



BDO TAX TALK

Year-End Planning Series

YEAR-END STATE AND LOCAL TAX PLANNING FOR BUSINESSES

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Today's Discussion Topics

- ▶ Power to Tax (*Wayfair*)
- ▶ Sales Tax Update
- ▶ State Income Tax Update

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Power to Tax (*Wayfair*)

Wayfair Decision

- ▶ On June 21, 2018, the U.S. Supreme Court issued its decision in *South Dakota v. Wayfair*.
- ▶ In a 5-4 decision, the Court ruled in favor of South Dakota and overruled *Quill Corp. v. North Dakota* and *National Bellas Hess, Inc. v. Department of Revenue of Ill.*
- ▶ The Court concluded that “the physical presence rule of *Quill* is unsound and incorrect.”
- ▶ As a result, a physical presence is no longer required for substantial nexus under the (dormant) Commerce Clause for any state tax.
- ▶ Remanded back to South Dakota Supreme Court; recently parties settled.

Wayfair - the Threshold

- ▶ To replace the physical presence rule of *Quill and National Bellas Hess*, the Court held that substantial nexus is established -
 - “When the taxpayer [or collector] ‘avails itself of the substantial privilege of carrying on business’ in” a state.
- ▶ *Wayfair’s* economic and virtual contacts with South Dakota, as measured by more than \$100,000 of sales or 200 separate sales transactions satisfied the substantial nexus requirement.

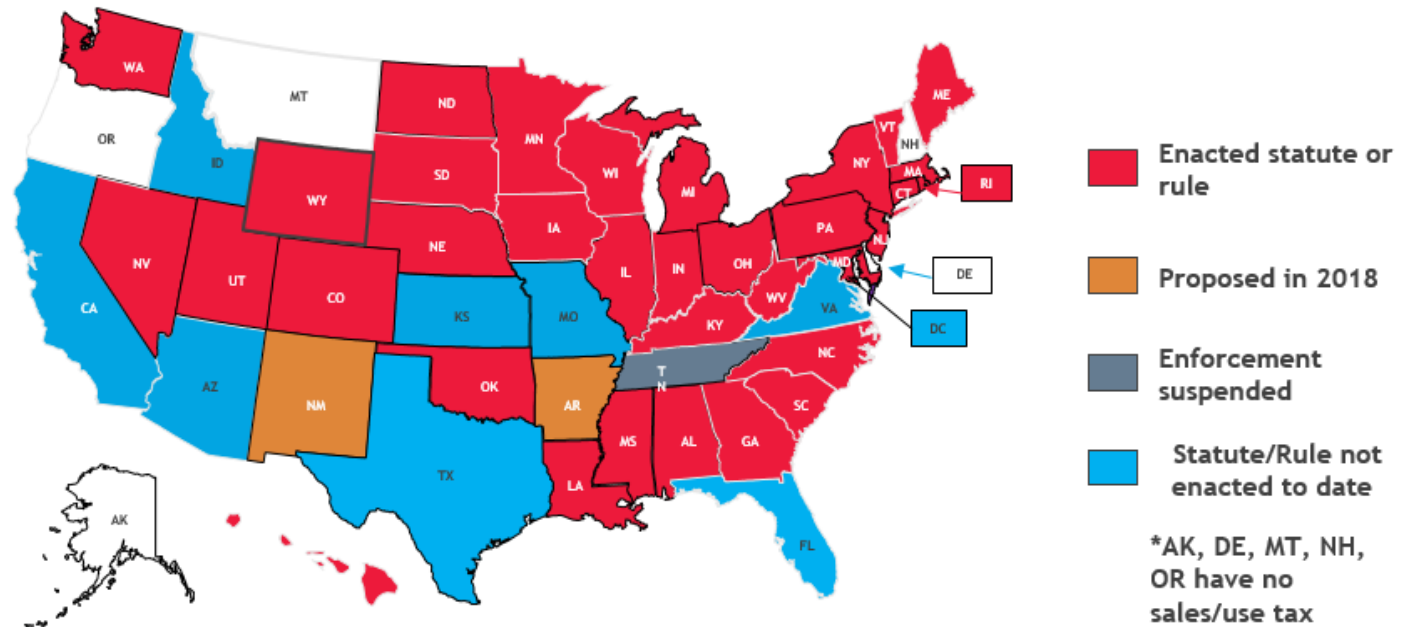
115th U.S. Congress (1/3/17 to 1/3/19)

Proposed Federal Legislation

Date Introduced	Title	Bill
4/27/17	Marketplace Fairness Act of 2017	S. 976
4/27/17	Remote Transactions Parity Act of 2017	H.R. 2193
6/21/17	No Regulation without Representation Act of 2017	H.R. 2887
9/13/17	Online Sales Simplicity and Small Business Relief Act of 2018	H.R. 6824
11/28/17	No Retroactive Online Taxation Act of 2018	H.R. 7184

States with Sales/Use Tax Economic Nexus Statutes (As of 11/19/2018)

www.bdo.com/wayfair



Sales Tax Remediation

Six Step Approach



Wayfair and State Corporate Income Tax Consequences

State Corporate Income Tax and Economic Presence Nexus Prior to *Wayfair*

- ▶ State economic nexus case law - since 1993, 14 state courts have ruled economic presence nexus is sufficient for substantial nexus for income taxes.
- ▶ State economic nexus statutes - were becoming more prevalent prior to the *Wayfair* decision.
 - Some states assert income tax jurisdiction “to the extent permitted by the US Constitution.”
- ▶ State factor presence statutes - nine states have adopted factor-presence nexus statutes for corporate income tax or gross receipts tax purposes: AL; CA; CO; CT; MI; NY; OH (“CAT”); TN; WA (“B&O”).
 - All of these states’ sales thresholds exceed \$100,000.
- ▶ Public Law 86-272 protections against state net income taxes still apply!
 - But only for sellers of tangible personal property

Significance of Market-Based Sourcing

- ▶ The sales thresholds of state factor-presence nexus statutes are tied to the state's sales factor sourcing provisions.
- ▶ Currently, 25 states require service providers and licensors of intangibles to use market-based sourcing.
- ▶ Starting in 2019, Colorado and New Jersey will join these 25 states. Arizona and Missouri require market-based sourcing if SSF is elected (Missouri will require SSF and market-based sourcing starting in 2020.)
- ▶ All of the nine states with factor-presence nexus statutes require the use of market-based sourcing (except Colorado, which will start with the 2019 tax year).
- ▶ There is no state uniformity for determining market location.

Its Not All Bad News

- ▶ Avoiding sales factor throwback.
- ▶ Qualifying for state elections to file nexus consolidated/combined returns.
- ▶ P.L. 86-272 protections still apply.
- ▶ Mitigation.

Sales Tax Update

- Who's responsible for administering tax
- What's taxable
- Tax base issues
- Exemptions & credits

Who's Responsible for Administering Tax

Marketplace Facilitator Laws

These laws generally require an entity (such as Amazon) to **either** (1) **administer sales/use tax** on a retailer's sales when the entity lists or advertises sales by a retailer; and collects payments from the retailer's customers, or (2) **comply with use tax notification and reporting laws**.

	State	Collect	-	Notify	Effective Date
1	Rhode Island			Notify	8/17/17
2	Washington	Collect	or	Notify	1/1/18
3	Pennsylvania	Collect	or	Notify	4/1/18
4	Oklahoma	Collect	or	Notify	7/1/18
5	Minnesota	Collect			10/1/18
6	New Jersey	Collect			11/1/18
7	Connecticut	Collect			12/1/18
8	Alabama	Collect	or	Notify	1/1/19
9	Iowa	Collect			1/1/19
10	South Dakota	Collect			3/1/19

What's Taxable

Software-as-a-Service (SaaS)

State	Case / Ruling	Summary
Massachusetts	Citrix Systems (ATB 11/2/18)	Board held that online products (e.g., GoToMeeting) were taxable as a transfer of “standardized computer software.”
Texas	Letter 2017010121 (7/10/18)	Texas taxes sales of website hosting service when the taxpayer is located in Texas and provides a taxable service, regardless of the customer’s location. But, customers can claim exemptions.
Pennsylvania	Reed Smith (BF&R 5/9/18)	Refund granted to the extent that cloud-based users were located out-of-state.
North Carolina	PLR 2018-0005 (1/24/18)	Cloud-based software accessed via the Internet only (no download) is not taxable .
Indiana	Info. Bulletin ST-8 (7/1/18)	The right to remotely access pre-written computer software is not taxable after 6/30/18 (expires 7/1/2024).

Streaming

State	Case / Ruling	Summary
Chicago (Illinois)	Labell (Cir. Ct. 5/24/18)	Court upheld Chicago's 9% amusement tax as applied to Internet-based streaming over claims including alleged violation of ITFA.
D.C.	Netflix (OTC 2/9/18)	An ALJ upheld D.C.'s 10% gross receipts tax which applies to the distribution of TV, video, or radio services (a public utility tax), to Netflix's services, despite Netflix's claimed ITFA violation.
Arizona	Netflix (Tax Court Complaint filed 6/14/18)	Netflix has appealed an ALJ decision that upheld a \$532K transaction privilege tax assessment of streaming. The ALJ found that the subscription was a "rental of TPP."

Tax Base Issues

Withdrawn Inventory

FLIS Enterprises (Burger King), Ark. S.Ct. 3/1/2018

▶ Facts:

- State assessed use tax on free meals provided to restaurant managers.
- Taxpayer countered that any tax due should be measured by its wholesale values of food ingredients.

▶ Procedural history:

- Circuit Court agreed with Taxpayer.

▶ Holding:

- Government wins. Tax is due on “value,” and “value” is properly measured by the “retail value.”

Exemptions & Credits

Exemptions & Credits

Issue	Case	Summary
Resale	Cincinnati Reds (Ohio S.Ct. 11/21/18)	Promotional items qualified for the resale exemption.
Trade-Ins	Gamestop (Wash. Ct. App. 10/30/18)	Video game software & hardware are not of like kind and, therefore, trade-in exemption did not apply.
Credit for Taxes Paid	American United Life Ins. (Ind. Tax Ct. 10/27/17)	<p>Taxpayer, based in Indiana, paid:</p> <ul style="list-style-type: none"> ▶ Texas state (6.25%) & local use (2%) tax on software loaded on services in Texas; AND ▶ Indiana state (7%) use tax. <p>Indiana's decision to cap the credit at 6.25% was erroneous. Taxpayer was entitled to a full refund of Indiana use tax.</p>

State Income Tax Update

- Business Interest Expense Limitation
- Deemed Repatriation Tax
- GILTI

State Impact of Business Interest Expense Limitation - IRC Section 163(j)

State Impact of Interest Expense Limitation - IRC Section 163(j)

Amended IRC Section 163(j)

- ▶ Limits interest expense to the extent of business interest income plus 30% of the taxpayer's "adjusted taxable income" (defined similar to EBITDA for 2018 to 2021, and defined similar to EBIT for 2022 and thereafter).
- ▶ Will not apply to certain businesses (i.e., certain regulated utilities, real property business, farming business, and certain other businesses).
- ▶ Applies to related and unrelated party debt and to debt existing prior to January 1, 2018.
- ▶ Disallowed interest (i.e., interest expense in excess of ATI limit) is "excess interest"
 - Indefinite federal carryover.
 - Subject to IRC Sections 381 and 382.
- ▶ For corporations, the limitation will be determined at the consolidated return level after netting of interest income, interest expense, and adjusted taxable income among members of the federal consolidated group.

State Impact of Interest Expense Limitations - IRC Section 163(j)

State Implications

- ▶ 2018 State Legislative Reactions.
- ▶ A fixed-date IRC conformity state must update to conform.
- ▶ Will states follow the federal excess interest indefinite carryforward?
- ▶ Does the state follow IRC Sections 381 and 382?
- ▶ State NOL valuation allowance considerations will likely get very complex if a company has both state NOL carryovers and an interest expense carryover.

State Impact of Interest Expense Limitations - IRC Section 163(j)

State Implications (con't)

- ▶ Separate filing states (and in combined reporting states where the federal consolidated group and the combined group are different)
 - Netting of business interest income and interest expense that is allowed among entities in a federal consolidated return may not be allowed by these states.
 - Eliminated interest expense and interest income in the consolidated return will need to be restored for purposes of the state calculation.
 - Thus, a separate State/separate entity interest expense limitation will likely need to be computed for entities filing in separate filing states (and possibly some unitary combined reporting states).

State Impact of Interest Expense Limitations - IRC Section 163(j)

State Implications (con't)

- ▶ Need to determine how IRC Section 163(j) limitation will interact with a state's related party interest expense addback rules.
 - If an entity has both related party interest expense and third-party interest expense and section 163(j) limits the amount of total interest that can be deducted, then which federal deductible interest “dollars” are considered third-party and which federal deductible interest “dollars” are considered related party subject to state add-back?
- ▶ Starting in 2022 it will be unclear how to calculate “adjusted taxable income” when a state decouples from federal depreciation.
- ▶ Corporations and Pass-Through Entities (PTEs) will have to re-evaluate their existing and contemplated debt structures for state tax purposes.

State Impact of Interest Expense Limitations - IRC Section 163(j)

State Implications - PTEs

- ▶ Application of IRC Section 163(j) in a state PTE context is incredibly complex and contains unique state tax consequences.
 - Need to evaluate how the section 163(j) limitation will impact PTEs in states that tax PTEs at the entity level (e.g., DC, New Hampshire, New York City, Tennessee).
- ▶ New Sec. 163(j) proposed federal regulations recently released.
- ▶ Composite return considerations when a PTE has Excess Business Interest.
- ▶ NR Withholding obligations for a PTE subject to Sec. 163(j) may be very different from actual tax owed.

SALT Update - Deemed Repatriation Tax

State Impact of IRC Section 965 - What We Learned for 2017

- ▶ State reactions: early reactions, laggards, and federal/state reporting issues.
- ▶ IRC Section 965(b) netting: when must a separate state IRC Section 965(a) amount be recomputed?
- ▶ Some states still haven't conformed to the 2017 IRC - CA, MN, NH, IA (delayed).
- ▶ Federal tax payment deferral does not mean state tax payment deferral.
- ▶ Major area of state impact: individuals and PTEs.
- ▶ Expense attribution and disallowance
 - CT/MA approach
 - NY approach

State Impact of IRC Section 965 - What We Expect for 2018 and the Future

- ▶ The “Day two” issue - actual repatriations.
 - Will a state follow/conform to IRC Section 959 (actual distributions of PTI)?
 - Impact of water’s-edge combined reporting partial DRDs.
- ▶ Expense disallowance - audit issues.
- ▶ Sales Factor representation and sourcing?
- ▶ Still some state IRC Section 965-related legislation to be seen in 2019?
- ▶ Potential refund opportunities, but also other audit exposure items.

SALT Update - GILTI

State Impact of GILTI

IRC Section 951A - Global Intangible Low-Taxed Income (“GILTI”)

- ▶ U.S. shareholders of any CFC must include in gross income for a taxable year its GILTI in a manner generally similar to inclusions of subpart F income (new IRC section 951A).
- ▶ Domestic C corporations (other than RICs and REITs) permitted a deduction equal to 37.5% of its *foreign derived intangible income (FDII)* and 50% of (i) *GILTI* (if any) and (ii) the amount treated as a dividend received by such corporation under IRC section 78 which is attributable to the amount in (i), subject to taxable income limitation as provided under the provision (new IRC section 250).
- ▶ Applicable for taxable years beginning after 12/31/2017.
- ▶ A U.S. shareholder’s pro rata share of GILTI is determined as of the last day of the CFC’s taxable year.

State Impact of GILTI

State 2018 Legislative Reactions

- ▶ During state 2018 legislative sessions, states were comparatively more focused on IRC Section 965.
- ▶ State subtraction for GILTI from federal taxable income starting point enacted
 - Georgia - qualifies as “foreign source dividend” and eligible for DRD
 - Idaho - eligible for Idaho’s partial (85%) foreign-source DRD
 - Indiana - qualifies as “foreign source dividend” and eligible for DRD
 - North Carolina - subtraction modification (net of related expenses)
 - South Carolina and Wisconsin - decouple from most of the TCJA, including IRC § 951A (Iowa delayed IRC conformity - 2019)

State Impact of GILTI

State 2018 Legislative Reactions

- ▶ The IRC Section 250 is a special deduction of corporations.
 - Unavailable without specific legislation in “Line 28” states.
 - Unavailable for S corporations, PTEs, individuals (for federal and state purposes).
 - State add-back statutes enacted:
 - Georgia
 - Hawaii
 - Idaho
 - Indiana
 - New York
 - North Carolina

State Impact of GILTI

State Administrative Reporting Guidance

- ▶ States are starting to address GILTI reporting in administrative guidance.
- ▶ Connecticut (Special Notice 2018(7)) - GILTI will qualify for DRD, subject to new statutory 5% expense disallowance offset.
 - Silent regarding IRC Section 250 deduction (CT is a “line 28” state)
- ▶ Michigan (Corporate Income Tax Guidance on the TCJA) - report GILTI and apply 100% DRD.
 - Silent regarding Section 250 deduction (MI is a “line 30” state)

State Impact of GILTI

Issues for States that have not addressed GILTI

- ▶ States that exclude “Subpart F income” as defined under IRC Section 952 or as included in federal gross income under IRC Section 951 may not exclude GILTI.
 - GILTI is included in the U.S. shareholder’s FTI under IRC Section 951A.
 - GILTI is not a Subpart F income inclusion under IRC Section 951(a).
 - GILTI is not included in the definition of “subpart F income” under IRC Section 952.
- ▶ For states whose Subpart F income deduction is operative through the state’s foreign source DRD, it is uncertain if the GILTI will qualify as a foreign source dividend.
 - Could state case law treating Subpart F income as a “deemed dividend” eligible for state DRD apply GILTI as well?
 - GILTI is not determined by reference to a CFC’s E&P.

State Impact of GILTI

Issues for States that have not addressed GILTI (con't)

- ▶ Is there the potential for double inclusion of GILTI in water's-edge states with "tax haven" provisions (Alaska, Connecticut, DC, Montana, Rhode Island, West Virginia)?
- ▶ Should GILTI be included in the sales factor?
 - GILTI is income of the CFC; may not be a "receipt" of the U.S. shareholder.
 - Is GILTI unitary, business income of the water's-edge group?
- ▶ Could a separate return state's taxation of GILTI for corporate income tax purposes discriminate against foreign commerce under *Kraft General Foods, Inc. v. Iowa*?

Questions?

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Conclusion

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