State and local tax after the OBBBA

Transcript

DAVID SITES 00:05

Welcome and thanks for tuning in to the D.C. Dispatch. I'm David Sites, National Managing Principal of Grant Thornton's Washington National Tax Office. The D.C. Dispatch provides quick insights on how developments coming out of Washington, D.C. could impact your business. Through topical discussions with thought leaders across our global network, we uncover opportunities and expose risks so business leaders can thrive in this dynamic environment.

Today, we turn to an examination of how state and local tax regimes work, how policies developed in state legislatures, and what happens when federal changes like the One Big Beautiful Bill Act come down the pike. We'll talk about what businesses need to think about when these changes occur, and we'll discuss state specific dynamics that make tax developments extremely challenging to track, making tax compliance incredibly complex.

Joining me today to unpack these issues, I have a fantastic guest. Jamie Yesnowitz of our Washington National Tax Office, a state and local tax partner, is joining me. Jamie's been with Grant Thornton for 20 years, providing state and local tax consulting and controversy services to clients in collaboration with our nationwide network of experts. He is a recognized thought leader in the SALT community, having a wide variety of salt leadership roles in external organizations, currently serving as the co-chair of the NYU SALT Conference that's going to be held in December of this year. Right, Jamie?

JAMIE YESNOWITZ 01:33

Can't wait.

DAVID SITES 01:35

Jamie, I'm super excited to have you here. We've worked together for a long time, and I always love talking about state and local tax issues with you. And so, I thought maybe a good place to start, for those who may not be familiar, I want to talk a little bit about kind of the broad picture on how states kind of develop and adopt tax policy. And I think maybe the best place to start is what is the current balance of political power in the states and how's that affecting the tax policy process?

JAMIE YESNOWITZ 02:07

Well, it's a good place to start. It's important to understand that states impose several different types of taxes: income taxes, sales taxes, property taxes, other types of targeted taxes. And those types of taxes, they are not uniform amongst the states. Fifty different varieties. And they have to be adopted by state legislatures as well as signed by the governor. And so the question of, well, what political party are the legislatures? What political party is the governor? That's really, really important. So currently there is, if you account for the 50-state breakout, there are about 27 states that have Republican governors, 23 states that have Democratic governors, and from the legislature standpoint, more of the seats are controlled by Republicans than they are Democrats. So, you have plenty of situations where you have what we call "trifectas." Trifectas are where both branches of the legislature as well as the governor are of one political party. You also have situations where the legislature has a super-majority, meaning more than 2/3 of the legislature is of one political party, And in those circumstances, where you have control by one political party, they can do essentially what they want from a tax policy perspective.

There are a few states out there that are sort of in the middle. We consider them the purple states, if you will, if the Republicans are the red states, the Democrats of blue states. So in those relatively competitive states, that's where we have the really interesting discussions over whether big tax policies can happen or whether they're defeated in committee or whether the legislature can't get anything done. So, there are all sorts of different facts and areas that we get to deal with when it comes to, well, where's the state going to go with regard to tax policy,

DAVID SITES 04:05

So Jamie, just to repeat, I think this is really important. There's like over 20 states that currently have a Republican trifecta, correct, where they have a Republican governor and Republicans control both, or control the state legislatures, I should say. And that's meaningful, right? And that's a lot of states to have a trifecta. And do you, maybe you don't know this, but historically, has it always been like this where states have kind of been … or are we more in a more polarized time from a … from a trifecta perspective?

JAMIE YESNOWITZ 04:36

I would say over the past 20 years things have gotten a lot more polarized in a lot more states. So, this is about as polarized as I think we've ever seen. So, and that has implications from a tax policy perspective.

As far as the tax policy itself, it's not the same as the federal system where Congress evaluates tax policy over the course of an entire year, a couple of years, and there's this vast effort to get a big bill done. From the state perspective, it gets done in pretty short windows of time. Many states have short legislative sessions, two to three months, usually in the spring, where they handle all of the budgetary issues and tax is a portion of that.

I think that it's interesting … the timing perspective is interesting, as well as the fact that there are very few stakeholders within the legislatures that actually know state tax policy really well. So, the negotiations are often with a very few … very few people within the legislature and the governor to come to tax policy agreements that affect the whole state. So that's important to understand.

And then there's the potential for very dramatic tax policy changes in particular states from year to year because of the fact that there are just a few stakeholders involved. It's difficult for some of these legislators that have other jobs the rest of the year to really understand the nuances of state tax policy.

DAVID SITES 06:08

Right, and so I imagine shorter sessions, more targeted. So, they're very focused on kind of reacting, I suppose, in a lot of cases to kind of what's happening on the federal level, what the state needs are. So recently, you know, I'd love for you to talk about, you know, talk about a couple of trends that you're seeing in states with respect to state and local tax policy.

JAMIE YESNOWITZ 06:31

I think the states that are more Republican tend to want to reduce or, in some cases, even eliminate the income taxes imposed on individuals as well as corporations. There's also this recent trend of trying to reduce or eliminate property taxes. There are a couple of states that're really evaluating that issue closely. Florida is a current example of that.

The reductions in these taxes are often based on whether the states meet their revenue goals or not. And in figuring out what the revenue goals are and whether those goals have been met, that's often the party in power that decides that, you know, what the answer is going to be on that front. So, that's the state of play in the states controlled by Republicans.

DAVID SITES 07:16

So let me ask a question about that. So, if they want to eliminate property taxes and they're reducing income taxes, where's the revenue shortfall made up? Is it state … is it sales tax? Is it something else or …

JAMIE YESNOWITZ 07:29

Well, many of the Republican states believe that they're collecting more than they really need to and so they feel they can afford to not impose these types of taxes. However, that … sales taxes often are the place where the deficit is going to be picked up, either by increasing tax rates or increasing the scope of the sales tax base. Those are the two ways that they can effectively make up for the deficit.

DAVID SITES 08:02

Yeah, and I suspect in the progressive states, the story's a little different, right?

JAMIE YESNOWITZ 08:06

Definitely. In the progressive states, increases in income taxes often, particularly on high-income individuals, is often offered up as a way to balance budgets. Expanding the scope of the sales tax also (is) important in many of those more progressive states, and I think that the gap between the conservative states, the Republican states, and the progressive states, the Democrat states, has increased over time. The tax rates in these jurisdictions, the spread, has increased over time. So, you have several states out there that impose no personal income tax, for example.
And then there are other states out there that are imposing 8, 9, 10% income tax rates. Well, that's going to provide plenty of incentive for the residents of those high-tax states to move to lower-tax states, especially as those residents get on later in life, they've finished their careers, they've earned their income, or they're waiting to earn a significant amount of income. They want that income event to occur when they're in a low-tax state, not in a high-tax state.
And so, this is particularly true when a high-tax state and a low-tax state are very close to each other. For example, Maryland and Virginia. Maryland has a very high income tax rate. Virginia has a much more moderate income tax rate. One could expect that in the future, if that gap remains, folks are going to want to move from Maryland to Virginia, independent of lifestyle choices and all that.

DAVID SITES 09:45
Yeah, I would point out for our listeners, I'm a Virginia resident and Jamie's a Maryland resident, so I'm doing better on the state tax side than Jamie is doing. But I hear you, and I think that's real, right? The numbers kind of bear out the fact that there's a migration towards these low-tax states, especially for folks that are, you know, higher earners … like you said, are at the twilight of their careers and maybe are getting retirement payouts and things like that.
Maybe a bonus question for you here before we move off of this topic. Are progressive states enacting provisions to try to attach to some of that income? So: "I work my whole life in New York and I get a bunch of, you know, delayed compensation or deferred compensation. And then I moved to Florida." If I'm New York, I'm thinking, well, that money was earned while you were working in New York. I

should get a chance to tax that. Have we seen stuff like that come out of the states where they're attempting to kind of preserve their right to tax?

JAMIE YESNOWITZ 10:39

I think New York has been the has been very strict with regard to that issue. They've been consistent with that for a long period of time. Their audit policy is such so that folks that are moving from New York to Florida, when an income hit like that occurs, they've always been really aggressive in New York State. Have we seen a lot of other states act in this area? I would say no. California has, and I think that you'll see more efforts in states like Maryland and Washington states. Those are a couple of the states that have recently enacted capital gains taxes that are often … are very, they're prominent, and they hit hard at a point where … my thought is that in Maryland and in Washington state, these capital gains taxes may incentivize folks, residents, to move to different jurisdictions because of the fact that it's a concentrated amount of income that's coming in in a particular year. It might provide a lot more incentive for them to move to the no-tax states, like Florida, Texas.

DAVID SITES 11:49

So if I'm an executive, I got a bunch of stock options throughout my career. I expect I'm going to have a big payday coming up as I cash out some of those options after they vest. Do the math. It might be cheaper to cash them out while I'm a resident of Florida than when I'm a resident of Maryland, for example, especially if they're enacting capital gains taxes, right?

JAMIE YESNOWITZ 12:09

Yeah, correct.

DAVID SITES 12:10

All right. I want to switch to the Big Beautiful Bill Act. No doubt, Jamie, you're aware on July 4th, massive sweeping legislation. It was broad: 174 or the treatment of research and experimentation costs was changed, Section 163(j) was changed to make it a little bit more taxpayer favorable. We saw the return of bonus depreciation

at 100% for capital asset investment, and all those things are permanent now. I mean, they were all temporary provisions since 2017 and the Tax Cuts and Jobs Act. All that stuff's permanent now. It's hard to believe we live in a world with permanent, full 100% bonus depreciation.
State corporate income tax regimes, you know, generally, right., state taxes start with federal taxable income. So, what happens in states when we see huge changes like the OB3 bill come around?

JAMIE YESNOWITZ 13:12
Well, it's interesting because over the last eight years we've had to deal with this situation several times. We had the TCJA back in 2018, we had the CARES Act right after the pandemic, and then a couple of additional changes over the course of the past couple of years. And then you have OBBBA, OB3, however we want to characterize that.
And OB3 is problematic from the states' perspective because it tends to reduce the base. And so that's problematic because states typically base their corporate income taxes on the federal tax base. And so that puts states in a bind.
Now to think about what states have to face here, one point to consider is, well, what Internal Revenue Code are states looking at? That half, or a little more than half of the states look to the current Internal Revenue Code. We call those rolling states. And then the rest of the states look to an Internal Revenue Code that was as of a date prior to today. Those are the static states.
The rolling states automatically conform, unless they do something else, to the OB3. The static states, by and large, have not reached the OB3 date yet, and so they don't conform. States have the ability to change their policies on all of these issues. But it's good to know if you're interested in a particular state on whether they're conforming to OB3 or not, you need to know whether they're a rolling state or a static state.

DAVID SITES 14:51
Yeah, and the static states are static, all of different dates, right? Some states are even before TCJA, from what I understand, correct?

JAMIE YESNOWITZ 14:59

Yes, most of the static states are maybe a year or two years behind. California is one of the outliers. They have a static date as of 2015. So, in California, they have not adopted to CARES. They have not adopted to TCJA. They have not adopted to really anything current over the past 10 years. And so that has some interesting implications because California is actually now considering, and there's just … the legislature has just passed legislation to move that date from 2015 to 2025, still pre-OB3.

DAVID SITES 15:37

OK, so a date prior to July 4th, 2025, right?

JAMIE YESNOWITZ 15:41

But it would capture the TCJA provisions. And having said that, you look into the bill and the conformity bill, it still decouples from a lot of things that you would have found in TCJA, the international provisions with GILTI and FDII, well, used to be GILTI and FDII, as well as, potentially, 174, so the research and development provision. It seems like California is choosing to remain back in 2015 for certain things.

And so when you examine a conformity bill, you really need, and particularly in a static state, you need to see whether they are static with respect to everything, what date they pick for everything, or whether they kind of pick and choose where they want to conform versus where they want to be coupled.

DAVID SITES 16:29

Interesting. So, if I'm in a static state, I got to figure out what date and what I'm static to and whether that's kind of modified. Tell me about rolling states, because that seems to be where the action probably is, right? New bill passes, I'm a rolling state. That stuff kind of automatically impacts me, right? Unless …

JAMIE YESNOWITZ 16:47

Right. Unless they decide to do something different. Now for rolling states, a lot of states do this because, well, it's easier from a compliance perspective, you're just using the same laws you did for federal. Pretty easy to follow. The problem is when you have a bill, a federal bill, that cuts the base, that cuts the revenue in the state and the state's like, "Well, we don't really want to conform to that," or "Give us a chance to think about these provisions before we conform to that."

So there are a couple of states, our Virginia and Maryland are two of the states that do this, that say, "OK, we're rolling, or we are rolling for the vast majority federal changes, but we're going to put a pause and we're going to say, 'OK, we're decoupling from things that have revenue effect to the state for a period of time to consider whether we want to conform to it in the next year or we want to stay decoupled from it.'"

And so that, I think, is one of the trends we're going to see. I think we're going to see more states say "We've seen what's going on in Washington. The federal income tax base is just getting a little bit too uncertain. We're going to kind of say, 'Let's take a break. Let's decouple from whatever is new until the legislatures have had a chance to look at it.'" And that's because the legislatures, they only meet a couple months a year. So, they only, unless a special session is called, they only really have one chance to address those federal changes in their bill, those rolling states.

So, the static states, they keep it static because, well, they've automatically decoupled from anything new until they get to the next session, in which case oftentimes they'll move the conformity date forward a year,

DAVID SITES 18:42

They'll move the conformity date forward. Yeah. So, it's only been, jeez, a little over, what, 2-3 months since OB3. That's my favorite term for it, by the way. It's the safe place. You can call it OB3 on the podcast here. So, what have ... have we seen stated action so far? What have states done in the wake of OB3?

JAMIE YESNOWITZ 19:04

We've already seen a lot from some of the rolling states. Virginia changed its policy to allow for decoupling for the next couple of years or until the legislature decides otherwise. Rhode Island, literally the day before OB3 passed, passed a provision that said, “We decouple from everything OBB … OB3-related …

DAVID SITES 19:27

Oh wow.

JAMIE YESNOWITZ 19:28

… until further notice.” And so, they didn't like anything in that bill. So, all the tax provisions in OB3 are ignored in Rhode Island for the time being. Colorado did a selective decoupling from certain OB3 provisions. And then the state of Maryland, which I said has a decoupling policy, at least if there's a revenue effect, they were required to put out a report – the controller's office in state – was required to put out a report showing the revenue effect of OB3. They did that a couple weeks ago and as a result there are several provisions that they are decoupling from: 163(j), 174A and 168(n), at least for the time being, those provisions are out. They may change, and I mean that's certainly a possibility that they decide to move forward with that. But Maryland being a progressive state, I would expect them permanent decoupling on at least one of those big provisions is certainly possible.

One other point to raise. I mean, we talked about the big four provisions in here from a business perspective. It's really interesting when you look at the 50 states, there are so many different ways that they conform or be coupled to it that it becomes a compliance nightmare for a multi-state business.

For example, 168(k), the bonus depreciation provision. Historically, a lot of states have decoupled from that because of the benefit that you have for federal purposes. The states didn't want to give that immediate benefit. With 168(k) being 100%, there's going to be massive decoupling from that provision just because, first of all, 2/3 of the states don't … they don't conform to that provision in the first place. I wouldn't expect any states to pick it up and say, “Yeah, let's just use that.”

For 163(j), the interest provision, I think that it's going to be interesting times there because states, some states, use the EBITDA calculation, other states use an EBIT calculation. Some states say we don't like any limitation on our interest. Let's go back to pre-TCJA and just allow for a more broadened interest deduction. And so, the change here in OB3 from pushing it from EBIT back to EBITDA, I think is going to make states think again about, well, what kind of limitation do we want? Do we want it to be stricter? Do we want it to be a little bit looser, or do we just want to get rid of it altogether? So, that's going to be something to consider as well.

DAVID SITES 22:08

Yeah, I want to … I want to come back and talk a little bit about the business side of this., But I want to highlight on the state side, right, Jamie, states, as I understand it, largely have to balance their budgets, right? They don't have the luxury that the federal government has of, "Oh well, we'll just run up another 3 1/2 trillion dollars of debt over the next 10 years with these tax provisions." So, states have to be in a really tough position on things like bonus and 174 because those provisions have the ability to completely wipe out taxable income for a lot of people. But as you mentioned, as a result, I think you end up with all these different fragmented systems where you could end up with multiple depreciation books, for example, depending on whether the states are under the MACRS system, or the TCJA system, or the OB3 system, right? So, incredibly difficult, I think, for states to manage the fiscal responsibilities that they have at the same time without this, like, these periods of decoupling, like you said, to let them evaluate it. I think Maryland's a good example. We put out a report, right? Maryland looked at it and said, "Hey, this is going to be impactful." But OK, so that's hard on the states. Talk a little bit about taxpayers. Like as a taxpayer, how do you respond to this? How do you plan? You don't really know what your state tax provision is going to look like right now for 2025 completely, do you?

JAMIE YESNOWITZ 23:26

No, as a multi-state taxpayer, you have to start by tracking what's going on. And tracking the developments is not an easy task. When you've already seen, two months into OB3, four or five states have looked at it, they've already made some concrete decisions about where they want to go. So, taxpayers have to consider the estimates. They have to consider the financial statements. They have to consider potential strategy on the returns that they're following right now for 2024 because there are some retroactive elections that could be made under OB3.

And that poses the interesting question of whether the states, even the states that conform on a rolling basis, whether they'll allow an election to go retroactive. So you have to account for that.

And of course, if you're doing estimates for 2025, you need to think about how you're ultimately going to have that position on the return and whether that changes in the 2026 legislative sessions – whether a state policy changes so that you then have to either pay in more or maybe what you have paid in already is enough.

DAVID SITES 24:33

Yeah, so it seems like agility is key and recognizing that this can kind of be ever-evolving. And I will say this: thank God for state and local tax professionals like yourself that monitor this stuff and keep up with it. It is a vast array of changes and I … you know … I hear clients all the time say, “Boy, we knew this was going to be a big deal from a federal perspective, but the state stuff kind of caught us by surprise,” right? So, for the listeners, I'd say don't sleep on the states. There's a lot of action there right now and they may be some of your most challenging things. And you also have to think about the decisions you make on federal, in some cases, and what the impact's going to be on your state provision. So …

JAMIE YESNOWITZ 25:15

My sense is that over the course of the next six to 12 months, this will ferret out and we'll have a lot more to, you know, to grasp from the perspective of where states are going to be on these issues. I do think … one other point on the 168 and the incentive for building plants. It's interesting because states wouldn't normally want that type of benefit. It feels like bonus depreciation with 100%. But if you want companies to come in and build plants in your state, it's a great incentive. And so, you might end up seeing some states saying, “Well, we don't do bonus depreciation. But if you want to build a plant and give us all these jobs and all this investment in the state, we'll be OK with the 168(n) incentive.”

DAVID SITES 26:01

“We'll give you the write off as long as it's in our state,” presumably, right? Yeah. So, all right. So, you, as I mentioned at the beginning, you're a prolific author and I know one of the things you like to do is you like to predict what you think is.
to happen in the SALT world in the next couple of years. So maybe give me some predictions here on the podcast. What do you think states are going to do with respect to OB3 now that it's federal law?

JAMIE YESNOWITZ 26:27
Well, I think from the international perspective, I know I didn't go into that all that much, but the new regimes, the NCTI and the FDDEI …

DAVID SITES 26:36
The old GILTI and FDII, right? The new NCTI, which doesn't roll off the tongue quite as well, does it?

JAMIE YESNOWITZ 26:42
No, it doesn't. But back in 2018, when the regime came into place, a lot of states decoupled from that through either incorporating into the base, but then deducting it out as dividends received, even though not necessarily dividends, but from a state perspective they were. So that was what would happen in 2018. I would expect a couple more states to kind of opt into the international taxation regime. Saw that Illinois already went that route concurrently with OB3 being adopted. And so, we might see more states try. Yeah, they see the revenue grab and, at some point, it becomes a little bit too tempting for them not to want to take it.

DAVID SITES 27:25
Yeah, a chance to tax that offshore income that's not otherwise being taxed. And then also the benefits though, right? The FDDEI regime could presumably yield some sort of state tax benefit if you were allowed to have that deduction for export, for export stuff. So, good and bad, right? Good and bad.

JAMIE YESNOWITZ 27:44

Good and bad. And I think that this does provide the opportunity for some states to deal with the issue of how do you apportion this type of amount that goes into the base? Because you have to figure out, each state, you have to figure out what your apportionment factor is, and you have income that's coming into the state that's included in many cases, or should be included in your sales factor. How do you account for that? What kind of sourcing do you use to bring that income in? And I mean, the states really haven't been overly clear as to how to do that. Some states just say ignore it, exclude it, which in … many, many folks feel that that's unfair because if you have a sales factor inclusion of international income, it's almost always going to be in the denominator and not the numerator, which is very helpful from a tax liability perspective. If a state says, "Eh, just ignore it from a sales factor perspective," well, now you have base inclusion and you don't have a way to dilute the tax liability through a lower factor.

DAVID SITES 28:45
Right.

JAMIE YESNOWITZ 28:45
So, my hope is that we see some states provide more guidance on how this is supposed to work and provide some fair factor representation to reduce it, to reduce the tax liability.

DAVID SITES 28:57
Interesting, interesting. Hey, bonus question before we get on to the next one. One of the things that was in the bill, and it was President Trump's kind of pet parts of the bill, was no tax on overtime, no tax on tips, benefit for a certain car loan interest, right? I suspect states have to evaluate whether they're going to extend that benefit too, right? There's a deduction on your federal tax return if you have … if you're a qualifying taxpayer, which is a slim slice of the working population. But have states said anything about whether they're going to have … will it be no state tax on overtime and no state tax on those tips too? Or …

JAMIE YESNOWITZ 29:37

Just a couple of jurisdictions so far have decided that they're probably going to go along with it. Of course, for those jurisdictions that are rolling, they've already signed off on it. And so, it would take a legislative act to decouple from that. I think that it's an interesting policy from a federal perspective, from the state side, especially something that hits individuals, they're more likely to go along with it than, say, the corporate Big Four business provisions.

DAVID SITES 30:08

Yeah, got it. OK. So, the rolling ones are kind of in the soup and the other ones need to kind of affirmatively decide, just like on the business provisions. OK. So, we've talked a lot about the OB3 provisions, but there's so much going on in the state world kind of beyond that. So you live in this world. What are some particularly interesting state tax developments that I haven't asked you about that you think businesses should be focusing on?

JAMIE YESNOWITZ 30:33

I think one of the developments that we've been following relates to this digital advertising tax that Maryland has, and many other states are waiting to find out about how it turns out in Maryland, to determine whether they want to impose this tax as well. It's a tax on big tech companies largely, and right now it was adopted by the Maryland Comptroller about four years ago, adopted by the state about four years ago. Litigation with the Maryland Comptroller's office has gone on since that time with a variety of business groups and like saying that this tax is unconstitutional for a variety of perspectives. You can't tax free speech, things like that. It's against the Internet Tax Freedom Act.

And so there's this litigation in federal and state court. It's going to take a while for that to be hashed out. It's important because, if this ultimately goes through, other states, New York, Washington, Minnesota, many of the other progressive states are going to say, "Well, we like this tax and we're going to impose it on big businesses as well."

DAVID SITES 31:41

So, so just so I'm clear, for the listener, I'm an international tax guy and we've got all kinds of digital taxes floating around. This is a digital advertising tax. So it's aimed at tech companies, right, that collect advertising revenue and then advertise presumably to people, for example, in Maryland, right? It hits your eyeballs on your phone or on your computer screen in Maryland, and they know, obviously, where you are when it hits your eyeballs. And so, Maryland saying, “Hey, that's our residents that you're advertising to. You're collecting advertising revenue for that. And so, we're going to try to tax you on some of that revenue in some way.” Is that essentially the thought here?

JAMIE YESNOWITZ 32:22

That's essentially the thought. The problem with the tax is that they're targeting businesses with large amount of worldwide gross income and then they're trying to come up with an apportioned way of getting them in. And it's just a really … it's a challenging formula that they use that the controller doesn't necessarily have a full handle on. And so, the largest businesses are being targeted here, and the in-state activity may not be representative of what the tax ultimately is because it is a very. very highly progressive tax. The largest businesses have to pay a 10% tax on this item.

DAVID SITES 33:02

Wow.

JAMIE YESNOWITZ 33:03

That's really large. I mean, you cross that 10% tax threshold on a state tax, people take notice of that.

DAVID SITES 33:09

Yeah. So it's a form of market kind of based taxation, which has been challenging on the international front to reach consensus. A lot good ideas, and a lot of desire for markets to reach in and say, “Hey, if you're generating revenue based off the people resident in my country, even if you don't have physical, traditional physical presence, a building, a storefront, salespeople running around, we still think we should be able to reach out and get you." That's a very hard tax to design. So I'll be, I'll be watching that. So, what else? What else on the state front?

JAMIE YESNOWITZ 33:39

The ability of state tax authorities to use what we characterize as alternative apportionment. How sales factor calculations for corporate income taxpayers, it's designed to figure out how much of the piece of the pie does the state get for a particular sale. And so there are a variety of statutory and regulatory rules, and over time, the analysis has changed from looking at where the business was located and incurred cost for services and things like that to more of a market-based focus on the side of services and intangible-based … intangible sales, which has become a bigger and bigger chunk of what a company makes. Tangible personal property, you've always looked to where the customer is located. But for services and intangibles, you're looking more consistently with that because more states, far more states, have looked to a market-type of component.

So, the rules are what they are from a statute regulatory perspective. If those rules don't "barely reflect" your taxable income in a particular state, a state tax authority can say, "Well, we think a different type of formula is appropriate. Alternative apportionment is appropriate. And if we disagree, we'll challenge you in court and say, well, we think that our version of a market-based sourcing rule is more appropriate than the one that you're trying to use."

DAVID SITES 35:05

Yeah.

JAMIE YESNOWITZ 35:06

So, we saw a recent case in Minnesota, the DuPont case, where DuPont had all these treasury receipts in their sales factor. So, they generated it from foreign transactions and the like. It was kind of like a hedging function, if you will. And they said, well, since it's a hedging function, there are a lot of iterative receipts. You have this huge

amount of receipts that they report, which was far more than the income that they earned from it. And so, DuPont's like: put this all in the denominator, nothing in the numerator, lower our tax liability and we're all good. Minnesota's like: no, you're not all good because it's distortive to have this huge amount of receipts in the denominator. You can use your net amount, but not your gross amount.
And (the) Minnesota Supreme Court just recently decided in favor of the state on this issue. My expectation is we'll be seeing more and more of these types of disputes go through the court system because it's definitely …

DAVID SITES 36:05
Yeah, this is going to be an ongoing … an ongoing challenge, right? As business models are evolving and we look at how people do business in the past, you had to have a storefront or a catalog or some sort of distribution, as you mentioned, for tangible. But now with SaaS and online service delivery and even just streaming and things like that, you really … it does seem to make sense to look more at a market … at a market-based approach.
All right, last chance. Anything else that we need to know about?

JAMIE YESNOWITZ 36:33
Well, Public Law 86272. For those that are uninitiated, that's a federal law that provides protection for a taxpayer that all they … a business taxpayer … that all they are doing is they are going into a state, they're soliciting or they're doing activities that are like soliciting tangible personal property. And that's all they're doing in the state. They're generating sales. They're doing a limited amount of activity.
The federal provision was enacted in 1959 for an economy that was built in 1959. We're more than 60 years out. They've never changed the bill. So, a variety of organizations, governmental organizations, have said, “Well, we need to evolve.” And so the Multistate Tax Commission, which is a consortium of governments, similar to like the OECD for international, they put out a series of interpretive guidelines that essentially say Internet activities, a broad array of Internet activities, are going to lose the protection from 86272 if you engage in those.

So by doing that, that kind of makes it very difficult for most of these businesses that have historically said, “We are PL 86272 protected” on their returns. These companies need to re-evaluate what's going on to see if they don't come under, or they lose the protection because of these new guidelines. My sense is that now that the guidelines have been published and been out for a couple of years, some of the states have started to put in their regulations: “We adopt these provisions.” It's the subject of litigation already and we'll be watching to see what comes of that. I think that the right to use, to interpret 86272, it's, you know, that's what the government is claiming they can do.

I personally think that Congress needs to step in and say, “Well, we have this law from 1959. It's no longer relevant in our new economy where it's so electronically based. Let's put in a new standard, or a standard that updates what we had in 1959 for a new economy that kind of makes more sense for taxpayers.”

DAVID SITES 38:48

Yeah, no prospect, right, of Congress doing that? We don't know of a vehicle or a bill now that might carry that.

Well, Jamie, I am so glad that we have you on the team keeping up with this stuff because it is a wide range of stuff to consider and I really appreciate you taking the time to come on the podcast and give us all your insights. So, thank you for being here.

JAMIE YESNOWITZ 39:11

Thank you.

DAVID SITES 39:12

If our listeners have any more questions or want to learn more about how SALT developments might impact your business, please visit GrantThornton.com. Check out our D.C. Dispatch page for timely updates on tax and regulatory developments that matter. Until next time, thanks for listening.