State and local taxes

Businesses should monitor the tax rules in the states in which they operate or make sales. Taxpayers that cross state borders—even virtually—should review state nexus and other policies to understand their compliance obligations, identify ways to minimize their state tax liabilities and eliminate any state tax exposure. The following are some of the state-specific areas taxpayers should consider when planning for their tax liabilities in 2021 and 2022:

- Does the state conform to federal tax rules (including recent federal legislation) or decouple from them? Not all states follow federal tax rules. (Note that states do not necessarily follow the federal treatment of PPP loans. See *Considerations for employers,* above.)
- Has the business claimed all state NOL and state tax credit carrybacks and carryforwards? Most states apply their own NOL/credit computation and carryback/forward provisions. Has the business considered how these differ from federal and the effect on its state taxable income and deductions?
- Has the business amended any federal returns? Businesses should make sure state amended returns are filed on a timely basis to report the federal changes. If a federal amended return is filed, amended state returns may still be required even there is no change to state taxable income or deductions.
- Has a state adopted economic nexus for income tax purposes, enacted NOL deduction suspensions or limitations, increased rates or suspended or eliminated some tax credit and incentive programs to deal with lack of revenues due to COVID-19 economic issues?
- The majority of states now impose single-sales factor apportionment formulas and require market-based sourcing for sales of services and licenses/sales of intangibles using disparate sourcing methodologies. Has the business recently examined whether its multistate apportionment of income is consistent with or the effect of this trend?
- Consider the state and local tax treatment of merger, acquisition and disposition transactions, and do not forget that internal reorganizations of existing structures also have state tax impacts. There are many state-specific considerations when analyzing the tax effects of transactions.
- Is the business claiming all available state and local tax credits, e.g., for research activities, employment or investment?
- For businesses selling remotely and that have been protected by P.L. 86-272 from state income taxes in the past, how is the business responding to changing state interpretations of those protections with respect to businesses engaged in internet-based activities?
- Has the business considered the state tax impacts of its mobile workforce? Most states that provided temporary nexus and/or withholding relief relating to teleworking employees lifted those orders during 2021 (also see *Considerations for employers*, above).
- Has the state introduced (or is it considering introducing) a tax on digital services? The definition of digital services can potentially be very broad and fact specific. Taxpayers should understand the various state proposals and plan for potential impacts.

- Remote retailers, marketplace sellers and marketplace facilitators (i.e., marketplace providers) should be sure they are in compliance with state sales and use tax laws and marketplace facilitator rules.

- Assessed property tax values typically lag behind market values. Consider challenging your property tax assessment.

State pass-through entity elections

The TCJA introduced a $10,000 limit for individuals with respect to federal itemized deductions for state and local taxes paid during the year ($5,000 for married individuals filing separately). At least 20 states have enacted potential workarounds to this deduction limitation for owners of pass-through entities, by allowing a pass-through entity to make an election (PTE tax election) to be taxed at the entity level. PTE tax elections present state and federal tax issues for partners and shareholders. Before making an election, care needs to be exercised to avoid state tax traps, especially for nonresident owners, that could exceed any federal tax savings. (Note that the Build Back Better Act proposes to increase the state and local tax deduction limitation for individuals to $80,000 ($40,000 for married individuals filing separately) retroactive to taxable years beginning after December 31, 2020. In addition, the Senate has begun working on a proposal that would completely lift the deduction cap subject to income limitations.)