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State Tax Matters
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Income/Franchise:
California: Partnership Income from Stock Sale Deemed Apportionable Rather Than Sourced Entirely In-State

Case No. CGC18571122, Cal. Super. Ct. (1/22/25). In a case addressing the sourcing of gain realized by a limited partnership (LP) on the sale of stock of a wholly-owned C-corporation where numerous trusts (*i.e.*, the taxpayers) owned the limited partnership interests in the LP, as well as the stock of the S-corporation that was the general partner, the San Francisco Superior Court (Court) held in favor of the trusts that the underlying gain was not solely California-source income. Specifically, the Court considered the sourcing of gain realized by the LP on the sale of stock of the C-corporation. The three entities at issue – the LP, the S-corporation, and the C-corporation – jointly operated a movie-theatre business in multiple states, including California. The original LP tax return for the period in question did not allocate income between California and non-California sources, and the trustees subsequently sought a refund, arguing that the gain should have been reported as apportionable between California and non-California sources. The Court agreed and held that because the partnerships are part of "a unitary business that conducts itself within and without California," the income from the sale should not have been fully apportioned to California as it was previously reported; rather, income from the sale should have been apportioned at the partnership level under Cal. Code Regs. section 17951-4(d) and therefore apportioned in part outside of California, entitling the trusts to a refund. [Note: see Case No. A154691, Cal. Ct. App., 1st Dist. (6/29/20) and previously issued Multistate Tax Alert for more details on a related 2020 California Court of Appeal ruling]. Please contact us with any questions.
URL: https://www.courts.ca.gov/opinions/documents/A154691.PDF
URL: https://www2.deloitte.com/us/en/pages/tax/articles/california-court-of-appeal-rules-that-a-trust-is-taxable-on-all-california-source-income-without-regard-to-the-residence-of-fiduciaries.html?id=us:2em:3na:stm:awa:tax:013125&sfid=701ap000001peEAAAY

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Income/Franchise:
Hawaii Department of Taxation Adopts Temporary Rules Implementing Pass-Through Entity-Level Tax

Temporary Administrative Rules 18-235-201-01 through 18-235-201-09; 18-237-200-01 through 18-237-200-25, and 18-237D-200-01 through 18-237D200-25, Haw. Dept. of Tax. (eff. 1/2/25); *Announcement No. 2025-01, Haw.* Dept. of Tax. (1/21/25). The Hawaii Department of Taxation adopted temporary administrative rules, some of which reflect state law allowing qualifying pass-through entities to make an annual election to pay an entity level state tax (PTET) applicable to taxable years beginning after December 31, 2022 [see S.B. 1437 (2023) and previously issued Multistate Tax Alert for more details on this PTET]. Among the topics addressed in the rules are making the election, underlying income tax credit eligibility and allowance, filing and calculating the new tax, and making estimated payments. The new temporary rules took effect on January 2, 2025, and are scheduled to expire on July 2, 2026. Please contact us with any questions.
URL: https://tax.hawaii.gov/legal/taxlawandrules/
URL: https://files.hawaii.gov/tax/news/announce/ann25-01.pdf
URL: https://www.capitol.hawaii.gov/session/measure_indiv.aspx?billtype=SB&billnumber=1437&year=2023
URL: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-multistate-tax-alert-hawaii-enacts-pass-through-entity-tax-election.pdf

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Income/Franchise:
Idaho: New Law Generally Updates State Conformity to Internal Revenue Code

H.B. 3, signed by gov. 1/27/25. Effective immediately and applicable retroactively to tax years beginning on and after January 1, 2025, new law generally updates select corporate and personal income tax statutory references in Idaho to conform to federal Internal Revenue Code provisions as in effect on January 1, 2025 (previously, January 1, 2024). Please contact us with any questions.
URL: https://legislature.idaho.gov/sessioninfo/2025/legislation/H0003/

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Income/Franchise:
Indiana: Tax Base and Apportionment Calculations for Foreign Corporation in Toll Manufacturing Arrangement

Revenue Ruling 2024-02CCP, Ind. Dept. of Rev. (1/3/25). An Indiana Department of Revenue ruling involving a foreign corporation (domiciled outside the United States) that is a partner in a United States partnership ("toll manufacturer") with which it engages in a contract manufacturing arrangement wherein i) the partnership performs the manufacturing activity in various states (including Indiana) but does not take title to the inventory/raw materials during production, and ii) the foreign corporation subsequently sells the finished goods to the toll manufacturer for ultimate sale to customers nationwide concludes that, based on the provided information, the foreign corporation:
URL: https://iar.iga.in.gov/register/20250122-IR-045250013NRA

1. Must exclude its income from the sale of finished goods to the toll manufacturer for Indiana adjusted gross income tax purposes, and
2. Correspondingly, must exclude any such receipts from the sale of finished goods to the toll manufacturer from its Indiana apportionment factor.

Under the facts, the foreign corporation and toll manufacturer have a unitary relationship; the foreign corporation has Indiana nexus due to its partnership interest in the toll manufacturer doing business in Indiana; and the foreign corporation does not have US payroll or property – other than the raw materials and work in process inventory used in the toll manufacturing process. Additionally, the ruling notes that the foreign corporation is protected from US federal income taxation on its income pursuant to a tax treaty between the corporation and its resident nation; however, the foreign corporation is *not* protected from federal income taxation on its income derived from the toll manufacturer.

Pursuant to these facts, the ruling explains that because application of the treaty with the corporation's federal taxable income results in it *not* including its profit/loss from the sale of finished goods to the toll manufacturer on Line 1 of its federal corporate income tax return, such income is also excluded from its Indiana adjusted gross income. However, because the corporation's income from its ownership in the toll manufacturer must be included in the corporation's federal taxable income, it also must include its share of income from the toll manufacturer in its Indiana adjusted gross income. Moreover, to prevent any unfair representation of its income from an apportionment perspective, the corporation's receipts from the sale of finished goods to the toll manufacturer must be excluded from its Indiana apportionment factor – from both

its numerator and denominator – but the foreign corporation must include its share of the toll manufacturer's receipts for Indiana apportionment purposes. Please contact us with any questions.

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Sales/Use/Indirect:
Indiana: Video Game Publisher's Optional Subscriptions, In-Game Items, and Virtual Currency are Not Taxable

Revenue Ruling 2024-04-RST, Ind. Dept. of Rev. (1/7/25). An Indiana Department of Revenue ruling involving an out-of-state video game publisher that does *not* sell video games but does offer purchasers of its video games (*i.e.*, purchased from a related entity that sells the video games in electronic format directly to customers and through third-party vendors) optional i) monthly subscriptions; ii) in-game items; and iii) virtual currency that such optional items are *not* subject to Indiana sales tax because they do not constitute tangible personal property or specified digital products. Under the facts, while the publisher does *not* sell customers the video games, it does offer them the "option to enhance their gaming experience through the purchase of three additional items." Each of these optional items is offered after the sale of the video game and include:
URL: https://iar.iga.in.gov/register/20250122-IR-045250012NRA

1. A monthly online subscription that allows the player to play the game in an online, multi-player setting;
2. In-game items, such as costumes or weapons, or time saving enhancements; and
3. Virtual currency that allows the purchaser to acquire in-game items or pay for the monthly online subscription within the game.

Under these facts, the ruling explains that services in Indiana generally are not subject to Indiana sales and use tax unless specifically enumerated under law. Although specific digital products are subject to tax in Indiana, the ruling concludes that the publisher's offerings in this case do not meet the definitions of such and therefore are not subject to Indiana sales tax. Please contact us with any questions.

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Sales/Use/Indirect:
Tennessee: True Object of Website Design and Consulting is Nontaxable Service Rather than Taxable Software Sale

Letter Ruling No. 24-10, Tenn. Dept. of Rev. (11/26/24). In a letter ruling involving application of Tennessee sales and use tax to certain fees for consulting, startup, and website design, the Tennessee Department of Revenue held that under the totality of the circumstances, the true object of the transactions at issue was the administration of an employee recognition program – which is *not* an enumerated taxable service under Tennessee law – rather than the taxable procurement of software functionality inherent in a website. Accordingly, the fees related to a company's consulting, startup, and website design and configuration were not subject to Tennessee sales and use tax. Please contact us with any questions.
URL: https://www.tn.gov/content/dam/tn/revenue/documents/rulings/sales/24-10.pdf

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Multistate Tax Alerts

Throughout the week, we highlight selected developments involving state tax legislative, judicial, and administrative matters. The alerts provide a brief summary of specific multistate developments relevant to taxpayers, tax professionals, and other interested persons. Read the recent alerts below or visit the archive.
Archive: https://www2.deloitte.com/us/en/pages/tax/articles/multistate-tax-alert-archive.html?id=us:2em:3na:stm:awa:tax

Michigan establishes an R&D tax credit for certain authorized businesses
Michigan recently enacted legislation establishing a Research and Development ("R&D") credit for certain authorized businesses. Authorized businesses with 250 or more employees may be eligible for up to $2,000,000 annually in R&D credits and those with fewer than 250 employees may be eligible for up to $250,000 annually. These authorized businesses are also entitled to an additional credit for R&D expenses incurred in collaboration with a Michigan research university of up to $200,000 annually. No more than $100 million of R&D credits in the aggregate may be claimed by authorized businesses in a single calendar year.

This Multistate Tax Alert summarizes some of the relevant provisions related to these R&D credits in House Bills ("H.B.") 4368, H.B. 5099, H.B. 5100, H.B. 5101, and H.B. 5102 and also highlights a newly created program, the Michigan Innovation Fund Program.
URL: https://legislature.mi.gov/Bills/Bill?ObjectName=2023-HB-4368
URL: https://legislature.mi.gov/Bills/Bill?ObjectName=2023-HB-5099
URL: https://legislature.mi.gov/Bills/Bill?ObjectName=2023-HB-5100
URL: https://legislature.mi.gov/Bills/Bill?ObjectName=2023-HB-5101
URL: https://legislature.mi.gov/Bills/Bill?ObjectName=2023-HB-5102
[Issued January 24, 2025]
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