State Tax Alert
01/03/2023

State corporate income and franchise tax developments in the fourth quarter of 2022

This alert provides a summary of the significant legislative, administrative and judicial actions that affected US state and local income/franchise and other business taxes for the fourth quarter of 2022. These developments are compiled from the EY Indirect/State Tax Weekly and Indirect/State Tax Alerts issued during that period.

Key developments

Texas appeals court allows taxpayer's use of cost-of-performance data to apportion its subscription receipts for services to Texas

In *Sirius XM Radio*[1] (Taxpayer), a Texas Court of Appeals, on remand from the Texas Supreme Court, held that the Taxpayer provided sufficient evidence to support its cost-based analysis of the "fair value" of services performed in the state for purposes of sourcing gross receipts from the sale of services. Accordingly, the Taxpayer can use cost-of-performance (COP) data to apportion its subscription receipts for services performed in Texas.

In March 2022, the Texas Supreme Court held[2] that gross receipts from the sale of services should be sourced using an "origin-based" system. Thus, in determining whether services are performed in Texas for purposes of apportioning receipts, taxpayers should look to where their employees or equipment performed services. Although the Texas Supreme Court reversed the appeals court's technical ruling, it remanded the case back to that court to review whether the Taxpayer had sufficiently established the "fair value" of services performed in the state by applying the COP analysis.

On remand, the appeals court affirmed the trial court's finding that the method used by the Taxpayer to apportion the fair value of its services performed in the state for tax years 2010 and 2011 was supported by the comparative COP evidence presented by the Taxpayer. In so affirming, the appeals court rejected the Comptroller's argument that the Taxpayer's evidence to establish "fair value" was legally insufficient because a taxable entity, as a matter of law, cannot use COP data to apportion the fair value of its services.

As neither the Comptroller's rules nor the applicable Tax Code provisions define "fair value" under former Rule 3.591(e)(26), the appeals court looked to the dictionary, which defined "fair value" as "the monetary worth of the services at issue, based on an objectively reasonable assessment." The Comptroller, without offering an alternative interpretation of the term "fair value," contended that "nothing in the plain language of Rule 3.591(e)(26) suggests that 'fair value' means [COP]." The Comptroller also argued that it was aware of the term [COP] at the time of the Rule's adoption, but did not include it in the Rule; therefore, the rule's "use of the term 'fair value' … indicates that something other than [COP] was intended." The appeals court disagreed, finding instead that, even though the terms have different meanings, nothing in the Rule mandates the use of a specific method to calculate "fair value" or exclude the use of COP as a reasonable method of assessing "fair value" for apportionment purposes.

The appeals court further noted the Comptroller's previous allowance, in certain circumstances, of COP as "an appropriate method" for calculating "fair value" of services. The appeals court specifically mentioned Letter No. 200807139L (July 24, 2008), in which the Comptroller, citing former Rule 3.591(e)(26), said that the "best means" for determining the "fair value" of services in Texas, when services are performed both inside and outside the state, is the costs attributed to services performed in Texas versus the costs attributed to out-of-state processing. The appeals court concluded that the Comptroller's interpretation of the Rule – allowing "fair value" to be determined using COP – "is not plainly erroneous or inconsistent" with the Rule or the Tax Code. (See Tax Alert 2022-1755.)

[1] *Hegar v. Sirius XM Radio, Inc.*, No. 03-18-00575-CV (Tex. Ct. of App., 3rd Dist., Nov. 10, 2022).
[2] *Sirius XM Radio, Inc. v. Hegar*, No. 20-0462 (Tex. March 25, 2022).

Legislative developments

Pennsylvania: HB 324 (enacted Nov. 1, 2022) effectuates a law change made by the City of Philadelphia to its Business and Income Receipts Tax increasing the net operating losses (NOLs) carry forward period from 3 years to 20 years. This change, which took immediate effect, applies to NOLs incurred in 2022 and thereafter. (See SALT Weekly Oct. 28, and Nov. 4, 2022.)

Pennsylvania: HB 1059 (enacted Nov. 3, 2022) establishes Pennsylvania Economic Development for a Growing Economy tax credits, which provide tax incentives to certain industries to locate new facilities within Pennsylvania. Such industries include clean hydrogen, semiconductor, biomedical and milk processing. Credits under these programs cannot be carried back or carried forward, and they are not refundable. (See SALT Weekly Nov. 11, 2022.)

Philadelphia, PA: Bill 220660 (enacted Nov. 9, 2022) amends Bill No. 210284, which was enacted in June 2022, to "fix a mistake in identifying the tax year to which a [business income and receipts] tax reduction applies." As originally enacted, the reduction of the relevant rate to 5.99% (from 6.20%), applied to tax years 2023 and thereafter. As revised, the reduced rate applies to tax years 2022 and thereafter. (See SALT Weekly Nov. 18 and 25, 2022.)

Philadelphia, PA: Bill 220659-A (enacted Nov. 9, 2022) amends Bill No. 220402, which was enacted in June 2022, to fix the effective date of the reduction of the net profits tax rate. Effective Jan. 1, 2022 and thereafter, the tax on net profits earned in businesses, professions or other activities is 2.29% (from 2.3398%) for residents and 3.44% (from 3.4481%) for nonresidents. (See SALT Weekly Nov. 18 and 25, 2022.)

Ballot measure

Colorado: Proposition 121 (approved Nov. 8, 2022) reduces the Colorado corporate and individual income tax rate from 4.55% to 4.40% for tax year 2022 and future years. On Dec. 27, 2022, Colorado Governor Jared Polis, as part of his Constitutional responsibility, issued a proclamation "declaring the vote for voter-approved ballot measures passed in the 2022 election." The ballot measure took effect upon the governor's proclamation. (See SALT Weekly Nov. 11, 2022.)

Judicial developments

Colorado: In *Avnet, Inc.*,[3] the Colorado Court of Appeals (appeals court) held that a taxpayer's subsidiary was an "includible corporation" for combined reporting purposes under Colo. Rev. Stat. § 39-22-303(12)(c) because 20% of its property and payroll, considered together, was in the United States. In so holding, the appeals court held that Colo. Rev. Stat. § 39-22-303(12) applies the 20% figure to one number, which is computed by combining the results produced by property and payroll factors. The appeals court said that the separate calculation of the property and payroll factors does not necessarily mean that the 20% requirement in Colo. Rev. Stat. § 39-22-302(12) must apply to each of those factors separately. The appeals court noted that its conclusion was consistent with the 80/20 test in Colo. Rev. Stat. § 39-22-303(8), finding that the two tests were "reciprocal" of one another. (See Tax Alert 2022-1783.)

In a matter of first impression, the appeals court held that individual taxpayers were allowed to amend their state income tax return after retroactive changes to federal law made by the Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136) reduced their state taxable income for those years.[4] The taxpayers based their claim on Colo. Rev. Stat. § 39-22-103(5.3), which, for Colorado individual and corporate income tax purposes, defines Colorado's version of the Internal Revenue Code (IRC) as "the provisions of the [federal IRC], as amended … as the same may become effective at any time or from time to time, for the taxable year." In June 2020, the Colorado Department of Revenue (CO DOR) adopted Emergency Rule § 39-22-103(5.3), which was replaced with a permanent rule effective Sept. 30, 2020. Under that rule, federal changes enacted after the end of a tax year do not affect a taxpayer's Colorado tax liability for that tax year, and those changes are incorporated

[3] *Avnet, Inc. v. Colorado Dept. of Rev.*, No. 21CA1231 (Colo. App. Ct. Nov. 17, 2022) (unpublished).
[4] *Anschutz v. Colo. Dept. of Rev.*, No. 21CA1242 (Colo. Ct. App. Nov. 17, 2022).

into Colo. Rev. Stat. § 39-22-103(5.3) only to the extent they were in effect in the tax year in which they were enacted and prospectively. Citing the Emergency Rule, the CO DOR denied the taxpayers' refund claim. On appeal, the appeals court agreed with the taxpayers' interpretation based on the plain language of the Colorado statutory provision, which they concluded was unambiguous. The appeals court also declined to defer to the CO DOR's Emergency Rule, concluding that it was contrary to the statute's plain language. The appeals court noted that the legislature can amend the Colorado income tax code to decouple with changes in the IRC, but, until such amendments become effective, Colorado law automatically incorporates amendments to the IRC. (See Tax Alert 2022-1769.)

Administrative developments

Arkansas: The Arkansas Department of Finance and Administration (AR DFA) issued guidance on the income tax benefits that Arkansas taxpayers may receive under the American Rescue Plan Act of 2021. The AR DFA has determined that forgiven paycheck protection program (PPP) loans are not subject to Arkansas income tax and expenses paid with forgiven PPP loan proceeds are deductible for state tax purposes. The following are subject to Arkansas income tax: Economic Injury Disaster Loan grants, Restaurant Revitalization grants, Shuttered Venue Operator grants, Aviation Manufacturing Job Protection grants, and USDA grant and loan forgiveness programs. Business expenses paid with these grants, however, are deductible. Employee retention credits (ERC) are not subject to Arkansas income tax and eligible business expenses, including qualified wages funded through the federal ERC, are deductible if the expense otherwise qualifies for a business expense for state tax purposes.[5] (See SALT Weekly Oct. 21, 2022.)

On Nov. 18, 2022, the AR DFA adopted a rule that implements the state's elective pass-through entity (PTE) tax. The new rule is effective for tax years beginning on or after Jan. 1, 2022. (See SALT Weekly Nov. 18 and 25, 2022.)

Kansas: On Dec. 13, 2022, the Kansas Department of Revenue issued guidance on the state's SALT Parity Act, which allows certain PTEs to elect to pay Kansas income tax at the entity level. This election can be made starting in tax year 2022 and thereafter.[6] (See SALT Weekly Dec. 16 and 23, 2022.)

Louisiana: The Louisiana Department of Revenue (LA DOR) issued guidance on the income tax treatment of state and federal COVID-19 relief benefits.[7] Louisiana law exempts from corporate income tax, the state and federal COVID-19 relief benefits that were included in the corporation's federal gross income. COVID-19 relief benefits are defined as gratuitous grants, loans, rebates, tax credits, advance refunds, or other qualified disaster relief benefits directly or indirectly provided by the state or federal government as a COVID-19 relief benefit. The guidance lists the COVID-19 relief benefits that do and do not qualify for the exemption. The LA DOR noted that, for corporate income tax purposes, a deduction is not allowed for expenses that were paid using qualifying COVID-19 relief benefits and that would otherwise be deductible. Lastly, the guidance explains how to claim the exemption for the 2020 or 2021 income tax year. (See SALT Weekly Oct. 28, and Nov. 4, 2022.)

Maryland: The Maryland Comptroller has updated an income tax administrative release to expand the section on regulatory special apportionment formulas for banks and financial institutions.[8] COMAR 03.04.08.03 was amended to require banks use a single-receipts factor apportionment formula on original returns filed after the amendment's May 2, 2022 effective date. In addition to using a single-receipts factor formula, banks also must continue to compute their property, payroll and receipts factors as required by COMAR 03.04.08.04.-06. (See SALT Weekly Oct. 28, and Nov. 4, 2022.)

Massachusetts: The Massachusetts Department of Revenue (MA DOR) issued guidance[9] on the apportionment of gain from the sale of a PTE interest following the Massachusetts Supreme Judicial Court's (MA SJC) ruling in

[5] Ark. Dept. of Fin. Admin., DFA Income Tax Notice "Impact of State Income Tax Law on Federal Benefits Under the American Rescue Plan Act of 2021 (ARPA)" (Oct. 11, 2022).
[6] Kan. Dept. of Rev., Notice 22-16 "SALT Parity Act" (Dec. 13, 2022).
[7] La. Dept. of Rev., Revenue Ruling No. 22-002 (Oct. 26, 2022).
[8] Md. Comp., Md. Income Tax Administrative Release No. 43 (Oct. 27, 2022).
[9] Mass. Dept. of Rev., TIR 22-14 "*VAS Holdings & Investments LLC v. Commissioner of Revenue*: Apportionment of Gain from the Sale of a Pass-through Entity (PTE) Interest Based Entirely Upon the Attributes of the PTE" (Nov. 30, 2022).

VAS Holdings.[10] In *VAS Holdings*, the MA SJC held that the commonwealth lacked statutory authority (because of the statute's references to the unitary business principle) to impose corporate excise and nonresident composite taxes on gain that an out-of-state limited liability company (LLC) treated as an S corporation – as well as its nonresident owners – realized from selling its interests in an in-state LLC treated as a partnership. As part of its decision, the MA SJC held that it would have been constitutionally permissible for Massachusetts to tax this capital gain. The MA DOR said that it "will construe *VAS Holdings* as controlling with respect to the facts of the case …" Regarding other sales of PTE interests, the MA DOR explained when it will and will not apply the decision. (See SALT Weekly Dec. 2, 2022.)

Michigan: A Michigan Department of Treasury Revenue Administrative Bulletin discusses the composition of a unitary business group (UBG) and the pro-forma calculation of federal taxable income that is the starting point for computing the base of each corporation that is a member of a UBG that files a standard combined return.[11] (See SALT Weekly Dec. 9, 2022.)

New Jersey: Following New Jersey's adoption of rules clarifying the exclusion of income exempt from federal taxation under a treaty with a foreign nation, the New Jersey Division of Taxation explained[12] that for taxpayers filing on a separate company, water's-edge or affiliated group basis, treaty-protected income is not required to be added back to entire net income (ENI) for New Jersey Corporation Business Tax purposes, unless required by other related-party addback statutory provisions. Taxpayers that added back this treaty-exempted income can file an amended return for privilege periods that are still open. Income from foreign corporations and foreign non-corporate entities is included in the ENI of a taxpayer filing on a worldwide group basis without regard to any treaty protections. (See SALT Weekly Dec. 9, 2022.)

New York: The New York Department of Taxation and Finance (NY DoTF) announced that the rate of the N.Y. Tax Law Article 9-A Metropolitan Transportation Business Tax Surcharge (MTA surcharge) will remain at 30.0% for tax years beginning on or after Jan. 1, 2023 and before Jan. 1, 2024. The NY DoTF also announced that the deriving receipts from activity in New York State and in the Metropolitan Commuter Transportation District thresholds for purposes of imposing the Article 9-A franchise tax and the MTA surcharge will remain at $1,138,000 for tax years beginning on or after Jan. 1, 2023 and before Jan. 1, 2024.[13] (See SALT Weekly Dec. 9, 2022.)

North Carolina: The North Carolina Department of Revenue updated its frequently asked questions on the state's elective PTE tax. New questions address whether a PTE tax election can be made by (1) a partnership or LLC that is classified as a partnership for federal income tax purpose and does business in North Carolina as a rental real estate company, or (2) an investment partnership. An eligible PTE doing business in North Carolina as a rental real estate company can make the PTE tax election if it is required to file a North Carolina information return for partnerships under N.C. Gen. Stat. § 105-154(c). An investment partnership, however, cannot make the PTE tax election because it is not considered to be doing business in the state and, as such, is not required to file a North Carolina tax return. (See SALT Weekly Nov. 18 and 25, 2022.)

Portland, OR: Metro,[14] Multnomah County and the City of Portland (City) have adopted proposed changes to the business tax codes[15] for these jurisdictions (collectively, "tax codes") that conform to select Oregon state income tax provisions. Specifically, City Code § 7.02.610, Apportionment of Income, has been amended to conform the local business income tax apportionment provisions with the state's allocation and apportionment provisions in Ore. Rev. Stat., chs. 314, 317 and 318, as well as related administrative rules. All business income will be apportioned to the City using a single-sales factor apportionment formula. The City also will follow Oregon's market-based sourcing statute and regulations. In addition, the changes align the City's nexus standards with the state's economic nexus standard and give "business income" and "non-business income" the same meaning as

[10] *VAS Holdings & Investments LLC v. Commissioner of Revenue*, 489 Mass. 669 (MA SJC 2022).
[11] Mich. Dept. of Treas., RAB 2022-23 (Dec. 6, 2022).
[12] N.J. Div. of Taxn., "Income Excluded Pursuant to a Tax Treaty and CBT Returns" (last updated Dec. 1, 2022).
[13] New York Dept. of Taxn. and Fin., TSB-M-22(2)C (Dec. 1, 2022).
[14] Metro is a regional government that serves those in Clackamas, Multnomah and Washington counties. It encompasses Portland and 23 other cities.
[15] The changes specifically affect the Portland Business License Tax; the Multnomah County Business Income Tax; and the Metro Supportive Housing Services Business Income Tax.

"apportionable income" and "nonapportionable income" as defined in Ore. Rev. Stat. § 314.610. These changes apply to tax years beginning on or after Jan. 1, 2023.[16] (See SALT Weekly Oct. 28, and Nov. 4, 2022.)

Rhode Island: The Rhode Island Division of Taxation (RI DOT) issued guidance on the use of passive losses at the state level, finding no statutory support for the application of passive losses as a reduction of the addback of bonus depreciation under R.I. Gen. Laws § 44-61-1. The RI DOT "cautioned" against reducing bonus depreciation addback for passive losses not available on the federal return due to federal loss limitations, noting that "to remain in compliance with tax obligations and [Rhode Island] law … the federal treatment for passive losses" must be followed.[17] (See SALT Weekly Dec. 16 and 23, 2022.)

Utah: The Utah State Tax Commission posted frequently asked questions on the state's new elective PTE tax. Under Utah law, a PTE can elect to pay tax on behalf of all final PTE taxpayers (Final PTET) (i.e., a resident or nonresident individual who is a member of a limited liability company, partner in a partnership, shareholder of an S corporation, or beneficiary of an estate or trust). The election can be made by a PTE that distributes its Utah-source income to one or more Final PTETs; the election cannot be made by an entity disregarded for federal income tax purposes. (See SALT Weekly Dec. 9, 2022.)

Developments to watch

Colorado: The Colorado Department of Revenue issued for public comment draft rules for (1) Colorado NOL for corporate taxpayers (Rule 39-22-504-2); (2) corporation subtractions for IRC § 78 dividends (Rule 39-22-304(3)(j)); and (3) the foreign source income exclusion (Rule39-22-303(10)). Additional information on the proposed rules is available here. (See SALT Weekly Nov. 18 and 25, 2022.)

Illinois: Proposed amendments to Rule 100.3380 would provide guidance for when receipts from certain sales-inducing payments from vendors to retailers, such as buying allowances and merchandising allowances and cost sharing agreements, should be included or excluded from the sales factor. As currently proposed, the Illinois Department of Revenue would exclude rebates and other buying allowances, which generally are considered reductions to cost of goods sold, from the sales factor. Merchandising allowances, which are part of the product's selling price, would be included in the sales factor to the extent they promote sales. The guidance also addresses whether to include or exclude sales from certain cost-sharing agreements. (See SALT Weekly Dec. 16 and 23, 2022.)

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[16] The ordinance for the City of Portland is available here (adopted Sept. 28, 2022); the ordinance for Multnomah County is available here (adopted Oct. 13, 2022) and the ordinance for Metro is available here (adopted Oct. 27, 2022).
[17] R.I. Div. of Taxn., Advisory 2022-39 "Guidance for Tax Pros regarding passive losses and bonus depreciation" (Dec. 13, 2022).

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