State Tax: Multistate Legislative Session Review

Thursday, June 10, 2021

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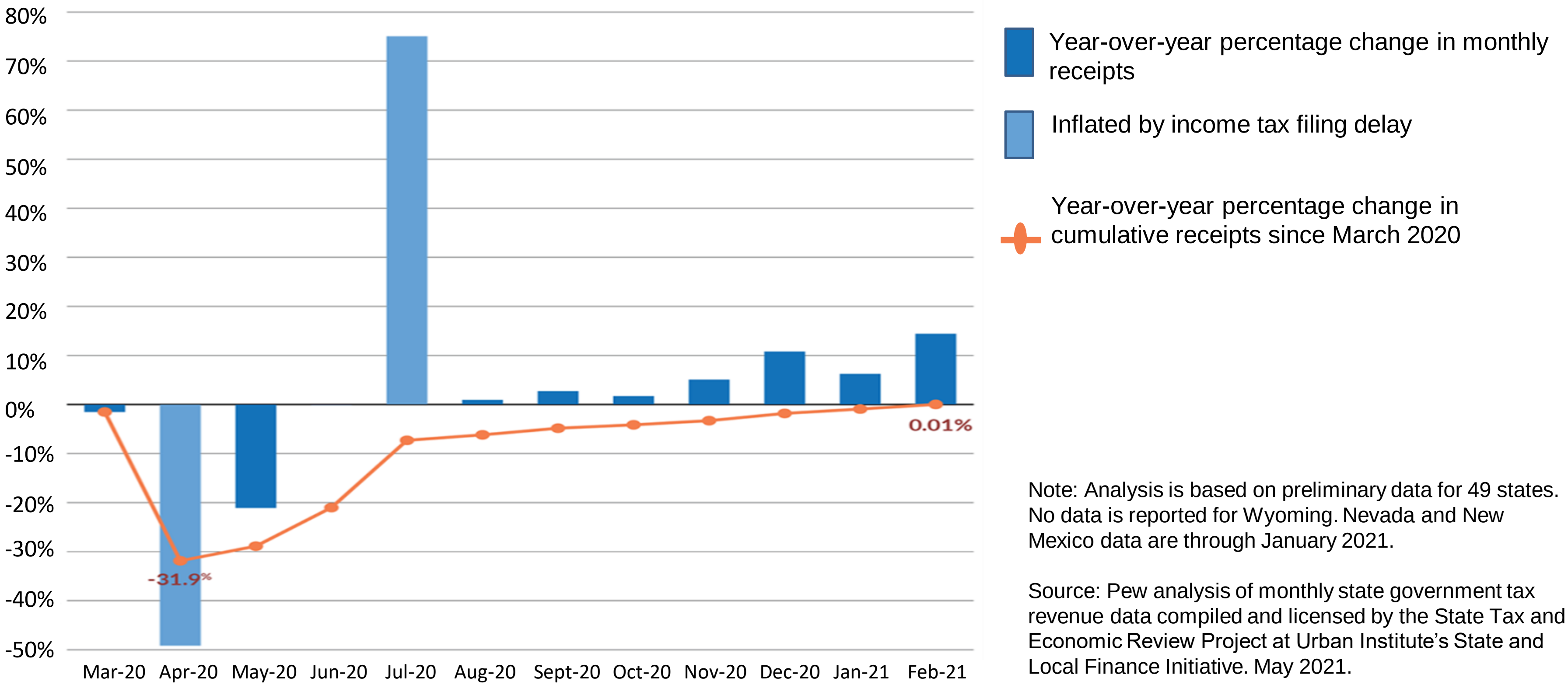
States' Overall Revenue Situation

State Tax Revenues Overcome Early Pandemic Losses

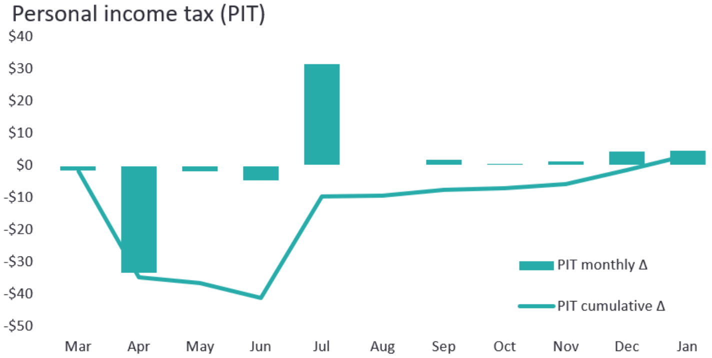
How monthly and cumulative receipts compare with totals from a year earlier

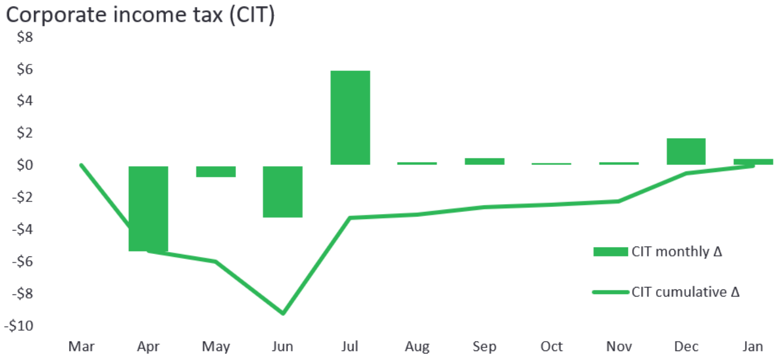


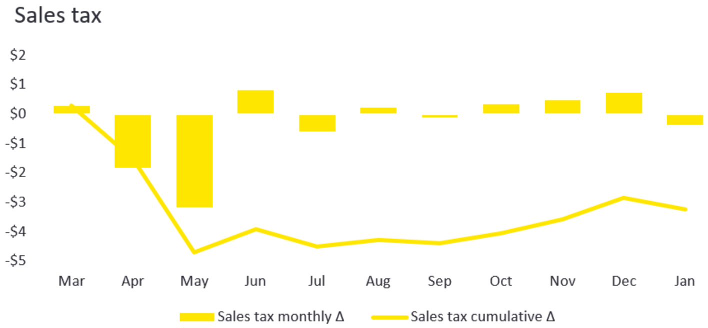
Note: Analysis is based on preliminary data for 49 states. No data is reported for Wyoming. Nevada and New Mexico data are through January 2021.

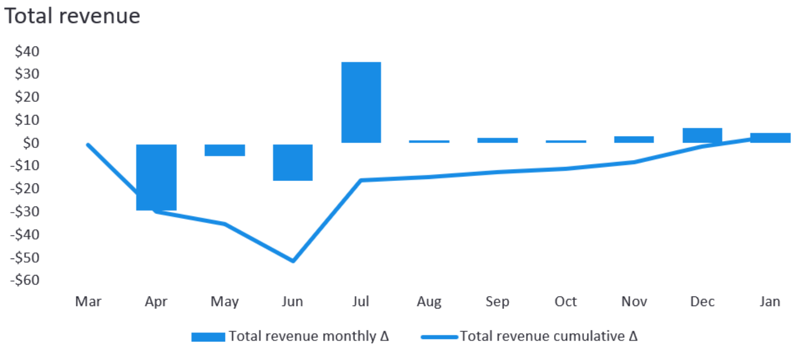
Source: Pew analysis of monthly state government tax revenue data compiled and licensed by the State Tax and Economic Review Project at Urban Institute's State and Local Finance Initiative. May 2021.

State Taxes Have Surpassed Initial Negative Pandemic Fiscal Outlook









Source: EY calculations based on state monthly tax collection reports, top 15 states ranked by 2019 tax collections.

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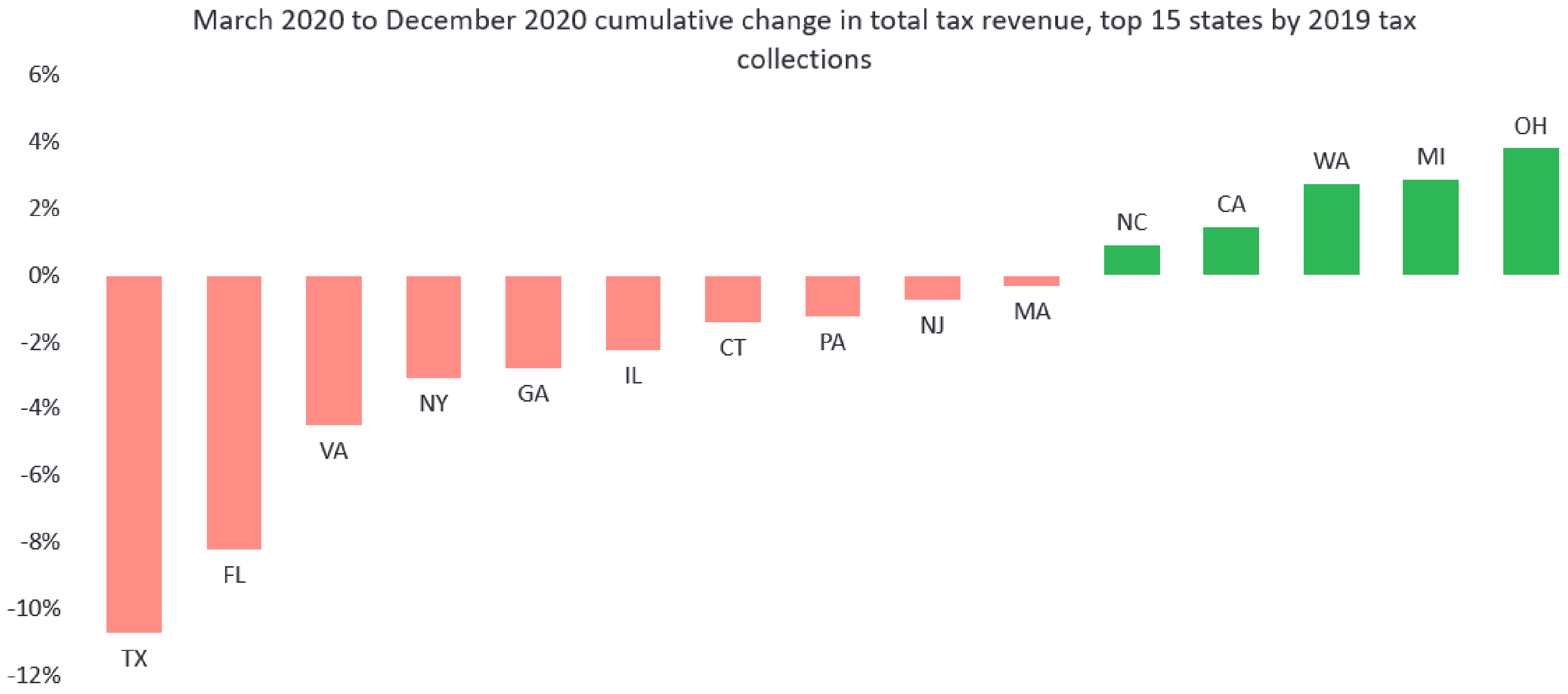
Cumulative Tax Collection Changes March-December 2020



Source: EY calculations based on state monthly tax collection reports, top 15 states ranked by 2019 tax collections.

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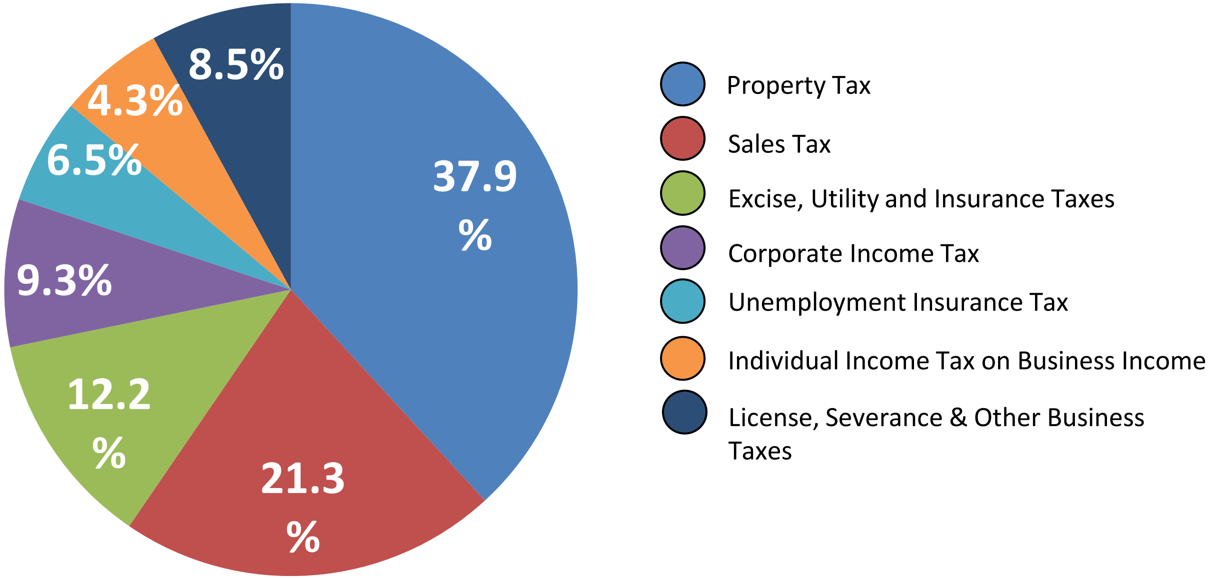
Are Businesses Paying Their Fair Share:

How Much Do Businesses Pay in State and Local Taxes (Pre-COVID-19)?

STATE AND LOCAL BUSINESS TAXES - MINNESOTA



- Businesses paid more than $833 Billion in U.S. state and local taxes in FY19, an increase of 5.7% from FY18
- Total state and local taxes from businesses, individual income taxes on nonbusiness income, and other taxes was $1,893 Billion
- State business taxes increased by 6.3% and local business taxes grew by 5.1%
- In FY19, business tax revenue accounted for approximately 44% of all state and local tax revenue, up from 43.5% in FY18
- Remarkably, the business share of SALT nationally has been within approximately **1% of 44% since FY03**

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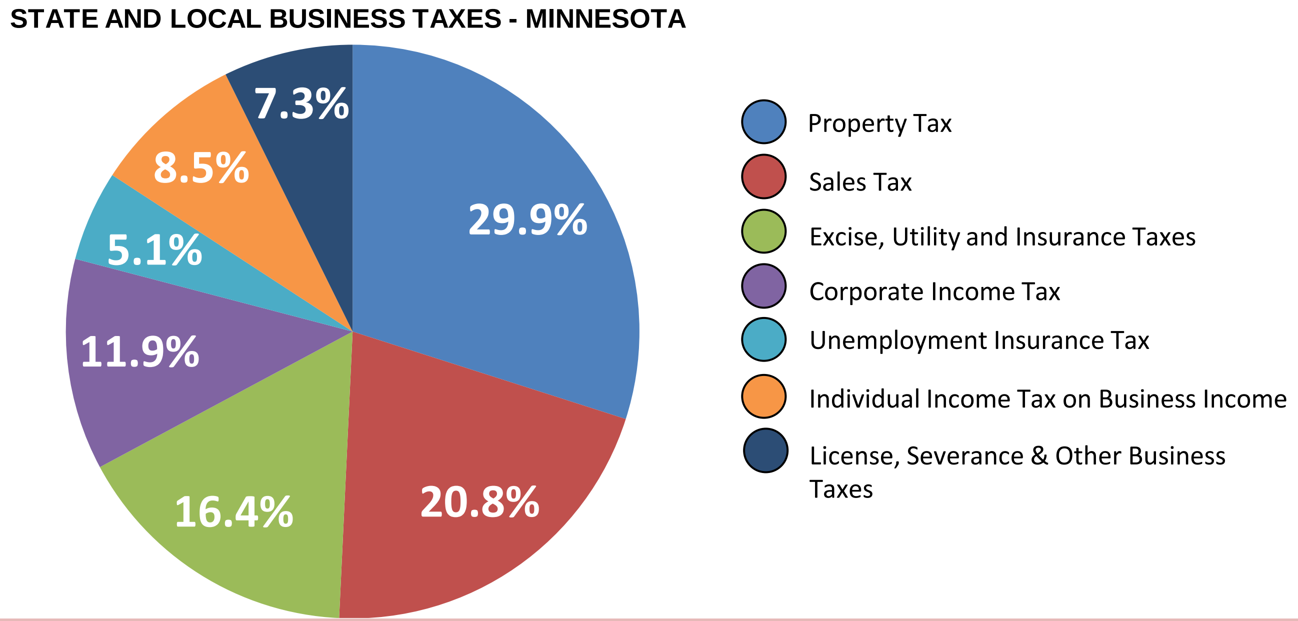
Source: Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2019, study prepared by Ernst & Young LLP for the State Tax Research Institute and the Council On State Taxation, November 2020.

Are Businesses Paying Their Fair Share:
How Much Do Businesses Pay in State and Local Taxes (Pre-COVID-19)?



- Businesses paid more than $14 Billion in Minnesota state and local taxes in FY19, an increase of 6.5% from FY18
- Total state and local taxes from businesses, individual income taxes on nonbusiness income, and other taxes was $38.4 Billion
- Minnesota business tax revenue accounted for approximately 38% of all state and local tax revenue in FY18 and FY19

Source: Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2019, study prepared by Ernst & Young LLP for the State Tax Research Institute and the Council On State Taxation, November 2020.

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Minnesota Session Update

Stay Tuned, But Here are our MN Projections

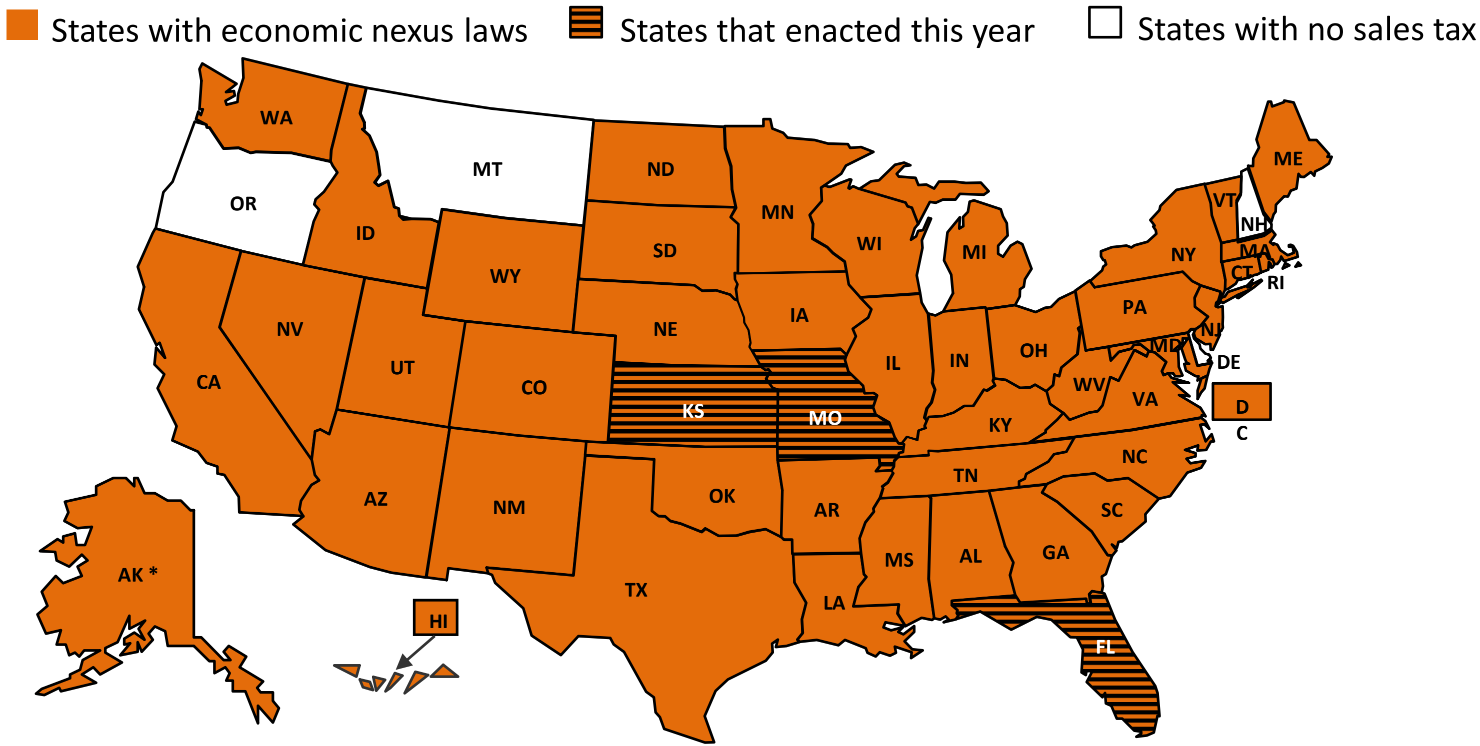
- Special Session
- General Disagreement Between House/Governor and Senate
- Going To Happen
  - Adopt MTC Partnership Audit Model Retroactive to TY2018
  - Allow Pass-throughs to Avoid SALT Cap
  - Conformity on 179 (Depreciation) Expensing
  - Exclusion of PPP Forgiveness from Income
  - Restaurant COVID-Purchases Exemption
  - Increase Commercial/Industrial Property Tax Exemption from $100k to $150k
  - Lots of New Local Sales Taxes (e.g. $90mm in Maple Grove, $40mm in Edina and Oakdale, $30mm in Moorhead and Wait Park, $75mm in Itasca County, $60mm in Carlton County)

Stay Tuned, But Here are our MN Projections

- Not Going To Happen
  - Tax Credit for COVID-related Liquor Spoilage
  - Changes to Qualified Data Center Exemption
  - Vendor Allowances
  - Private Letter Rulings
- Legislation from the Executive Branch
  - Proposed Revenue Notices on “Services Necessary to Complete the Sale”, and “Third Party Installation Labor”

Economic Presence & Marketplace Laws – Law of the Land for Sales Tax States

State Sales Tax Adoption of Economic Nexus Threshold



* = Alaska has no state sales tax, based on Alaska Remote Seller Sales Tax Commission Uniform Code

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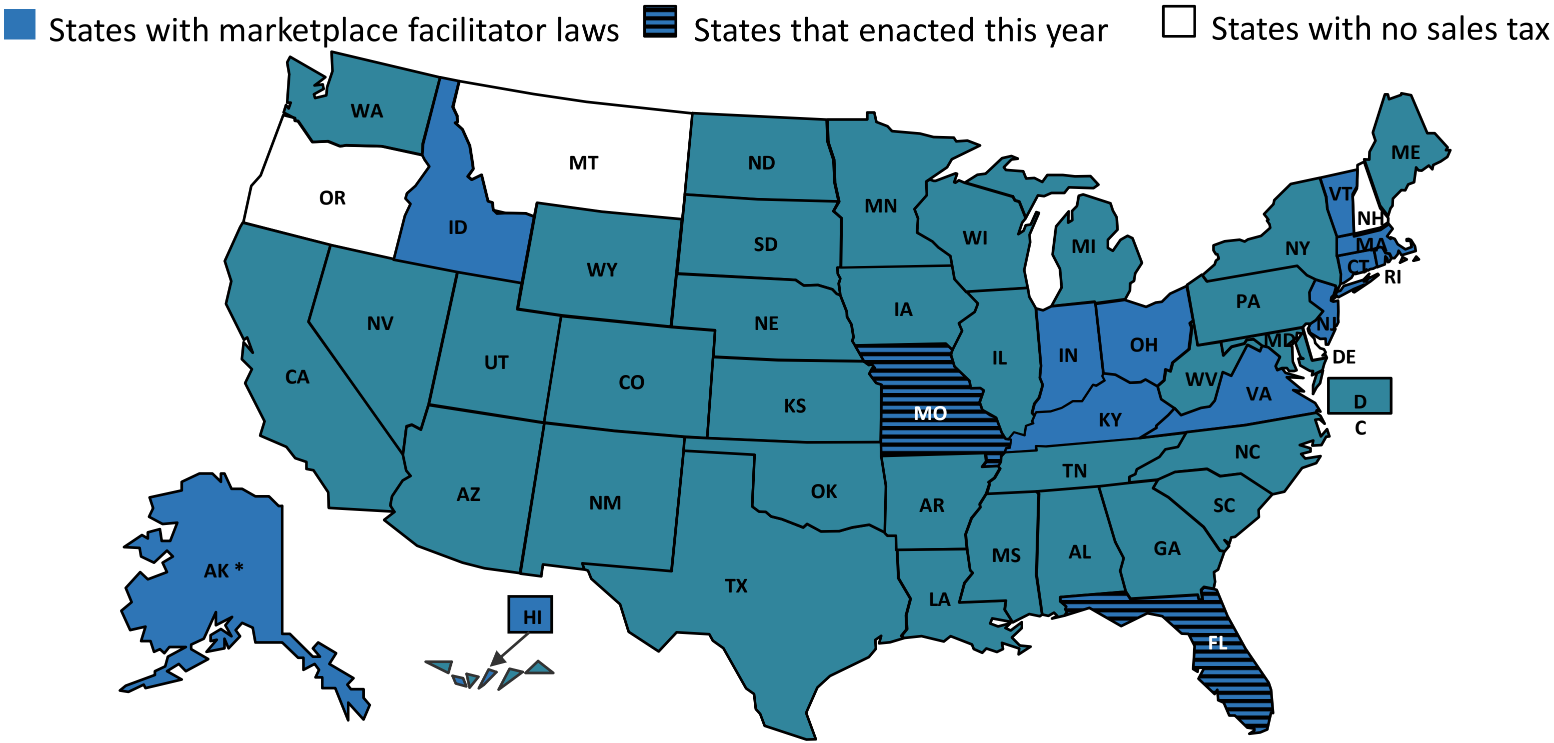
State Adoption of Marketplace Facilitator Laws



* = Alaska has no state sales tax, based on Alaska Remote Seller Sales Tax Commission Uniform Code

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Sales Tax Issues with Economic Presence Laws

- Most states use $100k or 200 transactions
  - How calculated – gross, retail, or taxable?
  - Some states have higher threshold (AL - $250k, CA - $500k, MS - $250k, and TX - $500k)
  - Measurement period – current, current and/or preceding year, trailing nexus
  - Some states exclude services in calculation – *e.g.*, California & Georgia
  - SSUTA's Disclosed Practices should help sellers and practitioners in this area

Pre-*Wayfair* Sales Tax Issues Still Pending

- **California** is looking at sellers with inventory in the State that used facilitators to sell their products
  - Lawsuit filed against CDTFA in federal district court in IL stating facilitators should have collected tax (*Rubinas v. Maduros*)
- **Massachusetts** asserting its “cookie nexus” rule eff. 10/1/2017
- **Pennsylvania** federal district court dismissed suit by online retailers against PA DOR stating state court should address issue first (*Online Merchants v. Hassell*)
- **South Carolina** Department of Revenue asserting marketplace seller collection back to 2016, prior to state enacting such a law in 2019
  - *Amazon Services v. SC Dep’t of Revenue*
  - SC A.G. has attempted to get *amicus* briefs dismissed as not being relevant

Post-*Wayfair* Sales Tax Issues

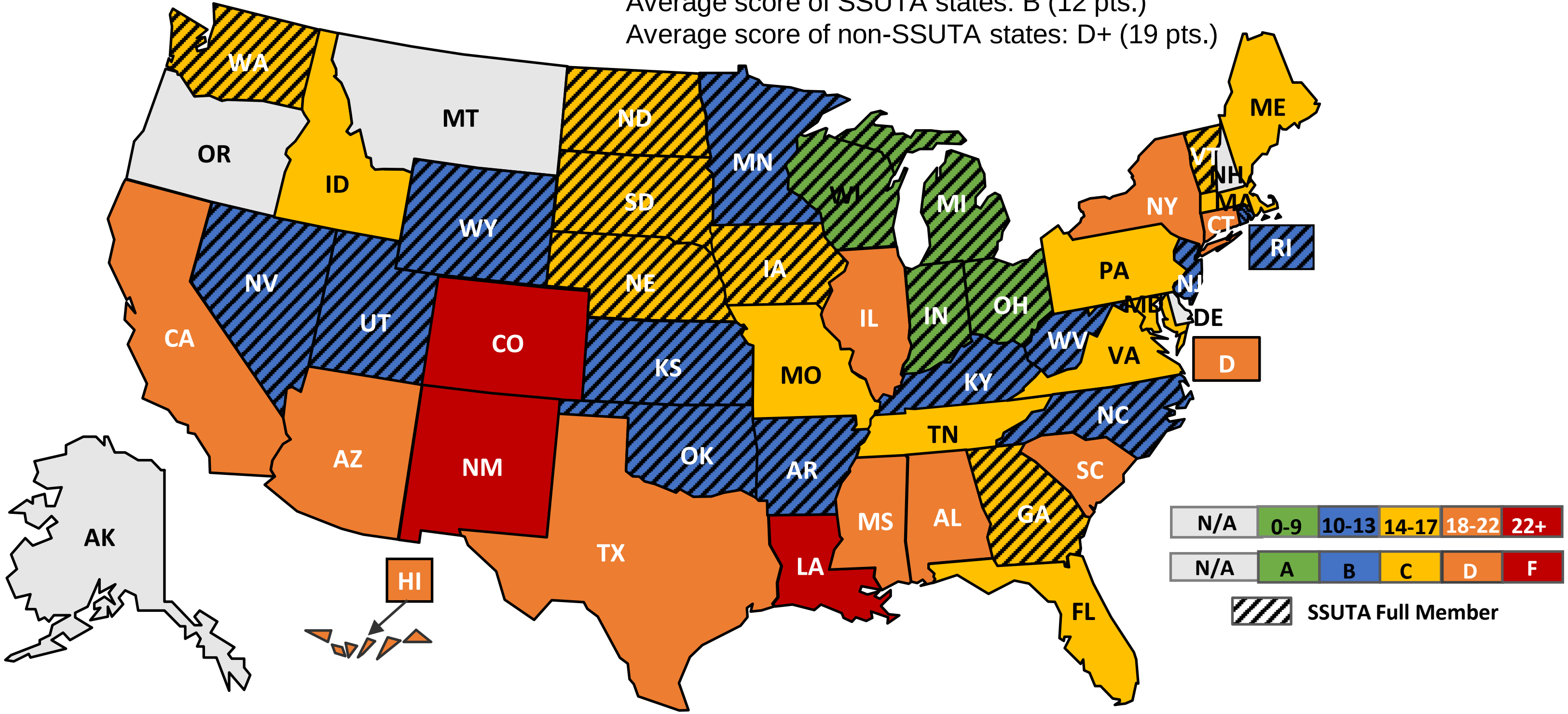
- **New Hampshire –** a state without a sales tax enacted legislation, S.B. 242, to allow the State's Department of Justice to determine if another state's law:
  - Provides a safe harbor to NH businesses that conduct limited business in the state; and
  - Provides a deduction or reimbursement to NH sellers for their cost to collect the state's sales taxes.
- **U.S. Government Accountability Office** (GAO) asked to update study on *Wayfair's* impact on small businesses
- **Uniformity - Streamlined Sales Tax State –** Generally, most sales tax states followed 2 out of 3 features SCOTUS noted with South Dakota's law in *Wayfair*. The states 1) have not applied an economic nexus requirement retroactively and 2) have a small business exception (KS enacted this year). However, a third feature noted by SCOTUS was South Dakota being an SSUTA state and it having uniform laws with other states. No additional states, thus far, has joined the SSUTA to address this feature.
  - Alaska, Colorado, and Louisiana (H.B. 199) are working on their local tax burdens

Issues with Marketplace Laws

- While the NCSL adopted model legislation, most states use ad hoc variations
  - Breadth of definition of who is a facilitator
  - Marketplace seller waivers if substantially all marketplace sellers collect or for a marketplace seller that already collects tax in every state
- How will exemptions apply
- How will coupons apply
  - Can marketplace facilitator use marketplace seller coupon to reduce price?
  - Ohio coupon rule – 5703-9-15 – does not directly address but COST raised issue with purchased coupons/vouchers
- Refunds, vendor discounts & Bad Debt (IRC § 166)
- Collection of other taxes and fees
  - States, *e.g.*, Georgia requiring local lodging taxes not filed with a sales tax return (also WI S.B. 198)

Comparison of Grades Between SSUTA and Non-SSUTA States on COST's Sales Tax Administration Scorecard

Average score of SSUTA states: B (12 pts.)
Average score of non-SSUTA states: D+ (19 pts.)



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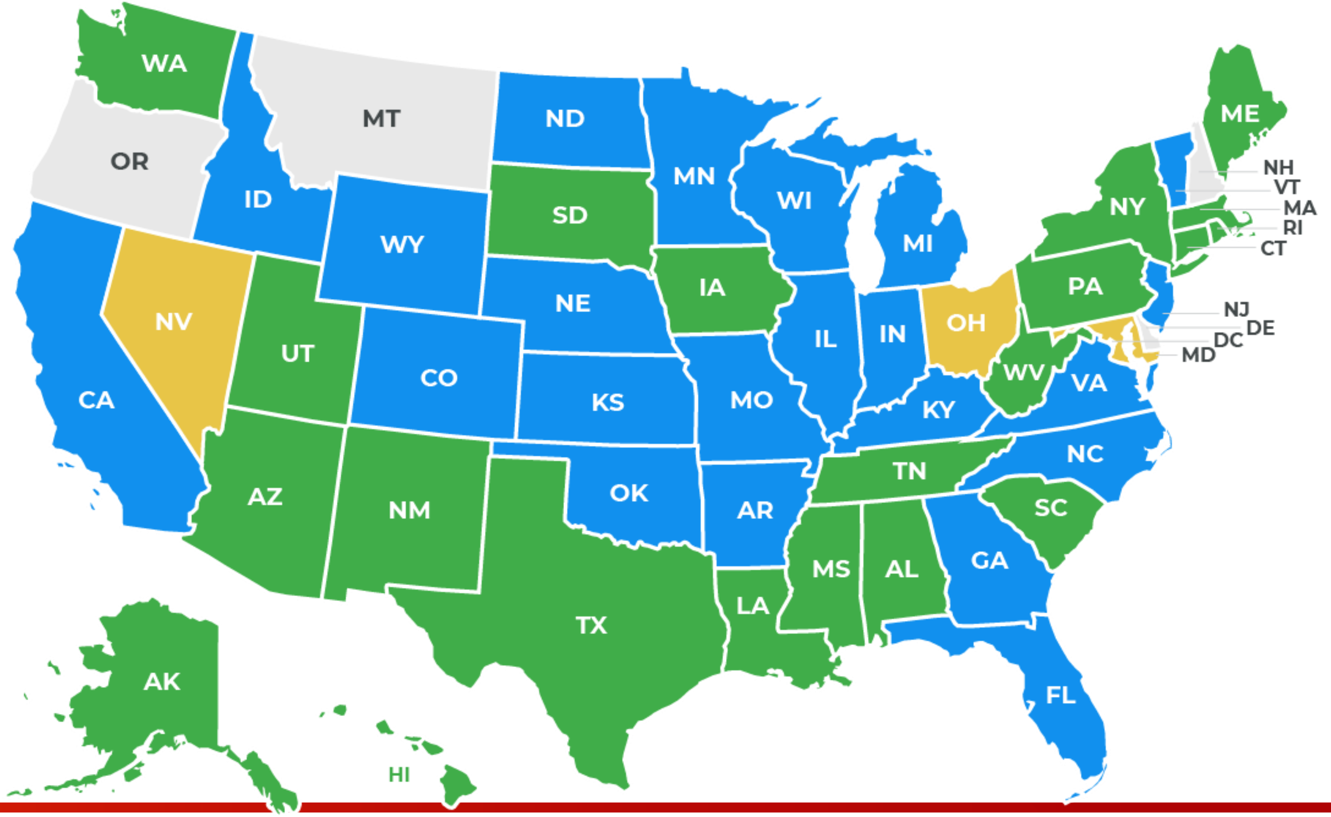
Source: The Best and Worst of Sates Sales Tax Systems: COST Scorecard on Sales Tax Simplification, Uniformity & the Exemption of Business Inputs (April 2018)

State Taxation of Software as a Service (SaaS) Continues to Grow

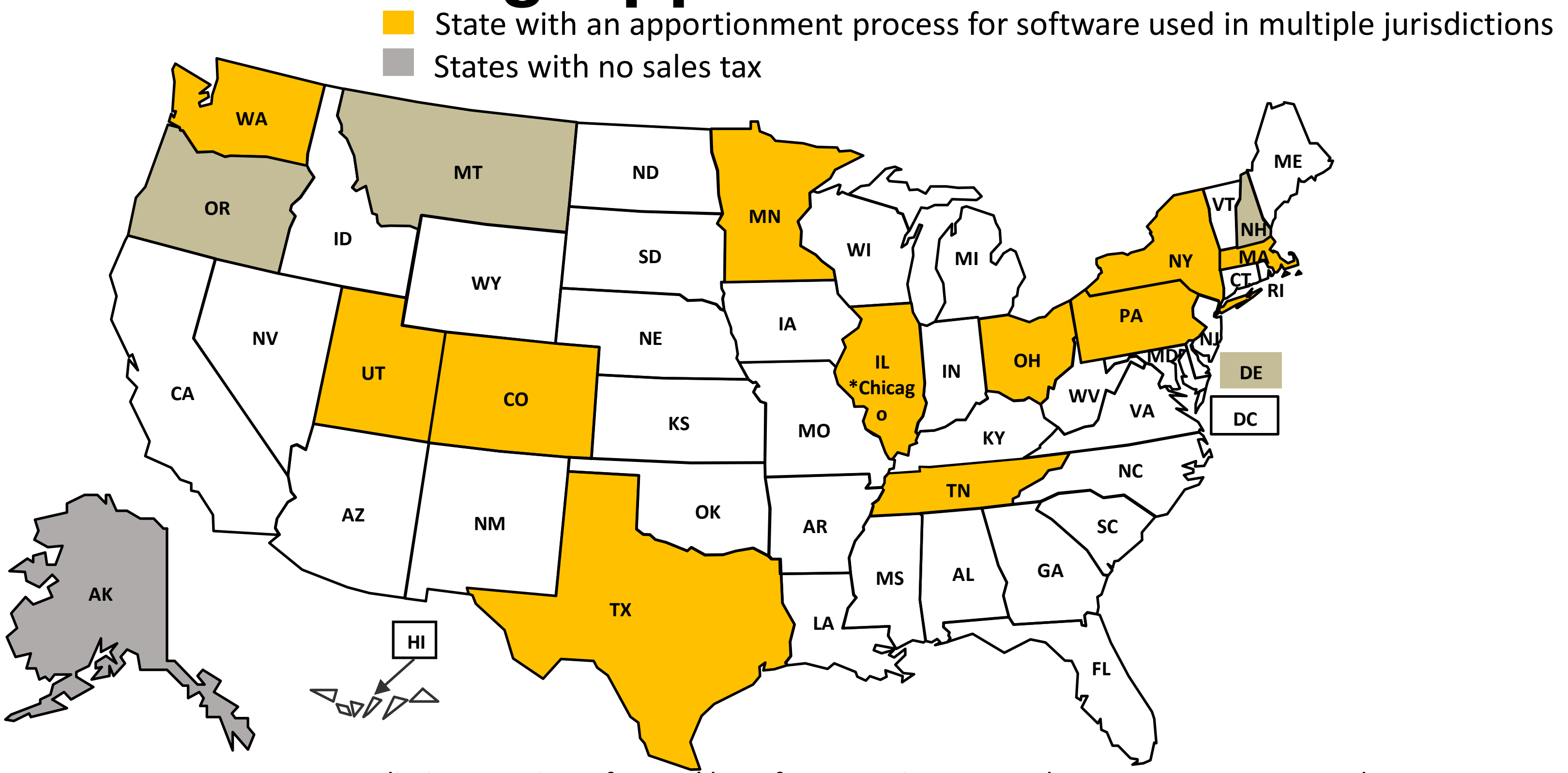
States Taxing Software as a Service (SaaS)

- State where SaaS is taxable
- State where SaaS is not taxable
- State where SaaS is taxed differently depending on business or personal use
- States with no sales tax



Source: Tax Jar (March, 2021)

States Allowing Apportionment of Software



Source: COST Preliminary review of states' laws for upcoming 2021 Sales Tax Systems Scorecard

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Issues with SaaS

- There are no uniform definitions in the SSUTA addressing SaaS (software not actually delivered to a customer, but merely accessed)
- Some states tax it as a service while others try to carve it into its tangible personal property definition (*e.g.*, pending legislation in Colorado (H.B. 1312))
- Sourcing issues and many states do not have Multiple Points of Use (MPU) provisions
  - Massachusetts' Supreme Judicial Court recently held in *Oracle USA v. Comm. Of Revenue* (5/21/21), that a seller did not have to comply with a rule requiring MPU claim to be made prior to filing of tax return
- Some states do not have clear imposition statutes, using administrative provisions: AZ, CT, IL, MA, NM, NY, and TX (source: COST 2018 Scorecard – update in process)
- MTC is broadly looking at a white paper addressing how states are taxing certain digital products and may follow up with model legislation

Impact of Federal Corporate Tax Reform Proposals on State Taxes

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Biden Administration’s “The Made in America Tax Plan”

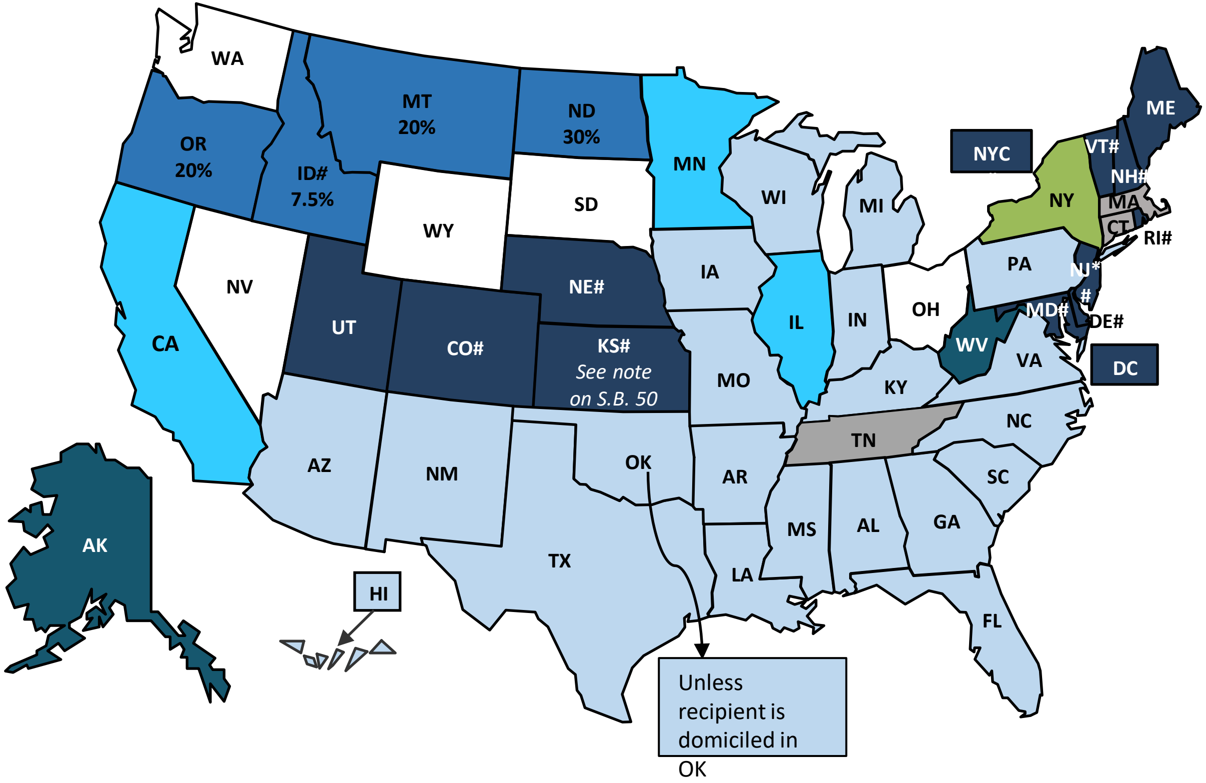
- In April 2021, the Biden administration made public “The Made in American Tax Plan ”to raise corporate income taxes by about $1.8 trillion over 10 years ($2.5 trillion over 15 years) to pay for its “American Jobs Plan” of infrastructure spending.

The key proposed CIT provisions are:

- Raise the corporate income tax rate to 28 percent
- Raise the GILTI tax rate to 21 percent.
    - Expand the GILTI tax base by eliminating QBAI and calculating GILTI based on a country-by-country basis.
- Enact a 15 percent minimum tax on book income of large companies
- Replace BEAT with SHIELD
- Repeal FDII and replace it with expanded R & D investment incentives
- Tighten anti-inversion rules
- Eliminate tax preferences for fossil fuels; provide incentives for clean energy production
- Increase funding and ramp up corporate tax audit enforcement

GILTI: State Corporate Income Tax Conformity

Generally based on 80% or more direct corporate ownership. Other rules may apply for smaller % ownership or PIT purposes.



States Taxing GILTI:

- 5%
- 7.5% - 30%
- 50% (based on the state's position)
- State guidance is unclear

States Not Taxing GILTI:

- Currently does not impose its corporate income tax on GILTI
- Considered legislation to tax GILTI in 2021
- No corporate income tax

Kansas S.B. 50, passed Legislature on March 30, vetoed by Governor Kelly (D) on April 16, would provide a subtraction modification exempting GILTI beginning in tax year 2021. The Legislature is expected to attempt a veto override.

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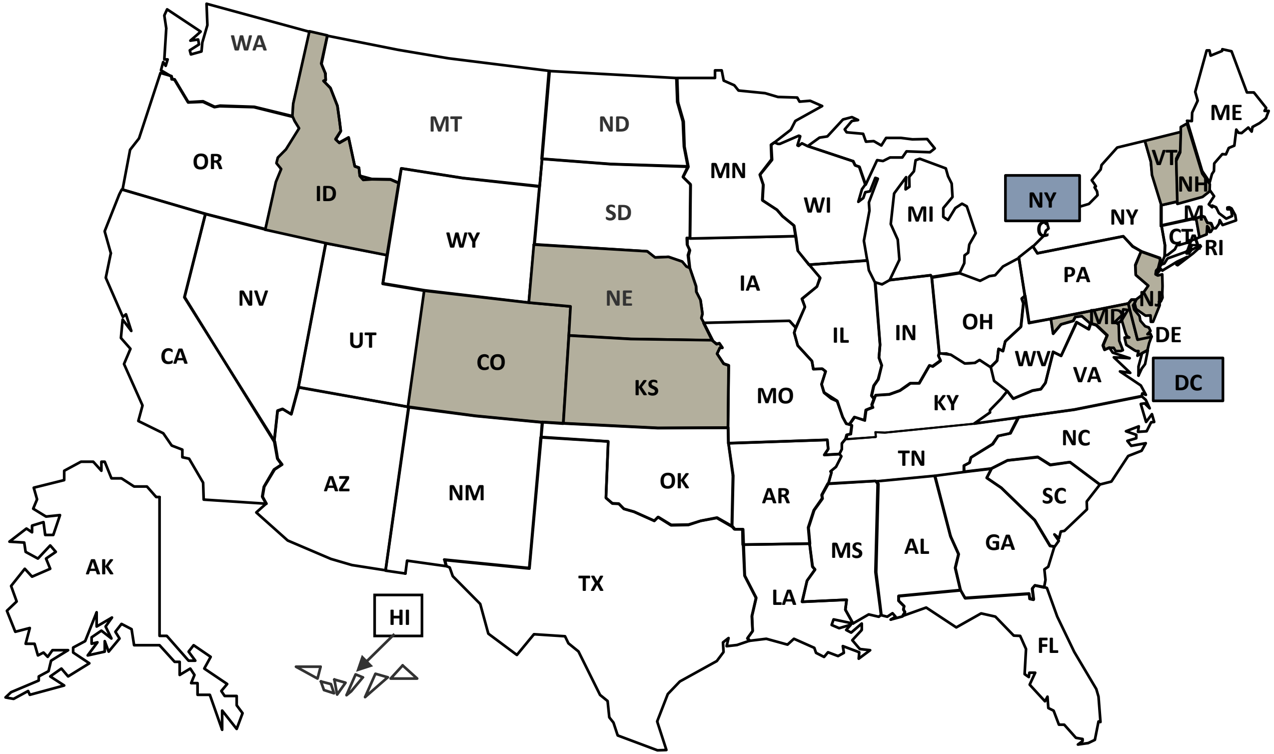
 # CO, DC, DE, ID, KS, MD, NE, NJ, NH, NYC, RI, VT allow Sec. 250 deduction

***Disclaimer**: This map is based on the best available information, but several states do not have clear guidance on GILTI. Therefore, this information should be used for general guidance and not relied upon for compliance.* **Source**: Council On State Taxation (COST)

States that Allow the Section 250 Deduction for GILTI Purposes



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Source: Council On State Taxation (COST)

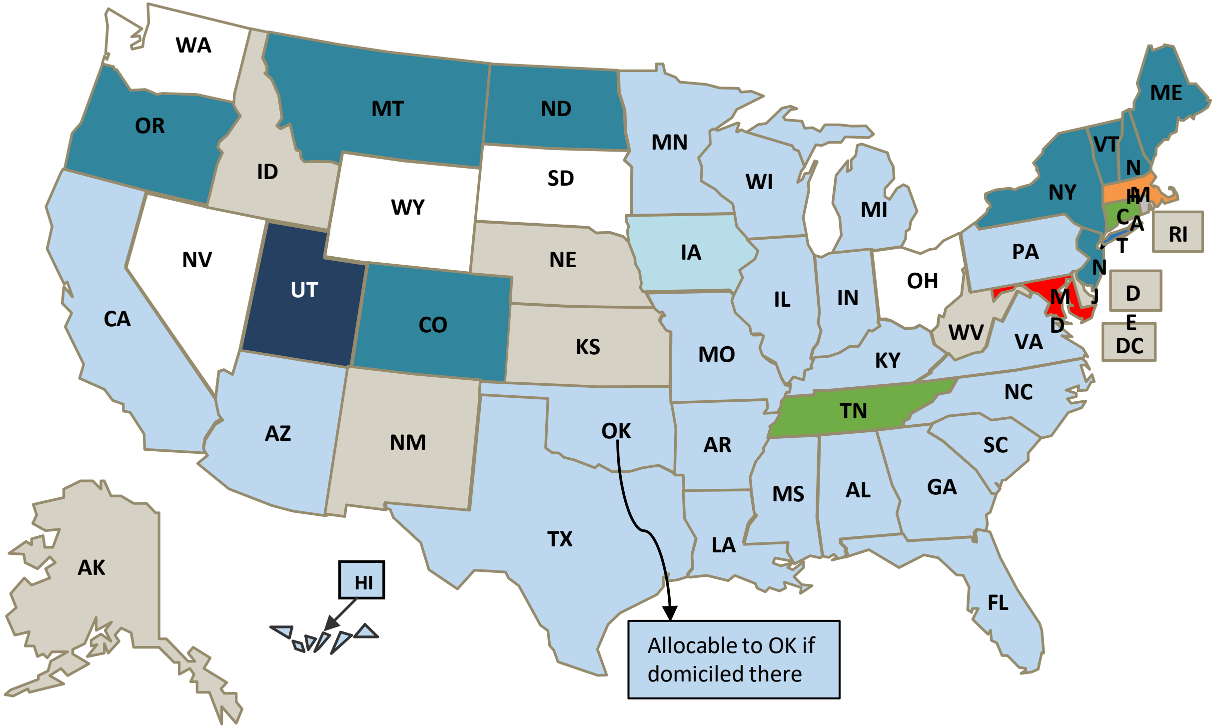
Federal Taxation of GILTI: The TJCA Provision Compared to Biden's Proposal

	Timing of Tax	Rate	Tax Base Determination	Calculation Method	Foreign Tax Credit	Net Operating Loss Carryover
TCJA (GILTI)	Current	10.5%/ 13.125 %	Allows QBAI deduction	Aggregate	80%	None
Biden Proposal (GILTI)	Current	21%	No deduction	Country-by-Country	100%*	Not clear

*Assumed to be 100%.

GILTI State Factor Representation

Based generally on 80% or more direct corporate ownership of foreign corporations. Other rules may apply for smaller % ownership or PIT purposes.



- Currently does not impose its corporate income tax on GILTI
- Sales factor denominator only includes net GILTI
- Foreign factors (including foreign gross receipts) relating to taxable income allowed in denominator(s)
- No factor representation allowed
- Other methodology
- No new guidance
- No corporate income tax

Disclaimer: *This is based on the best available information, but several states do not have clear guidance. Therefore, this information should be used for general guidance and not relied upon for compliance.*

Source: Council On State Taxation (COST)

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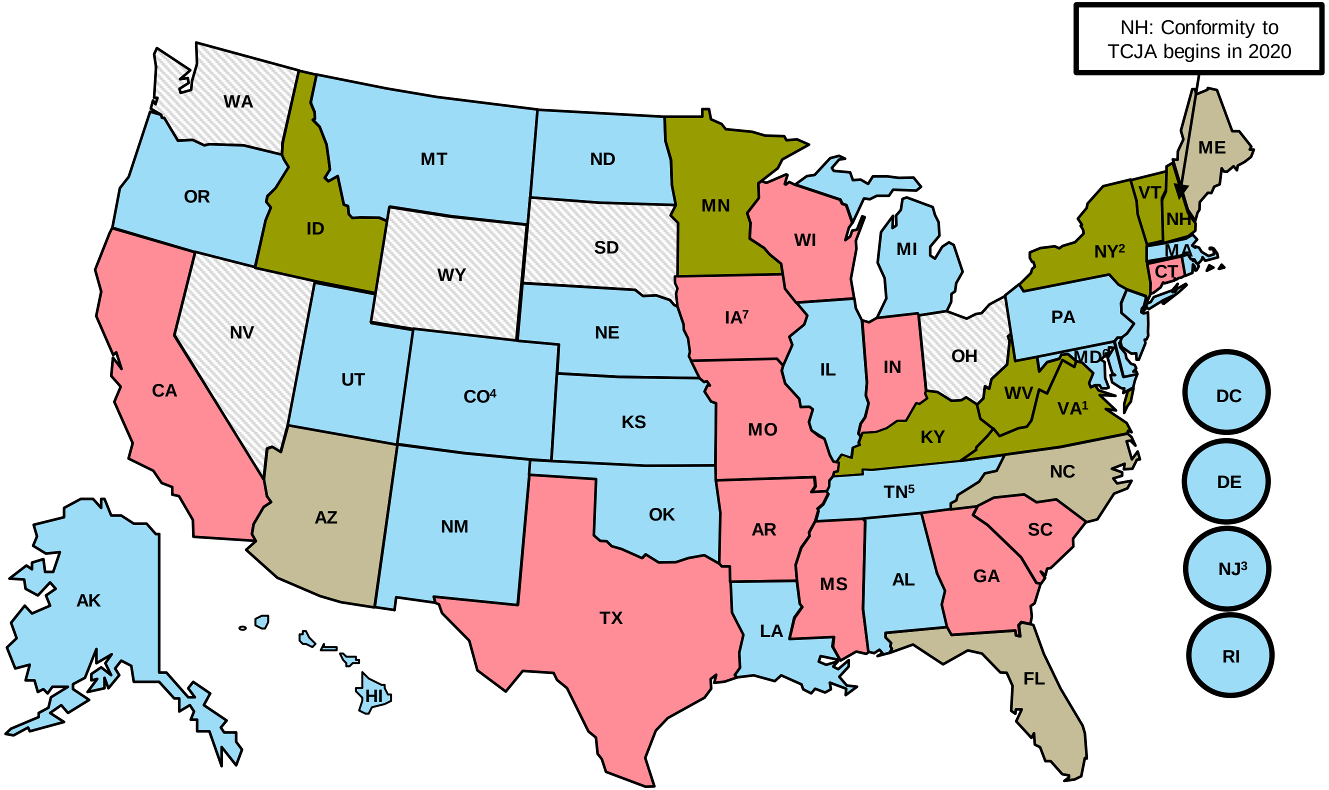
State Corporate Tax Law Conformity with IRC § 163(j) Interest Expense Limitation

- No corporate income tax
- Does not adopt or decoupled from IRC § 163(j)
- Adopts IRC § 163(j) with rolling conformity (with CARES Act changes)
- Adopts the TCJA's IRC § 163(j) with static or selective conformity (with no CARES Act



VA[1]: Corporate subtraction equal to 20% of the business interest disallowed pursuant to IRC § 163(j)
NY[2]: Decoupled from IRC § 163(j)(10)(A)(i) (increased 50% threshold) CARES Act change; NYC fully decoupled from IRC § 163(j) CARES Act changes
NJ[3]: Limitation calculated on a pro-rata basis between related and unrelated parties
CO[4]: CARES Act does not apply for tax years ending before March 27,2020
TN[5]: Adopts IRC § 163(j) pre-TCJA provision on or after January 1, 2020
MD[6]: Decoupled from the CARES Act provisions affecting 2020 tax year, but conforms to CARES Act provisions affecting 2018 and 2019 tax years
IA[7]: Conformity to TCJA in 2019; decouples from IRC § 163(j) on or after January 1, 2020 (i.e., full deduction)

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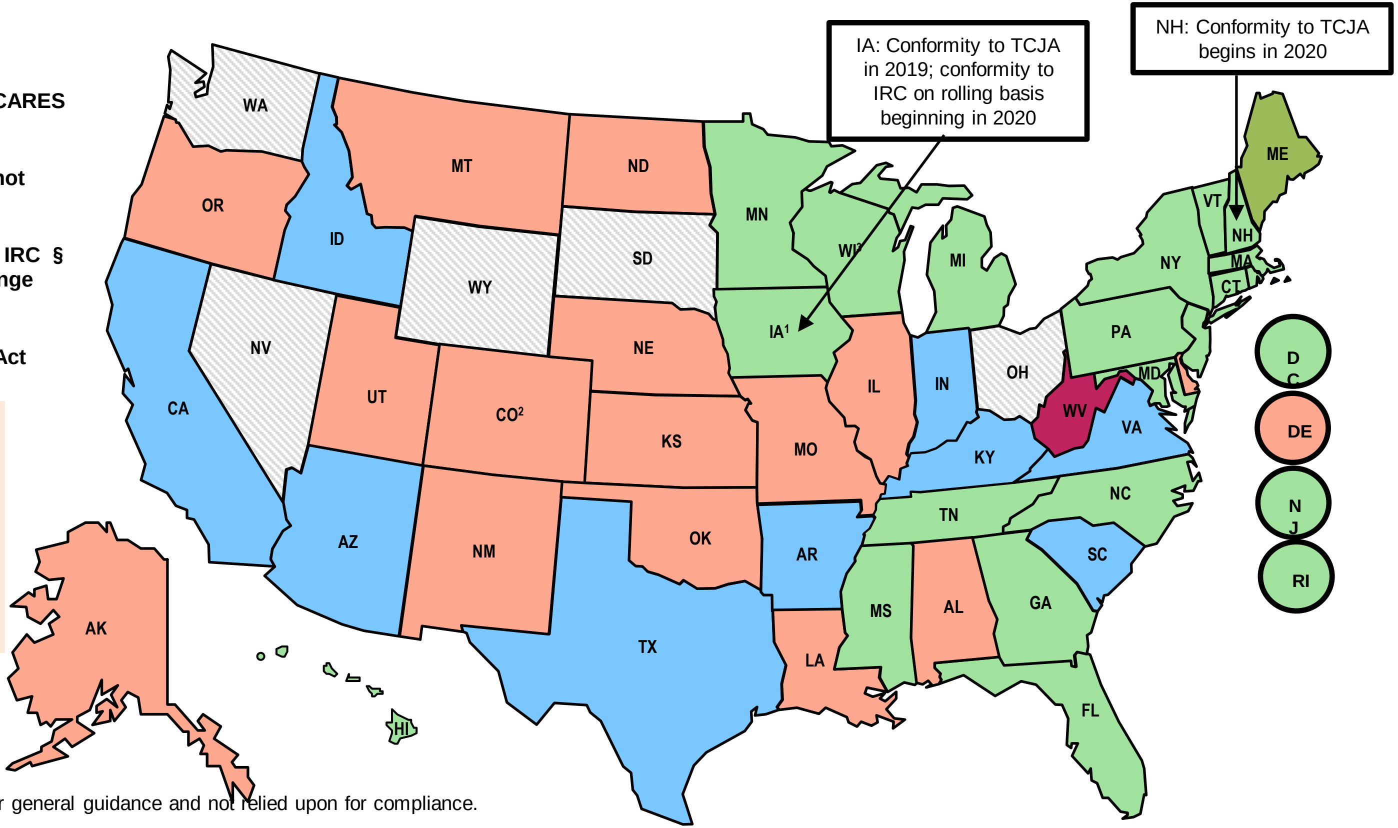
Source: Council On State Taxation

State Corporate Tax Law Conformity with Bonus Depreciation & CARES Act QIP Life

- **No corporate income tax**
- **Adopts TCJA's IRC § 168(k) and CARES Act change**
- **Adopts TCJA's IRC § 168(k), but not CARES Act change**
- **Does not adopt or decouples from IRC § 168(k), but adopts CARES Act change**
- **Does not adopt or decouples from TCJA's IRC § 168(k) and CARES Act change**

IA[1]: Does not adopt the CARES Act changes to QIP (i.e., 15-year asset life) until 2020
CO[2]: CARES Act does not apply for tax years ending before March 27,2020. June 2020 guidance
WI[3]: Selective conformity to CARES Act sec. 2307



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American Rescue Plan State Tax Cut Limitation Provision

"A State or territory shall not use the funds provided under this section or transferred pursuant to section 603(c)(4) to either directly or indirectly offset a reduction in the net tax revenue of such State or territory resulting from a change in law, regulation, or administrative interpretation during the covered period that reduces any tax (by providing for a reduction in a rate, a rebate, a deduction, a credit, or otherwise) or delays the imposition of any tax or tax increase."

- May 10, The U.S. Treasury issued a Fact Sheet and Interim Final Rule addressing the states use of the federal funds and how it would address the limitation on states reducing any tax
  - Congress did not want federal funds (est. $195.3 billion for the state governments) to be used to pay for states to decrease their taxes (only applies to state and not local taxes)
  - Treasury will use fiscal year 2019 as the base year of net state tax revenue collected (inflation adjusted) to create a safe harbor for the calculation and conformity to IRC would not count as a reduction along with tax redeterminations
  - There is a one percent *de minimis* threshold that would not trigger recoupment
- Litigation still pending:
  - Broad call for clarification from state associations, state attorneys general and taxpayer community – State Attorney General litigation pending
  - Ohio legal challenge – pending on standing challenge
  - S. 730 – Let States Cut Taxes Act

Other Corporate Income Tax Issues

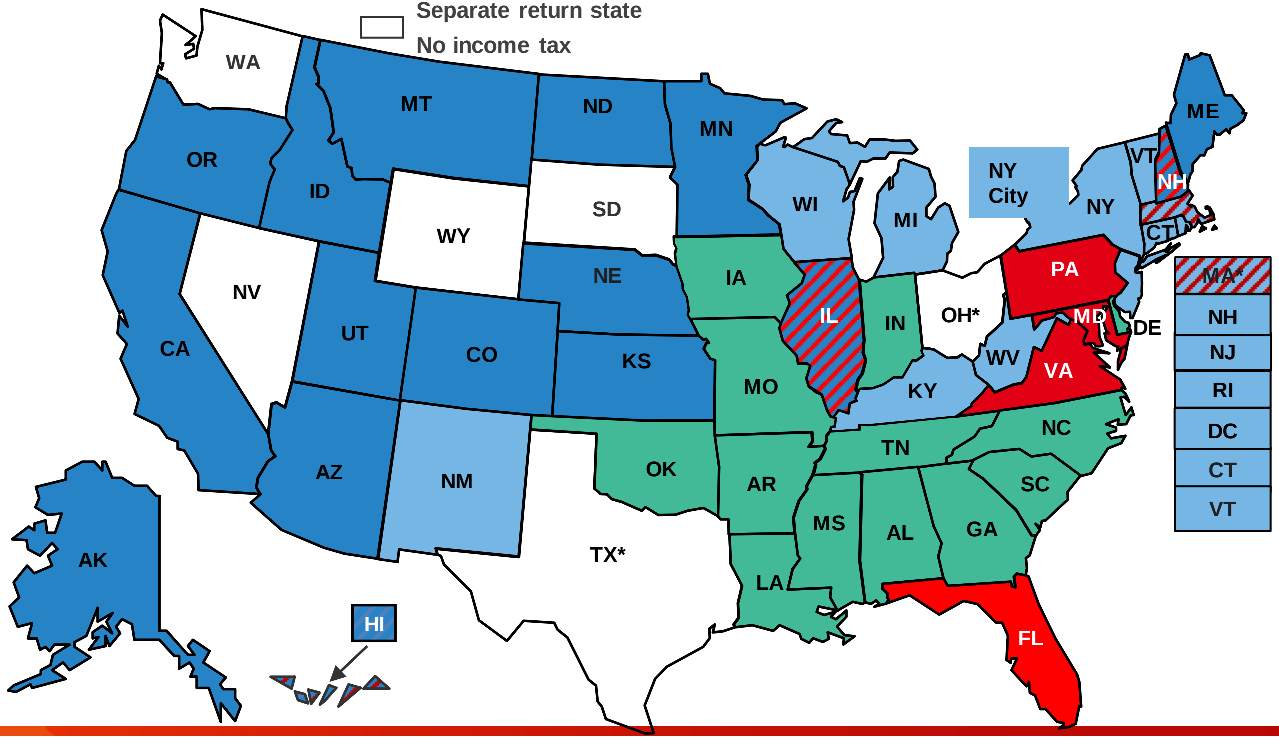
Mandatory Unitary Combined Reporting (MUCR)

- Pending Legislation in FL (H.B. 999), MD (H.B. 172, S.B. 123), VA (S.B. 1353, H.J.R. 563), PA (H.B. 1222), IL (H.B. 3477)
- Mandatory Worldwide Combined Reporting: NH, HI, and MA
- “Backdoor” Worldwide Combined Reporting: IL (H.B. 3477) and MN (H.F. 991, H.F. 2114, and H.F. 2228)
- COST Policy Position
  - Unitary Definitions are Vague and Uncertain
  - MUCR Creates Winners and Losers in States
  - Not a Solution to Revenue Shortfalls
  - Complex and Lengthy Audits
  - Include a Consolidated Election based on ownership %
- If state already imposes MUCR or legislation is bound to pass - seek beneficial provisions:
  - Provide federal consolidated election
  - Water’s-edge default filing with worldwide combined election
  - Follow federal (IRC) consolidated return regulations
  - Allow sharing of tax attributes
  - Exclude foreign source income
  - Exclude entities subject to alternate tax regimes

Combined Reporting Adoption And 2021 Proposals

Updated: April 2021

- Combined reporting/consolidated return required prior to 2004
- Combined reporting/consolidated return adopted for 2004 or later
- Separate return state
- No income tax
- 2021 legislation introduced in separate reporting states
- 2021 legislation introduced in combined reporting states*



***HI introduced** S.B. 1302 to require corporate taxpayers to include the income of foreign subsidiaries in their computation of corporate income tax, effectively imposing taxation on worldwide income.

***IL introduced** H.B. 3477 to subject the entire worldwide income of a unitary business to Illinois corporate income tax, has water's-edge election with broad discretion to the DOR to disregard the election.

***NH introduced** H.B. 102 to change the water's edge method of taxation for unitary business groups under the business profits tax to worldwide combined reporting.

***MA introduced** H.B. 2860 to mandate worldwide combined reporting.

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*Combined reporting for a tax based on gross receipts

Transfer Pricing

- **Renewal of MTC SITAS**
  - Transfer pricing is one of many tools
  - Focus on training and information sharing
- **Creation of Alternative Dispute Resolution**
  - North Carolina – voluntary disclosure agreement program
  - Indiana – advanced pricing agreement program
- **Continued Engagement with External Transfer Pricing Experts**

Expansion of False Claims (Qui Tam) Acts to Tax Issues

- **District of Columbia** B23-0035: False Claims Amendment Act modified existing false claims statute in D.C. to expressly authorize tax-related false claims actions against a person that "reported net income, sales, or revenue totaling $1 million or more in the tax filing to which the claim pertained, and the damages pleaded in the action total $350,000 or more"
- **California** AB 310 – would apply FCA to the wealth tax for controversies over $200,000
- **Pennsylvania** HB 2352 (2020) – would create a FCA for tax issues
  - Sept. 30, 2020 – amended to include a tax bar
- **Michigan** SB 484/HB 4875 (2019/2020) – would create FCA, with tax dollar thresholds similar to the DC legislation above
- **New York** – A.B. 11066 and S.B. 8872 (2020) would retroactively change FCA culpability standard and impose strict liability, resulting in it including inadvertent non-reckless tax mistakes, misunderstandings or mere negligence (currently prohibited by law)
- **South Carolina** SB 40 (2019/2020) – would create FCA, with tax application limited only in the income tax context
- **Notable Mention: Maryland** HB 804 (2021) – creates an internal whistleblower program within the Comptroller's Office; intended to be similar to the IRS' program

State Income Tax Repeal Proposals With Sales Tax Base Expansion

Mississippi (H.B. 1439 and S.B. 2971):

- Proposed phase out of the State's personal income tax and decreasing the State's sales tax rate on retail food from 7 percent to 3.5 percent (after June 30, 2026); the income tax on individuals, partnerships, trusts, and estates would be repealed when a certain trigger is met
- Increasing the State's general sales tax rate from 7 percent to 9.5 percent, increasing the State's sales tax rate on motor vehicles from 3 percent to 5.5 percent, and increasing the State's sales tax rates on certain industries such as manufacturers from 1.5 percent to 4 percent

West Virginia (H.B. 2027 and H.B. 3300):

- With a Republican-led Statehouse, Governor Jim Justice (R) called for an ultimate repeal of the State's progressive income tax with a top marginal rate of 6.5 percent beginning with a 60 percent reduction in the income tax rate
- A subsequent Senate proposal began the phase-out with a 50 percent reduction
- To offset revenue loss, both proposals increased sales tax rate (from 6 percent to 7.9 percent [Governor], to 8.5 percent [Senate]), expanded the sales tax base to professional services and other business inputs including advertising, Governor's proposal had a new luxury tax, Senate proposal taxed groceries at 2.5 percent

Iowa (S.B. 149):

- Would have eliminated Iowa's personal income tax (not corporate income tax) and increased the State's sales tax rate from 6% to 11%
- Bill did not garner support of the Governor and many legislators

Nebraska (L. 133):

- EPIC bill – Eliminate Property Tax, Income Tax, and Corporate Income Tax
- Existing sales tax would have been replaced with broad-based sales tax (10.64% rate) imposed on almost all services and sales of tangible personal property – with a business-to-business exemption

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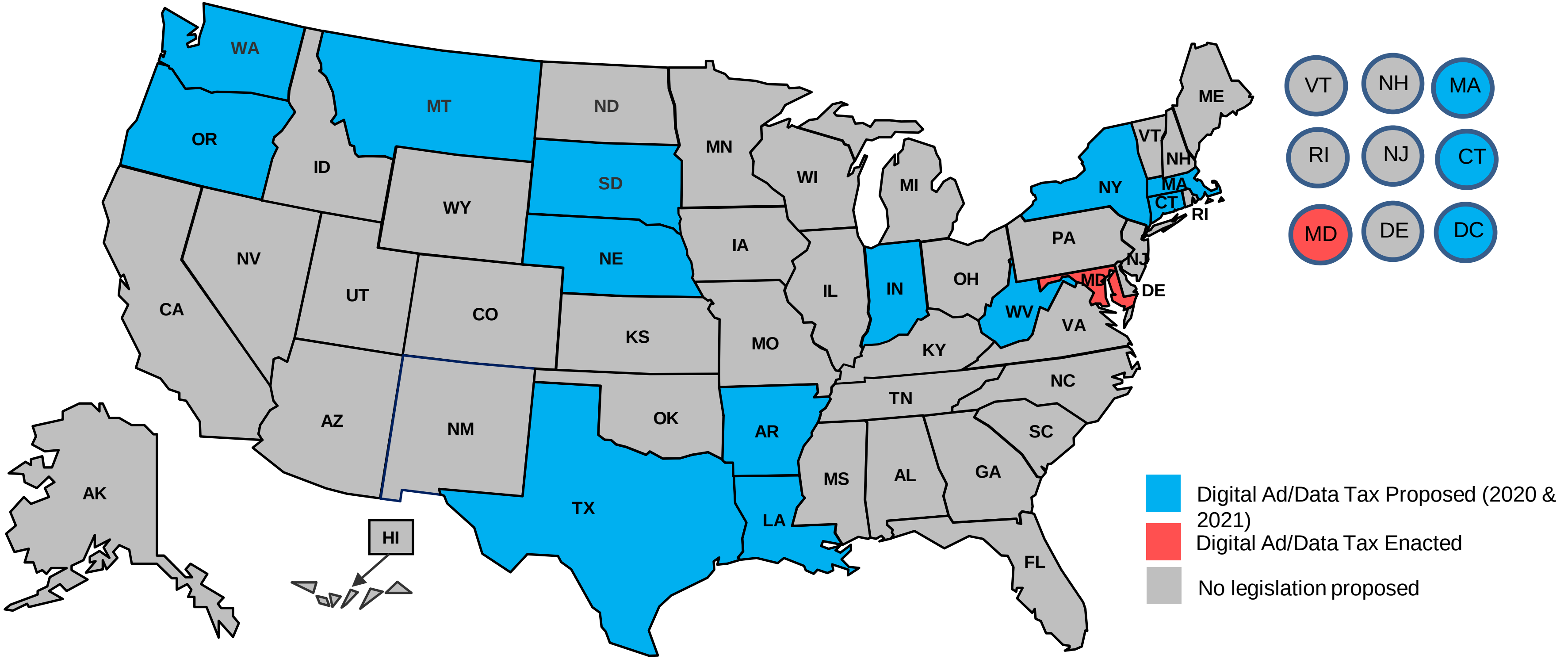
Digital Services Taxes and Gross Receipts Taxes

2020 & 2021 Digital Advertising Services & Data Tax Proposals



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Source: Council On State Taxation

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Maryland

New digital advertising gross revenues tax

- Tax imposed on a person's annual gross revenues derived from digital advertising services in Maryland
- Tax imposed at rates of 2.5% to 10% depending on annual gross revenues.
- Additional 2021 amendments
  - Excludes digital interfaces owned, or operated by, or operated on behalf of, a broadcast entity or news media entity; and
  - Prohibit a person from directly passing the cost of the tax to a customer by means of a separate fee, surcharge, or line item
  - Moves the state date to tax year 2022

"Things Not Worth Doing Are Especially Not Worth Doing Poorly"

- Litigation in federal and state court
- Constitutional and federal law challenges
- Issues with the underlying tax policy

State Adoption of European Digital Services Taxes: Misguided and Unnecessary

- There are many good arguments in opposition to state DSTs including they violate ITFA; they are unconstitutional under the Commerce Clause; they punitively "ring-fence" digital only businesses; and they are overwhelmingly complex to administer
- However, there is a **fundamental flaw** to state adoption of DSTs that has received much less attention
- State DSTs are generally designed to replicate the French DST and other national-level DSTs enacted or proposed in other advanced nations
- But states ignore (or fail to consider) that adoption of DSTs in other countries is a **temporary fix** to structural deficiencies in the international tax system that do not exist at the state level in the United States
- **Other nations** can not effectively tax digital business models under current international income tax rules because they rely almost exclusively on physical presence nexus rules (PE), not economic nexus rules; and on sourcing of income to the location of the income-producing activity, not to the market jurisdiction
    - The foreign nations that have enacted DSTs are **generally committed to withdrawing these new and controversial taxes** once a broader "consensus" solution of reforms to the existing international income tax laws is agreed upon under the auspices of the OECD's Pillar One project
    - Moreover, the **U.S. government is vehemently opposed to foreign DSTs** which are viewed as discriminatory against U.S. multinationals
    - The **state adoption of DSTs is a misguided and unnecessary reform,** out of step with the functionality of their own modernized income tax statutes, the direction of the OECD's Pillar One project; for more information see: Karl Frieden and Stephanie Do, "State Adoption of European Digital Services Taxes: Misguided and Unnecessary," forthcoming in Tax Notes State, May 10, 2021.

States' Taxation of Nonresident Workers

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COST COUNCIL ON STATE TAXATION

States Lack a Uniform Threshold when Taxing Non-Resident Workers

States have widely varying and inconsistent requirements for:

Employees to file personal income tax returns when traveling to a nonresident state for temporary work periods

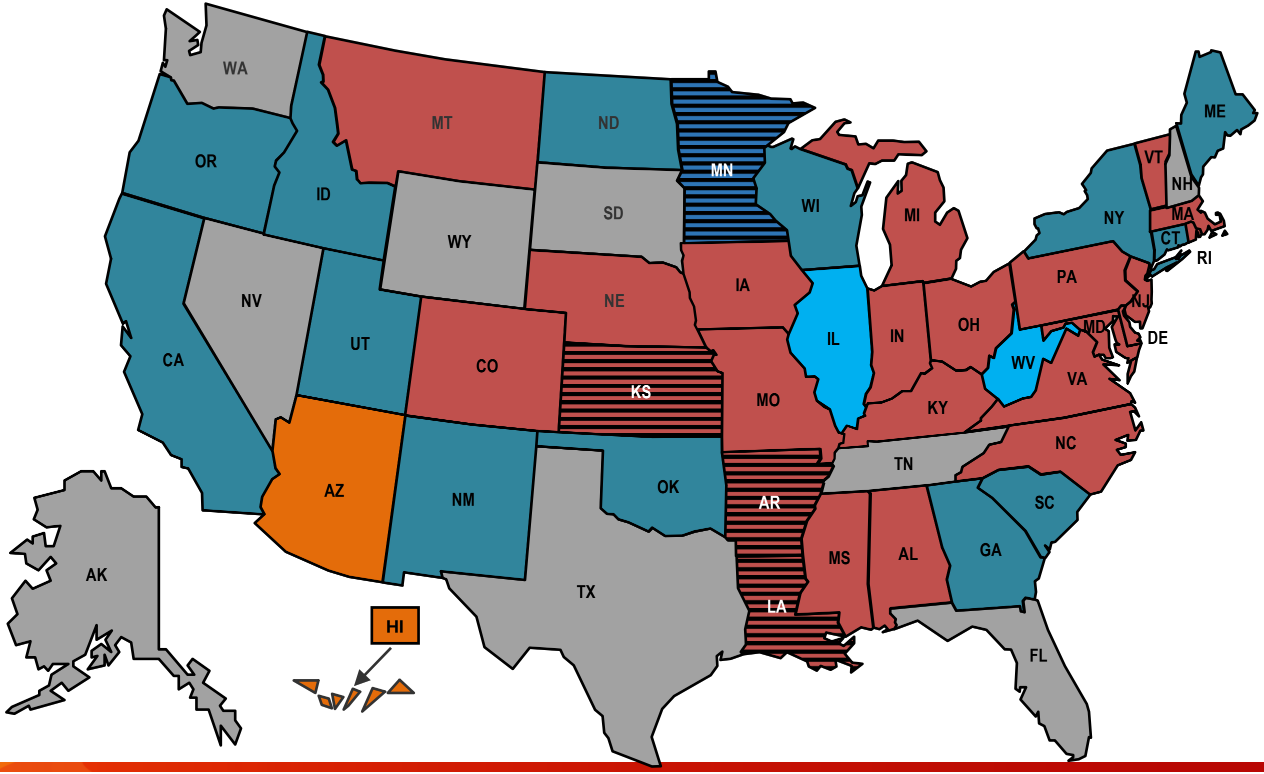
Employers to withhold income tax on employees who travel outside of their state of residence for temporary work periods

Issues:

- Unnecessary compliance burdens for employees, employers, and state tax administration agencies
- Unnecessary tax swap and burden with income tax credits provided by employee's resident state to tax paid to non-resident states
- Especially unfair to residents of states with no personal income tax

When is a Non-resident Employer Required to Withhold?

Important note: These don't necessarily align with an *employee's* filing requirements.



Nonresident employee is subject to withholding on the first day of travel into the state

Nonresident employee is subject to withholding after reaching a specific threshold

AZ & HI: 60 days for withholding only

IL: 30 working days (2019)
WV: 30 days (2021)

No general state personal income tax

Legislation in 2020, 2021: AR, KS, LA, MN

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Ongoing Mobile Worker Legislation and Litigation

- **Arkansas** – S.B. 484 – ends tax based on "convenience of employer" eff. 1/1/2021 – special session may address taxation of nonresidents in state less than 30 days
- **Louisiana** – S.B. 157 – in Conference Committee – would exempt wages if nonresident works in state less than 25 days eff. 1/1/2022
- Withholding based on employer versus employee location
  - **Ohio** – H.B. 110 - required withholding at employer location subject to refund in State's budget bill (Senate version) – open litigation issue in H.B. 157 for 2020
  - **Missouri** – S.B. 604 – would allow refunds to St. Louis employees that did not work in city during COVID-19 – did not pass (litigation pending)
- **New Hampshire** – Case pending before SCOTUS – U.S. Solicitor General recently opined SCOTUS should not review case addressing Massachusetts's position that income tax owed based on employer location and not temporary location of an employee

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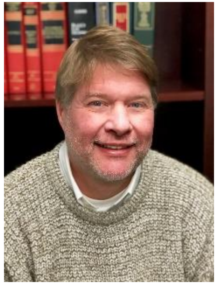

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