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5 KEY TAKEAWAYS
SALT and Multinational Businesses

On June 2nd, Kilpatrick Townsend State and Local Tax partner Jeff Reed participated in a Strafford webinar titled SALT and Multinational Businesses. The webinar discussed state and local tax consequences of international transactions. Here are five key takeaways from the presentation:

1

For Inbound Transactions, the SALT Analysis Often Differs from the Federal: When there is an inbound transaction, the federal income tax analysis considers whether there is effectively connected income (ECI) within the United States and whether there is treaty protection on the basis of a lack of a permanent establishment in the United States. In contrast, at the state level treaties generally do not apply and state revenue departments assert jurisdiction at activity levels far below that of a permanent establishment. Rather, the key SALT consideration for inbound transactions is often how a state's statutory scheme defines "income" and whether it is possible for there to be income for state income tax purposes in the absence of any line 28 or line 30 income for federal income tax purposes.

2

Sales of Partnership Interests by Foreign Partners (the Grecian Magnesite Issue) is a Hot Issue at the State Level: For federal income tax purposes, the sale of a US partnership interest by a foreign seller was held to produce foreign source income not subject to US Taxation in the Grecian Magnesite case. That result was changed legislatively by a statutory scheme that now imposes a withholding tax on certain sales of partnership interests. At the state level, sales of partnership interests by out-of-state (or foreign) partners is a hot topic, with states increasingly asserting that the in-state presence of the partnership provides a basis for imposing income tax on the out-of-state partner's proceeds from the sale of the partnership interests. Opinions handed down over the last two months in Massachusetts and New York reached opposite results on this issue, with the Massachusetts high court holding that the state revenue department lacked statutory authority to tax the out-of-state partner, and the New York court holding that imposition of the income tax was supported by the presence of the in-state partnership.

3

State Revenue Departments are Increasingly Scrutinizing 80/20 Companies and Other Entities Outside Water's Edge Combined Return Groups: For state combined reporting purposes, only domestic entities are included in water's edge combined returns. But states are increasingly looking at ways to include foreign entities with considerable income in those returns. More and more states have been enacting legislation to include entities domiciled in "tax haven jurisdictions" in water's edge combined returns. And state revenue departments have increasingly been scrutinizing 80/20 companies and arguing on audit that income from those entities should be included in water's edge combined returns.

4

State Addback Statutes May Deny Deductions Available at the Federal Level: For federal income tax purposes, it may be possible to claim a deduction for a royalty payment or an interest payment to a related foreign entity. But the same deduction may not be available for state income tax purposes due to addback statutes. Almost all state addback statutes deny deductions for royalty payments made to "related members," including related members in other countries. Addback statutes in several states also deny interest payments made to related members (including foreign related members). In the international arena, it may be possible to fit under a "treaty exception" to addback or to one of the other exceptions, depending on the nature of the transaction and the facts and circumstances.

5

The Foreign Commerce Clause Can be a Useful Tool in Challenging Burdensome State Tax Schemes: In the international tax area, the dormant commerce clause has two additional requirements has not applicable to domestic transactions: (1) a tax cannot create an unconstitutional risk of international double taxation; and (2) a tax must not impede the U.S. government from "speaking with one voice." Anytime a state tax scheme seems to disproportionately burden or disfavor an international actor or transaction over a domestic one consideration should be given to whether the scheme operates in such a way that it is vulnerable to a foreign commerce clause challenge. An example was given of a successful challenge to a NY insurance scheme that disfavored alien insurance companies; the taxpayer's successful argument made use both of the foreign commerce clause and treaty nondiscrimination concepts.

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