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State Tax Matters
The power of knowing.
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In this issue:

Income/Franchise:
Illinois Appellate Court Affirms that Affiliate Was Not an 80/20 Company and Must be Included in Combined Return

Case No. 1-23-0913, Ill. App. Ct., 1st Dist. (3/19/25). An Illinois Appellate Court (Court) affirmed the Illinois Independent Tax Tribunal's 2021 ruling [see *State Tax Matters*, Issue 2021-16, for more details on the Illinois Independent Tax Tribunal's 2021 ruling in this case], which held that a taxpayer filing Illinois income and replacement tax returns on a combined basis for the prior tax years at issue (*i.e.*, for tax years 2011 through 2013) failed to successfully show it could exclude a certain affiliate from its return as an "80/20 company" that conducted 80% or more of its business outside the United States. In doing so, the Court explained that the taxpayer failed to demonstrate it had exercised "ordinary business care and prudence" when it formed a certain single-member limited liability company (SMLLC) owned by that affiliate and then attempted to qualify the affiliate as an 80/20 company based on the SMLLC's alleged expatriate employees – agreeing with the Illinois Independent Tax Tribunal that the taxpayer's actions in this case constituted an "aggressive tax strategy to create a non-operational shell company" whose sole purpose was generating mostly domestic income that would avoid Illinois income taxation. Note that this Court order was filed under Illinois Supreme Court Rule 23, and therefore, is "not precedent except in the limited circumstances allowed under Rule 23(e)(1)."
URL: https://ilcourtsaudio.blob.core.windows.net/antilles-resources/resources/ba03a212-8d49-400e-be42-bd8239b91e27/PepsiCo,%20Inc.%20v.%20Illinois%20Department%20of%20Revenue,%202025%20IL%20App%20(1st)%230230913-U.pdf
URL: https://dhub.deloitte.com/Newsletters/Tax/2021/STM/210423_3.html

Additionally, note that an Illinois circuit court recently concluded similarly in a case involving the same taxpayer for different tax years (*i.e.*, for tax years 2016 and 2017) [see *State Tax Matters*, Issue 2025-2, for more details on this 2025 Illinois circuit court ruling]. Please contact us with any questions.
URL: https://dhub.deloitte.com/Newsletters/Tax/2025/STM/250117_2.html

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Income/Franchise:
South Carolina DOR Posts Draft Guidance on Sourcing Receipts from Services

Revenue Ruling #25-x: Sourcing Gross Receipts from Services (Income Tax) [Public Draft], S.C. Dept. of Rev. (3/10/25). The South Carolina Department of Revenue (Department) posted a draft revenue ruling "circulated for public comment" that addresses its current position on the "income-producing activity method" of sourcing gross receipts from services to South Carolina (*i.e.*, including such receipts in the numerator of a taxpayer's gross receipts factor) for state corporate income tax purposes. The draft guidance includes sections discussing:
URL: https://dor.sc.gov/resources-site/lawandpolicy/Advisory%20Opinions/PDRR-Sourcing%20DRAFT.pdf

1. Apportionment, generally;
2. South Carolina's apportionment statutes;
3. Gross receipts;
4. The determination and sourcing of gross receipts from services, including income-producing activity, under South Carolina law; and
5. Considerations for characterizing certain transactions as services or the use of an intangible.

In doing so, the Department notes that "income-producing activity," "costs of performance," and "market sourcing" are distinct concepts, and that it is presently "a party to litigation" related to its sourcing methodology, and therefore, its position may be re-evaluated as that litigation is "resolved by the judicial system."

According to the draft guidance, "income-producing activity" is the purpose or reason that participants pay to enter a transaction (or combination of transactions) which produces income for the service provider. That is, "income-producing activity is what participants in the transaction(s) providing the taxpayer's income want in exchange for payment." The draft guidance also explains that income-producing activity is determined by the substance rather than the form of the transaction(s) related to the activity, considering all relevant facts and circumstances. Moreover, the draft guidance states that if income-producing activity occurs in more than one place, state law "takes a proportional approach" where receipts are considered South Carolina receipts to the extent the income-producing activity is in South Carolina. The Department also explains that "where the taxpayer's income is generated by transactions that may be plausibly viewed as either using intangibles or providing services, the income will often be sourced to the same state regardless of the characterization under which the facts are analyzed." Comments on this draft guidance are due by April 8, 2025. Please contact us with any questions.

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Income/Franchise:
Texas: COGS Deduction and Reduced Rate Do Not Apply Given Receipts Were Derived from the Sales of Services Rather than Goods

SOAH Docket No. 304-24-15211 [CPA Hearing No. 119,652], Tex. Comptroller of Public Accounts (12/4/24). The Texas Comptroller of Public Accounts adopted a proposal for decision issued by a Texas administrative law judge (ALJ) with the State Office of Administrative Hearings, affirming an underlying audit assessment whereby the taxpayer's revenue from bundled "printing as a service" (PaaS) was determined to constitute revenue from services rather than retail sales; therefore, the taxpayer was *not* allowed to deduct costs related to the PaaS as cost of goods sold (COGS) in computing its Texas franchise tax base and ineligible for the Texas franchise tax's reduced tax rate for retailers and wholesalers. In the decision, the ALJ explained that if a transaction contains elements of both a sale of tangible personal property and a service, a taxable entity generally may subtract as COGS the costs otherwise allowed in relation to the tangible personal property sold. Here, while the taxpayer's PaaS sales constituted a bundle of printing services and tangible personal property, the ALJ concluded the taxpayer failed to meet its evidentiary burden based on an absence of documentation demonstrating "what pieces of equipment were transferred to its customers, when they transferred, and the cost of purchasing the equipment." Accordingly, the adopted decision upheld the auditor's revised COGS calculations for the taxpayer. For similar reasons, the decision concluded the taxpayer failed to establish it was primarily engaged in wholesale or retail sales, and, thus, was ineligible for the reduced franchise tax rate for retailers and wholesalers. Please contact us with any questions.
URL: https://star.comptroller.texas.gov/view/202412006H

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Gross Receipts:
California: San Francisco Tax Collector Proposes Market Sourcing Rules for Revised Business Tax

Proposed Sourcing Regulations and Tax Collector Hearing, City and County of San Francisco Treasurer & Tax Collector (2/28/25). Pursuant to voters in the City and County of San Francisco (San Francisco) recently

approving "Proposition M" – which includes various changes to San Francisco business taxes and requiring the San Francisco Tax Collector (Tax Collector) to promulgate regulations interpreting how businesses must now allocate their receipts to San Francisco [see previously issued Multistate Tax Alert for more details about the tax law changes in Proposition M] – the Tax Collector released proposed market sourcing regulations applicable to gross receipts from services, intangible property, and financial instruments. Much like the proposed regulations issued by the California Franchise Tax Board (FTB) earlier this year [see *State Tax Matters*, Issue 2025-1, for details on the FTB's latest proposed market-based sourcing rule changes], the Tax Collector's proposed regulations use a cascading series of rules to assign receipts to where the benefit is ultimately received. The Tax Collector has scheduled an online public hearing on April 8, 2025, to discuss the proposed market sourcing rules and is accepting comments on or before April 8, 2025.
URL: https://sftreasurer.org/proposed-sourcing-regulations-and-tax-collector-hearing
URL: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/multistate-tax-alert-san-francisco-voters-approve-changes-to-city-business-taxes.pdf
URL: https://dhub.deloitte.com/Newsletters/Tax/2025/STM/250110_3.html

See recently issued Multistate Tax Alert for additional details on and some related implications of these proposed market sourcing rules, and please contact us with any questions.

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Sales/Use/Indirect:
Pennsylvania DOR Says it Will No Longer Accept Vendor Attestation Letters on Certain Taxpayer Refund Requests

Sales and Use Tax Bulletin 2025-01 – Purchase Price of Employment Agency Services, Help Supply Services and Building Cleaning Services, Penn. Dept. of Rev. (3/12/25). A new Pennsylvania Department of Revenue (Department) sales and use tax bulletin clarifies the taxable purchase price of and taxpayer refund requirements for "employment agency services," "help supply services" and "building cleaning services" – announcing that while taxpayers requesting a refund of the tax paid on such costs historically have provided letters from the vendors attesting to the cost of the supplied employees, "the Department will no longer accept a letter from a vendor attesting to its nontaxable employee costs." In doing so, the Department explains that state law requires that such employee costs be itemized or stated in the aggregate on the billing.

Accordingly, taxpayers seeking a refund of the tax paid on such employee costs where the vendor has *not* itemized or separately stated the costs of the supplied employee or employees on the original invoice "are advised to have the vendor issue a revised invoice with the employee costs specifically itemized or stated in the aggregate." Please contact us with any questions.
URL: https://www.pa.gov/content/dam/copapwp-pagov/en/revenue/documents/taxlawpoliciesbulletinsnotices/taxbulletins/sut/documents/st_bulletin_2025-01.pdf

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Unclaimed Property:
South Dakota: New Law Addresses Required Liquidation of Abandoned Virtual Currency

H.B. 1196, signed by gov. 3/12/25. Recently signed legislation enacts various changes to South Dakota unclaimed property law, including explicitly subjecting defined "virtual currency" to its provisions and establishing circumstances under which virtual currency is presumed abandoned. Under the new law, virtual currency generally is deemed abandoned three years after the latest indication of interest, and a holder of unclaimed virtual currency must liquidate the virtual currency within 30 days prior to filing its required report and remit the underlying proceeds to the administrator. Moreover, "if the holder is unable to liquidate the virtual currency, or reasonably believes the virtual currency cannot be liquidated, the holder must promptly provide written notice to the administrator explaining why the virtual currency cannot be liquidated," and the administrator must "direct the holder concerning an alternate disposition of the virtual currency" in such cases. The legislation defines "virtual currency" as a "digital representation of value used as a medium of exchange, unit of account, or store of value, which does not have legal tender status recognized by the United States," and provides that it does *not* include:
URL: https://sdlegislature.gov/Session/Bill/26050

1. The software or protocols governing the transfer of the digital representation of value;
2. Game-related digital content; or
3. A loyalty or gift card.

Please contact us with any questions.

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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

No new alerts were issued this period. Be sure to refer to the archives to ensure that you are up to date on the most recent releases.