



State & Local Tax **Alert**

Breaking state and local tax developments from Grant Thornton LLP

SALT Outlook, Trends and Predictions for 2018

Grant Thornton's 2018 Outlook, Trends and Predictions Alert focuses on how we believed 2017 would unfold from a state and local tax (SALT) perspective, and how these predictions lined up with what actually happened. We have also included ten new predictions on critical SALT issues which we believe will dominate in 2018.

Keeping in line with prior years, we first turn to a review of our predictions for last year. In assessing our 2017 predictions, it was notable to reflect on case law decisions and legislative developments involving state tax issues that seemed important or urgent at the beginning of the year (enough to be the subject of some of our predictions), but lost their relevance by the end of the year. Examples of these issues included state tax conformity to the proposed IRC Section 385 regulations and additional guidance on retroactivity and the *Wynne*¹ case. It remains to be seen whether this represents a temporary blip with respect to how relevant these specific issues may truly be, but it stands in contrast to issues like state efforts to expand the sales tax base and the taxation of remote sellers, which consistently continued to capture the interest of courts, legislatures and the public alike.

As 2017 closed, the enactment of federal tax reform and how it may impact the states became a topic of extreme importance in SALT, dwarfing some of the issues that SALT practitioners frequently debate. Accordingly, as we considered our predictions for 2018, we focused a fair amount of attention on what federal tax reform may bring for the states. What is most fascinating about this topic is the potential for some state governments to challenge the new federal regime. This aim may be accomplished by challenging the reach of new limitations on the SALT deduction taken on Federal personal income tax returns, as well as by decoupling from certain amended provisions of the Internal Revenue Code.

At the same time, we did not ignore the SALT-specific topics that will continue to be relevant in a post-federal tax reform world, like sales tax matters, apportionment, state tax incentive programs, and the adoption of novel types of sin taxes. Many of these issues may be resolved, or in some cases exacerbated, through budget battles in states that often have a governor and a legislature controlled by different parties. Other state-specific issues will

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Contact details
Jamie C. Yesnowitz Washington, DC T 202.521.1504 E jamie.yesnowitz@us.gt.com
Chuck Jones Chicago T 312.602.8517 E chuck.jones@us.gt.com
Lori Stolly Cincinnati T 513.345.4540 E lori.stolly@us.gt.com
Priya D. Nair Washington, DC T 202.521.1546 E priya.nair@us.gt.com
www.GrantThornton.com/SALT

¹ *Comptroller of the Treasury v. Wynne*, 135 S. Ct. 1787 (2015).

need to be addressed by the courts, including most prominently, the U.S. Supreme Court's consideration of *Wayfair*.²

2017 Predictions – A Review

- *Conformity with the IRC Section 385 regulations.* The issuance of the final and temporary regulations under IRC Section 385 by the U.S. Department of the Treasury and the Internal Revenue Service (IRS) was a significant development in 2016.³ Given the potential impact of the federal Section 385 regulations, we predicted that at least two states would issue specific guidance related to conformity with the regulations. This prediction did not verify as a result of a series of developments at the federal level. Specifically, President Trump's issuance of Executive Order 13789 (EO) ordered the Treasury Department to review all "significant tax regulations" issued on or after January 1, 2016, and submit a report identifying regulations that (1) impose an undue burden on U.S. taxpayers, (2) add undue complexity to federal tax laws or (3) exceed the statutory authority of the IRS. In response, the Treasury Department issued Notice 2017-38 on July 24, 2017 in which it identified eight regulations that could be the subject of some reform, including modification, streamlining, or potential repeal. Included on the list were the Section 385 regulations.⁴ Subsequently, in October, the Treasury Department issued a second report, as required under the EO, in which it indicated that it is, among other things, considering a revised documentation rule under the Section 385 regulations that would be "substantially simplified and streamlined."⁵
- *The role of Wynne hypotheticals.* In *Wynne*, the U.S. Supreme Court held that state provisions allowing credits for income taxes paid to other states, but denying credits for income taxes paid to localities, violated the Commerce Clause.⁶ Notably, in its analysis, the Court provided an elaborate hypothetical example to show how double taxation would exist if each state were to impose the same Maryland personal income tax structure that was at issue in the case. Two subsequent cases in 2016 employed the *Wynne* hypothetical.⁷ In light of this, we

² *South Dakota v. Wayfair, Inc.*, 901 N.W.2d 754 (S.D. 2017), *cert. granted*, U.S. No. 17-494, Jan. 12, 2018.

³ T.D. 9790.

⁴ For a discussion of this development, see [GT Alert: Treasury Identifies Eight Regulations Subject to Modification and Potential Repeal](#).

⁵ *Second Report to the President on Identifying and Reducing Tax Regulatory Burdens*, Oct. 2, 2017. For a discussion of this development, see [GT Alert: Treasury Report Details Next Steps for Controversial Guidance Projects](#).

⁶ *Comptroller of the Treasury v. Wynne*, 135 S. Ct. 1787 (2015). For a detailed discussion of this case, see [GT SALT Alert: U.S. Supreme Court Holds Lack of County Personal Income Tax Credit for Taxes Paid to Other States Violates Commerce Clause](#). For an analysis of the potential effect and applications of *Wynne*, see Vito Cosmo Jr., Matthew Melinson and Patrick Skeehan, *Supreme Court Delivers Blow to Some State and Local Tax Regimes*, CPA JOURNAL (Vol. 86, Issue 4, Winter 2016).

⁷ *The First Marblehead Corp. v. Commissioner of Revenue*, 56 N.E.3d 132 (Mass. 2016). For a discussion of this case, see [GT SALT Alert: Massachusetts Supreme Judicial Court Upholds Constitutionality of Financial Institution Excise Tax Apportionment Rules](#); *Matkovich v. CSX Transportation, Inc.*, 793 S.E.2d 888 (W. Va. 2016). For a detailed discussion of this case, see [GT SALT Alert: West Virginia Supreme Court Extends Wynne to Sales and Use Tax Credits of Municipal Taxes](#).

predicted that *Wynne* hypotheticals would continue to play a role in at least two state supreme court decisions in 2017. This prediction did not verify.

- *States look for budget shortfall solutions.* At the beginning of January 2017, 31 states were projected to have budget shortfalls for the 2017 fiscal year.⁸ Against this backdrop, we predicted that at least three states facing budget difficulties would try to solve their issues by expanding their sales tax base, and at least one state would raise corporate income tax rates. This prediction partially verified. In 2017, Illinois enacted legislation increasing its corporate income tax rate from 5.25 percent to 7 percent for all corporations except S corporations, effective July 1, 2017.⁹ However, our prediction on the sales tax side did not materialize. States have long attempted to broaden their sales tax base, generally with respect to expanding the types of service-based transactions subject to tax. By mid-2017, “[t]wenty-three state legislatures [had] considered proposals...to impose taxes on at least some services.”¹⁰ None of these bills were enacted.¹¹ But despite these numbers, it appears that states will continue to forge ahead in their efforts. For example, Rhode Island’s Department of Revenue has submitted a proposal to state budget officials that “would require Apple’s iTunes, audio streaming site Spotify and video streaming service Netflix...to collect the state’s 7-percent sales tax on all transactions, including rentals, purchases and subscriptions.”¹²
- *Remote retailer notice requirements.* During the last weeks of December 2016, the U.S. Supreme Court denied certiorari in *Direct Marketing Association v. Brohl*,¹³ and in doing so, allowed Colorado to proceed with its notice and reporting regime.¹⁴ In the wake of this development, we predicted that the U.S. Supreme Court’s denial of certiorari in *DMA* would encourage at least three more states to enact sales tax remote retailer notice requirements in 2017. This prediction verified as Alabama,¹⁵

⁸ Ryan Maness, *Thirty-One States Face Revenue Shortfalls for the 2017 Fiscal Year*, MULTISTATE INSIDER, Jan. 3, 2017.

⁹ P.A. 100-0022 (S.B. 9), Laws 2017. Combined with the 2.5 percent replacement tax that remained in effect, the total tax for corporations is 9.5 percent. For a discussion of this development, see [GT SALT Alert: Illinois Enacts Budget Increasing Income Tax Rates, Eliminating Unitary Non-Combination Rule](#).

¹⁰ Elaine S. Povich, *Why States Are Struggling to Tax Services*, STATELINE.COM, June 27, 2017.

¹¹ *Id.*

¹² Patrick Anderson, R.I. *Eyes Expanding Sales Tax to Downloads, Streaming Services*, PROVIDENCEJOURNAL.COM, Nov. 3, 2017.

¹³ *Direct Marketing Ass’n v. Brohl*, 814 F.3d 1129 (10th Cir. 2016), cert. denied, 137 S. Ct. 591 (2016). For a discussion of this case, see [GT SALT Alert: Federal Court of Appeals Upholds Colorado’s Sales and Use Tax Notice and Reporting Requirements](#).

¹⁴ On July 1, 2017, Colorado’s Department of Revenue began to enforce these notice and reporting requirements which had been delayed as a result of protracted litigation between the state and DMA. Following a settlement agreement between the parties in February 2017, the Department moved forward with enforcement. For a discussion of these developments, see [GT SALT Alert: Colorado Enforcement of Remote Seller Notice and Reporting Requirements Commences](#) and [GT SALT Alert: DMA Enters into Settlement Agreement with Colorado on Remote Seller Notice and Reporting Requirements](#).

¹⁵ S.B. 86, Laws 2017. See [GT SALT Alert: Alabama Enacts Legislation Authorizing DOR to Implement Sales Tax Notice and Reporting Requirements](#).

Rhode Island¹⁶ and Washington¹⁷ all enacted legislation in 2017 establishing notice and reporting requirements on remote sellers.

- *Continuing scrutiny of property tax exemptions for non-profits.* Property tax exemptions for non-profits came under heavy scrutiny in 2017, with much of the focus being on exemptions for hospitals. In Illinois, two separate districts of the Illinois Appellate Court issued contradicting decisions on the constitutionality of Illinois Property Tax Code Section 15-86, which added a new category of charitable exemption for hospitals.¹⁸ In *Carle Foundation v. Cunningham Township*,¹⁹ the Illinois Appellate Court, Fourth District, held that Section 15-86 is facially unconstitutional and unenforceable, while the First District of the Illinois Appellate Court issued a decision in *Oswald v. Hamer*²⁰ upholding its constitutionality. Given this choice, we predicted that the Illinois Supreme Court would affirm *Carle*. This prediction did not verify. On March 23, 2017, the Illinois Supreme Court issued its opinion in *Carle*, declining to address the constitutionality of the property tax exemption and remanding the case on jurisdictional grounds.²¹ We also predicted that we would see increased scrutiny of property tax exemptions for other non-profits. This prediction verified as we continued to see many question the wisdom of providing property tax exemptions to universities.²² At the same time, legislatures are starting to consider whether taxpayers should even have standing to challenge the exempt status of non-profits like universities. For example, in 2017, a bill was passed by the New Jersey Senate that would “prohibit property taxpayers from filing property tax appeals with respect to the property of others.”²³ The bill was designed to “block lawsuits” similar to the 2011 lawsuit filed by “Princeton residents arguing that some activities of Princeton University are essentially commercial and therefore those buildings should be properly assessed and taxes should be paid.”²⁴ The bill did not pass and similar bills in the past have also failed to be enacted.²⁵
- *States consider tackling revenue fluctuations through gross receipts taxes.* While corporate income taxes remain the prevalent form of business taxation in the U.S., they have long been criticized for their revenue volatility.²⁶ As a result, we have seen states such as Ohio and Texas turn to gross receipts taxes as a more steady revenue

¹⁶ Ch. 302 (H.B. 5175 SUB A as amended (“H.B. 5175Aaa”)), Laws 2017. See [GT SALT Alert: Rhode Island Imposes Notice and Reporting Requirements on Non-Collecting Retailers; Establishes Tax Amnesty Program.](#)

¹⁷ Ch. 28 (H.B. 2163), Laws 2017 (3rd Special Session). See [GT SALT Alert: Washington Imposes Collection and Remittance, Notice and Reporting Requirements on Marketplace Facilitators.](#)

¹⁸ 35 ILL. COMP. STAT. 200/15-86.

¹⁹ 45 N.E.3d 1173 (Ill. App. Ct. 2016).

²⁰ 73 N.E.3d 536 (Ill. App. Ct. 2016).

²¹ Illinois Supreme Court, Nos. 120427, 120433, March 23, 2017. For a discussion of this decision, see [GT SALT Alert: Future of Illinois Hospital Property Tax Exemption Remains Uncertain.](#)

²² See David M. Simon, Commentary: *Why Private Universities Should — Like the Rest of Us — Pay Property Taxes*, CHICAGO TRIBUNE, April 5, 2017.

²³ S. 2212.

²⁴ Gianluca D’Elia, *Bill That Could Block Citizens’ Right to Challenge Tax Exemptions of Universities, Hospitals and Other Nonprofits Still Awaits Assembly Approval*, PLANET PRINCETON, Dec. 9, 2017.

²⁵ *Id.*

²⁶ The Pew Charitable Trusts, *Fiscal 50: State Trends and Analysis* (Nov. 7, 2017).

source. The most recent implementation of a gross receipts-style tax was seen in Nevada.²⁷ In light of these developments, we predicted that at least one state would introduce legislation to move from a corporate income tax to a non-income tax regime as a means to dampen revenue fluctuations. This prediction clearly verified as interest in the topic intensified. Eight states (California,²⁸ Louisiana,²⁹ Missouri,³⁰ Oklahoma, Oregon,³¹ Pennsylvania, West Virginia,³² and Wyoming) considered the idea of a gross receipts tax,³³ and Oregon³⁴ and Louisiana³⁵ both introduced legislation to implement a gross receipts tax.

- *The anti-Quill movement.* In 2016, South Dakota enacted legislation implementing an economic nexus standard requiring remote sellers without a physical presence in the state to collect sales tax if certain gross revenue or transaction thresholds were met.³⁶ We predicted that this trend would continue with at least two states adopting anti-*Quill* legislation. This prediction verified as we saw Wyoming,³⁷ North Dakota,³⁸ Indiana³⁹ and Maine⁴⁰ all enacting similar legislation in 2017. We also predicted that the outlook on the anti-*Quill* movement in the courts would remain inconclusive amid questions of venue in the South Dakota challenge and the deliberate nature of the judicial process in Alabama's challenge in *Newegg, Inc. v. Alabama Department of Revenue*.⁴¹ This prediction substantially verified. The anti-*Quill* movement in the courts is still inconclusive, although not on venue grounds. On September 13, 2017, the South Dakota Supreme Court held the state's law to

²⁷ Nevada Governor Brian Sandoval signed legislation on June 9, 2015, Ch. 487 (S.B. 483), under which a new commerce tax on businesses was established. Nevada's Commerce Tax took effect on July 1, 2015 and has withstood several repeal challenges. For a discussion of Nevada's Commerce Tax, see [GT SALT Alert: Nevada Enacts Budget Bill Including New Commerce Tax](#) and [GT SALT Alert: Nevada Tax Commission Issues Final Regulations on New Commerce Tax](#). See also Metisse Lutz, *Top 5 Things to Know About Nevada Commerce Tax*, TAX ANALYSTS STATE TAX TODAY, June 20, 2016.

²⁸ Nicole Kaeding, *Carson, California, Considers a Gross Receipts Tax*, TAX FOUNDATION, Sept. 28, 2017.

²⁹ Scott Drenkard, *Louisiana Scraps Gross Receipts Tax Proposal*, TAX FOUNDATION, May 2, 2017.

³⁰ Jared Walczak, *Why Does Missouri Want a Gross Receipts Tax*, TAX FOUNDATION, Sept. 26, 2017.

³¹ Nicole Kaeding, *Oregon's Quest for a Gross Receipts Tax Ends...For Now*, TAX FOUNDATION, June 22, 2017.

³² Jared Walczak, *West Virginia Gross Receipts Tax Proposals Just Won't Die*, TAX FOUNDATION, May 31, 2017.

³³ Jared Walczak, *Trends in State Tax Policy, 2018*, TAX FOUNDATION, Dec. 2017.

³⁴ H.B. 2830; Paul Jones, *Oregon Gross Receipts Tax Efforts Is Dead for 2017*, TAX ANALYSTS STATE TAX TODAY, June 26, 2017.

³⁵ H.B. 628; Maria Koklanaris, *Louisiana Commercial Activity Tax Dies in Committee*, TAX ANALYSTS STATE TAX TODAY, APRIL 26, 2017.

³⁶ S.B. 106, Laws 2016. For a discussion of this legislation, see [GT SALT Alert: South Dakota Enacts Legislation Challenging Quill's Physical Presence Requirement](#).

³⁷ Ch. 85 (H.B. 19), Laws 2017. For a discussion of this legislation, see [GT SALT Alert: Wyoming Enacts Sales Tax Nexus Law Challenging Quill's Physical Presence Requirement](#).

³⁸ S.B. 2298, Laws 2017. For a discussion of this legislation, see [GT SALT Alert: North Dakota Enacts Contingent Bright-Line Sales Tax Nexus Law for Remote Sellers](#).

³⁹ P.L. 247 (H.B. 1129), Laws 2017. For a discussion of this legislation, see [GT SALT Alert: Indiana Enacts Bright-Line Sales Tax Nexus Law for Remote Sellers](#).

⁴⁰ Ch. 245 (S.P. 483), Laws 2017. For a discussion of this legislation, see [GT SALT Alert: Maine Will Impose Collection and Remittance Duties on Remote Sellers Beginning October 1, 2017](#).

⁴¹ Alabama Tax Tribunal, No. S. 16-613, filed June 8, 2016.

be unconstitutional in *South Dakota v. Wayfair, Inc.*⁴² On January 12, 2018, the U.S. Supreme Court granted the state's petition for a writ of *certiorari* to hear this case. Meanwhile, no decision has been made in *Newegg*, with the company filing its final brief with the Alabama Tax Tribunal on December 19, 2017.⁴³

- *Retroactive tax legislation.* In 2016 and 2017, petitions for *certiorari* were filed with the U.S. Supreme Court in a series of high-profile retroactive tax legislation cases. A slew of cases out of Michigan challenged the constitutionality of a state law that retroactively repealed the Multistate Tax Compact⁴⁴ and in *Dot Foods, Inc. v. Department of Revenue*⁴⁵ taxpayers challenged a law that retroactively narrowed a Washington Business and Occupation (B&O) tax exemption. In light of this, we predicted that the U.S. Supreme Court would grant *certiorari* in at least one of the retroactive legislation cases. This prediction did not verify. The Supreme Court relisted the cases for conference several times in 2017 leading many to believe that the Court would take up the issue.⁴⁶ However, on May 22, 2017, the Supreme Court denied *certiorari* in all seven cases.
- *Taxes on soft drinks and sugary items.* Cash strapped states seeking new sources of revenue have turned to sin taxes in recent years. Many states legalized the use of recreational marijuana and tax sales of the product as a means to generate substantial amounts of revenue.⁴⁷ We also saw cities turning to soda tax for its ability to generate revenue while at the same time promote a societal good. In light of this, we predicted that at least two more major municipalities would impose a soft drinks/sugary items tax. This prediction partially verified. While Seattle's City Council approved an ordinance⁴⁸ that imposes a sweetened beverage tax on distributors beginning January 1, 2018,⁴⁹ no other municipality enacted a soft drinks/sugary items tax in 2017 (though sweetened beverages imposed by Philadelphia and for a short time, in Cook County, Illinois survived legal challenges during the year).⁵⁰

⁴² 901 N.W.2d 754 (S.D. 2017), *cert. granted*, U.S. No. 17-494, Jan. 12, 2018.

⁴³ Chris Marr, *Alabama Digital Sales Tax Heading to Potential Hearing, Decision*, BLOOMBERG BNA DAILY TAX REPORT: STATE, Dec. 26, 2017.

⁴⁴ *Sonoco Products Co. v. Michigan Dept. of Treasury*, 137 S. Ct. 2157 (2017); *Skadden, Arps, Slate, Etc. v. Michigan Dept. of Treasury*, 137 S. Ct. 2157 (2017); *Gillette Commercial Operations v. Michigan Dept. of Treasury*, 137 S. Ct. 2157 (2017); *IBM Corp. v. Michigan Dept. of Treasury*, 137 S. Ct. 2180 (2017); *Goodyear v. Michigan Dept. of Treasury*, 137 S. Ct. 2157 (2017); *DIRECTV Group Holdings v. Michigan Dept. of Treasury*, 137 S. Ct. 2158 (2017).

⁴⁵ 372 P.3d 747 (Wash. 2016), *cert. denied*, 137 S. Ct. 2156 (2017). For a discussion of this decision, see [GT SALT Alert: Washington Supreme Court Upholds Retroactive Application of Amendment to B&O Tax Exemption](#).

⁴⁶ Che Odom, *High Court Keeps IBM, Goodyear Waiting on "Retroactive" Taxes*, BLOOMBERG BNA DAILY TAX REPORT: STATE, April 25, 2017.

⁴⁷ Jamie Yesnowitz and Emily Fiore, *The History and Purpose Behind Sin Taxes*, BLOOMBERG BNA DAILY TAX REPORT: STATE, Oct. 17, 2017.

⁴⁸ Ordinance 125324, § 1, enacting SEATTLE, WA., CODE § 5.53 (June 6, 2017). For a discussion of this ordinance, see [GT SALT Alert: City of Seattle Approves New Personal Income and Sweetened Beverage Taxes](#).

⁴⁹ SEATTLE, WA., CODE § 5.53.030(B)(2). The tax is specifically imposed on distributors of sweetened beverages, rather than manufacturers or retailers. SEATTLE, WA., CODE § 5.53.

⁵⁰ *Williams v. City of Philadelphia*, Pennsylvania Commonwealth Court, Nos. 2077 C.D. 2016, 2078 C.D. 2016, June 14, 2017. See [GT SALT Alert: Pennsylvania Commonwealth Court Upholds](#)

- *States may be faced with groundbreaking federal conformity choices.* At the beginning of January 2017, following the Republican sweep of the White House, House of Representatives and Senate, we predicted that if a ground-breaking federal income tax change occurred in 2017, several states would work in concert to address whether, and if so, how to conform to the federal change by the end of the year. Given that federal tax reform was enacted during the very last days of the year, this prediction did not fully materialize. However, states have already begun to consider the potential impact that changes to income tax provisions such as expensing and bonus depreciation will have on their revenues.⁵¹ One area in which we may see states act in unity is with the limitation on the state and local tax deduction. High-tax states such as New York, New Jersey and California have been vocal about their opposition to the limitation on the deduction.⁵²

Our 2018 Predictions

1. Bonus Depreciation

Federal tax reform, as enacted on December 22, 2017, allows for 100 percent bonus depreciation for property placed in service after September 27, 2017, and before January 1, 2023.⁵³ This bonus depreciation rate is then phased down over the next five years.⁵⁴ Historically, the trend has been for states to decouple from costly federal bonus depreciation provisions, most recently with the provisions contained in the Protecting Americans from Tax Hikes (PATH) Act of 2015.⁵⁵ At this point, it can be said that state decoupling from federal bonus depreciation provisions is commonplace and automatic in many cases, and state legislatures that do not automatically decouple from these provisions have the means to do so in the next few months. **In light of this, we predict that at least 80 percent of the states that impose corporate income taxes will decouple from the new 100 percent bonus depreciation provision contained in IRC Section 168(k).**

2. Gross Receipts Tax

As noted above, several recent attempts by states to implement gross receipts taxes on business entities have failed. However, given the somewhat uncertain impact of federal tax reform on states (both from an overall economic perspective, and from a tax revenue standpoint), states are likely to renew efforts in this area. As we think a more favorable

[Philadelphia's Beverage Tax](#). *Illinois Retail Merchants Association*, No. 17 L 50596, July 28, 2017 opinion and order dismissing complaint; Cook County Department of Revenue Sweetened Beverage Tax Reg. 2017-05, July 28, 2017. Notably, the Cook County tax was later repealed. See [GT SALT Alert: Cook County, Illinois Imposing Soda Tax Following Dismissal of Legal Challenge](#) and [GT SALT Alert: Cook County, Illinois Board of Commissioners Repeals Soda Tax](#).

⁵¹ *Memorandum: Federal Tax Reform Corporate Estimate*. Montana Department of Revenue (Dec. 4, 2017).

⁵² Paige Jones, *Democratic Governors Explore Legal Challenge to SALT Deduction Repeal*, TAX ANALYSTS STATE TAX TODAY, Dec. 5, 2017.

⁵³ H.R. 1, commonly referred to as the "Tax Cuts and Jobs Act," (P.L. 115-97), amending IRC § 168(k)(6).

⁵⁴ *Id.*

⁵⁵ P.L. 114-113.

environment for a gross receipts tax to be implemented exists in 2018, **we predict that at least three states will propose, and one state will enact legislation converting from a corporate income tax to a gross receipts tax.**

3. *State and Local Tax Deduction*

Federal tax reform limits the state and local tax deduction for individuals to \$10,000 in combined property and income taxes from 2018 to 2025.⁵⁶ Taxpayers have the option to elect to deduct sales taxes in lieu of income taxes. This new limitation has generated a substantial amount of controversy in high-tax states. New Jersey Governor-elect Phil Murphy, New York Governor Andrew Cuomo, and California Governor Jerry Brown have all indicated that they are “exploring legal options to block the federal government from repealing the state and local tax deduction” and lawmakers in other states are considering options for how best to lessen the impact of the provision.⁵⁷ In California, academics have considered two potential options to effectively uncouple the state from the limited SALT deduction: an employer-paid payroll tax that would “replace a portion of California’s income tax revenue” and an income tax credit for charitable contributions to the state government that could also be a deduction against federal tax liability.⁵⁸ These ideas are being given serious consideration by California lawmakers.⁵⁹ **Given the developments on this issue in California, we predict that at least two states will challenge the new federal restriction on the SALT deduction through the enactment of provisions converting individual income taxes into payroll taxes or charitable contributions that are fully deductible for federal income tax purposes.**

4. *Repatriation*

Under federal tax reform, unrepatriated foreign earnings are subject to a one-time transition tax of 15.5 percent for cash and cash equivalents and 8 percent for other assets applicable to U.S. shareholders in “specified foreign corporations.”⁶⁰ Specified foreign corporations are defined to include all controlled foreign corporations (CFCs) and all other foreign corporations (which are not passive foreign investment corporations) with at least one U.S. corporation as a U.S. shareholder.⁶¹ **We predict that states will have considerable issues in determining how to conform to the federal repatriation provisions, with at least two states deciding to impose either: (i) a state-specific surtax on deemed repatriation income; or (ii) a tax on the full amount of the deemed repatriation, without consideration for the IRC Sec. 965 subtraction adjustment.**

⁵⁶ IRC § 164(b)(6).

⁵⁷ Lauren Loricchio, *Governors’ Reactions to GOP Tax Bill Range From Anger to Praise*, TAX ANALYSTS STATE TAX TODAY, DEC. 22, 2017.

⁵⁸ Paul Jones, *California Could Use Payroll Tax, Charitable Credits to Mitigate SALT Cap*, TAX ANALYSTS STATE TAX TODAY, DEC. 29, 2017, citing Darien Shanske, a professor at the University of California, Davis.

⁵⁹ *Id.*

⁶⁰ IRC § 965(c).

⁶¹ IRC § 965(e). For a discussion of these provisions, see [GT Alert: President Signs Sweeping Tax Bill Into Law](#).

5. *Expansion of the Sales Tax Base*

As discussed above, state efforts to expand the sales tax base are challenging to achieve, with strong lobbying groups often being successful in preventing, the sales and use taxation of many service-based industries. For example, in 2016, voters in Missouri approved an amendment to the state's constitution that prohibited a new state or local sales, use or other similar tax on any service or transaction that was not subject to such a tax as of January 1, 2015.⁶² It was reported at that time that organizations representing real estate agents, concerned that the tax would extend to services on home sales, spent \$7 million in their efforts to see the amendment approved.⁶³ **We predict that we will see legislative proposals in at least ten states to expand the sales tax base to a significant number of services, but with no success.**

6. *Marketplace Providers or Facilitators*

States have created an arsenal of tools to address the sales and use tax collection and remittance obligations of remote sellers. We have seen states enact economic nexus laws, click-through nexus laws, affiliate nexus laws, notice and reporting laws and, most recently, “cookie nexus” laws. Additionally, four states, Pennsylvania,⁶⁴ Rhode Island,⁶⁵ Washington⁶⁶ and Minnesota,⁶⁷ all enacted legislation in 2017 based on the marketplace provider or facilitator concept. **We believe that the marketplace provider or facilitator concept, like the notice and reporting requirement before it, will grow in popularity in 2018, and predict that at least five states will consider, and at least three states will enact sales tax nexus laws focused on marketplace providers or facilitators.**

7. *Market-Based Sourcing*

Sourcing issues continued to take center-stage in 2017. On the market-based sourcing side, the MTC adopted long-awaited amendments to its model regulations to reflect the adoption of market-based sourcing for receipts from transactions other than sales of tangible personal property.⁶⁸ On the cost of performance (COP) side, two significant state tax court cases, *Apollo Education Group, Inc. v. Department of Revenue*⁶⁹ and *The University of*

⁶² Missouri Secretary of State, 2016 Ballot Measures (2016).

⁶³ Jeff Roberson, *Missouri Voters to Weigh Ban on Expanding Sales Tax to Services*, THE NEW YORK TIMES, Oct. 29, 2016.

⁶⁴ Act 43 (H.B. 542), Laws 2017.

⁶⁵ Ch. 302 (H.B. 5175 SUB A as amended (“H.B. 5175Aaa”)), Laws 2017. See [GT SALT Alert: Rhode Island Imposes Notice and Reporting Requirements on Non-Collecting Retailers; Establishes Tax Amnesty Program](#).

⁶⁶ Ch. 28 (H.B. 2163), Laws 2017 (3rd Special Session). See [GT SALT Alert: Washington Imposes Collection and Remittance, Notice and Reporting Requirements on Marketplace Facilitators](#).

⁶⁷ Ch. 1 (H.F. 1), Laws 2017 (1st Special Session); House Research Bill Summary for H.F. 1, Minnesota House of Representatives, May 25, 2017. See [GT SALT Alert: Minnesota Enacts Omnibus Tax Legislation Including Expansion of Sales Tax Nexus](#).

⁶⁸ Multistate Tax Commission, *Model General Allocation and Apportionment Regulations*, Feb. 24, 2017. See [GT SALT Alert: Multistate Tax Commission Adopts Amendments to Model General Allocation and Apportionment Regulations](#).

⁶⁹ Oregon Tax Court, Magistrate Division, No. TC-MD 150352C, Aug. 24, 2017. For a discussion of this case, see [GT SALT Alert: Oregon Tax Court Applies Broadened Transactional Approach, Narrowed Cost Analysis to Source Receipts for Online University](#).

Phoenix, Inc. v. Indiana Department of State Revenue,⁷⁰ shed light on the distinctions between COP applications in different states, as well as the importance of COP studies. **As sales factor sourcing issues drive the apportionment calculation that often significantly impacts state corporation income tax liability, we predict that at least two state courts will issue opinions on industry-specific COP issues that reference cost studies, and at least one state court will issue an opinion analyzing a recent market-based sourcing statute.**

8. Tax Incentives

The tax incentive landscape changed dramatically in 2017 as a result of two large-scale developments. First, Wisconsin enacted legislation in a special session that developed and expanded the state's tax incentives to attract Foxconn Technology Group's first U.S. manufacturing facility.⁷¹ The move was heavily criticized and the progress of the project is sure to be closely watched. Second, Amazon's plan to build a second headquarters sparked a national bidding war between over 200 jurisdictions. Unsurprisingly, few of the bidders have revealed the details of the tax breaks that they offered the company.⁷² The American Civil Liberties Union of Maryland even went so far as to file a Maryland Public Information Act request to put "pressure on the state and several local jurisdictions to disclose the local government proposals submitted" after Baltimore denied a local newspaper's request for a copy of its proposal.⁷³ Once Amazon makes a final decision and the details of the incentives offered under the winning bid are made public, it is very likely that there will be a public evaluation of how fair the deal may be to the winning jurisdiction and its taxpayers, along with a critique of the incentives given to Amazon. As an example of what a state has been offering Amazon in this process, New Jersey "has offered Amazon \$7 billion in tax credits 'among other incentives' to build HQ2 in Newark."⁷⁴ **Against this backdrop, we predict that Amazon's announcement regarding the location of its second U.S. headquarters, along with continuing developments in Foxconn's incentive agreement with Wisconsin, will lead to additional scrutiny and interest in high-profile state incentives packages. Specifically, we predict that at least one state will adopt related reporting requirements designed to test the effectiveness of its incentives.**

⁷⁰ Indiana Tax Court, No. 49T101411-TA-00065, Nov. 30, 2017. For a discussion of this case, see [GT SALT Alert: Indiana Tax Court Adopts Operational Cost of Performance Approach for Sourcing Services](#).

⁷¹ Act 58 (A.B. 1), Laws 2017 (Aug. 2017 Special Session). The legislation called for the Wisconsin Economic Development Corporation to create an electronics and information technology manufacturing zone in the state and to certify a business that begins operations within the zone for certain benefits in the form of income and franchise tax credits. For a discussion of this legislation, see [GT SALT Alert: Wisconsin Establishes Electronics and Information Technology Manufacturing Zone; Authorizes Creation of New Refundable Credits](#).

⁷² Lauren Loricchio, *ACLU Presses Maryland for Public Disclosure of Amazon HQ2 Proposals*, TAX ANALYSTS STATE TAX TODAY, Nov. 13, 2017.

⁷³ *Id.*

⁷⁴ Paige Jones, *Amazon Offered Billions in Tax Breaks as Progressive Groups Long for a Good Neighbor*, TAX ANALYSTS STATE TAX TODAY, Oct. 20, 2017.

9. *Remote Seller Special Voluntary Disclosure Initiatives*

Earlier this year, the MTC offered its special voluntary disclosure initiative for certain online marketplace sellers.⁷⁵ The program received 852 applications, which will be keeping the MTC busy for some time. While one would think the success of the program would lead the MTC to consider a second program, according to the MTC's nexus panel, "it lacks the resources to host any new application windows for an amnesty program for third-party sellers on marketplace platforms."⁷⁶ Notably, in 2017, we saw New Jersey offer its own limited voluntary disclosure program to help certain out-of-state businesses comply with the state's sales and use tax click-through nexus provisions.⁷⁷ **Given the success of the MTC's program, as well as New Jersey's efforts in this area, we predict that at least two states outside those that participated in the MTC's voluntary disclosure initiative will provide their own special amnesty/voluntary disclosure initiative targeted towards remote sellers.**

10. *Sin Taxes*

As discussed earlier, sin taxes are growing in popularity as states seek new, and constant, forms of revenue. Traditionally, sin taxes have been imposed on liquor, gambling and tobacco.⁷⁸ Newer forms of sin taxes that have recently emerged include sugary beverage taxes and bag taxes, both of which have had mixed results.⁷⁹ Marijuana taxes, once seen as a guaranteed revenue raiser as a complement to legalization in many states, may see increased scrutiny in the face of reports that Attorney General Jeff Sessions is "rolling back Obama-era guidelines that stopped the federal government from enforcing its anti-marijuana laws in states that have marijuana-friendly laws."⁸⁰ Last year, we suggested that we may even see efforts to create new sin taxes targeted at activities like excessive meat consumption.⁸¹ Not surprisingly, it has been reported that governments may eye a meat tax as they "aim to improve public health and hit emissions targets set in the Paris Climate Agreement."⁸² Reports show that 14.5 percent of the world's total greenhouse gas

⁷⁵ Multistate Tax Commission, *Online Marketplace Seller Voluntary Disclosure Initiative* (2017). See also [GT SALT Alert: Multistate Tax Commission Establishes Special Voluntary Disclosure Initiative for Online Marketplace Sellers \(UPDATED\)](#); Brian Howsare and Aaron Fell, *MTC FBA VDA? IDK: What All FBA Sellers Should Consider About Sales Tax and Voluntary Disclosures*, BLOOMBERG BNA DAILY TAX REPORT: STATE, Oct. 18, 2017.

⁷⁶ Ryan Prete, *Multistate Group Unlikely to Offer Tax Amnesty Program Again*, BLOOMBERG BNA DAILY TAX REPORT: STATE, Jan. 5, 2018.

⁷⁷ *Notice: New Jersey Offers Voluntary Disclosure Program to Out-of-State Sellers with Customer Referral Agreements*, New Jersey Division of Taxation, Aug. 2017. For a discussion of this program, see [GT SALT Alert: New Jersey Offers Voluntary Disclosure Program to Out-Of-State Sellers with Customer Referral Agreements](#). This initiative was offered by the Division in addition to New Jersey's participation in the voluntary disclosure program which was conducted by the MTC for certain online marketplace sellers.

⁷⁸ Jamie Yesnowitz and Emily Fiore, *The History and Purpose Behind Sin Taxes*, BLOOMBERG BNA DAILY TAX REPORT: STATE, Oct. 17, 2017.

⁷⁹ *Id.*

⁸⁰ Ryan Struyk, *Marijuana Legalization by the Numbers*, CNN.COM, Jan. 4, 2018.

⁸¹ Yesnowitz, *supra*.

⁸² *Enjoy Your Cheap Burgers Now Because a "Meat Tax" Could Be on the Way*, FORTUNE.COM, Dec. 11, 2017.

emissions are from livestock.⁸³ **Given these signs, we predict that, in the area of sin taxes, at least one state will propose a targeted tax on the purchase or consumption of meat.**

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⁸³ *Id.*, citing Food & Agriculture Organization.