

{ State & Local Tax Advisor }

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District of Columbia

Market-Based Sourcing Effective Date Modified

For District of Columbia corporation franchise tax and unincorporated franchise tax purposes, a resolution has been adopted that modifies the effective date of the market-based sourcing law changes from October 1, 2014, to tax years beginning after 2014. The resolution can be viewed at <http://lms.dccouncil.us/Download/33132/PR20-1206-Introduction.pdf>.

D.C.R. 20-1206, effective December 17, 2014

Illinois

Tax Rate Decrease and Net Operating Loss Changes Discussed

The Illinois Department of Revenue (DOR) has issued an information bulletin that discusses the decrease in corporate income and personal income tax rates effective for income received on or after January 1, 2015. The bulletin also provides information on how estimated payments are affected by the income tax rate change, how fiscal-year filers, short-year filers, and 52/53 week filers will calculate their income tax rate, and changes to the Illinois net operating loss (NOL) deduction for corporations.

The tax rate for corporations is decreasing from 7% to 5.25%, and the tax rate for individuals, trusts, and estates is decreasing from 5% to 3.75%. The replacement tax rates of 2.5% for corporations and 1.5% for S corporations, partnerships, and trusts remain the same. The new income tax rates apply to exempt organizations with unrelated business income.

Fiscal-year filers must divide total net income between the periods subject to different rates using either the apportionment (blended rate) method or the specific accounting method for calculating their tax liability. The apportionment or blended rate method is figured by dividing net income based on the total number of days in one accounting period in equal ratio to the total number of days in the second accounting period. The specific

accounting method allows taxpayers to treat net income or loss and modifications as though they were earned in two different taxable years (prior to January 1, 2015, and on or after January 1, 2015) and to calculate tax liability at the appropriate rate for each period. Taxpayers must make an irrevocable election to use one of these methods by the extended due date of the taxpayer's return. Short-year and 52/53 week filers are not allowed to use the blended rate method.

The \$100,000 limitation on the use of Illinois NOL deductions by corporations has expired for tax years ending on or after December 31, 2014. Corporations may use the deduction without the \$100,000 limitation for tax years ending on or after December 31, 2014.

Informational Bulletin FY 2015-09, Illinois Department of Revenue, January 2015

Indiana

Construction Materials Pulled From Inventory Not Subject to Sales Tax

A retail merchant that also acted as a general contractor was not liable for Indiana sales tax on construction materials it incorporated into its customer's real property because the retail merchant properly assessed use tax on the wholesale cost of the construction materials. Sales tax must be collected when a seller acquires tangible personal property for resale, then transfers title to the property for consideration. Title does not pass where tangible personal property is put in a condition required by contract terms before the property's sale is complete. The retail merchant entered into installation contracts and used its inventory as construction materials in the installation services it performed. The materials lost their identity as tangible personal property when they were converted to real property, and the retail merchant did not transfer tangible personal property to its customers.

Lowe's Home Centers, LLC v. Indiana Department of Revenue, Indiana Tax Court, No. 49T10-1201-TA-6, December 19, 2014

Massachusetts

Corporate Nexus Regulation Amended

The Massachusetts Department of Revenue has adopted a number of amendments to the corporate excise tax regulation on the circumstances that create taxable nexus in Massachusetts for out-of-state corporations doing business in the state. Specifically, the rules on separate accounting and apportionment for the unrelated business activities of corporate limited partners have been eliminated from the regulation. The rules have been incorporated into the regulation on the apportionment of income by multistate corporate excise taxpayers. The amended regulation also eliminates the nexus exception for upper-tier partnerships that exclusively hold limited partnership interests in unrelated partnerships that conduct business activity in Massachusetts. The definitions of "partner" and "partnership" have been amended to incorporate the meaning of those terms under IRC §7701, except that the terms also apply to other entities and their members treated as partnerships and partners for Massachusetts income tax purposes. The terms were previously tied to common law rules and provisions of the Uniform Partnership Acts. The term "partnership" does not include any trust or estate subject to taxation under Massachusetts personal income tax law or any entity taxed as a corporation. Finally, a new provision has been added on the general rule for attribution of partnership activities to out-of-state corporate partners. If an out-of-state corporate partner engages in a unitary business with a partnership in which it holds an interest, the activities of the partnership are deemed to be activities of the partner for purposes of determining whether taxation of the income of the partner is precluded by the state income tax protections of Public Law 86-272.

830 CMR 63.39.1, Massachusetts Department of Revenue, as amended on January 2, 2015

Michigan

Affiliate and Click-Through Nexus Provisions Enacted

The legislation provides that a seller is presumed to be engaged in business in Michigan if it or any other person, including an affiliated person, other than a common carrier, engages in the following activities:

- sells a similar line of products as the seller under the same or a similar business name;
- uses its employees, agents, independent contractors, or representatives to promote sales by the seller in Michigan;
- maintains an office, distribution facility, warehouse, storage place, or similar place of business in Michigan to facilitate the delivery of tangible personal property sold by the seller to customers in the state;
- uses, with the seller's knowledge or consent, trademarks, service marks, or trade names in the state that are the same or substantially similar to those used by the seller;
- delivers, installs, assembles, or performs maintenance or repair services for the seller's customers in Michigan;
- facilitates the seller's delivery of property to customers by allowing the seller's customers in the state to pick up tangible personal property sold by the seller at an office, distribution facility, warehouse, storage place, or similar place of business maintained by the person in the state;
- shares management, business systems, business practices, or employees with the seller, or, in the case of an affiliated person, engages in intercompany transactions related to the activities occurring with the seller to establish or maintain the seller's market in Michigan; or
- conducts any other activities in the state that are significantly associated with the seller's ability to establish and maintain a market in the state.

The presumption may be rebutted by demonstrating that activities of the other person or affiliated person were not significantly associated with the seller's ability to establish or maintain a market in Michigan.

Click-Through Nexus

The legislation also provides that a seller is presumed to be engaged in business in Michigan if the seller enters into an agreement with one or more residents under which the resident, for a commission or other consideration, directly or indirectly, refers potential customers, by a link on an Internet website, in-person oral presentation, or otherwise, to the seller. The presumption requires that the cumulative gross receipts from sales by the seller to customers in this state who are referred to the seller be greater than \$10,000 during the immediately preceding 12 months and that the seller's total cumulative gross receipts from sales to customers in Michigan be greater than \$50,000 during the immediately preceding 12 months.

The presumption may be rebutted by demonstrating that the persons with whom the seller had agreements did not engage in activities that were significantly associated with the seller's ability to establish or maintain a market in Michigan. The presumption would be considered rebutted by evidence of the following: (i) written agreements prohibiting all residents with an agreement with the seller from engaging in solicitation in Michigan on behalf of the seller and (ii) written statements from all residents with an agreement with the seller stating that the residents did not engage in any solicitation activities on behalf of the seller during the immediately preceding 12 months.

An agreement where a seller purchases advertisements from a person in Michigan to be delivered via television, radio, print, the Internet, or any other medium is not an agreement that would lead to a presumption of nexus unless the revenue paid to the persons is commissions that are based on completed sales.

Act 553 (S.B. 658) and Act 554 (S.B. 659), Laws 2015, effective October 1, 2015

Yacht Brought Into State within 90 Days Was Taxable

A taxpayer owed Michigan use tax on its purchase of a yacht because it was brought into Michigan within 90 days of its purchase and the taxpayer did not rebut the presumption of taxability. A rebuttable presumption of taxability arises when tangible personal property is brought into the state within 90 days of its purchase. In the present case, the taxpayer's yacht was delivered into Michigan only 49 days after its purchase. Furthermore, the taxpayer was not eligible for exemption, as the sales contract indicated that no sales tax was added to the purchase price and there was no evidence that tax was paid on the yacht in any jurisdiction. There was also no evidence that the taxpayer's use of the yacht in Michigan was "temporary." Service records revealed that the yacht underwent repairs within the state over the course of a four-month period. As the taxpayer failed to rebut the presumption of taxability and did not qualify for any exemption, the use tax assessment was upheld.

JF Ventures v. Department of Treasury, Michigan Tax Tribunal, No. 461233, October 23, 2014, received December 18, 2014

Unclaimed Property Appeal Process Enacted

Michigan has enacted legislation regarding unclaimed property that provides a process by which holders of property may contest a determination of unclaimed property liability and appeal to the state circuit court. Under the legislation, a holder of unclaimed property that receives an examination determination may contest it within 90 days by either bringing an action in circuit court or filing a request for reconsideration with the administrator. The legislation also provides provisions for:

- requirements surrounding format and documentation for a request for reconsideration;
- withdrawal of a request for reconsideration;
- conditions for filing in circuit court following the request for reconsideration process; and
- an administrative appeal process for reconsidered decisions.

Act 423 (H.B. 4703), Laws 2015, effective 90 days following adjournment

Higher Interest Available for Some Refunds

Beginning January 1, 2015, certain Michigan business tax refunds that are not paid within 90 days after the claim is approved or 90 days after the date established by law for filing the return, whichever is later, are eligible for an additional 3% interest. Required statutory conditions include the following: the refund is claimed on a timely-filed original return and the refund is not claimed by a unitary business group, among other things.

Act 424 (H.B. 4760), Laws 2014, effective December 30, 2014, applicable as noted

Nebraska

Market-Based Sourcing Explained

The Nebraska Department of Revenue has issued guidance on the market-based sourcing method taxpayers must use for tax years beginning on or after January 1, 2014, to apportion income derived from sales other than sales of tangible personal property for corporation income tax purposes. Market-based sourcing does not require that a specific percentage of the market be in Nebraska. Sales are apportioned to the state based on the proportion of the receipt or use in Nebraska of the service, intangible, or any other sale other than sales of tangible personal property. The department has also provided a chart to explain the sourcing of income from the following types of sales: services, application services, intangible property, intangible assets, loans, credit cards,

and real or tangible personal property. The notice can be viewed on the department's website at http://www.revenue.nebraska.gov/info/market_based_sourcing.html.

Market-Based Sourcing, Nebraska Department of Revenue, December 30, 2014

Ohio

Legislation Creates More Unified Municipal Income Tax System

Ohio Gov. John Kasich has signed legislation that will create a more unified municipal income tax system for Ohio by requiring municipal corporations levying an income tax as of January 1, 2016 (and that intend to continue levying the tax) to amend their existing income tax ordinances to comply with the limitations set out in the legislation. The legislation expressly prohibits municipal corporations and tax administrators from adopting rules to administer a municipal income tax that are in conflict with the newly created statutory limitations.

The legislation generally establishes a uniform tax base applicable to all municipal corporations levying an income tax by defining the forms of income that municipal corporations may tax and the forms that they may not tax.

For business organizations, the definition of net profit is the same as under current law except that municipal corporations are required to permit taxpayers to deduct and carry forward net operating losses (NOLs) for five years and deduct or add the net profit or loss, respectively, of any pass-through entity included in the taxpayer's adjusted gross income unless the taxpayer includes the pass-through entity as part of the taxpayer's affiliated group filing a consolidated corporate return.

For individuals, the tax base generally includes compensation, net profits from business activities minus NOL carryforwards, and winnings from lotteries and gambling activities.

The legislation sets up various statewide standards that local governments have to follow, including that:

- businesses with an annual income of \$500,000 or less will be charged municipal income tax only in the area where they are located;
- workers on a job in a different city will not have to start paying income tax in that municipality during their first 20 days (currently 12) there;
- under a phase-in plan starting in 2016, companies will also be able to carry forward NOLs for five years to offset taxes on future profits;
- individual taxpayers will also be allowed to carry forward NOLs; and
- local governments will no longer be able to tax supplemental retirement benefits given to company executives.

The legislation also modifies and further specifies how the sales and payroll factors will be computed in the apportionment formula for taxpayers that have income from both within and outside a municipal corporation. The legislation authorizes taxpayers to use an alternative method of apportioning income and expressly allows tax administrators to require the use of an alternative method if the statutory formula does not fairly represent the extent of the taxpayer's business activity in a municipal corporation.

Individuals with net profit from rental activity will be permitted to elect to use separate accounting to calculate their net profit from rental activity. The legislation also prescribes an income tax employer withholding schedule for all municipal corporations that depends on recent withholding amounts and requires all municipal corporations levying an income tax to comply with a uniform annual tax return filing schedule, with some exceptions.

Additionally, the legislation creates a municipal income tax NOL review committee, which will be required to produce a report, by May 1, 2017, regarding the impact of the legislation's NOL carryforward provisions on the revenues of municipalities that levy an income tax.

H.B. 5. Laws 2014, effective 91 days after filing with the Secretary of State, applicable as noted

DOT Implementing Safeguards against Tax Fraud/Identity Theft; Refunds May be Delayed

The Ohio Department of Taxation (DOT) has announced that it is implementing additional safeguards that will inevitably cause some personal income tax refunds to be delayed this upcoming filing season. The DOT stated that the safeguards are being taken to further bolster defenses in anticipation of the continuing increase in attempted tax fraud involving identity theft.

To detect and counter refund fraud related to ID theft, an additional up-front filter will now be applied to all tax refund requests to analyze the demographic information reported on a return. This analysis will then assign a "probability of fraud" factor that will determine how the return is then further processed by the DOT.

If a return is pulled for review, the DOT's additional security measures will require some taxpayers to successfully complete an Identification Confirmation Quiz before the return is processed further. If a taxpayer's return is selected for identity confirmation, he or she will receive a letter from the DOT explaining the process.

It is expected that the additional screening and security measures will slow the processing of electronic and paper returns and the issuance of refunds. Electronic returns requesting a refund may take up to 15 days to be direct-deposited this year, and paper returns could take up to 30 days for a physical check to be mailed out.

Release, Ohio Department of Taxation, January 13, 2015

West Virginia

Governor Announced Elimination of Franchise Tax

West Virginia Gov. Earl Ray Tomblin has issued a press release announcing the elimination of the business franchise tax, effective January 1, 2015. The business franchise tax, created in 1987, has been reduced each year for tax years beginning after 2006, and repealed for tax years beginning after 2014. The press release can be accessed at www.governor.wv.gov.

Press Release, West Virginia Gov. Earl Ray Tomblin, December 30, 2014

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