Multistate Taxation

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Developments in Multistate Taxation

Illinois

The Appellate Court of Illinois reversed a circuit court decision and held that a corporation did not have to include its insurance subsidiary in its Illinois combined income tax returns.[1] The Appellate Court found that the corporation had established that its insurance subsidiary's business was the furnishing of insurance, and the insurance subsidiary's ownership of a disregarded entity that earned royalty income from the licensing of intangibles did not change this result. The Appellate Court held that the insurance subsidiary was a *bona fide* insurance company, that it had been so treated by the IRS after two federal income tax audits and had engaged in the necessary risk shifting and risk distribution required of an insurance company. Since Illinois law does not permit insurance companies to be included in combined returns with companies taxed under the corporate income tax, the Appellate Court concluded that the insurance subsidiary could not be included in the corporation's combined returns.

Indiana

The Indiana Department of Revenue disallowed a deduction for payments of interest, royalties and a mark-up on intercompany expense reimbursements paid by a corporation to its subsidiary.[2] The Department determined that the payments were not ordinary and necessary expenses. The Department stated that multiple transfers of a note between the corporation and its subsidiary brought into question the financial realities necessary to justify the interest payments claimed. The Department also stated that the royalty payments claimed exceeded the value of the licensed intangibles. In addition, the Department stated that the mark-up

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on the intercompany expense reimbursements, which was based on the corporation's sales, represented an 80-percent mark-up on the actual expense reimbursements and did not fairly represent the corporation's income derived from Indiana sources.

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The Department ruled that an out-of-state company must include the revenue it generated from sales of financial information services to clients in Indiana in its Indiana sales factor numerator.[3] The Department determined that the sales constituted Indiana sales because the "income producing activity" was performed in Indiana. The Department reasoned that the "income producing activity" was performed in Indiana because the acts "engaged in by the [company] for the ultimate purpose of obtaining gains or profit" occurred in the state. According to the Department, the company did not earn money from conducting out-of-state financial research or because a specific Indiana customer hired the company to conduct out-of-state financial research on that particular customer's behalf; rather, the company earned money because it conducted financial research and then sold the results of the research to Indiana customers.

Tennessee

The Tennessee Department of Revenue ruled that an out-of-state company's remote server storage and virtual computing services were not subject to the Tennessee sales and use tax.[4] The Department also ruled that the company's incidental usage fees, charged to customers based on customer activity on the company's network, were also not subject to the Tennessee sales and use tax. Among the Department's reasons were that: (1) no sale, transfer or electronic delivery of tangible personal property (TPP) or computer software occurs in Tennessee in conjunction with the company's furnishing of its services; (2) the company's services do not constitute the furnishing of a taxable service in Tennessee; (3) because the company does not make sales of taxable goods or services in conjunction with the sale of its services, the sale of such services cannot be characterized as the furnishing of an otherwise nontaxable service that is sold as part of the sale of a taxable good or service; (4) the company does not sell any item of TPP with its services; and (5) even though the company's services do involve the use of TPP in the form of computer server hard drives, the servers are located outside Tennessee so there is no use of TPP occurring in the state.

Washington

The Superior Court of Washington for Thurston County held that an out-of-state LLC did not have a sufficient nexus to support the imposition of Washington's wholesaling business and occupation tax and litter tax.[5] The court found that the LLC's use of leased rail cars to deliver its products in Washington was insufficient to establish a substantial nexus with the state. Similarly, the court found that a single visit to Washington by a salesman for the LLC constituted "little human physical presence" and was insufficient to establish a substantial nexus with the state.

Endnotes

1 *Wendy's Int'l, Inc. v. Hamer*, No. 4-11-0678 (Ill. App. Ct., Oct. 7, 2013). Hollis L. Hyans and Irwin M. Slomka of Morrison & Foerster LLP represented Wendy's International, Inc., in the appeal.

2 Letter of Findings, No. 02-20120690 (Ind. Dep't of Rev., Aug. 28, 2013).

3 Letter of Findings, No. 02-20130238 (Ind. Dep't of Rev., Sep. 25, 2013).

4 Letter Ruling, No. 13-12 (Tenn. Dep't of Rev., Sep. 12, 2013).

5 *DOR v. Sage V Foods, LLC*, No. 12-2-01893-3 (Wash. Super. Ct., Aug. 20, 2013).