Multistate Income Tax: Year in Review and 2024 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.

Agenda

1. Multistate income tax trends
2. Noteworthy Ohio income tax developments
3. Reflections on the first year of Ohio's elective pass-through entity tax
4. CAT reforms taking effect in 2024
5. Outlook for Ohio tax legislation

Multistate Income Tax Trends

Tax Rate Reductions

- Reductions in both personal and corporate tax rates in many states, including in some of Ohio's border states.
- On May 4, 2023, Indiana Governor Holcomb signed into law HB 1001, which, starting in 2024, accelerates the personal income tax cuts passed in 2022 under HB 1002. The rate for 2024 will be 3.05%.
- Kentucky reduced personal income tax rate from 5.0% to 4.5% for 2023 and to 4.0% beginning in 2024. H.B. 8 (2022) was superseded by H.B. 1 (2023).
- Michigan announced a personal income tax rate reduction to 4.05% for 2023. The rate will return to 4.25% on January 1, 2024.
- On March 7, 2023, West Virginia Governor Justice signed HB 2526 immediately reducing the income tax in tax year 2023 by an average of 21.25%. Largest tax cut in West Virginia history.

Multistate Income Tax Trends

Tax Rate Reductions

- Arkansas Senate Bill 549 reduces the state's highest corporate income tax rate from 5.3% to 5.1% effective for tax years beginning on or after January 1, 2023.
- Idaho's corporate income tax rate was reduced to 5.8% effective January 1, 2023.
- Utah's corporate income tax rate also reduced to 4.65% for tax years beginning on or after January 1, 2023.
- Philadelphia BIRT rate is reduced from 5.99% to 5.81% for the 2023 tax year.
- When planning for 2023 and 2024 compliance, confirm personal and/or corporate rate reductions in other states.

Multistate Income Tax Trends

State Apportionment

- States are continuing the trend of movement to single-sales factor apportionment.
- Tennessee will phase in single-sales factor apportionment over three years, and it will apply for purposes of determining net earnings under the excise tax and net worth under the franchise tax. For tax years ending on or after December 31, 2025, the state will be fully transitioned to single-sales factor apportionment.
- On Oct. 4, 2023, Massachusetts Governor Healey signed into law H. 4104 which implements single-sales factor apportionment beginning January 1, 2025.
- Montana Senate Bill 124 signed March 13, 2023, implements single-sales factor apportionment effective January 1, 2025.

Multistate Income Tax Trends

State Apportionment – Other Notable Developments

- In New Jersey, for tax years beginning on or after January 1, 2023, taxpayers subject to the NJ Gross Income Tax (GIT) must apportion income using the Corporation Business Tax (CBT) rules.

- Texas reacts to Sirius *XM Radio, Inc. v. Hegar*, No. 20-0462 (Tex. March 25, 2022)

- Arkansas is phasing out its throwback rule over a seven-year period starting in 2024 (HB 1045 enacted April 10, 2023).

Multistate Income Tax Trends

Nexus and P.L. 86-272

- Continued uncertainty around state adoption of the MTC's updated guidelines concerning P.L. 86-272 protected activities.
- New Jersey adopted aspects of the MTC's revised statement on P.L. 86-272 as applied to a seller of tangible personal property. Companies claiming P.L. 86-272 protection in New Jersey should review that position.
- New Jersey also adopted a bright-line nexus threshold for economic nexus in the state. A non-New Jersey corporation will be deemed to have a substantial nexus with New Jersey if it derives New Jersey receipts in excess of $100,000 or has 200 or more separate transactions delivered to customers in New Jersey during the taxable year.
- In *Uline, Inc. v. Comm'r. of Revenue*, File No. 9435-R (Minn. Tax Ct. June 23, 2023), the Minnesota Tax Court reviewed the taxpayer's assertion of P.L. 86-272 protection.

Multistate Income Tax Trends

Enactment of Elective Pass-Through Entity Taxes

- Kentucky HB 360 allows partnerships and other PTEs to elect to pay Kentucky income tax at the entity level for tax years beginning on or after January 1, 2022.

- Indiana Gov. Eric Holcomb signed Senate Enrolled Act 2 into law on Feb. 22, 2023. The law authorizes certain pass-through entities to elect to pay tax at the entity level based on each owner's total share of adjusted gross income. It is retroactively effective for taxable years beginning on or after January 1, 2022.

- Iowa enacted an entity-level tax election for pass-through entities retroactive to January 1, 2022. Iowa's PTET allows a partner or shareholder to claim a credit against the individual and franchise taxes paid.

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Multistate Income Tax Trends

Enactment of Elective Pass-Through Entity Taxes

- On May 31, 2023, Nebraska Governor Pillen signed LB754, which enacted an elective pass-through entity tax that is retroactive to 2018.

- Other states that enacted elective PTETs in 2023 include Hawaii, Montana, and West Virginia.

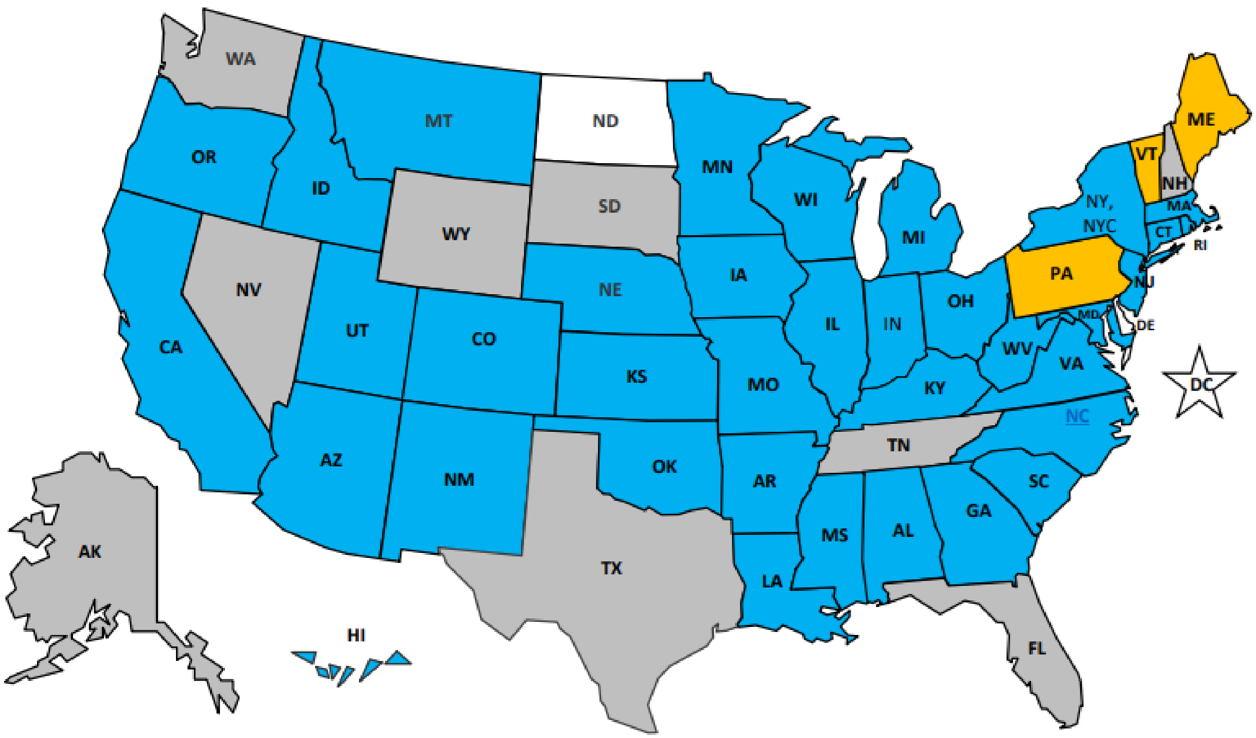
- Several states made important technical corrections and updates to their elective PTET guidance in 2023.

- Connecticut’s PTET will be *elective* for tax years beginning on or after January 1, 2024.

Multistate Income Tax Trends

States with Enacted or Proposed Pass-Through Entity (PTE) Level Tax

As of November 12, 2023



36 states (& 1 locality) that enacted a PTE tax since TCJA SALT deduction limitation, effective for 2021 (or earlier) unless noted:

AL, AR[1], AZ[1], CA, CO[3], CT[4], HI[2], GA[1], IA[1], ID, IL, IN[1], KS[1], KY[1] (& KY) ,LA, MA, MI, MD, MN, MO[1], MS[1], MT[2], NC[1], NE[3], NJ, NM[1], NY, OH[1], OK, OR[1], RI, SC, UT[1], VA, WI, WV[1], and NYC[1]

[1] Effective in 2022

[2] Effective in 2023 or later

[3] Retroactive to 2018

[4] Mandatory

3 states with proposed PTE tax bills:
ME - LD 1891 carried over to next session
PA – SB 659 referred to Finance

VT – SB45 passed Senate, failed in House

9 states with no owner-level personal income tax on PTE income:
AK, FL, NH, NV, SD, TN, TX, WA, WY

3 states with an owner-level personal income tax on PTE income that have not yet proposed or enacted PTE taxes:
DC, DE, and ND

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Multistate Income Tax Trends

Current PTE tax workarounds (36 states and 1 locality)

State	Effective Year	State	Effective Year
Alabama	**2021**	Minnesota	**2021**
Arizona	**2022**	Mississippi	**2022**
Arkansas	**2022**	Missouri	**2022**
California	**2021**	Montana	**2023**
Colorado	**2018 (retroactive)**	Nebraska	**2018 (retroactive)**
Connecticut	**2018 (mandatory 2018-2023, elective starting 2024)**	New Jersey	**2020**
Georgia	**2022**	New Mexico	**2022**
Hawaii	**2023**	New York	**2021**
Idaho	**2021**	New York City	**2022**
Illinois	**2021**	North Carolina	**2022**
Indiana	**2022 (retroactive)**	Ohio	**2022**
Iowa	**2022 (retroactive)**	Oklahoma	**2019**
Kansas	**2022**	Oregon	**2022**
Kentucky	**2022 (retroactive)**	Rhode Island	**2019**
Louisiana	**2019**	South Carolina	**2021**
Maryland	**2020**	Utah	**2022**
Massachusetts	**2021**	Virginia	**2021**
Michigan	**2021**	West Virginia	**2022**
		Wisconsin	**2018**

Multistate Income Tax Trends

Remote Worker Legislation and Issues

- On July 21, 2023, New Jersey Governor Murphy signed into law A.4694, which establishes a convenience of the employer rule, subjecting New Jersey nonresidents assigned to work primarily for a New Jersey employer to New Jersey state income tax and withholding. The law applies only to New Jersey nonresidents who are residents of states that impose a similar rule. This law is retroactive to January 1, 2023.
- On March 8, 2023 the Alabama Tax Tribunal ruled that an Idaho resident who worked remotely for an employer located in Alabama was liable for Alabama tax.
- The Tennessee Department of Revenue's Hearing Office upheld a franchise and excise tax assessment against an out-of-state manufacturer because an engineer was providing services from his Tennessee home office.
- Indiana and Montana both established 30-day withholding thresholds for nonresidents performing services in the state effective January 1, 2024.

Ohio Income Tax Developments – Budget Bill

Income Tax

- Rate reductions for 2023 (3.75% top rate) and 2024 (3.5% top rate)
- Resident Credit amended to include PTET paid to another state but added back to income. Now Ohio residents can benefit from making elections outside Ohio. Effective for 2023 but taxpayers may elect to apply to 2022.

Targeted Incentives

- Home Purchasing Savings Accounts - deductions for contributions (capped $10,000 per year with $25,000 lifetime max), interest earned is deductible. See Treasurer of State announcement 12/4/2023.
- Welcome Home Ohio Program – encourage housing for lower-income owners
- Low-Income Housing Credits – piggyback on the federal credit
- Single-Family Housing Development Tax Credits

Municipal Income Tax Developments

Budget Bill

- Minors are exempt beginning in 2024
- Net Profit Apportionment – Remote Employees. For years ending on or after 12/31/2023, a business with remote employees is permitted to use a modified municipal income tax apportionment formula. Factors associated with such employees will be sourced to the employees' reporting location (e.g., the employees' office).
- Net Profits Tax Return Due Date is extended to November 15th for a calendar year taxpayer with a federal extension.
- Penalties for late filing are limited to $25, and a city must abate a taxpayer's first penalty once the return is filed.

Other Developments

- *Schaad v. Alder* (oral arguments held March 2023): 2020 city income tax refunds?
- Other cases still pending
- No 50% NOL limitation for tax year 2023 and forward

Ohio Pass-Through Entity Tax (PTET)

- Effective for tax years beginning on and after January 1, 2022, an “electing pass-through entity” can make an annual and irrevocable election to be taxed at the entity level.
- This includes a partnership, S corporation, limited liability company or any other person not classified for federal income tax purposes as a corporation.
- Allows taxpayers to deduct Ohio tax at the entity level rather than an itemized deduction on a personal return
- Owners add back the Ohio PTE tax on their individual Ohio returns but then claim a credit against their personal tax liability and any excess is refunded to the individual.
- 2022 Tax Rate: 5.0%, 2023 Tax Rate: 3.0%
- Ohio resident credit now allowed for other states’ elective PTETs

Ohio Pass-Through Entity Tax (PTET)

2022 Complications

- Enactment in late 2022 created uncertainty and complexities.
- 5.0% tax rate required a significant overpayment, to be refunded.
- Resident PTE owners already made income tax estimated payments.
- Deductibility in 2022 – cash or accrual basis?
- Impact of accounting treatment as distribution
- Expansion of the resident credit during 2023 – late in the game for 2022 returns.

Ohio Pass-Through Entity Tax (PTET)

2022 Compliance Developments

- The Ohio Department of Taxation has begun sending variance notices for IT 4738 filers and owners claiming PTET credits.
- Bonus depreciation (see ODT FAQs)
- Addback of PTET deducted for federal purposes (cash v. accrual)
- Adjustments to IT 4738 may require owners to file amended 1040s to claim additional refundable credits.

2023 Compliance Developments

- New form to make the election (Form EPTE-ELEC) – advised but *not required*
- Updates to K-1: tracing of PTET through tiered structures, disclosure of PTET deducted
- Addback of Ohio / other states' PTET on 1040 (Sch. A and IT BUS)
- Credit for PTET paid to another state (IT CR)

CAT Reforms

Ohio's most recent budget bill made significant changes to the Ohio CAT that will take effect on January 1, 2024. Many taxpayers will no longer pay CAT, while the rest will see their CAT liability decrease.

2024: Two important changes take effect in 2024.

- The annual minimum tax ($150, $800, $2,100, or $2,600) is eliminated.
- The exclusion amount increases to $3,000,000. Accordingly, only taxpayers with taxable gross receipts in excess of $3,000,000 will owe CAT for 2024.
- Annual savings of up to $7,800 ($3,000,000 x 0.0026).

2025: The exclusion amount will increase to $6,000,000 for annual savings of up to $15,600.

CAT Reforms

- The Ohio Department of Taxation recently explained how it plans to administer these changes. CAT_2023-01_info_release.pdf (ohio.gov).
- A taxpayer expecting taxable gross receipts of less than $3,000,000 should cancel their CAT account effective 12/31/2023.
- Do not just stop filing!
- After 1/1/2024, an unregistered taxpayer must register and begin filing and paying once it exceeds $3,000,000 taxable gross receipts.
- The exclusion applies to a combined or consolidated group, not each member.
- Draft rule: A taxpayer whose taxable gross receipts would be less than the exclusion amount if it were to make a consolidated election, is not required to register and file the election.

CAT Litigation

Ultimate Destination: Sourcing of receipts from sales of goods in the distribution chain.

- *VVF Intervest* (BTA 2019-1233)
- *Jones Apparel Group / Nine West Holdings* (BTA 2020-53)
- BTA rejected the Tax Commissioner's requirement of contemporaneous knowledge of the ultimate delivery location.
- BTA found that VVF showed sufficient evidence of ultimate delivery, Jones Apparel did not.
- The TC appealed *VVF* to the Ohio Supreme Court, and Jones Apparel appealed too.

Agency Exclusion

- *Aramark* (BTA 2019-2975): The controlling test is whether the purported agent has the authority to bind its client for the activities that generate the receipts.

Ohio Income Tax Legislation

Potential issues

- Additional rate cuts (flat tax?)
- Bonus depreciation
- Municipal income tax
- Targeted incentives (e.g., housing, economic development)
- Sin taxes on newly legalized activities

Other Business Taxes

Sports Gaming Tax

- As enacted, 10% tax on sports gross receipts (eff 1/1/2023)
- Budget Bill increased it to 20% (eff 7/1/2023)
- Senate Bill 190 (Introduced): back to 10%

Issue 2 (Recreational Marijuana) takes effect TODAY (12/7/2023)

- Excise Tax of 10% on the sale of cannabis by a dispensary to a consumer. Sales tax also applies.
- Excise Tax revenues go to a social equity and jobs fund (36%), to cities/townships where dispensaries are located (36%), substance abuse and addiction fund (25%), and 3% to the Tax Commissioner to cover expenses.
- Legislative proposals include:
    - 15% gross receipts tax on dispensaries. Increase the Excise Tax to 15%.
    - Redirect revenue to the GRF, law enforcement training, safe driver training

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Questions

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