

PUBLICATION

New Louisiana Franchise Tax Law Attempts to Dispense with Nexus

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Most of the backlash following the Louisiana Legislature's 2016 First Extraordinary Session (Session) seemed to focus on the additional one percent state sales and use tax and the suspension of numerous sales and use tax exemptions and exclusions. However, the changes to the Louisiana corporate franchise tax adopted during the Session appear to be potentially more far reaching than the changes to the state sales and use tax. For tax periods beginning on or after January 1, 2017, Act 12 (signed by the Governor and effective March 10, 2016) expands the Louisiana corporate franchise tax to all entities (whether state law corporations or not) taxed as C corporations for federal income tax purposes including those entities whose only connection with Louisiana is through an ownership interest in a second entity doing business in Louisiana.

Pre-Session Louisiana Corporate Franchise Tax Law

Under Louisiana Revised Statutes 47:601, the general rule was that every corporation incorporated in Louisiana and every corporation incorporated outside Louisiana, exercising its charter, or qualified to do business or actually doing business in Louisiana, or owning or using any part or all of its capital, plant, or any other property in Louisiana was required to pay an annual corporate franchise tax. The rate remains the same following the Session: \$1.50 for each \$1,000, or major fraction thereof on the first \$300,000 of the corporation's taxable capital and at the rate of \$3.00 for each \$1,000, or major fraction thereof, which exceeds \$300,000 of taxable capital. "Taxable capital" means the amount of a corporation's issued and outstanding capital stock, surplus and undivided profits. Fortunately, taxable capital no longer includes long-term debt, historically a major disincentive for businesses thinking about moving to, or incorporating in, Louisiana.

What was clear under the old law is that a non-corporate entity such as a limited liability company or a partnership, even if taxed as a C corporation under the Federal check-the-box rules, was not subject to Louisiana corporate franchise tax. Less clear was the extent to which corporations incorporated outside of Louisiana but owning interests in non-corporate entities formed or doing business in Louisiana would be subject to the Louisiana corporate franchise tax. The Louisiana Department of Revenue (Department) certainly made its attempts to impose the franchise tax on these out-of-state corporations. The battle lines were ultimately drawn with respect to this issue in *Utelcom, Inc. v. Bridges*, 77 So.3d 39 (La. App. 1st Cir. 9/12/2011, *rehearing denied*).

In *Utelcom*, the Department attempted to impose Louisiana corporate franchise tax on two corporations incorporated respectively in Kansas and Missouri. The corporations' only connection to Louisiana was that they owned limited partnership interests in a Delaware limited partnership that was registered in Louisiana as a foreign limited partnership and conducted business in Louisiana. The corporations contended that they were not subject to the franchise tax for the relevant periods because they were non-resident corporations whose only contacts with Louisiana were through their passive ownership interests as limited partners in a limited partnership that owned property and conducted business in Louisiana.

The Department did not dispute that during the relevant periods neither corporation was registered or qualified to do business in Louisiana; engaged in any business activities in Louisiana; rendered any services to or for any affiliate, or to or for any other party in Louisiana; had any employees, independent contractors, agents or other representatives in Louisiana; bought, sold, or procured any services or property in Louisiana; or

maintained any bank accounts in Louisiana. Furthermore, each corporation maintained its office and only commercial domicile outside Louisiana, where the corporations maintained their respective corporate books and records and where all management decisions regarding their respective limited partnership interests were made and implemented. Nevertheless, the Department contended that the corporations were subject to Louisiana franchise tax based on the actions of the limited partnerships in which they owned limited partnership interests.

In addition to claiming that the Department had improperly applied the Louisiana statutes pertaining to the imposition of the franchise tax to them, the corporations further contended that the proposed assessment of the franchise tax by the Department violated the privileges, immunities and protections afforded them by the Commerce Clause of the United States Constitution and the Due Process and Equal Protection Clauses of the United States and Louisiana Constitutions.

The *Utelcom* appellate court found for the corporations relying heavily on the fact that under pre-Session Louisiana Revised Statutes 47:601(A)(3), the franchise tax was imposed only on a corporation owning or using any part or all of its capital, plant, or other property in Louisiana in a *corporate capacity* and that no mention was made in the statute of the use of capital through a partnership or in any other indirect capacity. The court determined that because it had already determined that assessment of the franchise tax on the corporations was improper under the language of the statute itself it would not pass on the constitutionality of the Department's proposed franchise tax.

At a recent meeting a Department spokesman reported that in 2015 alone the Department had settled more than 60 cases with taxpayers who had established that their circumstances were sufficiently similar to the taxpayers in *Utelcom*.

Post-Session Louisiana Corporate Franchise Tax Law

With Act 12, the Louisiana Legislature revised the Louisiana corporate franchise tax law in three key respects:

- First, new Louisiana Revised Statutes 12:1368 was revised to provide that for state income and franchise tax purposes, a limited liability company will be treated and taxed in the same manner that it is treated and taxed for federal income tax purposes, meaning that if a non-corporate entity such as a limited liability company or partnership has checked the box to be taxed as a C corporation it will be subject to Louisiana corporate franchise tax.
- Second, new Louisiana Revised Statutes 47:601(A)(3) (relied on by the *Utelcom* court) was revised to expand the reach of the Louisiana franchise tax beyond just entities owning or using any part or all of their capital, plant, or other property in Louisiana in a *corporate capacity* to any entity owning or using any part or all of their capital, plant, or other property in Louisiana whether owned directly or indirectly by or through a partnership, joint venture, or any other business organization of which the entity is a related party as defined under rules similar to the control group rules under Internal Revenue Code 1563.
- Third, new Louisiana Revised Statutes 47:601(C)(1) was revised to provide that the entities subject to the reach of new Louisiana Revised Statutes 47:601(A)(3) includes all entities taxed as C corporations for Federal income tax purposes.

Under new Louisiana Revised Statutes 47:601(A)(3), an entity taxed as a C corporation for Federal income tax purposes and having no contacts with Louisiana except through its ownership of a second entity formed or doing business in Louisiana will be related to the second entity and, thus, potentially subject to the Louisiana franchise tax if, among other scenarios:

- The entity owns 80 percent by vote or value of the ownership interests in the second entity.
- Five or fewer individuals, estates or trusts own actually or constructively more than 50 percent by vote or value of both the entities.

Presumably, the Department believes that Act 12 has filled the statutory gap, as described in *Utelcom*, in its ability to reach beyond Louisiana borders to tax entities that have no contacts with the state except through their ownership interests in pass-through entities doing business in the state. However, there remains constitutional issues with the new law that the *Utelcom* appellate court did not address which could be used to defeat the extended reach of the new franchise tax law.

Arguably, a non-Louisiana entity that has no contacts with Louisiana except through its ownership interest in a second entity formed or doing business in Louisiana, particularly if the non-Louisiana does not manage the second entity, has not established the minimum contacts necessary under the Due Process Clause of the United States Constitution to be subject to tax in Louisiana.

On May 4, 2016, in *Corrigan v. Testa*, case number 2014-1836, the Ohio Supreme Court unanimously held that Ohio could not tax a nonresident's capital gains from the sale of a limited liability company that conducted some business in the state, reasoning that it would be a violation of the Due Process clause of the United States Constitution. Similar to Louisiana's new franchise tax law, in 2002 the Ohio Legislature had amended its income tax law to expand its reach to out-of-state investors in pass-through companies if the investor held at least a 20 percent share in the entity. The Ohio Supreme Court explained that this case was distinguishable from its other cases where the proposed tax was based on income derived from instate activities. In *Corrigan v. Testa*, the non-resident's income that he derived from the sale of his interest in the Ohio limited liability company did not result from instate activities. In this way, the Ohio Supreme Court struck down the proposed income tax as being unconstitutional as applied to the taxpayer but did not strike it from the books entirely explaining that it had not been established that there was no set of circumstances under which the amendment would be valid. It remains to be seen under what set of circumstances a Louisiana franchise tax on an out-of-state company based solely on its ownership interest in another company doing business in Louisiana would be constitutional.

If you or your company is potentially subject to Louisiana franchise tax under this new and far-reaching franchise tax law and would like to discuss defenses, including constitutional challenges, or if you have questions regarding any other Louisiana tax issues, please contact the author of this alert, Robert L. Wollfarth, or any of the attorneys in the Firm's Tax Group.