



Iowa General Assembly

2017 Legal Updates

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CORPORATE INCOME TAX—TAXABLE NEXUS WITH REGARD TO OWNERSHIP AND CONTROL OF SUBSIDIARY

Filed by the Iowa Supreme Court

March 24, 2017

Myria Holdings Inc. & Subs v. Iowa Department of Revenue

No. 15-0296

http://www.iowacourts.gov/About_the_Courts/Supreme_Court/Supreme_Court_Opinions/Recent_Opinions/20170324/15-0296.pdf

Background Facts and Prior Proceedings. Myria Holdings Inc. (Myria), a Delaware corporation with its principal place of business in Texas, joined in filing a consolidated Iowa income tax return for tax year 2009 with two of its corporate subsidiaries doing business in Iowa: Natural Gas Pipeline Company of America (NGPL) and NGPL PipeCo (PipeCo). Although both NGPL and PipeCo are limited liability companies, they elected to be treated as corporations under federal tax law, so must also be treated as corporations under Iowa tax law. A consolidated tax return is a single comprehensive tax return covering the activities of all corporations within an affiliated group of corporations that share common ownership.

All three corporations are in the business of natural gas pipeline transmission and storage, but play different roles within the group (Myria, NGPL, and PipeCo). Myria, as the parent company, received from each subsidiary distributions of earnings as well as payments of each subsidiary's allocated tax liability, because Myria was responsible for making federal tax payments for the entire group pursuant to an intercompany tax allocation agreement. Myria did not report any Iowa receipts, nor did it receive any interest, fees for service, or any other fees under the tax allocation agreement in connection with its payment of the group's tax liabilities. Although NGPL earned a net income, the group's federal and Iowa consolidated tax returns reported a net loss.

The Department of Revenue (department) determined Myria was ineligible to join in the Iowa consolidated tax return pursuant to Iowa law. Excluding Myria (and its net loss) from the group's Iowa tax return caused the group to have a net income and positive tax liability in Iowa. Therefore, the department issued a notice of assessment against the group.

Myria protested the tax assessment, which was upheld on administrative appeal by the department. The district court later affirmed the department's decision after Myria sought judicial review. Myria filed this appeal to the Iowa Supreme Court (Court).

Issue. Whether the activities of Myria in Iowa are limited to the ownership and control of a subsidiary corporation within the state which would exempt Myria from being subject to the Iowa corporate income tax pursuant to Iowa Code section 422.34A(5).

Analysis. The Court started its analysis by identifying the Iowa corporate income tax statutes at issue. Iowa Code section 422.33(1) provides that a corporation is subject to the Iowa corporate income tax if it is "doing business in this state, or deriving income from sources within this state," and Iowa Code section 422.37 permits such a corporation to join an Iowa consolidated tax return with other members of an affiliated group subject to the tax. However, Iowa Code section 422.34A(5) provides a safe harbor from being subject to the Iowa corporate income tax for a foreign corporation whose activities in Iowa are limited to "[o]wning and controlling a subsidiary corporation" and the foreign corporation lacks a physical presence in Iowa related to that ownership or control.

The parties agreed Myria lacked a physical presence in Iowa with regard to its ownership of the subsidiaries. But Myria argued that its Iowa activities were more than, or different from, the activities of simply owning and controlling a subsidiary. As a result, it should not be exempt from taxation under Iowa Code section 422.34A(5), and therefore should not be prohibited from joining a consolidated Iowa tax return. Myria's activities included coordination on tax compliance, financial reporting, intragroup distributions, legal and financial matters, and setting strategic priorities. It also assisted with day-to-day operations and made interest payments to lenders at each level of the parent-subsidiary hierarchy. Myria also argued that it provided working capital to its subsidiaries under its tax allocation agreement because, while its subsidiaries' tax obligations accrued daily, they were paid to Myria only quarterly. Myria contended that this provision of working capital went beyond the mere ownership or control of a subsidiary.

The Court first defined the terms "owning" and "controlling" in Iowa Code section 422.34A(5), after reviewing the relevant dictionary definitions and the history and context of the statute, because those words were not defined by the Iowa Legislature in the statute or by the department in associated administrative rules. The Court concluded that "owning" and "controlling" respectively mean "the holding of the possessory right to use and manage a subsidiary and the holding of the power or authority to directly or indirectly manage, direct, or oversee a subsidiary's management and policies." The Court found that Myria's activities in Iowa were all related to owning or controlling a subsidiary within the meaning of Iowa Code section 422.34A(5).

Myria next argued that it nonetheless had a taxable nexus in Iowa because it owned two types of intangible property in Iowa, namely, shares of stock in its subsidiaries and money. Although the department's administrative rules list both as types of intangible property that may acquire a location in Iowa, the Court rejected these arguments. First, the Court held that ownership of such stock shares does not, by itself, create a taxable nexus for Myria. If it did, the safe harbor provisions of Iowa Code section 422.34A(5) would be rendered meaningless because that statute necessarily contemplates the existence of an ownership interest by the parent in the subsidiary. Second, the Court held that the temporal lag between when the subsidiaries' tax obligations accrued (daily) and when they were paid to Myria (quarterly) did not transform the payments to money assets of Myria in the interim.

Holding. All of Myria's activities in Iowa were routine features of a parent corporation's ownership and control of its subsidiaries and fall within the safe harbor from being subject to the Iowa corporate income tax in Iowa Code section 422.34A(5). Thus, Myria did not establish a taxable nexus with Iowa. As a result, Myria could not join in a consolidated Iowa income tax return pursuant to Iowa Code section 422.37. Because Myria lacked a taxable nexus with Iowa, the Court determined that it did not need to consider whether the distributed earnings or tax allocation payments under its tax allocation agreement would constitute taxable income under Iowa Code section 422.33(1).

The Court noted that its holding in this case is compatible with its prior holding in *KFC Corp. v. Iowa Department of Revenue*, 792 N.W.2d 308 (Iowa 2010), in which it determined that Iowa could impose the corporate income tax on a foreign corporation whose only connections to Iowa were franchise agreements through which it licensed its trademarks and systems to independent franchisees doing business in Iowa. Unlike *KFC Corp.*, Myria received no royalty payments, license fees, or other earned fees in connection with a group's business in Iowa.

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