which will be set by the Department of Revenue (Department). During the amnesty program, the Department will waive penalties and interest (or any portion thereof) at its discretion for any taxpayer that complies with the terms of the amnesty program. For example, amnesty is available if the taxpayer voluntarily files all delinquent tax returns and pays in full all taxes due.

Texas: HB 32, enacted 15 June 2015, reduces all the franchise tax rates by 25% for report years 2016 and beyond, the tax rate for entities not primarily engaged in retail or wholesale trade is reduced to 0.75% (from the initial 1.00% rate) and the rate for entities primarily engaged in retail or wholesale trade is reduced to 0.375% (from the initial 0.500% rate). The total revenue threshold for taxpayers to elect the EZ computation will be increased to an amount not to exceed $20 million (from $10 million). In addition, the franchise tax rate for an entity making an EZ computation election is reduced to 0.331% (from 0.575%).

HB 2896, enacted 19 June 2015, clarifies, for Texas franchise tax purposes, the interpretation of the term “location of the payor” for sourcing licensing income of broadcasters. Effective with reports due on or after 1 January 2018, taxpayers that fall under the definition of a “broadcaster” will be required to include licensing income in the numerator of their sales factor if their customer is legally domiciled in Texas.

Vermont: HB 489 updates the state’s conformity to federal income tax laws to the laws in effect for taxable year 2014 (formerly 2013). This change retroactively applies to taxable years beginning on and after 1 January 2014. HB 489 was enacted on 11 June 2015.

Judicial

California: In Harley-Davidson, Inc., the California Court of Appeal (the Court) held that a statutory provision which allowed intrastate unitary businesses, but not similar interstate business, to file on a separate return basis was facially unconstitutional under the dormant Commerce Clause. The Court, however, remanded this issue back to the trial court to consider whether the discriminatory provision would be permissible under the strict scrutiny standards established by the U.S. Supreme Court. The Court also found the taxpayer’s out-of-state subsidiaries, which did not have any physical presence in the state (i.e., no employees or property in California), still had nexus with California based on an agency theory relating to activities undertaken on their behalf in California by related entities.

Maryland: On 18 May 2015, the U.S. Supreme Court issued its opinion in Wynne, holding that Maryland’s personal income tax scheme, which provides a credit for taxes paid to other states for the state portion of the income tax but not for the county portion, violates the dormant Commerce Clause of the U.S. Constitution.

In Staples, Inc., the Maryland Tax Court (court) found that “enterprise dependency” existed and that the out-of-state corporations were not separate business entities from in-state affiliated companies; were part of a unitary business; and, thus, had nexus with Maryland. The court also upheld the Comptroller of Treasury’s use of the apportionment factor of the in-state companies to the out-of-state affiliated companies that received the interest and royalties, consistent with other recent tax rulings by the Maryland courts (e.g., Gore Enterprises; NIHC, Inc.; and ConAgra Brands, Inc.).

Michigan: In Anheuser Busch Inc., the Michigan Court of Claims (the COC) rejected a national brewing company’s refund request based on its use of the Compact’s equally weighted, three-factor apportionment formula (MTC Compact election) instead of the state-mandated single sales factor apportionment formula to determine its business income tax under the since-repealed Michigan Business Tax. Citing its rulings in Ingram Micro, Inc. and Yaskawa America, Inc., the COC concluded that PA 282, which retroactively repealed the Compact effective to 2008, applied to this action and “negates the basis” for the company’s claim.

In addition, the COC in IBM held that the retroactive repeal of the Compact applies to the taxpayer. Although this decision does not overturn the Michigan Supreme Court’s conclusions in IBM, in which it upheld the use of the MTC Compact election, the COC ruling in effect prevents the taxpayer from receiving its refund.
Lastly, in EMCO Enterprises Inc., the COC held that the Michigan single business tax (SBT) was an income tax, as defined by the Compact and, thus, the MTC Compact election could be applied. The COC, however, concluded that the MTC Compact election was implicitly repealed by the Legislature changing the SBT apportionment formula multiple times and, as a result, the MTC Compact election should not be permitted. In its ruling, the COC made it clear that the SBT should not be viewed as an income tax for all purposes, including for purposes of Public Law 86-272.

Minnesota: The Minnesota Tax Court (tax court) ruled against the taxpayer in Kimberly-Clark Corporation, rejecting all of its claims as to the effectiveness of the state’s repeal of the Compact election (Article III) and the Compact’s three-factor apportionment formula (Article IV). The tax court generally applied a judicially devised “unmistakability” doctrine in concluding that the Legislature had not taken all the necessary steps to unequivocally surrender its sovereign taxing authority in enacting or repealing the Compact.

Texas: On 1 May 2015, the Texas Supreme Court declined to review the appellate court’s ruling in Titan Transportation that a transportation company qualified for a revenue exclusion for payments made to subcontractors in former Section 171.1011(g)(3) of the Texas franchise tax statute. In American Multi-Cinema, Inc., a Texas Court of Appeals (appeals court) upheld a lower court’s ruling that a movie theater business is allowed to include its costs of exhibiting films and other content in its cost of goods sold (COGS) subtraction for purposes of calculating its Texas Franchise Tax, but reversed the lower court’s determination regarding which facility-related costs associated with the square footage of the movie theater should be included in the COGS subtraction. Ultimately, the appeals court held that the entire square footage of the auditoriums should be included in the COGS calculation, not just the square footage occupied by the speakers and screens, as determined by the trial court.

In Rent-A-Center, Inc., a case of first impression, the appeals court held that a national rent-to-own company is engaged in a retail trade business and, therefore, entitled to use the lower franchise tax rate because the majority of its revenue is generated from payments for merchandise arising from rental-purchase agreements. In reaching this conclusion, the appeals court found that the company’s activities are more like selling than leasing because the characteristics of the rental-purchase agreements showed that the company was engaged in the selling of merchandise. The appeals court pointed out that title passes to the customer for 97% of merchandise sold and the customer can acquire title to the merchandise at any time by paying the remaining cost of the rental. Finally, the agreements also use terms such as “purchase,” “consumer,” “owner” and “ownership,” which all support the notion that the company is engaged in sales rather than leasing.

Administrative

Multistate: On 7 May 2015, the Executive Committee of the Multistate Tax Commission (MTC) approved the Arm’s Length Adjustment Services (ALAS) program. The ALAS program is intended for participating states to pool their resources by having the MTC develop and retain its own transfer pricing expertise and conduct multistate transfer pricing audits akin to the multi-state income and sales/use tax audits the MTC already conducts. The state tax authorities in Alabama, Iowa, Kentucky, North Carolina, New Jersey and Pennsylvania agreed to commit to participate as charter members of the ALAS program. The ALAS program formally launches in July 2015. Audits will begin promptly thereafter. By the spring of 2016, the MTC expects to have completed 10 economic analyses of transfer pricing studies, which will then enable it to move on to case assistance and resolution with the states.

New York: In reversing an Administrative Law Judge’s ruling in SunGard Capital Corp., the New York Tax Appeals Tribunal held that a group of affiliated companies, except for a few specific members that were determined not to be engaged in a unitary business with such group, were entitled to file a combined return for the tax years at issue (2005-06) because the necessary capital stock, unitary business and distortion requirements were met. As New York’s combined report rules were changed in 2007 (combined reporting was generally required if there were substantial intercorporate transactions) and again changed for tax years beginning on or after 1 January 2015 (mandatory unitary combined reporting), this case is instructive on what is required to meet the unitary business and distortion requirements under prior law.

In Matter of Purcell, an Administrative Law Judge (ALJ) of the New York Division of Tax Appeals held that an S corporation in the construction industry properly included
the payroll of all of its employees, not just those who worked within an empire zone, in the numerator of the payroll component of the zone allocation factor for the qualified empire zone enterprise (QEZE) tax reduction credit. The ALJ also found that the Division of Taxation incorrectly reduced the individual taxpayer’s tax factor component for purposes of computing the tax reduction credit for determining the QEZE credit by using only the S corporation’s business allocation percentage. The ALJ concluded that this method resulted in computing the QEZE amount based on the S corporation’s income rather than the shareholder’s entire income inconsistent with the provisions of the QEZE credit statute.

South Carolina: In DIRECTV, Inc., an administrative law judge (ALJ) denied a corporation’s request for refund and determined that 100% of its subscription receipts from South Carolina customers should be included in the numerator of the gross receipts ratio. The ALJ found that all of the taxpayer’s income-producing activities related to South Carolina customers occurred entirely within South Carolina.

On 12 June 2015, the South Carolina Department of Revenue (SC DOR) issued Revenue Ruling #15-5 (the Ruling) and Revenue Procedure #15-2 (the Procedure) regarding the use of alternative allocation or apportionment methods, including combined unitary reporting. The Ruling provides guidance to taxpayers on when and how the SC DOR will apply an alternative apportionment method, and describes the SC DOR’s application of combined unitary reporting, including which members will be considered part of the unitary group, the treatment of partnerships and the use of the Finnigan method of apportioning sales of members of the unitary group that do not have a South Carolina income tax obligation of their own. The Ruling also provides a description of the step-by-step approach the SC DOR will use to calculate the group’s income and apportionment factors. The Procedure outlines the process taxpayers must use to request an alternative apportionment method.

Wisconsin: Rule 2.495, amended 29 April 2015, provides an electable method for apportioning income of interstate broker-dealers, investment advisors, investment companies and underwriters. Prior to the rule amendment, gross receipts and net commissions from sales of trading assets were assigned to Wisconsin if the day-to-day decisions regarding the trading assets occurred at a location in the state. If the day-to-day decisions were made both inside and outside Wisconsin, the assets were deemed located where the trading policies and guidelines were established. Effective for taxable years beginning after 31 December 2014, at the election of the taxpayer, such gross receipts and net commissions are assigned to Wisconsin if the customer’s billing address is in the state. If this election is made, it cannot be revoked without prior consent from the Department of Revenue. Wis. Register, CR 14-077 (May 26, 2015).

Developments to watch

District of Columbia: Provisions of the FY 2016 budget bill (B21-158) would accelerate the franchise tax rate reduction applicable to both corporations and unincorporated businesses. Provisions of the bill also would make clear that market-based sourcing provisions are effective for tax years beginning after 31 December 2014, and it would make clarifying changes to the City’s combined reporting provisions. B21-158 was approved by the DC Council on 30 June 2015, next goes to Mayor Bowser for her consideration and then, to the U.S. Congress for a mandatory 30-day in-session review period.

Tennessee: On 2 June 2015, the Tennessee Supreme Court heard oral arguments in Vodafone, a significant case that raises the issue of whether the Commissioner of the Tennessee Department of Revenue has the authority to require a taxpayer to use an alternative sales factor market-based sourcing method rather than the statutorily mandated COP method when calculating its Tennessee franchise and excise taxes.

Texas: On 3 June 2015, a Texas Court of Appeals heard oral arguments in Graphic Packaging, Inc., on the issue of whether the taxpayer properly elected to use the Compact’s equally weighted, three-factor apportionment formula to apportion its taxable margin under the Revised Texas Franchise Tax instead of using the single sales factor apportionment formula mandated by the Franchise Tax law.
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