Multistate Taxation

By Philip M. Tatarowicz and Ted W. Friedman

Developments in Multistate Taxation

California

The California Franchise Tax Board (FTB) ruled that a subsidiary corporation was "doing business" in California and was subject to filing income or franchise tax returns for the tax years 2000 to 2010 because the subsidiary had a single full-time employee in the state who engaged in transactions "for the purpose of financial or pecuniary gain or profit," and the subsidiary's in-state activities were not protected by P.L. 86-272.[1] The FTB concluded that the subsidiary was not protected by P.L. 86-272 because its employee engaged in a number of activities that were neither essential nor ancillary to the solicitation of orders for tangible personal property filled out of state, including: collecting delinquent accounts; installing the subsidiary's product for retailers; training retailers on general sales techniques that were not specific to the subsidiary's product; providing technical assistance to retailers by providing services related to the design and construction of custom products; resolving customer complaints; selling the subsidiary's products that were used for demonstrations at trade shows; and, on a regular weekly basis, taking orders from a retail store and passing the purchase orders not to the subsidiary but to a California distributor for fulfillment.

Montana

Legislation has been introduced that would repeal the water's edge election for combined reporting groups for corporation license tax purposes.[2] If enacted, the legislation would require the use of a worldwide combined reporting method. The legislation permits any existing water's edge election to remain in place until it expires.

Ohio

The Ohio Department of Taxation issued a notification to calendar quarter taxpayers regarding a recent legislative

Philip M. Tatarowicz is Of Counsel to Morrison & Foerster in Washington, D.C., and Professor of Law and Distinguished Visitor from Practice at Georgetown University Law Center.

Ted W. Friedman is an Associate at Morrison & Foerster LLP in New York, New York.

change to the application of the annual $1 million exclusion for purposes of the commercial activity tax (CAT).[3] For tax periods beginning on or after January 1, 2013, a company that pays on a quarterly basis will exclude the first $1 million of taxable gross receipts on its first-quarter return and carry forward any unused portion of the exclusion amount to subsequent quarters within the same calendar year.

Oklahoma

The Oklahoma Court of Civil Appeals held that the Oklahoma capital gains deduction under Title 68, Section 2358(D), of the Oklahoma Statutes violated the Commerce Clause of the U.S. Constitution.[4] An S corporation headquartered in Florida that was registered to do business in a number of states and had a manufacturing facility in Oklahoma entered into a stock purchase agreement with a company pursuant to which it sold all of its assets to the company. The S corporation claimed the Oklahoma capital gains deduction on its return, which was subsequently denied by the Compliance Division of the Oklahoma Tax Commission (OTC). The S corporation protested the denial and claimed that Section 2358(D) is unconstitutional because it requires a three-year holding period for sales by Oklahoma companies to qualify for capital gains treatment but requires companies that are not primarily headquartered in Oklahoma to meet a five-year holding period to receive the same treatment. The court held that Section 2358(D) "discriminates on its face against interstate commerce and that its effects on interstate commerce are not evenhanded or incidental." The court reasoned that the capital gains deduction discriminates between corporate transactions based on interstate considerations and that it affords Oklahoma companies different treatment than out-of-state companies for "similar taxable events." Furthermore, the court concluded that the OTC failed to show that the "discrimination apparent on the face of the statute" was "justifiable as furthering the purpose of increasing significant investment in Oklahoma's economy in the absence of reasonable nondiscriminatory alternatives."

Pennsylvania

The Supreme Court of Pennsylvania held that a company's gain from the disposition of timberland property located in Delaware was taxable business income because the acquisition and management of the timberland constituted integral parts of the company's regular business operations.[5] The court stated that, under the functional test set forth in Pennsylvania's amended definition of business income, for a gain from the sale of property to be classified as business income, the acquisition or the management or the disposition of the property must constitute an integral part of a company's business operations. The court pointed out that the company's sole business activity was to obtain pulpwood, partially from the timberlands it owned, and to sell the pulpwood to its parent company. The court cited the fact that the company had acquired the property as part of a timberland acquisition program to guarantee a source of pulpwood for its parent and to serve as a hedge against the risk associated with any decline in the future availability of appropriately priced pulpwood on the open market. In addition, the court pointed out that the company's employees or third-party contractors planted, thinned and harvested the timber and monitored the soil and water quality on the timberlands in order to maximize the sustainable pulpwood yields. The court concluded that the acquisition and the management of the timberland constituted an integral part of the company's regular business operations and that the gain from the sale of the timberland constituted business income subject to taxation in Pennsylvania.

Endnotes

1. Chief Counsel Ruling 2012-07, Cal. Franchise Tax Bd., Dec. 5, 2012 (released Jan. 22, 2013).
2. Mont. S.B. 208 (introduced Jan. 30, 2013).
3. Information Release, CAT 2013-01, Ohio Dep't of Tax'n, Feb. 2013.
4. *CDR Syss. Corp. v. Okla. Tax Comm'n*, No. 109,886, Okla. Civ. App., Jan. 17, 2013.
5. *Glatfelter Pulpwood Co. v. Commonwealth*, No. 62 MAP 2011, Pa., Jan. 22, 2013.