January 2017

CCH
a Wolters Kluwer business

Illinois

2016 Tax Return Due Dates, Expiring Credits, and Other Changes Summarized

The Illinois Department of Revenue (DOR) has issued a bulletin summarizing Illinois income tax return changes that affect corporations, partnerships (including limited liability companies classified as partnerships for income tax purposes), and individuals for the 2016 tax year, including:

- extension of April 15, 2017 due dates to April 18, 2017 because of the Emancipation Day holiday being observed on April 17 in the District of Columbia;
- new due dates for calendar year and fiscal year C corporations that follow federal filing due date changes;
- changes to filing extension periods to accommodate the new C corporation due date changes;
- expiration of the Research and Development credit and, for short year or fiscal year filers, the River Edge Redevelopment Zone Investment Credit, River Edge Redevelopment Zone Remediation Credit, Veterans Jobs Credit, Angel Investment Credit, Live Theater Production Credit, and the Hospital Credit;
- an increase in the individual taxpayer standard exemption allowance from $2,150 to $2,175; and
- changes to various return line items and schedules.

MyTax Illinois, the department's free online tax filing and payment system, started accepting 2016 individual and business income tax returns on January 23, 2017. Employers are also reminded that all electronically submitted W-2 forms are due by February 15, 2017. Finally, the bulletin discusses new income tax withholding requirements for 2017 and important information for tax preparers and software vendors regarding 2017 tax forms.

Informational Bulletin FY 2017-12, Illinois Department of Revenue, January 2017

Personal Property Lease Tax Does Not Apply Outside Chicago

The Illinois Supreme Court held that Chicago's taxation of car rentals outside city limits under its personal property lease transaction tax ordinance violated the city's home rule powers under the home rule article of the Illinois constitution. Home rule units may not extend their taxing power beyond the home rule unit's borders absent express legislative authority. Chicago announced it would assume that short-term vehicle lease transactions occurring within three miles of the city's borders were taxable under its ordinance if the lessee intended to use the vehicle in Chicago more than 50% of the time or was a Chicago resident. To help determine whether a transaction was taxable, the ordinance provided language for rental agreements through which the lessee would notify the lessor that she intended to use the leased vehicle either inside or outside of Chicago more than 50% of the time. The ordinance was challenged by car rental companies. Chicago argued that the tax was imposed on the use of vehicles inside Chicago. The Court found that the tax was not imposed on a lessee's use but on either a lessee's stated intent as to where the lessee would use the vehicle, or a conclusive presumption that a Chicago resident would use the vehicle in Chicago.

The Hertz Corp. v. The City of Chicago, Illinois Supreme Court, No. 119945, 119960, January 20, 2017

Taxpayers Required to File Quarterly Withholding Tax Returns in 2017

The Illinois Department of Revenue (IDOR) announced in a press release that all taxpayers are required to file quarterly personal income withholding tax returns and report detailed payroll data beginning in 2017. The annual filing and payment frequency has been eliminated. The new quarterly reporting requirement has been introduced to reduce taxpayer filing and payment errors, and increase the detection of false income reporting and insolvent employers. The change will impact employers, payroll service providers, software developers and individuals that pay gambling and lottery winnings.

Press Release, Illinois Department of Taxes, January 5, 2017

Indiana

Invalid Corporate Loans Taxable as Income of Shareholder

An Indiana personal income taxpayer's protest of a Department of Revenue assessment of tax on loans from the taxpayer's S corporation was denied because he failed to meet his burden of establishing that the audit's original decision was incorrect. The taxpayer and his wife were the shareholders in the Indiana S corporation that the husband owned. The taxpayer executed "promissory notes" lending himself money from the corporation at an interest rate of 3%. The department assessed income to the taxpayer based on the invalidity of the "promissory notes." A loan by a corporation to a corporate officer should have the characteristics of a loan made at arm's length. The taxpayer provided the "promissory notes" and a letter from a third party reviewer stating that the reviewer/attorney did not see anything in the promissory note which would invalidate them. However, the "promissory notes" did not provide a repayment schedule, state any collateral by the borrower, or proof of repayment. Consequently, the taxpayer's protest was denied.

Letter of Findings No. 01-20160161, Indiana Department of Revenue, December 28, 2016

Michigan

Material and Supplies Deductible from MBT Tax Base

Granting summary disposition to the taxpayer, the Michigan Tax Tribunal found that drugs, injections, implants and office supplies did constitute materials and supplies for purposes of the definition of "purchases from other firms" and could be subtracted from the Michigan Business Tax (MBT) base. The taxpayer wanted to subtract these items from its gross income in calculating its MBT base. The Department of Treasury (Department) argued that definition of "purchases from other firms" in subsection (c) of Sec. 208.1113(6), M.C.L. meant that the deduction was only for tangible personal property used or consumed in, and directly connected to either the production or management of inventory or the operation or maintenance of depreciable assets. The Department's interpretation was set out in three frequently asked questions (FAQ). The taxpayer argued that the Department had no authority to interpret the statue and add additional restrictions that were neither present nor implied and that materials and supplies were known terms under federal tax law.

The Department made three arguments supporting its interpretation. The first argument was that the definition of "purchases from other firms" was limited to material and supplies supporting inventory or depreciable property because those items were listed in the same subsection, and were referred to "to the extent not included" in subsection (c). The Tax Tribunal found this argument to be without merit as the qualifier "to the extent not included" was an acknowledgment that material and supplies might also be considered inventory or depreciable assets. The fact that "material and supplies" was enumerated as its own subsection, was a strong indicator that these terms referred to a category of purchases from other firms, separate from inventory or depreciable assets. The Department also argued that subsection (c) was a catch all for tangible personal property that did not fit under subsections (a) and (b) and that those subsections would be meaningless if all tangible personal property were to qualify as purchases from other firms. The Tax Tribunal found that the Department's characterization of subsection (c) overstated its effect, since tangible personal items that were not ordinary and necessary would not qualify even without the Department's additional restrictions. Further, the Tax Tribunal stated that statutes are not to be interpreted unless the language is ambiguous and there was nothing ambiguous in the definition of materials and supplies. Finally, the Department argued that its interpretation required deference. However, the Tax Tribunal rejected the Department's addition of language to a clear and unambiguous statute. The Department's interpretation was never adopted as a regulation. However, even if it had been adopted, a regulation cannot go beyond the scope of the statute.

Plastic Surgery Associates, PC v Department of Treasury, Michigan Tax Tribunal, No. 16-000011, November 15, 2016

Certain Farmland Preservation Credits Transferred to a Trust Can be Claimed Under MBT

Recently signed legislation amends the Michigan Business Tax (MBT) to allow certain taxpayers with certificated farmland preservation credits previously claimed under the individual income tax to now elect to claim the certificated credit under the MBT. The taxpayer must not be eligible to claim the certificated credit under the individual income tax because of the death (occurring after December 31, 2011) of an individual farmland owner or an individual considered the farmland owner.

Further, the ownership of the farmland property that is subject to the farmland development rights agreement upon which the certificated credit is based must have been transferred into an estate or trust. Under these circumstances, the taxpayer may elect to pay the MBT in the first tax year that the certificated credit could be claimed under the MBT. However, once the election is made the taxpayer must to continue to file an MBT return and pay the tax for each subsequent tax year until the certificated credit is used up or the taxpayer no longer owns the property.

Act 426 (H.B. 5720), Laws 2016, effective retroactively for tax years beginning after December 31, 2011

Sales Tax Refund Allowed as Taxpayer Remitted Tax Out of Profits

Affirming the Michigan Tax Tribunal, the Michigan Court of Appeals found that the taxpayer was entitled to refund of sales tax remitted on nontaxable bottled water and prepackaged candy from movie concession stand sales for tax years 2007 to 2010. Previously, the Michigan Court of Appeals had remanded the case to the Michigan Tax Tribunal to determine if the taxpayer had, in fact, collected sales tax from its customers. After a full hearing, the Tribunal found that taxpayer had not considered sales tax when establishing its prices and that the sales tax ultimately came out of the taxpayer's profits. The taxpayer's vice president of operations testified that he did not include sales taxes when setting the prices for the menu board. The Tribunal concluded that taxpayer had not charged its customers sales tax and was not inappropriately keeping sales tax it had actually collected from customers. The Department of Treasury appealed the determination.

The Court of Appeals found that a reasonable mind could accept as true the vice president of operations' statements that he, as the person who set the menu prices, did not include sales tax in those prices but rather considered tax an eventual cost of doing business. Also, a reasonable person could credit the controller's testimony that the taxpayer was the party ultimately responsible for paying taxes on all items sold, particularly when it made more sense in light of taxpayer's accounting software. Because a reasonable person could conclude that taxpayer did not, in fact, collect sales tax from its customers, the Court of Appeals concluded that competent, material, and substantial evidence supported the Tribunal's decision. Taken as a whole, record evidence supported a conclusion that taxpayer charged round prices for concession items to speed up transactions and then separated out the sales tax it was required to remit to the Department from its net profit.

MJR Group, LLC v. Department of Treasury, Michigan Court of Appeals, No. 329119, December 29, 2016

New York City

Changes to Mandatory First Installment of Estimated Tax Discussed

The New York City Department of Finance has issued a memorandum discussing amendments that changed the estimated tax mandatory first installment (MFI) for corporations subject to the business corporation tax, applicable to payments due on or after March 15, 2017. Specifically, the law was amended to require corporations to use the second preceding year's tax as the basis for determining whether an MFI payment is required and also for computing the amount of the payment. Corporate taxpayers that do not have a second preceding tax year because a return was not required do not have to make an MFI payment.

These corporate taxpayers are still required to make a declaration of estimated tax and pay the remaining three installments of estimated tax with Form NYC-400. Although certain corporate tax return due dates have been amended, no changes were made to the due dates for MFI payments. Corporations required to make MFI payments continue to pay their MFIs by the 15th day of the 3rd month following the close of each tax year. Accordingly, beginning with MFI payments due on or after March 15, 2017, the payment can no longer be made with the prior year's tax return or with the request for an extension of time to file. MFI payments must be made on Form NYC-300.

Finance Memorandum 16-7, New York City Department of Finance, December 30, 2016

Entire Gain From Installment Sale Included in Final Year Return

In a New York City case involving a taxpayer that sold property in a 2009 installment sale and then indicated that its final general corporation tax return would be for the 2009 tax year, it was proper for the Department of Finance to recompute the taxpayer's entire net income to reflect the entire gain from the sale, including amounts that the taxpayer had not yet received. Although the taxpayer later filed an amended, non-final return, it failed to prove that 2009 was not its final tax year. The taxpayer did not file a general corporation tax return for any subsequent period, and the department determined that it could not assess tax on installment payments made to the taxpayer after 2009. The facts presented a rational basis for determining that it was necessary to account for all gain from the sale in the 2009 tax year in order to reflect the taxpayer's proper entire net income. Protecting the city's right to impose general corporation tax on the gain from a property sale within its jurisdiction clearly comported with the plain meaning of "necessary" as used within the applicable statute.

1018 Morris Park Avenue Realty Inc., New York City Tax Appeals Tribunal, Administrative Law Judge Division, TAT(H)14-4(GC), December 5, 2016

Oregon

Finance Company Had Nexus with Oregon

The Oregon Tax Court held that a finance company had substantial nexus with Oregon and was liable for tax on its income earned in Oregon because the company had an economic presence in Oregon. Oregon taxes income earned from economic activities in Oregon through its bank excise tax regime and its corporate income tax regime. Substantial nexus for purposes of taxation exists when a taxpayer purposefully avails itself of the economic benefits of a market in a state. The court determined that physical presence is not required to create income tax nexus under *Quill Corp. v. North Dakota*, 504 US 298 (1992) as Oregon's income tax laws did not put an undue burden on interstate commerce and pre-existing law did not give rise to settled expectations that physical presence was required for income tax nexus. The taxpayer did not have a physical presence in Oregon, but engaged in marketing, solicitation, acquisition, billing and collecting, and retention of Oregon customers. It extended credit or made loans to hundreds of thousands of customers. It collected fees from those customers including finance charges, late fees, overlimit fees, and membership fees. It collected fees from credit card terminals when customers used its credit cards. It used Oregon's debt enforcement mechanisms thousands of times a year to collect unpaid debts. Not only did the company do business in Oregon for excise tax purposes, its income was earned from sources inside Oregon as required for income tax purposes. As a result, either the bank excise tax or the corporate excise tax applies to its income earned from its business in Oregon. Oregon's taxation of the company's income does not violate the U.S. Commerce Clause.

Capital One Auto Finance Co. v. Dept. of Revenue, Oregon Tax Court, No. TC 5197, December 23, 2016

{State & Local Tax Advisor}

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

Julie Corrigan
877.622.2257, Ext. 26509
julie.corrigan@plantemoran.com

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