

State Taxation in a COVID-19 World

TEI Denver – State and Local Taxation Webinar

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Learning Objectives

- Understand how the COVID-19 crisis has affected the state and local tax landscape
- Understand the state tax implications of the CARES Act
- Learn about the state employer withholding and unemployment insurance tax implications of mandatory teleworking policies and other remote working arrangements during the COVID-19 crisis

Agenda

- SALT Implications of the CARES Act
 - Overview
 - General Background on State Conformity
 - Setting the Landscape: Pre-, Post-TCJA, and CARES Act Changes
 - SALT Impact
 - State Responses to the CARES Act
- State Tax Considerations for Employers
 - Employer Withholding
 - Unemployment Insurance
 - Nexus and Other Issues

Overview

The Coronavirus Aid, Relief, and Economic Security Act

What is the CARES Act?

- The Coronavirus Aid, Relief, and Economic Security Act (CARES Act)
 - Signed into law on March 27, 2020
 - Largest stimulus package in United States history:
 - Provides direct financial assistance to distressed businesses;
 - Significantly expands unemployment assistance; and
 - Provides rebates directly to taxpayers (so called stimulus checks, with eligible taxpayers receiving up to \$1,200 (\$2,400 if married) and an additional \$500 per child)

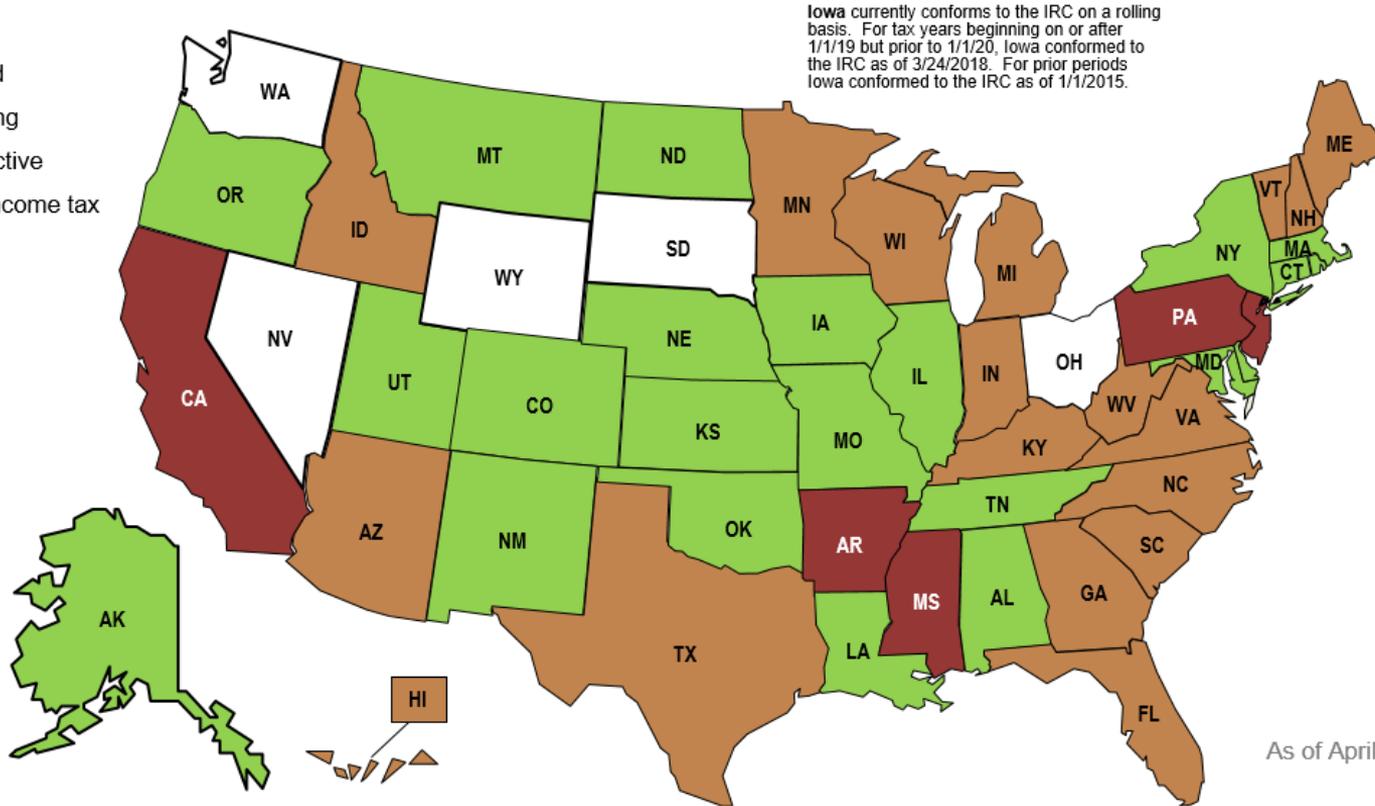
Why is this Relevant?

- The CARES Act also includes several taxpayer-favorable changes to core federal tax provisions that were enacted or revised by the Tax Cuts and Jobs Act (TCJA)
- The CARES Act:
 - Establishes a new employee retention payroll tax credit,
 - Permits employers to defer the payment of payroll taxes,
 - Modifies:
 - **Net operating loss (NOL) provisions under IRC § 172**
 - **Business interest limitation provisions of IRC § 163(j)**
 - Bonus depreciation provisions of section IRC § 168(k)
 - Excess business loss limitation provisions under IRC § 461(l), and
 - Corporate alternative minimum tax (AMT) provisions under IRC § 53(e)

General Background on State Conformity

State Conformity: The Gating Question

- Key**
- Fixed
 - Rolling
 - Selective
 - No income tax



Iowa currently conforms to the IRC on a rolling basis. For tax years beginning on or after 1/1/19 but prior to 1/1/20, Iowa conformed to the IRC as of 3/24/2018. For prior periods Iowa conformed to the IRC as of 1/1/2015.

New York has static IRC conformity of 3/1/2020 for personal income tax purposes (tax years beginning before 1/1/2022); rolling conformity for corporate franchise tax purposes.

- RI
- NJ
- DE
- DC

As of April 13, 2020

Setting the Landscape: Pre-, Post-TCJA, and CARES Act Changes

NOLs (IRC § 172)

— Pre-TCJA

- Subject to the application of the AMT (which was repealed by the TCJA), companies could fully offset their current year taxable income with NOL carryforwards
- NOLs could also be carried back 2 years and carried forward 20 years to offset, without limitation, taxable income in those years

— Post-TCJA

- 80% limitation (determined without regard to the deduction) on the deductibility of loss carryforwards arising in taxable years beginning after December 31, 2017
- Elimination of NOL carrybacks
- Unlimited NOL carryforwards for losses arising in taxable years beginning after December 31, 2017

The CARES Act's Changes to NOLs (IRC § 172)

- Elimination of the 80% Limitation
 - “The Temporary Repeal of Taxable Income Limitation”
 - Applicable to taxable years beginning before January 1, 2021
 - NOLs from taxable years beginning after December 31, 2017 that are carried forward to taxable years beginning after December 31, 2020 will be subject to the 80% limitation that was enacted as part of TCJA

- Reinstatement of NOL Carrybacks
 - 5-year carryback period for NOLs arising in 2018, 2019, and 2020 (taxable years beginning after December 31, 2017 and before January 1, 2021)

IRC § 163(j)

— Pre-TCJA

- Business interest allowed as a deduction in the year in which the interest was paid or accrued, subject to limitation rules, as applicable

— Post-TCJA

- Generally limits the amount of net business interest expense that may be deducted for US federal income tax purposes to 30% of the taxpayer's adjusted taxable income (ATI)
- Any business expense in excess of the 30% threshold is carried forward and can be deducted in a future year, subject to the application of the same limitation
- Limitation is applied at the federal consolidated group level in the case of consolidated group filers; elimination of intercompany transactions

The CARES Act's Changes to IRC § 163(j)

— New IRC § 163(j)(10)

- In the case of any taxable year beginning in 2019 or 2020, the business interest expense limitation amount is increased from 30% of ATI to 50% of ATI
- Taxpayers may elect not to have IRC § 163(j)(10) apply, retaining the application of the 30% ATI limitation
- Permits taxpayers to elect to use 2019 ATI for taxable years beginning in 2020

SALT Impact

NOLs

- Historic deviation from the federal carryback/carryforward rules
- States that explicitly adopt the federal NOL deduction by use of line 30 of federal Form 1120 (taxable income after the NOL deduction and special deductions) without modification as the starting point for determining state taxable income
- States that use line 30 as the starting point of federal Form 1120, but add back the federal NOL deduction and provide a separate computation to calculate the state NOL deduction
- States that begin the tax calculation with line 28 of federal Form 1120 (taxable income before NOL deduction and special deductions) and provide their own set of rules for determining the NOL deduction

IRC § 163(j) Disconnect

- IRC §163(j) limitation under the proposed IRC §163(j) regulations is impacted by the filing of a federal consolidated return
- Separate return state guidance:
 - New Jersey (TB-87)
 - Application of the IRC §163(j) limitation comes before application of the state's addback rules
 - Move to unitary combined reporting
 - Pennsylvania (Corporation Tax Bulletin (CTB) 2019-03)
 - Separate calculation methodology on a separate company basis
 - Only applied if the federal consolidated group of which the Pennsylvania taxpayer is a member actually reported an IRC §163(j) limitation for the applicable tax year
 - Virginia (2019 Va. Acts c. 17 (H 2529) and c. 18 (S 1372))
 - Fixed conformity state
 - Provides an additional current year Virginia deduction of 20% of the business interest limited by IRC §163(j) at the federal level

A GILTI Trap?

— GILTI Refresh

— IRC § 250 Deduction Hit –

- IRC § 250 deduction is taxable income limited
 - A company's utilization of The CARES Act's changes to NOLs and/or IRC § 163(j) will result in a decrease in taxable income, thereby reducing or eliminating a company's IRC § 250 deduction
- In contrast to the IRC § 250 deduction, NOLs and/or excess interest expense under IRC § 163(j) is carried forward and may be deducted in a future year

— The Trap –

- Potential for an increase proportion of GILTI to be subject to state tax
 - Some line 28 states include the full amount of the GILTI (IRC § 951A) in taxable income. And then allow as a deduction the full or partial amount of a taxpayer's IRC § 250 deduction
 - If the IRC § 250 deduction is reduced, the amount a company can deduct is equally reduced

State Responses to the CARES Act

In New York...

- First State to respond to The Cares Act
- New York fiscal year 2021 budget
 - Static conformity to IRC as of March 1, 2020 for personal income tax years beginning before January 1, 2022
 - Applies to both New York State and New York City
 - Decouples from the increased IRC § 163(j) interest expense limitation
 - Conforms to the IRC § 163(j) election for year of ATI calculation (2019 or 2020)
 - Likely no impact with respect to NOLs since New York provides specific rules for determining NOL carryforwards

Other Considerations

- Short-term and long-term impact on state budgets
- Bills to exempt individual rebate checks from state tax
 - Arkansas, Pennsylvania
- Other potential tax reform initiatives?

State Tax Considerations for Employers

State Employment Tax Considerations

- Given the dramatic limitations on business travel and mandatory WFH policies, U.S. employers should evaluate how these disruptions impact their state and local employment tax obligations.

Employer Withholding- Business Travel Limitations

- Employers should revisit their employees' business traveler policies and multistate withholding allocations.
 - Due to elimination of most business travel, a nonresident employee may not cross a state's or locality's withholding threshold
- Consider adjusting nonresident withholding certifications or allocations to avoid over-withholding from employee wages.
 - E.g., NY Form IT-2104.1 or internal HR forms
- Consider impact on deferred compensation allocations and statutory residency issues

Employer Withholding - Teleworking

- Jurisdictions generally require employers to withhold tax based on where an employee performs services, i.e., the location where the employee earns wages subject to tax, or in some cases where the employee resides.
- Prolonged teleworking may change the jurisdiction where an employer is required to withhold
- Considerations – technical v. practical
 - Relative tax rates between work state and resident state
 - Availability of credit for taxes paid
 - Employer compliance burdens to the employer

Employer Withholding – Exceptions to Source Taxation

- Employers should review not only the “work state” but also the “residency state” of their employees
- Reciprocity
- Convenience of the Employer
 - New York State, Connecticut, Delaware, Pennsylvania, Nebraska, and (maybe) Arkansas
 - Temporary adoption during COVID-19 emergency declarations

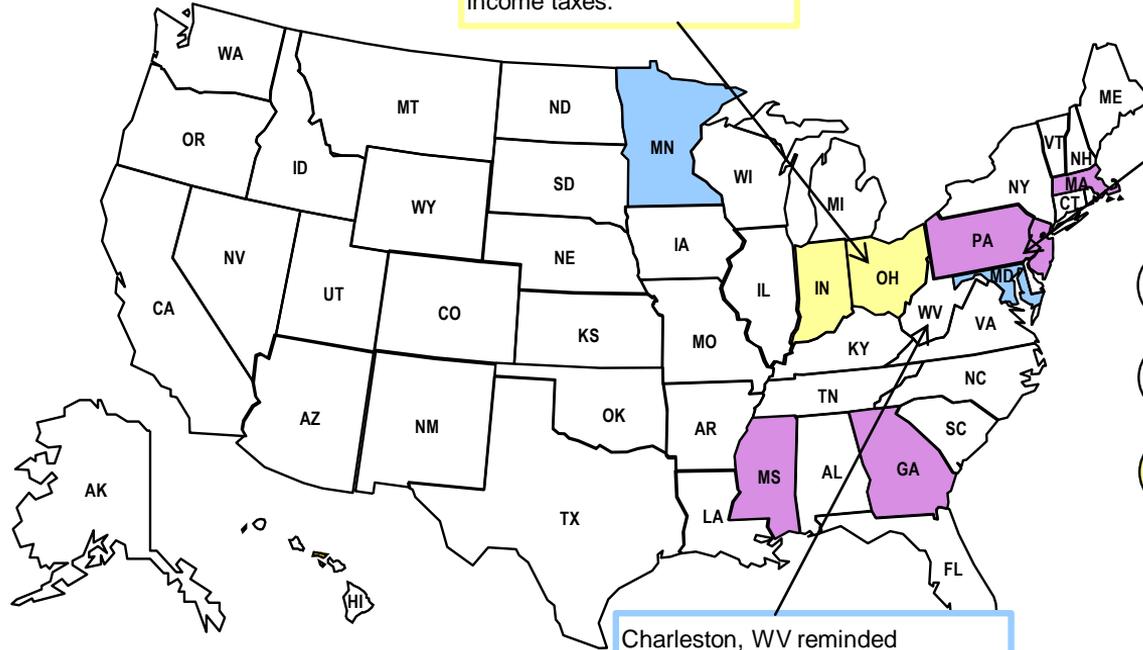
State Employer Withholding Guidance

As of May 9, 2020
(Does Not Include Extensions)

Key of General Approaches

- Current Withholding Rules Still Apply
- No New Withholding Guidance
- Remote Work Does Not Create Sales and/or Income Tax Nexus
- No New Withholding Obligations & No Sales/Income/Local Tax Nexus

Pandemic-related remote work does not count toward the 20-day grace period for the imposition of municipal income taxes.



City of Philadelphia clarified that its existing withholding standard does not impose wage tax on teleworkers outside of the city.

Charleston, WV reminded employers that the application of the city's user fee will not change based on temporary pandemic-related work arrangements.

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Impact on Federal Legislation

Will WFH policies reinvigorate federal legislation related to state withholding?

- Telecommuter Tax Fairness?
- Mobile Workforce?
- Other?

State Unemployment Insurance

- Impact of COVID-19 on a Multistate Employer's UI Contributions
 - Localization
 - The UI sourcing rules materially differ from the withholding rules based on residence and source and, absent prolonged social distancing/teleworking, localization likely not to change for many employees.
 - Reserve account charges and experience rate adjustments?
 - Increased scrutiny on worker classification?
 - Other long term impacts?

Working-From-Home and Localization

- Employment “localized” in a state
 - Service performed entirely in the state, or
 - Service performed in/out of the state, but the out-of-state service is incidental to in the state
 - “Incidental” service = temporary or transitory in nature, or isolated transactions
- Not localized in a state, but (A) some service is performed in the state and (B):
 - (i) Base of operations in the state, or
 - (ii) If not (i), then place of direction and control, or
 - (iii) If not (i) or (ii), then residence.
- Impact of reciprocity agreements (IRCA)

Worker Classification and Other Long Term Issues

- Increased scrutiny on worker classification?
 - For example –
 - *A Special Touch v. Pennsylvania Dep't of Labor and Indus.*, Case No. 30 MAP 2019, Pennsylvania Supreme Court (April 23, 2020).
- Other long term impacts?
 - Federal loans
 - Wage base increases?

Other State Tax Considerations – Nexus & Apportionment

- Even absent guidance, employees working from home may not generate nexus exposure for employers.
 - One employee working from home within a state has the potential to trigger nexus for income tax and/or sales tax purposes
 - Is employee “maintaining a market” (soliciting) in the state? It may – or may not – matter?
- Still more possibilities:
 - To the extent UI localization of service changes, the payroll factor in some state’s corporation income tax (which frequently tracks the localization rules for state unemployment insurance taxes)
 - Liability under local payroll-based excise taxes?



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