

State Tax News – On the Airwaves Today

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Introductions



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Agenda



State Income/Gross Receipts Tax Nexus in a Post-Wayfair World



Sales Apportionment Considerations



Gross Receipts Taxes



Other Developments

State Income/Gross Receipts Tax Nexus in a Post-Wayfair World

Wayfair US Supreme Court decision on nexus

Decision Summary

On March 22, 2016, Governor Dennis Daugaard signed Senate Bill 106 (S.B. 106) amending S.D. Codified Laws § 10-45 and 10-52, **effective May 1, 2016**, to require the collection of South Dakota sales tax on sales into South Dakota if, in the previous or current calendar year:

- The seller's sales into South Dakota were **higher than \$100,000**, or
- The seller **had two hundred or more separate transactions** into South Dakota.

Quill overturned – Substantial nexus does not require physical presence

- In its June 21, 2018 decision in *Wayfair*, the U.S. Supreme Court overruled *Quill* and *National Bellas Hess* finding the physical presence rule promulgated under these decisions were “unsound and incorrect.”
- 5-4 decision
 - Justices Kennedy with Ginsburg, Alito, with Justices Gorsuch and Thomas concurring; and Chief Justice Roberts with Justices Breyer, Sotomayor, and Kagan dissenting.
- The main reasons the court found for overturning *Quill* -
 - The application of a physical presence requirement is an “incorrect interpretation of the Commerce Clause” particularly when measured in a vastly expanded e-commerce marketplace.
 - South Dakota's law does not violate substantial nexus requirements because remote sellers have the potential to maintain a significant virtual presence in the state.
 - The principle of stare decisis cannot stand when it prohibits states from exercising lawful powers.

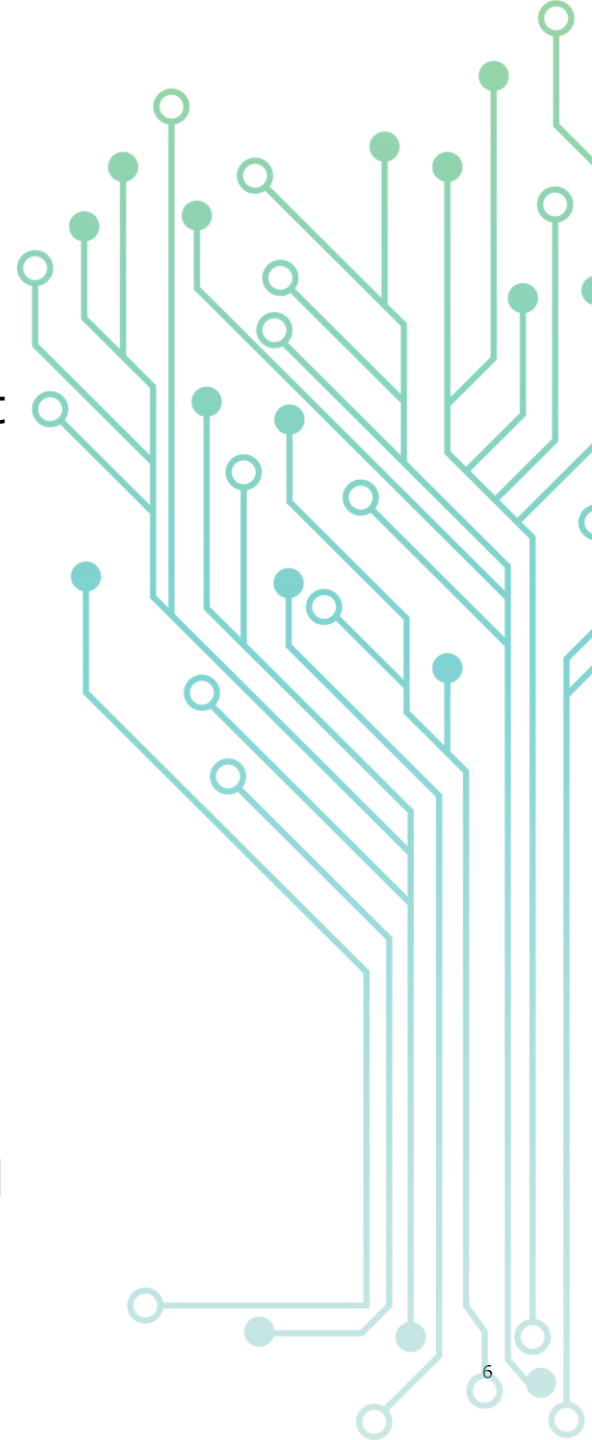


State Income Tax Considerations

Wayfair Implications

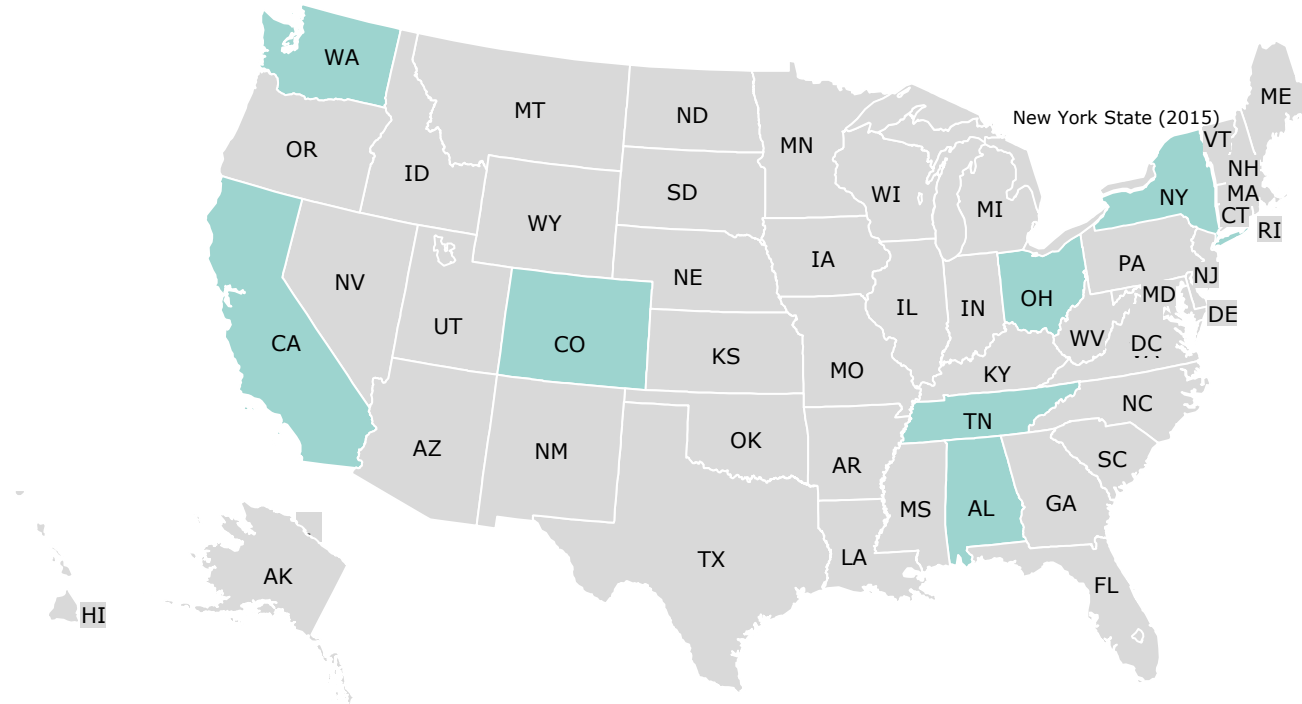
Uncertainty in the Income Tax Arena

- In 1993, South Carolina Supreme Court held that physical presence was not required for the imposition of income tax, and that *Quill's* physical presence standard was limited to only sales and use tax.
- To date, the U.S. Supreme Court has not granted *certiorari* in any such case pertaining to economic nexus.
- Number of states have enacted so-called “factor-based” economic nexus presence standards for income or gross-receipts type taxes.
- Potential retroactive application and enforcement to the effective date of a state’s applicable income tax nexus statute or rule is possible.
- *Wayfair* will also receive careful consideration by other states, which may seek to adopt economic or factor-based presence nexus provisions. Is adoption of a new provision/policy required? Or will such policies be applied retroactively to 2018 (i.e., the year of the *Wayfair* decision)? Will they be applied retroactively to 2017 and earlier?



Factor-Based Nexus Standards

- Under a bright-line “factor-based” standard, nexus is created with a state when a minimum amount of property, payroll or sales in the state is met.



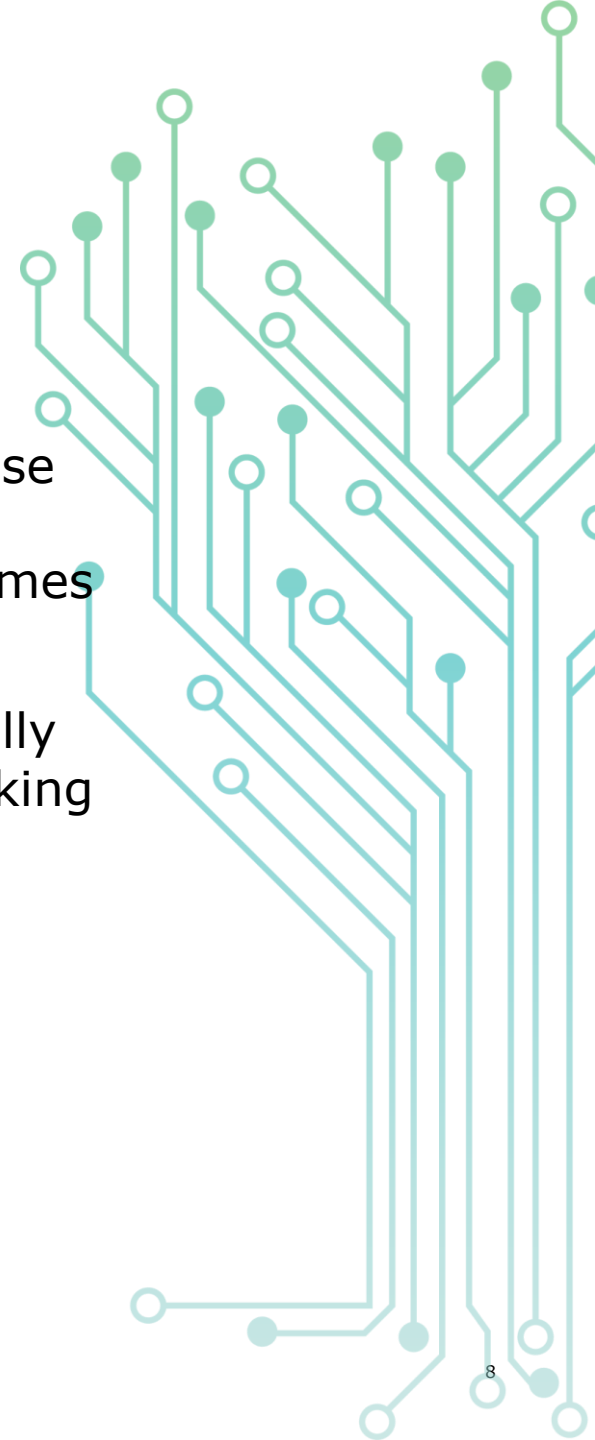
Example of States adopting “Bright-Line” Nexus Tests

- Multistate Tax Commission Model “Factor Nexus” Statute
- Substantial nexus is established if any of the following thresholds are exceeded during the tax period: \$50,000 of property; or \$50,000 of payroll; or \$500,000 of sales; or 25% of total property, total payroll or total sales.

COVID-19 Nexus Implications

Telecommuting and Corporate Tax Nexus

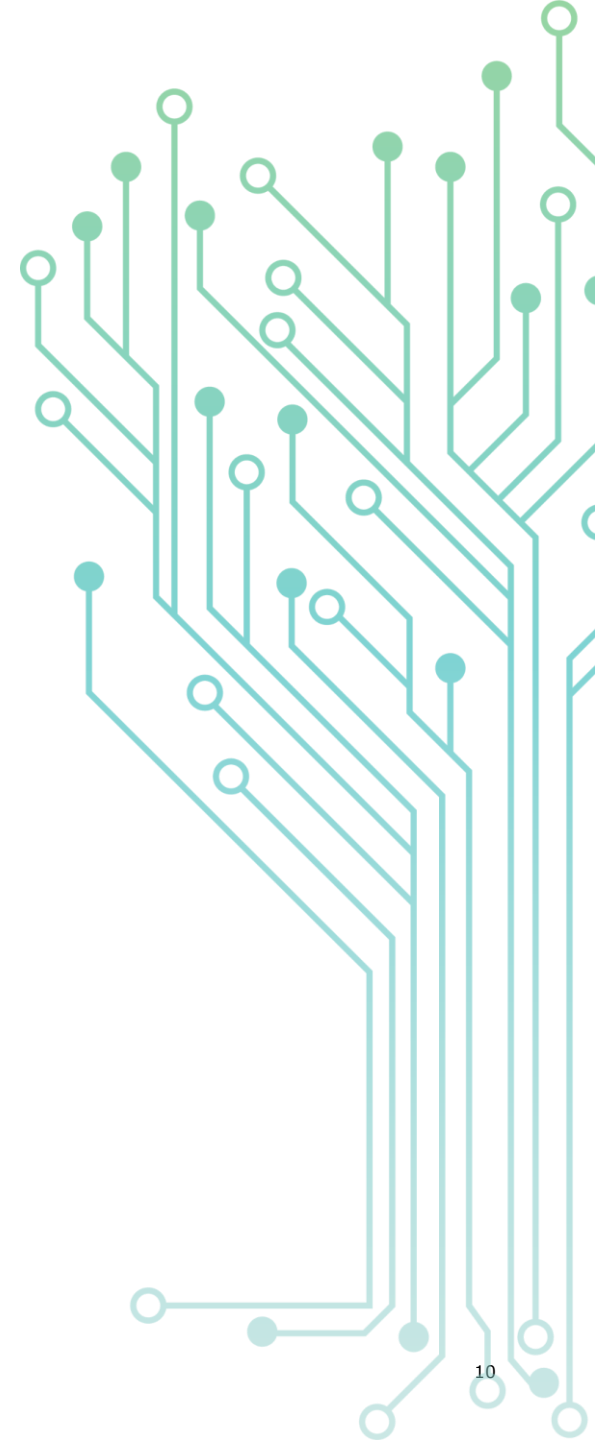
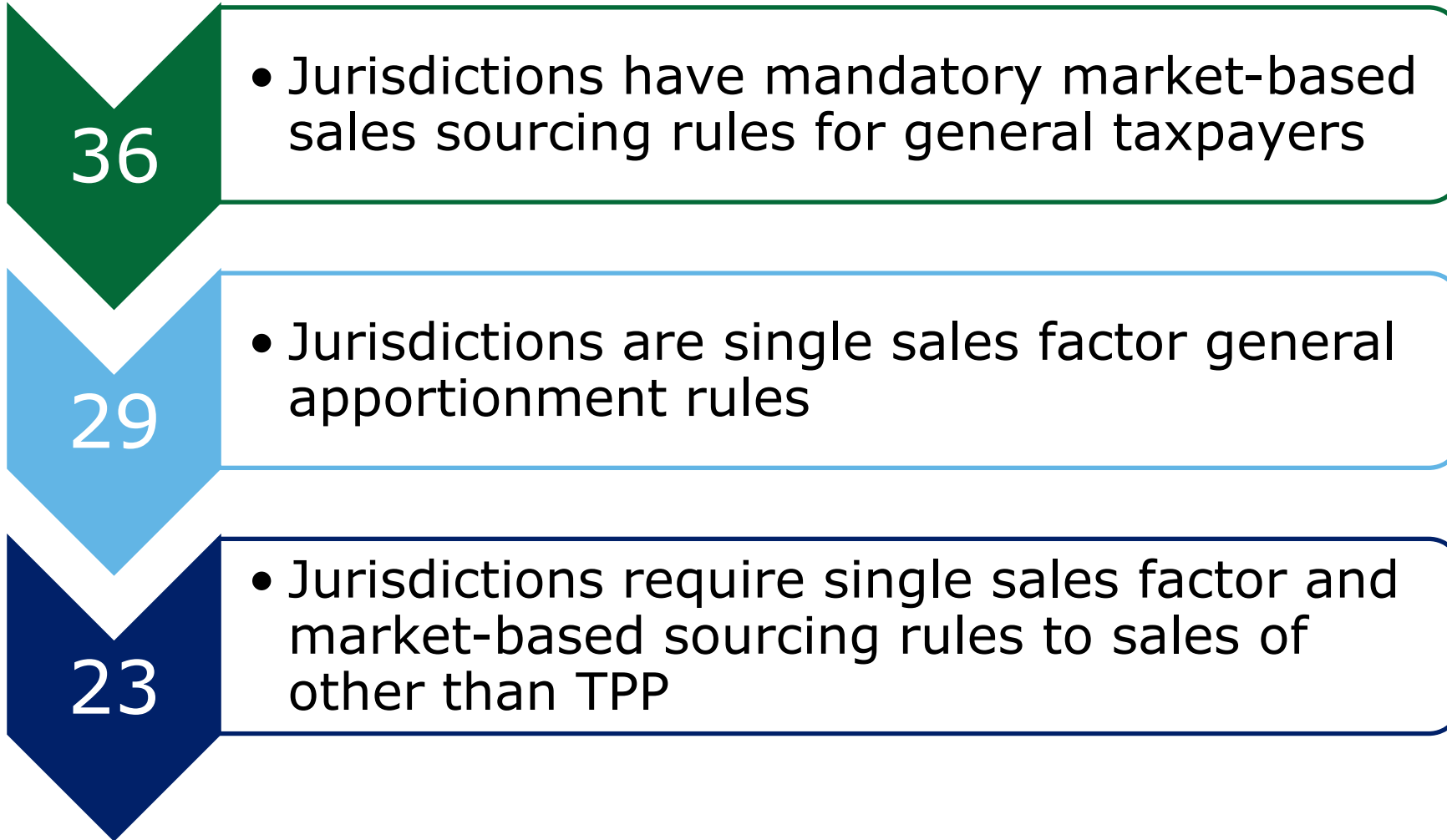
- Many states have issued guidance indicating that they will not seek to impose income tax nexus for exceeding P.L. 86-272 protection solely based on an employee's physical work location or property used to complete tasks at homes during periods of remote working due to the pandemic.
- Several states have also issued guidance regarding apportionment specifically indicating that there will be no consideration of changes during remote working periods.



Sales Apportionment Considerations

Market-Based Sales Sourcing Overview

By the Numbers



Market-Based Sales Sourcing Overview

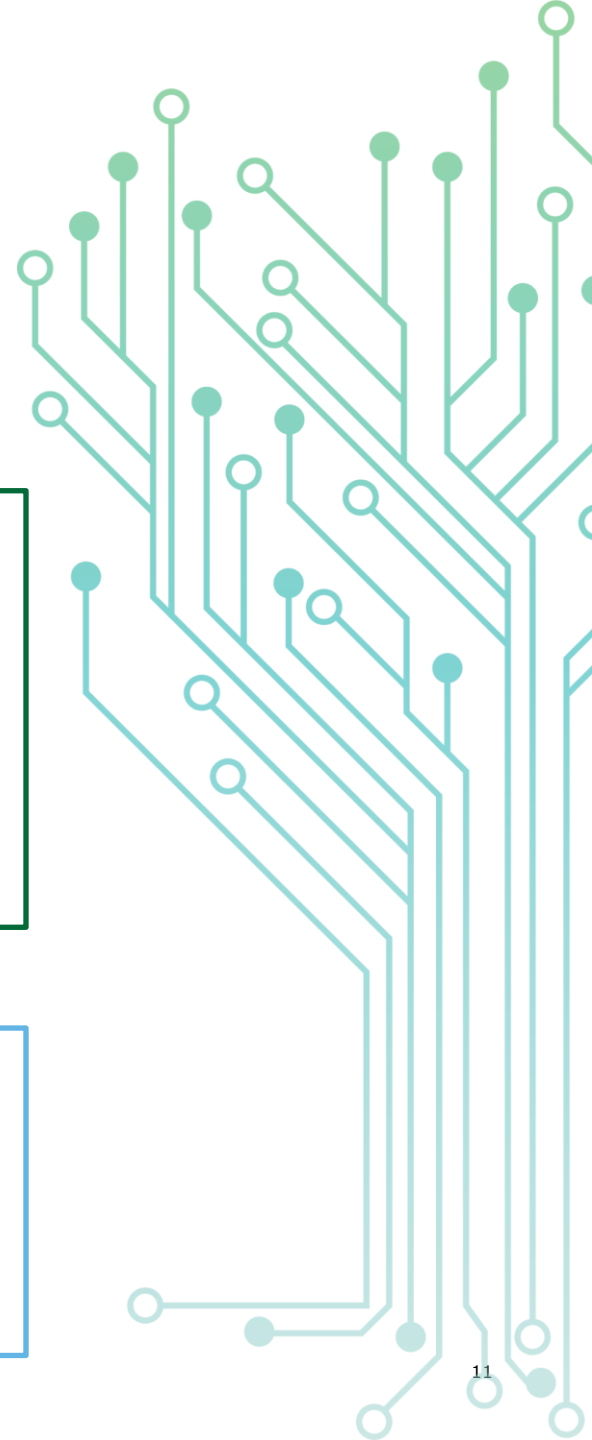
2020 Updates

•Adopted Market-Based Sourcing

- Indiana
- New Hampshire (2021 tax year and forward)
- New Mexico (2020 tax year and forward)
- North Carolina (2020 tax year and forward)
- Vermont (2020 tax year and forward)

Rules or Regulations Revisions for Market-Based Sourcing

- Colorado
- Kentucky
- Louisiana



Market-Based Sales Sourcing Overview

General Rules

• Market-based sourcing rules for sales of services are generally considered:

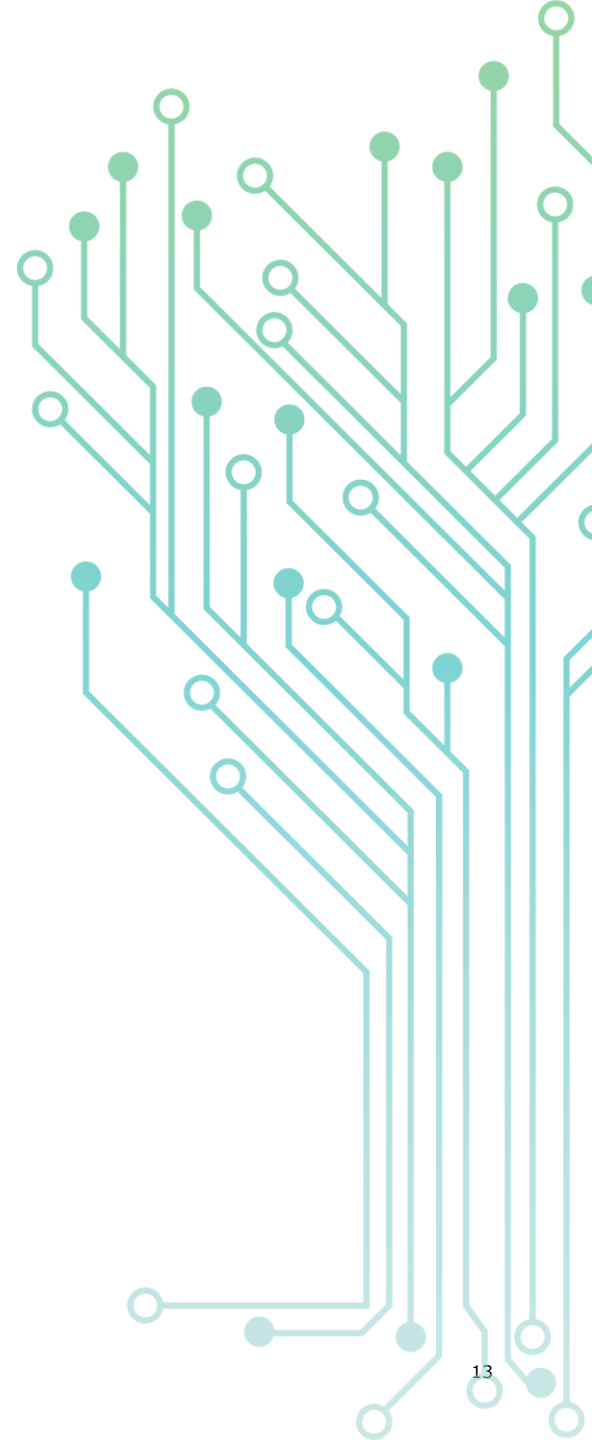
- Where the service was received;
- Where the benefit of the service was received;
- Where the service was delivered; or
- Where the customer is located

Application of different market-based sourcing rules to taxpayer's facts is often not a straightforward exercise under varying rules



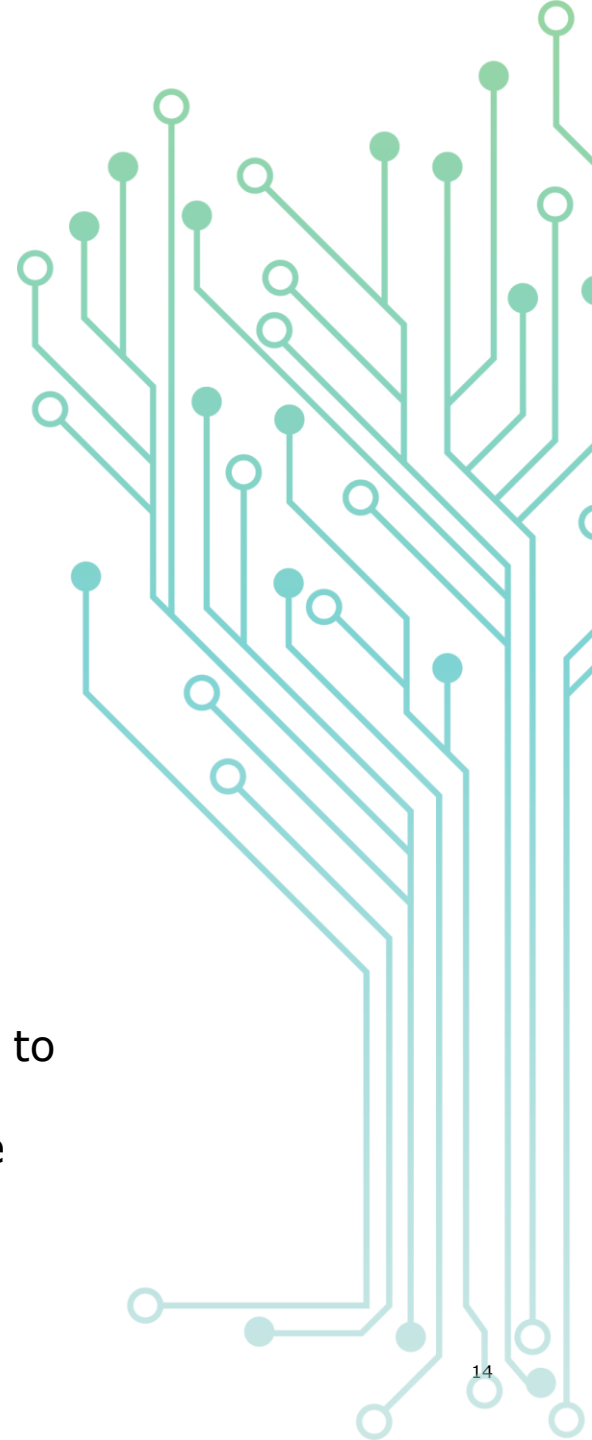
Taxpayer Perspective: Potential Risks of Market-Based Sales Sourcing

- Differing approaches may apply for determining where benefit of service received
 - In general, benefit received at location of customer
- If benefit received in more than one state, different rules may apply depending on following variables:
 - Individual customers vs. business customers
 - Your customer vs. your customer's customer (i.e., look-through)
 - Order location vs. billing location
 - Benefit location is indeterminable
 - No nexus or fixed place of business in business location



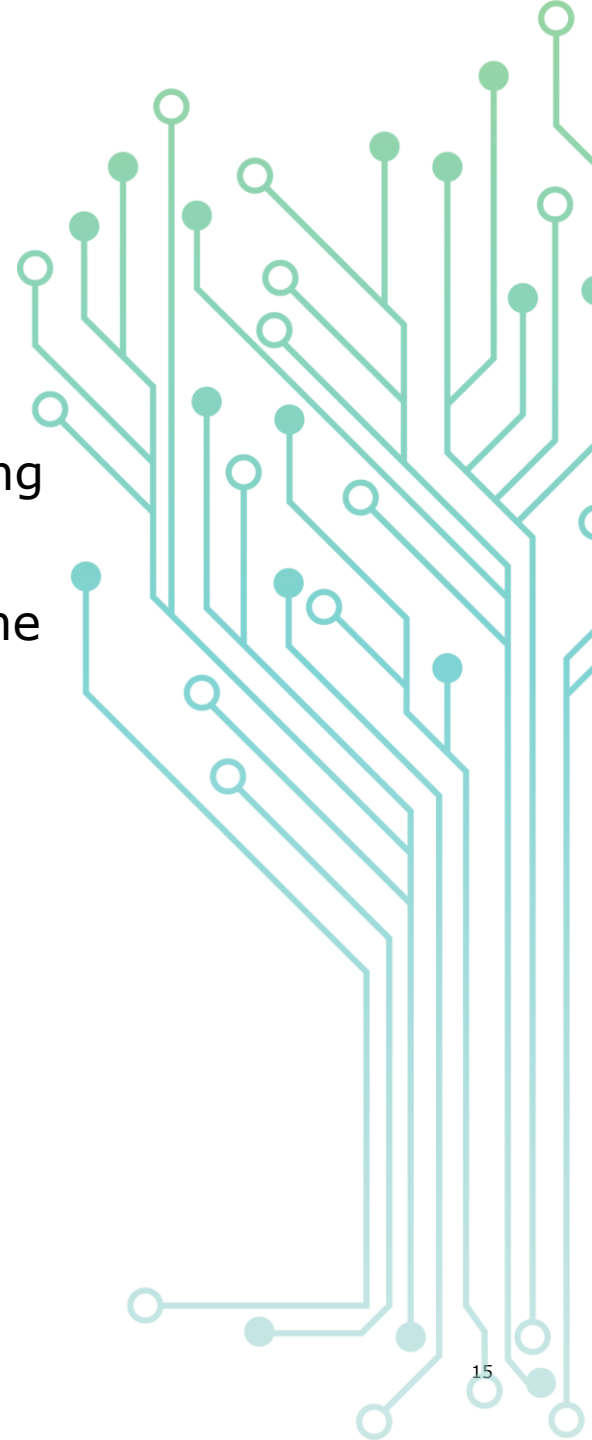
Taxpayer Perspective: Potential Risks of Market-Based Sales Sourcing (cont'd)

- Market-based sourcing rules raise several issues taxpayers should be prepared to recognize and address
- Limited guidance
 - Many states with market-based sourcing rules do not define key terms such as “received” or “delivered”
 - Some states have not issued regulations to interpret and clarify
 - Since most of these rules have recently been enacted, may be several years before well-developed body of case law addresses market-based sourcing issues
- Proportionate or “All-Or-Nothing” Sourcing
 - Market-based sourcing states are divided on whether receipts from sales of services to a multistate customer should be sourced exclusively to one state (all-or-nothing) or proportionately among all states customer receives portion of benefits of the service
- Requiring taxpayers to use alternative sales factor apportionment methodology



Taxpayer Perspective: Potential Risks of Market-Based Sales Sourcing (cont'd)

- Taxpayer Burden
 - Navigating and tracking various states' application of market-based sourcing rules
 - Spending time and resources formulating determinations around what is the "market"
 - Defending taxpayer's position on audit
 - Financial reporting for income taxes ASC 740

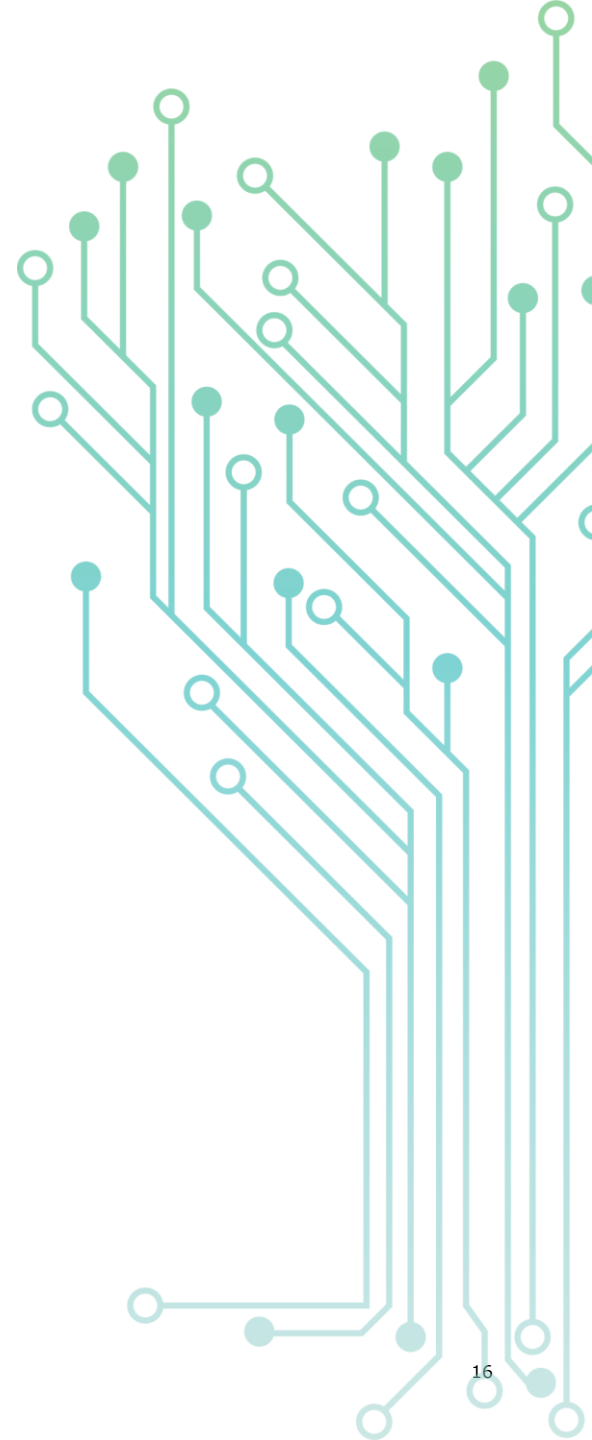


Apportionment Considerations

Specialized Apportionment for Media and Entertainment Industry

Two "market" based methods generally exist for sourcing receipts earned by taxpayers in the media and entertainment industry such as advertising and licensing revenue.

- Audience Factor
 - Approach looks to where content is viewed
- Commercial Domicile
 - Approach looks to where the commercial domicile of the advertiser or licensee of the content is located



Common Revenue Streams and Apportionment

Common Revenue Streams

Advertising

- National
- Local
- Online

Retransmission

Paid Content

- Download
- Broadcast

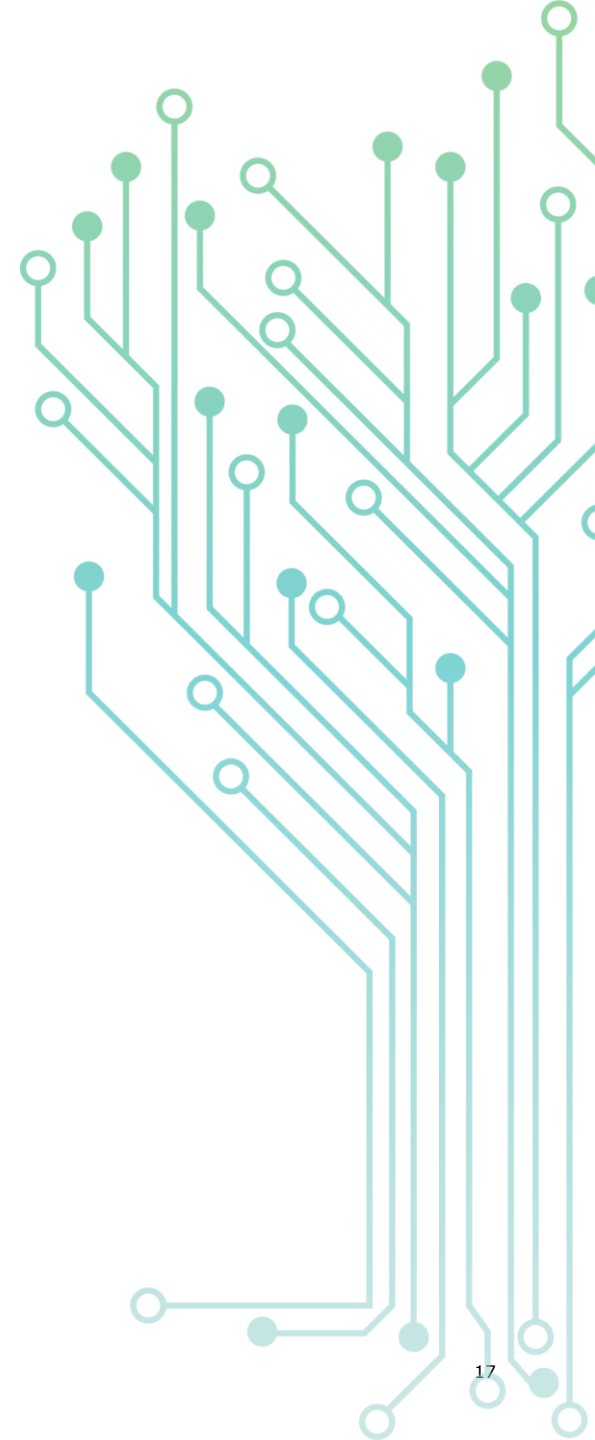
Affiliate Revenue

General Methods of Sourcing

- Cost of Performance
- Time Spent
- Market
- Commercial Domicile

General Sourcing Rules

- UDITPA Sec. 17
- MTC Article IV, Sec. 17



Alternative Apportionment

2020 Updates

- California - The Franchise Tax Board (FTB) has issued proposed draft regulatory amendments regarding its alternative apportionment method petition procedures.
- Kentucky – Amended rules clarifying the required standards in alternative apportionment petitions.
- Michigan - Issued guidance on the procedures and standards governing alternative apportionment relief provisions within Michigan’s Income Tax Act and Michigan’s Business Tax Act.



Gross Receipts Taxes

Gross Receipts Taxes

New Trends

Recent trend of jurisdictions turning to gross receipts taxes as a means to raise state and city revenues.

- Oregon recently enacted a commercial activities tax (CAT) that will be based on taxpayers' gross receipts.
 - This is on top of an already existing city level gross receipts tax in Portland passed by voters in 2018.
- San Francisco adopted a gross receipt tax originally designed to replace the city's payroll tax, and most recently, San Francisco enacted the Homelessness Gross Receipts Tax ("Homelessness GRT") and the Commercial Rents Gross Receipts Tax ("Commercial Rents GRT"), effective January 1, 2019
 - A San Francisco superior court judge recently upheld the validity of this tax on appeal.
- These new gross receipts taxes are in addition to already well-established gross receipt taxes
 - Washington B&O tax (state/city)
 - Ohio Commercial Activity Tax
 - Nevada Commerce Tax, and
 - West Virginia Business and Occupation Tax

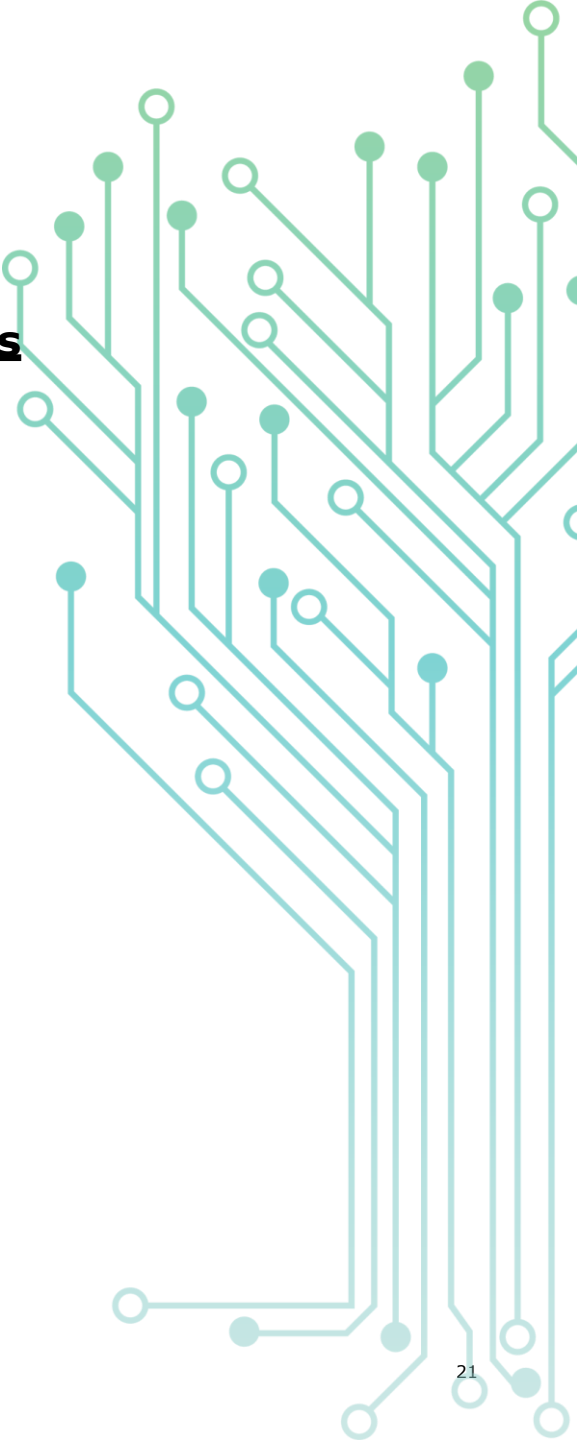


Gross Receipts Taxes

Summary

Below is a non-inclusive summary of some of the more prevalent gross receipts taxes:

California–Los Angeles & San Francisco Gross Receipts Tax	Delaware Gross Receipts Tax	Georgia Business Occupation Tax	Hawaii General Excise Tax
Nevada Nevada Commerce Tax	Ohio Commercial Activity Tax	Oregon Corporate Activity Tax	Pennsylvania Gross Receipts Tax
Tennessee Gross Receipts Tax	Virginia Business Professional Occupational License Tax	Washington Business & Occupation Tax	West Virginia Business & Occupation Tax



Oregon Commercial Activity Tax

Summary

- **Registration:** Taxpayers with commercial activity exceeding \$750,000 must register with Oregon DOR
- **Compliance:** Every person doing business in Oregon with commercial activity for the tax year in excess of \$1 million must file an annual return no later than April 15th of the following year
 - Quarterly estimated payments are required, first estimate due April 2020
- **Apportionment:** Oregon CAT legislation applies similar sourcing methodology that applies to Oregon corporate income tax apportionment, except:
 - No throwback rule for CAT for sales of TPP shipped from Oregon; and
 - Oregon apportionment factor administrative rules not yet incorporated into CAT (including market-sourcing rules, special industry apportionment rules, etc.)
- **Subtraction:** Taxpayers entitled to one subtraction – 35% of the greater of either COGS or compensation (subtraction must be apportioned)
- **Imposition of Tax:** Tax imposed on the person receiving the commercial activity and is not a tax imposed on the purchaser
- **Administrative Rules**

Maryland Digital Advertising Tax

Proposed Legislation Vetoed

Summary: The Bill would create a digital advertising gross receipts tax.

Imposition: Tax would be imposed on a company's annual gross revenue in the state.

Digital Advertising Definition: Banner ads, search engine ads, and other advertisements posted on a website, an application, or within a piece of software.

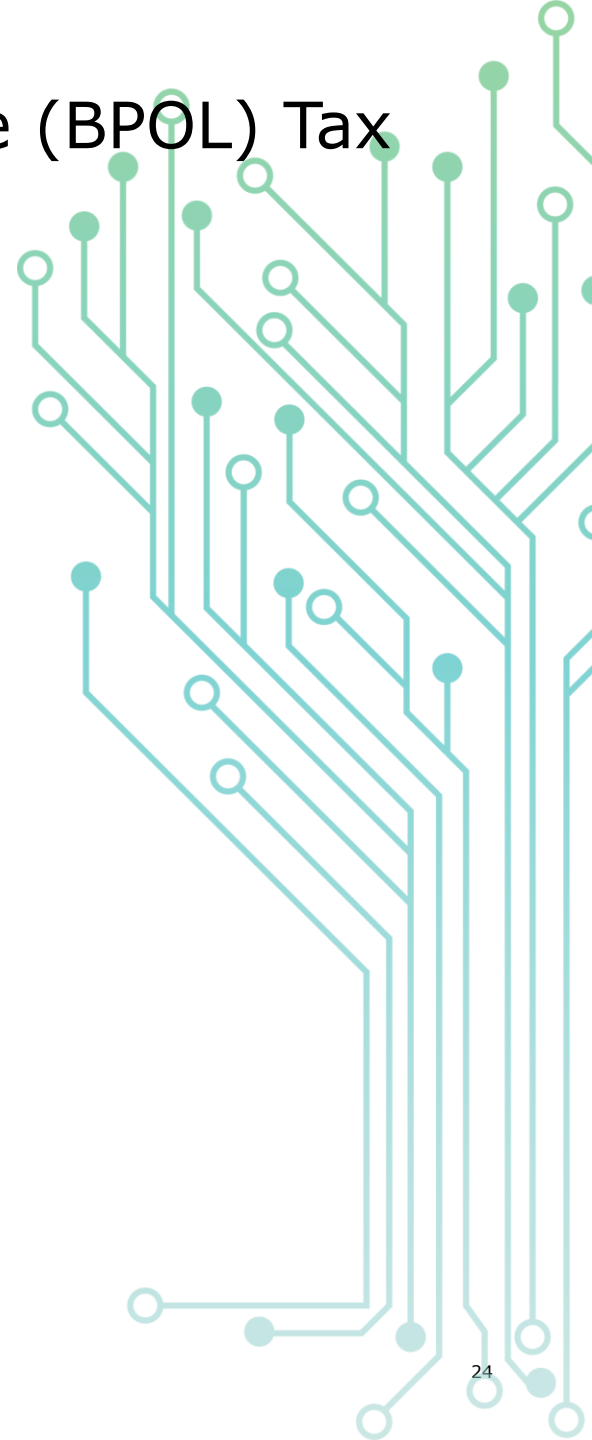
Proposed Tax Rates:

Total Global Revenues	Tax Rate
\$100 million to \$1 billion	2.5%
\$1 billion to \$5 billion	5%
\$5 billion to \$15 billion	7.5%
\$15 billion or more	10%

Current Status of Legislation: The General Assembly adopted the legislation during the 2020 legislative session. However, on May 7, 2020, the proposed legislation was vetoed by the Maryland Governor. The General Assembly now has the option to the override the Governor's veto.

Virginia—Business, Professional, and Occupational License (BPOL) Tax Summary

- Virginia **localities can impose BPOL tax** on licensable activities at locations/offices within locality
- BPOL tax based on gross receipts sourced within locality
- **Opportunities may exist**, including:
 - Deduction available for gross receipts attributable to business in another state if return based on income filed in jurisdiction
 - Certain localities allow deductions for receipts derived from internally developed software
 - Tax rate varies by classification of licensable activity
 - Sourcing under direct allocation vs. payroll apportionment
- Most Virginia **counties accept BPOL filing methodologies** which are generally more advantageous for taxpayers providing data analytics, information, and technology services



Other Developments

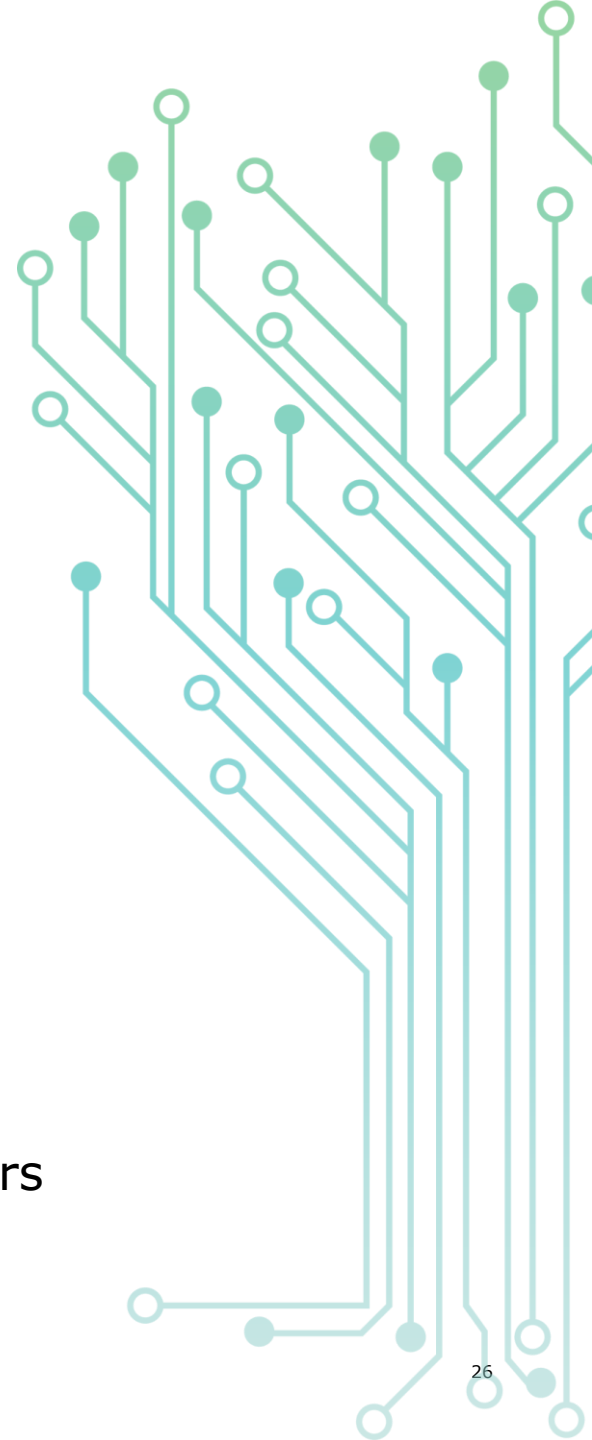
California Budget

Proposed Legislation

Assembly Bill 85 (Passed June 15, 2020, awaiting Governor's signature):

1. NOL suspension for the 3 tax years beginning on or after January 1, 2020 and before January 1, 2023
 - 2020, 2021 & 2022 tax years
 - Limited exceptions for small taxpayers with net income subject to tax of less than \$1,000,000
2. Business Tax credits limited to offsetting no more than \$5 million of tax liability during the same three year period (years beginning on or after January 1, 2020 and before January 1, 2023):
 - R&D tax credits
 - EZ credits
 - Film credits
 - California competes credits

Carefully consider implications for FY filers; 52/53 week filers & short tax years



New York

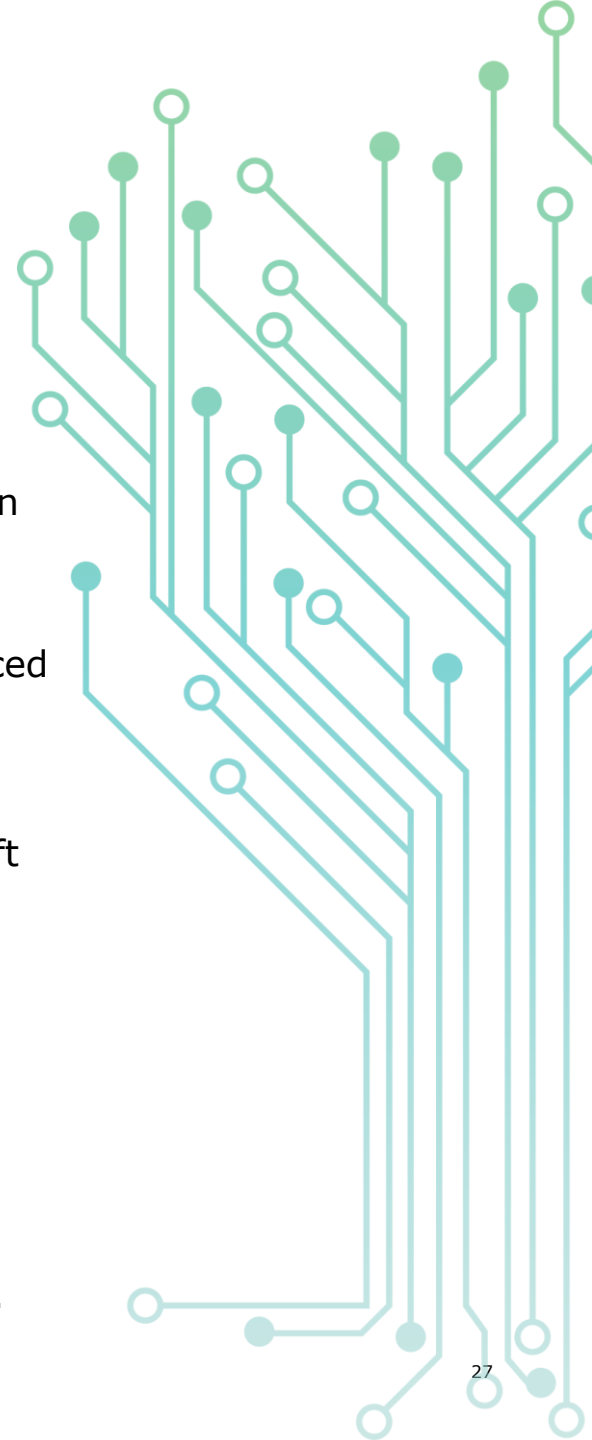
Tax Rate – Qualified Emerging Technology Company (QETC)

- New York State offers a reduced income tax rate for companies located in NYS that are deemed “qualified emerging technology companies” (“QETCs”):
 - For a QETC, the business income tax rate for NYS corporation franchise tax purposes of 6.5% for ordinary taxpayers is reduced to 4.875% for QETCs taxpayers for 2018 and forward along with a reduced capital base tax rate.
- To qualify as a QETC, a company must be “located” in NY (i.e., rent or own real property in NY) and in the business of selling qualifying product or services.
- Qualifying products or services includes items such as
 - information and communications technologies, such as equipment and systems that involve advanced computer software and hardware;
 - Engineering, production, and defense technologies such as computer-integrated manufacturing, robotics and automated equipment, sensors, biosensors signal and image processing, defense command and control equipment, guided missile and space vehicle propulsion units, military aircraft space vehicles, and surveillance, tracking, and defense warning systems etc.
- The Company must also meet one of the following two tests –
 1. The primary products or services test; or
 2. The research and development test.

Considerations: New York locations and activities being performed at those locations.

Potential Credit Opportunities: QETC Employment Credit, QETC Capital Tax Credit, New York Investment Tax Credit.

Commercial Rent Tax Opportunities: Opportunities may exist to exclude charges not subject to CRT. Additionally, companies may have a refund opportunity for prior CRT filings.



CARES Act Provisions

State NOL and Other CARES Act Provisions

Federal/State NOL Carryback

- Federal/state conformity (election, amount, approach)
- Separate vs combined/consolidated
- Planning considerations to utilize loss carryback or value of NOLs
- Interaction with nonbusiness income, dividends, credits, etc.

Utilization

- Impact of federal/state audits
- Entity vs group vs member
- Planning considerations to utilize post apportioned NOLs or impact

Limitations

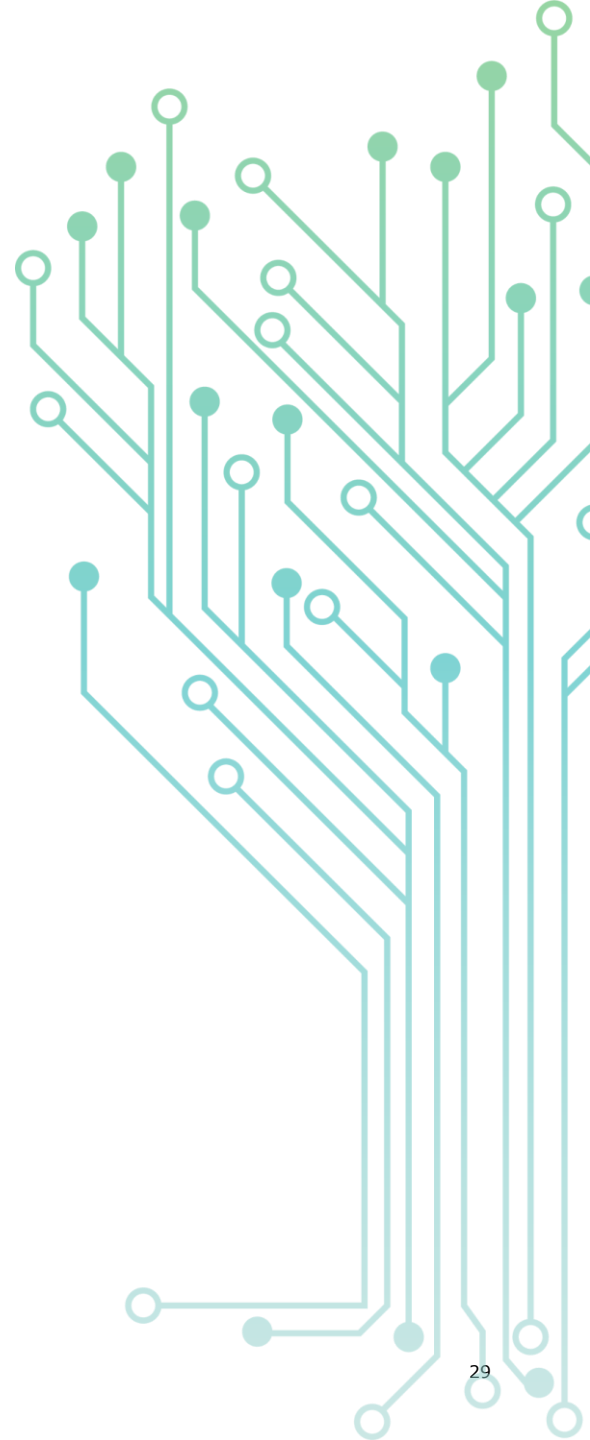
- Federal/state conformity
- 163(j), QIP, 382, SRLY, jurisdiction specific limitations
- Mitigation of impact

Revaluation of Deferred Asset

- Changes in apportionment/ETR
- Law changes
- Forecasting

NOL Tracking

- Substantiation of NOL balances
- Maintenance of NOLs for tax compliance, provision and planning
- Up keep of rules by state/year
- Application of proper methodologies and limitations
- Visibility into NOL/tax posture



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