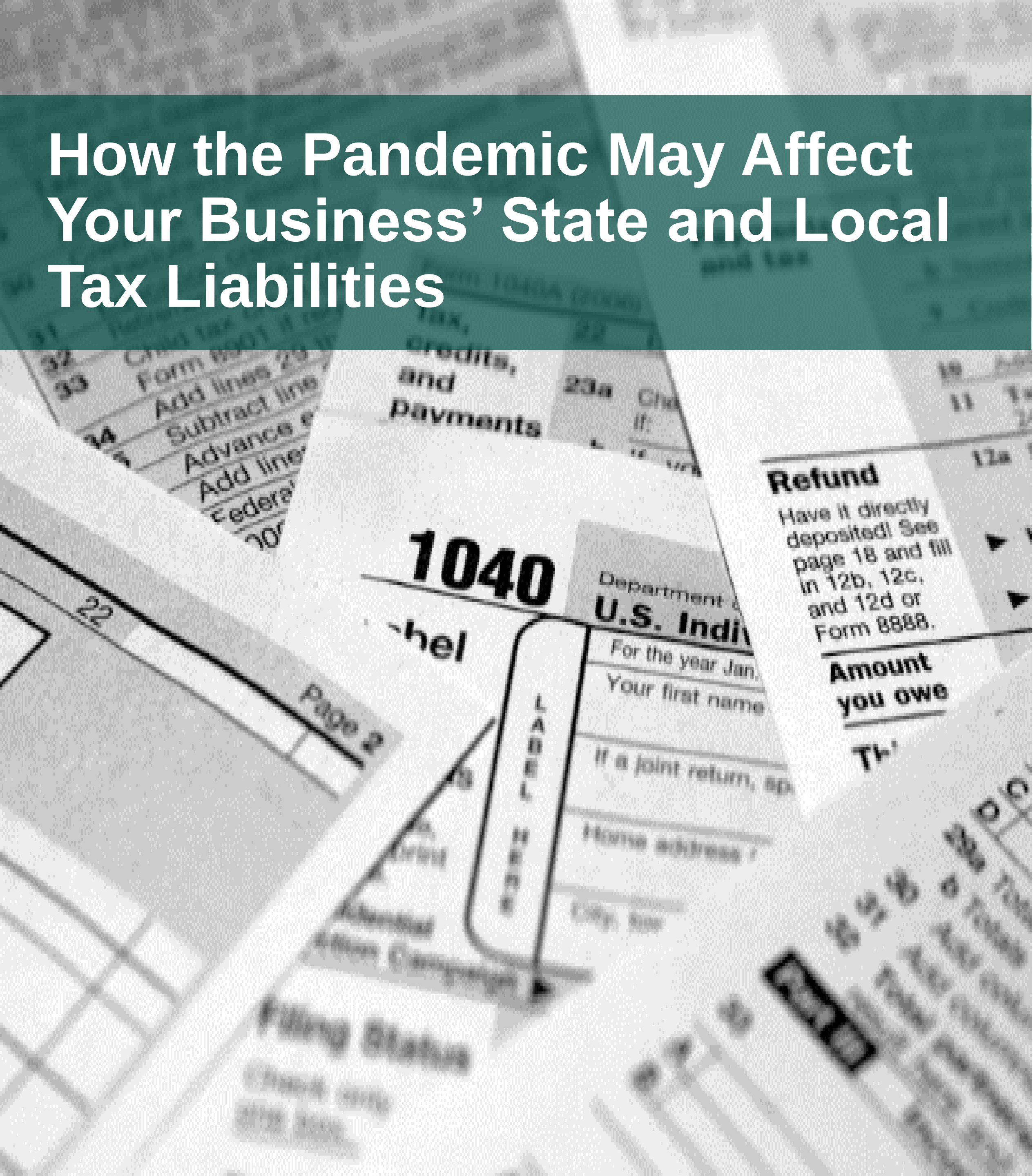
How the Pandemic May Affect Your Business' State and Local Tax Liabilities



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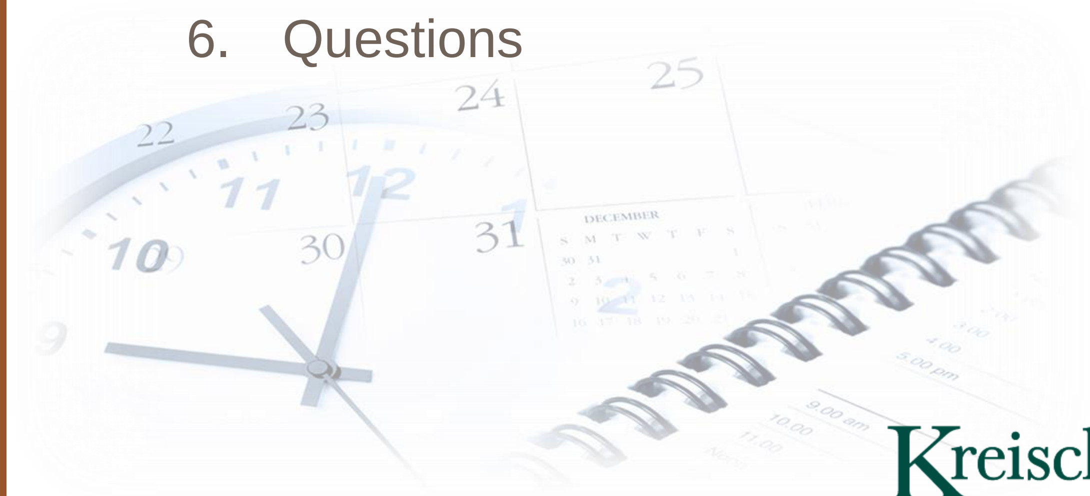
Agenda

1. State of the States Overview
2. State Conformity with Federal Tax Reform
3. Telecommuting
4. Sales Tax Considerations
5. Predictions
6. Questions



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State of the States Overview

- States are projecting record deficits
  - PA is projecting a $4 billion deficit through end of FYE 2020
    - Philadelphia's projected budget is $600 million
  - NJ is projecting a total deficit of $11 billion through the end of FYE 2021
  - NY is projecting a deficit of $4 - $7 billion dollars through the end of FYE 2021
  - CA is projecting a deficit of $54 billion dollars related to COVID 19 (January 2020 the State was projecting a surplus of $5 billion)

- Budget Impacts
  - Estimated $650 Billion budget shortfalls over the next three years
  - Reductions to Eds and Meds
  - Virtually every aspect of state operations affected
  - States rolling out austerity programs
    - Frozen spending, lay offs, spending cuts

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State of the States *(continued)*

- Limited policy options
  - States cannot borrow as easily as the feds due to constitutional limits or requirements for voter approval
  - Raise revenue through increased/new taxes
  - Cut spending
- Cares Act
  - To date, federal legislation has set aside $150 billion dollars for state, local and tribal governments
  - Additional relief is needed

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State Conformity with Federal Tax Reform

- What does federal tax reform mean at the state level?
  - Depends on the state adoption
  - Some states have what is called fixed date conformity (also called static) with the IRC – adopts the IRC as of a certain date
  - Some states have rolling conformity with the IRC – adopts the most current version of the IRC
  - Some states do not conform to any version of the IRC – adoption of specific provisions within the IRC
- Business interest limitation
  - CARES Act increased the limitation from 30% to 50% of adjusted taxable income for 2019 and 2020
  - Most states with rolling conformity did not decouple from the TCJA and will now automatically adopt the revised limitation
  - NY will still apply the 30% limitation and CA and TX will allow 100%

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State Conformity with Federal Tax Reform

- Net Operating Losses
  - CARES Act reversed modifications enacted as part of TCJA for 2018, 2019 and 2020
  - Most states decoupled from federal NOL provisions in favor of their own state rules by either disallowing carrybacks or limiting the number of carryforward year
- Qualified improvement property
  - Under the CARES Act, QIP became a 15 year asset eligible for bonus depreciation
  - Most states decouple from the federal bonus depreciation rules
  - State conformity to the QIP changes will require specific legislation to adopt this provision of the CARES Act

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Nexus Implications of COVID 19

- Nexus is a connection with a state – no longer required to be a physical connection
- Telecommuting employees can create nexus for employers
    - Sales Tax
    - Income tax
    - Employer withholding
- State adoption of the "convenience of the employer" rule requires state income tax withholding in the location where the employer is physically located
- Some states have issued guidance that states that employees working remotely due to COVID 19 will not trigger nexus

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Nexus Implications of COVID 19

- Suspension of the nexus created by telecommuting employees is only temporary
- Employers will need to address any changes it adopted related to income tax withholding
  - Convenience of the employer rule at the state level
  - Physical location of employees for local EIT
  - Philadelphia City Wage Tax considerations
- Income and sales tax nexus as businesses begin to reopen
  - State guidance lacks specificity

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Sales Tax Considerations

- One of the main sources of funding for governments
- Shelter and work in place requirements during the pandemic have resulted in historic reductions of sales tax collections
- State response to this reality will likely focus one or more of the following:
  - Increase in the sales tax rate – politically unattractive
  - Broadening of the sales tax base - more acceptable and most likely
  - Additional funding sources – typically target out of state taxpayers
    - At home entertainment sources such as gaming and gambling
    - Digital products and services
    - Cloud based solutions such as SaaS, IaaS and PaaS

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Sales Tax Considerations *(continued)*

- Recessions come and go but the changes that result are here forever
- State response will likely include increased audit activity
  - Exemption certificate audits may become more routine
  - Enhanced data mining to identify non-compliant remote sellers
  - Aggressive and expanded interpretations of sales tax policies
- Taxpayers need to be prepared
  - Need to identify state sales tax nexus
  - Understand the taxability of their product/services in the states where nexus exists
  - Consider automating sales tax compliance
  - Develop an internal compliance policy for sales and use tax
  - Proactively manage exemptions

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Predictions

- State and local audits will increase across all taxes
  - Income, employer withholding, sales, unemployment compensation
  - May see industries that are not typically targeted, such as tax exempts, selected for audit
  - Stricter enforcement of exemptions and exemption certificates
- Aggressive enforcement of nexus standards
  - Increase in nexus questionnaires and audits
  - Aggressive enforcement of residency rules (domicile vs residency)
- State pursuit of reduced nexus thresholds
- State adoption of non-income taxes
- States will need to pivot quickly to raise revenue

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Questions?

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Contact the Presenters at kmiller@kmco.com

Thomas M. Frascella
Director, Tax Strategies

Tom has a wide range of experience providing state and local tax services in the areas of income/franchise, sales and use, realty transfer, and unclaimed property taxes to a variety of businesses, including multi-state and multi-national businesses in the light and heavy manufacturing, distribution, life sciences, not-for-profit and services industries. He helps businesses address their multi-state tax needs. Tom has developed a solid understanding of the issues and concerns of growing middle market companies and large publicly-traded enterprises and has been proactive in anticipating their issues and developing solutions to minimize administrative burdens and tax exposures.

Lisa G. Pileggi
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As the Director-in-Charge of Kreischer Miller's Tax Strategies practice, Lisa provides strategic leadership and management of the group, including recruiting, training, team member development, and serving as a resource on technical matters. She is a trusted advisor to her clients, providing tax and business advisory services for a broad range of privately-held businesses including real estate developers and investors, construction contractors, manufacturers, and distributors.

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