Tax Specialty Updates: Year-End Planning Considerations

October 2024

Today's Speakers

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Agenda

1. Accounting Methods Year-End Planning
2. Upcoming Form 6765 Changes
3. Tangible Property Regulations – Repairs & Maintenance Studies
4. The Rise in Aircraft Audits & How to Prepare
5. The Inflation Reduction Act: Current State & How to Navigate It
6. State & Local Tax: Public Law 86-272 Update
7. State & Local Tax: Impact/Aftermath of Microsoft vs. California Apportionment Decision

Accounting Methods

Year-End Need-to-Know Tax Updates

Brittany Cummings

Accounting Methods

How Accounting Methods Can Help

UNMATCHED CLIENT
EXPERIENCE

Listen to understand

Be responsive

Consult with purpose to deliver value

Our team implements a variety of strategies & initiatives to mitigate risks & identify opportunities

Year-End Need-to-Know Tax Updates

Accounting Methods

Action Required by 12/31/24:

- Advance Consent Changes
  - Require consent/approval from the IRS & must be filed in the tax year of the change
    - Overall Cash method of accounting for eligible businesses other than Small Business Taxpayers
    - Accrued Service Contracts
    - Long-term contracts subject to §460 (interaction with §174 Research Capitalization)
- Fix Accrued Liabilities
  - Fix liabilities to accelerate tax deductions

Year-End Need-to-Know Tax Updates
Accounting Methods

Planning Considerations

- Consider an accounting methods review:
  - What are the business's current methods?
  - Are the business's current methods permissible?
  - Are there opportunities for the business to defer revenue?
  - Are there opportunities for the business to accelerate deductions?
  - Is the business no longer a small business taxpayer?
  - How can accounting methods impact the business's global tax position, *e.g.*, FTC, GILTI, FDII, Pillar II

Federal Tax Speciality Services
Accounting Methods Overview

Forvis Mazars' Accounting Methods team helps businesses reduce risk and identify accounting method tax positions based on your organization's goals. Our team has industry-specific experience to help improve cash flow and manage tax burdens while helping to verify that tax positions follow applicable law.

What We Do & How We Do It

We've developed an effective process for working with businesses to help them implement tax accounting method changes that can improve results.

1. Analyze financial statements, tax returns, and supporting workpapers for accounting method change opportunities and the impact to taxable income
2. Present our findings and work with decision makers to determine which accounting method changes to implement
3. Develop a customized plan for implementation
4. Implement the accounting method changes: includes calculation of adjustments, preparation of summaries, and Form 3115 to request the accounting method changes

Key Areas of Change in Accounting Methods

Our professionals have experience helping businesses rationalize and implement accounting method changes in many areas, including:

- Revenue recognition: advance payments, cost offsets, long-term contracts, retainage
- Acceleration of deductions:
  - Accruals and reserves: recurring item exception, 2.5-month rule for compensation, 3.5-month rule for services
  - Prepaid expenses
  - Bad debt expense
- Inventory: UNICAP, LIFO/FIFO, valuation, LCM, subnormal goods, obsolescence reserve
- Capitalization and cost recovery: bonus depreciation, cost segregation, in-service date determination, change in recovery period
- Section 174—capitalization of research and development costs

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Upcoming Form 6765 Changes

Overview & Implications of the Updated Form 6765 for R&D Credit Claims

Mike Boenzi

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Updated Form 6765

Research & Development Tax Credit

New Section E: Mandatory Responses Required for 2024 Tax Returns

- Total number of business components (identified & analyzed)
- Officer wages included in the credit
- Acquisitions/dispositions
- New categories of Qualified Research Expenses (“QREs”)
- Follow ASC 730 Directive

Section E—Other Information. See instructions.

37	Enter the number of business components generating the QRE on line 5 or line 20	37	
38	Enter the amount of officers' wages included on line 42	38	
39	Did you acquire or dispose of any major portion of a trade or business in the tax year? ☐ Yes ☐ No		
40	Did you include any new categories of expenditures as current year QRE? . . . . ☐ Yes ☐ No		
41	Did you determine any of the QRE on line 5 or line 20 following the ASC 730 Directive? . . . . ☐ Yes ☐ No		
	If “Yes,” enter the amount from Appendix C Line 19 (you may attach your Appendices A, B, C, and D here)	41	
	This ASC 730 Directive only applies to taxpayers with assets equal to or greater than $10,000,000 who follow U.S. GAAP to prepare their Certified Audited Financial Statements showing the amount of currently expensed Financial Statement R&D. See instructions.		

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Updated Form 6765

Research & Development Tax Credit

New Section G: Optional for 2024 Tax Returns for ALL Taxpayers

The following information required for each Business Component:

- Business component's name (or unique alphanumeric identifier)
- Business component type: *product, process, formula, technique, invention, software*
  - If software, the type will need to be identified (instructions pending)
- Information sought to be discovered (not original return claims)
- Amounts of QREs *(wages, supplies, computer rental, contractor costs)*
  - Wages will need to be further identified as *Direct R&D, Direct Supervision, or Direct Support*

Updated Form 6765
Research & Development Tax Credit

New Section G: For Tax Years After 2025

Mandatory for Taxpayers unless a Taxpayer qualifies for an exception:

- Meet the definition of a Qualified Small Business & claim a reduced payroll tax credit:

  Qualified Small Business:

  - A corporation or partnership if the gross receipts < $5 million, &
  - Such entity did not have gross receipts for any taxable year preceding the 5-taxable-year period ending with such taxable year.
- Have less than $1.5 million in QREs & less than $50 million of gross receipts.

Updated Form 6765

Research & Development Tax Credit

Recommendations for Taxpayers:

- Maintain an ongoing project/business component list
  - Update regularly with new project details
  - Adopt a time-tracking &/or cost-tracking system
- Begin R&D analysis earlier to gather qualitative information prior to filing taxes
- Adopt an analysis methodology for tax year 2024 analysis that complies with newly requested information to prepare for tax year 2025 requirements.
- Include the Forvis Mazars R&D credit team in tax planning conversations for the upcoming year.

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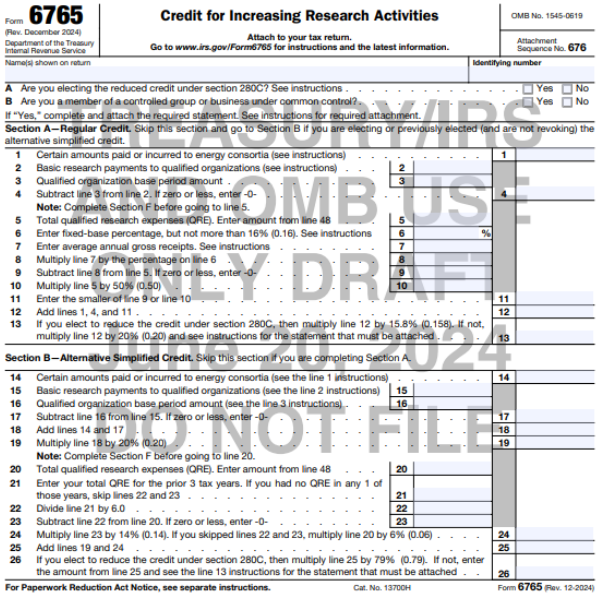
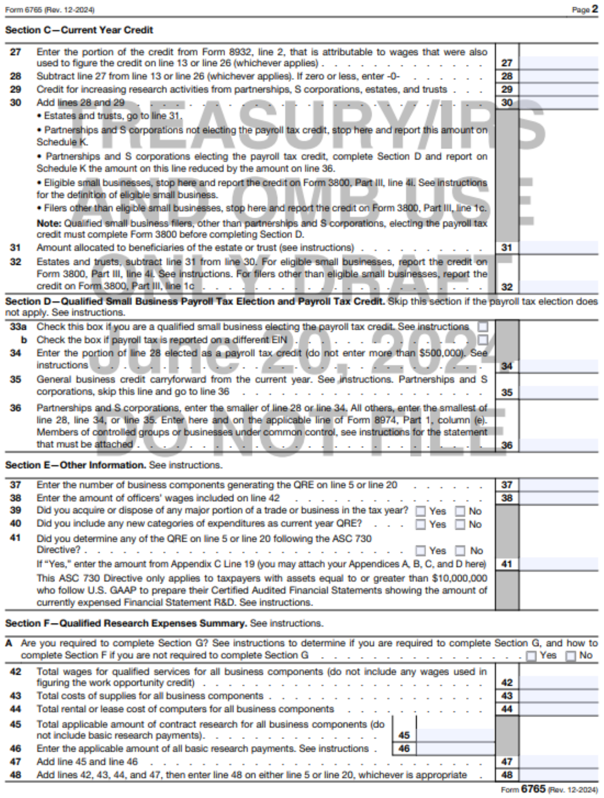
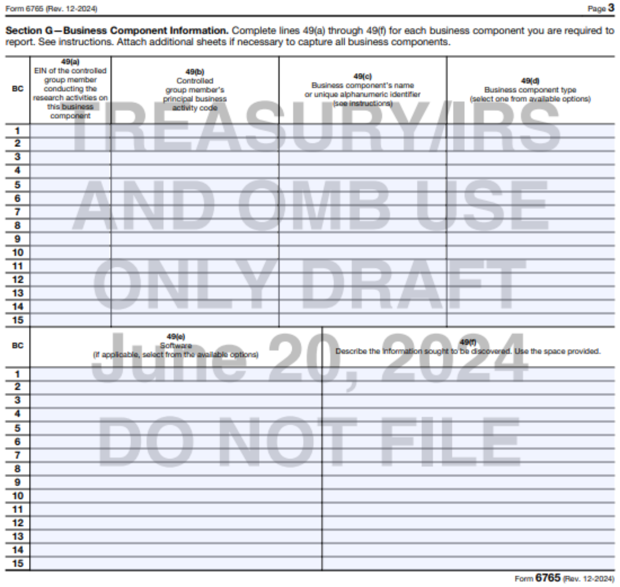
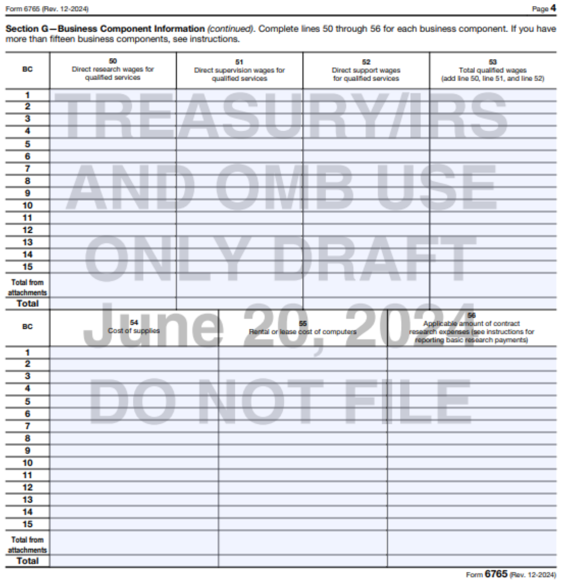
Updated Form 6765

Research & Development Tax Credit









[Form 6765 (Rev. December 2024) (irs.gov)](https://www.irs.gov)

Instructions & Final Form expected by year's end.

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Tangible Property Regulations

Repairs & Maintenance Studies

Lisa Pedatella

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Tangible Property Regulations (TPR)
Repairs & Maintenance Studies

Whether an expenditure can be classified as a repair can be determined by answering the following questions:

1. Can the Rules be applied?
2. Does the Safe Harbor Rule apply?
3. Are they Materials & Supplies?
4. Is it Routine Maintenance?
5. What is the Unit of Property?
6. Does it fail the BAR test?

Can the Rules Be Applied?

TPR – Repairs & Maintenance Studies
Basis in Law

A repair needs to be distinguished from a capital improvement. This distinction is heavily reliant on the facts & circumstances of each situation, but there are some basic rules that provide a framework for deciding whether work on an asset is a deductible expense or an improvement that needs to be capitalized.

Repairs are written off in the year they are incurred

Capital Expenditures are depreciated over their useful lives as determined by MACRS.

In 2013, the IRS issued the final tangible property regulations, aka the “Repair Regs” or “TPR.” These regulations sought to clarify the existing rules to determine whether certain costs are currently deductible or must be capitalized.

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TPR – Repairs & Maintenance Studies
When They Apply

If the taxpayer made improvements to an existing property (renovations) or they refreshed their space, a Repairs & Maintenance study (R&M) can be done.

A couple of very important things to keep in mind:

There are no repairs if the TP did ground-up (new) or improvements that increase the footprint of the building (such as an addition)—& sometimes they do both additions and improvements—so an understanding of the scope of work is very important.

They did not change the existing rules & for that reason taxpayers are allowed to look backwards & collect any missed repairs & maintenance costs which is typically via a Form 3115 & 481a Adjustment

Does the Safe Harbor Rule Apply?

TPR – Repairs & Maintenance Studies
Safe Harbor Rule

Within these Repair Regs is a De Minimis Safe Harbor rule whereby the property owner can deduct as expenses amounts up to $5,000 per invoice or per item as substantiated by the invoice, provided the property owner has an audited financial statement ($2,500 without), written accounting procedures treating the item as an expense for book purposes, & a supporting invoice.

Example:

- Assume taxpayer has an AFS & a written expense policy that expenses items up to $5,000.
- Taxpayer buys 1250 computers at $5,000 a piece.
- Taxpayer receives an invoice of $6.25M detailing the purchase.
- How much can the taxpayer expense?
- Answer= $6.25M

Are They Materials & Supplies?

TPR – Repairs & Maintenance Studies
Materials & Supplies (M&S)

- **Options for Accounting for Materials & Supplies:**
  - Deduct “non-incidental” materials & supplies when used or consumed, unless used in a capital improvement
  - Deduct “incidental” materials & supplies in the year purchased
  - Deduct any material supply in the year purchased under the safe harbor de minimis rule
  - Capitalize & depreciate only materials & supplies that are routable, temporary, or emergency standby parts (can’t go back!)
- **Materials & Supplies Defined:**
  - Any component acquired to maintain, repair, or improve a unit of tangible property owned, leased, or services by the TP
  - A unit of property with an economic useful life of 12 months or less
  - A unit of property that has an acquisition or production cost of $200 or less
  - Fuel, lubricants, water, & similar items that are reasonably expected to be consumed within 12 months or less, beginning when used in the taxpayer’s operations
  - Property identified in published guidance as M&S
  - Rotable, temporary, or emergency stand-by spare parts

Is It Routine Maintenance?

TPR – Repairs & Maintenance Studies
Routine Maintenance

Expenditures made for routine maintenance of a UoP of a building is deemed to not be an improvement.

Routine maintenance of a building are the reoccurring activities that are expected to be performed to keep the building structure system in its ordinary efficient operating condition. An activity is routine if it is reasonably expected to be performed more than once during a ten-year period beginning when the building structure or system is placed in service.

Examples

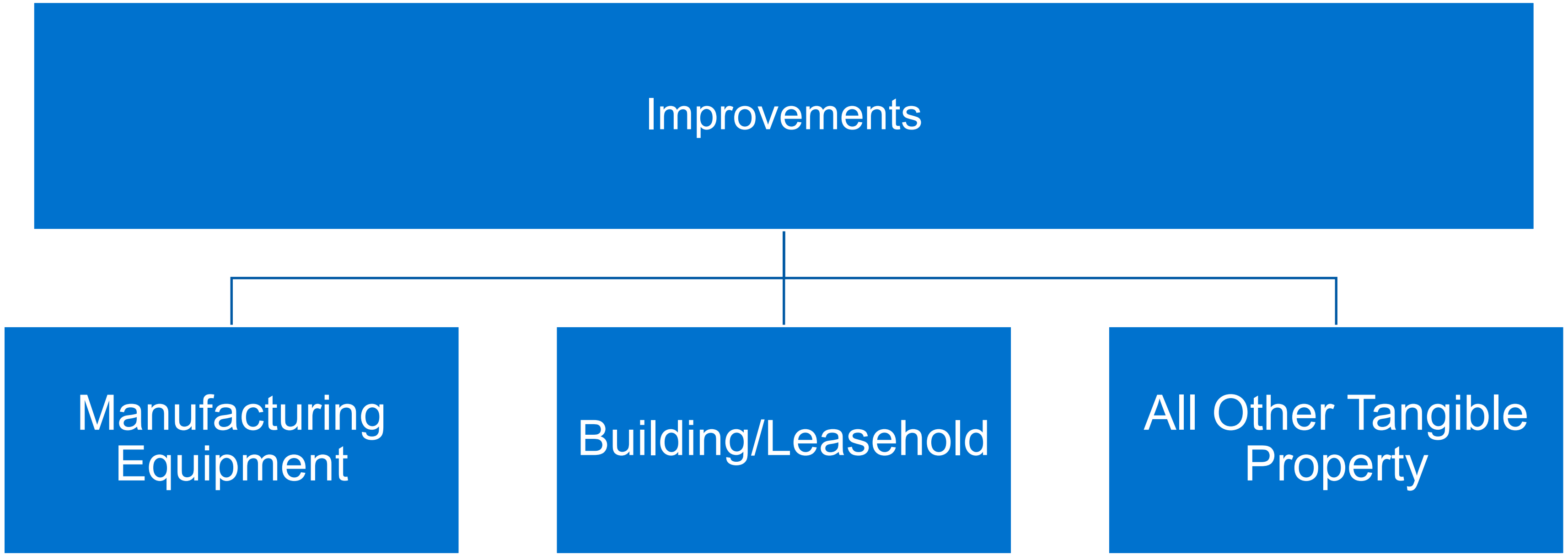
- Client purchases a shopping center which has 40 escalators. Client expects that they will need to replace the handrails every four years. The escalator system is the UoP. Since the handrails are expected to be replaced more than once in ten years, this replacement constitutes routine maintenance.
- Client purchases an office building; they reasonably expect that every four years to test & maintain the HVAC system to keep it in efficient operating condition, they will need to replace parts. This service is recommended by the manufacturer & is commonly performed. Client performed this service in years four & 11. If TP demonstrates its expectations of service intervals are reasonable, the amounts paid in both years are considered deductible maintenance expenses.

What Is the Unit of Property?

TPR – Repairs & Maintenance Studies
Unit of Property

Unit of Property (UoP)

- A unit of property (UoP) consists of all the components of a property that are functionally interdependent – a component that can be placed in service by the taxpayer without depending on any other components. As it pertains to improvements, UoP will fall into one of the three categories below:



TPR – Repairs & Maintenance Studies
Unit of Property

Buildings

- For a taxpayer that is a lessor or owns their building, the entire building & its structural components constitute one UoP. However, when evaluating whether an expenditure should be capitalized or deducted, improvement standards must be applied separately to each building system as defined below:

Building Structure	HVAC	Plumbing Systems	Electrical Systems	Elevators	Escalators	Fire Protection Systems	Security Systems	Gas Distribution Systems
Roof	Motors	Pipes	Wiring	Elevator boxes	Rails	Sensors	Locks	Pipes
Walls	Boilers	Drains	Outlets	Control equipment	Steps	Detectors	Cameras	Valves
Floors	Furnace	Valves	Junctions	Cables & movement equipment	Supports	Sprinklers	Recorders	Utility equipment
Ceilings	Chillers	Sinks	Lighting		Controls	Plumbing	Monitors	
Foundation	Pipes	Toilets	Fixtures			Alarms	Lighting	
	Ducts	Bathtub	Connectors			Computers	Alarms	
	Radiators	Sewage equipment				Control panels	Entry access	

TPR – Repairs & Maintenance Studies
Unit of Property

Leasehold Improvements

For a taxpayer that is a lessee, the UoP is defined as each building & the structural components associated with the leased portion of the building, as defined in the lease agreement.

Example

If a taxpayer leases three units in the same building, all under ***separate*** lease agreements, the taxpayer has three units of property. Assume each of these units has a separate heating, ventilation, & air conditioning (HVAC) system. Because the lease agreement defines the unit of property, whether expenses are deductible repairs or must be capitalized will be determined on a leased-unit basis. If the HVAC system goes out in one unit & is replaced, the expenditure would require capitalization because the unit has only one HVAC unit & replacement of that unit would qualify as substantial.

If three HVAC units are included in ***one*** lease agreement, the replacement of one unit is only one-third of the total units of the HVAC building component. In that case, the cost of the replacement would be deducted as a repair.

TPR – Repairs & Maintenance Studies
Unit of Property

All Other Tangible Property

All other tangible property constitute one UoP.

In the context of repair regulations, other tangible property refers to physical assets that are not specifically categorized as buildings, structural components, or machinery.

This means that most property that meets the definition of 1245 property & 1250 land improvements is considered its own UoP. Below lists some examples of this type of property:

Removable Floor Covering such as Carpeting	Qualifying Cabinetry, Counters, & Millwork	Tele/Data Outlets & Wires	Electrical Systems for Qualifying Equipment	Plumbing Systems for Qualifying Equipment	Cooling/Ventilation Equipment for Qualifying Processes/Systems
Paving, Curbs, Gutters, Landscaping, & Site Lighting	Decorative Lighting & Power Systems	FF&E such as appliances, tables, desks etc.	Electrical Systems for Qualifying Equipment	Demountable Office Fronts/Folding Partitions	Removable/Decorative Wall Coverings

It is important to segregate out these expenditures for audit worthiness

Does It Fail the BAR test?

TPR – Repairs & Maintenance Studies
BAR Test

Per Code Sec. 263; Reg. §1.263(a)-1, a capital improvement results in:

A **B**etterment to the unit of property; or

Adaptation of the unit of property to a new or different use; or

A **R**estoration of the unit of property.

This if often referred to as the **BAR** test & if the expenditure *fails* the BAR test it can be classified as a repair.

TPR – Repairs & Maintenance Studies
BAR Test

Betterment

- Correct pre-existing material defect
- Material addition or expansion
- Reasonably expected to increase productivity, efficiency, strength, quality, or output

Adaptation

- New or different use inconsistent with intended use when originally placed in service by taxpayer

Restoration

- Return UoP to 'like-new' condition at end of class/asset life
- **Replace major component (discrete & critical function) or substantial structural part of UoP**
- Return UoP to ordinarily efficient operating condition if it has deteriorated to the point of not being functional for intended use
- Replace component of UoP in which a loss was deducted on the replaced component
- Replacing component of UoP in which gain/loss recognized from sale or exchange
- Repairing damage to UoP in which basis adjustment taken due to casualty loss

Most of the repairs identified for improvements will be in this section

TPR – Repairs & Maintenance Studies
Buildings – Adaptation Example

Deduct	Capitalize
Building Refresh Cosmetic & Layout Changes Patching Holes Repainting Repairing Ceiling Tiles Flooring Repairs	Building remodeling involving: • Replacement of large sections of walls with windows • Rebuilding interior & exterior facades with updated materials • Rebuilding walls to be stronger • Replacing ceilings & flooring with better quality Material additions & increases in capacity New stairways & mezzanine Material increase in efficiency Addition of new insulation

TPR – Repairs & Maintenance Studies
Buildings – Adaptation Example

- An amount paid to adapt the UoP to a use not consistent with the taxpayer's use at the time they placed it into service.

- For example, converting an office building to a residential property by removing & replacing various structural components must be capitalized.

TPR – Repairs & Maintenance Studies
Buildings – Restoration/Replacements Examples

A major component is a part or combination of parts that perform a discrete & critical function in the operation of a UoP.

Rule of Thumb: 40% or more of the operational system is replaced = capitalize

A substantial structural part is a part or a combination of parts that comprises a large portion of the physical structure of the UoP.

Rule of Thumb: 30% or more of the physical structure is replaced = capitalize

Deduct		Capitalize	
Replacement of 30% of the wiring in building	Less than 40% of the electrical system's discrete & critical operation component was replaced	Replacement of the main electrical distribution panel.	The main distribution panel is a major component that performs a discrete & critical function in the operation of the electrical system
Replacement of 3 of 10 roof mounted HVAC units	Less than 40% of the HVAC's discrete & critical operation component was replaced.	Replacement of the chiller unit for HVAC system	The chiller is a major component that performs a discrete & critical function in the operation of HVAC system
Replacement of entire roof membrane	Less than 40% of the roof's discrete & critical operation component was replaced	Replacement of entire roof	100% of the physical structure of the roof was replaced
Replacing a building's storefront	The storefront comprises less than 30% of the building's physical structure	Replacing all the walls but the historical front wall of a building's façade.	The back three walls comprise more than 30% of the building's physical structure

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The Rise in Aircraft Audits & How to Prepare

Katie Simmons

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The Rise in Aircraft Audits & How to Prepare
IRS Business Aircraft Campaign

Campaign announced February 21, 2024

- Objective: "to ensure tax compliance while also increasing awareness related to the business aircraft regulations and reporting requirements" (https://www.irs.gov/businesses/corporations/lbi-active-campaigns)

- Focus on large corporations, partnerships, & high-income individuals

- Areas of emphasis:
  1. Qualified business use
  2. Personal use & fringe benefit inclusion
  3. Entertainment use

The Rise in Aircraft Audits & How to Prepare
IRS Business Aircraft Campaign

What information is being requested in these exams?

1. Airplane ownership & relationship to the taxpayer
2. Depreciation schedule
3. Passenger listing including relationships to specified individuals, control employees, & five-percent owners
4. Documentation
    a. Meeting minutes discussing business purpose of airplane
    b. Aircraft use policy
    c. Management agreements
    d. Dry leases
    e. Security studies
    f. Purchase documents & FAA registration

The Rise in Aircraft Audits & How to Prepare
IRS Business Aircraft Campaign

What information is being requested in these exams?

5. Flight Logs
   a. Flight date
   b. Arrival & departure locations
   c. Statute miles
   d. Flight time
   e. Passenger names & flight purpose
6. For each business flight,
   a. Documentation to substantiate the business purpose
   b. Host names for all personal guests
   c. Documentation to support the business relationship of the passengers to the business purpose
7. Qualified business use, entertainment disallowance, & personal usage fringe benefit calculations

IRS Business Aircraft Campaign

How should your business prepare?

- ✓Keep accurate passenger manifests
- ✓Review passenger listing annually to ensure all specified individuals, control employees, & five-percent owners are properly accounted for
- ✓Ensure all legs of every flight are recorded in the flight logs, including maintenance, training, & unoccupied “deadheads”
- ✓Record business purpose in the flight logs & maintain contemporaneous documentation in the event of an exam – *Don’t wait to get the notice!*
- ✓Properly compute & report entertainment expense disallowance, qualified business use, & fringe benefit income on tax returns in workpapers that are ready to be presented to an examiner

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The Inflation Reduction Act

Current State & How to Navigate It

Troy Taylor

IRA – Why It Matters

- The Inflation Reduction Act (IRA) provides many clean energy credits for energy production & clean energy property investment

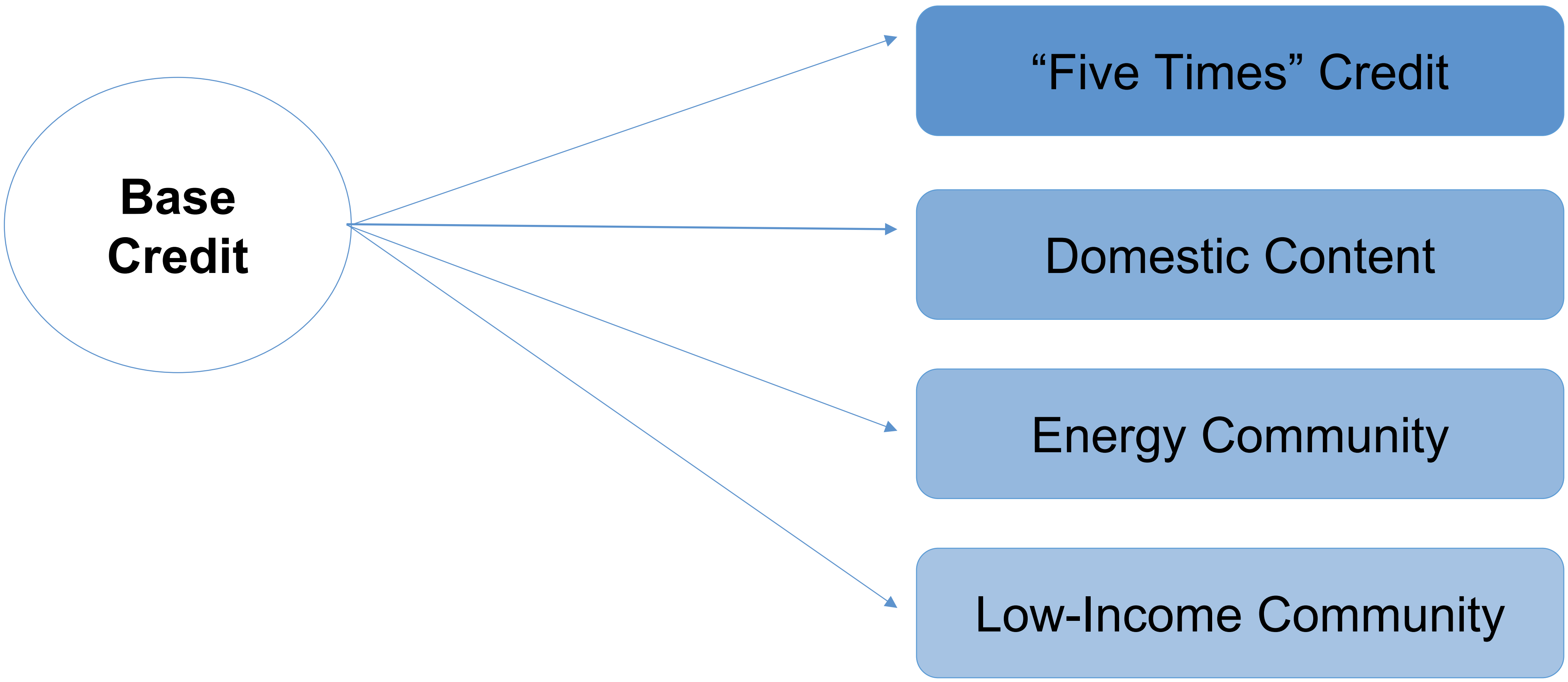
- Examples are solar panels, geothermal heating systems, energy storage, EVs, etc.

- Most credits are now transferable/sellable

- Nonprofits & governmental agencies can now claim most credits via direct pay election

Credit Mechanics

Bonus Credits



Bonus Credits

Base x 5

- “Five Times” Bonus Credit – Either:
    - Project less than 1 megawatt, OR
    - Prevailing wage & apprenticeship requirements (PWA)

Prevailing Wage Requirement

- Pay at least prevailing wage to all laborers & mechanics on project
    - Employed by taxpayer, contractor or subcontractor
    - Consider including in contracts
- Wage determination: http://www.sam.gov
- Recordkeeping requirements
- Cost/benefit analysis of increased pay versus credit benefit

Apprenticeship Requirement

- If 4 workers, must have at least one qualifying apprentice
- Request from qualifying apprenticeship programs
- Recordkeeping requirements
    - Daily “proof” required

Bonus Credits

Domestic Content	Energy Community	Low-Income Housing
10%	10%	10%-20%

Domestic Content

- Steel & Iron– 100% U.S. Sources
- Manufactured product – 40% U.S. components
- Safe Harbor rules

Energy Community

- Brownfield Site
- Statistical area – specific requirements
- Census tract with (or adjoining) closed coal mine
- Website/map available

Low-Income Housing

- Solar facilities
- Wind facilities

Investment/Production Tax Credit

	Section 48 – Investment Tax Credit	Section 45 – Production Tax Credit
How is it calculated?	• Credit is a % of cost	• Credit is dependent on energy produced
How much is the credit?	• 6% base • Bonus credits eligible (50% possible)	• 0.3 cents/kWh • Bonus credit eligible (1.8 cents/kWh possible) • Adjust for inflation
When can I take the credit?	• Taken when property placed in service • Construction to begin before 1/1/25 for some property (then Section 48E)	• Credit over 10-year period • Construction to begin before 1/1/25 for some property (then Section 45Y)
Examples	• Battery storage • Heating/cooling equipment using ground or ground water • Combined heat & power system • Dynamic glass • Solar panels	• Closed or open-loop biomass facilities • Qualified hydropower facilities • Gas or trash facilities • Wind facilities • Solar or geothermal facilities

IRA – Example

Company X placed a solar panel in service in 2023. The basis of the property is $100,000. Assuming all bonus credit requirements are met, the credit calculation would be:

Pre IRA

Description	Rate/ Calculation	Credit Amount
Base credit	30%	**$30,000**

Post IRA

Description	Rate/Calculation	Credit Amount (Cumulative)
Base credit	6%	$6,000
5 times bonus	x5	$30,000
Domestic content	10%	$40,000
Energy community	10%	**$50,000**

Building & Construction

- Section 179D – Energy Efficient Commercial Buildings Deduction
  - Deduction for construction & improvement of buildings
    - Property reduces energy costs by 25% or more vs. building meeting ASHRAE standards
    - Available for improvements or new construction
    - Building envelope, HVAC, hot water systems, interior lighting
  - Changes made by IRA:
    - Now a permanent credit
    - “Max” potential credit $1 or $5 per square foot (subject to inflation)
    - Annual rather than lifetime cap
    - Lower ASHRAE standards
    - Tax exempt entities can “transfer” credit to designer

EV Related Credits

- Section 45W – Qualified Commercial Electric Vehicle Credit
  - Electric vehicle OR mobile machinery
  - Credit limits: $7,500 (GVWR <14,000 lbs.) or $40,000 (all other)
  - Examples:
    - Electric transport trucks
    - Electric vehicle fleet
    - Qualifying mobile machinery
- Section 30C – Alternative Fuel Vehicle Refueling Property
  - “Charging stations”
    - Recharges electric vehicles
    - Stores or dispenses clean-burning fuel to a motor vehicle tank
  - 6% base, bonus eligible up to 30%
  - $100,000 credit limit per item of property
  - Non-urban or low-income area required
  - Examples:
    - Electric charging stations/Clean fuel recharging stations

TaxCred PRO for Clean Energy

- Free dynamic questionnaire
- Users: individuals & businesses
- Resulting report provides potential credit opportunities & an estimated benefit amount
- Easily connects a user to a Forvis Mazars adviser
- Access on the [Forvis Mazars]

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State & Local Tax

Public Law 86-272 Update

Dave Landwehr

State & Local Tax
Public Law 86-272 Update

Background

- Public Law 86-272 (PL 86-272) is a federal law that protects certain sellers of tangible personal property from state net income taxes if their activities are generally limited to solicitation of orders.

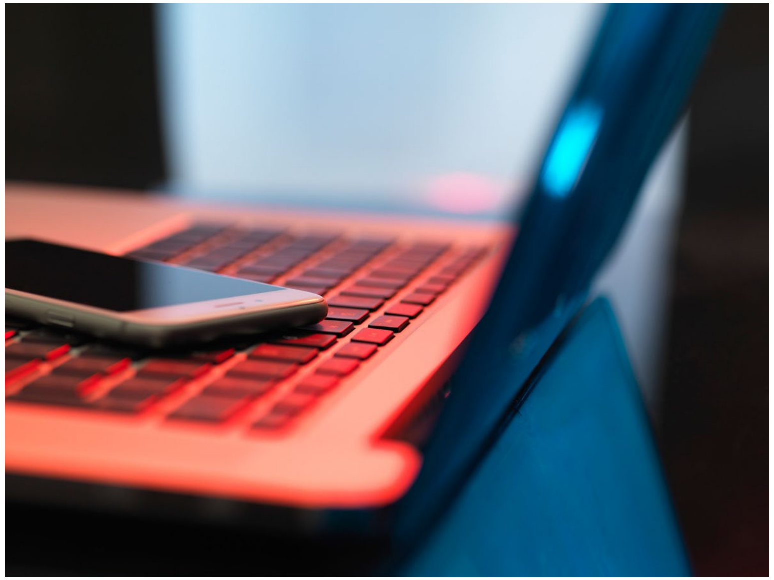
State & Local Tax

Public Law 86-272 Update

MTC Updated Statement on Public Law 86-272 (2021)

- In 2021, the Multistate Tax Commission released an updated statement on PL 86-272 activities that included an additional section related to activities conducted via the Internet.
- The updated statement includes the following as examples of unprotected activities conducted via the Internet.

Unprotected Activities via Company Website
Providing post-sale assistance to in-state customers via either electronic chat or email accessed from the business's website.
Soliciting & receiving online applications for its branded credit card.
Inviting viewers in a customer's state to apply for non-sales positions.
Placing Internet "cookies" onto the computers or other electronic devices of in-state customers that are used for non-sales activities.
The business offers & sells extended warranty plans via its website to in-state customers who purchase the business's products.



State & Local Tax

Public Law 86-272 Update

Reactions to the MTC's Updated Language

- California
  - Issued a now-rescinded Memo adopting the MTC's updated language (still imposing the provisions under audit).
- New Jersey
  - Eff. June 30, 20203, New Jersey issued a Tax Bulletin adopting the MTC's updated language.
- New York
  - New York issued regulations implementing the MTC's updated language (currently being challenged in court).
- U.S. Congress – HR 2021
  - HR 2021 defines "solicitation" more broadly than what the courts have interpreted. The bill is in committee currently.

What Comes Next?

- Absent intervention by the courts or unlikely federal legislation, more states are likely to adopt language provided by the MTC's updated guidance on PL 86-272 for Internet activities.
- Sellers of tangible personal property need to remain abreast of these developments.
- Consider reviewing online & in-person activities to prepare for further & additional state action on out-of-state sellers.

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Specialty Tax (State & Local Tax)

Impact/Aftermath of Microsoft vs. California Apportionment Decision

Kayla Wall, October 2024

forvis mazars

Impact/Aftermath of Microsoft vs. CA **Apportionment Decision**

Facts of Appeal of Microsoft Corp. & Subsidiaries

- Microsoft, a CA water's edge filer, received dividends from entities that were not included in the water's edge group & included the dividends in its income tax base. Microsoft deducted 75% of the dividends based on the dividends received deduction.
- Microsoft filed an amended return & requested a refund, based on calculating its apportionment sales factor by including the gross dividends received from its foreign affiliate in the sales factor denominator, which in turn diluted the apportionment factor to California.
- OTA relied on the plain language of the statute & looked to the definition of gross receipts for purposes of sales factor apportionment, & determined the dividends were gross receipts & an exclusion was not provided within the statute.
- OTA refused to give deference to the FTB's interpretation & ultimately determined the gross receipts from the dividends included in the sales factor should not be reduced to account for dividends deducted under the tax base.

Impact/Aftermath of Microsoft vs. CA
Apportionment Decision

Subsequent legislation

- Four months after the OTA denied a petition for rehearing, on June 27, 2024, California enacted Senate Bill No. 167 (S.B. 167) which effectively overturned the OTA's Microsoft decision.

- The bill operates retroactively.

- There have been two lawsuits filed in different California superior (trial) courts arguing that the new law is unconstitutional as violating the Due Process Clause of the U.S. constitution & the California Constitution.

Impact/Aftermath of Microsoft vs. CA
Apportionment Decision

Impact/Aftermath

- Depending on how the pending lawsuits challenging S.B. 167 unfold, there still may be a possibility of refunds for taxpayers receiving foreign dividends that originally had excluded the dividends from their California sales factor.

- Other states may define sales or gross receipts included in their sales factors by statutes similar or identical to California's statute at issue in Microsoft. Accordingly, similar positions for refunds for taxpayers may be available in those states.

Thank you!

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