2021 RSM state and local tax year-end guide

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The nation continued to struggle with the health effects of the global pandemic in 2021. Unexpectedly, however, state budgets largely rebounded from the challenges faced in early 2020. The relatively good news for state finances was largely driven by a rebounding economy and a massive influx of federal aid. The improving fiscal situation has allowed a number of states to reduce corporate and personal income tax rates for 2021 and beyond. No state significantly increased taxes in the past twelve months.

Taxpayers should consider a variety of issues as they enter 2022. First, federal conformity issues remain, including various conformity to the federal CARES Act and provisions like the Paycheck Protection Program (PPP) and the Employee Retention Credit (ERC). Second, the transition and adoption of remote employment has spread to many industries and has been widely accepted by both businesses and employees. Hybrid workforces are likely to remain for the next few years, if not permanently. Finally, several trends have emerged that affect the income taxes of both individuals and businesses. Many states have considered, or will consider, pass—through

entity taxes. Indeed, over a dozen state legislatures in 2021 adopted workarounds to the federal state and local tax (SALT) deduction limitation. Public Law 86–272 is also receiving new attention that will affect taxpayers in 2022 due to updated guidance issued by the Multistate Tax Commission (MTC). We address many of these considerations below.

For a more comprehensive planning guide, please consider reviewing RSM's 2021 year–end tax guide for businesses.

FEDERAL LEGISLATION AFFECTING STATE AND LOCAL TAX

Consolidated Appropriates Act, 2021 (CAA)

The CAA, signed Dec. 27, 2020, includes provisions affecting both individual and corporate taxpayers. Individual relief provisions included direct payments, certain charitable contribution deductions for nonitemizers, charitable contribution deduction limitation modifications and grants. The business tax provisions included clarification of PPP loan forgiveness and expense deductibility, extension of the ERC and a number of credits and incentives extenders, among other provisions. Please read RSM's article, Congress passes appropriations bill, containing COVID-19 relief bill for more information on the federal provisions.

American Rescue Plan Act of 2021

 The American Rescue Plan Act of 2021 was signed on March 11, 2021, providing additional relief and stimulus for the pandemic recovery. The act included payments to individuals, expansion of PPP loans, various incentives and grants, including the extension and modification of the ERC, Affordable Care Act premium credits and paid sick leave benefits, among other provisions. Please read RSM's article, President Biden signs <u>American Rescue Plan Act of</u> 2021 for more information.



REMOTE WORKFORCE

Due to the ongoing pandemic, essential and nonessential businesses have been forced to change how employees perform their duties either because of mandatory orders or business environments. Businesses in a wide range of industries have transitioned to entirely, or mostly, remote work arrangements. While some businesses may already have had remote working procedures in place, many employees are working remotely for the first time in their careers.

Employees may live in states and localities that are different from the office or business location, especially when businesses are located near state borders. There are three primary SALT concerns with remote employees. First, a business that does not have any offices or other operations in a state could establish income tax or sales and use tax nexus based on the presence of employees in the state, even if the employee's activities are based within the employee's home. Second, if the employee resides or works in a state that differs from the employer's state, the shifting of the employee's responsibilities to remote locations can affect the sourcing of revenues in both states that adopt cost-of-performance and market-based sourcing type regimes. Third, wages are generally sourced based on the employee's physical location or relative number of working days in the state. States generally treat any day worked in a state as part of this analysis. Accordingly, a day spent working from home in a state due to the pandemic is likely to be counted for purposes of allocating state wages.

In response to the pandemic, a number of states have addressed whether income or franchise tax nexus is created for a business when its employees temporarily telework in a state during the pandemic, in situations where the business has no other nexus-creating presence or activities within the state. Without official state guidance to the contrary, the presence of an employee working in a state is typically sufficient presence to create corporate income tax nexus in that state. At least 18 states offered nexus or withholding safe harbors, although many of these measures are temporary or effective only through the duration of a state emergency order.

For more information on SALT issues due to remote work, please read RSM's articles, <u>When the office can be anywhere</u>, <u>where are taxes paid?</u> and <u>Remote workforces are complicating state tax nexus and withholding</u>.

STATE TAX AMNESTIES

Connecticut Senate Bill 1202

 On June 23, 2021, Connecticut Gov. Ned Lemont approved legislation enacting a tax amnesty program for the period Nov. 1, 2021, through Jan. 31, 2022. Eligible participants receive an interest reduction of 75% and full waiver of penalties.

Nevada Senate Bill 3 (2020)

Nevada provided a general tax amnesty program from Feb.
 1, 2021, to May 1, 2021. Interest and penalties waivers were provided to eligible participant.

INCOME/FRANCHISE TAX DEVELOPMENTS

Pandemic responses and federal legislation conformity continued in 2021 state legislative sessions. States also used a surprisingly robust budget outlook and positive tax collection revenue to offer minor rate reductions. Below is a highlighted sample of 2021 state legislative changes as well as summaries of other noteworthy developments.

1. Rate changes

Numerous rate changes occurred in 2021 in addition to previously scheduled changes. Many of the changes involved minor reductions to the corporate or individual income tax rate bolstered by unexpected tax collections. Please note that these changes do not reflect previously scheduled changes or reductions due to revenue triggers.

Arizona Senate Bills 1827 and 1828

 On June 30, 2021, Arizona Gov. Doug Ducey approved two bills affecting individual income tax rates. The first bill replaces the current individual income tax brackets with two and provide for a rate reduction in future years contingent on revenues. The second bill provides a cap to the total rate imposed on high earners subject to the Proposition 208 surcharge. For more information, please read our alert, <u>Arizona enacts significant individual</u> income tax reductions.

Idaho House Bill 380

 On May 10, 2021, Idaho Gov. Brad Little approved a bill to reduce individual income tax rates in each bracket and reduce the corporate income tax rate to 6.5%.

Iowa Senate File 619

 On June 16, 2021, Iowa Gov. Kim Reynolds approved a bill that removes certain revenue triggers allowing previously contingent individual and corporate tax changes to become effective Jan. 1, 2023. Among other changes, the individual top rate will be reduced from 8.98% to 6.5%. For more information, please read our alert, <u>Iowa continues tax reform efforts into 2021</u>.

Montana Senate Bills 159 and 399

 Montana Gov. Greg Gianforte approved a rate reduction for the highest marginal individual income tax rate effective Jan. 1, 2022. Effective in 2024, the state's seven individual income tax brackets are reduced to two.

Nebraska Legislative Bill 432

 On May 26, 2021, Nebraska Gov. Pete Ricketts approved corporate rate reductions beginning in 2022. For more information, please read our alert, <u>Nebraska cuts</u> <u>corporate income tax rates</u>.

New Hampshire House Bill 2

 House Bill 2 reduces the business enterprise tax rate from 0.6% to 0.55% and reduces the business profits tax from 7.7% to 7.6%, effective tax years ending on or after Dec. 31, 2022.

New York Senate Bill 2509C/Assembly Bill 3009C

 New York's fiscal year 2022 budget legislation makes a number of changes to personal and corporate income tax rates. For individuals, the highest marginal rate is eliminated in favor of three brackets with rates ranging from 9.65% to 10.9%, effective with 2021 tax years. For corporate income tax, the rate increases to 7.25% for taxpayers with business income over \$5 million effective Jan. 1, 2021. For more information, please read our alert, New York to increase income tax rates; enact SALT workaround.

Oklahoma House Bills 2960, 2962 and 2963

 On May 21, 2021, Oklahoma Gov. Kevin Stitt approved bills reducing the corporate income tax rate to 4%, reducing each individual income tax bracket by 0.25% and reducing the elective pass-through entity tax to 4%. For more information, please read our alert, <u>Oklahoma cuts</u> <u>corporate and individual income tax rates</u>.

2. Income and franchise tax developments

- Alabama House Bill 170

House Bill 170 adopts a number of corporate tax changes including single-sales factor apportionment, a repeal of the throwback rule and section 163(j) changes, all effective Jan. 1, 2021. Retroactively effective to tax years beginning after Dec. 31, 2017, the state decouples from federal GILTI—global intangible low-taxed income—rules. For more information, please read our alert, Alabama enacts significant corporate tax and COVID-19 relief.

District of Columbia "terminating business exclusion" eliminated

 Effective for tax years beginning on or after Jan. 1, 2021, the District of Columbia eliminated an exemption used to exclude the gain on the sale of property in the District for unincorporated business tax purposes. For more information, please read our article, <u>D.C. eliminates</u> terminating business exclusion for UBT.

Illinois Senate Bill 2017

- The fiscal year 2022 budget bill makes a number of corporate tax changes. Effective for tax years on or after

June 30, 2021, the bill requires taxpayers to add back the GILTI deductions allowed under section 250(a) and add back the deductions related to sections 243(e), certain dividends from foreign corporations, and section 245A(a), dividends received from a specified 10% owned foreign corporation. Effective Jan. 1, 2022, the state will decouple from the 100% depreciation deduction allowed under section 168(k). The bill also limits net loss deductions to \$100,000 annually between 2021 and 2024. Finally, the franchise tax phase–out is suspended. For more information, please read our alert, Illinois enacts fiscal year 2022 budget with tax changes.

Iowa Senate File 619

 On June 16, 2021, Iowa Gov. Kim Reynolds approved a bill that removes certain revenue triggers allowing previously contingent individual and corporate tax changes to become effective. A number of individual and corporate tax changes are effective Jan. 1, 2023. For more information, please read our alert, <u>Iowa continues tax</u> reform efforts into 2021.

Maryland House Bill 732

 In February, the Maryland legislature overrode the governor's veto of the first-in-the-nation digital advertising tax imposed on digital advertising revenue derived from Maryland. The effective date of the tax was subsequently delayed until 2022. For more information, please read our alert, <u>Maryland delays digital ad tax</u>; <u>provides digital goods clarification</u>.

Montana Senate Bill 376

 Senate Bill 376 adopted a double-weighted sales factor for apportionment purposes effective for tax years beginning after June 30, 2021. Previously an equallyweighted three-factor apportionment formula was used.

Texas franchise tax sourcing rules

 On Jan. 15, 2021, the Texas comptroller adopted final amendments reflecting sourcing changes to a number of services including general services, advertising, internet hosting, capital assets and investments, financial derivatives, and transportation. The sourcing rules also affect the sourcing of receipts related to the sale of computer hardware and digital property. These changes may affect previous sourcing methodology for many taxpayers. For more information, please read our alert, Texas issues revised franchise tax sourcing rules.

Washington Senate Bill 5096

 Senate Bill 5096 enacted a capital gains tax on the sale of long-term capital assets of individuals at a rate of 7%, effective Jan. 1, 2022. The tax is highly controversial and is currently in litigation. For more information on the tax, please read our alert, <u>Washington state enacts capital</u> gains tax.

West Virginia House Bill 2026

 House Bill 2026 adopts market-based sourcing for sales other than sales of tangible personal property and single-sales factor apportionment, effective Jan. 1, 2022.
 For more information, please read our alert, West Virginia enacts market sourcing and single-sales factor.

A number of other income and franchise tax updates are available through RSM's quarterly provision updates. Please read the 2021 state tax law changes for <u>quarter one</u> or <u>quarter two</u> for more information.

3. Paycheck Protection Program loan forgiveness and state conformity

The Consolidated Appropriations Act, 2021 signed into law on Dec. 27, 2020, provided clarity on PPP loan forgiveness and the deductibility of related expenses. While the treatment of PPP loan forgiveness has been resolved for federal income tax purposes, as with any federal tax law change, the state treatment remained uncertain for much of the year. By fall of 2021, most states have adopted PPP forgiveness and allow deductibility of expenses; however, some states have not yet, and may not, conform to the federal treatment. Businesses should continue to monitor state legislation and guidance regarding PPP loan forgiveness and the treatment of eligible expenses. For more information, please read our article, PPP forgiveness and expenses: State tax implications.

4. State pass-through entity workarounds

The Tax Cuts and Jobs Act (TCJA, P.L. 115–97) limited the individual taxpayer deduction for SALT payments to \$10,000 a year (\$5,000 for a married person filing a separate return). SALT payments (including income and real property taxes) that exceed these amounts are no longer deductible by individual taxpayers unless the payments are in pursuit of a trade or business.

As a response to the TCJA's limitation, several states began to adopt a pass–through entity–level tax intended as a workaround. The intended benefit of the pass–through entity paying the tax is that the ultimate partner can recharacterize a nondeductible individual state income tax expense to a deductible state income tax expense for federal income tax purposes. The taxes paid by the pass–through entity are deductible for federal income tax purposes, where the SALT limitation would apply if that tax was passed through to the member.

Several of these workarounds were adopted beginning in 2018 through 2020. However, over a dozen states passed workarounds in 2021. As of the date of this guide, the states that have enacted workarounds (with the first effective year in parentheses) include Alabama (2021), Arizona (2022), Arkansas (2022), California (2021), Colorado (2022), Connecticut (2018), Georgia (2022), Idaho (2021), Illinois (2021), Louisiana (2019),

Maryland (2020), Minnesota (2021), New Jersey (2020), New York (2021), Oklahoma (2019), Oregon (2022), Rhode Island (2019), South Carolina (2021) and Wisconsin (2018). Workarounds were passed, but vetoed, in Massachusetts and Michigan. The Massachusetts and Michigan vetoes may be overridden, but those actions have not yet occurred as of the date of this guide. Pass–through entity tax workarounds may provide substantial benefit for some owners. For more information on pass–through entity tax workarounds, please read our article, Not a panacea: State pass–through SALT deduction workarounds.

5. Public Law 86-272

The Interstate Income Act of 1959, commonly known as Public Law 86–272 or P.L. 86–272, generally prohibits states from imposing net income taxes on income derived from interstate commerce if the business activities in the state are limited to solicitation of orders of tangible personal property that are sent outside the state for approval and, if approved, are filled by shipment or delivery from a point outside the state. On Aug. 4, 2021, the MTC unanimously adopted an updated version of its P.L. 86–272 guidance specifically to address internet activities. MTC guidance is usually adopted by its member states, and in the short term, full adoption is anticipated in over 20 states. Additionally, this guidance will likely influence policies in nonmember states.

The MTC's new guidance generally provides that interaction between a business and its customer via the business's website or app is business activity in the customer's state for the purposes of applying P.L. 86–272, and will be treated as exceeding protected activities to the same extent that such interactions would be unprotected if done in person. The guidance provides a carve–out for websites and apps that limit interaction to static text or photos; however, websites and apps have long been trending away from this narrow exception. To read more about the new guidance and what it may mean for businesses currently taking or considering taking a P.L. 86–272 position, please read our article, MTC adopts new P.L. 86–272 guidance: What you need to know.

SALES AND USE TAX

Sales tax revenues dropped considerably in 2020 with total state sales tax revenue in the second quarter dropping almost 14% from the same quarter in 2019. A slight rebound emerged in quarter three of 2020 through quarter one of 2021, although with only minor increases from the same quarters the year before. However, through mid–2021, it was clear that sales tax revenues had more than rebounded from 2020. In Q2 2021, total state sales tax revenues were 37% higher than Q2 2020. With that in mind, total state revenues, including income, gross receipts and other taxes were well above estimates for the 2021 legislative sessions and the fiscal year 2022 budget process. Very few legislative increases in sales tax base were enacted and there were no state sales tax rate increases.

Economic nexus has generally helped bolster and sustain state sales tax collections and will continue to do so. However, the taxation of services, including professional services and cloud-based services will continue to be considered, especially if states experience budgetary unease in the coming years.

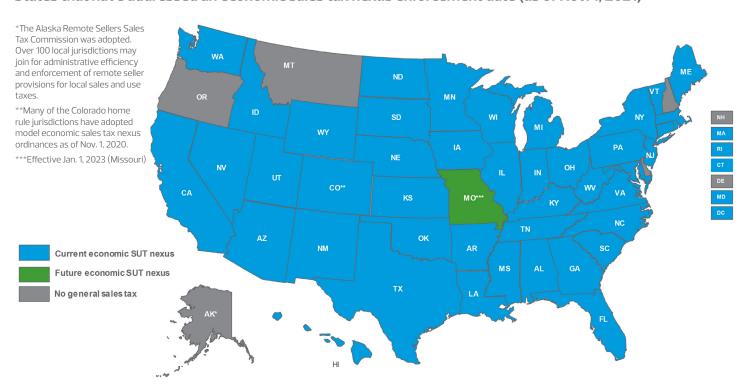
1. Wayfair and economic nexus: Year four

On June 21, 2018, the U.S. Supreme Court issued its decision in *South Dakota v. Wayfair*, overturning the long–standing physical presence nexus standard established through *Quill v. North Dakota* in 1992. Soon after the decision, the states began to adopt economic nexus and marketplace nexus thresholds.

Within two years, most of the states had adopted economic sales tax nexus. In just over three years, every state with a general sales tax adopted economic nexus. In 2021, the last remaining states adopted economic nexus. Florida adopted economic nexus and marketplace nexus, effective July. 1, 2021; Kansas adopted a legislative threshold and marketplace nexus, effective July 1, 2021; and Missouri, the last holdout, adopted economic nexus and marketplace nexus, effective Jan. 1, 2023.

For a more comprehensive summary and update on business considerations addressing Wayfair, please read our article, <u>Wayfair</u> nexus turns three by celebrating near universal adoption.

States that have addressed an economic sales tax nexus enforcement date (as of Nov. 1, 2021)



Thank you for reading our 2021 RSM SALT year–end guide. Other sources of SALT updates can be found through our <u>articles and alerts</u>. Also, please consider attending live sessions scheduled for the <u>2021 RSM Tax Summit, Tax in Motion, in November</u>.

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