SALTrends - Multistate Income Tax: Year in Review and 2021 Outlook

December 3, 2020

Note

1. This presentation is intended to make participants aware of tax issues that may apply to this audience.

2. Information presented herein is not intended to be tax advice.

3. Please consult with a qualified practitioner for tax advice related to specific transactions.

Speakers

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Agenda

- Recent multistate and local income tax updates
- Income tax nexus outlook
- State tax impacts of COVID-19 relief legislation
- Employment tax challenges in the year ahead

Multistate and Local Income Tax Updates

Multistate and Local Income Tax Updates

Tax Rate Updates

- New Jersey corporation business tax surtax extended through 2023.
- Colorado voters approved a retroactive reduction in the state's flat income tax rate for individuals and corporations from 4.63% to 4.55%, effective with taxable years commencing on or after January 1, 2020.
- Illinois voters rejected an amendment that would have allowed the state to impose a progressive rate structure on the individual income tax and would have increased the state's corporate tax rate.
- Proposition 208 in Arizona imposes a 3.5% income tax surcharge on taxable income over $250,000 for individuals and $500,000 for married couples. This is effective January 1, 2021. However, Prop. 208 is now being challenged in Court.
- In Ohio, City of Toledo tax rate will increase to 2.5% effective January 1, 2021.

Multistate and Local Income Tax Updates

Tax Cuts and Jobs Act

- Continue to see guidance from the states on the treatment of GILTI and 163(j). For example, on November 19, 2020, Nebraska issued a General Information Letter on the treatment of GILTI and FDII.
- States are still reviewing potential workarounds for the $10,000 "SALT Cap." The IRS published Notice 2020-75.
- The $10,000 SALT Cap may be impacting state residency decisions.
- The CARES Act modified certain provisions of the TCJA.

Multistate and Local Income Tax Updates

IRS Notice 2020-75

- On November 9, 2020, the IRS announced that it intends to issue proposed regulations to clarify that state and local income taxes imposed on and paid by a partnership or an S corporation on its income are allowed as a deduction by the partnership or S corporation in computing its non-separately stated taxable income or loss for the taxable year of payment.

- For states that have enacted *an entity-level pass-through entity tax*, the entity can deduct the SALT taxes paid.

- This concept is meant to be a workaround to the $10,000 cap on state and local taxes ("SALT Cap") that an individual can deduct as an itemized deduction.

- Seven states have enacted some type of entity-level pass-through entity tax. They are CT, LA, MD, NJ, OK, RI and WI.

Multistate and Local Income Tax Updates

IRS Notice 2020-75 – cont'd

- In CT, pass-through entity filing is required, but composite is elective. In the other states, filing at the entity level is elective.
- This Notice does not change the treatment of payments made *on behalf of* PTE owners.
- Individual owners need to consider the impact of entity-level taxes on their resident state credits.
- If Congress and the Biden administration change the cap, these SALT cap workarounds may not be as impactful.
- We will likely see more states propose entity-level pass-through entity taxes.

Multistate and Local Income Tax Updates

Other Multistate Trends

- Many states enacted legislation to address conformity with both the TCJA and the CARES Act.
- Ohio is currently in conformity with federal law as it existed on March 27, 2020, the date the CARES Act was signed into law. However, Ohio law continues to decouple from certain IRC provisions, such as the deductibility of §179 and §168(k) depreciation.
- States continue to switch to market-based sourcing of service revenues. For 2020, Hawaii, Missouri, New Mexico, North Carolina and Vermont are now market-based sourcing states. Remember to confirm both corporate and individual income tax guidelines.
- For corporations, New Mexico requires combined reporting for tax years beginning on or after January 1, 2020.
- Amnesty programs: Information will be forthcoming from Nevada. The City of Los Angeles is offering a Tax Penalty Amnesty Program through December 17, 2020.

Multistate and Local Income Tax Updates

Ohio Business Income Deduction

- The Ohio Department of Taxation continues to heavily review the Ohio Business Income Deduction and related business income tax rate.
- This issue is particularly important when selling a business.
- Taxpayers also need to be aware of ORC §5747.212 and the impact of *Corrigan v. Testa*, 149 Ohio St.3d 18, 2016-Ohio-2805.

Income Tax Nexus Outlook

Income Tax Nexus Outlook

Income Tax Nexus

- Whether physical presence is necessary to create income tax nexus has been a topic of debate for many years.
- In 1993, in Geoffrey, Inc. v. South Carolina Tax Commission, the South Carolina Supreme Court held that physical presence was not required for the imposition of income tax.
- The court concluded that the presence in South Carolina of Geoffrey's intangibles was enough to establish substantial nexus for corporation income tax.
- Quill is a sales and use tax case only!
- Given the uncertainty of the concept of economic nexus, we began to see the adoption of factor-presence, or bright-line, nexus standards.

Income Tax Nexus Outlook

Factor-Presence Nexus

- For corporate income tax and gross receipts tax purposes, some states have already enacted factor-presence nexus standards.
- Out-of-state corporations are deemed to have nexus for corporate income tax or gross receipts tax purposes where they have property, payroll, or sales in those states that exceed the statutory thresholds.
- States with a factor-presence nexus standard for income tax include Alabama, California, Connecticut, Colorado, Michigan, New York and Tennessee.
- States with a factor-presence nexus standard for gross receipts tax include Nevada, Ohio and Washington.
- In 2016, the Ohio Supreme Court ruled that the bright-line presence standard of the Ohio Commercial Activity Tax (CAT) satisfied the substantial nexus requirement under the Commerce Clause of the U.S. Constitution.

Income Tax Nexus Outlook

Public Law 86-272

- P.L. 86-272 is a federal law that prohibits states from imposing a net income tax upon an out-of-state company if the company's activities in a state are limited to the solicitation of orders for the sale of tangible personal property and the orders are approved and filled from outside the state.
- P.L. 86-272 does not protect a company from state franchise tax.
- *Wayfair* does ***not*** overrule P.L. 86-272.
- P.L. 86-272 will remain in force unless Congress decides to change it.
- The general consensus currently in the state tax community is that Congress will not eliminate P.L. 86-272.
- Federal Bill H.R. 3063 – Business Activity Tax Simplification Act of 2019

Income Tax Nexus Outlook

Economic Nexus Thresholds

- Washington recently updated its economic nexus standard for B&O Tax. Effective 1/1/20, the threshold matches the $100K (gross income) sales tax threshold.

- Hawaii was the first state to enact a sales or transaction nexus standard for an income tax based on the economic sales tax nexus thresholds at issue in *Wayfair*.

- Effective for tax years beginning after December 31, 2019, if a business engages in or solicits 200 or more business transactions with persons in Hawaii or the person's gross income attributable to Hawaiian sources is $100,000 or more, it will be subject to Hawaii business taxes.

- Texas, Pennsylvania, Massachusetts and the City of Philadelphia have followed with economic nexus thresholds.

Income Tax Nexus Outlook

Impact of COVID-19

- Some states have released guidance on the income tax nexus implications of teleworkers due to COVID-19.
- Of those states, the majority have said that they will not impose nexus due to employees temporarily teleworking in their states.
- Per California FTB website, California will not treat an out-of-state corporation whose only connection to California is the presence of an employee who is currently teleworking in California due to Executive Order N-33-20 as being actively engaged in a transaction for the purposes of financial or pecuniary gain or profit.
- Indiana will not use temporary telework during the pandemic as the basis for establishing Indiana nexus or for exceeding the protections provided by P.L. 86-272 for the employer of the temporary relocated employee.
- Teleworkers may have an impact on state income tax apportionment and sales sourcing for apportionment purposes.
- Many states have *not* released guidance on this topic.

Income Tax Nexus Outlook

What's next?

- As a result of Wayfair and budget shortfalls due to COVID-19, states will likely be more aggressive in trying to impose income tax nexus.
- More states may enact factor-presence nexus standards for corporation income tax purposes.
- Look for an increase in state nexus questionnaires.
- Companies may need to evaluate their no nexus positions for income tax purposes, as well as any potential financial statement implications.
- In regards to teleworkers, companies will need to understand which arrangements are temporary versus permanent.
- When registering for sales tax or employer withholding, it is a good time to review income tax nexus positions.

State Tax Impacts of COVID-19 Relief Legislation

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Multistate Income Tax

- Review state conformity to the Internal Revenue Code.
- If some states don't take action, it's possible that taxpayers could face unexpected state tax bills. For example, questions have emerged about the state taxability of Paycheck Protection Program (PPP) loan forgiveness. Under the CARES Act, PPP loan forgiveness is not taxable for federal income tax purposes. However, if some states don't take action, they may end up unintentionally taxing this income.
- Even if a state conforms, has it decoupled from any specific provisions? For example, many states decouple from federal bonus depreciation.
- Taxpayers will need to confirm the state treatment of certain provisions under both the TCJA and CARES Act.

State Tax Impacts of COVID-19 Relief Legislation

Multistate Income Tax – cont'd

- Specific CARES Act provisions that must be addressed on a state-by-state basis include:
  - Net operating loss utilization and carrybacks
  - IRC § 163(j)
  - Taxability of PPP loan forgiveness
  - Correction of the "retail glitch" related to qualified improvement property
  - Modification of §461(l) excess business loss limitations
- Because Indiana does not allow NOL carrybacks, the state does not adopt the 5-year carryback provision in the CARES Act.
- Kentucky does not adopt the 5-year carryback provision in the CARES Act.
- Ohio adopts the 5-year carryback provision of the CARES Act. For tax years beginning after December 31, 2020, no carryback is allowed.

State Tax Impacts of COVID-19 Relief Legislation

Ohio Commercial Activity Tax

- Per the Ohio Department of Taxation COVID-19 Tax Relief website:
  - The amount of a PPP loan and any amount of the loan that is forgiven under the CARES Act is excluded from a taxpayer's gross receipts for purposes of the Ohio CAT.
  - Economic injury disaster loan (EIDL) advance grants of up to $10,000 authorized by the CARES Act are *not* excluded from CAT gross receipts under uncodified section 36 of Am. Sub. H.B. 481.
  - The employee retention tax credits authorized by the CARES Act are excluded from CAT gross receipts under R.C. 5751.01(F)(2)(m), which excludes tax refunds and other tax benefit recoveries.

State Tax Impacts of COVID-19 Relief Legislation

Ohio Commercial Activity Tax – cont'd

- Per the Ohio Department of Taxation COVID-19 Tax Relief website:
  - The CARES Act established the Coronavirus Relief Fund, which some local governments have used to establish grant programs to support businesses. The receipt of such a grant by a business is not excluded from gross receipts for the CAT. If the local government extends a loan to a business using these funds (and the loan was not forgiven), the amount of the loan is excluded from gross receipts for the CAT under R.C. 5751.01(F)(2)(e).

Employment Tax Challenges in the Year Ahead

Employment Tax Challenges in the Year Ahead

Mobile or Telecommuting Employees

- With the advancement of technology, the use of the Internet to reach more customers, and the increase of business travel, a greater number of companies have employees who:
  - Work remotely from home;
  - Travel to new states for short periods of time on a project-by-project basis.

- In 2020, we are seeing unprecedented telecommuting due to COVID-19. Telecommuting employees can create tax obligations or liabilities for businesses in a state where a business doesn't otherwise have nexus.

- Registering for one tax type will put a company on a state's radar for other taxes.

Employment Tax Challenges in the Year Ahead

Impact of Telecommuting Due to COVID-19

- Employers must understand income tax withholding for remote workers and the nexus implications of income tax withholding.
- Will the employee be telecommuting temporarily or permanently?
- Employers must be aware of jurisdictions that use the "convenience of the employer" test. Compensation is sourced to the employer's location where the employee is based unless the arrangement is for the employer's necessity. Applicable states include CT, DE, NE, NY and PA.
- Employers must also consider states with reciprocal agreements.
- Similar to income tax, some states have issued guidance on withholding requirements due to COVID-19 remote work.
- Local rules may differ from state rules.
- Need to review state unemployment tax implications.

Employment Tax Challenges in the Year Ahead

Unemployment Tax Rates

- Ohio unemployment tax rates are to increase for 2021 because a mutualized tax is to be in effect.
- For calendar year 2021, the mutualized tax rate will be 0.5% and is to be added to experienced employers' unemployment tax rates.
- The annual taxable wages base will remain at $9,000.
- Employers must review for rate and/or wage base changes.

Employment Tax Challenges in the Year Ahead

Ohio Municipal Tax Withholding due to COVID-19

- Ohio House Bill 197 allowed employers to continue to withhold municipal income tax in the city of the employee's traditional workplace during the health emergency plus 30 days.
- Senate Bill 352 was recently introduced to repeal this piece of legislation.
- The Buckeye Institute filed a lawsuit against the City of Columbus and the State of Ohio.
- This will continue to be a topic of discussion in 2021.

Employment Tax Challenges in the Year Ahead

Federal Legislation

- Over the years, legislation has been introduced to both the House of Representatives and the Senate in order to simplify state income tax issues for mobile workforces.
- The Remote and Mobile Worker Relief Act of 2020 (S. 3995) was introduced on June 18th.
- Employees and employers would be relieved of nonresident income tax and withholding if employees are working in the nonresident state for less than 30 days in the calendar year.
- S. 3995 would, through December 31, 2020, increase the 30-day threshold to 90 days for employees temporarily working in a state due to COVID-19. S. 3995 also provides nexus relief for purposes of the imposition of state business taxes due solely to employees temporarily working in the state because of COVID-19.

Employment Tax Challenges in the Year Ahead

Challenges of a Mobile or Remote Workforce

- As we've seen, all of the states and cities are different.
- Employers and employees have difficulty tracking and documenting travel.
- Employers find that allocating wages to multiple taxing jurisdictions is difficult…if not impossible.
- Lack of communication between internal departments can also make tracking employees difficult.
- The administrative burden can be significant.

Looking Ahead to 2021

What will 2021 bring?

- Additional federal and state COVID-19 relief legislation?
- An increase in permanent teleworking arrangements?
- More state and local tax enforcement activities?
- Ohio municipal tax withholding guidance?
- Ohio tax reform in the Fiscal Year 2022-2023 operating budget?

Thank you!

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