SALTrends - Multistate Income Tax: Year in Review and 2022 Outlook

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Speakers

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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.

Multistate Income Tax Updates

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.
- On August 4, 2021, the Multistate Tax Commission (MTC) updated its Statement of Information concerning practices of the MTC and supporting states under P.L. 86-272.
- Added a section on activities conducted over the Internet and includes several examples
- The guidance is not automatically adopted by the States.

Multistate Income Tax Updates

Public Law 86-272 – MTC Examples

"1. The business provides post-sale assistance to in-state customers by posting a list of static FAQs with answers on the business's website. This posting of the static FAQs does not defeat the business's P.L. 86-272 immunity because it does not constitute a business activity within the customers' state."

"5. The business places Internet "cookies" onto the computers or other electronic devices of in-state customers. These cookies gather customer search information that will be used to adjust production schedules and inventory amounts, develop new products, or identify new items to offer for sale. This in-state business activity defeats the business's P.L. 86-272 immunity because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property."

Multistate Income Tax Updates

2021 Income Tax Compliance

- Review for apportionment changes. For example, Alabama is a single sales factor for tax years beginning on or after 1/1/2021, as is West Virginia for tax years beginning on or after 1/1/2022.
- Review each state's rules on the taxability of COVID-related programs and conformity to the IRC and various Acts, such as the CARES Act.
- Many states have changed their corporate and/or individual tax rates.
- Some states, such as Illinois and California, have enacted temporary limitations on NOL carryover deductions.
- Increase in indexed nexus threshold values in California for the tax year 2021. Sales threshold increases to $637,252.
- Colorado has switched from the *Joyce* rule to the *Finnigan* rule for combined groups for tax years beginning on or after January 1, 2022.
- Connecticut is offering a tax amnesty program from November 1, 2021, to January 31, 2022.

Ohio Municipal Income Tax Withholding

2021

- Employers can continue withholding to the employee's principal place of work city through December 31, 2021, for any days an employee works at home or another location in response to the pandemic.
- These wages should be treated the same for net profits tax returns and withholding, e.g. if tax is withheld for Columbus then the wages are included in Columbus wages on the company's Columbus net profits return.
- For March 9, 2020, through December 31, 2021, if an employer withholds for the principal place of work city, no other city can assess that employer for withholding tax or net profits tax based on sourcing the wages in question to the other city.

Ohio Municipal Income Tax Withholding

2021

- An employee may seek a refund from the principal place of work city. A city may not require the employer to provide any statement or documentation other than a statement verifying (i) the number of days the employee worked at the employee's principal place of work, and that (ii) the employer did not already refund any of the withheld taxes to the employee.

Ohio Municipal Income Tax Withholding

Beginning 1/1/2022, local withholding (and net profits) reverts to pre-pandemic rules.

- Withhold for location where employee performs services.
- 20-Day Rule
- Small employer exception

Ohio Municipal Income Tax Withholding

Buckeye Institute v. Kilgore (10th Dist., Nov. 30, 2021). Plaintiffs challenge the state laws regarding local tax during the pandemic.

- Cities may not tax nonresidents on income earned outside the city (Due Process Clause of U.S. Constitution)
- Ohio Constitution does not authorize the General Assembly to expand the taxing power of municipalities
- Franklin County Common Pleas dismissed.
- Court of Appeals affirmed.

New Hampshire v. Massachusetts: U.S. Supreme Court declined to hear NH's challenge to MA's tax on NH residents working remotely in NH. (6/28/2021)

Nexus – Remote Employees

- Some states released guidance on the income tax nexus implications of remote employees due to COVID-19.
- Of those states, the majority said that they would not impose nexus due to employees *temporarily* teleworking in their states.
- Some policies have expired or will expire on 1/1/2022.
- Many states never released guidance on this topic.

Nexus – Remote Employees

- The MTC's Statement on P.L. 86-272 lists as an **un**protected activity:
  - Activities performed by an employee who telecommutes regularly from within the state unless the activities constitute the solicitation of orders for sales of tangible personal property or are entirely ancillary to such solicitation.

Nexus – Remote Employees

- 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 AR, CT, DE, NE, NY and PA.

Nexus – Remote Employees

- Employers must also consider states with reciprocal agreements.
- Local rules may differ from state rules.

Nexus - Remote Employees

What's next for companies?

- Update withholding and based on remote workers, where applicable. Temporary v. permanent?
- Remote employees may have an impact on state and local apportionment and sales sourcing for apportionment purposes.
- Companies should reevaluate their no nexus positions for income tax purposes, and any potential financial statement implications.

Nexus - Remote Employees

What's next for states and tax agencies?

- As a result of *Wayfair* and budget shortfalls due to COVID-19, states might be more aggressive in their nexus positions.
- More states may enact factor-presence nexus standards for income tax purposes.
- Look for an increase in state nexus questionnaires.

Elective Pass-Through Entity Taxes

The federal Tax Cuts and Jobs Act of 2017 made numerous changes to the individual income tax, e.g.,

- Reduced marginal tax rates
- Increased the standard deduction
- Capped the itemized deduction for state and local taxes at $10,000.

NY, NJ, CT, MD sued the Treasury Department, arguing the SALT cap is unconstitutional.

- Federal district court dismissed.
- Second Circuit Court of Appeals affirmed (10/5/2021)

Elective Pass-Through Entity Taxes

IRS Notice 2020-75: The IRS intends to issue regulations clarifying that state and local income taxes paid by a partnership or S corporation to satisfy its liability for taxes imposed on the partnership or S corporation, are deductible in computing non-separately stated income or loss.

Regardless of whether the income tax is the result of an election.

Regardless of whether the partners or shareholders receive a state deduction or credit based on their share of the amount paid by the partnership or S corporation.

Any such payments are not taken into account in applying the SALT limitation to an individual partner.

Elective Pass-Through Entity Taxes

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

- Approximately twenty states have enacted some type of entity-level pass-through entity tax, including AL, AR, AZ, CA, CO, CT, GA, ID, IL, LA, MA, MD, MN, NJ, NY, OK, OR, RI, SC and WI.

- Ohio S.B. 246 (in committee) proposes to levy a tax on a pass-through entity's income apportioned to Ohio.

Elective Pass-Through Entity Taxes

- In CT, pass-through entity filing is required, but composite is elective. In the other states, filing at the entity level is generally elective.
- Individual owners need to consider the impact of entity-level taxes on their resident state credits.
- We will likely see more states propose entity-level pass-through entity taxes. Others proposed in NC, PA and MI.
- Build Back Better: The House passed an increase of the SALT cap to $80,000. The Senate could make changes.

Ohio Legislation

2022/2023 Biennial Budget Bill

- Reduced income tax rates, top rate now 3.99%
- New deduction (beg. 2026) for capital gains of investors in certain Ohio-based Venture Capital Operating Companies certified by Dept. of Development
- New deduction (beg. 2026) relating to the sale of certain Ohio-based business, the lesser of either (i) capital gain, or (ii) percentage of the business' payroll equal to the owner's interest

H.B. 228

- Requires the Department of Taxation to notify cities of taxpayers who elect to file net profits returns on the Ohio Business Gateway. Old law required a taxpayer to notify each city.
- Removes payments to a retired owner from a pass-through entity's taxable income.

Ohio Legislation

Introduced

S.B. 246: PTET election

S.B. 247: Clarify definition of “business income.”

Thank you!

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