

{ State & Local Tax Advisor }

Provided by the National Tax Office

February 2016



California

Contractors May Want to Consider Manufacturing and R&D Partial Exemption

The California State Board of Equalization (BOE) advises construction contractors that they may be able to purchase and/or sell materials and fixtures at a partial sales and use tax rate (3.3125%, plus applicable district taxes) for certain jobs when contracted by qualified companies engaged in manufacturing or Research and Development (R&D). Legislation made effective July 1, 2014, allows certain companies engaged in manufacturing or R&D to make annual purchases up to \$200 million of qualifying property at a reduced sales and use tax rate. The partial exemption also applies to qualifying property purchased for use in constructing or reconstructing a special purpose building. The BOE advises that the law is unusual because qualified companies can authorize the construction contractor to make purchases of materials and fixtures for the special purpose building at a reduced tax rate and pass the tax savings back to the qualified manufacturing or R&D company.

Special Purpose Buildings and Foundations

The special purpose building must be used exclusively for manufacturing, processing, refining, fabricating, or recycling, or as a research or storage facility for these activities in order to qualify for the partial exemption. Buildings such as warehouses used solely to store a product after it has completed the manufacturing process are ineligible for the partial exemption.

Exemption Certificates

Contractors are required to get a partial exemption certificate from qualified persons. Construction contractors need to retain records that support their purchases of materials and fixtures at the reduced sales and use tax rate. There are two separate exemption certificates that construction contractors may need:

- *BOE-230-M, Partial Exemption Certificate for Manufacturing, Research & Development Equipment; and*
- *BOE-230-MC, Construction Contracts – Partial Exemption Certificate for Manufacturing, Research & Development Equipment.*

To make qualifying purchases using the partial exemption, construction contractors must first get a signed exemption certificate *BOE-230-M* from the manufacturing or R&D company that certifies they are a qualified person, and that the special purpose building qualifies for the partial exemption. General contractors who hire subcontractors to furnish materials, fixtures, machinery, or equipment for a qualifying job, must provide the subcontractors with a copy of the *BOE-230-M* partial exemption certificate received from the qualified person, and issue the subcontractor a *BOE-230-MC*.

Once a construction contractor has obtained the *BOE-230-M* from the qualified person, or once a subcontractor has obtained a *BOE-230-M* and *BOE-230-MC* from the general contractor, the contractor may then issue a separate *BOE-230-MC* partial exemption certificate to the contractor's supplier to make qualifying purchases at the reduced sales and use tax rate.

Special Notice L-430, California State Board of Equalization, January 2016

Delaware

Single Sales-Factor Apportionment Formula, Other Income Tax Changes Enacted

Gov. Jack Markell has signed the Delaware Competes Act which, among other changes, replaces the equally weighted three-factor apportionment formula for determining a corporation's income that is attributable to Delaware property, payroll, and sales with a single-factor formula based exclusively on sales. The single sales-factor apportionment formula is phased in over four years for tax periods beginning after 2016, except telecommunication corporations and certain corporations with worldwide headquarters in Delaware are allowed to use either the three-factor or the single sales-factor apportionment formula after 2016 for determining Delaware income tax liability. Other developments that are effective beginning after 2016 include:

- a reduction in the amount of quarterly installments of estimated tax liability for certain small businesses from the current amount of 50%, 20%, 20%, and 10% to equal installments of 25% each quarter;
- an increase in the thresholds for determining the frequency at which employers must file withholding tax returns and make tax payments; and
- annual inflation adjustments to thresholds for determining withholding tax filing periods, assessment notification requirements, tax credit and credit calculations, and miscellaneous license requirements.

H.B. 235, Laws 2015, effective January 27, 2016 and as noted; *Press Release*, Office of Delaware Gov. Jack Markell, January 27, 2016

Michigan

Additional Challenges to Retroactive Repeal of MTC Rejected

In sixteen consolidated appeals, the Michigan Court of Appeals affirmed the Court of Claims decisions that granted summary disposition to the Department of Treasury. The taxpayers raised multiple state and federal constitutional challenges to 2014 PA 282, the statute which expressly repealed the Multistate Tax Compact (MTC) and its apportionment formula election under the Michigan business tax retroactively to January 1, 2008. The Court of Appeals stated that the arguments raised by the taxpayers in the consolidated appeals were identical in all relevant respects to the arguments rejected in *Gillette Commercial Operations North America &*

Subsidiaries, et al. v. Department of Treasury. The *Gillette* decision upheld the constitutionality of 2014 PA 282, thus preventing taxpayers from electing to use the MTC's three-factor apportionment formula.

Sapa Extrusions, Inc. v. Department of Treasury, Michigan Court of Appeals, Nos. 326414, 326415, 326512, 326513, 326585, 326586, 326732, 326733, 326818, 326819, 327360, 327725, 327880, 327962, 327963, January 21, 2016

New York

Draft Corporate Tax Reform Regulations on Combined Reporting Released

As part of the process to update New York's corporate franchise tax regulations to incorporate changes made by tax reform legislation, the Department of Taxation and Finance is seeking public comment on draft regulations regarding combined reports. The draft regulations indicate the requirements for filing a combined report, including detailed descriptions of the capital stock and unitary business requirements. Requirements for the commonly owned group election are also described.

Comments on the combined reporting draft regulations should be submitted by April 21, 2016.

In addition, the department has updated previously posted draft regulations regarding activities that will subject a foreign corporation to tax. Specifically, a definition of "unitary group" was added, and changes were made regarding the taxation of corporate members of limited liability companies treated as partnerships.

The draft regulations are available at https://www.tax.ny.gov/bus/ct/corp_tax_reform_draft_regs.htm.

Corporate Tax Reform Draft Regulations, New York Department of Taxation and Finance, January 25, 2016

North Carolina

Guidelines on Market-Based Sourcing and Information Reporting Requirements Issued

The North Carolina Department of Revenue has issued guidelines for corporate income taxpayers that are required to file informational reports to assist the Revenue Laws Study Committee with a study on the effect of computing the sales factor of the apportionment formula using market-based sourcing rules. The comprehensive guidelines address market-based sourcing with respect to: the sale, rental, lease, or license of real property; the rental, lease, or license of tangible personal property; the sale of services; the rental, lease, or license of intangible property; and the sale of intangible property. The guidelines incorporate principles from the most recent model regulations on market-based sourcing drafted by the Multistate Tax Commission (MTC) and other model apportionment regulations or statutes that are consistent with the MTC regulations. Numerous examples to assist taxpayers in understanding the provisions of market-based sourcing are included in the guidelines. Special industry guidelines for financial institutions that are based on the MTC model regulations detail sourcing for specific streams of income specific to that industry.

Information Reporting Requirements

Every corporation must file an information report on Form CD-400 MS if with respect to the 2014 taxable year:

- the taxpayer had apportionable income greater than \$10 million;
- the taxpayer had a North Carolina apportionment percentage of less than 100%; and
- the taxpayer was subject to apportionment of income based in whole or in part on the sales factor as determined under the North Carolina apportionment statute.

The informational report is due by April 15, 2016 and is not subject to extension. The principal member of a group authorized by the Secretary of Revenue to file a combined return for tax year 2014 must complete all lines of the CD-400 MS. Other members of the group are required to file CD-400 MS and complete lines 6 through 8 only. Failure to timely file the informational report will result in a \$5,000 civil penalty.

The report for all corporations, other than excluded corporations and public utilities, must contain:

- the three-factor apportionment percentage and sales factor used with respect to the corporation's 2014 North Carolina corporate return ("Original");
- the three-factor apportionment percentage and sales factor as calculated under Market-Based Sourcing ("MBS") guidelines with respect to the corporation's 2014 taxable year;
- the primary economic sector under the North American Industry Classification System (NAICS) in which the corporation has business activities;
- the taxpayer's apportionable income;
- income apportioned to North Carolina using the Original three-factor apportionment percentage and income apportioned to North Carolina using the Original sales factor only;
- income apportioned to North Carolina using the MBS three-factor apportionment percentage and income apportioned to North Carolina using the MBS sales factor only;
- capital stock, surplus and undivided profits before apportionment;
- capital stock, surplus and undivided profits after apportionment using the Original three-factor apportionment percentage and capital stock, surplus and undivided profits after apportionment using the Original sales factor only; and
- capital stock, surplus and undivided profits after apportionment using the MBS three-factor apportionment percentage and capital stock, surplus and undivided profits after apportionment using the MBS sales factor only.

The report for excluded corporations (i.e., building or construction contractors, securities dealers, loan companies, or corporations that receive more than 50% of ordinary gross income from intangible property) and public utilities must contain information based on the sales factor only.

Market-Based Sourcing

Under current North Carolina law, receipts from services are sourced to North Carolina if the income-producing activities are performed in North Carolina. Receipts from intangible property are sourced to North Carolina if the source of the receipt is in North Carolina. Under MBS, receipts from sales other than sales of tangible personal property are in North Carolina if and to the extent that the taxpayer's market for the sales is in North Carolina. In general, the MBS guidelines establish uniform rules, many of which must be applied in hierarchical order, for:

- determining whether and to what extent the market for a sale is in North Carolina;
- reasonably approximating the state or states of assignment where such state or states cannot be determined;

- excluding certain receipts (i.e., throwout rule) in connection with the sale of intangible property (e.g., the sale of business “goodwill,” the sale of an agreement not to compete, or similar intangible value) from the sales factor; and
- excluding receipts from the denominator of the sales factor where the state or states of assignment cannot be determined or reasonably approximated.

The North Carolina MBS guidelines do not adopt the MTC throwout provision where a taxpayer is not taxable in a state to which a sale is sourced.

Sale, rental, lease or license of real property.—In the case of a sale, rental, lease or license of real property, the receipts from the sale are sourced to North Carolina if and to the extent that the property is in North Carolina.

Rental, lease or license of tangible personal property.—Receipts from the rental, lease or license of tangible personal property are also sourced to North Carolina if and to the extent that the property is in North Carolina. Special sourcing rules apply to mobile property and automobiles assigned to traveling employees.

Sales of services.—The MBS guidelines generally provide that the sale of a service is sourced to North Carolina if and to the extent that the service is delivered to a location in North Carolina. Special sourcing rules apply to:

- in-person services (e.g., cleaning and plumbing, hair care and salon, child care services, etc.);
- professional services (e.g., legal, engineering, architectural, tax-related services, etc.);
- services that are physically delivered to or on behalf of a customer (e.g., direct mail, advertising services, etc.);
- services that are electronically delivered to or on behalf of a customer (e.g., software, web-based services, etc.); and
- services that are delivered electronically through a customer or on behalf of a customer (e.g., cable, network, or internet advertising services, etc.).

License or lease of intangible property.—Receipts from the license or lease of intangible property are sourced to North Carolina if and to the extent the intangible is used in North Carolina. Distinct rules are set forth for:

- marketing intangibles (e.g., license of a service mark, trademark, or trade name, copyrights, franchise agreements, etc.);
- production intangibles (e.g., license of a patent, a copyright, or trade secrets to be used in a manufacturing process, etc.);
- mixed intangibles; and
- intangible property where the substance of a transaction resembles a sale of goods or services.

Sale of intangible property.—Sourcing rules for the sale of intangible property depend on the nature of the intangible property sold, including whether:

- the property sold or exchanged is a contract right, government license, or similar intangible that authorizes business activity in specific geographic area;
- the sale or exchange is contingent on the productivity, use or disposition of the property; and
- the sale resembles a sale of goods and services.

Special rules are also provided for software transactions and sales or licenses of digital goods or services.

Market-Based Sourcing Guidelines, North Carolina Department of Revenue, January 26, 2016; *Summary of Market-Based Sourcing Guidelines*, North Carolina Department of Revenue, January 29, 2016

If you have any questions, please contact your tax advisor or:

Curtis Ruppal
877.622.2257, Ext. 34069
curtis.ruppal@plantemoran.com

Mike Merkel
877.622.2257, Ext. 33264
michael.merkel@plantemoran.com

Bob Woolley
877.622.2257, Ext. 29160
bob.woolley@plantemoran.com

Ron Cook
877.622.2257, Ext. 3211
ron.cook@plantemoran.com

The information provided in this alert is only a general summary and is being distributed with the understanding that Plante & Moran, PLLC is not rendering legal, tax, accounting, or other professional advice, position, or opinions on specific facts or matters and, accordingly, assumes no liability whatsoever in connection with its use