STATE AND LOCAL TAX UPDATE

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With You Today

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AGENDA

- Introduction – State Taxes (focus I/F and S&U)
  - Types of Income and Similar Taxes
  - Nexus Trends (Sales versus Income Taxes)
  - P.L. 86-272 Recent Developments
- Individual State Income Tax Updates
- State Corporate Income Tax Updates
- Sales and Use Tax Updates
- Legislative updates

Types of Taxes

INCOME TAX

Assessed on the state's portion of federal taxable income

FRANCHISE / NET WORTH TAX

Assessed on the state's portion of Equity from GAAP balance sheet

GROSS RECEIPTS TAX

Assessed on top line revenue assigned to a particular state

Nexus: Background

- Nexus = connection or presence in a state sufficient to subject to state taxes.
- Nexus describes the amount and degree of business activity that must be present before a state can tax an entity's income or require an entity to collect use (sales) tax on sales within the state.
- Requires a minimum connection, between the state and the person, property, or transaction – Physical or Economic

Physical Nexus

- Physical Presence in a State
  - Property in the State
    - Locations (facilities, offices, renting property)
    - Inventory stored in the state
  - Payroll Related Activities in the State
    - Employees (or contractors) working in the state
    - Employees making visits in the state
- States have special exemptions for certain in-state activity, including attending trade shows, recruiting or interviewing job candidates.

Economic Nexus

- Economic Nexus is generally created by the purposeful direction at a market with significant sales or benefits derived by these activities:
  - Applies to businesses that earn significant income within the state and "enjoy benefits from doing business there."
  - Does not require physical presence in the state.
  - Economic nexus is generally created by having intangible assets or customers in a state.
- Each state's definition varies:
  - Standards generally include broad language but to date have only been tested for very specific types of activities such as financial related activities or licensing of intangibles.
  - Today many states do include some type of economic nexus language in their nexus or "doing business" statute.
- Trend – nexus moving from physical attributes to economic activity
  - Geoffrey, Inc. v. South Carolina Tax Commission (1993) – Court set precedent for economic nexus, upholding that a state could impose an income tax on a corporation with no physical presence.

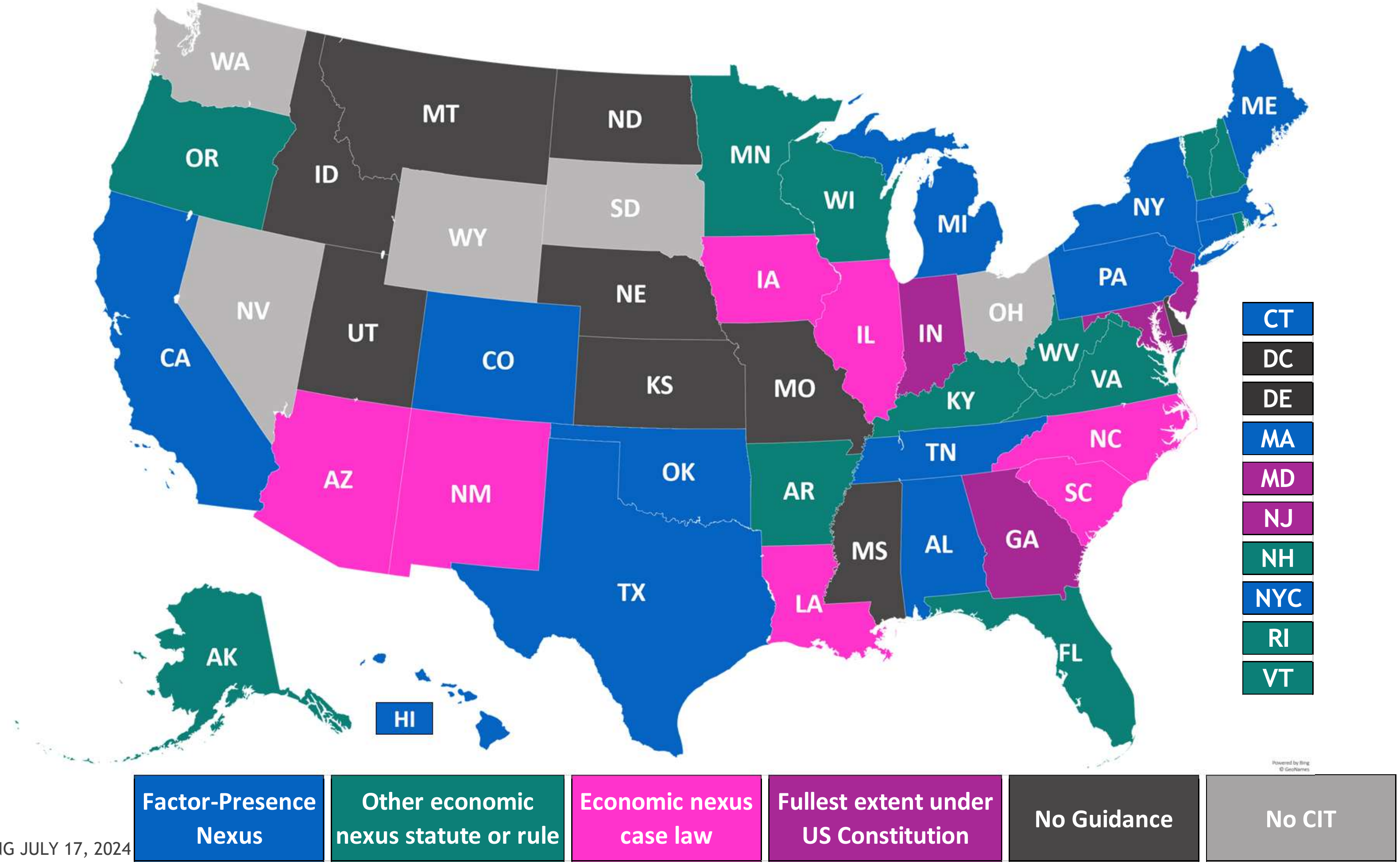
Factor Presence (Economic) Nexus Standard

The following states have adopted factor-presence nexus statutes for corporate income tax or gross receipts tax purposes: AL, CA, CO, CT, MA, ME, MI, NY, OH (“CAT”), PA, TN, OR (“CAT”), VA, WA (“B&O”).

- Example: Texas
  - Texas applies an economic nexus standard. Under the plain language of Texas law, the franchise tax applies to each taxable entity doing business in the state.
  - For federal income tax accounting periods ending in or after 2019, the Texas Comptroller's implementing regulation provides that a foreign taxable entity has nexus in Texas if, during that federal income tax accounting period, it had gross receipts of $500,000 or more from business done in Texas.

States with Corporate Income Tax Economic Nexus Thresholds

(AS OF 10/31/2022)



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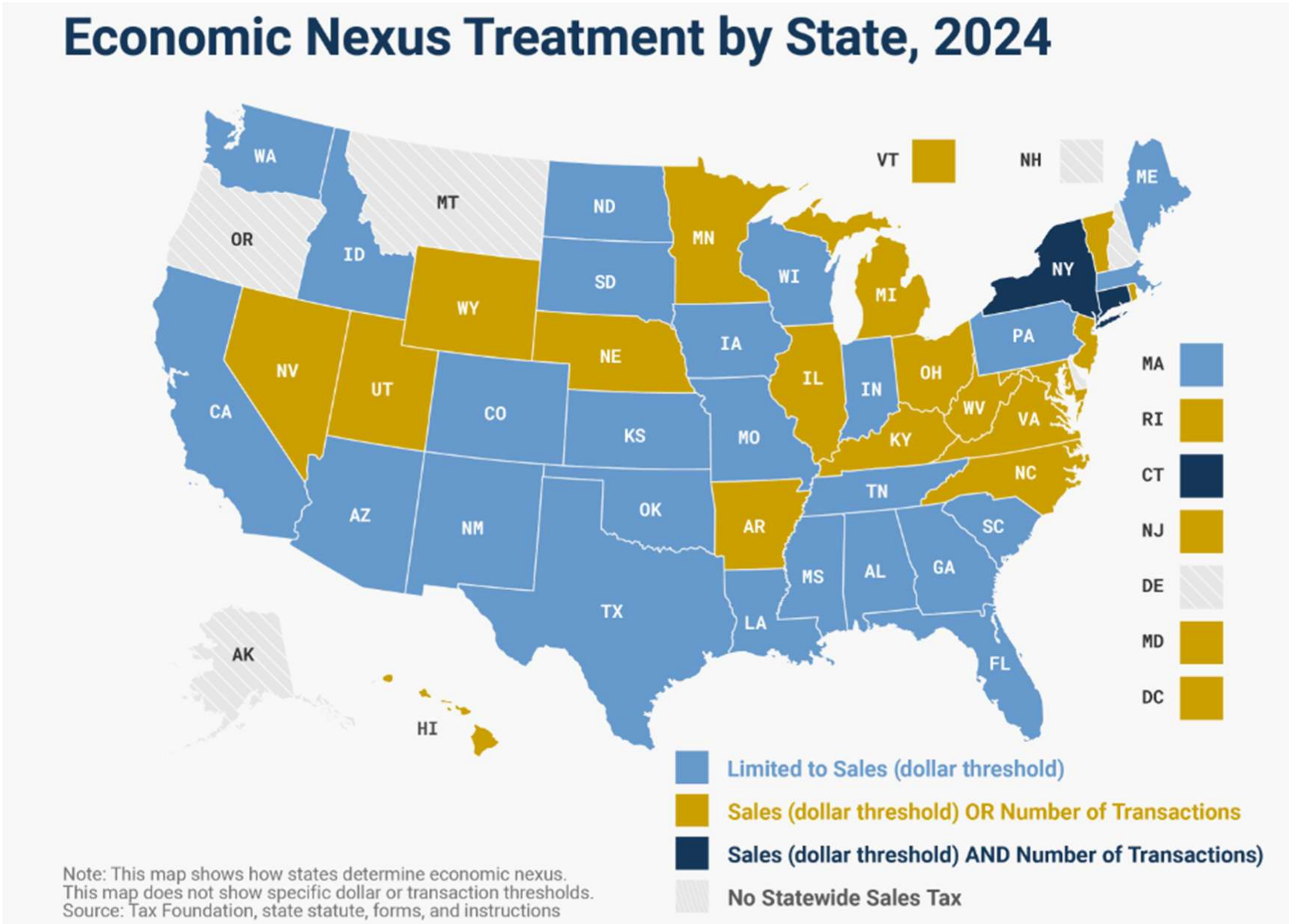
Economic Nexus Treatment by State, 2024
WA
OR
ID
MT
ND
SD
WY
NV
UT
CA
CO
NE
KS
AZ
NM
OK
TX
MN
IA
MO
AR
LA
WI
IL
MI
IN
OH
KY
TN
MS
AL
GA
SC
FL
NC
VA
WV
PA
NY
ME
VT
NH
AK
HI
MA
RI
CT
NJ
DE
MD
DC
Limited to Sales (dollar threshold)
Sales (dollar threshold) OR Number of Transactions
Sales (dollar threshold) AND Number of Transactions)
No Statewide Sales Tax
Note: This map shows how states determine economic nexus.
This map does not show specific dollar or transaction thresholds.
Source: Tax Foundation, state statute, forms, and instructions

NEXUS CONSIDERATIONS

Public Law 86-272

- Congressional action enacted in 1959 due to business protests against prior Supreme Court decisions.
- Prevents states from imposing taxes on or measured by income, **if the only activity carried on within a state is the mere solicitation of orders of tangible personal property.**
  - All other activities connected to the state must be performed outside of the state (but certain de minimis activities allowed).
- Sales of services and sales/lease of real or intangible property are not protected.
- Taxes on other than income taxes (i.e. gross receipts, sales/use, value added, franchise, net worth etc.) are not protected.

NEXUS CONSIDERATIONS

Public Law 86-272 Developments

- Challenged over the years as states try to expand their ability to tax out-of-state companies.
  - **Heublein, Inc. v. South Carolina Tax Commission (1972)** – Confirmed soliciting orders (even by independent contractor) falls under protected activities.
  - **Wisconsin Dept. of Revenue v. William Wrigley Jr. Co. (1992)** – Defined "solicitation" ruling that some activities went beyond protection (replacing stale gum).
- Recent Developments – (2021) MTC - issued guidance suggesting that may online business activities such as providing post-sale assistance via electronic means, or using internet cookies for purposes beyond solicitation, could disqualify business from PL 86-272 protections.
  - State Adoptions
  - CA Technical Advice Memorandum (TAM) 2022-01
  - New York Regulations (12/23)
  - New Jersey (9/2023)

NEXUS CONSIDERATIONS

Public Law 86-272 Developments – Cont'd

- Judicial interpretations
  - **Oregon Supreme Court Ruling (2024):** The court determined that an out-of-state tobacco manufacturer's activities, which included taking "prebook orders," exceeded mere solicitation and thus were not protected under PL 86-272. This case has been escalated to the U.S. Supreme Court for further review.
  - **Minnesota Tax Court Decision (2023):** In Uline, Inc. v. Commissioner of Revenue, the court examined whether certain in-state activities, such as providing free samples and demonstrations, went beyond solicitation, potentially nullifying PL 86-272 protections.

  These disputes highlight the ongoing tension between state tax authorities seeking to expand their taxing rights in the digital age and businesses aiming to maintain protections under the original provisions of PL 86-272. As e-commerce and online business activities continue to evolve, further legal challenges and clarifications are anticipated.

State and Local Income Tax

- 45 states and the District of Columbia levy a corporate income tax.
- Some states require each legal entity with "nexus" to file a "separate" tax return while others require "group" filings (including other related legal entities).
- Certain localities (cities) also impose income taxes.
- Most states use the federal definition of federal taxable income as their starting point in computing tax liability.
  - However, states deviate from federal rules in some instances (example: bonus depreciation).

- States use "apportionment" formulas to determine the portion of corporate income taxable in the state.
  - In the past most states used a 3-factor formula based on property, payroll, and sales in a state over all property, payroll, and sales everywhere.
  - In recent years, more states have enacted single sales factor apportionment treatment.

- Certain income may be "allocable" to a state.
  - Not included in apportionable income.
  - May be required to include 100% in taxable income.
  - Not common.
  - Example: DE requires Rental, Royalty and Interest income, certain gains treated as allocable.

STATE INCOME TAX CALCULATION

Overview

Federal Taxable Income

±

State Adjustments

±

Allocable Losses/(Income)

Modified Federal Taxable Income

x

State Apportionment Formula

State Taxable Income

±

State allocable income/(loss)

State Income Tax Base

x

Tax Rate

State Income Tax

-

Credits

State Income Tax Liability

APPORTIONMENT EXAMPLE

- Payroll Factor:
  - Payroll in Oklahoma- $250,000
  - Payroll Everywhere - $1,000,000
  - What is the payroll percentage? 25% (250,000/1,000,000)

- Property Factor:
  - Property in Oklahoma - $35,000
  - Property Everywhere - $650,000
  - What is the property percentage? 5.38% (35,000/650,000)

- Sales Factor:
  - Sales in Oklahoma - $2,000,000
  - Sales Everywhere - $15,000,000
  - What is the sales percentage? 13.33% (2,000,000/15,000,000)

  - What is the total apportionment percentage? **14.57% ((25%+5.38%+13.33%)/3)**

Apportionment

- Right to Apportion
  - Requirement that taxpayer be "doing business" in another jurisdiction sufficient to justify imposition of tax
- Payroll Factor
  - Cash wages
  - Some states may exclude officer salaries to be included in factor
- Property Factor
  - Generally, use cost basis (average) per book reporting
  - Rent expense X 8 is included in the factor
- Sales Factor
  - Sales of tangible personal property, generally source state sales based on ultimate destination
- Weighting of Factors
  - General Rule
  - Industry Specific

Gross Receipts Taxes

- California LLC Fee
- Ohio Commercial Activities Tax
  - 2024 TGR Threshold > $3,000,000
  - 2025 TGR Threshold > $6,000,000
- Oregon Corporate Activities Tax
- Nevada Commerce Tax
- Washington Business and Occupancy (B&O) Tax
- Virginia Local Business, Professional, Occupancy License (BPOL) Taxes
- Some states have fixed dollar minimums based on gross receipts in the state included on corporate income tax filing (i.e., NY, DC, MN etc.).
- Typically, not prepared by BDO, but we have specialists who can assist.
- Potential ASC 450 implications.
- Can apply to PTEs and loss companies.
- Frequently overlooked by Taxpayers.

Franchise/Net Worth Taxes

- States which impose a franchise tax vary on how the tax base is calculated. Tax base could be based on the following:
  - an entity's **assets** or **net worth**
  - value of a company's **capital stock**
  - apportionment formula may differ from the income tax apportionment.
  - other states may charge a flat fee to all businesses operating in their jurisdiction.
- Example states: AL, MS, NC, TN etc.
- Could have a minimum or maximum liability.
- BDO assists with any filings made with state revenue departments.
- Any Secretary of State special filings usually handled by the company's third party registered agent (i.e., CT Corp.)

REPORTING OF INCOME BY INDIVIDUAL OWNERS

- Resident Owners
  - Taxable on entire share of entity income
  - Credit generally allowed for taxes paid to other states

- Nonresident Owners
  - Taxable on distributive share of income attributable to sources within the state

- Composite Return Considerations
  - Only nonresident individual partners may be included
  - Partner may not have income from other sources within the state
  - Partner may not be included in another composite return field with the state
  - Partner consent may be required either initially or annually

2024/2025 SALT UPDATES

State Tax Updates - Individuals

Effective January 1, 2025, Individual Income Tax Rate Reductions

- Indiana 3.05% to 3%
- Iowa 5.7% to 3.8%
- Louisiana 4.25% to 3%
- Mississippi 4.7% to 4.4%
- Missouri 4.8% to 4.7%
- Nebraska 5.84% to 5.2%
- North Carolina 4.5% to 4.25%
- West Virginia 5.12% to 4.82%

Effective January 1, 2024, Individual Income Tax Rate Reductions

- Arkansas 4.4% to 3.9% (signed into law 6/19/24), retroactive to 1/1/24
- Kansas – reduced tax brackets from 3 to 2, reduction of top marginal tax rate from 5.7% to 5.58% and increased standard deduction and personal and dependent exemptions.

State Tax Updates - Individuals

Proposed legislation

- Oklahoma
  - SB 305 (2/3/2025) – eliminate the state individual income tax
  - SB 308 (2/3/2025) – reduce income tax by 1% per year until fully eliminated in 2029
  - SB 1 (2/3/2025) – reduce personal income tax from 4.75% to 4.5%
  - HB 1009 (2/3/2025) reduce personal income tax by equal amounts per year until fully phasing out by 2035.

Oklahoma's current top rate of 4.75% is higher than the income-tax rates imposed in several neighboring states, including Texas (which has no personal income tax) and Colorado (4.4%).

In Arkansas, the top individual tax rate was 4.9 percent, which was higher than in Oklahoma. Now it has a top rate of 3.9%. Similarly, the top rate in Missouri fell to 4.7 percent starting 1/1/25.

State Tax Updates - Corporations

Effective January 1, 2025, Corporate Income Tax Rate Reductions

- Louisiana (3.5%-7.5%) to 5.5%
- Nebraska 6.5% to 6.24%
- North Carolina 2.5% to 2.25%
- Pennsylvania 8.49% to 7.99%

Effective January 1, 2024, Corporate Income Tax Rate Reductions

- Arkansas 4.8% to 4.3% (signed into law 6/19/24), retroactive to 1/1/24
- Georgia 5.75 to 5.39% (signed into law 4/18/24), retroactive to 1/1/24

Effective January 1, 2024

- Oklahoma – eliminated franchise tax as of 12/31/2023
- Louisiana – repealed state’s throw-out rule
- Texas – doubled “no tax due” threshold for the state franchise tax (under $2.47M in revenue, no tax due)

State Tax Updates – Sales and Use

Effective for 2025

- Louisiana – Restoring a 5% sales tax rate, up from a temporary 4.45 %rate, to help pay for reforms elsewhere in the tax code, while expanding its tax base to include digital goods.
- Illinois – expanded its tax base to include retail leases of specific tangible personal property
- Kansas - exempts groceries from the sales tax, narrowing its base and eliminating the 2% tax

Effective for 2024

- Oklahoma
  - enacting a 0% state tax rate on sales of food and food ingredients, beginning (8/29/24)
  - Any Oklahoma county may levy a sales tax, not to exceed 1%, upon the gross proceeds or gross receipts derived from all sales or services in the county upon which a consumer's state sales tax is levied, and designates the funds collected for emergency medical services (11/1/24)
  - Sales tax exemption on the sale of M&E (including, but not limited to, servers and computers, racks, power distribution units, cabling, switchgear, transformers, substations, software, network equipment, and electricity, used for commercial mining of digital assets in a colocation facility) (11/1/24 – 12/31/29)

2023 Illinois State Tax Updates

Illinois

H.B 4951 (enacted, June 7, 2024)

- The $100,000 limitation for tax years ending on or after December 31, 2021, and before December 31, 2024, has been increased to $500,000 for tax years ending on or after December 31, 2024, and before December 31, 2027.
  - The three years during which NOLs are suspended will not count against the carry-forward period, so taxpayers will not lose their NOLs, but their ability to claim them will be delayed.

- Effective January 1, 2025, the budget increases the corporate franchise tax credit from $5,000 to $10,000.

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QUESTIONS


THANK YOU