

Domestic and Multistate Update

Jeff Borghino, Partner - Washington National Tax Office
Dana Lance, Partner – State and Local Tax



Grant Thornton

An instinct for growth™

Learning objectives

- Identify key U.S. domestic tax developments of relevance

- Identify significant SALT developments in state legislatures and significant court decisions

- Analyze how these developments will affect taxpayers' positions on filed tax returns, as well as positions to be taken on prospective tax returns

Agenda

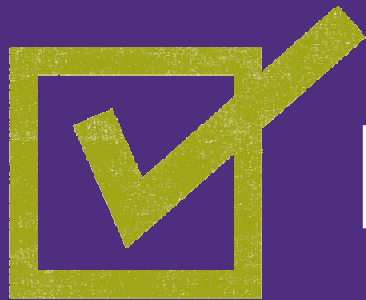
Domestic Update

- New filing season deadlines
- Depreciation update
- Credits update
- Qualified Small Business Stock

Multistate update

- California Update
- State legislative sessions





New Filing Deadlines

Filing deadlines

Filing deadline changes:

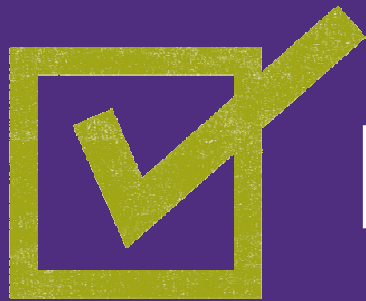
- Partnerships move to 3/15
- C corps move to 4/15

Starting in 2017 filing season for 2016 returns:

- 3/15: Partnerships and S corps
- 4/15: Trusts, Estates, Individuals, C corps

Automatic 6-mo extensions for everyone but trusts

- Delayed effective date for C corps: Extended deadline 9/15 until 2026 (Special rule for 6-30)



Depreciation Update

Depreciation Update

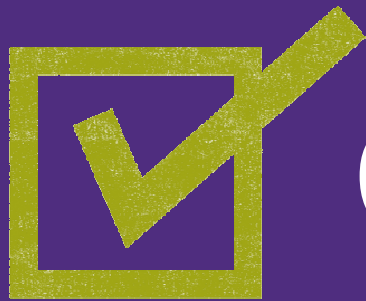
Bonus depreciation was extended to property placed in service during 2015 through 2019 by the Protecting Americans from Tax Hikes (PATH) Act of 2015

The bonus depreciation amount phases out as follows:

- 2015 through 2017: 50%;
- 2018: 40%; and
- 2019: 30%

Depreciation Update

- The PATH Act of 2015 also continues to allow taxpayers the election to accelerate the use of AMT credit in lieu of bonus depreciation for property placed in service*
 - ***Beginning in 2016, the amount of unused AMT credits that may be claimed is increased**
- PATH modified the availability of bonus depreciation qualified improvement property by eliminating the previous requirements
- Bonus depreciation is also now available for certain trees, vines, and plants bearing fruit or nuts to be eligible for bonus depreciation when planted or gifted (rather than placed in service)



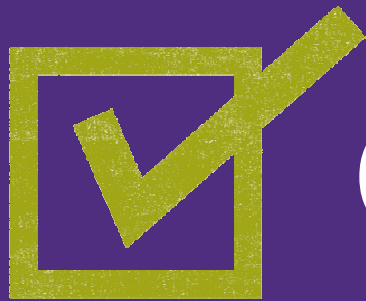
Credit Update

Credit Update

- PATH permanently extended the research and development (R&D) tax credit
- Beginning in 2016, certain eligible small businesses with \$50 million or less in gross receipts may claim the R&D credit in lieu of AMT
- The R&D credit may also be used against up to \$250k in payroll taxes for certain small businesses with:
 - Less than \$5 million in annual gross receipts; and
 - No more than 5 years of gross receipts

Credit Update

- 5-year extension for the following:
 - New markets tax credit; and
 - Work opportunity credit
- Extension of §45 and §48 energy credits (subject to gradual reduction in the credit rates):
 - Wind through 2019; and
 - Solar through 2021



Qualified Small Business Stock

Qualified Small Business Stock Background

- Section 1202 provides an exclusion from gross income for a specified amount of gain from the sale or exchange of Qualified Small Business Stock (QSBS) held for more than 5 years
- The exclusion under Section 1202 applies to taxpayers other than a corporation (other than a C corporation)
- Prior to the PATH Act, the exclusion was temporarily **100 percent** of the gain for QSBS acquired after September 27, 2010 but before January 1, 2015
- 100 percent exclusion of QSBS gain was also not subject to section 57(a)(7) as a preference item

Qualified Small Business Stock

Current Development

- The 100% exclusion under Section 1202 was made permanent on December 15, 2015 by the PATH Act
- 100% exclusion under Section 1202 is still not a preference item under section 57(a)(7)
- 100% exclusion **ONLY** applies only to QSBS acquired after September 27, 2010 (otherwise exclusion may be 50% or 75% and **subject to preference item add-back**)

Qualified Small Business Stock Current Development

- "Eligible gain" for the exclusion by a taxpayer is limited to the *greater* of:
 - \$10,000,000* less excluded gain from the sale of QSBS of the same corporation in prior tax years; or
 - 10 times the aggregate adjusted bases of QSBS issued by the corporation that was disposed by the taxpayer

* \$5,000,000 for a separate return by a married individual

Qualified Small Business Stock Requirements

QSBS Requirements in section 1202(c):

- Stock in a C corporation issued after August 10, 1993;
- Corporation is a C corporation when the stock is sold and during substantially all of the taxpayer's holding period;
- Corporation was a "Qualified Small Business" on the date the stock was issued;
- Corporation must meet "active business requirement" during substantially all of the taxpayer's holding period; and
- Stock was acquired at original issue for: (i) money; (ii) property other than stock; or (iii) compensation for services provided to the corporation (other than underwriting)

*Limitations on how much of the corporation's stock can be redeemed (directly or indirectly) by the corporation

Qualified Small Business Stock Requirements

Qualified Small Business

- Aggregate gross assets did not exceed \$50,000,000 before the issuance of the stock; and
- Aggregate gross assets immediately after the issuance of the stock did not exceed \$50,000,000

*Aggregate gross assets means money and the adjusted basis of all other property

**Adjusted basis of contributed property is equal to its fair market value for this purpose

***Parent-subsidiary controlled groups treated as 1 corporation. Section 1202(d)(3)

Qualified Small Business Stock Requirements

Active Business Requirement

- At least 80 percent (by value) of assets are used by the corporation in the active conduct of 1 or more qualified trades or businesses; and
- such corporation is an "eligible corporation"

* Special rules for start-up and research activities. Section 1202(e)(2)

** Stock and debt in any subsidiary corporation is generally disregarded. Section 1202(e)(5)

*** Computer software rights treated as active conduct asset if produce "active business computer software royalties" (under section 543(d)(1)). Section 1202(e)(8)

**** Requirement is not met if total assets consist of a specified amount of certain real property, stock of non-subsiary corporations, or cash, respectively. Section 1202(e)

Qualified Small Business Stock Requirements

- Qualified Trade or Business does not include:
 - services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset is the reputation or skill of 1 or more employees;
 - banking, insurance, financing, leasing, investing, or similar business;
 - any farming business;
 - businesses involving the production or extraction of products that qualify for depletion under sections 613 or 613A (*e.g.*, mining, drilling); and
 - operating a hotel, motel, restaurant, or similar business
- Eligible Corporation does not include: (i) a DISC or former DISC; (ii) a corporation with an election under 936; (iii) a RIC, a REIT, a REMIC; and (iv) a cooperative

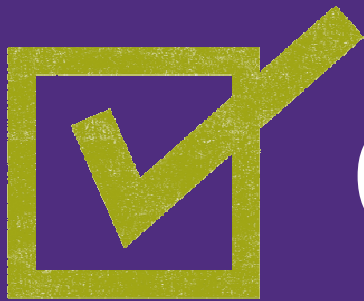
Qualified Small Business Stock Requirements

Acquisition of QSBS

- Generally must acquire QSBS at original issue. Section 1202(c)
- Conversion of QSBS into stock of the same corporation will be treated QSBS with a holding period including the converted stock. Section 1202(f)
- The recipient of QSBS from gift, death, or a partnership to a partner is treated as acquiring the stock in the same manner as the transferor including the holding period of the transferor. Section 1202(h)(1)
- Look-through rule for sale of QSBS by pass-through. Section 1202(g)
- Carryover provision for QSBS that is transferred in certain transactions under sections 351 or 368. Section 1202(h)(4)

Qualified Small Business Stock Planning Considerations

- Requirements for QSBS gain exclusion
- Amount of Eligible Gain (*i.e.*, \$10,000,000 or 10 times adjusted bases of QSBS)
- Section 1045 – provides for non-recognition of gain from sale of QSBS for a rollover into another QSBS



California Update

California – *Gillette*

U.S. Supreme Court DENIES certiorari on October 11, 2016.

- On Dec. 31, 2015, in *Gillette v. Franchise Tax Board*, California Supreme Court held that taxpayers are precluded from making the three-factor election contained in the Multistate Tax Compact
- Unanimously reversed a 2012 decision reached by California Court of Appeal
- California Supreme Court held:
 - Compact is not binding among Member States
 - Reenactment rule did not bar double-weighted sales factor legislation
 - Compact's election provision intentionally superseded by the legislature

California

Technology Transfer Agreements

- The Board of Equalization has issued guidance on the California Court of Appeal's decision in *Lucent Technologies, Inc. v. Board of Equalization* and the tax treatment of technology transfer agreements (TTAs).
 - Does not address the way sales and use tax applies to off-the-shelf retail of canned software on tangible storage media, embedded non-custom software, or pre-loaded non-custom software
- BOE to hold interested parties meetings to discuss proposed changes to Regulations 1507 and 1502

California

Market Based Sourcing Amendments

On September 15, 2016 the FTB amended its regulation providing market-based sourcing rules for sales other than sales of tangible personal property.

- Generally applicable for tax years beginning on or after January 1, 2015 but election available to retroactively apply to tax years beginning on or after January 1, 2012.
- Amendments govern the sourcing of marketable securities, dividends, goodwill, and interest.

California

Market Based Sourcing Amendments

Marketable Securities

- Receipts from the sale of marketable securities are sourced to the customer location
 - In the case of an Individual customer, the sale is assigned to the customer's billing address
 - In the case of a business entity customer, the sale is assigned to the customers commercial domicile
 - Where the billing address or commercial domicile cannot be determined, the location shall be reasonably approximated.

California

Market Based Sourcing Amendments

Interest

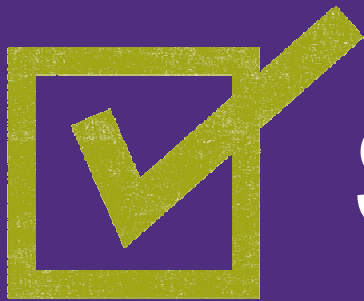
- Gross receipts from interest are sourced as follows:
 - Interest from investments – state where managed
 - Interest from loans secured by real property – location of real property
 - Interest from loans not secured by real property – location of borrower

California

Market Based Sourcing Amendments

Dividends & Goodwill

- Dividends and goodwill are treated in the same manner as sales of intangible property related to shares of stock in a corporation or of ownership interest in a pass through entity
 - If a majority of the entity's assets is real and/or tangible personal property, the average of the payroll and property factors is used to source receipts from dividends and goodwill.
 - If a majority of the entity's assets is intangible property, the rule generally provides for the use of the sales factor to assign the receipts.



State legislative sessions

Connecticut

Single Sales factor apportionment

- For income years beginning on or after Jan. 1, 2016, gross receipts from services are assignable to Connecticut if the market for the services is in the state

Combined Reporting

- Incremental tax on combined group cannot exceed the "nexus combined base tax" by more than \$2.5 million
- Inclusion of "tax haven" member not applicable if that jurisdiction has a comprehensive tax treaty with the U.S.

Tax Credit Limitations

- Generally, tax credits may not exceed 50.01% of tax due beginning with tax year 2015, increasing to 70% by 2019.

Delaware

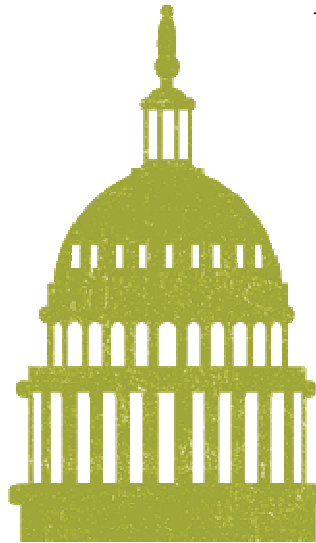
Sales factor apportionment

- Sales factor apportionment
 - Legislation was enacted on Jan. 27, 2016, which requires a transition from the equally-weighted three-factor apportionment to a single sales factor apportionment formula
 - Tax years beginning before Jan. 1, 2017: Equally-weighted three-factor formula continues to be used
 - Tax years beginning in 2017: Double-weighted sales factor
 - Tax years beginning in 2018: Triple-weighted sales factor
 - Tax years beginning in 2019: Sales factor is six-times weighted (75%) with property and payroll factor each weighted at 12.5%
 - Tax years beginning after 2019: Single sales factor only
 - Certain telecommunications corporations and corporations with their worldwide headquarters in Delaware may annually elect to use either the single sales factor or equally-weighted three-factor apportionment formula

District of Columbia

Combined Reporting

- FAS 109 deduction is delayed until the 10th year of combined filings.
- Listing of tax haven jurisdictions permanently repealed



Louisiana

First special legislative session

Franchise Tax & Rate for Years Beginning 1/1/2017

- Scope of franchise tax base expanded to include all entities classified as corporations for federal purposes.
- Possible 6.5% flat corporate tax (pending voter approval in November of amendment that would eliminate the federal income tax paid deduction)

Related Party Addback Beginning 1/1/2016

- Addback required for related party intangible, interest, and management fee expenses, with certain exceptions

NOL Usage Effective 1/1/2017

- NOL usage on LIFO basis versus FIFO

Louisiana

Second special legislative session

- On June 28, 2016, Louisiana enacted legislation adopting *single sales factor apportionment* and *market-based sourcing*, effective for tax years beginning on or after Jan. 1, 2016
- Taxpayer's market for service is in Louisiana *to the extent the service is delivered to a location in the state*
 - Special sourcing provisions if:
 - Taxpayer's customer is an individual
 - Taxpayer's customer is an entity that is unrelated to taxpayer

Louisiana

Sales tax changes

Clean Penny Tax

- Additional 1% sales tax on sales of TPP and certain services through June 30, 2018.

Click Through & Affiliate Nexus

- Updated definition of "dealer" creates both click through and affiliate nexus provisions as of April 2016.

Notice Requirements

- Notice requirements for remote retailers that sell to Louisiana purchasers and do not collect and remit sales tax.
 - Notice to purchaser at time of sale and annually (Jan 31st)
 - Notice to Department annually (March 1st)

Nevada

Commerce tax

- Background
 - Nevada is imposing a commerce tax on businesses with more than \$4 million in annual gross Nevada revenue
 - First report due August 15th, 2016, but extensions may be available for initial return
- Final regulations issued (effective June 28, 2016)
 - Provides list of activities that constitute "commencing or conducting business" in Nevada
 - Siting rules for gross receipts

Oklahoma

Nexus definition

- Effective Nov. 1, 2016, new legislation makes significant changes to the sales and use tax nexus standards, amending and substantially expanding definition of “maintaining a place of business in this state” to mean the presence of any person, other than a common carrier, which has substantial nexus in Oklahoma and that:
 - Sells similar line of products as the vendor and does so under same or similar business name;
 - Uses trademarks, service marks or trade names in Oklahoma that are the same or substantially similar to those used by the vendor;

Oklahoma

Nexus definition (cont'd)

- Delivers, installs, assembles or performs maintenance services for the vendor;
- Facilitates the vendor's delivery of property to customers in Oklahoma by allowing the vendor's customers to pick up property sold by the vendor at an office, distribution facility, warehouse, storage place or similar place of business maintained by the person in Oklahoma; or
- Conducts any other activities in Oklahoma that are significantly associated with the vendor's ability to establish and maintain a market in the state

Oklahoma

Notice requirement

- New statute provides that each retailer or vendor making sales of TPP from outside Oklahoma for use in the state that is not required to collect use tax must notify its customers of their potential obligation to remit use tax
- Out-of-state sellers must provide to each customer to whom TPP was delivered in the state a statement of the total sales made to the customer during the preceding calendar year by Feb. 1 of each year

Oklahoma

Other changes

- ***Compliance initiative (tax amnesty):*** Tax Commission will not seek payment of uncollected use tax from an out-of-state retailer who registers to collect and remit applicable sales and use tax on sales to purchasers in Oklahoma prior to registration under the initiative
- ***Refund claims:*** Effective Aug. 26, 2016, statute of limitations for claiming refund of sales and use tax overpayments has been shortened from three years to two years from the date of payment

Oregon

Minimum tax initiative

- Initiative Petition 28 (IP 28) for ballot on Nov. 2016 (will appear as Measure 97)
- Effective Jan. 1, 2017
- Currently, Oregon corporate taxpayers pay the greater of the corporate income tax or corporate minimum tax
- Current minimum tax structure:
 - Amount of tax is based on Oregon gross receipts
 - Tax ranges from \$150 - \$100,000
 - Tax is capped at \$100,000 for corporations with greater than \$100 million in Oregon sales

Oregon

Minimum tax initiative (cont'd)

- Minimum tax structure per IP 28
 - Broadens minimum tax brackets
 - imposes \$30,000 + 2.5% gross receipts tax on corporations with greater than \$25 million in Oregon sales
 - **No cap on minimum tax**
 - Applicable to C corporations only
 - cannot be offset with tax credits or NOLs

South Dakota

Economic nexus

- South Dakota governor signed S.B. 106, effective May 2016
- Institutes economic nexus standard for sales tax
 - Remote sellers are required to collect and remit sales tax on sales of TPP, any product transferred electronically, or services delivered into South Dakota if:
 - Gross revenue exceeds \$100,000; or
 - The seller sold 200 or more separate transactions



Q&A





Dana Lance
Partner
Income/Franchise Tax
San Jose, CA
T: 408-346-4325
E: Dana.Lance@us.gt.com



Jeff Borghino
Partner
Tax
Washington, D.C.
T: 202-521-1532
E: Jeff.Borghino@us.gt.com

Disclaimer

This Grant Thornton LLP presentation is not a comprehensive analysis of the subject matters covered and may include proposed guidance that is subject to change before it is issued in final form. All relevant facts and circumstances, including the pertinent authoritative literature, need to be considered to arrive at conclusions that comply with matters addressed in this presentation. The views and interpretations expressed in the presentation are those of the presenters and the presentation is not intended to provide accounting or other advice or guidance with respect to the matters covered.

For additional information on matters covered in this presentation, contact your Grant Thornton, LLP adviser.

Disclaimer

IRS Circular 230 disclosure: To ensure compliance with requirements imposed by the U.S. Internal Revenue Service, we inform you that any U.S. federal tax advice contained in this PowerPoint is not intended or written to be used, and cannot be used, for the purpose of (a) avoiding penalties under the U.S. Internal Revenue Code or (b) promoting, marketing or recommending to another party any transaction or matter addressed herein.
