

Massachusetts enacts FAS 109 deduction extension, governor threatens to veto other tax provisions

July 18, 2013

In brief

UPDATE: On July 17 and July 18, the House and Senate, respectively, passed an amended version of H.B. 3535, which did not affect the tax provisions below but for changing the effective date of the sales tax item from July 1, 2013, to seven days after enactment. Both chambers of the legislature passed their measures with a greater than 2/3 majority vote. On July 19, the governor vetoed the amended bill, which has been returned to the House for further action.

On July 12, 2013, Massachusetts enacted [H.B. 3538](#), its Fiscal Year 2014 budget, which includes a delay in the state's implementation of its FAS 109 deduction. [H.B. 3535](#), the state's transportation financing bill, contains provisions necessary to support revenue needs in the budget, including market-based sourcing, a sales tax imposed on computer system design services, and the repeal of the utility corporation classification. On July 2, 2013, the governor [returned H.B. 3535 to the legislature](#) with suggested amendments. The governor has since threatened to veto H.B. 3535 if the bill is returned to him in its original form, though supporters of the bill appear to have sufficient votes to override such a veto.

In detail

FAS 109 deduction delayed

A 'FAS 109' deduction was approved for certain publicly held companies as part of a Massachusetts tax law change that lowered the corporate tax rate in stages and adopted combined reporting for tax years beginning on or after January 1, 2009. In general, if the enactment of combined reporting for unitary businesses resulted in an increase to a

combined group's net deferred tax liability, the combined group is eligible to claim a FAS 109 deduction.

Under prior law, the deduction was to be prorated over the 7-year period beginning with the combined group's taxable year that begins in 2014. Under H.B. 3538, sec. 142, the first year of the 7-year period to claim the FAS 109 deduction is the combined group's taxable year that begins in 2015. This is the

third time that implementation of the FAS 109 deduction has been delayed.

Proposed market-based sourcing, including throw-out

Under current law, sales, other than the sales of tangible personal property, are sourced to where income-producing activity occurs, based on costs of performance. For licensing intangible property, income-producing activity is performed

in the state where such intangible property is used

Effective for tax years beginning on or after January 1, 2014, H.B. 3535 would source sales, other than sales of tangible personal property, to Massachusetts if the corporation's 'market for the sale' is in the state. With respect to determining a corporation's market, the proposed legislation provides that a corporation's market is considered to be in Massachusetts if and to the extent the services are 'delivered' to a location in the state.

The proposed legislation provides for a **throw-out rule** to the extent that a service provider is not taxable in the state to which the receipts are ultimately sourced. The amendment specifically reads:

- if the state of assignment cannot be determined, it shall be reasonably approximated; and
- if a corporation is not taxable in the state to which a sale is assigned, or if the state or states of assignment cannot be determined or reasonably approximated, such sale should be excluded from the numerator and denominator of the sales factor (*i.e.* thrown-out).

It remains unclear how the throw-out rule will be interpreted regarding when a taxpayer is considered taxable in another state.

Also effective for tax years beginning on or after January 1, 2014, a corporation's 'market for sale' would be in Massachusetts:

- in the case of lease or license of intangible property, if and to the extent the intangible property is used in Massachusetts;
- in the case of the sale of intangible property, where the property sold

is a: (1) contract right, (2) government license, or (3) otherwise authorizes the holder to conduct a business activity in a specific geographic area, if and to the extent that the intangible property is used in or otherwise associated with Massachusetts.

However, any sale of intangible property, not otherwise described in the two above bullet points, would be excluded from the numerator and the denominator of the sales factor.

Proposed sales and use tax on computer system design services

Under current law, the only services subject to the sales and use tax are the provision of telecommunications services. In addition, the retail sale of standardized computer software, irrespective of how it is delivered, is subject to the sales and use tax. The sale of custom software is not subject to the sales and use tax.

Under the proposed legislation, the provision of computer system design services would be subject to sales and use tax. Computer design services are defined as the planning, consulting, or designing of computer systems that integrate computer hardware, software, or communication technologies, and are provided by a vendor or a third party. In addition, the definition of taxable services would be expanded to include not only computer system design services but also "the modification, integration, enhancement, installation, or configuration of standardized software."

One of the suggested amendments proposed by the governor when he returned the transportation financing bill to the legislature concerned the effective date of this provision. As originally proposed, the effective date is July 1, 2013, which would now have

retroactive application. The governor proposed that the new sales tax provision would become effective seven days following the enactment of the bill.

Proposed repeal of utility corporation classification

Under current law, entities classified as 'utility companies' are subject to a 6.5% tax rate on their net income and are not subject to the non-income measure of the corporate excise tax. Utility companies include those companies that are regulated by Massachusetts or other state law and that operate electric, water, telephone, railroad, and other similar businesses.

Effective for tax years beginning on or after January 1, 2014, the utility corporation classification would be repealed and such corporations would be taxed as business corporations subject to the 8.0% income tax rate and the non-income measure. Their new designations presumably would make them eligible to carry forward net operating losses and be permitted to claim a less restrictive dividends received deduction. However, any corporation that was previously classified as a utility corporation would not be allowed a net operating loss deduction for losses incurred before January 1, 2014.

Under current law, utility corporations are afforded certain local property tax exemptions. The repeal of the utility corporation classification would have the unintended consequence of subjecting telephone switching equipment to local property taxation. The proposed legislation addresses this unintended consequence by exempting telephone switching equipment from the local property tax. Other types of utility corporations that would be affected by the repeal of the utility corporation entity classification should review their listing of tangible personal

property to determine if the repeal of the utility corporation classification might have similar unintended consequences.

The takeaway

Massachusetts is poised to adopt market-based sourcing, eliminate the utility corporation classification, and extend its sales and use tax to computer system design services. However, the enactment of these provisions is caught up in a

disagreement between the governor and the legislature over the proper amount of funding needed for improving the state's transportation infrastructure. Moreover, the legislature leaves open issues on the proposed sales tax provision since there is no guidance regarding the sourcing of services subject to tax. The only thing 'certain' seems to be the budget's further delay in the implementation of the FAS 109 deduction, a measure that was intended to ease the financial impact

some corporations experienced following the state's adoption of combined reporting.

As of July 17, 2013, the House passed the transportation finance bill with some corrective language but it did not amend the existing language on computer and software services. The House did change the effective date to 7 days after the bill is signed into law, consistent with the governor's request.

Let's talk

If you have questions about the tax provisions in the Fiscal Year 2014 budget or in the transportation financing bill, please contact:

State and Local Tax Services

Jon Muroff
Principal, *Boston*
+1 (617) 530-4573
jon.muroff@us.pwc.com

David Sheehan
Managing Director, *Boston*
+1 (617) 530-4872
david.sheehan@us.pwc.com